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 Friday, November 18, 1949, at 10:10 a.m.

PRESENT: Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Leach
Mr. Vardaman
Mr. Draper (alternate for Chairman McCabe)

Messrs. Szymczak and Evans, members of the Federal Open Market Committee

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Young, Director of Division of Research and Statistics, Board of Governors
Mr. Youngdahl, Chief of Banking Section, Division of Research and Statistics
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held on September 21, 1949, were approved.

Mr. Rouse submitted and discussed a report prepared at the Federal Reserve Bank of New York on the Government securities market, during the period September 21 to November 16, 1949, and a report of operations in the System open market account for the same period. He also submitted a supplementary report covering operations in the account on November 17, 1949.

> Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account as reported to the members of the executive committee for the period September 21 to November 17, 1949, inclusive, were approved, ratified, and confirmed.

During the meeting there were distributed copies of memoranda prepared by the Division of Research and Statistics of the Board of Governors on (1) the outlook for bank reserves and Treasury cash requirements, under date of November 17, 1949, and (2) Treasury financing, under date of November 10, 1949.

Mr. Thomas summarized the information contained in the first of the two memoranda and in the course of the ensuing discussion of possible changes in short-term rates Mr. Rouse said that, if short-term rates remained at their present levels, the schedule of rates on Treasury savings notes should be adjusted, and that, if the issuing rate on certificates were raised to 1-1/4 per cent, a change in the schedule of rates on savings notes would not be necessary but there were certain technical changes that should be made in the terms of the notes.

Mr. Sproul stated that it appeared to be the consensus of the System economists that present business conditions would continue at about existing high levels through the first half of 1950, that the Treasury deficit and the high level of business activity were re-introducing an inflationary bias in the economy, and that in these circumstances it would be his suggestion that during the remainder of the year, when there is a tendency for short-term rates to move upward, the tendency be allowed to have its effect within reasonable limits without offsetting open market actions. Such a policy, he said, would raise a question as to what the recommendations of the Committee should be with respect to the December financing and whether the note which the Treasury had announced would be offered in connection with the financing should be priced on the basis of an increase in short-term rates.

Mr. Eccles referred to the upward movement that had taken place in the volume of business activity, to the Treasury deficit for the fiscal year which would be the largest peacetime deficit in the history of the United States at a time of very high levels of production and employment, to the likelihood that the level of Government expenditures would not be greatly reduced during the succeeding fiscal year, and to the easy money situation which had stimulated further credit expansion particularly in the field of consumer credit and housing. In the light of all of these factors, he felt that if the June 28 statement of the Federal Open Market Committee was to have any meaning in the direction of greater flexibility in interest rates, the System should follow a more restrictive credit policy which would mean somewhat higher short-term rates during the remainder of this year and possibly beyond. In that situation, he said, it would be unfortunate if the note to be offered in connection with the

December financing, which would be the first large postwar refunding operation into securities other than certificates, were priced on the basis of present easy money market conditions which might result, if a more restrictive credit policy were later adopted, in the new note falling below par. Unless the short-term rate was increased before the announcement of the December refunding, Mr. Eccles preferred to see the refunding operation take the form of a new certificate rather than a note. It was his opinion that the System should give some indication through a firming of short-term rates that it had recognized the change in conditions that had taken place in recent months and he preferred to see short rates move up to a point where the January refunding would be on the basis of 1-1/4 per cent rate for one-year obligations.

There was a general discussion of the form that the December financing should take. Mr. Sproul stated that between now and the end of the year it probably would be necessary for the System to supply a very substantial amount of additional reserves to the market, and that as he understood the discussion at this meeting it was the consensus that these reserves should not be supplied except at a somewhat higher rate.

Mr. Leach commented that if the System took no action to supply reserves over the next several weeks short-term rates would advance, that if the System were to take action to prevent such an increase it should have good reasons for that action, and that in the face of the existing situation no such reasons existed.

Mr. Eccles referred to the decline in long-term rates during the recent weeks and stated that unless the short-term rate were allowed to move upward the spread between the long and the short-term rates would be narrowed by further declines in the rates on long-term issues. In his opinion that movement was an additional reason for increasing short-term rates. He thought it would be a mistake to try to slow the decline of long-term rates, in the absence of some increase in short rates, by sales of restricted issues in the System account (as had been suggested by the Federal Advisory Council at its meeting with the Board of Governors on November 16, 1949) as that would not be effective in correcting the underlying causes of the decline which included the accumulation of investment funds in excess of the demand for such funds. There was general agreement among the members of the committee present with the view expressed by Mr. Eccles on this point.

At this point Mr. Szymczak withdrew from the meeting.

Mr. Sproul stated that the discussion raised the question of the changes to be made in the ranges at which 91-day bills and one-year certificates should be purchased and sold for the System open market account. In the discussion which followed, it was proposed that the range of bills be increased from .96-1.08 to 1.00-1.12, and that the recommendation be made to the absent members of the Federal Open Market Committee that they approve an increase in the range on certificates from 1.06-1.12 to 1.10-1.16.

Mr. Thomas suggested that the upward limit of the range on bills be increased somewhat so that the rate on bills could go as high as certificates if market forces should have that effect.

