

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 Tuesday, January 5, 1954, at 10:45 a.m.

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

Messrs. Robertson and Szymczak, Members 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. Gaines, Securities Department, Federal
Reserve Bank of New York

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 open market operations for the period from December 15 to December 30, 1953, inclusive. At this meeting there was distributed a supplementary report covering commitments executed on December 31, 1953 and January 4, 1954. Mr. Rouse commented briefly on the reports, copies of which have been placed in the files of the Federal Open Market Committee.

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Upon motion duly made and seconded, and by unanimous vote, transactions in the System account during the period December 15, 1953-January 4, 1954, inclusive, were approved, ratified, and confirmed.

Mr. Young presented a memorandum dated January 5, 1954 reviewing recent economic and financial developments. The memorandum was distributed at the meeting and a copy has been placed in the files of the Federal Open Market Committee. In summarizing the economic situation, Mr. Young included the comment that businessmen for the most part appeared to expect further moderate declines in activity and, at recent meetings in Washington, professional economists seemed to concur in that view.

Mr. Thomas reviewed the banking and credit situation, stating that bank credit demands over the year-end proved to be somewhat larger than had been indicated by the projections presented at the meeting of the Federal Open Market Committee on December 15, 1953. Loan demand was somewhat smaller than a year ago, except in the last week of the month, while the deposit expansion during December was appreciably larger than in the previous year. Not only did private deposits show a substantially larger increase, but Treasury tax and loan account balances were drawn down less than had been expected. The System put more credit into the market during the last half of December than had been projected, partly because of the greater increase in required reserves, but also because dealers maintained a substantial volume of repurchase contracts. Banks reduced borrowings at the Federal Reserve and maintained a fairly high level of excess reserves. Whereas the projections had allowed for roughly \$100 million of

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free reserves (excess reserves less borrowings by member banks), free reserves had varied on a weekly average basis from \$300 to \$600 million during the last three weeks of the month. Yet the money market had not been unduly easy. Mr. Thomas stated that evidently the market required a lot of surplus reserves to carry it through the year-end needs without more tightening in the situation than the committee felt would be desirable.

In looking to future reserve needs, Mr. Thomas commented on the influence of a return flow of currency and repayment of repurchase agreements, stating that it would appear that such agreements would be completed by the end of this week. Little change in the net reserve position of banks appeared likely during the next statement week, which would indicate that no further decline in System holdings of securities and no open market operations would be needed. The Committee had already decided to replace in full the bills that mature next Thursday. In the statement week beginning January 14, there would be an abundance of reserve funds due to temporary factors but this excess would be largely absorbed during the following week and there might be a further moderate drain on reserves over the month end.

In this connection Mr. Rouse commented that the Treasury might be expected to borrow from the Federal Reserve temporarily on a special certificate of indebtedness to avoid an overdraft in its account during the third week of the month and this would add to the supply of funds in the market.

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Mr. Thomas went on to say that the sort of pattern he had described might be expected in subsequent months of the year--with an easy money market around the third week of the month and less ease at the month end. The question for the committee to decide was at about what level should member bank borrowing be kept to contribute to the maintenance of monetary ease and still avoid undue money market variations. The course indicated by the projections presented would keep borrowings generally below \$250 million with excess reserves at \$600 million and sometimes much more. This policy, which called for little or no reduction in the System account, would result in very easy markets around the middle of each month.

An alternative course would be to allow some of the System portfolio to run off in January and to take care of month-end periods of somewhat greater tightening by repurchase agreements and increased discounts. Such a program would give relatively more stability in the money market situation and would avoid the extreme ease during mid-month periods with subsequent tightening at the end of the month. Mr. Thomas added the comment that if it were desired to permit some increase in repurchase agreements in order to take care of the month-end situation, it would appear necessary to keep the repurchase rate around 1-3/4 per cent. If that rate were increased to 2 per cent, the facility would not be used to meet temporary needs unless the money market became much tighter than presumably was envisaged in the existing directive of the Federal Open Market Committee.

Mr. Mills raised the question whether there was sufficient leeway within the \$275 billion limitation on the public debt for any substantial

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use by the Treasury of special certificates of indebtedness, and Mr. Rouse expressed the view that the Treasury could probably issue around three-quarters of a billion dollars of additional debt obligations--at least a half billion--without exceeding the debt limitation.

Chairman Martin stated that the first item for consideration by the committee was whether the rate on repurchase agreements should be increased from 1-3/4 per cent to the 2 per cent level that had prevailed prior to December 8, 1953, and he asked Mr. Rouse to express his views on this question.

Mr. Rouse stated that there were ample funds in the market to absorb the securities which were held under the repurchase agreements, and that there is a substantial demand in the market for bills, such demand coming from banks and business organizations and the proceeds of bond issues. It was his recommendation that the rate be restored to 2 per cent which would have the effect of throwing such borrowings back to the commercial banks.

Chairman Martin noted that while the influence of an increase in the repurchase rate would be less than would be a change in the discount rate, there would, nevertheless, be some psychological impact which meant that the committee should consider the advantages and disadvantages of a change such as Mr. Rouse proposed. He also expressed the view that the repurchase agreement is a money market device for meeting a temporary need and that when the temporary need had passed, it was preferable that the System not continue to encourage its use. Chairman Martin also noted that

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the System provided a good deal more money to the market than had been anticipated over the year-end, that the turn of the year had now come and contraction in the demand for funds was now in process. The question was, he said, just how easy does the committee want the market to be, and does it wish to induce the continued use of repurchase agreements by retaining the present rate.

During the ensuing discussion it was suggested that perhaps, rather than to increase the repurchase rate, the discount rate should be reduced from 2 per cent to 1-3/4 per cent. There was also discussion whether it would be desirable to encourage the use of repurchase agreements as a means of helping to smooth out fluctuations in the money market over month-end periods during the next few months. With respect to the timing of a possible increase in the repurchase rate, it was suggested that if the rate were to be restored to 2 per cent, that should not be done until the existing volume of repurchase agreements had been repaid which would not take place until tomorrow or the next day; in the meantime, renewals of such agreements might be made at the present rate for a one- or two-day period. Another suggestion was that rather than to increase the rate on repurchase agreements, their use might be reduced by declining to make the repurchase facilities available even at the 1-3/4 per cent rate. The discussion also was turned to the discount rate of the Federal Reserve Banks and whether the time had arrived when it might be appropriate to reduce that rate.

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Following a discussion of these and other suggestions, it was agreed unanimously that the rate on repurchase agreements should be increased from 1-3/4 per cent to 2 per cent effective on agreements executed on or after Thursday, January 7, 1954, it being understood that as agreements matured today and tomorrow such agreements would be renewable to the extent desired by the dealers at the existing rate of 1-3/4 per cent for a period through Tuesday, January 12, 1954. It was also understood that on Thursday of this week, Mr. Rouse would announce to all dealers in Government securities, both bank and nonbank dealers and regardless of whether they now had securities under repurchase agreements with the Federal Reserve Bank of New York, that any further repurchase agreements would be at the 2 per cent rate.

Mr. Rouse withdrew from the room at this point in order to telephone his office at the Federal Reserve Bank of New York regarding the foregoing action, after which he returned to the meeting.

Chairman Martin then inquired whether any member of the executive committee felt that a change should be made in the general program for actively maintaining a condition of ease in the money market, as authorized under the policy adopted by the full Committee at its meeting on December 15. None of the members of the executive committee felt that any change was called for in the general policy established by the full Committee.

With respect to the executive committee's program for carrying out the general policy of actively maintaining ease, Mr. Mills commented that

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in his judgment, there had been an inclination to move at too close range. He thought holdings of Treasury bills which would mature on January 14 should be replaced by the bidding that would take place on Monday, January 11, even though projections indicated there might be a mid-month easing in the reserve position of banks. Mr. Mills went on to say that his concept of actively maintaining a condition of ease in the money market would be attained by a combination of an adequacy of reserves and a minimum of member bank borrowings which would indicate determinedly to the market that open market policy had reached a judgment that the economic situation was such that traditional policy should conform to that situation and should invite active interest on the part of commercial banks to seek loans and to utilize their loaning position as a stimulant to the economy. In other words, he would put the commercial banking system in a frame of mind as to the adequacy of reserves so that it would, within reason, reach for loans that would give a momentum to the economy within proper banking limitations, a momentum which would sustain as high a level of economic activity as is possible. In his opinion, the System should be ready to reduce reserve requirements and to make offsetting adjustments in holdings of Government securities through open market operations. Mr. Mills agreed, in response to a question from Mr. Szymczak, that this general approach would also call for a reduction in the discount rate but said that the latter action involved a matter of timing. A reduction in the discount rate should follow the market and not lead it, he said; the adequacy of

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reserves should indicate the structure of the market and the reduction in the discount rate should confirm it.

Mr. Szymczak then said that in his opinion that situation now exists, i.e., a decrease in the discount rate at this time would merely follow the market and not lead it. A further supply of reserves would later call for further action on the discount rate.

Mr. Riefler also commented on the question from Mr. Szymczak, stating that a reduction in the discount rate would be consistent with a program such as Mr. Mills suggested, but that the reduced rate would have less effect than the other actions. It was Mr. Riefler's view that to make sure that an easy money market had gotten to the borrower who wished to obtain funds for expanding his operations and creating employment, the real influence should come from open market policy and changes in reserve requirements.

Mr. Rouse felt that the line of discussion indicated much more concern regarding the economic situation and the possibility of a rapid or sharp decline than appeared to be generally accepted.

Mr. Mills responded that his remarks did not imply concern such as Mr. Rouse mentioned, that he regarded the present as no more than an easing situation. The economy was entering a new year where business management was making plans for the year to come, he said, and the commercial banking system should be in a position to assure the adequacy of funds and to reaffirm a judgment of the central bank that funds would be available. He felt that action by the central banking system along the lines he had indicated would generate a whole chain of reactions on the banking, industrial,

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and commercial system which could be very effective in stimulating the economy.

Mr. Riefler noted that the real problem is that Government outlays are going down, that the economy is finding it necessary to shift from defense to private demands so that the output of goods will go into the standard of living of the public to a greater degree than in the past few years. This was a major shift, he said, at a time when there are no pent-up demands for consumer goods such as existed in 1945 after several years of war. An appreciable part of the resources of the economy would be shifted from defense to private use and, in Mr. Riefler's judgment, a free demand for these products would have to come as a result of private incentives. In the capital market, interest rates must be conducive to larger proportions of funds being devoted to private use. The shift-over and the suggested steps to deal with it, he said, in no sense implied a rapid decline in the situation. It simply represented carrying out by a central bank of actions to stimulate the shift of resources from defense to private use. The reduction in taxes becoming effective currently and later this spring is one of the most important elements in stimulating the economy, Mr. Riefler said, and the suggested steps in credit policy represented the actions to be taken on the credit side to accomplish the same end.

Mr. Rouse stated that he could not see any accelerating factor in the economic situation that would imply the type of actions under discussion

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or actions which would go as far as had been suggested.

After a further discussion, Chairman Martin suggested that, in pursuit of the general policy of actively maintaining a condition of ease in the money market, the committee look toward rolling over its holdings of bills maturing next week and that, with respect to bills maturing during the following week (i.e., the week commencing January 18, 1954), the Manager of the System Account consider what procedure should be followed in the light of the projections for changes in the supply of reserve funds, but with the assumption that some of the bills maturing that week probably would be permitted to run off. He also suggested that each member of the committee keep in close touch with the situation from day to day with the thought that the next meeting would be on Tuesday, January 19, 1954, at which time the question of operations during the latter part of the month could be considered.

There was general agreement with the program outlined by Chairman Martin including his suggestion that the next meeting of the committee be held on January 19.

Chairman Martin then referred to the forthcoming Treasury refunding of some \$8 billion of certificates of indebtedness maturing February 15, 1954, and \$4.7 billion of Treasury notes maturing March 15, 1954. He expressed the view that it would be desirable if these refundings would make available Treasury bills which the System open market account could obtain in replacement for part of its holdings of the maturing securities which total about \$3.9 billion. It was Chairman Martin's thought that this question might be discussed with Treasury representatives at luncheon today.

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There was a brief discussion of this matter during which the members of the committee agreed that it would be desirable to increase the proportion of the System account in the form of Treasury bills if that were practicable, and that the question of the refunding should be discussed with Treasury representatives.

Mr. Rouse stated in response to a question from Mr. Riefler that he would suggest no change in the limitations contained in the directive to be issued by the executive committee to the Federal Reserve Bank of New York.

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 promoting growth and stability in the economy by actively maintaining a condition of ease in the money market, 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 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

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one time by the Federal Reserve Banks shall not exceed in the aggregate \$500 million;

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of 2-1/4 per cent Treasury certificates maturing February 15, 1954, as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate \$500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

Thereupon the meeting adjourned.


Secretary