

Because the market in FHL Bank debt is still relatively small, at least when compared to the market for U. S. Government securities, purchases on such a large scale would quickly force other buyers out of the market leaving the Federal Reserve the dominant market force.

Federal Reserve preemption of the buy side of the secondary market would, of course, tend to reduce interest yields on FHL Bank issues, at least temporarily. But it has generally been our view that financial markets are benefitted most over the long run if basic forces of supply and demand are allowed to work themselves out in the marketplace independent of direct Federal Reserve support. Since the Treasury-Federal Reserve accord in the early 1950's, all of our open market operations have been conducted with this view in mind. Otherwise, uncertainties are engendered in the minds of investors and dealers whether pegged interest rates or general monetary objectives will be given first priority. Such uncertainties in turn create arbitrary price fluctuations which retard the market's development.

The market for FHL Bank debt and agency securities in general has already grown considerably in depth and breadth in recent years, and the Federal Reserve would not wish to inhibit further improvement. Consequently, I believe Federal Reserve transactions in the secondary market for agency securities should be undertaken only to the extent they contribute to the market's long run development. With this objective in mind, the Federal Reserve began in late 1966 to make repurchase agreements with dealers in agency securities. Since then, nearly \$1 billion of such transactions have been made, about half of which have been in the obligations of housing agencies.

More generally, any undertaking to finance the FHL Banks through Federal Reserve buying of FHL Bank debt would have to be accomplished within the constraints of general monetary policy--which in the circumstances assumed would be strongly anti-inflationary. Federal Reserve experience with the pegging of interest rates during and after World War II showed that efforts to hold any given interest rate at artificially low levels cause the Federal Reserve to become "an engine of inflation."

If Federal Reserve purchases were to be made on the scale required without releasing substantially more reserves to the banking system than would be consistent with general monetary policy, the Federal Reserve would have to make partly offsetting sales of U. S. Government securities. And over the longer run any additions of FHL Bank obligations to the Federal Reserve security portfolio would represent substitutions for U. S. Government securities.