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, May 20, 1948, at 9:30 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Szymczak
Mr. Williams

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager of the System Open Market Account
Mr. Riefler, Assistant to the Chairman of the Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
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 April 21, 1948, were approved.

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 April 21 to May 19, 1948, inclusive, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the letter sent to the Secretary of the Treasury under date of April 26, 1948, in accordance with the understanding reached at the meeting of the executive committee on April 21, 1948, was approved and its transmission to the Treasury was ratified and confirmed.

Chairman McCabe reviewed briefly the discussions which he and Mr. Sproul had with the Secretary and other representatives of the Treasury on April 28 and May 12, following which the Treasury reached a decision to refund securities maturing in June and July with 1-1/8 per cent Treasury certificates.

In the discussion of the Treasury decision it was noted that, while the Federal Advisory Council apparently was unanimous in the opinion expressed to the Board of Governors that the rate should be raised in connection with the June financing, two members of the Council, who were also members of the Committee on Government Borrowing of the American Bankers Association had, as individual members of that Committee, advised the Secretary against the increase. The point was also brought out that apparently the Secretary felt that if the rate were raised at this time it would not be as effective as at some future time when if inflationary pressures were increased the rate could well be raised.

Mr. Szymczak stated that the action of the Treasury did not foreclose action by the Federal Reserve System towards increasing the short-term rate in the market between now and September so that the refunding of securities maturing in September and October would be at a 1-1/4 per cent rate.

In a discussion of the action that might be taken in that connection, Mr. Sproul suggested that until the July refunding was completed the System should sell from its open market account to the extent possible without interfering with the success of the refunding operations. He thought that, if the market should decline during that period to the existing support levels, consideration should be given to dropping some of the support prices to the extent that that could be done without affecting the refunding adversely. After the first of July, he said, and if the situation at that time appeared to warrant the action, steps could be taken to move up the short-term market rate, and to adjust other rates accordingly, in anticipation of an increase in the certificate rate to 1-1/4 per cent in September. He also suggested that, if the inflationary movement seemed to be getting out of hand prior to September, consideration should be given to increasing the discount rate to 1-1/2 per cent, but that otherwise the rate should not be raised until after the increase in the short-term rate to 1-1/4 per cent. He added that the increase in reserve requirements of central reserve city banks should be deferred until such time as the increase would have some effect on a developing inflationary situation. He also said that the Treasury could be advised that the "exposure" to further inflationary pressures had been increased by the continuation of the 1-1/8 per cent rate in connection with the June and July refunding and that the Federal Open Market Committee had in mind that after the July refunding had been successfully completed it might be necessary to take the actions outlined above in order to discharge its responsibilities.

As a collateral matter, Mr. Sproul referred to the suggestion contained in the letter of April 26, 1948, to the Treasury that a new series of savings notes be issued with an adjusted scale of rates. He said that the action on the new issue had been deferred for some months pending a decision on the short-term rate, that the new issue should not be delayed any longer, and that it should be offered with a scale of rates which would be closer to existing short-term rates and designed to reverse or at least offset the present drain on the Treasury resulting from redemptions of savings notes in excess of purchases. He also suggested that it would be helpful in the savings bond campaign which was now in progress if the Treasury would increase the limit on the amount of F and G bonds that could be purchased for pension fund investment.

In a discussion of Mr. Sproul's suggestions and of the effect on the market of the decision of the Treasury to continue the 1-1/8 per cent rate, Mr. Rouse stated that the current prices of Government bonds were well above present support prices and that this week, when there was a sharp rise in quotations with limited volume and no supply in the market, the Federal Reserve Bank of New York began to make bonds available from the System account.

He also said that bonds had been made available by reason of a selling order from the Treasury for the account of the Federal Deposit Insurance Corporation. While this action, he said, tempered the movement, there were indications that it might be resumed and it was his feeling that any real demand that developed should be partially filled by sales from the System account for the purpose of absorbing as large an amount of bank reserves as possible without completely stopping any rise that otherwise might take place.

It was made clear during the discussion that any decision with respect to an increase in the short-term market rate prior to September should be reached only after consultation with the Treasury, and Mr. Eccles questioned whether the System should take such action over the objections of the Treasury even though the Committee felt strongly that the short-term rate should be increased. On the matter of sales of securities from the System account to temper a rise in bond prices, Mr. Eccles suggested that, since it would not be possible for some weeks to increase the short-term rate, which was the most satisfactory way under present conditions to prevent a decline in the long-term rate, the System should not sell long-term securities for the purpose of achieving the same result.

Mr. Sproul expressed the opinion, in view of the discussion over the past two or three months during which there appeared to be general agreement as to the desirability of an increase in the short-term rate, but with a difference on the part of the Treasury as to the timing of the increase, that if the conditions foreseen by the Committee justifying an increase in the short-term rate were to develop, the Treasury would be in accord with a decision by the Committee to lower the support prices in the short-term market. As to the question of sales of bonds from the System account, Mr. Sproul said that there were two considerations involved, first, stability of the Government security market and, second, the desirability in the present situation of selling securities whenever that could be done in order to absorb as large an amount of bank reserves as possible.

Mr. Szymczak suggested that the questions before the Federal Open Market Committee were the actions to be taken before July 1 and the policy to be followed after the July refunding had been completed.

Chairman McCabe expressed the opinion that any discussions before the middle of June with the Treasury as to what should be done after July 1 would be premature.

