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 19, 1954, at 10:45 a.m.

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

Mr. Robertson, Member of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Mr. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee of the Federal Open Market Committee held on December 15, 1953, and January 5, 1954, were approved.

Reference was made to the action taken on January 8, 1954 by the members of the executive committee who were present at the meeting of the committee on January 5, 1954 in modifying the understanding at that meeting with respect to replacement of bills maturing during the week commencing January 11, 1954.

At the meeting on January 5, 1954, the committee had agreed that in pursuit of the general policy of actively maintaining a condition of ease in the money market, it would look toward rolling over its holdings of bills maturing during the week beginning January 11 and that, with respect to bills maturing during the week commencing January 18, the manager of the System account would consider what procedure should be followed in the light of the projections for changes in the supply of reserve funds, but with the assumption that some of the bills maturing that week probably would be permitted to run off.

On the basis of additional information relating to the prospective supply of funds in the market during the week commencing January 11, 1954, the members of the committee who were present at the meeting on January 5 agreed on January 8 (Messrs. Erickson and Johns by telephone) that it would be desirable to permit at least part of System holdings of bills maturing January 14, 1954 to run off. In accordance with this decision, the Secretary advised the Federal Reserve Bank of New York on January 8, 1954 that the understanding reached at the meeting on January 5 as stated above had been modified to provide that "in pursuit of the general policy of actively maintaining a condition of ease in the money market, the manager of the System account consider the projections for changes in the supply of reserve funds during the week commencing January 11, 1954 as well as the week commencing January 18, 1954 with the assumption that at least part of the bills maturing during each of those weeks would be permitted to run off. It would also be understood that the manager of the account would have authority to sell or buy bills in either week if in his judgment such action was necessary in pursuit of the general policy of actively maintaining a condition of ease in the money market.

> Upon motion duly made and seconded, and by unanimous vote, the action of the members of the executive committee on January 8, 1954, as stated above was ratified and confirmed.

Before this meeting there had been sent to the members of the committee a report prepared at the Federal Reserve Bank of New York covering open market operations for the period from January 5 to January 14, 1954, inclusive. At this meeting there was distributed a supplementary report covering commitments executed January 15 to January 18, 1954, inclusive. Mr. Rouse commented briefly on the reports, copies of which have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, transactions in the System account during the period January 5 to January 18, 1954, inclusive, were approved, ratified, and confirmed.

Mr. Young made a statement with respect to recent economic and financial developments, noting that despite recent declines in output and employment, the level of activity remained high. In both commodity markets and the stock market, prices have continued relatively stable. This stability of prices in the face of sizable cuts in production is unusual, he said, and suggests that both consumers and business are relatively confident about the strength of underlying conditions. A memorandum regarding the economic situation was sent to members of the committee under date of January 15, 1954, and a copy has been placed in the files of the Federal Open Market Committee.

Mr. Thomas stated that figures for bank lending showed substantial liquidation of credit during the first two weeks of January, the decrease totaling nearly a billion dollars. The main decline was in commercial loans which were down about a half billion--over twice as much as in the same period a year ago. Loans on securities also decreased seasonally. Private demand deposits declined somewhat during this period, whereas a year ago they increased. At the same time the return flow of currency, a sharp decline in Treasury balances at the Reserve Banks, and the usually large mid-month float supplied abundant reserves to the market. The net result of these changes was that an extremely easy condition currently was prevailing in the money market with excess reserves running around $1,300 million and member bank borrowings from the Federal Reserve Banks below $100 million. Prospects for coming weeks indicate continued ease even with a seasonal decline in float and a rebuilding of Treasury balances during the latter part of this month. The System might wish to consider absorbing some of the extremely large amounts of excess reserves that are likely to be in the market by selling securities, but if such sales are made it may become necessary for the System to put funds back into the market for a few days early in February.

