

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Monday, May 25, 1956, at 2:50 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Harrison, Vice Chairman
Mr. Broderick
Mr. Szymczak
Mr. McKee
Mr. Fleming
Mr. McKinney
Mr. Schaller
Mr. Hamilton

Mr. Morrill, Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Burgess, Manager of the System Open
Market Account
Mr. Thurston, Special Assistant to the
Chairman

The Committee was informed that certificates of the unanimous election by the directors of the Federal Reserve Banks of Chicago and St. Louis of President George J. Schaller as a member of the Federal Open Market Committee and of President Wm. McC. Martin as alternate for President Schaller for the period ending February 28, 1957, had been received by the Board of Governors of the Federal Reserve System.

The Secretary submitted the minutes of the meetings of the Federal Open Market Committee on March 18 and 19, 1956, and, upon motion duly made and seconded, and by unanimous vote, the minutes were approved as submitted.

The Secretary also submitted the minutes of the meeting of the executive committee of the Federal Open Market Committee held on March 19, 1956, and, upon motion duly made and seconded, and by unanimous vote, the actions set forth therein were approved, ratified and confirmed.

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It was then stated that during the interval between the meeting of the executive committee on March 19, 1936, and the present date the individual members of the executive committee had approved the following matters and that at the meeting of the executive committee held this morning the actions referred to were approved, ratified and confirmed:

- (1) A reduction by the Federal Reserve Bank of New York of approximately \$2,000,000 in the account carried with the Bank for International Settlements, by the gradual withdrawal of the proceeds of approximately \$1,600,000 of bills held in the account and \$400,000 in the sight deposit with the Bank for International Settlements.
- (2) A shift by the Federal Reserve Bank of Dallas of \$1,205,000 of 3 3/4% 1946-56 bonds held in the bank's own investment account into a like amount of 2 7/8% 1955-60 Treasury bonds.
- (3) An increase of \$10,000,000 in the authority granted to the Federal Reserve Bank of New York by the executive committee of the Federal Open Market Committee on March 19, 1936, to make shifts of securities in the System account into other securities having maturities within a range of one year from those of the securities sold.
- (4) Transfers of participations in the System Account, as follows:
 - \$5,000,000 to Dallas from New York.
 - \$5,000,000 to Dallas from Chicago.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee above described were approved, ratified and confirmed.

President Harrison expressed the view that there were certain respects in which there was a possible over-lapping of the jurisdiction of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System which he felt should be studied carefully with a

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view to clearing up and removing unnecessary duplication in these matters. There was a brief discussion as a result of which it was understood that President Harrison would prepare a review of the matters which he had in mind and take them up with the Secretary of the Board of Governors of the Federal Reserve System.

Mr. Burgess submitted the report of open market operations prepared by the Federal Reserve Bank of New York as agent for the Federal Open Market Committee covering the period since March 16, 1936, and up to and including May 20, 1936. Mr. Burgess discussed the principal features of the report and called particular attention to the fact that there had been no change in the total holdings in the system open market account. He discussed the shifts between maturities and transfers of participations in the account and referred briefly to each of the exhibits attached to the report.

Upon motion duly made and seconded, and by unanimous vote, the report as submitted was approved and the transactions set forth therein were approved, ratified and confirmed.

Mr. Burgess also submitted for the information of the Committee memoranda entitled:

"Summary of Methods of Allotment used in Distributing System Purchases of Bankers Acceptances and Government Securities."

"Government Security Holdings by Individual Reserve Banks for their Own Account"

The Committee then took up for consideration the recommendations which had been agreed upon at the meeting of the executive committee of

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the Federal Open Market Committee that morning, which are embodied in the minutes of that meeting. The first of these recommended that the Federal Open Market Committee approve and continue in effect the existing formula for allotment among the Federal reserve banks of their respective participations in the aggregate amount of United States Government securities held in the System open market account. It was pointed out that this formula provided for such allotments on the basis of the ratio of each bank's expenses, dividends and charge-offs to the total of such expenses, dividends and charge-offs for the twelve Federal reserve banks. It was agreed that the formula included the important factors that should be considered and that the current application of its provisions should result in a reasonable and equitable distribution of the participations in the account. It was observed that the principal reason that the existing formula had not worked out in the past as intended had been the fact that no bank was obliged under the law to accept or retain the particular amount allotted to it in accordance with the formula and that the actual participations were determined through informal negotiations on the basis of the amounts which individual banks desired or were willing to hold from time to time. This difficulty having been specifically provided against in the Banking Act of 1955 it was felt that, with the cooperation of the Board of Governors of the Federal Reserve System in requiring and obtaining periodical reports at reasonably frequent intervals showing anticipated charge-offs of unusual amounts by reason of possible losses in addition to the customary information as to current earnings and expenses, including the usual allowances for depreciation and other items,

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together with the development of a uniform policy with respect to unusual charge-offs, the formula would be practical in its operation.