Mr. Rouse stated that, in the absence of other instructions from the executive committee, the Federal Reserve Bank of New York would convert the System's holding of June and July maturities into the new refunding certificate. All of the members of the executive committee indicated agreement that that should be done.

In a discussion of the next meeting with representatives of the Treasury, there was agreement that if, at the meeting of the Federal Open Market Committee to be held immediately following this meeting, there should be agreement that the short-term market rate should be increased to 1-1/4 per cent by September and in subsequent discussions there were objection by the Treasury to that action, it would be necessary for the full Committee to meet again and issue new instructions to the executive committee.

Mr. Eccles suggested that the full Committee might authorize the executive committee, after conferring with the Treasury and if conditions continued to justify the action, to take such action as might be necessary to increase the short-term rate to 1-1/4 per cent so that the September refunding would be done at that rate, it being understood that if the Treasury objected to that action another meeting of the full Committee would be called. The other members of the committee indicated agreement with Mr. Eccles' suggestion.

Following a further discussion of the effect in the market of sales of long-term securities from the System open market account as proposed by Messrs. Sproul and Rouse, the meeting recessed to reconvene following the meeting of the Federal Open Market Committee.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.

The meeting of the executive committee of the Federal Open Market Committee was reconvened in the offices of the Board of Governors of the Federal Reserve System in Washington on Thursday, May 20, 1948, at 3:15 p.m.

PRESENT: Mr. McCabe, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Szymczak
Mr. Williams

Mr. Morrill, Secretary
Mr. Carpenter, Assistant Secretary
Mr. Vest, General Counsel
Mr. Townsend, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Bopp, Irons, Langum, and Robb, Associate Economists
Mr. Rouse, Manager of the System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman of the Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Smith, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Special Assistant, Securities Department, Federal Reserve Bank of New York

Messrs. Clayton, Draper, Evans, Gilbert, Leedy, and Young, members of the Federal Open Market Committee

Messrs. Leach, Gidney, McLarin, and Earhart, alternate members of the Federal Open Market Committee

Messrs. Whittemore, Davis, and Peyton, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively.

Messrs. Thompson and Johns, Vice Presidents of the Federal Reserve Banks of Cleveland and Kansas City, respectively

Consideration was given to the direction to be issued to the Federal Reserve Bank of New York as agent for the System account and it was suggested that a limit of $750,000,000 on changes in System holdings of Government securities would be adequate for the time being. It was pointed out that the executive committee had been given authority to make changes in the aggregate amount of securities in the account up to $1.5 billion and that the means were readily available for granting additional authority to the New York Bank in the event the $750,000,000 was not sufficient.

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 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 to the needs of commerce and business; provided that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than $750,000,000 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 $750,000,000.

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

Reference was made to the date for the next meeting of the executive committee and no objection was made to the suggestion by Mr. Sproul that the meeting be held during the week of June 21, 1948.

Mr. Rouse then submitted a memorandum reading as follows:

"At a meeting of the executive committee of the Federal Open Market Committee on June 10, 1946, the following question, among others, was discussed and the suggested solution approved unanimously:

'2. Whether the committee should recognize, at least informally, the present commission of 1/64 of a point on transactions with dealers for the System account in notes and bonds and the present limitation to exceptional cases of transactions in these securities on a net basis and whether the committee should establish a commission of perhaps 0.01 per cent on transactions in certificates.

'Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than 1/64 of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act "'as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities.'

"In view of the particular importance attached at times to System Open Market operations in Treasury bonds, it is the suggestion of the Federal Reserve Bank of New York that more flexibility could be provided in handling System transactions, if the above solution were revised to include the underscored insertion shown below:

Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than 1/64 of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. <u>If, however, it appears desirable in the interest of maintaining an orderly market to avoid the identification by the market of System operations, transactions in Treasury bonds may be confirmed to us by dealers as principals rather than as agents, provided the dealers' confirmations to us state that the bonds were bought from or sold to another at a price spread of not more than 1/64 of a point</u>. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities."

Mr. Rouse stated that the principal purpose of the June 10, 1946, action was to assure that the dealers' price spread would not be more than 1/64 of a point. He also stated that during the past few days when it was necessary to offer bonds in the market to stem a rapid rise in prices, under the instructions of the executive committee, these offerings were handled by the brokers on an agency basis which resulted in a disclosure of the fact that securities were being offered by the Federal Reserve Bank of New York because the System account was the only one known to require agency execution, and that, if the dealers were permitted to handle these transactions as principals and their confirmations of the transactions, as suggested above, were required to state that the securities were bought from or sold to another at a price spread of not more than 1/64 of a point, the original purposes of the executive committee could be accomplished without requiring disclosure of the fact that the Federal Reserve Bank of New York was the seller or purchaser of the securities in question.

Upon motion duly made and seconded, and by unanimous vote, the amended instructions of the executive committee to the Federal Reserve Bank of New York were approved unanimously as follows:

Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than 1/64 of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. If, however, it appears desirable in the interest of maintaining an orderly market to avoid the identification by the market of System operations, transactions in Treasury bonds may be confirmed to the Federal Reserve Bank of New York by dealers as principals rather than as agents, provided the dealers' confirmations to the Bank state that the bonds were bought from or sold to another at a price spread of not more than 1/64 of a point. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Thomas B. McCabe
Chairman.