Chairman Martin suggested that there be a discussion of open market operations having in mind the situation described by Messrs. Young and Thomas and the over-all policy of the Federal Open Market Committee of actively maintaining a condition of ease in the money market. Consideration should be given, he suggested, to whether "active ease" had become more than active ease, and whether the System should take action to change the situation.

Mr. Sproul then made a statement substantially as follows, noting that the estimates of the situation prepared at the Federal Reserve Bank of New York were substantially in agreement with those presented by Messrs. Young and Thomas:

1. Gradual readjustment of the economy from the "overtime" basis of 1952 and early 1953 appears to be continuing, but the economy also continues to operate at high levels, and with recent improvement in the general inventory situation. I gather, however, that there is a growing undercurrent of concern in some quarters that a more serious downward movement may be in the making.

2. This concern, I believe, grows out of the feeling that we are now going to be called upon to make the readjustments implied by a decline in Government spending, and greatly increased productive capacity, without the supporting influence of a large backlog of consumer demand for durable consumer goods and housing, which maintained the economy after the war, and without the fillip of expected shortages, higher prices and renewed Government spending which followed upon hostilities in Korea and the stepped-up defense measures of that period.

3. It appears reasonably clear that such key industries as steel and automobiles are going to operate at somewhat lower levels of output, the volume of new construction is not expected to do more than hold its own, unemployment figures have increased, consumers do not seem to be ready to borrow and buy so many consumer durable goods, and export demand for our products is at least less urgent than it was. Yet, even at reduced levels, output of steel and automobiles is expected to be relatively high, enlargement of present living quarters can fill in behind new residential construction, business investment plans are reported still to be large, and the scope for modernization and replacement of old equipment is still great, state and local construction projects continue to come forward, consumers will be getting some tax relief, retail sales are holding up well, prices of basic materials haven't acted as if a major decline were in the offing, unemployment still appears to be at what is, historically, a low level, and there is still a strong growth factor in the economy.

4. I do not think it is possible yet, therefore, to take either too gloomy or too cheerful a view of the economic outlook. The kind of credit policy this situation calls for is the kind we have been following, with free availability of reserve funds, but without resorting to dramatic actions to try to force increased borrowing or increased investment commitments; to try to do more than can be done by monetary policy alone. Following the less than seasonal expansion of bank credit during the fall, there is a period of seasonal contraction ahead, but it is very hard to judge what the "normal" for this period might be because of extraneous influences such as a decline in borrowing accompanying the expiration of the excess profits tax. I should say that we want to keep reserve funds so readily available, through open market operations, that there will be no reason for contraction of bank credit from the supply side.

5. Specifically, with respect to open market policy I wouldn't try to pinpoint our operations too exactly on assumed figures of bank borrowing, or excess reserves, or free reserves. These are useful guides, but we know how wide of the mark they can be. I think we also know that more important than detailed adherence to some arithmetical formula, is to have the policy consequences of our estimate of the general credit situation clearly understood. And so I wouldn't be concerned if temporarily free reserves went below $400 million or some other figure, nor would I be concerned by larger figures, if we maintain the expectation of ready availability of reserve funds without sloppiness. During the next two statement weeks, when other factors are expected to take substantial amounts of reserve funds out of the market, and even though free reserves will be relatively high in the first of these weeks, I think I would to nothing more than reduce our portfolio by the run-off of maturing bills already arranged, and I think I would increase our portfolio by small purchases in the second week, just to show which side of the street we are working.

Chairman Martin inquired whether there was any feeling that the situation in the money market had gotten too sloppy, and Mr. Sproul responded that perhaps the market had gotten a little sloppy but that he did not feel the committee should try to make 51-49 decisions in supplying reserves to the market. Since the general objective is one of ease, he would not be greatly concerned about the current situation but, at the same time, he would be entirely ready to take off some of the froth. On the other hand, he felt it was desirable for the committee to put some funds into the market from time to time to indicate its continuing policy of ease.

