

REC'D IN RECORDS SECTION

To: Members of the Federal Open
Market Committee

Date: September 26, 1955
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From: Robert G. Rouse

Subject: Federal Open Market
Committee Authorization to
the Federal Reserve Bank of
New York to Purchase Bankers'
Acceptances for Its Own
Account

This memorandum summarizes the considerations underlying my suggestion, made at the meeting of the Federal Open Market Committee on September 14, that the Committee raise from \$25 million up to \$50 million the maximum limit set on holdings of bankers' acceptances for the account of this Bank.

During the discussion that led up to the resumption of acceptance purchases for this Bank's account (which began on March 30, 1955) several reasons were advanced for re-establishing direct System participation in the bankers' acceptance market. Without attempting to repeat here all of those considerations, it has appeared to me and my associates that there was general agreement that the initial steps should consist in the acquisition of a basic holding of acceptances, in order to identify the System's resumption of interest in this type of financing, and possibly to encourage the development of a wider market in acceptances. As a reflection of this fundamental consideration, the initial maximum was set at \$25 million, and the Management of the System Account has aimed at maintaining a basic holding below that limit, generally in the range of \$10-15 million, with a peak of \$19.7 million on April 21, 1955.

Although it was recognized that the System would be acquiring its initial holdings at a time when the seasonal decline in the outstanding volume of acceptances was approaching, there was also a realization that the volume of acceptances fluctuated seasonally, and this suggests that the System's own holdings should also follow the seasonal pattern, once a basic holding has been maintained for some time, provided such further increase would be in step with other credit policy action.

This interpretation of policy would envisage a moderate increase in the holdings for the account of this Bank as the seasonal expansion in outstanding acceptances gets under way. (Such expansion appeared to be developing somewhat earlier than usual this summer, and the data available from the most recent monthly survey of acceptances, completed about mid-September, confirm that a slight increase of roughly \$5 million did occur in August.) Such a policy would also be consistent with the general attitude expressed at meetings of the Federal Open Market Committee during recent months that the System should provide additional reserves as needed for essential financing, including the normal seasonal expansion of borrowing by Government, commerce, industry and agriculture. It has appeared that the Committee expected, within the framework of a generally restrictive credit policy, that a considerable volume of reserves would have to be provided through outright open market transactions, over and above any increase brought about by rising member bank borrowing. Although the pace of any increases in System Account holdings will necessarily be set from meeting to meeting by the Federal Open Market Committee, it seemed to us that some general conclusions with respect to the possibility of making purchases of acceptances as part (though necessarily a very minor part) of the program could be reached in advance, without need for detailed review of the relatively small amounts involved at each meeting of the Federal Open Market Committee.

It would be my recommendation that further acquisitions of acceptances be made in line with purchases of Government securities. I would not propose that any significant further purchases of acceptances be made, however, until there is also evidence of further seasonal growth in the volume of outstanding acceptances. The week-to-week determination of specific amounts could then be left to the judgment of the Management of the Account, to be exercised in the light of current conditions in the acceptance market and within the framework

of an overall limit intended to set an outside maximum on potential purchases over the entire autumn period. The advantage of spreading some part of the System's outright purchases into the acceptance market would be a further indication that some real use is intended for this means of providing reserves directly through this channel of business financing, in addition to the expected concentration of outright purchases in the Treasury bill market.

As my associates and I have attempted to make clear in the weekly and other periodic reports to the Federal Open Market Committee, during the recent succession of changes in the market rates on bankers' acceptances, the Account Management has endeavored to avoid any kind of action that might have exercised a direct or indirect influence on judgments reached in the market itself concerning appropriate rates. I would hope that further acquisitions of acceptances could also be carried out with such care that there would be no interference with the kind of flexibility of rate movements that has been evident over recent months. It has been our understanding from the inception of the System's acceptance program that the System was not to become a buyer of last resort for any and all acceptances not readily salable in the market; that we were not to provide rate or price "support" for the acceptance market. We have understood the Committee's intention to be, however, that the evidence of the System's interest in this market, provided by its direct and modest participation, would be of some help in stimulating broader interest in the use of acceptances--if the needs of trade produce a basis for further use of this type of financing by concerns engaged in domestic and foreign trade.

Factors currently at work, influencing both the supply of new acceptances and the demand for outstanding acceptances, appear likely to produce a moderate, though probably not spectacular, seasonal expansion in the volume of acceptances. We suggest that the System should be in a position to take a small,

and roughly proportionate, part in any growing volume of acceptance activity as it occurs. In recommending that a new maximum of \$50 million be placed upon the potential holdings of the Federal Reserve Bank of New York, we contemplate only the provision of some latitude for relatively prompt reaction to actual market developments, on the same basis, and with the same understanding, that accompanies the usual setting of limits on market transactions in Government securities. It would be the intention of the Account Management, of course, to report on actual changes as they appear.