A meeting 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, February 27, 1947, at 10:35 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Sproul, Vice Chairman
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Clayton
Mr. Leach
Mr. McLarin
Mr. Young
Mr. Peyton (alternate for Mr. Clerk, who died on September 28, 1946)

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Townsend, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Rauber, Wheeler, and John H. Williams, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Chairman of the Board of Governors of the Federal Reserve System
Mr. Sherman, Assistant Secretary of the Board of Governors
Messrs. Ralph A. Young and Morse, Assistant Directors of the Division of Research and Statistics, Board of Governors
Mr. Musgrave, Chief, and Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Whittemore and Gidney, alternate members of the Federal Open Market Committee

Messrs. Alfred H. Williams, Leedy, Gilbert, and Earhart, Presidents of the Federal Reserve Banks of Philadelphia, Kansas City, Dallas, and San Francisco, respectively

Mr. Stead, Vice President of the Federal Reserve Bank of St. Louis
Mr. Johnson, General Counsel of the Federal Reserve Bank of Dallas

Chairman Eccles called for the reports of the economists. Mr. Thomas made a statement on the economic prospects for 1947-1948 and also presented a paper which analyzed the structure of the public debt and problems connected with its management. Mr. Wheeler then made a statement on means of increasing the effectiveness of actions taken by the Federal Reserve to influence credit conditions, and, following a discussion of the remarks of Messrs. Thomas and Wheeler, Mr. John H. Williams reviewed the current domestic and international economic situation and discussed the outlook. Copies of the statements by Messrs. Thomas, Wheeler, and Williams have been placed in the files of the Federal Open Market Committee and are attached hereto.

Following a general discussion of questions raised by the economists' statements, the meeting recessed and reconvened at 10:10 a.m. on February 28, with the same attendance as at the session on February 27, except that Mr. Davis, President of the Federal Reserve Bank of St. Louis and alternate member of the Federal

Open Market Committee, Mr. Kincaid, Associate Economist, and Mr. Smead, Director of the Division of Bank Operations of the Board of Governors, were present, and Messrs. Wheeler, Ralph A. Young, Morse, Townsend, and Johnson were not present.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 3, 1946, were approved.

The progress of the program for retirement of the Government debt since the last meeting of the full Committee and its effects on the Government securities and money markets and on the Treasury cash position were discussed, and Chairman Eccles stated that current receipts of the Treasury had held up better than had been anticipated, and that it appeared that another billion dollars of certificates could be retired April 1 and perhaps an additional amount before the end of this fiscal year. He noted that the Treasury desired renewal of the authority of the Federal Reserve Banks to purchase up to five billion dollars in securities direct from the Treasury, that a bill had been introduced in Congress continuing this authority after March 31, 1947, and that he had been called to appear at hearings on the bill to be held beginning Monday, March 3, 1947, before the House Banking and Currency Committee.

All of the members of the Committee had been furnished a draft of the letter to the Treasury with respect to the savings bond program, which had been prepared but which, in accordance with the decision reached at the meeting of the executive committee on February 17, 1947, had not been sent. Mr. Sproul stated that it was the intention of the executive committee of the Federal Open Market Committee to ask that the full Committee, at a meeting in the autumn of this year, consider what suggestions should be made to the Treasury before it reached a decision with respect to its policy during 1948 regarding the offering of a special security which would encourage holders of maturing savings bonds to reinvest their funds.

Chairman Eccles said that the matter would be of considerable importance from the longer range standpoint when Series E savings bonds started to mature in 1951, and that it should be given a great deal of study before a recommendation was made to the Treasury.

In connection with a discussion of proposals that the Treasury issue a long-term security, Chairman Eccles reviewed the letter and memorandum sent to the Treasury under date of January 22, 1947, and which had been approved by the executive committee at its meeting on February 17. He also said it might be desirable to send another letter to the Treasury which would answer some of the arguments recently presented to the Treasury by insurance and banker groups in support of a long-term marketable issue. A draft of a memorandum prepared under date of February 27, 1947, for consideration in this connection was then distributed by Mr. Musgrave and read by Mr. Carpenter. The memorandum,after stating the circumstances under which a long-term security would be desirable, pointed out the reasons why the objective sought would not be served by a marketable issue and the reasons for the recommendation that a nonmarketable issue of the Series G type be made available.

