

A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Thursday, April 5, 1951, at 2:35 p.m.

PRESENT: Mr. Martin
Mr. Szymczak
Mr. Williams
Mr. Gidney (Alternate for Mr. Sproul)
Mr. Powell (Alternate for Mr. Eccles)

Mr. Sherman, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Leach, Economist, Division of Research and Statistics, Board of Governors

At Mr. Martin's request, Mr. Rouse reviewed developments in the open market during the period since the books were opened on March 26, 1951, for subscription to the Treasury offering of 2-3/4 per cent non-marketable bonds in exchange for the 2-1/2 per cent restricted issues of 1967-72. During his comments Mr. Rouse stated that in view of the announcement by the Treasury that the books on the conversion would be closed at midnight on Friday, April 6, 1951, the instructions of the executive committee to the New York Bank would call for operations subsequent to that time in terms of an orderly market, in the light of the existing direction from the full Committee to the executive committee and the understanding with the Treasury as set forth in the minutes of the meeting of the full Committee on March 1 and 2 and of the executive committee on March 3, 1951.

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Mr. Rouse also said that, in accordance with the informal understanding of the members of the executive committee on March 30, 1951, \$2.5 billion of System account holdings of the 2-1/2 per cent restricted bonds of 1967-72 had been exchanged for the 2-3/4 per cent nonmarketable bonds, that something over \$100 million of restricted 67-72's were now held by the System account, and that it was probable that more of those securities would be purchased by the System today and tomorrow, in accordance with the understanding at the meeting on March 13 that they would not be permitted to fall below 99 during the period of the conversion. Mr. Rouse raised the question whether the additional holdings of the restricted 67-72's should be converted at the latest possible moment before the subscription books were closed. He also stated that since sales of Government securities by dealers on Friday, April 6, would be for delivery on the following business day, it would not be possible to convert 2-1/2 per cent restricted bonds purchased on April 6 for the 2-3/4 per cent nonmarketable bonds, and that he would like to have a discussion of the procedure to be followed in carrying on operations for the System account tomorrow, as well as on and after Monday, April 9, when the books would have been closed.

Mr. Szymczak stated that in addition to the two questions mentioned by Mr. Rouse, consideration should be given to the question when and in what amounts System holdings of the 2-3/4 per cent nonmarketable bonds should be exchanged for five-year notes, but that he would prefer to delay

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a discussion of that question until next week or later unless Mr. Rouse felt there was some reason for wanting to have some of the 1-1/2 per cent five-year notes in the System account at once.

Mr. Rouse replied that the System account now held over \$3 billion of notes which were three months shorter in maturity than those that would be issued if the 2-3/4 per cent nonmarketable bonds were exchanged at this time, that there was no need for the System account to have the new notes at once, and that while the decision to convert the 2-1/2 per cent restricted bonds into 2-3/4 per cent nonmarketable bonds was for the purpose of obtaining the 1-1/2 per cent marketable notes, he felt the timing of the exchange was a major question which might well be considered at the next meeting of the full Committee in the light of the Treasury's program for June refundings.

Mr. Martin suggested that, since a meeting of the full Committee was tentatively scheduled for the week beginning May 14, 1951, a decision on the timing for the exchange into the 1-1/2 per cent five-year notes be postponed until that meeting, with the understanding that in the meantime the members of the executive committee would consider whether the entire holdings of the 2-3/4 per cent nonmarketable bonds should be exchanged at one time or whether the exchange should be effected over a period of time.

This suggestion was approved
unanimously.

In response to a question from Mr. Martin as to the understanding that should be followed in effecting transactions in the System account

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tomorrow, April 6, Mr. Rouse stated that, since any 2-1/2 per cent restricted bonds of 67-72 which might be sold on April 6 for delivery on the next business day could not be converted into the 2-3/4 per cent non-marketable bonds before the books closed, the System might refrain from operations in the System account starting tomorrow morning except for the general instruction that an orderly market be maintained. His own view, Mr. Rouse said, was that in the light of the general understanding with the Treasury regarding maintenance of stability in the market during the period of the conversion and of the decision at the meeting of the executive committee on March 13 not to allow the 67-72's to go below 99 during the period of the conversion, it would be preferable to continue to operate tomorrow on the same basis that had been followed thus far during the conversion period. This might mean, he said, the purchase of \$40 to \$50 million of the restricted 67-72's tomorrow, or perhaps more.

There was a discussion of this question during which it was the consensus that operations for the System account should be carried out on the same basis as during the rest of the conversion throughout the day on April 6.

Turning to the question whether present holdings of restricted bonds of 67-72, and those acquired today and tomorrow, should be converted, it was suggested and agreed that the remaining amount held at the close of operations April 6 should be converted to the 2-3/4 per cent nonmarketable bonds before the books were closed at midnight on that day.

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Mr. Martin then raised the question of the direction to be given to the New York Bank for effecting transactions beginning April 9.

During the ensuing discussion, it was suggested that it was important that there should be a period of relative stability in the market for at least two weeks preceding the Treasury refunding in the first half of June, which would mean that, in carrying out the direction from the full Committee and in accordance with the understanding that after the close of the conversion period open market operations would be conducted with a view to maintaining an orderly market, there would be a period from about April 9 to about May 10 in which to let the market develop its own pattern. Mr. Rouse expressed the view that, while operations during that period would have to be "played by ear", he assumed that the supply of securities offered for sale would be greater than the demand with the result that prices would decline. He felt that it would be preferable to permit such a decline to take place fairly rapidly, but that he would place orders in such a way that the System account would have the initiative even though it was not operating with any particular price as a goal. With respect to the level to which the longest-term restricted bonds might go, Mr. Rouse said that he felt that they might decline to somewhere in the range of 96--97-3/4, and that he would contemplate placing orders depending on the volume of offerings but would not expect to buy any of the 67-72's above 98-7/8.

Mr. Gidney expressed the view that it would be desirable to put a

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little "starch" in the market so that the decline, if it developed, would take place slowly and not arouse fears of drastic decline since it would be his expectation that any substantial, rapid drop in prices would start the smaller banks and others to wondering whether securities were going to 82 as they had in the early Twenties.

Mr. Williams felt that it would be preferable to have a rapid adjustment to whatever level the market was going to stabilize at, expressing the view that a decline to the level suggested by Mr. Rouse would result in a good deal of buying for investment accounts.

Mr. Szymczak said that it could not be determined in advance just how the market was going to act and that it would be necessary for the New York Bank to operate within the terms of the instruction to maintain an orderly market, keeping in touch with the members of the committee by telephone if necessary.

Mr. Martin then made a statement substantially as follows:

I think we were very successful in the initial stages of this recent operation. I am not sure that we were quite right with the 99--99-1/4 level for the 2-1/2 per cent 67-72's during the conversion period. They quickly got us down to the point where they established our firm bottom. That is what we were trying to get away from and that is what I am concerned about now. We do not want to let it get established that 96 or 97 or any other figure is the bottom. We ought to have some point in mind that sets a reasonable range, but if the price went to 97-1/2, we might want to move up to 97-3/4 aggressively and then let it go back down to 97-1/4. We should be in the market actively rather than passively. I think that if we feel that these levels are approximately reasonable levels, we ought not be afraid to buy aggressively even if we have to even up our holdings by reselling. I realize that you can not do the same thing with bonds that might be done with stocks, but you have to be aggressive in the operation and you have to get away from

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a pin-point peg. I think we must disregard to a certain extent logic in this situation. We have \$1.2 billion of marketable Government securities outstanding. We have had a change in psychology and there has been a lot of hysteria. We want to be on guard against the possibility of any kind of panic or development which would create a certain amount of unnecessary disturbance. We are making a change that is substantial. The patient has suffered quite a shock and we do not want it to be worse. I think you build confidence slowly and, as Mr. Rouse points out, you have only about five weeks to get ready for the refunding in June. That is why I feel the System must be in there aggressively helping to make the market.

Mr. Rouse stated that it was his understanding of the existing instruction to the New York Bank that, upon conclusion of the conversion offering, operations in the System account would revert to an orderly market basis, and that the executive committee agreed that the conclusion of the conversion would be at the close on Friday, April 6. There was unanimous agreement with this understanding, and at the conclusion of a further discussion, it was agreed that, beginning on Monday, April 9, 1951, the New York Bank would be guided by the existing instruction of the executive committee to maintain an orderly market, it being understood, however, that the Bank would "play by ear" having in mind that prices would be permitted to decline but that, depending on the pressures that might develop in the market, it might be necessary to be an aggressive rather than a passive factor in the market.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the committee on March 29, 1951, increasing from \$700 million to \$1,250 million the limitation contained in the first paragraph of the direction issued to the Federal Reserve Bank of New York on March 8, 1951, authorizing

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transactions for the System open market account was approved, ratified, and confirmed.

In response to a question concerning the limitation in the direction to be issued to the New York Bank, Mr. Rouse suggested that, in view of the volume of transactions that might develop during the period immediately following the close of the conversion, the limitation in the first paragraph be increased to \$1,750 million.

Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York, until otherwise directed by the executive committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the total amount of securities in the account at the close of March 8, 1951, shall not be increased or decreased by more than \$1,750 million exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(2) To purchase direct from the Treasury for the System open market account such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held in the account at any one time shall not exceed \$750 million.

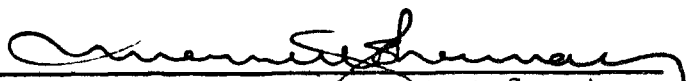
In taking this action it was understood that the limitations contained in the direction include commitments for purchases and sales of securities for the System account.

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Mr. Szymczak referred to an amended motion which he prepared for consideration by the executive committee, copies of which had been sent to each member of the committee on April 2, 1951, in which he recommended that the whole subject of qualified and unqualified dealers in Government securities be studied by a committee of three members of the executive committee. He stated that he contemplated that such a study would differ from the report which the full Committee, at its meeting on March 8, requested that the executive committee arrange for, and that perhaps the study he suggested should come as a result of a request by the full Committee. He went on to suggest that, since the matter was not urgent, it be referred to Mr. Martin with the understanding that he would look into it and, if he felt it desirable to do so, he might ask some of the members of the executive committee to make an informal study with a view to determining what if any recommendation should be made to the full Committee. No objection to this procedure was indicated.

Thereupon the meeting adjourned.


Assistant Secretary.