

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 Friday, August 29, 1952, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Bryan, Alternate for Mr. Leach
Mr. Mills, Alternate
Mr. Robertson, Alternate for Mr. Vardaman

Messrs. Evans 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. Sherman, Assistant Secretary, Board of
Governors
Mr. Youngdahl, Assistant Director, Division
of Research and Statistics, Board of
Governors
Mr. Leach, Acting Chief, Government Finance
Section, Division of Research and
Statistics, Board of Governors
Mr. Willis, Acting Assistant Secretary,
Federal Reserve Bank of New York

Upon motion duly made and seconded,
and by unanimous vote, the minutes of the
meeting of the executive committee held
on July 22, 1952 were approved.

Before this meeting, there had been distributed copies of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period July 22, 1952 to August 26, 1952, inclusive. At this meeting a supplementary report covering commitments executed on August 27 and 28, 1952, was presented. Copies of both reports have been placed in the files of the Federal Open Market Committee.

8/29/52

-2-

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period July 22 to August 28, 1952, inclusive, were approved, ratified, and confirmed.

Chairman Martin stated that the ad hoc subcommittee studying the scope and adequacy of the Government securities market was continuing its work, that meetings with securities dealers for the purpose of securing comments and information had been completed, and that a report was now in process of being prepared. He said that completion of this report would require somewhat longer than had been anticipated and that since it would not be available for distribution to all members of the Federal Open Market Committee for several weeks, the subcommittee suggested that a letter be addressed to each Federal Reserve Bank President explaining the status of the study and report. The Chairman then read a draft of letter as follows:

"This letter is written to report briefly in behalf of the ad hoc Subcommittee on organization and operation of the open market account. The report takes this interim form because the Committee is not yet ready to report more formally.

"As you know, early in the summer the Committee conducted the most extensive hearings with dealers and others closely associated with the Government securities market. The record was so voluminous that the Committee and staff have felt it necessary to review large sections of the transcript. This has been slow work.

"In addition, the press of other engagements on the members of the Committee has inevitably delayed its work and, latterly, we have received, as you have, the extensive report of the New York Bank entitled 'Federal Reserve Open Market Operations'. This has deserved and required the most careful review and discussion, tasks on which the Committee is now engaged.

"It has become evident, in hearings, discussions, and from the New York report, that the issues involved in the Committee's terms of reference are of the most fundamental and far-reaching character. They involve not only the most complicated problems of technique and organization but profound problems of a more

8/29/52

-3-

"theoretical and philosophical nature. It has thus become apparent to your Committee that the issues before it can only be usefully approached in the most searching and studious manner.

"Accordingly, the Committee has determined that it will proceed without haste in a genuine effort to fulfill what seem to be the requirements of the situation in arriving at conclusions and recommendations that it hopes may be sound and useful. Its work will thus continue into the fall, and I assure you that your Committee will try not to involve itself in unwarranted delay.

"Mr. Robert Craft, who has been consultant to the Committee during the summer, must shortly return to his bank. By special arrangement with the Guaranty Trust Company, however, he will be available to the Committee from time to time."

In this connection, Chairman Martin said that while the services of Mr. Robert H. Craft as a Technical Consultant would be needed until the latter part of September or early October in preparing the report, it did not seem necessary or desirable to ask him to remain away from his regular employer, Guaranty Trust Company of New York, longer, but that it would be necessary for him to be present when the report was presented and discussed at subsequent meetings of the executive committee or the Federal Open Market Committee. The Chairman went on to say that on the basis of informal discussions, he understood Mr. Craft's services would be available in that manner, and, in response to his inquiry, none of the members of the committee indicated any objection to completing the arrangements for Mr. Craft's assistance along lines indicated.

Thereupon, upon motion duly made and seconded, the letter to the Presidents of all Federal Reserve Banks set forth above, prepared for the signature of Chairman Martin, was approved unanimously.

There had been sent to the members of the committee before this meeting a memorandum from Mr. Young dated August 28, 1952 on the current and prospective economic situation. At Chairman Martin's request, Mr.

8/29/52

-4-

Young commented briefly on the memorandum stating that the current economic situation was relatively strong and that markets generally were firmer than at any time since early in July. Defense spending programs continued at a high rate with substantial further increases scheduled, Mr. Young said, and, while the protracted steel strike had had a substantial impact, aggregate output was recovering rapidly and by September probably would be at a level about as high as that reached immediately prior to the start of the steel strike last spring.

