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 Thursday, May 17, 1951, at 10:05 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Eccles
Mr. Evans
Mr. Gidney
Mr. Gilbert
Mr. Leedy
Mr. Norton
Mr. Powell
Mr. Szymczak
Mr. Vardaman
Mr. A. H. Williams

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Bopp, Irons, Thompson, and John H. Williams, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Thurston, Assistant to the Board of Governors
Mr. Riefler, Assistant to the Chairman, Board of Governors
Mr. Ralph A. Young, Director, Division of Research and Statistics, Board of Governors
Mr. Youngdahl, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Ralph F. Leach, Economist, Division of Research and Statistics, Board of Governors
Messrs. Hugh Leach, C. S. Young, Bryan, and Earhart, alternate members of the Federal Open Market Committee
Messrs. Erickson, Johns, and Peyton, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively.

Upon motion duly made and seconded, and by unanimous vote, William McChesney Martin, Jr., was elected Chairman of the Federal Open Market Committee to serve until the election of his successor at the first meeting of the Committee after February 29, 1952, with the understanding that in the event of the discontinuance of his official connection with the Board of Governors during that period, he would cease to have any official connection with the Federal Open Market Committee.

At the meeting of the Committee on March 1, 1951, it was noted that no alternate member of the Federal Open Market Committee had been elected for Mr. Gilbert, President of the Federal Reserve Bank of Dallas. At this meeting it was stated that advice of the election of Malcolm H. Bryan, President of the Federal Reserve Bank of Atlanta, as alternate member for Mr. Gilbert for the remainder of the year ending February 29, 1952, had been received, and that he had executed the customary oath of office.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on January 31, February 6-8, March 1-2, and March 8, 1951, were approved.

Upon motion duly made and seconded, and by unanimous vote, the actions of the executive committee of the Federal Open Market Committee as set forth in the minutes of the meetings of the executive committee held on January 31, February 8, February 14, February 26, March 2, March 3, March 8, March 13, and April 5, 1951, were approved, ratified, and confirmed.

A report of open market operations prepared at the Federal Reserve Bank of New York covering the period March 8 to May 11, 1951, inclusive, was then presented and commented upon by Mr. Rouse. He also presented a supplementary report covering commitments executed from May 12 to May 16, 1951, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, the transactions in the System account for the period March 8 to May 16, 1951, inclusive, were approved, ratified, and confirmed.

There was then presented a report by members of the staff of the Division of Research and Statistics of the Board of Governors, illustrated by chart slides, covering the economic situation and referred to by Mr. Ralph Young as a report on "Control Problems as Seen During a Lull in the Boom."

Following the presentation, Mr. Thomas made a statement in which he emphasized that the answer to the continuing inflationary pressures could not be found in more production of goods and services when the economy was operating at capacity, that primarily the inflationary pressures arose from the creation of additional money through credit expansion and through increased turnover of money. Vigorous restraints on credit expansion would have to continue if the development of substantial further inflation was to be avoided. Mr. Thomas noted that if the defense program developed as contemplated and as the needs of the Treasury for refunding of securities progressed during the remainder of this year, there would probably be continued demands for credit from both banks and other lenders, although credit expansion would probably be at a reduced rate. While some lending institutions would continue to sell Government securities, nonbank investors as a group would increase their holdings. The Federal Reserve would be called upon to purchase Government securities or increase advances to member banks in order to supply some of the funds needed to meet credit demands and also to cover a drain on bank reserves resulting from the seasonal currency demand and a probable outflow of gold. In the aggregate, he suggested the possibility of a further increase in Reserve Bank credit by the end of 1951 of as much as $3 billion. These needs for reserves would provide an element of restraint, particularly if a policy of reluctant buying is followed.

In a discussion of credit policy in the months ahead when developments in the international situation were so uncertain, Mr. Eccles raised the question whether, if the Federal Government budget were balanced, there was justification for any expansion in bank credit, and whether the objective of Federal Reserve policy should not be to avoid supplying additional reserves to the market except the amounts required by a rise in demand for currency, a gold outflow, or an over-all expansion of production.

There was a general discussion of the various factors in the continuing inflationary situation which would tend to increase the amount of Federal Reserve credit outstanding and it was agreed that the objective of System credit policy should be to limit the increase as much as possible.

During the discussion Mr. Verdaman left the meeting.

Chairman Martin stated that the principal development not previously reported to the Committee since the last meeting was the announcement on May 8, 1951, by the Secretary of the Treasury that he would not call the

September 2's of 1951-53, and that there would be issued a new series of tax savings notes, both of which actions were recommended to the Treasury by the executive committee on May 7, 1951. Chairman Martin also stated that the Treasury had decided not to announce its refunding of securities maturing in June, July, or August until the latest practicable date, which probably would be late this month, and that this too was in accordance with the recommendations of the executive committee.

In a discussion of open market policy, reference was made to a memorandum prepared in the Board's offices under date of March 16, 1951, with respect to the conversion of System holdings of 2-3/4 per cent bonds of 1975-80 into 5-year 1-1/2 per cent notes. Copies of the memorandum were distributed to the members of the Committee before the meeting and a copy has been placed in the files of the Federal Open Market Committee.

Mr. Sproul stated that the memorandum apparently had been prepared on the assumption that there would be an exchange of the nonmarketable bonds for marketable notes, and that the only question was when and on what kind of a schedule it should be made. His own judgment, he stated, was that it would be desirable to convert $1 billion of the bonds at the present time, $500 million on October 1, 1951, and an additional $500 million on April 1, 1952, at which time consideration might be given to the disposition to be made of the $700 million remaining in the System account.

Mr. Rouse stated that the 5-year notes to be obtained in exchange for 2-3/4 per cent bonds would bear the same maturity date if converted anytime between now and the end of September 1951.

> There was a general discussion of the advantages and disadvantages of converting the nonmarketable bonds under any of the suggested alternative procedures and at the conclusion of the discussion, upon motion by Mr. Sproul, it was agreed unanimously that steps should be taken at an appropriate time between now and the end of September to convert $1 billion of present System holdings of the 2-3/4 per cent nonmarketable bonds of 1975-80 into 5-year 1-1/2 per cent notes to be dated April 1, 1951, that an additional $500 million should be converted into notes to be dated October 1, 1951, and that an additional $500 million should be converted into notes to be dated April 1, 1952, with the understanding that further consideration would be given at a later meeting as to the program for conversion of the remaining $700 million held in the System account.

Chairman Martin suggested that, inasmuch as the terms of the new refunding offering to be made by the Treasury would not be announced until the latter part of this month, the executive committee be authorized to determine, within the limits of the general direction to be issued at this meeting by the full Committee to the executive committee, the basis upon which transactions would be conducted for the System account in bills and other short-term securities after the announcement was made.

> This suggestion was approved unanimously.

Chairman Martin then suggested that System operations in longer-term issues be carried on in a more aggressive manner than had been followed in the past, that such an operation be undertaken on an experimental basis with a view to probing the market for Government securities to see if there would be developed a more active interest on the part of potential buyers of such securities.

He also suggested that the Committee authorize him to appoint a committee to consist of himself as chairman and not less than two or more than four other members of the Federal Open Market Committee to make a study of the scope and adequacy of the Government securities market during the coming months with the understanding that the committee would be authorized to call on outside assistance if that should be considered to be necessary and that it would report to the executive committee and to the full Committee. Chairman Martin emphasized that his suggestion for a study of this type was in no sense a criticism of the operations of the System account. In response to questions, he indicated that there was a need for a broader market for Government securities, that perhaps there would be value in studying the British Government securities market, that the time may come when the Federal Open Market Committee might find it necessary to change the procedure whereby it did business with only a small number of qualified dealers, and that he hoped the study proposed would make some worthwhile suggestions along these and other lines.

Several other members of the Committee expressed the view that it would be desirable to have a study such as that proposed by Chairman Martin.

> Thereupon, upon motion duly made and seconded, Chairman Martin was authorized to appoint a committee to make a study of the Government securities market along the lines he suggested.

Turning to a discussion of the suggestion for more aggressive operations in the System account, Chairman Martin said that the Government securities market had suffered a distinct shock since the Treasury-Federal Reserve accord was announced on March 4, that there was a feeling in some quarters that the market for Government securities was deteriorating because of pressures from more sources than institutional investors who were liquidating securities to meet previous commitments, and that he would like to see the Committee authorize the use of, say, $250 million to carry on a more aggressive operation with a view to probing the extent of the underlying demand for Government securities. This, he said, would mean that instead of waiting for dealers to offer securities to the System when they were under pressure there would be times when the System might have aggressive bids in the market. The general purpose of such a probing operation would be to bring out buying which could result in a stronger and more certain market for the large volume of Treasury refunding issues that would be coming on the market.

Mr. Sproul stated that he did not feel the Committee had been entirely passive although it had not been aggressive in exactly the manner suggested by Chairman Martin. He agreed that there had been a shock to the Government securities market in recent weeks but he did not think there was deterioration in the market, that quite the reverse was true, and that the market had shown stability and steadiness and was not one which reflected a psychology of fear. He added that there was no indication of a feeling that could lead to failure of Treasury refunding issues over the next six months. He went on to say that if the full Committee wished to direct the executive committee, and the executive committee to direct the New York Bank and Manager of the Account, to operate in a more aggressive fashion, it could do so without any special authorization of a specific amount to be used for that purpose. Mr. Sproul added that it should be remembered that the Government securities market is <u>sui generis</u>, that it is the market in which most adjustments of cash positions are now made, that our operations in the market are conducted in a "gold fish bowl" with weekly publication of our purchases and sales, and that when we buy or sell we use a special kind of money, namely, reserve funds. For these reasons, he said, the Government securities market and operations in it are quite dissimilar to the stabilizing operations of private interests in other security markets.

During a comment on Chairman Martin's suggestions, Mr. Eccles stated that he felt it would be worth while undertaking such an operation with a relatively small volume of funds, even though it involved the risk indicated by Mr. Sproul of adding to reserve funds in the market.

Other members of the Committee expressed themselves as favoring an experimental operation along the lines suggested by Chairman Martin, and it was agreed that, in issuing instructions to the Federal Reserve Bank of New York for transactions in the System account, the executive committee should do so in the light of the foregoing discussion.

Secretary's note: Before leaving the meeting Mr. Vardaman stated to the Secretary that he would favor whatever recommendations were made by Chairman Martin as to actions to be taken by the Committee.

Thereupon, upon motion duly made and seconded, the following direction to the executive committee was approved unanimously with the understanding that the limitation contained in the direction would include commitments for the System open market account:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury shall not be increased or decreased by more than $2,000,000,000.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury of 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 in the account at any one time shall not exceed $1,000,000,000.

The date for the next meeting of the Committee was tentatively set for October 3, 1951, with the understanding that a meeting of the Presidents' Conference would be held earlier in that week.

Thereupon the meeting adjourned.

Secretary.