A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, January 6, 1953, at 10:35 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Hugh Leach
Mr. Mills, Alternate
Mr. Vardaman

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Ralph A. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Willis, Assistant Secretary, Federal Reserve Bank of New York
Mr. Daane, Assistant Vice President, Federal Reserve Bank of Richmond

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee held in Washington on December 23, 1952 were approved.

Before this meeting there was sent to the members of the committee a report of open market operations covering the period December 23 to December 31, 1952, inclusive. At this meeting Mr. Rouse commented briefly upon a supplemental report covering the period from December 31, 1952 to January 5, 1953, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period December 23, 1952 to January 5, 1953, inclusive, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Ralph Young commented on a memorandum on economic and credit developments and outlook, dated January 5, 1953, copies of which were distributed before this meeting. Mr. Young stated that the situation is one of high level activity and continuing boom pretty much throughout the economy. Output in military and production-goods lines has been leveling off recently but production of nondurable and of consumer durable goods has expanded very sharply. Retail trade during December was slightly higher than a year ago and there is some indication that inventories were reduced. At any rate, the indications of inventory accumulation reported at the meeting on December 8 and earlier have disappeared. Wholesale prices have been steady with some indication of strength in basic commodities. Demand for bank credit continues strong. While there may be some decline in demand from food processing and commodity lines, consumer credit appears to be holding up in volume and even increasing rather than showing the usual seasonal contraction, and real estate credit is continuing to expand. All in all, Mr. Young felt that the demand for bank credit during the next few months would continue to be firm and unless there is some stronger restrictive action than presently exists, he anticipated less than the usual seasonal contraction of credit in the first part of 1953.

Mr. Thomas commented on total expansion of the active elements in the money supply in 1952, stating that, on the basis of preliminary estimates, total bank credit increased by a larger amount than in 1951 and that the growth in the latter part of the year was considerably greater than had earlier been projected as a moderate seasonal demand. The total of privately owned demand deposits and currency increased approximately $4.7 billion during the year, compared with an increase of $6.9 billion during 1951. The increase of about 4 per cent during 1952, while less than the increase in 1951, was still a large figure, Mr. Thomas noted, considering the over-all liquidity position of the economy and considering the very optimistic tone of business psychology which has developed in recent months. He added that, in view of the rapid increase in the latter part of 1952, there should be a proportionately large decline in volume of credit during the first half of 1953, if there was to be a stable situation. This would call for a continuation of restraint on credit extensions.

Chairman Martin noted that Mr. Young's comments suggested the likelihood of less than seasonal contraction in bank credit this spring and called upon Mr. Sproul for his views.

Mr. Sproul stated that he agreed with the general analysis of the situation but that he did not think the committee should be overwhelmed by evidences of increased use of bank credit or of expansion in business, production, and income, if the expansion was not accompanied by evidence of speculative activity and of price maladjustment which would indicate the development of an unstable situation. He felt that, if the situation seemed to be sound and healthy and indicated an expanding economy without the development of unstable conditions, the committee would be in an untenable position if it took restrictive action because business or bank credit increased more than had been expected.

Mr. Leach stated that he felt about the same as Mr. Sproul and that he was also inclined to agree with the outlook presented by Mr. Young. Mr. Leach noted that about two-thirds of the banks that had been borrowing from the Federal Reserve Bank of Richmond prior to repayment of discounts for the year-end statements were back in this week for about two-thirds of the amounts they had been borrowing beforehand. He also said that one bank which wished to obtain funds for the purpose of making a profit because of the differential in interest rates had been turned down. Mr. Leach commented that, while he would be happy with a discount rate more in line with the market, he did not feel that it would be consistent, if the rate was to be used as an instrument of credit policy, to change it just for the sake of bringing it into better adjustment with market rates.

Chairman Martin suggested that there be a discussion of the discount rate. He added that the committee now had the projections of the spring business outlook, inventory situation, and credit demand before it, and while it was always difficult to be certain that precisely the right moment had arrived for a change in the rate, it was clearly necessary at this time to make an evaluation of the outlook to determine whether on the whole a change in the discount rate would help promote greater stability.

