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 on Wednesday, May 13, 1953, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Erickson
Mr. Evans
Mr. Mills
Mr. Johns, Alternate for Mr. Sproul

Messrs. Robertson and Vardaman, Members of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Ralph A. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Ralph F. Leach, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Willis, Assistant Secretary, 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 of the Federal Open Market Committee held in Washington on April 24, 1953, were approved.

Before this meeting there had been sent to the members of the committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period May 6 to May 11, 1953, inclusive. At this meeting Mr. Rouse presented a supplementary report covering commitments on May 12, 1953, and commented on the reports. Copies of both reports have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period May 6 to May 12, 1953, inclusive, were approved, ratified, and confirmed.

Chairman Martin referred to a proposal regarding a revision in the directive of the Federal Open Market Committee which had been prepared pursuant to the understanding at the meeting of the full Committee on March 4-5, 1953, and copies of which had been distributed before this meeting. He suggested that there be a discussion at the next meeting of the executive committee of the proposal for revision in the directive of the full Committee as well as in the instructions issued by the executive committee to the Federal Reserve Bank of New York, with a view to presenting any suggestions which the executive committee might have at the meeting of the full Committee to be held during the week of June 8, 1953. In this connection, Chairman Martin suggested that the next meeting of the executive committee be held on Tuesday, May 26, 1953, at 10:30 a.m. and this suggestion was concurred in by the members of the committee who were present, Mr. Erickson noting that he would be unable to attend a meeting on or about May 26.

At Chairman Martin's suggestion, Mr. Vest made a statement with respect to the proposed revision in the directive of the Federal Open Market Committee, and there followed a brief discussion of the proposed changes. During this discussion, Mr. Erickson raised the question whether the terms of the directive as proposed for revision permitted sufficient latitude for operations between meetings of the Committee, and Mr. Riefler responded that the substance of the proposed directive was the same as that of the present directive, which had merely been rearranged as a means of illustrating the suggested change in form. He noted that the terms of the directive could be made more specific or less specific at any meeting of the Committee. There was also a brief discussion as to whether a change in the form of the directive of the full Committee would necessarily result in any change in the substance of the record of policy actions prepared pursuant to section 10 of the Federal Reserve Act and published in the annual report of the Board of Governors. At the conclusion of the discussion it was agreed that the matter would be placed on the agenda for consideration at the meeting of the executive committee on May 26 with a view to submitting any proposal which the committee might agree upon for the consideration of the full Committee at its meeting in June.

Chairman Martin then called upon Mr. Ralph Young who referred to a staff memorandum on the current economic situation dated May 11, 1953, copies of which were distributed before this meeting. Mr. Young stated that the economic situation is still strong with credit demand active, availability of credit tight, interest rates rising, and relatively faint traces of weakness in the economy. There is, however, an increasing number of observers who are projecting or forecasting that the economic situation may weaken and start downward in the near-term future. Statistical evidence of such a down turn is lacking, Mr. Young said, and his feeling was that no decline was in prospect in the immediate future. Nevertheless, Mr. Young stated that it must be recognized that during the past two months there had been little change in the Board's index of industrial production, that at the present time the economy is operating at a level from which there appears to be little possibility of further increase in activity, and that account must be taken of the fact that there has been a substantial adjustment in interest rates, especially in the longer term market, which has affected the liquidity position of the economy substantially. Mr. Young noted that for the first time in many years business is encountering changes in interest rates, and this development has affected plans for capital expenditures. The immediate prospect, Mr. Young said, seems to be for a continuing high level of activity but with a situation that would require very close observation from week to week and month to month. Some rise in inventories of durable goods is beginning to appear and it looks as though a real job of selling would have to be done in such lines as automobiles, although credit terms are relatively easy and may be expected to help in the continued movement of such goods through distributor channels.

Mr. Thomas stated that demands in the money markets are continuing very strong, that for the year to date there has been a somewhat larger increase in bank loans than occurred last year, and that liquidation of Government securities by banks has continued. Government deposits have decreased whereas they usually increase at this time of year, while other deposits have recently expanded somewhat more than they did in the same period last year. Figures of member banks for the past week show a continuing loan expansion and a moderate contraction of bank holdings of Government securities. It appears that very little bank credit was used in making the payments during the past week for the 3-1/4 per cent 30-year bonds recently issued by the Treasury. Treasury deposits at reporting banks increased by $450 million, while demand deposits adjusted declined by over $800 million. While slight easing in the money market is in prospect next week, Mr. Thomas said that this should be followed by further tightening toward the end of the month, as a result of increased demands for currency over the Memorial Day holiday and the month-end decline in float, assuming maintenance of Treasury balances at the Reserve Banks at a normal level. In subsequent weeks demand for Reserve Bank credit might be expected to show a tendency to increase.

Mr. Rouse, in commenting on the situation, cited figures showing the difficulty of carrying on operations for the open market account on the basis of projections made regarding the factors affecting the money market. He referred specifically to wide differences between projections as to Treasury operations and the actual figures of such operations during the past week or two.

Mr. Erickson mentioned certain developments in the Boston Federal Reserve District which suggested to him the possibility of readjustments in the economic situation in the near-term future.

Mr. Johns stated that the picture looked much the same to him as it did a week ago, that banks in the St. Louis District had been kept under pressure in connection with borrowings at the Reserve Bank, and that the St. Louis District was currently in the position of losing funds to other parts of the country.

Mr. Mills referred to Mr. Thomas' comment that apparently the recent Treasury issue of 3-1/4 per cent bonds had been financed largely outside the banking system with the employment of only a small amount of bank credit. He mentioned that the bill market is now largely a nonbank market, according to Mr. Rouse, and he raised the question whether funds being withdrawn by corporations and other nonbank purchasers of bills and short-term securities might be having an influence in the money market which might be an argument for purchases by the Open Market Committee to offset the drains of reserves on some banks as a result of these and other factors. He inquired of Mr. Rouse as to the basis on which he would introduce new reserves into the market through bill purchases or in any other manner and how such a program would be communicated to the market.

Mr. Rouse stated that, taking as a background the discussion at the meeting of the executive committee on May 6 and the projection made by Mr.

Thomas of possible needs for additional reserves during the remainder of this year, he felt some further purchases of short-term securities for the System account would be advisable without having any fixed amount in mind at this time. He felt that during the next week or two needs for additional reserves could be handled largely through repurchase agreements. In his comments, Mr. Rouse noted that there is a shortage of bills in the market at present and he suggested that the easiest procedure for getting reserve funds into the market would be for the System account to make purchases of 2 per cent Treasury bonds.

Chairman Martin felt it would be a mistake for the System account to make purchases of 2 per cent bonds in the open market at this time. His view was that it would be distinctly preferable for the System account to continue to operate in the bill market, and he believed bills would be available.

Mr. Rouse responded that he was not recommending purchases of the 2 per cent bonds, that he mentioned them merely as a means for getting reserves into the market easily in the most helpful form.

Mr. Thomas pointed out, with reference to Mr. Mills' inquiry, that purchases of bills by nonbank investors from banks did not deprive banks as a whole of reserves but released reserves for expansion of other types of credit, unless the purchases were made from the Federal Reserve or the reserves released were used to pay off borrowings at the Federal Reserve.

Mr. Robertson referred to the discussion at the meeting on May 6 stating that he had given further thought to the use of different instruments in carrying out credit policy, particularly to the possible use of the discount rate in connection with purchases of securities in the open market. He then made a statement substantially as follows:

> Judgment as to appropriate monetary policy must begin with a judgment as to the current and prospective economic situation. Most of the economic indicators suggest great strength in the economy for the present and the immediate future. Except in war, we have never utilized our resources as fully as we are today. Production and employment are at very advanced levels. Unemployment is at a postwar low. The decline in prices which was in progress some months ago has slackened off and prices have stabilized in recent weeks.
>
> The current economic situation has been characterized as an "overtime economy". That seems to be a proper characterization. If so, this situation is one from which we shall have to make readjustments sooner or later. To sustain a high level of activity, which is our aim, those readjustments must be made to come in serial fashion; if they do not, they may come together in the form of a recession.
>
> In my judgment, tl_ present economic situation necessitates the maintenance of an important measure of restraint on credit and monetary expansion tempered by an ever-readiness to move in reverse rapidly if the facts call for such action. We have been exercising this kind of restraint in the last two years and it has been a substantial factor in the comparative stability achieved. It should be continued. The real question before us is not whether our policy has been too restrictive, but whether we now have the right mixture of ingredients in our application of monetary restraint.
>
> Over the past year the System has put the basic emphasis of monetary policy on open market operations. We have operated the account so as to put banks heavily in debt to the Federal Reserve System and have relied on the growing pressure of member bank indebtedness to achieve the needed restraint on credit and monetary expansion. The record indicates that to achieve adequate restraint, a level of borrowing of around a billion and a half dollars was thought to be necessary. Some of this borrowing was actually not restrictive since it represented willing borrowing for purposes of tax avoidance. Nevertheless, the high level of borrowing, along with the pressure to repay, has been a factor putting real restraint on bank credit expansion.

Recently the Reserve Banks have been reviewing their lending practices, as they gained experience in operating the discount window, and borrowing is now more effectively policed, with the result that a billion dollars of borrowing at the Federal Reserve Banks today weighs more heavily on the market now than it did a few months ago.

We have properly been disturbed and concerned about developments in the money and capital markets in recent weeks. The tone in the Government security market and in other credit markets has not been good; in fact, there has on occasion been a tendency for markets to dry up or disappear. This is serious at any time and a special problem during a period when the Treasury is coming to the market as a heavy borrower.

In the report of the ad hoc subcommittee on the Government securities market it was pointed out that open market operations and the discount rate are complementary instruments of Federal Reserve policy to be used in the mixture most appropriate to the times. The mixture might now be changed with advantage. It seems to me that we may have been relying too heavily on the level of borrowing as an indicator of policy effectiveness, with the result that the money and capital markets have been kept under constant pressure, at times so great as to cause even the bill market to dry up. On the other hand, we may not have relied heavily enough on a flexible discount rate in achieving the objective of curbing credit and monetary expansion.

I see no reason at this time to relax our policy of restraint, but the existing measure of over-all restraint might be achieved better by easing the pressure on member bank borrowing through open market operations, and contemporaneously making an upward adjustment in the discount rate.

I use the word "contemporaneously" to mean that the rate action should come somewhat after the action has been taken in the open market area but not later than a few weeks after, assuming that the economic situation continues strong. If the open market action begun this week is continued on a steady basis, then the discount rate action should come early in June. This would permit the Treasury to refund its June maturities and raise some new money in the bill market prior to the change. It would place the change ahead of any new money financing the Treasury might do to take care of its July and August deficit.

I would hope that an easing in the open market area, together with the rise in the discount rate, would develop about the same total measure of restraint as we now have in the credit area, but that the different mixture of instruments would bring about a somewhat more satisfactory tone in the credit and capital markets.

Mr. Johns, in response to a question from Chairman Martin as to whether he had changed his position as expressed at the meeting of the executive committee on May 6, made a statement substantially as follows:

> I would like to reiterate what I said at the last meeting at which time I made a statement which was completely in agreement with the views Governor Robertson has expressed. Last week it was stated that a course such as Governor Robertson suggested would give the appearance of adding further confusion to an already confused situation. I am inclined to believe we are moving in opposite directions at the present time. Continually, bankers with whom we have conversations about their borrowings as well as people who are not borrowing say to us that we are in an inconsistent position when we offer to bankers an almost irresistible incentive to borrow and at the same time cudgel them with reasons for not borrowing. It seems to me that when we encourage banks to borrow by keeping the discount rate below the market for short-term funds, we are in an inconsistent position if we then tell them they should not borrow. Bankers say to me that so long as we have a 2 per cent discount rate they are under obligation to borrow in order to make money for their stockholders. It is not an effective answer to tell such bankers that theirs are quasi-public institutions, that as a means of helping to carry out a sound credit policy they should not avail themselves of the advantage we appear to offer them. I should think we would iron out an inconsistency in our position if we were to increase the discount rate. I think it would not be understood by the market as moving in inconsistent directions, but on the contrary, it would be regarded as removing an inconsistency. I would like to see such action taken.

Mr. Erickson disagreed with Mr. Johns with respect to an increase in the discount rate, stating that he thought such an action at this time would be a mistake, that bankers will borrow at 2-1/4 per cent about as readily as at 2 per cent, and that an increase in the rate at this time would be misinterpreted by the banking and business community. He reiterated the view he had expressed at the meeting on April 24 that the economy was in a twilight zone, with some inflationary factors present and some deflationary factors beginning to appear. Mr. Erickson added the comment that if the discount rate were to be increased at present it might be but a short time until a reduction would be called for by economic developments.

Chairman Martin said that, on the other side, an increase in the discount rate would provide the System with more latitude for reversing its policy if that became desirable, his feeling being that there was very little latitude within which the discount rate could be reduced from the present level of 2 per cent if it became necessary to relax credit.

Mr. Rouse thought that perhaps the members of the committee were not far apart in their views, that it was largely a matter of timing. He said that if the present situation continued through June and there still was no confirmation of the dire predictions of a down-turn in business by early July, it might be timely to increase the discount rate then.

Mr. Riefler stated that while he felt the diagnosis made by Mr. Robertson was excellent, it did not recognize adequately what had happened on Monday of last week when the new Treasury 3-1/4 bonds went below par. That, he said, was a shift to a restrictive policy stronger than the Federal Open Market Committee had envisaged. The fact that it may have happened because of the handling of "free riders" on the Treasury financing did not alter the fact that 2-1/2 per cent Treasury bonds were selling at 91-92.

Mr. Riefler felt the Committee's policy had become overly restrictive, that it was going to have an effect that the Committee did not desire, and that the situation was one which must gradually be adjusted through regular purchases of securities in the open market in a manner which would result in the least possible loss of confidence by the market. Mr. Riefler did not feel it would be desirable to increase the discount rate prior to July but if by that time the money market was interpreting the purchases of securities from week to week for the System account as a basis for another boom in credit, then action to increase the discount rate should be taken. He felt the existing degree of restraint, however, was more than adequate.

Mr. Young stated that he had much sympathy for the point of view expressed by Mr. Robertson. There was a problem of a mixture of policies which was very difficult to handle, he said, and the present mixture might be a little in danger of being too strongly restrictive. While the lag between System action and effects in the market was difficult to appraise, Mr. Young felt that an early adjustment of the discount rate which would put it in a better alignment with market rates would be desirable. Messrs. Youngdahl and Leach concurred in Mr. Young's views, while Mr. Willis stated that he was inclined to agree with the views expressed by Mr. Riefler, that he felt it was desirable to delay an increase in the discount rate and not run the risk of adding to confusion in the market.

Chairman Martin stated that at the meeting of the executive committee last week Mr. Mills had suggested that the limitation in the direction to the Federal Reserve Bank of New York be increased from $500 million to $1 billion and he asked Mr. Evans for his views on this suggestion, since it had been necessary for Mr. Evans to leave the May 6 meeting before the increase was proposed.

Mr. Evans said that while he could not see any necessity for such an increase under the contemplated program, he would not object if other members of the committee felt it desirable to give greater authority to the New York Bank.

Mr. Rouse stated that while the larger amount had been in effect much of the time in recent years, he could not visualize any development during the next two weeks which would call for use of authority in excess of the $500 million limitation.

Mr. Mills said that in making the suggestion for the larger figure, he had in mind that a situation might develop in which it would be necessary to make more aggressive purchases for the System account. He felt it would be helpful to have the larger figure as an indication that the executive committee believed that sufficient and positive action would be taken in making purchases for the System account during this period.

Chairman Martin stated that the committee appeared to be in agreement that it was not desirable to have a specific figure in mind in connection with injecting reserves into the market to prevent further tightening, and he questioned whether merely raising the figure in the directive as Mr. Mills suggested would give any assurance that market purchases would be made.

Mr. Rouse said that as he understood it, the instructions, in essence, were that the New York Bank should put reserves into the market over a period of time which would be sufficient to avoid further tightening of the money market. He understood that none of the members of the committee felt there should be a relaxation in the credit situation, that it was the objective to level-off the situation as far as that was possible, that he and Mr. Sproul had discussed the matter fully in the light of the meeting on May 6, that they were trying to "feel their way along", and that he felt they had an understanding of the committee's objectives regarding purchases in the open market.

Mr. Mills stated that with the present tightness in the money market there was no room for expansion in the economy along the lines of "moderate, normal growth" such as had been discussed by Mr. Thomas in projecting possible needs for reserves at last week's meeting, that there is a demand for credit in the market that is going unsatisfied, that he felt the committee should prepare to satisfy the legitimate credit needs growing out of moderate, normal growth and seasonal factors in the economy, and that in his judgment those needs should be satisfied without delay with a generous injection of reserves into the market.

Mr. Rouse stated that he thought this would take place through the use of repurchase agreements and outright purchases in the market, that in the next two weeks he did not think it would be necessary to make large further additions to the System account although this would depend on various factors including the extent to which repurchase agreements were used in this period. In response to a statement by Mr. Mills that the procedure outlined by Mr. Rouse would leave the market in suspense, the latter commented that the kind of assurance the market needs is that provided by week to week addition of reserves through increased holdings of the System open market account, that the amount of such purchases is not presently important except as it is considered in conjunction with the use of repurchase agreements.

Chairman Martin said that he felt Mr. Mills had raised a very real question, that he did not think the committee should set up a specific amount to be purchased from week to week, that the amount of purchases should not be related to Treasury financing, that it should not be sufficient to bring about a relaxation in the credit situation, that it should be sufficient to hold even the present situation, and that it appeared that in order to do this a fairly substantial injection of additional reserves might be necessary in line with a moderate, normal expansion in business between now and the end of the year.

Mr. Evans stated that he was not so sure there should not be some specific figure given by the executive committee to the New York Bank, that he had difficulty in understanding how the New York Bank could determine what it was to do in carrying out the wishes of the executive committee without such a figure.

Mr. Rouse responded that he felt he understood the intent of the executive committee on the basis of the discussion that had taken place, and Mr. Mills indicated that Mr. Rouse might carry back the idea that he (Mr. Mills) as an individual member of the committee felt the New York Bank in carrying out the instructions of the executive committee had been a little too restrictive in recent weeks.

Chairman Martin stated that one objection to the use of a figure such as Mr. Evans suggested was the danger of leaks and misunderstanding resulting from it. Apart from this, he felt it was important that System account operations be kept fluid at this time.

> 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 in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the total amount of securities in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date shall not be increased or decreased by more than $500 million;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) 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 at any one time by the Federal Reserve Banks shall not exceed in the aggregate $1 billion.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary.