A meeting 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, June 11, 1953, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Erickson
Mr. Evans
Mr. Fulton
Mr. Johns
Mr. Mills
Mr. Powell
Mr. Robertson

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Abbott, Hostetler, Peterson, Roelse, Parker B. Willis, and Ralph A. Young, Associate Economists
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. R. F. Leach, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Arthur Willis, Assistant Secretary, Federal Reserve Bank of New York

Messrs. Gilbert, Leedy, Williams, and C. S. Young, alternate members of the Federal Open Market Committee

Messrs. Bryan, Earhart, and Hugh Leach, Presidents of the Federal Reserve Banks of Atlanta, San Francisco, and Richmond, respectively

Messrs. Leonard, Director, Division of Bank Operations, Board of Governors, and Deming, First Vice President, Federal Reserve Bank of St. Louis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 4-5, 1953 were approved.

The Secretary stated that advices of the election by the Boards of Directors of the Federal Reserve Banks of Cleveland and Chicago of W. D. Fulton as a member of the Federal Open Market Committee for the remainder of the year ending February 28, 1954 had been received and that Mr. Fulton had executed the customary oath of office. The Secretary also stated that Mr. Fulton had proposed that L. Merle Hostetler, of the Federal Reserve Bank of Cleveland, be elected an associate economist of the Committee to succeed Donald S. Thompson of that Bank; and that Mr. Erickson had proposed that Parker B. Willis, of the Federal Reserve Bank of Boston, be elected an associate economist of the Committee to succeed Arthur A. Bright, Jr.

The election of Mr. Fulton as a member of the Federal Open Market Committee for the remainder of the year ending February 28, 1954 was noted, and, upon motion duly made and seconded and by unanimous vote, the election of Messrs. Hostetler and Willis to serve as associate economists of the Federal Open Market Committee until the election of their successors at the first meeting of the Committee after February 28, 1954 was approved. These actions were noted and approved with the understanding that in the event of the discontinuance of their official connections with the Federal Reserve Banks of Cleveland or Boston, as the case might be, Messrs. Fulton, Hostetler, or Willis would cease to have any official connection with the Federal Open Market Committee.

In taking this action, it was also understood that Mr. Fulton was selected as an alternate member

of the executive committee, and that the order in which the alternate members of the executive committee would serve for Messrs. Sproul and Erickson would be Mr. Johns, Mr. Powell, and Mr. Fulton.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee held on March 5, March 24, April 8, April 24, May 6, May 13, and May 26, 1953 were approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the Committee a copy of a report prepared at the Federal Reserve Bank of New York covering operations in the System open market account from March 4 to June 5, 1953, inclusive. At this meeting, Mr. Rouse presented a supplementary report covering commitments executed from June 6 to June 10, 1953, inclusive, and commented briefly on the reports, copies of which have been placed in the files of the Federal Open Market Committee.

Chairman Martin referred to operations in the System account during the past week, particularly to developments on Monday and Tuesday, June 1 and 2, 1953, when there was serious unsettlement in the Government securities market which brought prices of longer term Government securities to record lows for outstanding issues, and which caused the new issue of 2-5/8 per cent certificates of indebtedness to settle below par. He said that on June 2 the System account handled purchases of $81.5 millions of bills with dispatch and efficiency that seemed to bring commendation

from everyone. However, the question had been raised as to whether, in view of the position taken by the executive committee at its meeting on May 6, 1953 at which time it was agreed that there should be injections of reserves into the market to avoid a further tightening, System purchases of bills had been sufficient over the past several weeks. The Chairman then asked Mr. Rouse to give the Committee his rationale of operations for the account during this period.

Mr. Rouse stated that he felt the purchases of securities made for the System account had been sufficient although he recognized that in hindsight judgments might differ on this point. He had been surprised that more people did not apply the "multiplier" with respect to the amount of reserve funds that had been put into the market. He felt that it had been fortunate that funds had been available from Government investment accounts last week for purchases of Government bonds, noting that $3.5 million of long-term 2-1/2's were purchased at the opening on Tuesday, June 2, with considerable effectiveness. Mr. Rouse stated that while he knew there was some feeling that purchases for the System account may not have gone far enough, on the other hand it must be noted that the System had increased its holdings of securities by $328.8 million since the last meeting of the full Committee and that in recent weeks the Treasury had put $1100 million of reserves into the market through reductions in its balances with the Reserve Banks and in a special account, and through sales of special

certificates of indebtedness. If reserves were going to do the job, Mr. Rouse felt the reserves had been available. As far as the current market is concerned, Mr. Rouse said that at present the Treasury would have difficulty in selling securities in the amount of $4-1/2 billion to meet the prospective deficit in July and August. There is, however, some indication that the psychology in the market is improving, Mr. Rouse said, although fairly sharp movements in Government bond prices may still occur on a single day.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period March 4 to June 10, 1953, inclusive, were approved, ratified, and confirmed.

Chairman Martin referred to a draft of proposed revision in the directive of the Federal Open Market Committee prepared pursuant to the understanding at the meeting of the full Committee on March 4-5, 1953, a copy of which had been sent to all members of the full Committee and the executive committee. At the Chairman's request, Mr. Vest commented on the proposal, emphasizing that the drafts prepared by the staff were intended to change only the form of the directives and were not intended to make any changes of substance in them.

Chairman Martin stated that while the drafts of revision had been discussed by the executive committee at its meetings on May 13 and May 26, the committee had no recommendation to make with respect to the matter.

During a brief discussion, he suggested that the full Committee refer the matter to the executive committee with the understanding that the executive committee would appoint two of its members to consider the proposal for revision in directives, and with the further understanding that this special committee would submit its recommendations to the members of both the full Committee and the executive committee.

This suggestion was approved unanimously.

Reference was then made to a memorandum prepared in the Division of Bank Operations of the Board of Governors under date of May 21, 1953 with respect to the allocation of securities in the System open market account, the present formula for which had been adopted effective January 1, 1948. The memorandum had been prepared as a result of the action taken by the full Committee at its meeting on March 4-5, 1953, at which time it was suggested that the staff study the present basis of allocations in the System open market account with a view to having a discussion of any suggested changes at this meeting.

At Chairman Martin's request, Mr. Leonard, Director of the Board's Division of Bank Operations, reviewed the content of the memorandum, discussing the present basis of allocation, reasons why there might be a change, and possible bases of allocation. In his comments, Mr. Leonard stated that without making any recommendation the memorandum attempted to present various allocation formulae which might be related to (a) expenses

and dividend requirements as at present, (b) size of the Reserve Banks as measured by various factors, (c) equalizing reserve ratios initially with freedom of movement thereafter within some pre-determined range, (d) tending to equalize ratios of surpluses to capital, or (e) district, financial, and other economic data. Mr. Leonard said that it was his belief that any formula adopted should not only be logical, but should appear on its face to be so, that it should be simple, and that it should eliminate the necessity for frequent adjustments in holdings in the account. He went on to say that if the allocation were based on size of the Reserve Banks, about the same distribution would result from use of either total assets or the total of Federal Reserve Bank deposit and note liabilities. Similar distribution would result from use of a formula to equalize reserve ratios.

Chairman Martin said he had no fixed view on the matter but was inclined to believe total assets was the best basis.

There ensued a general discussion during which several of the Presidents of the Federal Reserve Banks expressed preferences for an allocation system based upon total assets. Mr. Bryan stated, on the other hand, that he would have a preference for the use of Federal Reserve Bank deposit and note liabilities, as being somewhat more closely related to the conventional concept of reserve requirements; he agreed it was desirable to have the allocation based upon some measure of the size of the

Federal Reserve Banks.

During the discussion, Mr. Earhart raised the question whether possible legal aspects of the loss-sharing agreement of the Reserve Banks might be affected by a change in the procedure for allocating securities, in response to which Mr. Vest expressed the tentative opinion that a change in allocation procedure would not be of such a basic nature as to affect the validity of the loss-sharing agreement.