Mr. Erickson stated that he had received many comments to the effect that the market is rather sloppy. He would like to see more flexibility in System operations; if the situation continued as at present, he would favor taking some reserves out of the market and when some tightening was occurring, he would then put them back.

Chairman Martin asked Mr. Rouse to comment on the feasibility of these suggestions, bearing in mind Mr. Sproul's comment that the committee wanted the market to know which side of the street it was working.

Mr. Rouse stated that he felt operations could go part way in taking out peaks of ease but that to go all the way might be impracticable. In his comments, Mr. Rouse spoke of the supply of Treasury bills in the market, noting that at the present time, the System could sell bills very easily but it might find it difficult to buy them back in any substantial volume a little later.

Mr. Mills stated that he concurred with the view that the current policy of active ease should be continued but that there was a question in his mind as to what should determine active ease. He felt that sometime in the relatively near future the System should give consideration to the possibility of reducing reserve requirements and offsetting the release of reserves by sales of securities from the System open market account, provided that could be accomplished without giving a false impression of what the System had in mind in its policy of actively maintaining a condition of ease in the money market. His thinking as to reasons for such a reduction, Mr. Mills said, did not come out of the Committee's policy of active ease but rather arose from the thought that commercial banks could well be offered an opportunity to improve their liquidity ratios. In the course of discussion of this suggestion, Mr. Mills made a statement substantially as follows:

> Historical precedent has found banks reluctant to lend freely when the total of their loans approaches 50 per cent of the total of their deposits. At December 31, 1953, the loans of the largest New York central reserve city banks represented a relatively high percentage of their deposits--41 per cent, in fact. As these banks customarily give leadership in the bank loan field, any hesitation on their part to lend can be an offsetting factor to any open market policy calculated to supply reserves in a quantity intended to stimulate their loan functions and, besides, will have a psychological reaction on the willingness of reserve city banks and country banks to lend. Now that defense spending is being reduced and it is essential that activity in the private sector of the economy pick up the slack, it is seemingly the part of open market policy to encourage bank lending where it can legitimately serve to stimulate the economy. The provision of adequate reserves is, of course, the conventional means to attain this objective of open market policy but the problem is in what quantity and how to make such reserves available.
>
> Since year-end a reduction in New York central reserve city bank loans and deposits has served to reduce their loan to deposit ratios and this trend will presumably continue for some time longer. The improvement in the loan to deposit ratios of these banks and the consequent reduction in their required reserves might be expected theoretically to encourage them to renew their lending activity. However, experience has shown that banks are not inclined to lend aggressively when their deposits are falling, which is understandable when it is considered that the individual bank does not know how far its deposits will fall and to what extent it may have to liquidate assets to meet their reduction, even though collectively all commercial banks, through the avenue of lower required reserves and rising excess reserves, are coming into a stronger lending position.

> Somewhat comparable conditions in more aggravated form confront New York central reserve city banks, whose loans remain at a roughly stationary level but who lose deposits to banks in other sections of the country who, in their turn, are experiencing a liquidation of loans and a reduction in deposits.
>
> A corrective to any lending reluctancy on the part of New York central reserve city banks is for Federal Reserve System policy to offer them an opportunity for strengthening their liquidity. Banks that possess substantial holdings of secondary reserves in the form of Treasury bills and certificates that can be liquidated to meet falling deposits are far less hesitant to employ excess reserves coming into their possession than are the banks not so situated. Furthermore, banks do not regard a high level of excess reserves as a measure of their liquidity as much as they do the adequacy of their holdings of very short-term U. S. Government securities.
>
> A reduction in the required reserves of all classes of banks, accompanied by the sale of short-term securities from the System Open Market Account, suggests itself as the obvious remedy to the dilemma that has been pictured. The timing for any such action would, however, be very important.

Chairman Martin inquired of Mr. Rouse what would be the effect of a reduction in reserve requirements and offsetting sales of securities from the System account, and Mr. Rouse replied that he thought it would be looked upon as an indication of a move toward further ease, regardless of whether securities were supplied from the System account to absorb the reserves that would be made available.

Mr. Sproul then made a statement with respect to a possible reduction in reserve requirements and in the discount rate substantially as follows:

> 1. Reduction in reserve requirements, by itself, is an unnecessary bludgeon, so long as it is quite unclear whether we are in a temporary inventory decline, or a continued rolling

readjustment, or a cyclical downturn. It is all right to lead, and we have been out in front, but we don't want to get so far out in front that we lose touch with the rest of the army, and are exhausted if and when the time comes for a major assault. And, of course, I question whether you can promote capital investment by trying to bring long term rates down by flooding the short term market.

2. Reduction in reserve requirements, plus sales and redemptions of Treasury bills to sop up some reserve funds released by the reduction, would be one of those two-way actions which are more likely to confuse than clarify policy.

3. The reserve situation at present is within the powers and scope of open market operations, and a further sign of the consistent direction of policy can be given by reducing the discount rate, which we shouldn't kill again. It is not necessary to resort to a reduction of reserve requirements now.

4. A reduction in the discount rate would give affirmation to our existing credit policy, without suggesting that we are trying to do more than monetary policy can do, nor than we think it necessary and desirable to do at this time. Despite the movement of the economy to lower levels during the last half of 1953, and the less than seasonal increase in demand for bank credit during that period, the discount rate has been maintained at the level of a year ago when we were still following a restrictive credit policy. The necessary relief, of course, has been given through open market operations, and bank borrowing was never allowed to rise so high as to be a deterrent to credit expansion.

5. We do not want to allow the discount rate to hang "up in the air" too long, however. As soon as the January readjustments in the money market have taken place, and the Treasury's February refunding has been completed (late in January or during first two or three days of February) I think the case for a reduction in the discount rate will become very strong. It would emphasize our intentions with respect to credit policy, in a way which everyone can understand, whether they know anything about open market operations or not, it would give a shove to lower lending rates and might encourage more aggressive lending, and it might give a fillip to business planning and consumer planning at the beginning of the spring season.

There followed a further discussion of Mr. Mills' suggestion for a reduction in reserve requirements for the purpose of improving the liquidity ratios of banks, during which he emphasized the view that he was merely suggesting a study of the question over the next few weeks for the purpose of finding out whether, even if the suggestion was theoretically desirable, it would be practicable to try to carry it out.

Chairman Martin expressed the view that the question whether such an action might be desirable was also dependent on how serious the committee felt the current economic situation to be.

Mr. Sproul stated that in conversations with officers of member banks he gathered that there had been a change in the instructions of bank managements with respect to seeking loans, that some months ago the banks were telling their representatives that they would take care of their regular customers and would ask for larger compensating balances, whereas now the instructions appeared to be that their representatives should go out and get more loans.

Mr. Erickson stated that the same situation appeared to exist in the Boston area. He did not feel that businesses would borrow heavily for payment of taxes in March of this year although there might be considerable borrowing for making payments of taxes in the second quarter of the year. Mr. Erickson agreed with Mr. Sproul that a reduction in the discount rate should precede a reduction in reserve requirements.

Mr. Riefler expressed the view that reserve requirements should be changed as a very long-range proposition and should not be used to effectuate current credit policy moves designed to handle variations in business psychology. On that basis, he felt that reserve requirements were now on the high side and he would welcome an opportunity to lower them. This, however, should be done in a period of business recession.

Chairman Martin stated that he did not think these suggestions could be taken out of context of the period in which the committee was operating. The committee had gone through a period of appraisal of its operations and it recognized that there was a difference between theory and practice. There was also a difference of opinion as to how serious the current situation is. Chairman Martin stated that he had not yet been able to get alarmed about the current situation, that he did not feel the time had yet arrived when the Federal Reserve should use the full strength of its authority to stimulate business recovery.

