A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System on Tuesday, September 8, 1953, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Erickson
Mr. Evans
Mr. Mills

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

Mr. Riefler, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Young, Associate Economist
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee of the Federal Open Market Committee held on August 25, 1953 were approved.

Before this meeting there had been sent to the members of the committee a report prepared at the Federal Reserve Bank of New York covering operations in the System Open Market Account from August 25 to September 3, 1953, inclusive. At this meeting, Mr. Sproul presented a supplementary report covering commitments on September 4, 1953, and commented briefly on operations since the last meeting of the executive committee. 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 August 25 to September 4, 1953, inclusive, were approved, ratified, and confirmed.

Mr. Young reviewed economic and financial conditions, stating that economic activity generally is being maintained at the advanced levels reached in the spring. Notwithstanding the strength shown in measures of output, employment, incomes, and profits and the continued high levels of demand, Mr. Young noted that business sentiment as reflected in the press and in recent declines in stock market prices appears cautious and somewhat uneasy. Basically, he said, these misgivings reflect inability to see the emergence in the near-term of important new expansive factors at a time when production continues to outpace final takings and when there are indications of reductions in demand in some important sectors. A copy of a memorandum prepared by the staff under date of September 3, 1953 to which Mr. Young referred in his comments has been sent to each member of the committee.

Mr. Thomas stated that credit growth has been negligible in the past month. The types of loans which usually increase at this season of the year have expanded a little less than usual in some cases, but in the case of public utilities, borrowings have increased whereas a year ago they were declining and loans to finance companies and to metal industries declined less than in the same period last year. Demand deposits and currency have shown no more than the usual seasonal increase since March and are now only about 2 per cent above a year ago. On the whole, Mr. Thomas felt that there were no particularly significant developments in the bank credit demand which need cause alarm at the time. Mr. Thomas stated that there was an indication that the Federal Reserve might be called upon to supply something like $1-1/2 billion of additional reserves during the remainder of this year, the amount to be approximately evenly distributed among the remaining months. Such an increase would be somewhat less than previously projected, Mr. Thomas said, reflecting the probable greater reduction in the Treasury balance and somewhat smaller Treasury borrowings as a result of the retention of the $275 billion debt limitation. Mr. Thomas felt that there was a question whether private credit demands would be adequate to require an increase of as much as $1-1/2 billion in Reserve Bank credit. Thus, it might not be necessary for the System to buy securities in the amount indicated and the System could follow a relatively easy credit policy without danger of overexpansion of credit in view of the moderate demands in prospect.

Mr. Sproul commented on the discussion at the last meeting of the executive committee and on the decision at that time that operations should be conducted to meet seasonal needs of banks for reserves and that if errors were made, as might be the case in view of the wide variations between estimated changes and actual changes in the several factors affecting reserves, those errors should be on the side of ease rather than restraint. Mr. Sproul went on to say that whereas previously it could be said that inflationary and deflationary forces were evenly balanced, now the forces of stability and deflation seemed to be evenly balanced. The principal underlying cause of the change is the failure of aggregate demand to expand in line with steadily increasing capacity to produce final goods. Mr. Sproul referred to a canvass of New York banks which indicated that the estimated increase in fall demand for bank credit this year would be less than last year, maybe 90 per cent of last year's demand. Two of the influences mentioned were that demand for working capital to support expanded productive capacity would be less and growth in consumer credit would be smaller. The regular seasonal business credit expansion could be expected to be about normal.

Mr. Sproul noted that the psychology of banks has changed and that there is not the feeling of credit restraint that existed last year. The banks now feel that the limit on credit expansion will be in the demand and not in the supply. As to reserves that will be needed, he estimated that during the last four months of 1953 banks would lose about $800 million of reserves due to regular market factors, and required reserves would increase about $500 million. The additional reserves needed would be from $1-1/4 to $1-1/2 billion, mostly in October and November and at the year-end. During the rest of September, a small additional amount of reserves might be needed and in October there might be a need for around $500 million reflecting an increase in required reserves due to Treasury cash borrowing.

Mr. Sproul suggested that in view of the economic outlook, it was desirable to provide banks with needed reserves and for the System to make errors on the side of ease. He referred specifically to Treasury estimates of receipts and expenditures stating that if those estimates reflected aspirations as well as expectations, the Treasury would probably have to use the approximately $1 billion of "free gold" to avoid reaching or breaching the debt limit. That would affect the amount of reserves the System might have to provide and Mr. Sproul suggested that a program should be worked out with the Treasury promptly whereby it would either (a) sell gold to the Federal Reserve on some regular schedule, say $500 million by weeks in October and $500 million by weeks in November, thus reducing the need for the System to put reserves into the market by roughly the same amount; or (b) redeeming System holdings of Treasury securities. If the latter were done, he noted, an additional $170 million, or thereabouts, of reserves would then be needed to support deposits arising from bank absorption of new Treasury securities. Mr. Sproul felt that open market purchases, repurchase agreements, and discounts should take care of the situation in either case, and he added that if the Treasury does not sell gold to the Federal Reserve there might be a case for another reduction in reserve requirements although his own view was that a "one shot" operation would not be as suitable as it was in July, since the need for reserves is spread out this time and psychologically another reduction in requirements might have a bad effect. He felt that open market purchases presently could fluctuate around a higher level than in recent weeks, somewhat anticipating the October needs for reserves, with the thought that less would be put in by the System account when other factors were putting in funds while purchases would be increased when other factors were taking reserves out of the market. During the current statement week, he observed, the System account had stayed out of the market except for repurchase agreements even though estimates showed some loss of funds; individual situations had been met by repurchases and discounts.

Mr. Mills stated that he subscribed thoroughly to the point of view indicated in Mr. Sproul's remarks that it would be desirable to introduce reserves liberally into the market on an ascending scale. He then made a statement substantially as follows:

> Current developments would seem to bolster further the arguments in favor of weighting open market policy on the side of relative ease by actions taken in advance of positive and irrefutable evidence that the provision of additional reserves are necessary to the maintenance of a stable economy. Three factors bearing upon monetary and credit policy require particular examination:
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> 1. The prospective seasonal demand for bank credit.
> 2. The status of the money supply.
> 3. The status of the long-term capital market.
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> 1. It is declared open market policy that the banking system will be supplied sufficient reserves on which to build the seasonal expansion of loans. The present high level of bank loans, and the apparent desire of banks to improve their liquidity through the retention or purchase of short-term U. S. Government securities, should act together as a brake against any possibility that the availability of new reserves will induce an unwise expansion of bank credit. Therefore, it should not be necessary to be seriously concerned over what will be the effects of a relatively easy money policy.
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> 2. The status of the money supply as related to the gross national product deserves careful study in the light of the possibility that growth in the money supply requires stimulation in order to preserve its appropriate relationship to the gross national product. Adequate bank reserves afford the obvious motive force for such a stimulation.
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> 3. There are increasing reports of heavy long-term capital financing in prospect for the last quarter of 1953. Public utility

and municipal works financing dominate the field. It is the writer's impression that current public utility financing is largely confined to providing transmission facilities and not generating facilities. Municipal works financing is importantly centered on toll road construction. Both of these financing objectives are conducive to the end-use of industrial products and not to the construction of primary productive capacity. As that is the case, where monetary and credit policy can reasonably foster long-term financing of these types, it is encouraging expansion in the outlets for such important industries as household appliances, steel and cement. Study might well be given to confirm the surmise that industry has largely completed the construction of new plant capacity. If that is the case, a monetary and credit policy leaning toward ease will assist in broadening the markets for existing industrial plant and will not bring unwanted capacity into production. This assistance should take the form of providing adequate reserves to permit commercial banks to finance the early stages of the outlays on capital projects in prospect until they can be brought to the point of refinancing by direct security offerings. At that juncture the banks will have served as primary credit sources pending the secondary distribution of the securities created in this process to permanent investors. Adequate reserves will be necessary to provide for this essentially self-liquidating financing cycle.

In the process of adapting monetary and credit policy to the initial needs of the longer term capital market, easier money market conditions can be expected to reflect themselves in a widening of the spread between short and long-term rates, with the short-term rate falling away from a relatively stationary long-term rate. The pressure of heavy offerings of long-term securities should presumably hold long-term rates at their present levels even though short-term rates fall slightly. If this situation is not realized, it will indicate too tight a money policy as evidenced by an increase of long-term rates and the postponement of some justifiable financing. Based on the experience of this spring, monetary policy should be aimed at preventing the type of cramped long-term money market that then occurred.

As above indicated, the best test of a monetary and credit policy that will facilitate justifiable capital market expansion in the manner outlined may well be the natural forming of a structure of interest rates witnessing slightly lower short-term and stationary long-term rates. Such a balance between long-term and short-term rates should continue to find Federal Reserve policy in firm control of the money market situation.

Chairman Martin stated that he had been impressed in reading the minutes of the meeting of the executive committee held on August 25 and by the comments of Messrs. Sproul and Mills at this meeting that there was an opportunity for the Federal Reserve to be a leader rather than a follower in the money market at this particular time. He felt that there were periods when it was wise for the System to follow rather than to lead but that to the degree the System now could provide leadership, it presented a real opportunity. His view was that by acquiring a steady lead in providing reserves in the market the System might have an important influence in easing what might otherwise become a very difficult situation.

Mr. Evans agreed that the System should be taking the lead at this time. He felt that such leadership should be in terms which would be widely understood and he suggested that an excellent way to accomplish this would be to reduce reserve requirements so as to have a direct and immediate effect on banks in outlying centers. Mr. Evans also expressed the view that it would be desirable, for reasons which he stated, to have in mind the possibility of reducing the System's portfolio when there was an opportunity to do so. A reduction in reserve requirements would make it possible to reduce the System portfolio at the same time the System was maintaining ease in the market, and this was an additional reason for studying the desirability of such a reduction later this year.

Mr. Erickson said that he subscribed to the general comments of Mr. Mills and Chairman Martin, that he did not feel at the moment that it would be desirable to reduce reserve requirements, that he would prefer the use of repurchase agreements and discounts along with some direct purchases of securities for the System account as a means of putting reserves into the market. He felt that the System should continue the policy of erring on the side of ease rather than restraint, of being early rather than late in its actions. It was Mr. Erickson's view that a reduction in reserve requirements at this time might increase uneasiness on the part of banks rather than allay their concern as to supplies of reserves.

Chairman Martin said that the System always had a difficult problem in the matter of dramatics in its actions, that he felt the reduction in reserve requirements which became effective in July worked out very well because a situation had been created which made it a natural time for such action. On the other hand, changes in reserve requirements could result in unsettling the situation and while he agreed with Mr. Evans to the extent that the reduction in July had been well received by country banks, he doubted whether a similar situation existed at the moment.

Mr. Evans felt that the country banks, faced at the moment with heavy demands from merchants, farmers, and others, would be very receptive to a reduction in reserve requirements, that it was a slow process to have reserves filter down from the money market to the outlying banks, and that a reduction in reserve requirements would be generally reassuring to the banks in looking ahead to future demands for credit. He also felt it would be reassuring to businessmen, many of whom currently hold the view that business levels are turning down.

Mr. Robertson said that he was largely in agreement with the general tenor of the discussion, that he thought the System should offset any restraining factors and should lean on the side of ease rather than tightness. He would oppose an introduction of reserves which would create sloppiness in the market, however, and at the present time he would not be in favor of a reduction in reserve requirements. On the latter point, he felt it desirable for the System to attempt to get a more satisfactory system of reserve requirements which would call for legislation, but this was a separate question from a change in reserve requirements at this time for the purpose of easing the position of member banks.

Mr. Szymczak agreed that it was desirable to place additional reserves in the market. While he would much prefer that the System portfolio be smaller than it is at present, he did not feel that a reduction in reserve requirements should be made at this time.

Mr. Robertson said he felt it would be desirable to take steps to carry out Mr. Sproul's suggestion regarding discussions with the Treasury of the possible use of its gold, and Chairman Martin responded that while he felt it would be desirable to find out as quickly as possible what the Treasury had in mind, he was under the impression that Treasury officials had not yet reached a decision. He indicated that he would, however, keep in touch with them concerning this matter.

Mr. Riefler said that developments in the last two weeks had resolved any doubts he had had as to whether the System should be shifting to a policy of "active ease". He noted that the System had maintained technical ease in the money market from late June or early July, that there were no signs that banks had expanded credit unduly on the basis of reserves available, that in fact quite the opposite was happening as was indicated by the sluggish demands for credit, and that on the whole there did not seem to be expansive factors present in the economy at this time. Mr. Riefler felt that the System should be trying to build factors which would offset any down-turn in the economy or in Federal Government expenditures. In his judgment, it would be desirable to pursue a policy of active ease by putting reserves liberally into the market; specifically, he would like to see the short-term money market made easier than it has been so long as the expansion in bank credit remain^ as sluggish as it is.

Mr. Gaines stated that in recent discussions with representatives of New York banks it was clear that they had the feeling that Federal Reserve policy has shifted to one of ease, that they were not contemplating any difficulty in obtaining funds to meet loan requirements later this year. Some of this had spread outside New York, he said, and there was considerable feeling that correspondent banks would be able to handle any loan needs that might arise during the latter part of the year. The sentiment of banks, he said, was that the economy is now in a position of stability; there was no indication that banks were fearful of recession immediately, and they expected a normal demand for credit during the fall months of this year.

Chairman Martin stated that in view of the indicated agreement among the members of the committee as to the program that should be followed, he would suggest that the instructions to the Federal Reserve Bank of New York be renewed along the same lines as the instruction given at the meeting of the executive committee on August 25, with emphasis on a program of "active ease".

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

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to avoiding deflationary tendencies without encouraging a renewal of inflationary developments, and (c) to the practical administration of the account; provided that the total amount of securities in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date shall not be increased or decreased by more than $500 million;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amount of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

It was agreed that the next meeting of the executive committee would be held on September 24, 1953, at the time the full Committee would meet in Washington.

Thereupon the meeting adjourned.

Winfield W. Riefler

Secretary