In connection with the question what treatment should be given to the profits that might accrue to individual banks from the transfer to the System account of Government securities held in their individual portfolios it was agreed that, since they had assumed and carried the risk of fluctuations in market values and possible losses in the ultimate disposition of these securities, they were entitled to such profits as a matter of equity and that, since such profits were of a non-recurring nature, they should not be taken into account in the future allocation of the securities held in the System account. The view was expressed by some of the members that such non-recurring profits might well be added to the reserves of these banks.

It was pointed out that the proposed provision for readjustments in the allocations if at any time the reserve ratio of a particular bank should fall below 50% should afford an ample margin of protection to such a bank and a reasonable opportunity for considering the possibilities of action which would enable the System to meet the situation thus presented.

After detailed discussion of the various aspects of the questions involved, upon motion duly made and seconded and by unanimous vote, the Committee (a) approved and continued in effect the formula adopted by the Federal Open Market Committee as constituted prior to March 1, 1936, and the practice followed under its authority, with respect to allotments to the various Federal Reserve banks of Government securities held in the system open market account; (b) authorized and directed the executive committee to make such adjustments as of June 15, 1936, as may be necessary to bring the

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allotment to each Federal reserve bank of Government securities held in the system open market account into conformity with such formula; and (c) authorized and directed the executive committee to make thereafter from time to time such readjustments as may be necessary to maintain the distribution of Government securities among the Federal reserve banks in accordance with such formula: provided, however, that if at any time the reserve ratio of any Federal reserve bank should fall below 50% or would be reduced below 50% by reason of the operation of such formula the executive committee shall make such readjustments in the allotments as shall be necessary to raise the reserve ratio of such bank to 50% by allocating the necessary amount of securities to the other Federal reserve banks in accordance with the formula. In this connection it was agreed that any profit received by any individual Federal reserve bank as a result of the transfer as of June 15, 1936, to the system open market account of United States Government securities held in the individual investment account of such Federal reserve bank should be treated as a non-recurrent item which should not be taken into account in the application of such formula. It was also agreed that there should be obtained from each Federal reserve bank at quarterly intervals reports showing the nature and amount of any unusual charge-offs which such bank anticipates will be made during or at the end of each calendar year and that the Board of Governors of the Federal Reserve System should be requested to endeavor to bring about the observance of a uniform policy among the Federal reserve banks with reference to such charge-offs.

In connection with the recommendation of the executive committee that the Federal reserve banks be directed to transfer on June 15, 1936, to the System open market account all of the United States Government securities held in the individual investment accounts of such banks, a question was raised as to the application of this requirement to Government securities in which the self-insurance funds of certain Federal reserve banks had been invested. It was stated that, while the executive

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committee had not discussed the effect of the recommendation upon such investments, such recommendation was broad enough in its terms to require such investments to be transferred to the System open market account. After some discussion it was the consensus that such investments were in reality a matter of individual bank bookkeeping and that there was no sufficient reason why such securities should not be included in those required to be transferred to the System open market account.

In view of the fact that the Banking Act of 1935 transferred to and lodged in the Federal Open Market Committee the final authority over as well as the responsibility for the determination of policy with respect to the conduct of open market operations, and provided that no Federal reserve bank should engage or decline to engage in such operations except in accordance with the direction or regulations of the Committee, it was the opinion of the Committee that the separate investments in Government securities now held by individual Federal reserve banks should be transferred to the System account.

Accordingly, upon motion duly made and seconded and by unanimous vote, the Committee directed that the Federal reserve banks transfer on June 15, 1936, to the System open market account, at the market prices prevailing on that date, all the United States Government securities held in the individual investment accounts of such Federal reserve banks, including Government securities held as investments of self-insurance funds.

In connection with the foregoing action there was a discussion of the disposition that should be made of the earnings accruing from the

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investments of self-insurance funds in Government securities and the view was expressed by certain members of the Committee that, as a matter of accounting, the earnings from such securities should be treated as a part of the current earnings of each Federal reserve bank and that any additions to the self-insurance fund should be made from current earnings as in the case of any other special reserve. Other members of the Committee expressed the view that earnings from investments of self-insurance funds might well be permitted to accumulate in such funds, especially if all reserve banks should invest their self-insurance funds.

It was agreed unanimously that it would be desirable to have a uniform policy in the twelve Federal reserve banks in regard to the establishment and maintenance of self-insurance funds and the allocation of investments thereto, and it was suggested that the matter be given consideration by the Presidents' Conference which will convene tomorrow.

The Committee then took up for consideration the practice which it was reported is now followed by only one Federal reserve bank of holding temporarily in a special investment account Government securities which it purchases and sells at the request of individual member and non-member banks. It was agreed that, since the principle had been adopted that the Government securities held by the Federal reserve banks in their own portfolios should be transferred to and held in the System account and since it did not appear that it was necessary for the Federal reserve banks to handle as an investment the securities thus purchased and sold, the practice should be discontinued but that a reasonable time should be allowed in which to enable the bank to effect the

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necessary adjustments.

Upon motion duly made and seconded and by unanimous vote, the Committee directed that any Federal reserve bank which purchases and holds for its own investment account Government securities pending their sale for the account of member or nonmember banks shall not later than June 15, 1936, discontinue such purchases and sell all Government securities so held.

Attention was then directed to the letter from President Hamilton, of the Federal Reserve Bank of Kansas City, in regard to temporary purchases of Government securities under resale agreements, which was submitted at the meeting of the Federal Open Market Committee on March 19 and to the fact that the consideration of this letter had been deferred until this meeting. It was pointed out that such purchases had been made from time to time in the past with the approval of the Federal Reserve Board and that permission to continue the practice would enable the Federal Reserve Bank to render a service. It was agreed that, if confined to short periods which would be adequate for the accommodations desired, there was no objection to the practice.

Upon motion duly made and seconded and by unanimous vote, the Committee granted authority to each Federal reserve bank to make temporary purchases of Government securities under resale agreements for periods not exceeding fifteen days.

Mr. Goldenweiser as the Committee's economist submitted a memorandum dated May 22, 1936, containing his report on business and credit conditions.

Reference was made to the proposal submitted by President Harrison at the meeting of the Federal Open Market Committee on March

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19, 1936, that authority be granted by the Committee under which, in an emergency, any Federal reserve bank might purchase Government securities when necessary to afford relief in a situation involving specific banking situations in its district, or, after obtaining the consent of the Federal Open Market Committee, might purchase or sell Government securities for its own account, all such purchases and sales to be reported promptly to the Federal Open Market Committee and its executive committee. Attention was directed to the fact that two members of the Board of Governors were absent and that Mr. Ransom had expressed a desire to be present and participate in the discussion when this matter was taken up for consideration.

In view of the fact that Mr. Ransom's illness prevented his attendance at this meeting, Mr. Harrison moved that consideration of this matter be deferred until the next meeting of the Federal Open Market Committee.

Carried unanimously.

The Chairman called attention to the resolutions which were adopted by the Committee at its last meeting covering open market operations. He read the resolution instructing the executive committee to direct the replacement of maturing securities and to make such shifts of securities in the System account as may be necessary in the proper administration of the account, and recommended that the Committee renew the authority granted in that resolution with an amendment to permit an increase in the maximum amount of bonds in the System account from \$350,000,000 to \$500,000,000.

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The Chairman stated that the suggestion had been made that it would be desirable to make some shifts in maturities from short-term to long-term obligations with a view to improving the earning position of the Federal reserve banks, and, in this connection, it was pointed out that in March the amount of bonds in the System portfolio had been increased by \$50,000,000. Reference was also made to the probability that Treasury financing in June and September would provide for conversions of maturing securities into bonds and that it might be desirable to take advantage of these opportunities to make further shifts into bonds. President Harrison expressed the view that the time to exercise such authority would be when it would serve not only the purpose of increasing earnings but when such purchases would be more appropriate from the point of view of market conditions and the interests of the reserve banks. It was agreed that an important aspect of the question was one of timing of the purchases of bonds.

Mr. Williams suggested that in view of the fact that the desirability of increasing the System's bond holdings might depend on whether or not it was likely that these bonds would have to be sold before maturity the question what course should be followed in this matter might depend upon the policy of the Board of Governors with reference to changes in reserve requirements.