In response to a question from Mr. Leach, Mr. Young stated that while he had indicated at the meeting of the executive committee late in November that there appeared to be some inventory accumulation, he had also brought out that such increases appeared to be in anticipation of a higher volume of sales and therefore were of a different character than if inventories were increasing as a result of a slowing down in business and an easing of market prices. Mr. Young noted that press and other non-statistical reports were very optimistic with respect to buying at the present time and that this sort of outlook, combined with the high level of sales and the decreases in inventories during December, might be an incentive to overestimate inventory requirements during the next few weeks.

Mr. Riefler expressed the view that at this stage of consumer buying consumers are taking goods out of shops more rapidly than new supplies are coming in; thus, even though retailers had tried to increase inventories recently, they had not actually done so. Mr. Riefler felt that the situation needed to be watched very closely, perhaps even more so because the indicated increase in inventories during December had not taken place and might therefore give a false assurance.

Chairman Martin stated that in his discussions during the past week or two he had gotten the impression that some danger signs of speculation were appearing, not the least of which was activity in the stock market itself. There was a tendency for people to think that the economy was going into a protracted boom and while he was not against booms, he felt the present situation was something that needed to be watched carefully with a view to judging whether it was sound. The problem the committee had been struggling with in its discussions of the discount rate, Chairman Martin noted, was that of finding the right time for making a change. His own thinking, he said, had reached the point of doubting whether the "stand-pat" position was the correct one.

In response to a question from Mr. Evans, Mr. Sproul stated that if there were reasonably clear evidence that the economy had reached a level that could not be sustained, or that there was in process of development a boomlet on top of a boom, he would favor trying to prevent such a boomlet from developing. Continuing, Mr. Sproul made a statement substantially as follows:

> General or nonstatistical evidence of a revival of boom psychology in business is growing, and is supported to some extent by the statistics for November and December. On the other hand, in the critical area of prices there is little confirmation and some denial of the claim that inflationary forces are again in the ascendant. Some warning other than "boom psychology" is contained, perhaps, in figures of consumer spending and consumer credit, mortgage credit, and in the fragmentary figures of inventories which are available.
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> a. Consumer spending during 1952 appears to have increased faster than consumer income, and was stimulated by a large increase in consumer loans, including instalment credit.

b. Investment in inventories has expanded since mid-year 1952, but whether in excess of need to enlarge depleted stocks at retail and wholesale and meet current demands is still unclear. Retail stocks appear to have been reduced by late fall and Christmas business.

c. Bank credit, except for consumer credit and perhaps mortgage credit, has not moved out of line with a balanced situation, although the amount, timing, and placing have varied from expectations or "seasonal" estimates.

d. Most other segments of the economy indicate precarious balance or stability; a balance or stability which probably must always be precarious at high levels of production, employment, and income.

If present estimates of the Treasury cash deficit prove out and if attrition on February refunding is about 10 per cent of holdings outside the System, the Treasury will not have to go to the market for new money until May, at which time it might have to borrow about $2 billion to provide cash until June taxes come in--assuming all of the tax anticipation bills will be paid when due. A change in the discount rate would most appropriately precede the announcement of the February financing or come after the March 15 period of stresses in the money market, but it might be made shortly after the February financing was completed if the economic situation made it urgent. Money market rates definitely moved away from the discount rate during the peak of seasonal and year-end credit demands, getting up around 2 1/4 per cent. They have since moved back to around the 2 per cent rate, but the outlook for continued tightness in the money market during January suggests that they will not go back to the discount rate range—say 1.65 to 1.90. The return flow of currency and a possible decline in loans may be largely offset by a decline in float and further gold losses. Banks are still borrowing heavily and dealers have repurchase positions to work off.

The present hardening of rates, if more than a temporary year-end phenomenon, is due to our policy of neutrality becoming a policy of modest restraint in the face of continuing substantial demands for private credit, and Treasury deficit financing. If during the next week or two the movement of currency, loans, rates, bank borrowing, etc., conforms to present estimates, the implication would be that the discount rate should be brought into line with open market policy by an increase of 1/4 per cent to 2 per cent. A larger increase would be interpreted as meaning that the System saw serious inflationary risks ahead, and would be unwise and unwarranted.