Messrs. Eccles and Sproul reported briefly on their discussion of this matter with Fiscal Assistant Secretary Bartelt at their luncheon meeting yesterday. They had gotten the impression from the discussion that the Treasury had not yet reached a decision on the issuance of a long-term security, and that in their discussion Mr. Bartelt had seemed impressed with the statement that merely putting out a 2-1/2 per cent bond for the purpose of keeping the long-term interest rate from declining would be dealing with the effects and not the basic causes, since, if the long-term rate should again come under pressure, it would probably be not because of an excess of savings but because of further monetization of the debt as a result of member banks "playing the pattern of rates". Chairman Eccles also said that, with the debt retirement program coming to an end, the pressure on the long-term interest rate would likely be resumed, and that, in the absence of the enactment by Congress of legislation such as that proposed in the Board's Annual Report for 1945, the Federal Open Market Committee and the Treasury would be faced with two alternatives as a means of preventing a decline in the long-term rate, (1) issuing enough 2-1/2 per cent long-term bonds to satisfy the demand for that type of security, a move which would cost the Treasury more than a rise in short-term interest rates, or (2) permitting a rise in short-term rates so as to remove the incentive to "play the pattern of rates". Chairman Eccles also suggested that the Committee write a letter to the Treasury along the lines of the memorandum mentioned above so that the Treasury would have this view as well as the views being presented by the groups recommending a long-term marketable security.

> After some further discussion, during which certain changes were suggested in the language of the memorandum, upon motion duly made and seconded, and by unanimous vote, the executive committee was authorized to send a letter to the Treasury transmitting substantially the recommendations contained in the memorandum on the issuance of a long-term security.

Reference was then made to the draft of a memorandum on changes in Treasury bill policies which had been discussed informally by Chairman Eccles and Mr. Sproul with the Treasury on February 17, 1947, in accordance with the action taken at the meeting of the executive committee on February 17, 1947. Subsequently Mr. Sproul had suggested several clarifying changes in the memorandum, which he had sent to Chairman Eccles with a letter dated February 21, 1947. Chairman Eccles stated that all of the changes except one were changes in form only and were acceptable to him. The one exception would eliminate a statement that any change in the rate at which bills were supported by the System would be made only after "concurrence by the Treasury", and Chairman Eccles felt that change should not be made. He stated that it was generally agreed that a change in the bill rate would not be made without the concurrence of the Treasury, that inasmuch as the preliminary memorandum discussed with the Treasury had contained the words "concurrence by the Treasury" its elimination now might raise a question as to whether the System intended to act without Treasury concurrence, that to raise such a question at this time would be a mistake, and that he believed the elimination would be an assertion of independence of the System which would not in practice be carried out.

Mr. Sproul said that he felt it was important not to abandon whatever independence we have, by giving our proxy to the Treasury in advance, that he agreed that it was extremely unlikely the System would take action on this matter without concurrence by the Treasury, that the Committee should not feel it had been committed as to wording and action by a preliminary memorandum prepared in haste and for exploratory discussions, and that he believed the relations with the Treasury were now such that the reason for the elimination of these words need not and would not cause any suspicion on the part of the Treasury that the System presently has in mind increasing short-term rates on the public debt against the wishes of the Treasury.

During a discussion of the matter, Mr. Clayton suggested a change in the memorandum which would eliminate the paragraph containing the words to which Mr. Sproul objected and which would state in the opening paragraph of the memorandum that policies followed during the war years needed to be reviewed "with the view to reaching an agreement for an adjustment of policies and action to changed conditions".

Mr. Sproul said that this wording would be acceptable to him, and Chairman Eccles stated that he preferred the original wording under the circumstances, but that he would not object to the rewording if it was approved with the understanding that he might say to Mr. Bartelt that the wording of the preliminary memorandum had been changed in order to enable the Committee to approve the memorandum without the statement of a minority view, and that the change did not mean that the Treasury would not have the complete cooperation of the Federal Reserve System.

Mr. Evans said he did not favor the proposed change because it was of no practical significance, and the retention of the language used in the preliminary memorandum would avoid the possibility of needlessly raising an issue between the Board and the Treasury.

At the conclusion of the discussion, upon motion duly made and seconded, the proposed change was approved with the understanding suggested by Chairman Eccles. On this action Mr. Evans voted "no".

Thereupon, upon motion duly made and seconded and by unanimous vote, the revised memorandum was approved unanimously as follows for transmission to the Treasury:

"CHANGES IN TREASURY BILL POLICIES

"Treasury and Federal Reserve policies and procedures followed during the war with respect to Treasury bills need to be reviewed, now that the period of heavy war finance has passed, with a view to reaching agreement for an adjustment of policies and action to changed conditions. Two aspects of these policies should be considered:

(A) Weekly replacement of Federal Reserve maturities, and

(B) Elimination of the posted buying rate and repurchase option.

"(A) Replacement of Federal Reserve Bill Maturities

"Existing arrangements, through which the Federal Reserve Banks replace their maturing holdings of Treasury bills, involve a cumbersome procedure initiated by the Secretary of the Treasury (Mr. Morgenthau) which is unsatisfactory, at least now that most of the bills are held by the Reserve System.

"The weekly refunding operations could be simplified by permitting holders of maturing bills to exchange them for the "new issue of bills. Under this procedure the Treasury would provide that bills awarded on tenders could be paid for either by cash or by surrender of a like face amount of the maturing issue of bills, with an adjustment for the discount. Pending any other change in policies, the rate could continue to be determined as at present. The Federal Reserve System would tender for the amount of maturing bills held in the System and option accounts (at a price it would determine—currently 99.905 for ninety-one day bills), and would not need to continue the present arrangement whereby dealers bid for bills and sell them to the System to replace its maturities. It would still be necessary, of course, to see that the total of each weekly offering of bills is covered by bids at the determined rate.

"This change in refunding procedure could be introduced immediately and without other changes in bill policy but in connection with it, a general revision of policy on Treasury bills may also be considered.

"(B) <u>Elimination of Posted Buying Rate and Repurchase Option</u>

"The posted rate of 3/8 per cent for the purchase and resale of Treasury bills by the Federal Reserve Banks was a wartime measure designed to influence market rates for Government securities and encourage banks to make full use of their reserves. Under current conditions these arrangements no longer serve their original purpose. With a pegged certificate rate and only $1\frac{1}{2}$ billion dollars of bill holdings outside the Federal Reserve Banks, certificates have replaced bills as the principal market instrument influencing short-term rates, and as a medium for investment of short-term funds or the adjustment of reserve positions of banks. Affirmatively, the reinstatement of the Treasury bill as a money market instrument would provide increased flexibility in debt management and reserve adjustment.

"In considering the termination of the buying rate and repurchase option, decisions need to be made with respect to:

(1) Timing of the actions
(2) New policy regarding amounts of bills issued and rates
(3) Added cost to Treasury and effect on System earnings

"(1) <u>Timing</u> — Because of the emphasis that the market may place on the elimination of the buying rate, the change "should be made when it is desired to exert some pressure or restraining influence. Accordingly, it might be postponed until there is a curtailment in the debt retirement program to the point of lifting the pressure on member bank reserve positions, which prevailed during the period of large-scale debt retirement last year, and has been accentuated by net tax receipts in the first quarter of 1947; or until private credit expansion appears to be proceeding at too rapid a rate. April might be a propitious time for such action. The change whenever made would apply only to bills issued subsequently; existing privileges would continue to apply to issues of bills outstanding at the time of the change, until they mature.

"(2) Bill policy -- If the posted buying rate and repurchase option on Treasury bills are eliminated, there are various possibilities as to policies that may be followed in issuing bills and establishing rates.

"(a) One possibility would be to permit bills to find their level in the market. It is assumed that the bill rate would rise toward the certificate rate which the Federal Reserve System would continue to maintain at the Treasury issuing rate of 7/8 per cent. The system would continue to refund its holdings of bills into new bills to the extent that they were not taken by the market. In view of the probable higher rate on bills, the market probably would take more bills than at present.

"(b) Another possibility would be for the Treasury to discontinue entirely the issuance of bills and replace maturing bills with additional issues of certificates. With the certificate rate supported at a fixed level and the bill rate permitted to rise to approximately the same level, it may be said that there is little reason to have outstanding two short-term instruments serving essentially the same purpose.