Mr. Eccles raised the question whether the upward limit of the range on certificates should not be somewhat higher, say 1.18, having in mind that the increase in the rate should be somewhat more rapid prior to the December financing which would leave less of an increase to take effect thereafter to bring the rate up to 1-1/4 per cent for one year obligations in connection with the January financing. It was suggested in this connection that an increase in the certificate rate to 1.16 would preclude December financing on the basis of 1-1/8 per cent, that it would not be desirable to raise the rate too rapidly, and that the notes to be offered in December could be priced in anticipation of an increase in the rate to 1-1/4 per cent for one year obligations.

At the conclusion of the discussion, Mr. Vardaman moved that the range within which bills would be purchased and sold for the System account be increased to 1.0-1.14 and that the executive committee recommend to the absent members of the full Committee that they approve an increase in the range on certificates to 1.10-1.16.

This motion having been duly seconded was put by the Chair and carried unanimously.

> <u>Secretary's Note</u>: Following the meeting, Messrs. McCabe, Szymczak, Clayton, McLarin, Earhart, and C. S. Young (as alternate for Mr. Gidney, who was away on vacation) were informed of the above action and they approved the increase in the range on certificates as recommended by the executive committee. Thereupon, the Federal Reserve Bank of New York was advised accordingly.

Mr. Evans withdrew from the meeting at this point.

Turning to the question of the replacement of maturing Treasury bills in the System open market account, Mr. Rouse suggested that as part of the program discussed by the executive committee at this meeting, it would be desirable to effect substantial redemptions of maturing System bill holdings as a means of absorbing bank reserves.

The matter was discussed in the light of the existing understanding with respect to Treasury bill maturities and it was unanimously understood that the Federal Reserve Bank of New York should be guided in the redemption or replacement of bill holdings by what would be required in the light of current conditions in the money market to carry out the general credit policy of the Federal Open Market Committee.

Mr. Rouse stated that, on the basis of that understanding, he would work toward substantial redemption of weekly maturities and would effect whatever adjustments were necessary by day-to-day purchases in the market.

Further reference was made to the possibility of sales of long-term securities in the System open market account. During a discussion of the various factors having a bearing on this problem Mr. Sproul suggested that it be understood that, in the light of changes that had taken place in the business and credit situation and, consistent with the statement issued by the Federal Open Market Committee on June 28, 1949, there be somewhat greater flexibility in the sales of lon--term securities than was contemplated when the matter was discussed at the Federal Open Market Committee meeting on August 5, 1949, having in mind the desirability of some sales of long-term securities as part of the program to be followed between now and the end of the year. Mr. Sproul's suggestion was approved unanimously.

In a further discussion of a recommendation to be made to the Treasury with respect to December financing, Mr. Sproul referred to the fact that the Secretary of the Treasury had announced that he would offer a note in connection with the refunding but that there was no commitment as to the amount of the refunding that would be done in that form. He also said that the question before the committee was whether it should recommend that all securities, both bonds and certificates, maturing on December 15 be refunded into a note, that the note be offered in exchange for maturing bonds and the certificates rolled over into a new certificate issue, or that the certificates be paid off. He added that if a 1-3/8 per cent note were priced on the present market, it would probably have a maturity of at least 4-3/4 years, but that if it were priced in anticipation of an increase in the short-term rate, as agreed upon at this meeting, the maturity would be in the neighborhood of four years.

Question was raised whether the note should be priced so that, if the short-term rate went to 1-1/4 per cent in connection with the January financing, the new issue would not go below par. This point was discussed and while there were somewhat different viewpoints expressed with respect to it, there was agreement that, if the program proposed by the executive committee at this meeting were carried out, it would not be probable that the new note would go much, if any, below par.

At the conclusion of the discussion, it was unanimously agreed that the recommendation should be made to the Treasury that all securities maturing on December 15 be refunded into a 1-3/8 per cent note with a maturity of about four years.

On the question of deficit financing, Mr. Sproul stated that the current deficit was being financed largely by the sale of savings notes and that it appeared that it would not be necessary for the Treasury to raise new money by other means until the last quarter of the current fiscal year. However, he said, there was a question, which had been considered at previous meetings whether any recommendation should be made to the Treasury with respect to changing the schedule of rates on savings notes.

After a discussion, it was agreed that, pending further developments in the short-term money market, no recommendations should be made to the Treasury at this time except with respect to certain technical changes that might be desirable.

Reference was made to the discussion at the last meeting of the full Committee of a program of long-term debt management and Mr. Morrill stated that Mr. Riefler, Assistant to Chairman McCabe, had suggested that, as a means of bringing about discussion of the possibilities of such a program, consideration be given to the submission to the Treasury staff of all of the suggestions that had been made by the Federal Reserve staff on this subject, without any implication of approval of any of these suggestions.

It was agreed that this matter would become increasingly important as the volume of maturing securities increased over the next few years and that the System should continue to work on it. In that connection, Mr. Thomas stated that, at a recent meeting of the Research Advisory Committee and the subcommittee of the Presidents' Conference Committee on Research, considerable time was spent in the discussion of this problem and that the Committee on Banking and Credit Policy had been asked to prepare a memorandum of possible policies and procedure which could be agreed upon as desirable in dealing with the matter.

It was agreed unanimously that the System Research Advisory Committee should continue to study the problem and that, in accordance with the suggestion made by Mr. Riefler, a memorandum should be prepared by the members of the staff that had been working on the problem and submitted to Messrs. Bartelt and Haas of the Treasury Department with the statement that the memorandum did not in any way commit the Open Market Committee, the Board of Governors, the Federal Reserve Banks, or their staffs but was submitted by the staff as a means of presenting to the staff of the Treasury for consideration the various suggestions that had been made in connection with the problem.

Mr. Sproul inquired whether any suggestions should be made to the Treasury at this time that further inducement be provided for holders of maturing E bonds to re-invest in new Savings Bonds. He pointed out that even if action in that direction were taken by the Treasury at this time, it probably would not be possible to put the changes into effect before January of next year.

In a discussion of this matter, it was stated that because of the relatively small amount of E bonds maturing prior to 1952, the problem would not be an urgent one until that time. Inasmuch as this subject would be on the agenda at the next meeting of the full Committee, it was agreed unanimously that the staff should be requested to prepare for consideration at that meeting a memorandum outlining the problem and the various ways in which it might be met.

Consideration was then given to the direction to be issued to the Federal Reserve Bank of New York to effect transactions for the System account and there was agreement that the directions adopted at the last meeting of the executive committee should be renewed.

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 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 changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; provided that the total amount of securities in the account at the close of August 5, 1949, shall not be increased or decreased by more than $3 billion 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 $1 billion.

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.

In a discussion of the procedure to be following in advising the Treasury of the decisions made at this meeting, it was stated that the Secretary of the Treasury would not be in his office until November 28, and that it would be desirable if advice of the committee's actions with respect to open market policy and suggestions with respect to December financing could be put in his hands before he returns.

Accordingly, it was agreed unanimously that the staff should prepare a draft of a letter which, when in a form satisfactory to Mr. Sproul, could be given to Chairman McCabe with the suggestion that it be sent to Secretary Snyder to reach him as promptly as possible.

Secretary's Note: The letter sent to the Secretary of the Treasury on November 22, 1949, in accordance with this action was in the following form:

"The executive committee of the Federal Open Market Committee met on November 18 and considered appropriate Federal Reserve policy in the light of recent developments in the business and credit situation. It appeared to the committee that these developments have demonstrated the great strength of the postwar economy of this country and that the outlook, at least for the next few months, is for an increased volume of public and private spending which will reintroduce an inflationary bias in our economy, even though it does not result in a renewal of general price advances. Under these circumstances, and within the general framework of the policy which the Federal Open Market Committee announced last June, a policy has now been adopted with the approval of all members of the Federal Open Market Committee which is designed to place mild restrictions on the availability of reserves through open market operations. This policy, in view of the demands that are expected to be made upon the System to supply additional reserves during the next few weeks, should result in some tightening of the money market and a consequent modest firming of short-term rates.

"The committee was mindful, of course, of the Treasury's continuing problems of debt management, and gave particular attention to the refunding of the December maturities of bonds and certificates. The committee believes that changes in the economic situation since you announced in August that you intended to offer a Treasury note in connection with the December refundings, have confirmed the wisdom of that decision. It is the committee's view and recommendation that all of the December maturities, including the $519 million of certificates of indebtedness, be exchanged for a new note. This would provide a note issue of appropriate size, would rid the maturity schedule of an odd certificate issue, and would avoid the problem of pricing a one-year obligation at a time of changing short-term rates. At the same time, "this last consideration suggests that the terms of the new note will have to be somewhat more liberal--at least on the side of the maturity of the note--than if these terms were fixed on the basis of recent markets. It is the committee's view at this time that a 1-3/8 per cent note with a maturity of about four years would meet the needs of the situation and improve the schedule of debt maturities.

"We shall be glad to discuss with you, at your early convenience, the background of the committee's action and its suggestions regarding the December refunding."

There was also unanimous agreement that a meeting of the Federal Open Market Committee should be called to convene in Washington at 10:00 a.m. on Monday, December 12, 1949, with the understanding that the Presidents of all of the Federal Reserve Banks would be invited to be present and that the informal suggestion would be made to Mr. Davis, President of the Presidents' Conference that a joint meeting of the Board of Governors and the Presidents of the Federal Reserve Banks might be held on Tuesday, December 13, 1949.

Mr. Rouse stated that, with two or three exceptions, all of the dealers in Government securities who were qualified to do business with the System open market account were living up to the agreements under which they were qualified and that in the two or three cases the dealers were meeting all of the requirements except that the volume of their business in Treasury bonds was not sufficiently wide in scope to discharge their responsibility for making a national market in these securities under all ordinary conditions. He said he had urged them to broaden their activities in this respect, that in the absence of objection from the members of the committee he would require that this be done, and that if satisfactory results were not obtained promptly he would bring the matter to the attention of the committee again. No disagreement was expressed by the members of the committee to the procedure outlined by Mr. Rouse.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Vice Chairman.