A general agreement was indicated that the executive committee should have such authority as may be necessary in the proper administration of the System account to enable it to replace maturing securities and to make shifts in maturities to meet changing market conditions, that

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in that connection it would be desirable to increase the authority of the committee to make shifts from short to long term securities, and that the question of the timing of such shifts should be left to the judgment of the executive committee. Messrs. McKee and Hamilton indicated that they would favor increasing the bond portfolio to the extent of \$50,000,000 or \$75,000,000 in connection with the next Treasury financing.

At the conclusion of the discussion, upon motion duly made and seconded and by unanimous vote, the Committee instructed the executive committee to direct the replacement of maturing securities in the System open market account with other Government securities and to make such shifts between maturities in the account as may be necessary in the proper administration of the account, provided that the amount of securities maturing within two years be maintained at not less than \$1,000,000,000 and that the amount of bonds be not over \$500,000,000.

It was also agreed that the executive committee should have authority to buy or sell (which would include authority to allow maturities to run off) securities for the System open market account within reasonable limits in order that the committee might be in a position to act promptly if circumstances not now foreseen should make such action desirable before another meeting of the full committee.

Accordingly, upon motion duly made and seconded, and by unanimous vote, the Committee authorized the executive committee, subject to telegraphic or written approval by a majority of the members of the Federal Open Market Committee, to direct the purchase or sale of Government securities for the System open market account up to an aggregate amount of \$250,000,000.

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It was pointed out that as a matter of practical operation until June 15, 1936, when the Government securities held in the individual investment accounts of Federal reserve banks are transferred to the System open market account, it would be necessary for the banks to replace maturing securities in such accounts and to make such shifts of securities held as may be desirable in the proper administration of the accounts.

Accordingly, upon motion duly made and seconded, and by unanimous vote, authority was granted, until June 15, 1936, to each Federal reserve bank holding Government securities in its individual investment account to replace maturing securities in such account and, with the approval of the executive committee, to make shifts between the maturities in such account, provided that no change in the total amount of Government securities held by such Federal reserve bank shall be effected by such transactions.

Reference was made to the action taken at the last meeting covering the replacement of bills payable in foreign currencies and it was agreed that the authority granted the Federal Reserve Bank of New York should be continued in order properly to maintain the investments of balances held with foreign central banks, including the Bank for International Settlements.

Upon motion duly made and seconded, and by unanimous vote, the Committee authorized the Federal Reserve Bank of New York to direct the purchase of bills payable in foreign currencies in such amount as may be necessary to replace maturing bills now held for the account of Federal reserve banks by foreign central banks, including the Bank for International Settlements. It was agreed, however, that the Bank might permit the payment of such maturing bills without replacement thereof to such extent as it might find advisable in the interest of the Federal reserve banks.

President Harrison raised a question as to the extent to which the Presidents of the Federal reserve banks who are members of the Federal

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Open Market Committee might report to the directors of their respective banks, and to the other Presidents, actions taken by the Federal Open Market Committee.

After discussion, it was agreed that the Secretary of the Federal Open Market Committee should prepare tentative drafts of excerpts of the minutes of this meeting setting forth the actions taken by the Committee relating to the formula for the allotment of securities in the System portfolio to the individual Federal reserve banks, the transfer of individual holdings of Federal reserve banks to the System account, the authority of individual Federal reserve banks to replace maturing securities and make shifts in securities in individual investment accounts until June 15, 1936, the authority granted to each Federal reserve bank to make temporary purchases of Government securities under resale agreements for periods not exceeding fifteen days, and the discontinuance by Federal reserve banks of purchases for their own investment accounts of Government securities pending their sale for the account of member or nonmember banks, so that such excerpts might be made available to the Presidents of the Federal reserve banks during their conference tomorrow, with the understanding that each President would be authorized to report such actions in confidence to the board of directors of his bank.

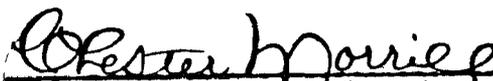
Mr. Broderick suggested that the Secretary of the Federal Open Market Committee be permitted to bring into future meetings of the Committee Mr. S. R. Carpenter, Assistant Secretary of the Board of Governors of the Federal Reserve System, for the purpose of assisting the Secretary in making the record of the proceedings of the Federal Open Market Committee.

Upon motion duly made and seconded and by unanimous vote, Mr. Broderick's suggestion was approved.

Thereupon the meeting adjourned.

Approved:


Chairman.


Secretary.