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 Tuesday, August 4, 1953, at 10:30 a.m.

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

Mr. Szymczak, Member of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Leach, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, 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 of the Federal Open Market Committee held on July 21, 1953 were approved.

Before this meeting there had been sent to the members of the committee a report prepared at the Federal Reserve Bank of New York covering operations in the System open market account from July 21 to July 31, 1953, inclusive, and at this meeting Mr. Rouse presented a supplementary report covering commitments on August 3, 1953. 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 July 21 to August 3, 1953, inclusive, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Young made a statement with respect to current economic conditions. He said that there had been little change in the underlying economic forces at work in the economy during the two weeks since the last meeting of the executive committee, that the armistice negotiated in Korea had had negligible immediate effects on sensitive markets in the United States or abroad, and that in general the picture of economic activity was one of continuing stability at high levels, with selective adjustments in different markets. Mr. Young also commented in some detail on various economic factors, substantially as reported in a staff memorandum dated July 31, 1953, copies of which were distributed before this meeting.

Mr. Thomas stated that following the large increase in bank holdings of Government securities in mid-July, holdings had declined sharply during the past two weeks. Total loans of banks did not change very much during July. Demand deposits adjusted increased by about the same amount in July as a year ago and, following a sharp rise in the week ended July

15, there was a reduction in Government deposits during the latter part of the month. Member bank borrowings from the Federal Reserve Banks averaged about $600 million during the last week of July and excess reserves $700 million, whereas a year ago borrowings were around $1-1/4 billion with excess reserves of $700 million. The prospect for the next two or three weeks is that there will be further additions to the supply of reserves, after which holiday demand for currency and the autumn seasonal loan expansion may be expected to result in some tightening of the situation. In response to a question from Chairman Martin, Mr. Thomas said that credit expansion figures are running about in line with the projections previously presented to the committee. There does not appear to be anything to indicate a need for direct purchases by the System open market account until October, Mr. Thomas said, and it is likely that at that time most of the demand for additional reserves can be taken care of by repurchase agreements or borrowings without the necessity for open market purchases.

Mr. Erickson noted that there were reports of new automobiles selling substantially below list prices, and Mr. Young commented that while this was true in many areas, inventories of automobile dealers were still generally less than "normal", accepting tho pre-war definition of a "normal" inventory as representing a supply equal to sales for a 30-day period.

Mr. Mills referred to the statement made by Mr. Thomas and to the figures which indicated that banks are in an easier reserve position than a year ago. He noted that this statement was true if their position was measured by the amount of their borrowings; on the other hand, liquidity of banks has been reduced and their loans are higher. This situation raised the question, Mr. Mills said, as to whether banks would prefer to retain the 2-1/2 per cent tax anticipation certificates which would mature in March 1954, rather than to acquire the 2-5/8 per cent 1-year certificates offered by the Treasury for the purpose of refunding the $2,881,576,000 of 2 per cent certificates maturing August 15, 1953. If they preferred to retain the March 1954 certificates, this might cause excessive attrition on the securities maturing August 15, Mr. Mills said, and thus handicap the Treasury in its September financing. He also referred to recent comments in the press regarding the fact that there had been no additions to securities held in the System open market account during the past two statement weeks. Mr. Mills wondered what importance the market was placing on the failure of the System account to acquire securities recently and what it might be expecting from System policy in connection with the August and September refundings.

Mr. Rouse said that the press comments to which Mr. Mills had referred had usually been accompanied by statements to the effect that if additional reserves were needed, they would be provided. He felt that the market atmosphere is excellent and stated that as far as the tax certificates maturing in March 1954 were concerned, there is a steady outflow of those securities from the banks which originally acquired them to nonbank buyers.

Mr. Mills felt that the March 1954 tax certificates might be considered by the banks to be more attractive at this point than the securities being offered for the August refunding, with the result that banks might permit the certificates maturing in August to run off as a means of enabling them to retain the tax anticipation certificates. He raised the question whether the fact that there had been no additions to the System account for more than two weeks would be interpreted as a conclusive indication that the reduction in reserve requirements which became effective in July was exclusively for the benefit of the Treasury in its financing program. He also raised the question whether, if the System account now made token purchases of securities, such action would be interpreted as for the purpose of giving additional support to Treasury financing.

Mr. Thomas said, in response to the latter question, that he thought any token purchases for the System account at this time would be regarded by the market as an unnecessary gesture since additional funds were not needed in the market, and Mr. Rouse said that he agreed with this statement.

Chairman Martin expressed the view that such token purchases at this time could easily be interpreted as indicating concern on the part of the Federal Open Market Committee, both as to the business outlook and as to the Treasury's financing, and he felt it would be undesirable to permit any indications of concern to develop.

Mr. Mills then inquired as to what would be done during the near-term future in connection with repurchase agreements. He noted that when dealers had raised the question with the New York Bank recently they were referred to commercial banks for funds, and inquired as to the reason for not making repurchase facilities available to dealers upon request.

Mr. Rouse stated that funds were available in the market, generally on a 2- 2-1/4 per cent basis, that the New York Bank had had practically no borrowings by member banks recently, that commercial banks in New York City were lending to dealers freely, and that, in addition, some funds were available from banks outside New York. In response to a further question by Mr. Mills, Mr. Rouse said that he did not think the action of discouraging the use of repurchase agreements recently would lead dealers to believe that, with the September Treasury refunding coming along, they would be unable to obtain funds with which to carry a position in securities. Mr. Rouse expressed the view that the dealers believed they could get the money from the System if there was any real occasion for it, and he added the comment that he had resisted the use of repurchase agreements recently because that course seemed desirable from the standpoint of letting the redistribution of reserves resulting from the recent reduction in reserve requirements proceed as far as possible without the Federal Reserve taking any part in it. Mr. Rouse felt that in the recent period there had been a development of confidence in the market, that there is now a feeling that, if necessary, the System will put in reserves that are needed, and that indications of this feeling have been present in collateral comments made regarding the absence of purchases for the System account during the last couple of weeks.

Chairman Martin said that he understood Mr. Mills' comments were for the purpose of making certain that repurchase facilities would be available as needed in the market; and Mr. Mills stated that this was correct, that he would lean on the liberal side in making such facilities available when requested.

Chairman Martin then inquired as to whether there should be any change at this time in the existing understanding regarding operations in the System account--that is, that emphasis should be on doing as little as possible in the way of supplying additional reserves to the market, that it would not be desirable to have the appearance of undue ease or tightness develop in the market, and that if there were any purchases of securities they should be limited to Treasury bills.

None of the members of the committee indicated that any change in the understandings referred to by Chairman Martin should be made at this time, or that the directive to be issued to the Federal Reserve Bank of New York should be changed.

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 (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to avoiding deflationary tendencies without encouraging a renewal of inflationary developments, and (c) 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 amount 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 $500 million.

At this point, Mr. Leonard, Director, Division of Bank Operations, Board of Governors, entered the room.

Mr. Riefler stated that pursuant to the action of the Federal Open Market Committee at its meeting on June 11, 1953, at which it agreed to adopt a procedure for allocating securities held in the open market account among the Federal Reserve Banks on the basis of total assets, Messrs. Rouse and Leonard had prepared a detailed statement of the procedure that might be adopted and that he, as Secretary, had submitted the statement to all members of the Federal Open Market Committee and to the Presidents of the Federal Reserve Banks who are not now members of the Committee, under date of July 14, 1953. The letter transmitting the procedure read as follows:

"At its meeting on June 11, 1953, the Federal Open Market Committee approved the allocation of securities in the Open Market Account on the basis of total assets of the several Federal Reserve Banks and directed that detailed procedures for such allocation be prepared for submission to the Committee. Enclosed is a memorandum dated July 14, 1953, prepared by Messrs. Rouse and Leonard, containing recommendations with respect to such detailed procedures. Copies of this memorandum are being sent to all members of the Federal Open Market Committee and to the Presidents of the Federal Reserve Banks who are not presently members of the Committee. If the responses to this letter show that there are no objections, it is proposed that the suggested procedures be put into effect September 1, 1953.

"The date of April 1 for the annual reallocation was suggested in order to give the new Open Market Committee each year the opportunity to consider the reallocations at its first meeting and have them become effective the first of the following month.

"In submitting the memorandum, Messrs. Rouse and Leonard suggested that the following paragraphs be included in this covering letter:

"'Particular attention is called to paragraph No. 7 which describes a somewhat different basis for the allocation of profits and losses on the sale of securities from the Account than the present practice in that it would put into effect at once the procedure which would be arrived at five years hence under the present procedure which is described in the alternative paragraph No. 7.

'The proposed change would reduce slightly the share of Boston and to a lesser extent Atlanta, St. Louis, and Minneapolis in any profits and losses, with increased shares in the profits and losses going to New York, Chicago, and San Francisco. This is due to the fact that prior to June 17, 1953, adjustments because of low reserve positions were made to the extent possible through transfer of allocations of Treasury bills. It follows that the percentage allocations of the low reserve position Banks have been greater in interest-bearing securities than in total holdings, while the reverse is true in the case of the Banks to which the securities were transferred.'

"It will be appreciated if in your reply you make specific reference as to whether you approve the revised procedure or desire the continuation of the present procedure described in alternative paragraph No. 7."

The memorandum referred to in the letter read as follows:

"Procedures with Respect to Allocations of the System Open Market Account

"The Federal Open Market Committee, at its meeting on June 11, 1953, approved the allocation of securities in the Open Market Account on the basis of total assets of the several Federal Reserve Banks and directed that detailed procedures for such allocation be prepared for submission to the Committee.

"This memorandum has been prepared pursuant to such directive, and it is recommended that the following statement of procedures be approved:

1. Securities in the System Open Market Account shall be reallocated on September 1, 1953, on the basis of the ratio of each Bank's total assets to the total assets for all Reserve Banks combined. Such ratios shall be on the basis of daily averages for the 12-month period ending July 31, 1953.

"2. Securities in the Account shall be reallocated April 1 of each year on the basis of daily averages of total assets for the 12 months ending with the last day of February.

3. No allocation shall be made which would reduce the reserve ratio of a Bank below 35 per cent. If, because of the provisions of this paragraph, a Bank is unable to take its prorata share based on total assets, the amount which it is unable to take without reducing its reserve ratio below 35 per cent shall be allocated to the Bank or Banks having the highest reserve ratios in such a manner that the ratio of the Bank or Banks to which securities are reallocated will not be reduced below the ratio of any other Bank. Regardless of possible subsequent improvement in reserve ratios, no reversal of these adjustments shall take place pending the next general reallocation.

4. Increases and decreases in total amount held in the Account shall be apportioned on the basis of the ratios computed for the latest general reallocation.

5. If a Bank's reserve ratio falls below 30 per cent on a Tuesday or the next to the last day of the month, sufficient of its holdings as of the close of business that day to raise its reserve ratio to 35 per cent shall be reallocated by an adjustment the following day, unless such day is a general reallocation date. Such securities shall be allocated to the Bank or Banks having the highest reserve ratios. (NOTE: This procedure does not contemplate partial reversal of these adjustments. However, full reversal of these adjustments will be made when a Bank's reserve position improves to the extent that the full amount of its participation allocated to other Banks under the provisions of this paragraph can be restored without reducing the Bank's reserve ratio below 35 per cent.)

6. If a Bank's reserve ratio should fall below 30 per cent on any other day, or if a Bank anticipates that its reserve ratio will fall below that figure, it may arrange with the Manager of the Open Market Account to make an adjustment similar to those provided for in paragraph No. 5 so as to increase the Bank's reserve ratio to 35 per cent.

"7. Profits and losses on the sale of securities from the Account shall be allocated on the basis of average daily participations in total holdings in the Account during the preceding five years. These ratios shall be computed as of the end of each month for the succeeding month."

The alternative to paragraph No. 7 read as follows:

"7. Profits and losses on interest-bearing securities shall be allocated on the basis of average daily participations during the preceding five years. These ratios shall be computed as of the end of each month for the succeeding month. (For the period prior to June 17, 1953, the ratios shall be of participations in holdings of interest-bearing securities; thereafter of participations in the entire Account.) Until the five-year cycle of ratios based on participations in total holdings is completed, profits and losses on Treasury bills shall be allocated in proportion to the participations in the total holdings in the Account at the opening of business on the date the profit or loss is realized."

Mr. Riefler went on to say that replies had now been received from all of the Federal Reserve Banks and that the responses showed that there were no objections to the procedure, although two of the Banks had made suggestions for possible consideration in the future. These two suggestions were: (1) that consideration be given to making the reallocations on a quarterly basis rather than on an annual basis, and (2) that a Bank unable to take its full allotment as of September 1, or annually thereafter on April 1, because of a low reserve ratio, be permitted to obtain its equitable share of securities whenever its reserve ratio permitted. Mr. Riefler also said that ten of the Banks specifically said that they favored the proposed paragraph 7 rather than the alternative, that one Bank did not comment on this point, and that another stated that while it was believed the alternative procedure would be more desirable, it was willing to go along with the proposed paragraph 7.

Mr. Riefler also said that Chairman Martin and Messrs. Szymczak, Evans, Mills, and Robertson had indicated their approval of the procedure, including proposed paragraph 7, as set forth above, to become effective September 1, 1953, and that in the absence of any comment from Mr. Vardaman, he assumed that he had no objection to the procedure. Mr. Riefler went on to suggest that in view of the apparent unanimous approval of the proposed procedure and in view of the statement in his letter of July 14 that, if responses showed there were no objections, the procedure would be put into effect September 1, 1953, the necessary steps could now be taken to make the revised allocation formula effective on September 1. Mr. Riefler also suggested that if the executive committee saw no objection to this course, it consider the desirability of issuing a statement for publication at the time the new procedure becomes effective, which would explain why the reserve ratios of some of the individual Federal Reserve Banks were being changed. The reason for the statement was that some of the Reserve Banks published their individual ratios and there was some interest in observing changes in those ratios, resulting in press comments.

Mr. Rouse stated that he felt a statement such as Mr. Riefler proposed would be desirable.

In response to a question from Mr. Szymcak, Mr. Riefler stated that the two suggestions for possible consideration in the future which he had mentioned did not seem to be of immediate concern, that the specific suggestion that securities be allocated quarterly instead of annually offered no problem but would create more work, and that it did not appear to be necessary to delay making the new procedure effective because of the suggestions that had been made for future consideration.

Mr. Leonard expressed the view that under the revised procedure it would not be likely that the ratio of any Bank would drop below 35 per cent in the near future.

> Thereupon, unanimous approval was given to the suggestions made by Mr. Riefler, with the understanding that a draft of public statement would be submitted for consideration at the next meeting of the executive committee, and that the revised allocation procedure would become effective on September 1, 1953.

Mr. Leonard withdrew from the meeting at this point.

It was agreed that the next meeting of the executive committee would be held at 10:30 a.m. on Tuesday, August 25, 1953; and thereupon the meeting adjourned.

Winfield W. Riefler

Secretary.