> Following the discussion, it was agreed unanimously that Messrs. Leonard and Rouse be requested to prepare a memorandum for the consideration of the Committee covering the detailed steps which might be necessary in order to change the present allocation procedure to one based upon total assets of the respective Federal Reserve Banks.

At this point Mr. Leonard withdrew from the meeting and members of the staff of the Board of Governors entered the room to participate in the presentation of an economic review, illustrated by chart slides, and of an analysis of the changing debt structure and its relationship to developing economic conditions, as well as the current issues of credit and monetary policy. A copy of the text of the presentation was sent to each member of the Federal Open Market Committee following the meeting and a copy has been placed in the Committee's files.

The review stated that the period since the meeting in March had been characterized by a moderately higher level of economic activity and generally stable prices. While the economic situation has continued

strong, financial markets have been unsettled at times and throughout the period there has been an undertone of concern about potential declines in economic activity. Doubts have related to the strength of underlying conditions, concern has been expressed lest measures designed to limit credit expansion to sustainable proportions be carried too far setting in motion forces of decline which would be difficult to check, and in recent weeks uncertainties have been increased by new developments in Korea.

As to the analysis of debt it was stated that, considering the nature of the defense economy in prospect for some time yet, the character of the present debt, and the financial position of lending institutions, it was difficult to visualize any widespread liquidation of debt. Thus, the study of the debt situation had been somewhat reassuring. However, restraint in further increasing the volume of debt may be important for preventing development of an unsound debt structure such as that of the late 1920's.

With respect to credit and monetary developments, Mr. Thomas stated that the cumulative effectiveness of monetary restraints had gradually become more evident in the financial and business community and that with the present tone of sensitive markets and the higher productivity of the economy, there seemed little immediate danger of excessive optimism or a renewed inflationary upsurge that would extend very far. Whether there is the opposite danger, requiring at some point an aggressive easing of

the credit situation, is not now evident, but it is evident that additional credit will be needed this year to meet seasonal demands and to finance further economic expansion and that these needs will be substantial.

During a discussion of the economic review, Mr. Powell referred to statements made on the Senate floor yesterday afternoon by Senator Humphrey of Minnesota with respect to the costs of servicing the Government debt and raised the question as to the probable future relationship between disposable income and debt servicing costs. Mr. Powell also raised the question whether the rise in interest rates might shut off the market for corporate and municipal investments with the result that the decrease in such issues might bring on unemployment because of the lack of capital funds for investment. He also inquired as to possible repercussions on the farm mortgage market and in other segments of the economy.

Mr. Ralph Young stated that the longer the increased level of interest rates was maintained, the higher would be the ratio of costs of debt service to disposable income. He went on to say that in so far as the volume of new issues was concerned, the rise in interest rates apparently had brought about acceleration in borrowing, partly reflecting the feeling that funds would not be available later in view of the heavy Treasury borrowing that might be anticipated in the second half of the year. Mr. Young also said that the volume of corporate issues scheduled for June was very large, that municipal issues were high in relation to

last year, and that it appeared that there would be a record volume of new issues in June of this year. With respect to the mortgage market, Mr. Young said that the situation developing was rather disturbing in that the higher rates available on corporate securities apparently were causing some firms which had furnished mortgage money in the past to defer making commitments for such loans, at least to large scale building operators.

Mr. Thomas commented that the whole purpose of the restrictive policy had been to exercise restraint, that if there were repercussions of the type Mr. Powell feared that was the course to be expected, and that the question was whether the restraint was too great. If the restraint were cutting down the flow of funds to a point where the resources of the economy were not being utilized, that would indicate restriction was too great. However, Mr. Thomas said, there is no evidence that such developments have occurred thus far.

Chairman Martin then made a statement substantially as follows:

> I would like to make some general comments on that question because it bears directly on the subject of this meeting and points up the problem the executive committee has been wrestling with since the last meeting of the full Committee in carrying out the policy laid down at that time. That policy, interpreting it broadly, was one of modest restraint. By the end of April, it was clear there were some forces shaping up which may have changed the situation from one of modest restraint to one of real restraint. The capital market had a real jolt. At the meeting of the executive committee on May 6, we took account of those developments. I think the charts indicate that we had a decrease in the money supply during May, probably more than we would have liked to have had

if we could have measured it beforehand. These are extremely difficult things to measure. This has been a most interesting period and there is room for difference of opinion with respect to its implications, but basically our thinking at the time of the May 6 meeting was that there would have to be put into the market between that time and the end of the year reserves of between $2-1/2 and $3-1/2 billion in order not to tighten the market further. That amount would be needed just to maintain the market as it was at that time.

As to the point Senator Humphrey referred to, which Mr. Powell has cited, the jolt in the capital market has served to accelerate the number of capital issues coming forward at this time rather than to decrease it. Regardless of whether some have been postponed permanently, so far as May and June are concerned you have had a terrific increase in capital flotations, particularly because of the fear that funds would be harder to obtain later on. All of us who have followed the capital markets know that the strongest volume of issues is written at the top of the boom and that is a cause for concern at the present time.

The point I am trying to focus on for discussion at this meeting is the point I raised with Mr. Rouse at the beginning of this meeting, that is, whether in pursuing the course of putting funds into the market so as not to tighten it further, we have erred on the side of not putting in sufficient funds during this period. In terms of its technical aspects, it is not a question of "easy money". But if we wish to supply the reserves indicated to the market between May 6 and the end of 1953, the question is, should we not have stepped up our purchases more rapidly?

That brings into focus the other problem we have had: namely, the fact that the discount rate is behind the market. If we wanted to meet the market, we certainly would raise the discount rate. We have had several suggestions that we raise the discount rate and at the same time step up open market purchases, and we have had suggestions that we reduce reserve requirements across the board. The result of this whole situation is now before this Committee. I think we ought to move forward and have a full discussion of the question. I would like to have Mr. Sproul's comment on the question of whether bills are an adequate medium in relation to our policy of supplying funds to the market. All of these questions ought to be put on the table. We ought to realize that this is a critical situation, that we may have to call the full Committee back into session during the summer months--not once but maybe twice. We can not dispose of this matter this morning and wait until next September. We are at a critical turning point where common sense indicates certain forces are operating in supply and demand areas. We are not engineering anything:

we ought not to be. If I am critical of anything in our operation, I am critical of my own judgment with respect to the tightness of the money market in May. I think the money market in May got so tight across the board that it violated one of the cardinal principles of good central banking operations. It became so tight that money was almost unavailable. We should discuss the most effective way of supplying reserves to the market aside from embracing an easy money policy.

Mr. Sproul then made a statement substantially as follows:

On the question of the amount of reserves put into the market during May, as Chairman Martin said, in making a change over from a policy of credit restraint which, partly due to other influences than our own had become more restrictive than was felt to be desirable, it was the view of the executive committee that we did not want to make a complete change to a policy of credit ease. Therefore, we had the difficult task of trying to put sufficient funds into the market to try to maintain a sufficient degree of restraint or ease without allowing it to become a policy of easy money. There are many other factors that impinge on reserve funds aside from our own operations and it is difficult to estimate these factors in advance so that, while you can lay out a fairly good estimate of a needed amount of reserve funds to the end of the year, you can not lay out an estimate which will be at all accurate from week to week. The amount of funds we put into the market has to be geared to other factors affecting the supply of reserve funds. The Chairman mentioned that during May, the amount of reserve funds put into the market may not have been sufficient, or may not have been put in in the right way or at the right time. We had days when the market had "air pockets" in it. Whether you could accurately say that credit was almost unavailable—though never quite unavailable, I doubt. It was difficult to obtain, more difficult to obtain than we wanted it to be, perhaps, but not unavailable. That leads me to the point of what we need to discuss as a policy of the Open Market Committee.