Chairman Martin also commented that, on the basis of the discussion, it seemed clear that there was no disagreement among the members of the committee as to the desirability of continuing operations with the view to carrying out the policy of actively maintaining a condition of ease in the money market. He then inquired of Mr. Sproul as to the significance of the figure of $400 million of free reserves that had been mentioned from time to time as a guide to open market operations.

Mr. Sproul said that he did not feel the committee should try to pin-point some figure, that he would not be concerned if free reserves were below $400 million or above that figure. He felt it would be entirely in order for the committee to take some reserves out of the market when conditions seemed to indicate that procedure and at other times to put reserves back into the market, so as, as he had said earlier, to show which side of the street the committee was working.

Mr. Rouse said that the committee could do a little more in the market than it had been doing, that instead of buying bills in the week ending February 3, it might make some repurchase agreements with dealers. In order to interest dealers, however, the rate on such agreements might have to be reduced to 1-3/4 per cent, or possibly to 1-1/2 per cent.

Chairman Martin questioned whether a change in the rate on repurchase agreements would be wise, especially if the System were to consider a reduction in the discount rate in the near future.

Mr. Sproul said that he would prefer to make outright purchases during the statement week of February 3 and have any change in the discount rate come along as a separate action, rather than to have it flagged by a reduction in the repurchase rate.

Chairman Martin concurred in this view. He suggested that the committee agree on a continuation of the current program for carrying out the policy of actively maintaining a condition of ease in the money market and that operations be along the lines discussed at this meeting without trying to pin-point any figures of reserves but of generally being on the side of ease. He also suggested that there be further study of Mr. Mills' proposal.

There was unanimous agreement with these suggestions.

Reference was then made to a memorandum with respect to the authority for the Federal Reserve Banks to buy securities directly from the Treasury, distributed to members of the committee under date of January 12, 1954. The memorandum, a copy of which has been placed in the files of the Federal Open Market Committee, noted that under existing provisions of

Section 14b of the Federal Reserve Act, all purchases and sales of Government securities by Federal Reserve Banks must be "only in the open market after June 30, 1954", and it then discussed the question of possible legislative recommendations on the subject.

Chairman Martin stated that since the matter was clearly related to open market operations, he would like to have comments of the members of the committee with respect to what might be desirable in this connection.

Mr. Sproul stated that he had read the memorandum which had been prepared by Mr. Solomon, that he felt the authority had been useful, and that he would favor having it extended on the present basis since that procedure would raise the least question regarding its continuance. In response to a specific question from Chairman Martin, Mr. Sproul said that he did not feel much would be gained by having the present limitation of $5 billion reduced to a lower figure or making any other change in the present provision of the law except possibly to make the authority permanent or to extend it for a number of years, since other changes might bring the provision into controversy.

Mr. Erickson stated that his views were about the same as those expressed by Mr. Sproul except that he would favor a definite time limitation, such as two years, on extension of the authority.

Chairman Martin stated that it was his impression that the Treasury would sponsor a bill for extension of this authority and he inquired whether any of the members of the executive committee felt it would be wiser for the Board of Governors of the Federal Reserve System to sponsor such legislation.

Mr. Sproul expressed the view that it would be preferable for the Federal Reserve to support Treasury sponsorship of a bill but that if the Treasury did not sponsor such a bill, he felt the Federal Reserve should do so since the continuation of the authority was very desirable.

Chairman Martin stated that it was not necessary for the committee to take a position on the legislation; he had raised the question for the purpose of finding out whether there was any thought on the part of members of the committee other than that the System should support continuance of the authority.

Mr. Rouse stated in response to a question from Chairman Martin that he had no suggestions for change in the directive to be issued by the committee to the Federal Reserve Bank of New York.

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

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

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one

or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million;

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

It was agreed that the next meeting of the executive committee should be held at 10:45 a.m. on Tuesday, February 2, 1954. In this connection, Mr. Sproul noted that he would be unable to attend a meeting during that week but that he assumed an alternate member of the committee would attend in his place.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary