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 Wednesday, May 26, 1954, at 2:30 p.m.

PRESENT: Mr. Martin, Chairman
Mr. Robertson
Mr. Szymczak
Mr. Williams
Mr. C. S. Young, Alternate for Mr. Sproul

Mr. Mills, Member of the Federal Open Market Committee

Mr. Thurston, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Mr. R. A. 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 meeting of the executive committee of the Federal Open Market Committee held on May 11, 1954 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 open market operations during the period May 11 through May 21, 1954, inclusive, and at this meeting there was distributed a supplemental report covering May 24 and 25, 1954 inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse stated that, although not a part of the report referred to, the System account purchased $40 million of Treasury bills this morning in view of the possibility of contraction in reserves over the coming holiday weekend and that it planned to purchase another $35 million this afternoon. He added the comment that, while the need for these purchases was not clearly established, in view of the market situation generally and the difficulty of anticipating precisely the reserve position of banks, it was felt that it was preferable to err on the side of ease, in accordance with the suggestion at the last meeting of the executive committee.

Mr. Robertson referred to the purchase on Tuesday, May 18, of $55 million of Treasury bills for delivery on May 19, and to the statement in the written report submitted by Mr. Rouse that such purchases "were undertaken in view of the temporary firmness in the New York money Market which, in the absence of System purchases in recent weeks, might have given rise to speculation that the System's easy money policy was becoming less active." He expressed doubt that purchases should be made for the reason indicated in the latter part of the sentence.

Mr. Rouse agreed, stating that the reason for making the purchases was the temporary firmness in the money market.

Mr. Robertson stated that he also had some doubt as to the advisability of purchasing additional bills today on the basis of the amount of reserves currently available to banks, and it was understood that the question of prospective open market operations would be discussed more fully later during this meeting.

> Upon motion duly made and seconded, and by unanimous vote, transactions in the System account during the period May 11 to May 25, 1954, inclusive, were approved, ratified, and confirmed.

Mr. R. A. Young made a statement with respect to recent economic developments concerning which a staff memorandum had been distributed under date of May 24, 1954. Mr. Young said that statistical data now becoming available as well as impressions gained from comments from business and financial sources were providing increasing support to the view that the down turn in activity, which had slackened after the first of the year, had leveled off. He cited particularly recent strength of meat prices as having possible significance in indicating a firmer undertone to commodity markets. Mr. Young stated that it appeared that the Board's industrial production index for May would be little changed from the March and April figures of 123 per cent of the 1947-1949 average.

Mr. C. S. Young stated that the situation in the Chicago district compared generally with the comments made on the national situation. He pointed out, however, that at the Chicago Bank it was felt that the building industry would not maintain its current level of activity, particularly in the residential field, throughout the remainder of the year. On the whole, Mr. Young's view was that the current decline in economic activity had about leveled off and that in some cases business concerns were stepping up their orders.

Mr. Williams commented upon remarks of speakers at the annual convention of the Pennsylvania Bankers Association which he attended earlier this week, citing statements by some to the effect that most of the decline in business this spring had now passed although it was not felt that there would be a rapid pickup from current levels.

Chairman Martin then called upon Mr. Thomas who reviewed capital market developments, the Treasury cash position, and the banking and credit situation.

Mr. Thomas stated that during the first three weeks of May total bank credit increased, in contrast to a decline in the corresponding weeks of last year. Although commercial loans declined this year as last, bank holdings of Government securities increased sharply this year, whereas last year they had declined. Private demand deposits declined $400 million at reporting member banks in the three week period this year compared with a decline of more than a billion dollars a year ago. Time deposits and Government deposits showed larger increases than last year. Mr. Thomas felt that the bank credit picture indicated that banks were making use of their funds in one way or another, even though business and consumer loans were going down. The reserve situation has been relatively easy, Mr. Thomas said, but the outlook was for some decline in connection with the weekend holiday, and end of month transactions which might call for some additional funds to be put into the market. Furthermore, toward the end of next week there would be drains on reserves, and free reserves could be expected to decline fairly sharply in the absence of System open market operations.

Chairman Martin said that, while the picture before the committee appeared fairly clear, he felt it would be desirable to have a full discussion of open market operations in terms of the current and prospective economic situation, and he called upon Mr. Mills for an expression of his views.