I would say the situation is not one of clear and present danger. It is not a situation, I should say, where the Board of Governors would want to use its power to review and determine in order to force an upward rate change on a Reserve Bank board of directors, even though it might fail to approve such a change if presented. We do not want to overplay the idea of more flexibility in the use of the discount rate or a return to orthodox central banking. We can't disregard the changes created in our environment by the national debt. One important reason for the effectiveness of increases in the discount rate in earlier days was the understanding that, if necessary, it could be raised and go on being raised until it had the desired effect. In these circumstances a small increase was a signal which usually was enough but large increases were not uncommon. Small increases may still be enough for a different reason, but we should not deceive ourselves into thinking we have that much freedom with respect to the discount rate, even though we are no longer supporting fixed prices and yields in the Government securities market. And as I have said before, we do not want to let the itch to be doing something get under our skin.

If we wait for the clear and present danger, however, we might be "too late". I think we should continue our open market policy of neutrality which is now restraint, and on the general theory that it couldn't do much harm and might do some good, I'd be willing, if present tendencies continue, to recommend to my directors on January 15 that they increase our discount rate to 2 per cent subject to the Board's approval.

Chairman Martin stated that Mr. Sproul had presented a very interesting analysis. While he felt the psychological point had been well covered, Chairman Martin emphasized that it was one which could not be discounted in an operation such as the Open Market Committee was carrying on. He noted that Mr. Rouse in connection with his report of open market operations had suggested that the System account, in bidding for bills next week, might place its bids so as to avoid taking any of the new issue with the thought that it would acquire an equivalent amount of short-term bills in the open market. Chairman Martin questioned whether, if it were contemplated that the discount rate might be increased in the near future, it would be desirable for the System account to avoid acquiring the new bills and to acquire short-term bills, since it might be better in the interest of a smooth adjustment for the dealers to hold short-term bills rather than long-term bills when the discount action is taken.

There was a discussion of this suggestion during which Mr. Sproul expressed doubt as to whether the System would wish to allow its entire holdings of bills maturing next week to run off. (These holdings now total $170 million.)

Chairman Martin commented that the discussion had served a purpose as indicating to Mr. Rouse points that might be considered in connection with the bidding for Treasury bills to be offered next week.

Mr. Mills reverted to the discussion of the discount rate expressing the view that if a contraction in credit was desired later in the spring, it seemed likely that an increase in the discount rate of more than 1/4 of 1 per cent would be needed, that in fact it might be desirable to have an increase which would be an indication to the market of informed judgment by the committee on the situation and outlook.

Mr. Sproul felt that an increase of 1/4 per cent would, in addition to aligning the discount rate with the market, be an indication of the committee's opinion that some further restraint was necessary and desirable; an increase of that amount would not, however, be a signal that the committee saw such a clear and overwhelming evidence of inflationary developments that it considered it necessary to shock the market or to "hit it with a club". In Mr. Sproul's opinion, the committee did not now have that kind of evidence nor was it sure that such a situation would develop. However, he felt that if developments during the spring indicated a need for further action the Reserve System would not be prohibited from further increases in the discount rate or changes in open market policy.

Mr. Vardaman stated that he felt now as in November that the committee should give serious consideration to an immediate increase of 1/4 of 1 per cent in the discount rate. He stated the view that such an increase would have a tremendous psychological effect in addition to bringing the rate into better adjustment with the market, and it was his opinion that the sooner such an increase could be made effective the better.

Mr. Leach stated that if an increase of 1/4 of 1 per cent in the discount rate would have a tremendous psychological effect, that would be a reason for not making such an increase at this time, since he did not see clearly a reason for taking an action which would have such a marked effect. It was his belief, however, that an increase of 1/4 of 1 per cent would not have much psychological effect although it would bring the rate into better adjustment with the market.

Mr. Vardaman stated that on further thought he did not believe an increase of 1/4 of 1 per cent would have a tremendous psychological effect, but he did feel that the effect of a change in the discount rate at this time would be greater than would be the case if the rate had been used flexibly during the past two and one-half years.

Mr. Daane commented in response to a question from the Chairman that he was inclined to think there would be considerable liquidation of bank loans during the next few weeks.

Mr. Youngdahl said that, as indicated at the meeting on November 25, he still felt that an increase in the discount rate would be desirable.

In response to a question from Mr. Robertson, Mr. Sproul stated that there was considerable feeling in the money market in December that the discount rate would be increased, that that feeling had disappeared toward the end of the month, but that in the present situation if market rates remained around present levels it could be expected that there again would develop a feeling that the discount rate would be brought into line with the market. Mr. Sproul also said, in response to a question from Mr. Riefler, that dealers in Government securities were making efforts to reduce their positions in Treasury bills by selling to nonbank investors, and that he felt it would be desirable to give them another week or ten days to clear up their position before taking action on the discount rate.

Mr. Vardaman stated that he had not taken this factor into consideration in urging immediate action on the discount rate, that he felt the rate should be increased as quickly as it could be done and still be fair to the dealers.

Chairman Martin then suggested that the instructions to the New York Bank be renewed and in response to a question, Mr. Rouse stated that no change in the limits contained in the general direction appeared to be necessary at this time.

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

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to 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 System account (including commitments for the purchase or sale of securities for the account) at the close of this date shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from

time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $1 billion.

Chairman Martin then referred to a memorandum from Mr. Riefler dated January 5, 1953 transmitting a memorandum from the staff entitled "A Program for Debt Refunding", copies of which had been sent to the members of the committee before this meeting as a basis for discussion of the subject. Chairman Martin stated that the suggestions contained in the memorandum were not prepared from the standpoint of the Treasury but were rather representative of a Federal Reserve approach to the problem of debt management. At the Chairman's request, Mr. Riefler summarized the memorandum, stating that it did not deal with all aspects of the problem of debt management but that it was prepared with the thought of stimulating debate, criticism, and suggestion on (1) the kind of structure the Open Market Committee would like for the Federal debt and (2) the means by which such a structure might be achieved. Mr. Riefler then reviewed the memorandum, outlining specifically that portion which dealt with principles of debt management which have special importance from the standpoint of the responsibilities of the Federal Reserve System. These principles as set out in the memorandum and as presented by Mr. Riefler were as follows:

"1. The maturity distribution of the debt, other than bills, should be such that moderate changes in the level of interest rates will be reflected in changes in the liquidity positions of lenders and other investors; that is, enough of the debt must be spread out over the intermediate and long-term maturities so that holders would be effectively locked in when interest rates rise and be given an inducement to sell when interest rates decline.

"2. The number of issues maturing in any year, other than bills, should be small in order that monetary and credit policy may not be hampered by frequent refunding requirements of the Treasury.

"3. There should be an adequate volume of short-term securities to meet the basic liquidity requirements of banks, financial institutions, corporations, and others without giving excess liquidity.

"4. The short-term instruments should be in such form that they are most readily assimilated and traded in the market. In the refunding operations over the next several years, it would be desirable that increased reliance be placed on discount obligations which do not involve pricing problems or problems of support in their refunding. Arrangements should be made for the Federal Reserve to shift the composition of its holdings; short-term coupon obligations, particularly certificates, should be shifted into bills."

Mr. Riefler noted that the memorandum did not cover extensively the principles of debt management from the standpoint of the Treasury, although it noted that from the standpoint of the Federal Reserve it was not of great importance whether a long-term bond had a maturity of 20, 30, or 40 years. Mr. Riefler also stated in response to a question from Mr. Sproul that the general principles suggested in the memorandum could be applied flexibly as economic conditions changed from year to year and that the program outlined did not contemplate a fixed program which would be carried out on a schedule without regard to whether recession in economic activity developed.

There was a brief discussion of the subject during which Chairman Martin suggested that copies of the memorandum be furnished to all members of the Federal Open Market Committee as a basis for further discussion, and it was understood that this procedure would be followed. He also felt that discussion of this subject would be a valuable adjunct to the discussion of the report of the ad hoc committee on operations of the Federal Open Market Committee during the next few weeks.

It was agreed that the next meeting of the executive committee would be held at 10:30 a.m. on Tuesday, January 27, 1953.

Mr. Sproul suggested that in order to permit the members of the committee to have the benefit of the economic review prepared by the Board's staff, arrangements be made to have such future memoranda distributed in time to reach each committee member at least one day in advance of the meetings of the executive committee. It was agreed that this procedure would be followed.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary