THIRTY-FOURTH

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of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1947

chase for the System open market account direct from the Treasury of 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 amount of such certificates held in the account at any one time shall not exceed 1.5 billion dollars.

Following the actions announced on April 24, 1947, there were further discussions with representatives of the Treasury of the proposed elimination of the ⅜ per cent posted rate and repurchase option on Treasury bills, but no decision as to the timing of this action was reached. There were also discussions of questions relating to Treasury financing, including an increase in the rate on Treasury certificates, and the issuance by the Treasury of a long-term Series G type security. The retirement of Government debt, for anti-inflationary purposes, had been continued and while the steps that had been taken by the System and the Treasury apparently had stopped temporarily the decline in yields on long-term securities resulting from "playing the pattern of rates," it was expected by the Committee that the long-term rate would continue to be under pressure. In that event, the Committee would be faced with the alternative of allowing the long-term rate to decline further or of permitting the short-term rate to rise to a point where there would be no incentive for banks to continue to "play the pattern of rates" with the resulting increase in member bank reserves.

The Committee therefore decided that, until a decision was reached on action to discontinue the posted rate on Treasury bills and to increase the short-term rate, no change should be made in existing open market policies, and that the direction issued by the Federal Open Market Committee on March 1, 1947, and amended on April 2, 1947, with respect to the purchase of Treasury bills, should be changed only to the extent necessary to bring the direction into conformity with the procedure approved on May 5, 1947, for transferring maturing bills held by the Federal Reserve Banks to the System account and the exchange of bills in the System account for new bills.

October 6-7, 1947

Members present: Mr. Eccles, Chairman; Mr. Sproul, Vice Chairman; Mr. Clayton; Mr. Davis; Mr. Draper; Mr. Evans; Mr. Gidney; Mr. Peyton; Mr. Szymczak; Mr. Vardaman; Mr. Whittemore.

1. Elimination of Posted Rate on Treasury Bills.

Upon motion duly made and seconded, and by unanimous vote:

The action of the members of the Federal Open Market Committee on July 2, 1947, discontinuing the posted rate on Treasury bills issued on or after July 10, 1947, in accordance with the following amended direction to the Federal Reserve Banks, was approved, ratified, and confirmed.

"Until otherwise directed by the Federal Open Market Committee, the 12 Federal Reserve Banks are directed to purchase all Treasury bills issued prior to July 10, 1947, that may be offered to such Banks on a discount basis at the rate of ⅜ per cent per annum, any such purchases to be upon the condition that the Federal Reserve Bank, upon the request of the seller on or before the last business day preceding the closing day on

which the Treasury will accept tenders of the bills for new Treasury bills, will sell to him Treasury bills of like amount and maturity at the same rate of discount. All bills purchased under this direction are to be held by the purchasing Federal Reserve Bank in its own account and prompt reports of all transactions in Treasury bills are to be made to the Manager of the System Open Market Account."

Following the meeting of the Federal Open Market Committee on June 5, 1947, there were further discussions with the Treasury of the proposed discontinuance of the posted ⅜ per cent rate on Treasury bills and agreement was reached that the rate should be terminated as to all bills issued on or after July 10, 1947. The above direction was issued to accomplish that result. The reasons for the action are set forth in the following statement released to the press for publication in the morning papers of July 3, 1947:

"The Federal Open Market Committee of the Federal Reserve System has directed the Federal Reserve Banks to terminate the policy of buying all Treasury bills offered to them at a fixed rate of ⅜ per cent per annum and to terminate the repurchase option privilege on Treasury bills. The new policy will apply to bills issued on or after July 10, 1947. Existing policy will continue to apply to bills issued prior to that date.

"The above action was taken by the Committee after consultation with the Secretary of the Treasury.

"The so-called posted rate on Treasury bills was a wartime measure adopted in 1942 to facilitate war financing and to stabilize the market for Government securities. It was designed primarily to encourage banks to make fuller use of their excess reserves and thus bring about a wider distribution of Treasury bills. Under current peacetime conditions these arrangements no longer serve their original purpose and tend to distort conditions in the money market and the securities market. Certificates of indebtedness, which bear a higher rate than Treasury bills, have largely replaced bills in the market, not only as a medium for the investment of short-term funds but also as a means by which banks adjust their reserve positions.

"Increased amounts of Treasury bills have been sold to the Federal Reserve Banks by the market, and bills have gradually ceased to be a market instrument. Currently, only about 1.5 billion dollars of the nearly 16 billion total of Treasury bills outstanding are held outside the Federal Reserve Banks. The Treasury bill rate has thus been eliminated as a factor in the money market. The need for large-scale borrowing of new money by the Treasury ceased with the completion of the Victory Loan Drive and since that time the public debt has been reduced substantially. Consequently there is no reason for continuing this wartime mechanism. On the contrary, its elimination will serve a useful purpose in restoring the bill as a market instrument and giving added flexibility to the Treasury's debt management program.

"Under the new policy the Treasury bill rate will be expected to find its level in the market in proper relation to the yields on certificates of indebtedness. The Federal Reserve System will continue to purchase and hold Treasury bills as well as other Government securities in amounts deemed necessary in the maintenance of an orderly Government security market and the discharge of the System's responsibility with regard to the general credit situation of the country.

"As a result of the action taken by the Board of Governors of the Federal Reserve System in April to transfer to the Treasury the excess earnings of the Federal Reserve Banks, the Reserve Banks are now paying into the Treasury approximately 90 per cent of their net earnings after dividends. Since most of the Treasury bills now outstanding are held by the Federal Reserve Banks, whatever increase in interest cost to the Treasury results from the termination of the posted buying rate and repurchase option will be largely offset by increased Reserve Bank payments to the Treasury."

2. Revised Authority to Effect Transactions in the System Account.

Upon motion duly made and seconded, and by unanimous vote:

A change made by the members of the Federal Open Market Committee on August 8, 1947, in the direction issued to the executive committee on June 5, 1947, so as to provide for supporting the current issuing rate on Treasury certificates instead of the ⅞ rate previously prevailing, was approved, ratified, and confirmed. The direction as revised read as follows:

"The executive committee be directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary in the practical administration of the account or for the purpose of maintaining an orderly market in Treasury securities and a general level of prices and yields of Government securities which will support the Treasury current issuing rate for certificates and 2½ per cent for 27-year bonds restricted as to ownership; provided that the aggregate amount of securities held in the account at the close of this date [other than (1) maturing bills transferred to the System account from the option accounts of the Federal Reserve Banks pursuant to the direction issued by the Federal Open Market Committee on May 5, 1947, bills purchased outright in the market on a discount basis at the rate of ⅜ per cent per annum, bills redeemed or exchanged at maturity, and bills taken in exchange for maturing bills, and (2) special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury] shall not be increased or decreased by more than 2 billion dollars.

"The executive committee be further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of 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 amount of such certificates held in the account at any one time shall not exceed 1.5 billion dollars."

As the first step in a program which contemplated an increase to one per cent in the issuing rate on Treasury certificates, the Treasury in July announced that the August 1 maturity of certificates would be refunded into an 11-month ⅞ per cent certificate. The direction issued by the Federal Open Market Committee on June 5, 1947, provided for support of an issuing rate of ⅞ per cent for one-year certificates, and the anticipated issuance by the Treasury of certificates at a higher rate made necessary the approval of the change in the above direction, which required that the current issuing rate on Treasury certificates be supported instead of the ⅞ per cent rate as previously.

3. Increase in Authority to Effect Transactions in System Account.

Upon motion duly made and seconded, and by unanimous vote:

The action of the members of the Federal Open Market Committee on September 4, 1947, increasing from 2 billion dollars to 2.75 billion the authority of the executive committee contained in the first paragraph of the direction issued at the meeting of the full Committee on June 5 and amended on August 8, 1947, was approved, ratified, and confirmed.

When the action was taken on September 4, the authority granted to the executive committee had been used to the extent of increasing the amount of securities held in the System account by 1.8 billion dollars. In view of the program for refunding Treasury securities maturing on September 1, September 15, and October 1, and of possible open market transactions over the tax payment period, it appeared that the executive committee would need further authority to increase the amount of securities in the System account to carry out the existing policies. The increase in the authority was granted for that reason.

4. Authority to Effect Transactions in System Account.

Upon motion duly made and seconded, and by unanimous vote, the following direction to the executive committee was approved:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of the general credit situation of the country, for the practical administration of the account, for the maintenance of stable and orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market more closely to the needs of commerce and business; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than 2 billion dollars.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of 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 1.5 billion dollars.

In the period since the previous meeting of the Committee conditions affecting the money market had changed considerably. Inflationary pressures had increased and there were indications that they would continue to be strong in the months immediately ahead. Conditions were favorable to further credit growth, bank loans were expanding rapidly and the demand for capital funds was strong, and there were further substantial gold imports. Because of the policy of supporting the Government securities market, which the Committee felt was a sound policy and should be continued, banks had ready access to additional reserves by the sale of securities to the System account. There was no prospect of the accumulation of substantial Treasury cash balances that could be used for the retirement of Government debt at this time, and therefore, the restraining influence of such accumulation could not be imposed. It was also recognized that the strongest forces working toward inflation lay outside the field of monetary policy and debt management and that measures available to the System and the Treasury could have only limited effectiveness.

It was the view of the Committee that, since further credit expansion would add to the inflationary pressures, the situation was such as to justify the Treasury and the Federal Reserve System taking such actions as were available to them to eliminate or moderate excessive credit expansion. While continuing the existing policy of maintaining orderly conditions in the Government security market, it was agreed that with a view to preventing to the extent possible further expansion of bank credit, there should be action by the appropriate authorities to carry out an anti-inflationary program which would contemplate (1) continued use of Treasury balances when available to retire Government debt, particularly bills and certificates held by the Federal Reserve Banks, (2) a further increase in the short-term rate on Government securities to 1⅛ per cent, (3) an increase in the discount rates at the Federal Reserve Banks in keeping with the increase in the rate on short-term Government securities, (4) an increase in reserve requirements of member banks in central reserve cities, (5) a statement by the Board of Governors emphasizing, in connection with the termination of Regulation W, the dangers of more liberal instalment credit terms and a further growth of outstanding consumer credit, (6) a joint statement by the Federal and State bank supervisory agencies which would point out the dangers of further overall expansion of bank credit through the medium of bank loans, and (7) a change in the policy with respect to the refunding of maturing savings bonds to encourage the reinvestment of proceeds of maturing bonds in new issues of savings bonds.

The language in the first paragraph of the direction issued by the Committee, setting forth the considerations governing transactions for the System account, was changed from the direction previously in effect for the purpose of relating it more closely to the current policies of the Committee in the light of existing monetary and credit conditions.

December 9, 1947

Members present: Mr. Eccles, Chairman; Mr. Sproul, Vice Chairman; Mr. Clayton; Mr. Draper; Mr. Evans; Mr. Gidney; Mr. Gilbert (alternate for Mr. Davis); Mr. Peyton; Mr. Szymczak; Mr. Vardaman, Mr. Whittemore.

1. Authority to Effect Transactions in System Account.

Upon motion duly made and seconded, and by unanimous vote, the following direction to the executive committee was approved:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of the general credit situation of the country, for the practical administration of the account, for the maintenance of stable and orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market more closely to the needs of commerce and business; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than 3 billion dollars.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of 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 1.5 billion dollars.

The above direction, which was in the same form as the direction issued at the meeting on October 7, 1947, was adopted for substantially the same reasons as the earlier direction. Inflationary forces had continued strong, substantial amounts of long-term Government securities were being sold to the System to meet the demands for funds, and it was felt that the existing open market policy should be continued as a means, coupled with other actions by the System and with debt-management policies of the Treasury, of keeping pressure on the market and thereby restraining the expansion of bank credit.

It was understood that, in carrying out the direction, the executive committee would continue the existing prices at which Government securities were being supported until after the Treasury January refunding had been completed, at which time prices of bonds should be permitted to decline rapidly, if the market did not support itself, to a level not more than 100½ and not less than par on the longest restricted 2½ per cent issue and to not less than par on 1⅛ per cent one-year certificates. It was also understood that if, before the completion of the January refunding, market selling should increase substantially, the executive committee would be authorized to permit prices to decline to the level stated above as rapidly as was consistent with the maintenance of orderly market conditions.

The limitation contained in the first paragraph of the direction was increased from 2 billion to 3 billion dollars because it was felt that it would be desirable for the executive committee to have the enlarged authority, in order to be in position to meet adequately the conditions that were likely to prevail in connection with the Treasury's refunding operations and tax collections before another meeting of the Committee.