Mr. Mills stated that his views seemed to be diametrically opposed to those expressed by Messrs. Robertson and Rouse in discussing the report of transactions for the System account earlier in this meeting. The objective of the committee, he said, was that the banking community would have assurance that there would be adequate reserves available to meet acceptable credit needs. Mr. Mills felt that if the System looked only to the needs of the commercial banking system, it might be overlooking an important area of credit which might be suffering at the present time. He referred specifically to the large issues of municipal, toll road, and corporate securities coming on the market at this time and compared the present situation with that existing in the spring of 1953. He felt that monetary policy had a secondary responsibility to this segment of credit to the extent that it could give confidence and assurance to the over-all money market and to the banking fraternity; this secondary responsibility was to assure that reserves were not only carried at a minimum point of convenience, but at a point well above that level. His concept of desirable free reserves would be a level around $700 to $800 million which might give confidence to the investment market that new securities would be conveniently carried in bank loans until they could be distributed. Mr. Mills stated that while he would have no more liking for a softening in the bill rate than had been indicated by others, he would have still less liking for a softening in the market for long-term Government and corporate securities. A steadily falling bill rate was not necessarily a reflection of easy money, since it might equally well be argued that the softening was a result of restricted supplies of bills. Mr. Mills went on to say that if the committee waited to supply reserves until it sensed a need for providing them, rather than supplying them in advance of anticipated needs, it might unwittingly provoke concern as to the System's credit policy among the investment fraternity by indicating that reserves were being supplied grudgingly and not with any willingness to meet the demand for credit which was evidenced by the volume of long-term securities backing up in syndicate hands. It was his view that the committee should act forcefully to provide additional reserves in advance of the demand and in a way that would produce confidence. Mr. Mills emphasized that his thinking was for the short-run period of the next two to three weeks, since estimates of reserve needs were subject to change in even less than two weeks.

Mr. Rouse interjected two comments on Mr. Mills' statement. First, open market operations attempt to anticipate the need for funds and do not wait until the need has actually arisen. Second, the projections upon which decisions are based are not unreasonably uncertain. Over the past ten weeks, the error in the projections has averaged only

$80 million. Even in the week of May 5, when reserves dropped unexpectedly on the last day of the week, they at no time fell below $219 million.

Chairman Martin said that Mr. Mills made a good point in connection with projections for any extended period ahead. It was perfectly obvious, he said, that the committee could not be too precise in preparing such estimates. However, it was difficult for him to see what the addition of a few more reserves would do under present conditions one way or the other.

Mr. Thomas stated, in response to a request of the Chairman, that he felt a level of $500 to $600 million of free reserves was too close to the minimum level to create real ease. He noted that country banks generally maintain around $500 to $600 million of excess reserves and that development of any situation at city banks calling for additional reserves would result in undue money market tightening. In the present situation of uncertainty this might be an influence on banks. Mr. Thomas also noted that with the discount rate and the repurchase rate as far above the market rate for bills as they now are, changes in the market result in wide gyrations in rates. If the System was going to maintain a situation which resulted in a bill rate below 1 per cent, this called for a discount rate or a repurchase rate closer to that level or for a larger amount of free reserves than was currently being maintained in the market. Mr. Thomas recognized that it might be difficult actually to maintain a higher level of free reserves since banks might put such reserves to use. This, however, would be attaining the objectives of the System in trying to create an easy money situation.

Chairman Martin inquired of Mr. Rouse whether he knew of any segment of the community, other than persons who had gotten caught because of their positions in securities, which was seriously worried about a shift in Federal Reserve policy from ease to tightness.

Mr. Rouse responded that he did not think any segment of the financial community was actually worried about such a shift. It was true that some of the underwriters were looking for signs of such a shift, but Mr. Rouse did not feel that there was a real belief that it would take place under the present economic situation. He felt that comments along this line represented an attempt to promote another "shot in the arm".

Chairman Martin then read a letter from Mr. Sproul, Vice Chairman, dated May 25, 1954, as follows:

> "I am sorry to have to miss the meeting of the Executive Committee of the Federal Open Market Committee tomorrow. In thinking over our recent discussions I have jotted down, in some sort of sequence, various views which I have expressed, and I am sending them along for what they may be worth.
>
> "1. Trying to maintain such a large volume of excess reserves and free reserves as would create standing pools of reserves in every bank or in every community is a self-defeating proposition, given a banking system in which there is a relatively free flow of funds between banks and between communities. It isn't possible to force a large volume of excess reserves on the banks unless they have reached a position at which they consider their total loans and investments to be at the maximum consistent with their capital funds and their management capabilities.
>
> "2. To try to force more reserves on the banking system (in the absence of immediate need) would be something like forcing more credit into a system in which productive forces are already fully employed. You drive up prices but don't increase output - in this case you drive down yields on

liquidity instruments but don't increase the kind of bank lending and capital investment which facilitates recovery. Our experience with very large excess reserves and free reserves during the thirties, when the banking system was super-saturated with reserves, is suggestive. It seems to me that we have created the required ease and the evidence is to be found in the loan and investment markets, not in statistics of bank reserves.

"3. It is not necessary nor desirable to have a large cushion of reserves to protect us against day-to-day errors in our projections of reserve needs. The way to meet such situations is not to try to lay down a thick cushion of reserves day in and day out, but to take care of doubtful cases as they occur by choosing the most appropriate course of action, which leans toward ease, in a given situation.

"4. Similarly in the case of shifts which may occur in the distribution of reserves between money market centers and the rest of the country. It is doubtful if a money market can perform its functions without occasionally swinging away from the reserve situation in the rest of the country. To maintain a volume of reserves at all times, which would prevent periodic tightening as between money market banks and other banks, would seem to be possible only if bank reserves were available without limit in New York and in the rest of the country. This problem of distribution of reserves can also be dealt with best as it occurs.

"5. I continue to believe that, for the present, our job is to maintain a climate of credit ease, with assurance that it will continue so long as the present economic situation persists. This we have done. The range of excess reserves and free reserves which has existed for some time has demonstrated, in the loan and investment markets, that it does not err on the side of 'too little'."