"(c) A third possibility would be for the System to stabilize the market for bills, not at 3/8 per cent but at whatever rate or rates would permit the Treasury to continue to issue one-year certificates with a 7/8 per cent coupon. The certificate rate would be maintained largely and indirectly through the supported bill rate. Since bills do not carry a fixed-rate coupon, their rate could be supported without public announcement of a fixed rate; this would have the advantage of permitting some flexibility within a narrow range. The system would engage in open-market operations in "bills for the purpose of stabilizing the bill rate at the desired level and would refund its weekly maturities through exchanges as proposed under (A) above. The Treasury would continue to issue Treasury bills weekly in the same amounts now outstanding or increase or decrease the amount to suit its needs. The Reserve System would tender for new bills to replace its maturities and be prepared to buy through the market any additional amount of bills that might be necessary to complete the sale by the Treasury of its weekly offerings at satisfactory rates. Under such conditions, it is likely that the market would take more bills than at present, which would result in partial allotments on our exchange subscriptions. Any such increase in holdings of Treasury bills by other than the Reserve System would probably be accompanied by a decrease in holdings of certificates of indebtedness and, conversely, any reduction in the Reserve System's holdings of Treasury bills would probably be accompanied by an increase in holdings of certificates.

"These changes in policies and practices would make the Treasury bills again a useful market instrument and would permit greater flexibility in monetary and debt management policies, without interfering with the general policy of stabilizing interest rates.

"(3) <u>Federal Reserve earnings and interest cost to the Treasury</u> — Elimination of the buying rate and repurchase option on Treasury bills raises questions of Treasury financing costs and System earnings. A rise in the bill rate, or the substitution of certificates for bills, would increase Federal Reserve earnings, which are already large, and would also increase the interest cost to the Treasury. Federal Reserve earnings will continue at a high level indefinitely, as it is unlikely that there will be any substantial reduction in the total amount of the System's holdings of Government securities in the near future.

"In order that the System may pass on to the Treasury its earnings in excess of requirements, two approaches may be considered:

"(a) Use may be made of a heretofore dormant provision of the Federal Reserve Act. Paragraph 4 of section 16 of that Act authorizes the Board of Governors to charge the Federal Reserve Banks interest on whatever amount of Federal Reserve notes they issue in excess of the amount of gold certificates held by the Federal Reserve Agent as collateral security for "such notes. The rate of interest charged at each Federal Reserve Bank could be fixed by the Board, from time to time, so as to absorb some of the earnings of the Reserve Banks, and the amounts collected could be turned over to the Treasury. This would require no legislation and could be made effective by Board action immediately.

"(b) Another possibility is to impose a tax on the earnings of the Federal Reserve Banks (similar to the old franchise tax). This would require legislation.

"Either provision would make it possible to return to the Treasury not only any additional earnings obtained by the System from higher rates on Treasury bills (perhaps 50 million dollars or more a year) but also some of the earnings of the System on its present portfolio at existing rates (from 50 to 75 million dollars a year)."

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee on October 3 and December 11, 1946, and January 10 and February 17, 1947, were approved, ratified, and confirmed.

A report of open market operations prepared by the Federal Reserve Bank of New York was presented by Mr. Rouse, Manager of the System Open Market Account covering the period from October 3, 1946, to February 24, 1947, inclusive, together with supplementary reports prepared by the New York Bank covering transactions executed on February 25, 26, and 27, 1947. During the course of Mr. Rouse's comments on the reports, copies of the report first mentioned were distributed, and copies of all reports have been placed in the files of the Federal Open Market Committee.

After a brief discussion, upon motion duly made and seconded and by unanimous vote, the transactions in the System account for the period from October 3, 1946, to February 27, 1947, inclusive, were approved, ratified, and confirmed.

Chairman Eccles then referred to the memorandum prepared by the staff group on foreign interests under date of May 1, 1946, which had been presented to the Committee at its meeting on October 3, 1946, and which, in accordance with the action then taken, had been placed on the agenda for consideration at this meeting. He said there was no pressure from the National Advisory Council or from the Aldrich Committee, which advises the President on the International Bank for Reconstruction and Development and the International Monetary Fund, to make securities of the Bank eligible for open market purchases by the System, that the only purpose of such action would be to provide a better market, that any legislation for that purpose would have to be initiated by the System, and that it seemed to him it would be a mistake for the Reserve Banks to engage in stabilization operations in securities of the International Bank, since it would lead to pressure for similar operations in other securities and the securities should either stand on their own feet in this market or should not be issued.

Upon motion duly made and seconded, and by unanimous vote, it was agreed that legislation to enable the Federal Reserve Banks to engage in stabilization operations in securities of the International Bank for Reconstruction and Development should not be sought by the System.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:
M S Eccles
Chairman.