1. Since the last meeting of the Federal Open Market Committee we have been operating under two prohibitions adopted by the Committee, the general prohibition limiting operations to short-term securities at all times, and the special prohibition limiting operations, during periods of Treasury financing, to exclude the purchase of maturing issues, when-issued securities, and outstanding issues of comparable maturity to those being offered in exchange.

2. In my opinion, the present situation and the likely situation during the next three months require that we remove these prohibitions and restore to ourselves greater freedom of action. Private demands for capital and credit continue strong, and the Treasury is going to be a large and necessitous borrower. Our policy, in the circumstances, is one of maintaining restraint on credit expansion, while trying to prevent that restraint from being intensified by Treasury demands on the banking system. If this continues to be our policy, and if we continue to confine our operations to purchases of bills, I do not think we can walk the tightrope successfully. Our policy of restraint will be intensified at a time when it should be leveling off with the boom.

3. On what grounds would we continue to deprive ourselves of freedom of action? With respect to the prohibitions we adopted at our last meeting,

(a) we were told that the market should be relieved of the threat of our intervention in the longer term areas so that it might develop breadth, depth, and resiliency.

(b) We have not intervened in these areas for some months and, in one way or another, the market has acquired the idea that we are not going to intervene. Yet seldom has the market shown less breadth and depth while quotations have shown, if anything, too much resiliency.

(c) I think it has been demonstrated that if apprehension concerning our intervention in the market was once the cause of uncertainty, it was a transient phenomenon. Other factors have since been at work. Recently there has been our restrictive credit policy, continued heavy private demands for funds, and mounting Treasury cash needs. These have generated the expectation of a decline in Government security prices (and private security prices) and a rise in interest rates of unknown extent and duration.

(d) Under such conditions a market of the size and present vulnerability of the Government security market doesn't develop real breadth, depth, and resiliency, and the Treasury's necessitous financing can be made unnecessarily difficult and onerous.

(e) In so far as credit policy is responsible for this, the problem is how to direct open market operations with sufficient flexibility and versatility to minimize the adverse effects of the general policy without sacrificing the general objective.

4. I don't think we can do it if we continue, as we have been doing, to confine ourselves at all times to operations in Treasury bills. We have been told that operations in bills

would have prompt and pervasive effects throughout the market. That was the theory of perfect fluidity--perfect arbitrage. I think historical records and current observation indicate that a prompt and invariable response between short and long markets can not always be expected. Under present conditions operations solely in bills may relieve the reserve position of the banks without giving timely relief from the complex pressures in the credit and capital markets created by large Treasury borrowing operations.

5. If the threat of our intervention isn't the source of lack of breadth, depth, and resiliency in the Government security market, and if that market and the whole capital market isn't as fluid as the theory of perfect arbitrage would suggest, why do we deprive ourselves of freedom of action? It seems to me that we must either still be reacting violently against market pegging or embracing a somewhat doctrinaire attitude on free markets.

6. There is a middle road. No one here wants to return to pegging nor to try to substitute our judgment as to prices and yields for those of the market. But if our credit policy calls for putting funds into the market, as it does, and if at the same time we can assist the Treasury with its very difficult task of debt management, we should do it. It would be in accord with the resolution we adopted on relations with the Treasury and it would contribute to economic stability. We should be free, particularly at times of Treasury financing, to make purchases in whatever area of the market is under most pressure, so that there will not be an unnecessary erosion of rates, affecting adversely investor and banking psychology and intensifying the restrictive effects of our credit policy at the wrong time.

7. We have made it clear to the market that we are not interested in pegging prices, and the Treasury has made it clear that it wants to price its obligations on the market, not on us. Within this framework, I think we should reserve for ourselves maximum freedom to operate in any way which, without sacrificing credit policy, will support the Treasury's program and the stability of the market.

8. To withhold the System portfolio from participation in the market, except for bill transactions, in the light of the present economic situation and the Treasury's needs, seems to me to be sacrificing credit policy to untried theory. To go further, and to withhold the System portfolio from participation in the tremendous redistribution and swapping process which takes place in the market during the short period of a Treasury financing is likely to prove to be irresponsible.

9. I suggest the elimination, from the instructions of the full Committee to the executive committee, of the present prohibition against open market operations in other than short-term securities, and against operations in certain kinds of securities during Treasury financings.

10. Even though our operations continue to be largely in bills, effective credit policy can best be achieved, in my opinion, by retaining flexibility of action to meet the unpredictable circumstances which are always arising. To freeze the System into a pattern of behavior which involves not doing certain things could be just as harmful to the success of credit policy as a frozen commitment to do certain things. We can't afford a succession of black Mondays and Treasury near-failures over the next few months and the omens are none too good.

Chairman Martin said that in adopting the two recommendations of the ad hoc subcommittee referred to by Mr. Sproul, it was not intended that they should be frozen into the Committee's understanding for all time. He disagreed with Mr. Sproul's judgment with respect to the depth, breadth, and resiliency in the Government securities market as far as operations of the System account may have affected that market. There had been no claim on the part of the ad hoc subcommittee that there would be perfect arbitrage, he said, and a clear indication of the validity of the subcommittee's recommendation had been given by the Government securities market on Tuesday, June 2, when market sentiment improved markedly following purchases of some $81 million of Treasury bills for the System account. It was Chairman Martin's belief that if the System account had made aggressive purchases of bills during the last several weeks there would have been a much sounder market. The full Committee had covered the matter of dealing with a disorderly market, Chairman Martin said, but so far as he knew the Manager of

the Account had never notified the executive committee that disorderly conditions existed.

Mr. Rouse agreed with the statement that he had not notified the Committee that, in his opinion, we had a disorderly market. He said he had considered the question on Monday and Tuesday, June 1 and 2, but that purchases of $3.5 million of long-term 2-1/2's for Treasury investment accounts at the opening on Tuesday morning took care of the situation. Mr. Rouse said that one of the factors affecting the market was the attitude of the Reserve Banks toward making advances to member banks; there had gotten to be a feeling around the country that the Federal Reserve was almost entirely opposed to discounting, and this was a factor in the current situation in the market.

Chairman Martin said that there was no question but that such a feeling existed, that there had been a conjunction of misinterpretations and rumors along with factors such as Mr. Sproul had mentioned which had created a tightness that was not anticipated, that had become more severe and more savage than he personally had anticipated. He did not wish to be doctrinaire, Chairman Martin said, but he was unconvinced that, in supplying reserves, it was desirable for the Committee to put them into the long-term market. There might be exceptions (there may have been conditions in recent weeks which were disorderly and it might have been advisable to invoke the authority for correcting that situation) but as a matter of minimizing intervention and of

not maximizing intervention, he felt, and it had seemed to the ad hoc subcommittee, that, by and large, dealing in short-term securities was a sound general policy to outline. He did not think that fears that the System would or would not get into the long end of the market had deterred that market. What had happened, the Chairman said, was that there had been a fear that the Federal Reserve was not going to supply any reserves between now and the end of 1953, a condition which could not help but have an effect on the market, whereas actually it has been the intention of the Committee to supply reserves needed for normal economic conditions, and it had been estimated that as much as $3 billion of reserve funds would have to be put into the market between May and the end of 1953. Chairman Martin said that his conception of the operation was that the Committee should put a minimum burden on the open market account and the Open Market Committee for determining what the market shall be, that it should be free not only of the peg per se, but of levels of pegs. Each member of the Federal Open Market Committee might have a different judgment from that of the Manager of the Account, he noted, with respect to what ought to have been done in order to have depth, breadth, and resiliency, but if the Federal Reserve is to be out of the business of making a market, there should be some general rule for the guidance of the account manager. Chairman Martin also disagreed with Mr. Sproul in that he questioned whether there had been a fair test of the extent to which arbitrage might take place if System purchases were confined to the

short end of the Government securities market.

Mr. Sproul said that he was suggesting that, so long as it was the policy of the Committee to put funds into the market, there be more freedom to put them in where the pressures were greatest in order to minimize the amount the Committee would have to put in to achieve its purpose; that he was objecting particularly to having the recommendation of the ad hoc subcommittee that operations be confined to short-term securities, whittled down so that only operations in Treasury bills are permitted. On June 2, he said, prompt aggressive purchases of a large amount of bills, aided by small Treasury purchases of long-term bonds, had a considerable effect, both actually and psychologically. However, at the time of the recent Treasury financing with 2-5/8 per cent certificates the pressure was not in the bill market: everyone was trying to get into the bill market along with the Federal Reserve, and the Federal Reserve was putting funds into the bill market where there was no need for them while other sectors of the market were responding more violently to a temporary lack of demand than was necessary under the Committee's policy. His suggestion, he reiterated, was that the full Committee give to the executive committee more authority than that embodied in the directive for correcting disorderly markets. He thought that the present prohibition put a premium on sluggish action which would not meet the situations that may arise.

Mr. Mills expressed the view that to follow Mr. Sproul's suggestion would run the risk of confusing monetary policy with the market itself and

of creating a condition which would only cloud the objectives of monetary policy. His view was that the position of the market was secondary to monetary policy, albeit a reflection of that monetary policy.

Mr. Sproul reiterated that his suggestion would apply only when it would not conflict with the objectives of monetary policy.

Continuing, Mr. Mills said that in his judgment the Committee should reaffirm the existing understanding as to confining operations to the short end of the market, that prior to the appearance of a disorderly condition in the market there was no good reason for putting funds into the market other than in the short end, but that if a disorderly condition were indicated then action to correct the situation should be prompt and immediate. In other words, there should be no change in the Committee's present policy in this respect.

Mr. Sproul responded that he could not see that there would be any change in credit policy under his suggestion, that he could see no deviation from credit policy if the Committee were to purchase bonds of 56-59 rather than bills, if it was going to put funds into the market anyway and provided the pressure was in that area of the market. The only time such purchases would be considered, he said, would be when they fitted into present policy; the Committee should not let concern for the Government securities market override credit policy.

Mr. Mills suggested that if the Committee were to buy other than bills for the purpose of reassuring the market, it would mean the selection of issues where purchases would relieve conditions which were affecting dealers' positions which, if given time, would correct themselves without Federal Reserve action.

To this, Mr. Sproul said that purchases would not be for the purpose of relieving dealers' positions, that they would take account of the fact that the System portfolio is a very large factor in the market and would allow the account to make some response to supply and demand conditions in the market in order to get the best results from its open market operations. Operations solely in bills, Mr. Sproul said, assume that through arbitrage the same effects would be gotten that might be obtained through direct action. All he was suggesting was that if operations are limited to bills, the response may be too late and too tardy in terms of the existing market to be effective; he felt it likely that there would be times and circumstances in the next few months when the reaction to bill purchases and arbitrage would be too tardy to accomplish the Committee's purposes.

Mr. Mills did not believe that situations in the market of the type Mr. Sproul was talking about necessarily deserved correction through open market policy other than through the medium of bills, and Mr. Sproul expressed the view that the Committee would be justified in acting if otherwise the situation might become so severe as to have an effect on the market

psychology of businessmen, investors, and the whole economy.

Chairman Martin referred to the 2-5/8 per cent certificates offered by the Treasury recently, stating that he felt that they were priced close to the market, that he had expressed the view at the time that it would have been better to price them at 2-3/4. He also said that the tightness in the availability of credit that occurred in May must have had a profound effect on the Government securities market at the time.

Mr. Sproul commented that this is a very difficult period for the Treasury, that it will have to come to the market very shortly for around $4 billion of new funds, that its need is not one that can be postponed, and that any assistance which the Committee can give would be justified if it does not conflict with credit policy. As to the 2-5/8 per cent certificate offering in May, Mr. Sproul felt it was not the tightness in the money market that had affected the Treasury financing. The money supply, as far as bank reserves were concerned, did not tighten in May, and banks were reducing their borrowing during that month and their free excess reserves were increasing. While there was a question whether they might have been given more funds by System purchases, the fact was that the banks' reserve position was easing during the month because of the System's operations.

Mr. Rouse said that there was a fluidity in the market during May but that with the decline in prices of Government securities and with losses showing on the books of the banks many of them just were not interested in moving.

Mr. Powell commented on Chairman Martin's remarks regarding the money supply during May, stating that he did not believe the money supply is always in the same relation to the volume of business. During the past few weeks, Mr. Powell said, the money supply has been going down partly because corporations have been buying securities and, while these funds get back into the banks shortly, the net effect is to reduce the money supply as a by-product of the increase in interest rates which has made it profitable for corporations to put funds into the bill market. He felt that the Committee should be very careful in its conclusions as to the significance of short-term changes in the money supply. As to the broader problem, Mr. Powell felt that in the last few months the Open Market Committee had been faced with an impossible task--inflation control, tightening up the money market to restrain undesirable credit expansion such as some forms of consumer credit, and at the same time putting funds into the market so that normal business would not die. Mr. Powell felt this was a tightrope, that present conditions did not call for what the account has been doing in its operations, that sticking to short-term Treasury securities was not desirable, that because of the imperfect flow of funds from the short end of the market into other sectors this involved the danger of supplying more bank money through the multiplier effect than was necessary. In other words, to put funds only into the short end of the market might create more bank reserves than was necessary, Mr. Powell said. He also felt the Committee should not overlook the public confidence factor. For

one reason or another, he said, the public is concerned about the present situation and he cited comments by members of the Board of Directors of the Federal Reserve Bank of Minneapolis, the concern shown by many banks regarding the decline in Government securities prices even though they did not have long-term securities in their portfolios, and bad reaction in the press. He felt that even though the System might be doing the things that would carry out its true function, the public, through lack of understanding or through misinterpretations of policy, might be critical of the System and irreparable damage might be done. He stated that he would like to support Mr. Sproul's thesis that the Manager of the Federal Open Market Account be allowed to use any part of the Government bond market for the purpose of supplying reserves in times such as the present.

Mr. Earhart felt that the System may have underestimated the effects of the tendency to move to a tougher discount policy in recent months. He noted that the view had been expressed several months ago that there might be around a billion dollars of borrowings but that banks should not borrow to avoid the excess profits tax. Gradually the System has moved practically to the position that banks should not borrow under present conditions because they should not be borrowing in order to make a profit, and there is a profit motive back of almost every borrowing operation. This has had the effect of exerting more pressure on the borrowing banks to follow a restrictive policy, at least in the Twelfth Federal Reserve District, Mr. Earhart said. As Federal funds have become available most of

the borrowing banks have reduced their indebtedness to the Reserve Banks and purchased Federal funds, but, as yet, there has been no appreciable easing of credit in the Twelfth District.

Mr. Hugh Leach said that city banks were very cautious and that country banks were very concerned because of conditions in the Government securities market and for other reasons. He felt that if there was anything the Federal Reserve could do to relieve this concern, it should be done if it did not conflict with credit policy.

Chairman Martin doubted that the suggestion that had been made would help the Treasury. The real point under discussion, he said, was whether the Committee was going to have a method of operation which leads to a minimum of intervention, or whether it was going to have a procedure which would lead to maximum intervention by the Federal Open Market Committee in the market. If the System account were to start specializing in some of the individual Treasury issues, it could uncover a role for itself that would be limitless. At the same time, Chairman Martin said, the Committee should not be doctrinaire and a provision for dealing with disorderly conditions in the market had been adopted. He went on to say that, while he did not wish it to be taken as criticism of the management of the account, he had been somewhat surprised that the Manager of the Account did not notify the executive committee of a disorderly condition recently in view of this provision of a method for dealing with an exceptional situation.

Mr. Rouse suggested that as background for further consideration of the problem, the Committee note that the Treasury had put $1100 million into the market recently which it would have to take out before the end of June. In addition, the Treasury shortly would have to borrow a large sum and it appeared that something like $1700 million of reserves in addition to those already put in by the System account would be needed within the next few weeks.

The meeting then recessed for luncheon and reconvened at 2:15 p.m. with the same attendance as at the close of the morning session.

Mr. Williams asked whether the Treasury had voiced any concern about conditions in the Government securities market in a way indicating that it felt that the Federal Reserve could help it through a transition period, or whether any action that might be taken by the Federal Reserve would be independent and gratuitous.

Chairman Martin replied that the Treasury had not "thrown itself on the mercy of the Federal Reserve" nor had it indicated that it needed the support of the Federal Reserve in order to carry on its financing operations. It had not been critical of System operations nor had it indicated in any way that it felt the Federal Reserve had let the Treasury down during this period. The Chairman felt, however, that the Treasury would welcome any assistance which the Federal Reserve could give it.

Mr. Rouse agreed with this statement and Mr. Sproul commented to the effect that immediately prior to the meeting of the executive committee

on May 6, when Messrs. Burgess and Heffelfinger of the Treasury met with members of the executive committee, Mr. Burgess had made it plain that the Treasury considered that credit policy was a problem of the Federal Reserve.

Chairman Martin then suggested that the individual members of the Federal Open Market Committee and the Presidents of the Federal Reserve Banks who are not now members of the Open Market Committee express their views concerning the proposal that had been made by Mr. Sproul.

Mr. Erickson said that he agreed generally with Mr. Sproul. While the major part of the Committee's operations should be in the bill market, he could visualize some circumstances where it might be desirable to operate elsewhere. Therefore, he felt that the Committee's policy should have flexibility. There should be no figure of the amount of operations to be carried on since figures have a habit of getting outside the Committee, he said, but whatever was advisable at the time should be done. He reiterated that he would prefer generally to operate in the short-term market, and he suggested that a more precise definition of "disorderly" might be helpful, adding the comment that he had felt last week that the market was bordering on being disorderly.

Mr. Sproul said that there had been some clarification of the meaning of "disorderly" at this meeting. His impression of a disorderly market as discussed at the March meeting had been the situation that might exist in the event of outbreak of war or some other major disruption of the market,

whereas it now had been suggested that during the past two weeks there may have been a disorderly condition, or incipient disorder.

Mr. Erickson reiterated the statement that he had felt a week ago that the market was bordering on being "disorderly", and that he had discussed the situation with Mr. Rouse by telephone at the time.

Mr. Robertson felt that there need be no greater flexibility in the authority given by the full Committee to the executive committee and that there need be no deviation from the policy adopted at the meeting last March. There might, however, be a need for greater flexibility between the executive committee and the Manager of the System Open Market Account.

Mr. Johns stated that he was a little uncertain about the question that had been raised; that he was not sure how far apart the two views which appeared to be in opposition really were. He was under the impression that those expressing the two points of view perhaps would agree that at times during the past two weeks it might not have been inappropriate to intervene in the market in some sector other than the short-term area: one side said it would not have been surprised if the management of the account had suggested the possibility of a disorderly market, while the other side would say that instead of trying to operate under a more flexible concept of a disorderly market, it would be better to relieve the account of the prohibition embodied in the present agreement regarding operations in the short end of the market. Mr. Johns felt this was a difference in procedure

without any radical difference in substance. He was inclined to believe that in the matter of procedure, it would be preferable to relieve the executive committee of the prohibition agreed upon at the March meeting, but in any event, he could not understand why any member of the full Committee should not suggest that a disorderly market existed or that it was an incipiently disorderly market; he could not see why the whole onus of determining whether the market was disorderly should be on the Manager of the Account and he felt that any member of the full Committee, regardless of whether he was located in New York or Washington or elsewhere, should be able to raise the question. On the whole, Mr. Johns said, his leaning was more toward the view expressed by Mr. Sproul than by the others.

Mr. Earhart referred to the views regarding the effects of the discount operations of the Reserve Banks which he had expressed at the meeting this morning, adding the comment that the relief the Committee had attempted to give to the market recently had not been as effective as it might have been because of the feeling on the part of the banks that the System did not want them to borrow. He went on to say that his views on the suggestions made by Mr. Sproul were much the same as those expressed by Mr. Johns; there seemed to be more or less agreement that something additional might have been done recently in the market and it was a matter of just how to proceed. He could not see any particular reason why the executive committee should have a firm instruction from the full Committee which

would prohibit the executive committee from deciding between bills and certificates.

Chairman Martin stated that there was no such prohibition on the executive committee at present, that the present understanding was that under present conditions operations should be confined to the short end of the market except in the case of correcting a disorderly market. The question being presented, he said, was whether it is better, as a general policy, to confine System account operations to the nearest thing to money. He referred to the recommendation made by the ad hoc subcommittee that some of the uncertainties that were detrimental to the development of depth, breadth, and resiliency of the Government securities market could be eliminated by an assurance that henceforth the Committee "will intervene in the market, not to impose on the market any particular pattern of prices and yields but solely to effectuate the objectives of monetary and credit policy, and that it will confine such intervention to transactions in very short-term securities, preferably bills". The wording of the Federal Open Market Committee's understanding on this point, as recorded in the minutes of the March meeting, had been written very carefully, Chairman Martin said, and provided that "under present conditions, operations for the System account should be confined to the short end of the market (not including correction of disorderly markets)". As to why the onus for determining a "disorderly market" should be on the management of the account, Chairman Martin said that anybody should be able to raise the question at

any time. The members of the Committee should realize, however, that the Manager of the Account is much closer to the market, and is in a position to see forces that others may not be able to judge from a distance. What the Committee has been driving at, he said, is giving the Manager of the Account the maximum protection but at the same time the maximum latitude so that he could operate as a broker, the members of the Committee should be careful about operating the account in relation to a scare situation, Chairman Martin said, emphasizing that the Manager of the Account is infinitely better qualified as the Committee's agent on the floor to evaluate the forces that may determine whether a disorderly or incipiently disorderly situation exists.

Mr. Gilbert said that under more normal conditions he would prefer to intervene in the market only through purchases of bills but that these were not normal conditions and he thought there should be more flexibility than there appeared to be. He would favor also permitting purchases of certificates, notes, and short-term bonds, but would not favor purchases of very long-term bonds, except to correct disorderly market conditions, because such purchases might tend to create confusion in the market and would very likely be interpreted to mean that the System had decided to support market prices at a given level and thus substitute its own judgment for that of the market itself. Although the understanding reached at the March meeting to which Chairman Martin had referred might not include a specific prohibition against purchases of short-term

securities other than bills, Mr. Gilbert said, it had been interpreted as being the sense of the Federal Open Market Committee that purchases should be limited to bills.

Chairman Martin then read the following provisions which were under discussion and which were set out on pages 41 and 42 of the minutes of the meeting of the full Committee held on March 4-5, 1953:

> "There was further discussion of the various suggestions made in the subcommittee's recommendations regarding relations with the market in the course of which unanimous agreement was reached on the following points:
>
> "1. Under present conditions, operations for the System account should be confined to the short end of the market (not including correction of disorderly markets).
>
> . . . .
>
> "5. It was understood that, pending further study and further action by the Committee, the Committee approved the subcommittee's recommendation that it should refrain during a period of Treasury financing from purchasing (1) any maturing issues for which an exchange is being offered, (2) when-issued securities, and (3) any outstanding issues of comparable maturity to those being offered for exchange."

Mr. Riefler noted that, as Secretary, he had transmitted the foregoing paragraphs to the Federal Reserve Bank of New York on April 8, 1953, in a letter which had been approved by the executive committee at a meeting on that day and which embodied the substance of the recommendations in the ad hoc subcommittee report which had been agreed upon at the meeting of the full Committee held on March 4-5.