In response to Chairman Martin's request for comments, Mr. C. S. Young stated that he would go along largely with Mr. Mills' views. This was one reason, he said, why the Chicago Bank had been recommending a reduction in reserve requirements for member banks. Mr. Young did not feel that banks would be aggressive in loaning unless they could be certain that they would have plenty of reserves. While many people think the recession has stopped, there was still uncertainty on such matters as Government borrowing and the international situation, and Mr. Young felt it would be necessary that the System supply additional reserves in order to get loan expansion. In response to a further question from Chairman Martin, Mr. Young thought that there was little or no belief that the System was changing from a policy of active ease to one of less ease, and any comments along that line could be disregarded. The System had let it be known that it would supply the funds for legitimate credit needs, he said, and this applied not only to banks but to issues of securities by municipalities, by toll road authorities, and by corporations. If the System failed to do this it would then create the impression that the policy had changed. Mr. Young added the comment that a feeling of optimism was very much in the air.

Mr. Szymczak felt that for the immediate future, open market operations should be continued about as they have been recently, with the System account making a few additional purchases rather than being on the conservative side. Mr. Szymczak would concentrate on seeing that there were plenty of reserves to take care of Treasury needs and seasonal needs on the basis of the best projections that could be made, and he would watch carefully for developments in the situation during the month of June.

Mr. Robertson said that he would agree almost completely with the views expressed in Mr. Sproul's letter. He felt there was a tendency to pay too much attention to keeping the bill rate low (one per cent) and too little attention to the availability of credit. He could find no unavailability of credit anywhere in the country at this time; as a result of the policy the System had followed for some months, funds were available for extending credit. Mr. Robertson would be inclined to stop erring on the side of ease in carrying on open market operations and would hope that the System would maintain about the "right" degree of ease. He felt the economy had been doing very well under the degree of ease thus far maintained and he would not try to drive interest rates further down by augmenting the level of reserves through open market actions.

Mr. Williams noted that Mr. Mills' comments were directed to the short-term outlook and that abrupt changes could be very disconcerting. He felt, on the basis of the short-term outlook, that the System had done very well in carrying out a policy of monetary ease and that it would not be desirable to ease the situation much more than has already been done. Mr. Williams would not, however, wish to project operations for more than about a two-week period.

Chairman Martin stated that it was necessary to look on both sides of the present picture. He thought that there was not a complete understanding of the impact of reserves on the money market. Chairman Martin's philosophy, quite apart from what was happening, was that he would like to see, normally speaking, interest rates as low as could exist without introducing inflationary pressures, so long as they added to capital formation. He did not believe, however, that there would be an addition to capital formation by forcing interest rates down, certainly not in a short period of time. He had considerable difficulty about acting in advance of a movement. It was one thing to operate aggressively as a matter of technique when you had decided that an action should be taken, but it was another thing to act in anticipation. More and more investors were saying that there was no point in investing because current policy was in the direction of starting inflation all over. Chairman Martin questioned very much whether in that atmosphere (and he recognized that he was making a judgment on the atmosphere) there would be any addition to capital formation by increasing the impact of free reserves over what now existed.

Mr. Solomon inquired whether sufficient allowance was being made for growth in the money supply in terms of long-term economic growth, and Chairman Martin noted that the money supply recently had been higher than a year ago despite a considerable decline in business and that, on a seasonally adjusted basis, at the end of April it was about as high as it ever had been. He also commented that velocity must be considered in judging the adequacy of the money supply.

In response to Chairman Martin's request, Mr. Ralph Young commented to the effect that the problem of the money supply and growth of the economy was linked closely with the level of business activity and the rate at which business was generating bankable assets. In a recession, there was a slowing down in the generation of assets of the quality that banks should hold, and in some recessions there had been liquidation that had been a part of the contraction process. In the current recession, Mr. Young said, the money supply had not been a factor contributing to the contraction. Mr. Young also was inclined to think that the System had done about as much as it could in meeting requirements concerned with the money supply. If there should be an upturn in business over the remainder of this year, there would be a substantial expansion in bank loans and investments with an accompanying rise in the liabilities of banks which would require substantial additions to reserves. The System was in a position, Mr. Young said, to supply the needed reserves without any tightening in the market, at least in the initial stages.

After further discussion, Chairman Martin stated that it was clear that open market operations were really a matter of degree. He noted that Mr. Mills, with some support, would prefer to have a little higher volume of free reserves, perhaps $100 or $200 million more than had existed recently, whereas the majority view seemed to be that free reserves were at about the right level. Chairman Martin said that he could not think that the degree of difference under discussion was decisive, but he recognized that was a matter of judgment. Under the circumstances, he suggested that it be understood that operations would be carried on in accordance with the majority views expressed, and there was agreement with this suggestion.

Mr. Rouse stated that he had no suggestion for change in the directive to be issued 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 Treasury securities maturing within one year 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 committee would be held on Tuesday, June 8, 1954, at 10:45 a.m.

Thereupon the meeting adjourned.

Assistant Secretary