Mr. Thomas then commented on a memorandum which he had prepared under date of August 28, 1952 on Guides for Open Market Operations, September-December, 1952, copies of which had been distributed before this meeting. The memorandum suggested four alternative possible guides that might be adopted by the committee to assist in carrying out open market operations in conformity with the objectives and policies of the Federal Open Market Committee. Mr. Thomas said that, while there were still strong inflationary forces, there were no definite indications of an inflationary movement at the present time, that the credit policies followed by the System appeared to have been having the restrictive influences contemplated, that money markets were tight with banks in debt to the Federal Reserve System by about \$1 billion, and that since the large bank credit expansion associated with the Treasury financing at the beginning of July there had been a significant liquidation of bank credit. Business loans had shown no more than a usual seasonal expansion, while loans on securi-

8/29/52

-5-

ties and bank holdings of securities had declined.

As a general indication of credit expansion that might reasonably occur in the next few months without contributing to inflation or requiring a more restrictive System policy, Mr. Thomas said that an increase of about \$2 billion in privately-held demand deposits for the year 1952--a growth of a little over 2 per cent--would appear to be neither excessive nor too small. Since there has been a decrease in such deposits thus far this year, a growth of over \$4 billion for the rest of the year would be needed to reach the amount projected. Such an expansion, after allowing for a decrease in the Treasury's balance and for a seasonal increase in currency demand, would probably require an additional \$1 billion of Reserve Bank credit. With member bank borrowings already in the neighborhood of \$1 billion, it would seem reasonable for the System to supply perhaps \$750 million through repurchase agreements and direct purchases in the open market. A good deal of this would be needed in September and October, if a substantial further tightening in the money market was to be avoided.

Chairman Martin stated that the policies of the Federal Open Market Committee, as summarized in the letter of the executive committee to the Secretary of the Treasury dated July 23, 1952, were clear but that the means of carrying out those policies must be evaluated in terms of the Treasury's October 1 financing and the accuracy of the market in reflecting what terms were indicated for that financing. While the market had come a long ways in getting back to a "free" basis, Chairman Martin cautioned against assuming

8/29/52

-6-

too quickly that it had reached a state where it would accurately reflect conditions and he suggested that there be a discussion of this problem, adding that he would be glad to have Mr. Sproul comment on recent press reports apparently based on an interview with Mr. Sproul which was interpreted as indicating an "open mouth" policy on the part of the System in order to influence the Government securities market.

Mr. Sproul then made a statement substantially as follows:

"The market has been estimating the prospects about as we have and has been finding about the same outlook for the remainder of the year, that is, a substantial increase in demand for reserve funds growing out of a variety of causes. In the absence of knowledge of what our policy is to be, it has been inclined to make the gloomiest interpretations of what our policy might be: for example, that the System might keep such a tight policy and force banks to come to the market in such large amounts over such extended periods of time that a substantial rise in money rates might be the outcome. That feeling has created in the market a desire to confine investments wherever possible to the shortest term obligations in keeping with the natural liquidity desire. The recent rising tendency of short-term interest rates has contributed to that desire.

"As to press reports of an 'open mouth' policy, I frequently see the press representatives when they come into the Bank. On the occasion in question I expressed the view that the market might at the moment be taking an exaggerated view of what developments might be over the next few months, and in response to a question I said that the market seemed to be assuming that there is a mechanical relationship between open market rates and the discount rate, and that since market rates had gone up it would only be a short time until there was an increase in the discount rate. Contributing to that talk was the suggestion that some of the commercial banks might increase their prime lending rate. I suggested that there was no automatic connection between the discount rate and these open market rates, that the discount rate would remain in some relationship to the open market rate but that they could not anticipate an automatic increase in the discount rate, that such a change would depend more largely on the economic situation and the development of inflationary pressures rather than on a rate rise that had already occurred.

8/29/52

-7-

"The market was in such a shape that there was some reaction to the press report in terms of improved prices and a lessening concern about the immediate future of the market. Of course, what the market is really looking for is some indication of what our policy is going to be and they are reading into each action some indication of policy. We have made some estimates of the business outlook which agree in general with the views expressed by Mr. Young, and we have made estimates of what the Treasury cash needs will be. They are higher than those presented by Mr. Thomas but they are rough. We can see the possibility of the banks needing up to \$2 billion of additional reserve funds if they are to meet the currency demand, the seasonal rise in borrowings, and their own activities in Government securities during the Treasury financing. We would agree that to meet that additional need -- whether it be \$1 or \$1½ or \$2 billion -- solely through the discount window would put an undue strain on the money market, would cause an undue rise in interest rates, and would not be supported by the general business and credit situation. While the situation has inflationary forces in it, it is on the whole one of balance at a high level. So we come down to the situation that the general policy we have outlined is the correct one, that is, a controlled release of reserves through open market operations while continuing to bring the banks to us through the discount window to meet temporary needs and some part of their seasonal needs for reserve funds. We are getting the long-term accumulative effects of our market operations. We may be faced with the possibility of having to buy up to \$1 billion of Government securities during the remainder of this year to maintain credit restraint but not tightness, and there might be a further increase in discounts going with that somewhere in the neighborhood of a half billion dollars."

Chairman Martin stated that the problem which the committee has been struggling with is the problem of projecting the need for reserve funds and the extent to which the System through its open market operations meets that need. He again commented that the general policy of the Open Market Committee as summarized in the letter to the Secretary of the Treasury dated July 23 was clear, but a specific question on which a determination was needed was how to gauge the magnitude of the amount of funds that

8/29/52

-8-

should be put into the market between now and the announcement of the Treasury financing. He said that he had been disturbed to note that for several days the rate on certificates each night had been closing at 2 per cent bid; this raised the question whether there was sufficient flexibility being permitted in the market; if the free play of forces in the market was resulting in that same figure day after day, it was one thing; but if the rate had been "mothered", it would make it difficult for the Treasury to know what rate was really indicated by the market for its forthcoming financing. There was the danger, he said, of getting back into something like a pegged market. There was a question in his mind whether possibly men on the trading desk at the New York Bank might inadvertently have let the impression get around that a different rate was against Federal Reserve policy. His own view, the Chairman said, was that when reserves were needed for the market, rates should be ignored and reserves should be put in without reference to rates. It was important that the Treasury not be misled as to the rate that was reflected by the variety of market forces, and it was important that the Federal Reserve not create a situation where it would have to put more money into the market at a later date by failing to do the right thing in the interim. The discussion at this meeting, he suggested, should center around the kind of guides which the committee might use in determining what market operations should be, and there should also be a discussion of what the committee might wish to suggest to the Treasury

8/29/52

-9-

in connection with the October 1 financing which would have to be announced around September 15.

In this connection, Chairman Martin suggested and it was agreed that another meeting of the executive committee should be held at 10:30 a.m. on Monday, September 15, 1952.

With reference to Chairman Martin's remarks, Mr. Sproul said that, since the meeting of the executive committee on July 22, the New York Bank in carrying out the policies of the full Committee and the directions of the executive committee had taken the approach suggested by the Chairman which was also the approach he (Mr. Sproul) favored: that is, one of providing reserves to the market in response to what seemed to be the needs of the market, rather than trying to maintain or fix or improve or harden interest rates. The natural effect of such action was, of course, to relieve the upward pressure on rates or perhaps to bring rates down, Mr. Sproul said, but that had not been the guide: the guide had been the need for reserves, modified during the period of Treasury financing when the need for supporting the refinancing was the parallel objective. The actual rates prevailing have been wholly the result of market decisions, Mr. Sproul said: he had sat at the trading desk a good deal recently and there had been nothing by word of mouth or in any of the operations on the part of any individual in the New York Bank which had caused the rate on certificates to stay so consistently at 2 per cent.

There followed a general discussion in which members of the Committee

8/29/52

-10-

and staff participated with respect to possible guides that might be used in connection with open market operations as discussed in Mr. Thomas' memorandum of August 28, particularly as they might be applied during the next few weeks. As an outgrowth of the discussion, it was the consensus that a long-term projection of the demand for bank reserves, such as the assumption of a \$2 billion increase in privately-held demand deposits during the year 1952, could be useful as a general guide to open market operations. It was also the consensus that, having in mind this general projection for credit demand, it would be helpful to relate open market purchases to the amount of member bank borrowings. However, it was not possible to forecast on the basis of projections the exact amount of reserves that should be put into the market over a given period or to use such forecasts as a basis for determining rigidly in advance the volume of transactions in the System open market account, since it was necessary that the management of the account have day-to-day administrative discretion in carrying out the directions of the executive committee in the light of the general policies determined by the Open Market Committee. There was also agreement that any purchases of securities in connection with Treasury financing should be taken into consideration in measuring the adequacy of System operations and that purchases during such a period would supply some of the reserves needed during the remainder of the year. There was no disagreement with Chairman Martin's statement that the maintenance of a specified level of interest rates should be avoided.

8/29/52

-11-

During the discussion of operations to be carried on in the immediate future, Chairman Martin expressed the view, in which Mr. Mills concurred, that it would be desirable for the Federal Reserve to be "overly generous" in supplying reserves between now and the announcement of the Treasury financing in mid-September. It was the Chairman's view that to wait until the Treasury financing was announced before acting might result in the System's putting a larger amount of funds into the market than it otherwise would; in any event, such timing would clearly subject the operation to misinterpretation as a return to a "pegged" market. Thus, it was his feeling that if the System was going to put funds into the market it should do so promptly, preferably in conjunction with the Labor Day holiday demand for additional currency. Some minimum amount of reserves would have to be put into the market by the System over the next two months in any case. More generous purchases at this time would help avoid the feeling that developed among some of the Treasury staff at the time of the recent financing that the System had not supported it adequately and had been responsible for a failure. Chairman Martin added that, by and large, the misinterpretations the market had put on the System's actions were getting less and less, but that with the large Treasury financing coming up and the impossibility of forecasting accurately the needs for reserve funds, he felt it would be wiser to be on the generous side in the immediate future in making reserves available and at the same time to continue precisely the general policy set out by the Committee.

8/29/52

-12-

Messrs. Sproul, Bryan, and Evans felt that it would not be desirable to lessen restraint on credit expansion any more than seemed absolutely necessary and that it would be preferable to delay putting funds into the market until they clearly were needed in order to prevent undue tightening. Mr. Sproul said that he felt any program such as the one we have adopted is going to result in some further tightening of the market and some further rise in interest rates during the fall, that it was just a question whether it would be a substantial rise or a modest rise, and that he felt there was a danger in the System's entering the market specifically to condition it for the Treasury's October 1 financing since, if that were done, there would be considerable further tightening of the market just after the October 1 financing was completed which would also be subject to misinterpretation. This led him to the conclusion that in managing the System account, the market forces should be observed from day to day, letting the market lead the way rather than having the System attempt to lead the market by its operations. The other alternative was to try to decide in advance what the committee thought the interest rate should be and to try to hold the rate at that level. With respect to the feeling that the recent Treasury financing had been a failure because the System did not put enough funds into the market, Mr. Sproul said the System had put in enough from the standpoint of credit policy but not enough to make the issue go well. He did not feel the offering had failed though it had not come up to Treasury expectations and the attrition was larger than when the Federal Reserve guaranteed the premium.

8/29/52

-13-

At the conclusion of the discussion, it was agreed that in continuing the present general policy of neutrality, which would mean restraint on undue credit expansion, the management of the account should consider whether it was preferable to supply additional reserve funds promptly in order to avoid some further tightening of money market conditions prior to announcement of the forthcoming Treasury financing with the thought that any purchases made during this period would be simply a part of total purchases which might be made during the next two months; or whether a smaller total volume of reserves would have to be put into the market in the next two months if System purchases were held to a minimum between now and the time the Treasury financing was announced. There was agreement with the view expressed by Chairman Martin that at this time, at least, the executive committee should not adopt a more specific guide for operations in the System open market account than the foregoing.

The discussion also included consideration of what if anything should be said to the Secretary of the Treasury prior to announcement of the October 1 financing, Chairman Martin expressing the view that it would not be desirable to make any innovations at this stage in the general procedure that had been followed recently.

Mr. Sproul felt that it might be desirable to review with the Secretary of the Treasury the general credit policy of the Open Market Committee so that he would have a basis for making a judgment as to how generous the coupon should be on Treasury securities to be issued for the October

8/29/52

-14-

1 refinancing. This could include, he said, the suggestion that the Secretary of the Treasury would have to determine in his pricing of whatever refunding issue was decided upon the premium that the Secretary would like to see the new issue command, and that he should not look to the Federal Reserve to assure a premium on the issue through open market operations. None of the members of the committee indicated any objection to the Chairman discussing the matter with the Secretary of the Treasury along the lines suggested.

Mr. Sproul stated that no change in the general direction to be issued to the Federal Reserve Bank of New York was needed at this time.

Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the executive committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account, either in the open market or directly from, to, or with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than \$1 billion exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(2) To purchase direct from the Treasury for the System open market account 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

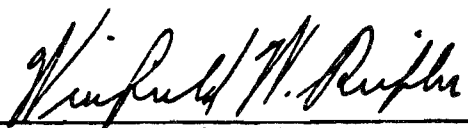
8/29/52

-15-

total amount of such certificates held in the account at any one time (including purchases made in connection with week-end transactions under the special authorization of the Federal Open Market Committee dated June 19, 1952) shall not exceed \$1 billion.

In taking this action it was understood that the limitations contained in the direction include commitments for purchases and sales of securities for the System account.

Thereupon, the meeting adjourned.


Secretary