Mr. C. S. Young commented that it was clear that no action by the full Committee was needed to permit the System account to go into

Treasury certificates and Mr. Rouse stated that while this was true, he had raised the question at the meeting of the executive committee on May 13, 1953, noting at that time that there was a shortage of bills in the market and suggesting 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 due in 1953 and 1954, in response to which Chairman Martin had expressed the view that it would be a mistake for the System account to make purchases of 2 per cent bonds in the open market at the time, that it would be distinctly preferable for the System account to continue to operate in the bill market, and that he (Chairman Martin) believed bills would be available. Mr. Rouse went on to say that since no member of the executive committee had taken exception to Chairman Martin's statement (Mr. Sproul was absent), he had taken it as a guide to operations in the account since that time.

Mr. C. S. Young expressed the view that wherever support was needed, the Committee probably should give it provided it did not go into the long-term market. If the Committee were to go into the long-term market, Mr. Young said, it might be the worst thing it could do in that critics would say that pressure had been brought to bear and that the Committee had acted accordingly. However, purchases in the intermediate market or in certificates might be desirable. Mr. Young said that, in his opinion, the Committee was minimizing the element of distrust and the lack of buying power in various segments of the economy.

He felt that the Committee should not be so optimistic about the business outlook, referring particularly to the agricultural income situation, the feeling of bankers and others about the restrictive credit policy, declines in Government bond prices, and widespread uneasiness caused by and resulting from various rumors. He mentioned specifically that there were rumors that the Comptroller of the Currency was going to require national banks to charge off depreciation in Government bond accounts of banks.

Mr. Johns said that he was having difficulty understanding why some seemed to assume that if purchases were made of securities other than bills, which, as Chairman Martin said, were the nearest thing to money, the transactions ipso facto lost their character as monetary policy operations and became support operations. He could not see why if other securities were purchased, when such purchases were consistent with monetary policy, they should not be considered as primarily to effectuate the objectives of monetary policy and that whatever support might be given to other segments of the market was wholly collateral.

Chairman Martin suggested that the question asked by Mr. Johns be put in reverse, i.e., why should not purchases of bills be equally satisfactory in carrying out monetary policy.

Mr. Sproul said that purchases of bills would put reserves into the market but that in view of the lack of liquidity of the banking system, they might not be as effective as would be desirable

in avoiding unwarranted changes in the Government securities market. Changes in that market might affect investment conditions generally and be a factor to be considered in carrying out the aims of monetary policy.

Mr. Mills stated that if the account were now to enter all segments of the market it might confuse the market thoroughly, that the market would not have any indication of how the System account was going to operate or what sector of the market it might enter. He went on to say this was one of the main considerations in the study of the ad hoc subcommittee, that its recommendations in this respect had been given credence by the full Committee at its meeting in March, and that before there was to be a change, the whole report of the subcommittee should be reviewed.

Mr. Sproul said that the full Committee had given credence to that part of the ad hoc subcommittee's report under present conditions but that in his opinion conditions had changed. It was not a question of trial under all conditions; the understanding reached in March had referred to present conditions and in Mr. Sproul's opinion conditions since then had changed.

In response to a statement by Mr. Powell that he could not recall voting on this matter at the meeting in March, Chairman Martin replied that the matter had been voted on, that it was agreed to unanimously, and that it was fully recorded in the minutes of the meeting

which had been sent to all members of the Committee and approved unanimously.

Mr. Sproul added the comment that the matter of confining operations to the short end of the market was voted on "under present conditions", and that the question of restricting operations during periods of Treasury financing was voted on "pending further action and study by the Committee". These actions, he said, could not be considered as permanent actions which could not now be considered and changed by the Federal Open Market Committee. Mr. Sproul felt that the market would not be disturbed if some of the funds the Committee put into it were in a form other than in bills, and he said that there was no thought that if the instructions in question were changed, the executive committee would authorize the New York Bank to go into the market under any and all conditions and buy securities of all maturities. Purchases other than bills would be made only, he said, if credit were needed in a certain sector of the market which was not being reached immediately and promptly by purchases of bills.

Mr. Hugh Leach said that ordinarily purchases for the System account should be in Treasury bills and that ordinarily the account should not come to the rescue of the Treasury. He did not like to have this as a permanent policy, however, and he thought the situation was now different from what it was in March. He felt that the

Manager of the Account had been right in not suggesting that a disorderly market existed recently but he said that if quotations for Government bonds were to change by several points in a day, the executive committee should be in a position to do something about it. Mr. Leach believed that disorderly markets should be interpreted a little differently now than had been the case earlier in view of the discussion at the March meeting and he said that he was more concerned at present about the Treasury's financing problem than he had been.

Mr. Evans said that the discussion at this meeting clearly indicated that pegging of Government security prices was deeply rooted in the Committee's thinking and that it was evident it was having a hard time getting rid of the idea. Some of the members of the Committee still seemed to look upon the Government security market as "our" market, he said, and while there was talk of a free market, it was not so clear that a free market was really wanted when we were faced with the reality of it. Mr. Evans said that there had been little discussion of the economic situation at this meeting, that as a member of the executive committee he felt it important that the full Committee indicate whether it believed the boom was still pretty stout and credit policy should be relatively neutral; or whether the boom was a thing of the past and the economy was approaching a serious deflationary period which would call for supplying ample reserves

to the market. Most of the discussion had been directed to market techniques, Mr. Evans said, and to a suggestion for changing some of the procedures that had been agreed upon in March as a result of the study by the ad hoc subcommittee. For his part, Mr. Evans would like to continue the operating procedures agreed to in March and, as a member of the executive committee, he would like to have the full Committee indicate whether, as a matter of credit policy, funds should be put into the market, whether the market should be kept about as it is, or whether it should be permitted to become tighter.

Mr. Leedy said that while he was not a member of the full Committee, as an alternate member, he felt this was a discussion basically of the question whether the agreement reached with respect to the report of the ad hoc subcommittee should be carried forward or dropped. He felt there had not been a fair trial of the procedure of putting funds into the short end of the market, which was just becoming acquainted with what it might expect from System operations. If the present procedure were to be changed now, the market would not have any guide as to what to expect from the Committee. As to the business situation, Mr. Leedy referred to the estimate that perhaps $3 billion of reserves would have to be put into the market between May and the end of the year in order to meet the needs of normal economic developments. He suggested that some indication from sources within the System that the Committee recognized that a sizeable amount of reserves would have to be put into the market and that it was prepared to

provide them might help to accomplish the Committee's objectives. Mr. Leedy also said that he would be greatly disturbed, as Chairman Martin had indicated, if the Committee got into an operation where there was a series of pegs and there seemed to be a substitution of the Committee's judgment as to where prices of Government securities ought to be, rather than letting market forces determine them. In sum, Mr. Leedy felt that conditions at present had not changed sufficiently to warrant a departure from the agreements reached in March regarding confining purchases for the System account to short-term securities and refraining from certain operations during periods of Treasury financing.

Mr. Mills said that while the recommendations in the ad hoc subcommittee report could be magnified out of their true importance, the principles expressed in the report were vital and fundamental to the Federal Open Market Committee's operation. It would be a great mistake in his opinion to depart from those principles as now in operation; such departure would be evidence of weakness and vacillation on the part of the Federal Open Market Committee.

Mr. Robertson stated that the discussion at this meeting proved the correctness and wisdom of the Committee's decision in March not to issue a statement of principles regarding its operations, that the mere fact that there had been this discussion of possible changes in techniques illustrated how embarrassing the position of the Committee might have been made if it had issued such a public statement of principles. Mr. Robertson

said that he had become convinced in his study of the recommendations of the ad hoc subcommittee that it was desirable to limit operations to the short term area of the Government securities market except in the case of disorderly conditions. He felt that Mr. Johns was mistaken in believing that there was little difference in the two opposing positions that were under discussion. While the Manager of the Account should, of course, be completely free to recommend action to correct a disorderly situation, Mr. Robertson said that he would not have thought that the market last week had been disorderly and he would have felt that the Committee's operations should have been limited to purchases of bills. To depart at this time from the understandings reached in March would be a step back toward the position of trying to rig the market, Mr. Robertson said; he thought that injection of reserves at the short end of the market should be just as effective as though the Committee were to put itself in the position of seeming to influence other sectors of the market, thus creating an additional factor for investment portfolio analysts to deal with in trying to measure the forces that were affecting the long-term Government securities market. In his opinion, some members of the Committee were getting a little panicky about the rise in interest rates; it was his judgment that this rise had been effective in reducing or postponing demands for credit and this was one of the objectives of the Committee. As to Mr. C. S. Young's suggestion that banks were getting concerned about the prices of Government bonds and the rumor that the Comptroller of the Currency might require them to

write down depreciation, Mr. Robertson said that the Comptroller still had in effect his agreement that such depreciation would not have to be taken in valuing bank portfolios. The Board had in effect the same policies with respect to bond accounts of State member banks. With respect to the economic situation, Mr. Robertson said that he could see nothing in the economic presentation of the staff this morning or in the comments of the members of the Committee or the Presidents from the individual Federal Reserve districts which would indicate that the situation had changed materially recently; it appeared still to be a situation of delicate balance at a very high level of activity. If there were to be any change in the understandings reached at the March meeting with respect to recommendations in the ad hoc subcommittee report, Mr. Robertson said, such proposals should be seriously considered only when the members of the Committee came fully prepared to discuss and debate the recommendations in that report.

Mr. Sproul felt that all members of the Committee should have studied the report and should have come to this meeting prepared to debate the subject.

Mr. Powell stated that he would wish to bar a doctrinaire attitude in a situation as critical as the present and that he would like to leave the open market operation as flexible as possible in any instructions given by the full Committee.

Mr. Fulton said that while he would like to see operations for the System account continued as largely as possible in the short end of the

market, he believed that greatèr flexibility for operations in other areas was needed. He noted that the only way many banks could adjust their reserve position was by selling securities of a type other than those which the System account was interested in buying, that some of the bankers were saying that they would rather make loans to any one than to buy a Government bond, and that the attitude of bankers with respect to the Government securities market seeped down through the whole community including holders of savings bonds. Mr. Fulton felt that a little support on the part of the open market account in the longer end of the Government securities market would be of great help to that market, if such support was within the amount of reserves that the Committee thought should be put into the market. He also noted that it takes time for reserves to seep down through the market to the smaller banks throughout the country, and he felt that purchases for the System account in the short end of the market were taking a longer time to seep into the long-term Government securities market than the requirements of the present situation dictated.

Mr. Williams said that Mr. Leedy had expressed his thoughts fairly closely. As a result of the ad hoc subcommittee's report, Mr. Willimas said, the full Committee made a change in policy. He did not think that there had to be a debate as to whether it was a permanent change or a temporary change; the Committee was now in the midst of an operation which was experimental. A lot of publicity had been given to the change which was generally considered, at least among bankers, to have resulted from the study of the

ad hoc subcommittee. If, at a time when the public was jittery, the Committee by another action indicated that there was still another change to come, it would add still another set of problems to those it was having to deal with. Mr. Williams did not feel that the Committee at this stage could be sure enough about the wisdom of a change such as that which was being proposed to be certain that it should make it now. It ought to continue to experiment along the present lines, with a willingness to make a change as that seemed to be indicated. Mr. Williams said that a shift in the Committee's operating technique in the Government securities market now would be interpreted as an indication that the Committee did not know what it was doing. It was his belief that the present general type of operation should be continued, that the situation should be watched carefully, that the Committee should try to give adequate publicity as to what it was going to do in the way of injecting funds into the market, and that it should try to counteract some of the present jitteriness in the market. As to the business situation, Mr. Williams said there was a wide difference of opinion, that at the last meeting of the Board of Directors of the Federal Reserve Bank of Philadelphia reports were brought in from nine regional meetings indicating businessmen were making plans for further expansion, while the representative on the Federal Advisory Council reported that at the May meeting of the Council the reports generally were to the effect that businessmen were disturbed about the outlook. Mr. Williams felt that the credit policy of the Committee should continue about as it is for the present.

Mr. Bryan stated that the discussion at this meeting had gotten into three fundamental questions: (1) Mr. Evans' question as to whether the policy of the Committee with respect to adding reserves to the banking system has been adequate. In his opinion, Mr. Bryan said, the program is not adequate. Although not a member of the Committee, Mr. Bryan felt that if it did not embark rapidly on a more adequate program of adding reserves to the banking system it was entirely possible that we might get what Mr. Sproul seemed to fear, a widespread convulsive tightening in the market. (2) There is the question of arbitrage between the short-term market and other sectors of the Government securities market, and (3) the question whether the Federal Open Market Committee should give discretionary authority to the management of the account to intervene in the long-term Government securities market. Mr. Bryan said that we had lived through a period in the market which was most unfavorable to arbitrage of the short- and long-term market. He recalled some of the things that had happened since last March when the present experiment in free markets was undertaken. Before that time, there had been an extraordinarily long period of more or less "administered" markets and it was then impossible to predict the extent and duration of changes in the yield curve in getting back to a free market. Within recent months there has been the tightening in reserve positions of banks, the Federal Reserve made no additions to its portfolio until May, the Treasury's 3-1/4 per cent 30-year issue was permitted to be slaughtered by the free-riders, the Treasury was indicating

at every opportunity that it would come into the long-term market, and it was evident that there could be an almost unlimited supply of long-term bonds, if the Treasury were determined in such a policy. Under these circumstances, Mr. Bryan said, it was remarkable that the long-term Government securities market had not "fallen completely out of bed". As to the immediate situation, Mr. Bryan felt that the manager of any investment portfolio would note that System purchases have been very modest, that the current easing in the market has come from Treasury operations and other considerations of a temporary nature, and that to expect the portfolio manager of an insurance or other investment company to show interest in long-term Government bonds under these conditions was to expect the impossible. While the Federal Open Market Committee might know that it had a policy of supplying reserves that might be needed for normal business operations during the next few months, managers of investment accounts do not know what that policy is. Mr. Bryan did not believe that the efficacy of arbitrage had been settled by any manner of means by the experience of the past few months. On the matter of giving greater discretion to the executive committee or to the management of the System account, Mr. Bryan noted that the Committee had already provided a procedure by which, with a considerable degree of latitude, the management of the account could call to the attention of the executive committee by conference telephone or individual telephone calls, in a matter of moments, any situation in which the market was or threatened to become disorderly in the long end.

He would dislike to see any change in the present procedure, which he felt was adequate, he did not believe this procedure had been fully tried, and he suggested that it be given a trial before the full Committee voted unlimited discretion to the executive committee along the lines suggested. It was his view that neither on the basis of experience during the past three months nor in principle would it be wise for the full Committee to give discretion of such magnitude.

Mr. Sproul said that the question under discussion at the moment was the instruction of the full Committee to the executive committee, that there was no question under discussion of giving full discretion to the management of the System open market account. Rather, the question was whether the full Committee should freeze the executive committee's authority or whether it should give the executive committee more discretion to meet a situation that might develop. In referring to a lack of an adequate period of testing, Mr. Sproul said, this got back to the idea that somehow the full Committee had permanently adopted a policy in March that would not be changed. In Mr. Sproul's opinion, the March policy was adopted "under present conditions," conditions have changed since March, and conditions in the next three to six months will be peculiar conditions such as we have seen in recent weeks. He did not feel the authority for dealing with a disorderly market situation, as understood at the time of the March meeting, was adequate to meet the situation that might develop, but at the moment he was not talking about abandoning that procedure. The

situation that the Committee now faces is whether it is making open market policy effective in the best way possible, in the light of the business situation and other factors.

Mr. Robertson inquired whether, if disorderly markets were defined to include a situation such as has existed in the last week or two, Mr. Sproul would feel differently, and Mr. Sproul responded that that would be much better than the basis on which the account had been operating but that he would prefer to have the full Committee not limit the executive committee at this stage with any attempt at definition of a disorderly market. Mr. Sproul reiterated that it would not necessarily be the objective to go into the long-term market, that that might or might not be the market under the most pressure or the weakest sector of the market at any given time. He did not feel it was a question of going back to pegging or to a series of pegs, nor was it a question of substituting the Committee's judgment for that of the market.

Chairman Martin said that, having heard the comments of all members of the Committee and of the Presidents who were not on the Committee, he still held the views he had expressed early in the meeting. With respect to the point raised by Mr. Fulton regarding efforts by the System to restore confidence among bankers, Chairman Martin said that he believed any actions which the System might take in that direction would not only not benefit the Government securities market but would actually harm it

through deviating from a policy which the Committee has been working toward over a period of two years. While he would grant that conditions have changed over the months, it was a matter of judgment as to the extent of such change and he did not feel that the operating procedure approved in March as a result of the recommendations of the ad hoc subcommittee had had a test at all. He felt that more aggressive purchasing of bills during the recent period would have had a marked reaction in terms of arbitrage, and he felt that the procedure which had been authorized by the full Committee and the instructions given by the executive committee fully permitted such operations. Chairman Martin noted that only nine voting members of the full Committee were in attendance at this meeting, and he inquired whether any member of the Committee thought that on a question as grave as this one it was appropriate to put the matter to a vote. His own feeling was that, where there was such a difference of opinion as had been expressed on a matter of as much importance as the one that was involved, the Committee should not put it to a vote in the absence of some members and a lack of real urgency.

Mr. Sproul inquired as to what kind of instructions would be given to the executive committee and, in turn, what kind of instructions would the executive committee give to the New York Bank.

Chairman Martin suggested that in order to answer Mr. Sproul's question, the Committee turn to consideration of the credit policy that should be followed. Should the Committee aggressively and on a rising and

progressive scale supply reserves to the market from this point on? Should the discount rate be changed upward? Should consideration be given to a reduction in reserve requirements? He noted that at its meeting on May 6 the executive committee took the position that there should be no further tightening in the market, and he raised the question whether the position then taken by the executive committee should be validated, or whether there should be an easing of the market, or whether there should be further tightening.

Mr. Evans stated that he felt the Committee should put more funds into the market to ease the reserve position of banks.

Mr. Sproul felt that the policy which the Committee has been following is the course that it should continue for the present, that is, it should maintain the existing degree of restraint but it should not allow the restraint to be further intensified, and if errors were made they should be on the side of ease rather than restraint.

Mr. Mills agreed generally with Mr. Sproul's position except that he would emphasize quite strongly supplying reserves to the market liberally.

Chairman Martin stated that he felt that in the immediate future the System should step up its purchases quite sharply. He noted that the views expressed by Messrs. Evans, Sproul, Mills, and Bryan all emphasized that operations should be on the side of easing the market, and Mr. Rouse said that he was thoroughly in accord with that view.

Mr. Earhart said that this view was reflected in recent comments by members of the Board of Directors of the Federal Reserve Bank of San Francisco,

that they felt generally that the economy was cresting, and that he felt sure the directors of that Bank would be loathe to take any restrictive action such as increasing the discount rate or doing anything else that might be interpreted as further tightening of the situation.

None of the other members of the Committee expressed views contrary to those indicated, and Mr. Rouse mentioned again the fact that the Treasury had put $1100 million into the market recently which would have to be replaced within the next few weeks along with additional reserves needed in connection with Treasury financing. This might mean, he said, that the System would have to put in around $1600 to $1700 million within the next six weeks. Mr. Rouse felt that some relaxation in the attitude of the Reserve Banks toward discounting would have an effect in the market and the extent to which discounts were used would, of course, have to be considered in connection with the amount of funds put into the market by the System account.

Following further discussion, Chairman Martin stated that it appeared to be the consensus of the Federal Open Market Committee that there should be an aggressive supplying of reserves to the market during the near future, on a sharply rising basis. None of the members of the Committee expressed a different view and Chairman Martin stated that, accordingly, this would be the general policy of the full Committee, to be carried forward in its instructions to the executive committee.

Chairman Martin then reverted to the proposals made by Mr. Sproul for changes in the understandings at the March meeting with respect to

confining purchases to the short end of the market and with respect to System operations during periods of Treasury financings.

Mr. Sproul stated that the only question being raised was that of the instructions from the full Committee to the executive committee: if no vote were taken on his proposals, that amounted to a vote to continue the present instructions, which he felt ought to be changed. His recommendation, therefore, as suggested earlier, was that the restrictions on the executive committee against buying securities in other than the short-term area except in correcting a disorderly market, and against certain purchases of securities during periods of Treasury financings, be rescinded.

Chairman Martin again questioned whether Mr. Sproul felt that the matter was of sufficient urgency to put it to a vote in the absence of some members of the Committee, when it involved, as it did, a change in policy of importance.

Mr. Sproul responded that he did feel the matter was urgent or he would not have kept proposing the change, and he referred to the Treasury financing needs during the next few weeks as a consideration. In response to a question from Mr. Thomas as to precisely what his suggestion was, Mr. Sproul said that he was proposing to rescind the two prohohibitions adopted at the meeting of the full Committee on March 4-5, 1953, namely, that (a) under present conditions, operations for the System account should be confined to the short end of the market (not including correction of disorderly markets), and (b) pending further study and further action by the Committee,

the Committee should refrain during a period of Treasury financing from purchasing (1) any maturing issues for which an exchange is being offered, (2) when-issued securities, and (3) any outstanding issues of comparable maturity to those being offered for exchange. This would mean, Mr. Sproul said, that the executive committee would not be prohibited from authorizing transactions in other than short-term securities, or from purchasing securities as indicated during periods of Treasury financing; whether the executive committee would want to use that authority would be up to the executive committee.

Thereupon, Mr. Mills moved that the two understandings referred to by Mr. Sproul and noted above be reaffirmed by the full Committee and that the executive committee be instructed to continue to operate accordingly.

Mr. Mills' motion was put by the Chair and lost, Messrs. Martin, Evans, Mills, and Robertson voting "aye", and Messrs. Sproul, Erickson, Fulton, Johns, and Powell voting "no".

Mr. Sproul then moved that the understandings relating to confining operations for the System account to the short-term sector of the market and to refraining from certain purchases during periods of Treasury financings, as approved at the meeting of the Committee on March 4-5, 1953 and as set forth above, be rescinded, with the understanding that the executive committee would be free to determine how operations should be carried on in the respects mentioned, in the light of the current general credit policy of the Federal Open Market Committee.

Mr. Sproul's motion was put by the Chair and carried, Messrs. Sproul, Erickson, Fulton, Johns, and Powell voting "aye", and Messrs. Martin, Evans, Mills, and Robertson voting "no".

Chairman Martin then referred to the directive to be issued to the executive committee and mentioned a suggestion by Mr. Riefler that, in view of the policy adopted at this meeting that operations in the account should be to supply reserves aggressively to the market during the near future on a sharply rising basis, there should be a change in the wording of the phrase in the present directive which stated that operations should be "with a view to exercising restraint upon inflationary developments". There was agreement with this suggestion and also with Mr. Rouse's suggestion that the limitations in the directive be continued at the present levels.

Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously:

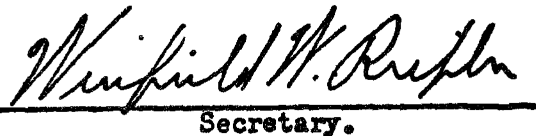
The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), 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 (which in the near future will require aggressive supplying of reserves to the market), (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $2,000,000,000.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) of 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 $2,000,000,000.

Mr. Hugh Leach stated that it was contemplated that the next meeting of the Presidents' Conference would be held during the week beginning September 20, 1953, at the time of the annual convention of the American Bankers Association which is to be held in Washington, D. C. on September 20-23, 1953.

Chairman Martin suggested that a meeting of the Federal Open Market Committee also tentatively be scheduled for the week beginning September 20, but he emphasized the probability of having to call at least one meeting of the full Committee before that time.

Thereupon the meeting adjourned at 3:45 p.m.



Secretary.