

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 Wednesday, September 22, 1954, at 10:07 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Bryan
Mr. Leedy
Mr. Miller
Mr. Mills
Mr. Robertson
Mr. Szymczak
Mr. Vardaman
Mr. Williams
Mr. C. S. Young

Mr. Riefler, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Bopp, Mitchell, Rauber, Roelse, Tow,
and R. A. Young, Associate Economists
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. D. C. Miller, Economist, Government Finance
Section, Division of Research and Statistics,
Board of Governors
Mr. Gaines, Securities Department, Federal Re-
serve Bank of New York

Messrs. Leach, Fulton, Johns, and Earhart, Alternate
Members of the Federal Open Market Committee

Messrs. Erickson, Powell, and Irons, Presidents of the
Federal Reserve Banks of Boston, Minneapolis, and
Dallas, respectively

Mr. O. P. Wheeler, Vice President, Federal Reserve
Bank of San Francisco

Upon motion duly made and seconded, and
by unanimous vote, Messrs. Miller and Balderston

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were selected to serve as alternate members of the executive committee for the remainder of the year ending February 28, 1955, it being understood that in the absence of Messrs. Martin, Szymczak, or Robertson, alternates for any one of those three would be, in the order named, Messrs. Vardaman, Mills, Miller, and Balderston.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 23, 1954, 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 June 23, July 7, July 20, August 3, August 24, and September 8, 1954, were approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the Committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period June 23 to September 17, 1954, inclusive. At this meeting there was distributed a supplementary report covering commitments executed September 20 and 21, 1954. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse commented briefly on the supplementary report, particularly with respect to the sale of \$25 million of bills from the System account on Monday of this week, and on the reaction of the securities market to the announcement made earlier this week of the offering of \$4 billion of 1-5/8 per cent Treasury notes to be dated October 4, 1954, and to mature May 15, 1957.

Upon motion duly made and seconded, and by unanimous vote, the open market

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transactions during the period June 23, 1954, to September 21, 1954, inclusive, were approved, ratified, and confirmed.

Chairman Martin withdrew from the meeting at this point, and members of the Board's Division of Research and Statistics and Division of International Finance entered the room for the purpose of assisting in the presentation of a review of the economic and credit situation, illustrated by chart slides. A copy of the text of the review, which was sent to the members of the Committee following the meeting, has been placed in the files of the Federal Open Market Committee.

Following the economic review, there was a discussion of the outlook, including reference to mortgage lending, the length of time during which the economy might move "sidewise" as contrasted with showing a definite upturn or downturn, and factors relating to the sharp rise in the average level of securities prices in recent months. At the conclusion of the discussion of securities prices, Mr. Sproul commented that perhaps the thing to be gotten out of the discussion was that the policy of active ease pursued by the Federal Open Market Committee has not brought about an inflationary and dangerous rise in stock market prices, but has helped maintain a stable economic and business situation which, in turn, has given encouragement to investors.

The members of the staff who entered the room to assist in presenting the economic review then withdrew.

Mr. Sproul asked for comments regarding recent open market operations by the members of the Federal Open Market Committee and Reserve Bank

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presidents who were not currently members of the Committee.

Messrs. Erickson, Irons, and Leedy expressed general approval of the handling of the account in terms of the general policy of active ease authorized at the June meeting of the Committee, and Mr. Earhart concurred in this view, stating, however, that there had been some complaint from dealers in Government securities who faced losses on a substantial portfolio. Mr. Earhart commented on the fact that aggregate excess reserves had been ample but that early in August there had been slowness in their reaching the money markets where they might be used. In his view, this indicated that the Committee might well give more consideration to rates in the money market along with such other considerations as the amount of excess reserves and free reserves. Furnishing reserves by buying Treasury bills at a time when dealers' portfolios were low was a factor in the decline in the bill rate to a point where many banks were no longer interested in bills at the prevailing rates and it became necessary to reestablish an interest.

Mr. Powell said that during the past few months there had been a "stickiness" of excess reserves at country banks, and such reserves had not flowed into central money markets as rapidly as had been contemplated by figures on which Committee operations were projected. In other words, some of the aggregate amounts of free reserves which served as a guide to operations for the System account simply were not effective in the market. He questioned whether, when central reserve city banks were deficient in reserves early in August, it had been wise for the System account to sell bills

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and then find that it had to take them back. In hindsight, Mr. Powell thought it might have been better to have allowed the larger total of free reserves to remain until there was evidence they were doing damage.

Mr. Rouse stated in response to a question from Mr. Erickson that there had been a tendency on the part of some central reserve city banks to overinvest, which had been a factor in their accumulating a deficiency in their reserves. This had resulted in an atmosphere in the market different from that indicated by the over-all reserve position which had existed immediately following the effective date of the reduction in reserve requirements for member banks at the end of July. Mr. Rouse also commented on the lag in movement of excess reserves from country banks to reserve and central reserve city money markets, a factor for which some allowance had been made in arranging for transactions for the System account in trying to comply with the instructions of the executive committee. This factor, he said, together with unexpected fluctuations in the Treasury's balance in August, had created a most difficult period in which to handle open market operations.

Mr. Johns said that he had no intention of being critical of the handling of the System account but that he had sympathy with the views expressed by Mr. Powell at this meeting and those expressed by Mr. Mills as recorded in the minutes of recent meetings of the executive committee. He felt August had been an unfortunate time to raise a question in the minds of a good many persons as to whether Federal Reserve policy had turned from one of active ease to one of tightness. He was inclined

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to think that an unnecessary risk of doing harm had been run, even though it was not apparent that any harm actually had been done.

Mr. C. S. Young felt that operations for the System account had been carried on in accordance with the understandings at recent meetings of the executive committee and that they should be continued about on this basis, although he would suggest that after the current Treasury financing was out of the way, consideration be given to a further reduction in the System portfolio by way of a reduction in reserve requirements, if that should prove feasible. Mr. Young also noted that country banks were not the only banks which had been slow to put their free reserves to use: a good many reserve city banks were equally slow in making use of free reserves.

Mr. Leach told of discussions which he had had with bankers recently who were in general agreement that everything the System account had done recently was about right, although some regretted that the bill rate had been permitted to go as low as $5/8$ per cent. Mr. Leach said that he would not have wanted the situation any easier than it had been; on the whole, he thought the Committee's policy and operations had been about right.

Mr. Vardaman stated that, as he had indicated at recent meetings of the executive committee, he personally would prefer to have as a target figure for free reserves an amount of \$800 million rather than a range of \$400-700 million. This, he felt, would counteract in some measure the failure of country banks and many city banks to use their free reserves

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more promptly. He indicated that his general philosophy of open market operations at this time was along the lines expressed by Messrs. Powell and Johns, and by Mr. Mills at recent meetings of the executive committee.

Mr. Mills then made a statement substantially as follows:

I have rather grave misgivings about the recent handling of the account, not having a bearing on either easy or tight money, but on what may be the consequences of our withdrawals and injections of reserves. It has already been touched upon. It could be we have been engrossed too much in an effort to maintain a target volume of free reserves and that in doing so we have prevented the natural forces in the market having their effect. It may be we have confused the market as to what our intentions may be or what they were intended to be. Going back three weeks, we have withdrawn reserves, then supplied them, then withdrawn them again. It would seem very difficult for those in the market to reach judgments on the basis of this behavior as to how they should react to policy in making their own purchases and sales. Beyond that, the matter that can prove to be of serious concern is the result these injections and withdrawals can have over a period of weeks by tending to set a pattern of interest rates, which could be fraught with danger because it allies itself very closely with a pegged market. It would be very difficult from the outside to look at our operations without having the impression they are aimed at a pegged rate. Now if the market should come to the view that we have a set rate, and if we should wish to make an abrupt change in policy, it will have a greater impact on the market than would be the case if we had permitted the natural forces to have their effect. To illustrate, it seems to me that within the next few days we face the fact we have withdrawn reserves; the Treasury will withdraw more reserves; float will withdraw a further amount; and the Treasury will come into the market before October 6. The consequence is that we now must inject a very substantial amount of reserves at a time when the market can only regard the action as a very palpable support of Treasury operations. We should support them. But to give the impression that that is a main objective of Federal Reserve policy could be a danger.

Mr. Sproul commented that the executive committee had never set a specific figure as a target for free reserves, that its target had

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always been a range and had been understood and interpreted with some flexibility, depending on developments in the banking situation and in the market. As a matter of fact, he said, over the past several weeks the volume of free reserves had tended to be above the upper level of the range indicated by the executive committee, rather than in the middle or lower part of the range, whereas at times, such as in August, a majority of the members of the executive committee had expressed the hope that the level of free reserves could be kept nearer the lower limits of the range. Swings in reserves during the last few weeks had been of the order of \$500 million, Mr. Sproul noted, and it was felt that open market operations should be in terms of moderating these swings but not offsetting them entirely. Mr. Sproul thought that operations had been in the direction of such moderation.

Mr. Robertson said that to his way of thinking the only way in which open market operations properly should be conducted was in accordance with the needs of the economy as a whole. He felt operations in the recent past had been good. It was true, he said, that the reserves provided country banks early in August did not flow back into the money markets promptly, a factor which had been taken into consideration by the executive committee in giving a range to be used as a guide for the operation of the account. As the free reserves at country banks come into the market, he would hope that the total level of free reserves could move to the lower limits of the range rather than to the higher side. So far as general policy was concerned, he hoped it would continue as at present.

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Mr. Bryan then made a statement substantially as follows:

I would in general associate myself with the comments made by Messrs. Powell and Johns and, certainly with the statement by Mr. Mills of deep misgivings. This is said with modesty because I am not certain I would have handled the situation any better.

As I see the problem, it has been one in which the distribution of free reserves, in combination with our policy, has allowed a very considerable increase in short rates, which has at times carried over into longer rates. The result can be explained on many grounds; but the effect has been that we have permitted a policy of monetary ease to some extent to be contravened by the holders of free reserves, who have wanted liquidity. I am puzzled to know whether this partial contravention of a policy of monetary ease was a result that was wanted or desirable.

The effect, as I see it, has been somewhat dangerous because the increase in rates came in an economic situation in which broad-scale and continuing economic recovery was far from assured. Among the adverse effects was the downward drag on the value of capital assets. There is a question, in my mind, whether we did not produce a result, not realized in a dangerous degree, but one that was contraindicated in the light of all the economic circumstances. We ought not overlook the possibility that the banks clinging to their free reserves may have been doing so for reasons to which we have given insufficient emphasis. They may regard the economic situation with less optimism than we have been inclined to do.

We have had demonstrated in the discussions of the economic situation before the Presidents' Conference and here at this meeting, the fact that no one can say with certainty where we are going. The best that can be said is that, at the moment, we are fairly stable at a fairly high level.

In a situation of that sort it has not seemed to me that it was appropriate policy to permit an increase in interest rates. At the same time, when the banks of the country who were holding the free reserves were showing that they had a preference for cash liquidity as against an increase in earning assets, we were saying to them by our discount rate that they could not restore their cash position except under the danger of considerable penalties. I thus also doubt the wisdom of our rate policy.

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I think our discount rate policy at this time encouraged banks to hold liquid assets rather than to use them. This was a period in history when I think they should have been used. I say this with a repetition of the statement that I am not certain I would have done any better if I had been making the decisions; but I think the rediscount rate should have been in much closer relationship to the short-term rates.

Mr. Williams stated that he felt the results of the Committee's recent operations had been generally satisfactory. The Committee had been faced with a problem of a maladjustment of free reserves and had been working on a range for the country as a whole, playing by ear from week to week. Mr. Williams doubted whether recent developments had given any widespread adherence to the theory that the System was trying to achieve a pegged market. He questioned Mr. Bryan's assumption that the behavior of country banks in holding on to free reserves indicated a judgment as to the future course of business. Mr. Williams felt there was a large element of inertia in the situation and that it would be desirable for the Committee to obtain information through use of the field forces of the Federal Reserve Banks so that it would pursue its operations without the need for speculation as to what the thinking was among country banks.

Mr. Irons reported on a check made during the first part of August in the Dallas District among some 40 or 45 country banks which indicated that the overwhelming majority had a neutral feeling regarding the recent reduction in reserve requirements, which had come at a time when they were not getting an increase in loan demand, and that 80 per cent of the banks contacted said they did not plan to employ their funds in the Government

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securities market since it was not worth their while to buy Treasury bills yielding less than 1 per cent. Mr. Irons thought that the frequency with which this comment was heard, stressing 1 per cent as a marginal rate, was significant.

On the matter of rates, Mr. Sproul remarked that the downward adjustment of bill rates in the spring had reflected the market's analysis of what our policy moves implied, and this analysis had overshot the mark, assuming greater ease than we had intended. Rates may be said to have moved down too far at that time and the recent rate recovery has brought bill yields to a level that probably is more consistent with the general kind of policy the System is attempting to pursue. He added that he would not place as much emphasis on the degree to which rising rates in the short-term market have "slopped over" into the capital markets as had Mr. Bryan.

Chairman Martin reentered the meeting at this point.

Mr. Fulton stated that in the Cleveland District there was some indication that to a considerable extent country banks were in an over-loaned position and that when these excess reserves came into their possession early in August they held on to them. The only criticism of System operations which he had heard among banks was that the bill rate had been permitted to go to a point below that which they liked.

Mr. Szymczak said that under the circumstances he felt recent operations for the Open Market Account had been very well handled. Such operations could not be perfect and must be based on the best information available at the time. The executive committee had used a range of \$400-700

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million of free reserves as a rough guide to its operations and while he personally had not liked the idea of supplying reserves through a reduction in requirements and then withdrawing them from the market, under the circumstances the operation had worked out very well as a means of providing a sort of stability in the market.

Mr. Thomas made a statement in which he brought out the view that a technical factor had affected the situation in recent months. The volume of money in the market measured by free reserves had been fairly stable. One of the factors in the market had been the performance of dealers, Mr. Thomas said, who had bought bills in May and June and helped to put the bill rate down and who had been selling bills since July, thus doing the opposite of what dealers might be expected to do. Another factor, Mr. Thomas pointed out was that the Treasury retired short-term securities from March to June and put out additional short-term securities since July.

Mr. Sproul then made a statement substantially as follows:

1. All during 1954, in the face of a declining or sidewise movement of the general economy, we have followed a credit policy labeled a policy of "active ease". It has involved the use of all of the three main instruments of credit management - open market operations, discount rates, and reserve requirements. Its objective has been to encourage the free use of credit and an active capital and mortgage market. Its main technical guide has been the maintenance of a substantial volume of "free reserves" in the banking system.
2. While the use of such a guide has raised problems of central banking technique, which have been discussed here, the general policy has served the economy well. The ready availability and low cost of bank credit and of capital

funds have maintained a monetary climate favorable to business expansion and high employment, recognizing that credit policy is only one part of the whole complex. The present economic outlook suggests to me a continuance of existing credit policy, relying on open market operations to make it effective.

3. We appear to have been on an economic plateau for the past three or four months following upon the decline in economic activity which began in the summer of 1953. It is possible to view this record doubtfully, if we do not have a substantial upturn during the fall. The expectation of a substantial upturn may have caused a check to the previous liquidation of inventories and reduction of working forces, which could be resumed if anticipated gains are not forthcoming, and private capital outlays might begin to show signs of fear of a prolonged slump.
4. It is also possible to view the record, hopefully. The downturn was checked while the economy was still operating at a high level, the recession has shown no signs of feeding on itself in a way which would bring on a cumulative downward movement, and the economy appears to have elements of strength which should prevent such a movement developing. While inventory liquidation does not seem to have been completed, the rate of liquidation has slowed down. While Government defense outlays may decline further, the decline will be small compared with that of the past year. Private capital investment and State and local capital outlays are holding up to earlier estimates. Consumer spending, on which much of the rest of the economy depends, has remained high, encouraged by the present and prospective stability of prices and evidently not too fearful of spreading unemployment and loss of income.
5. I prefer and hold the hopeful view. Despite the dangers of economic forecasting, we must make some judgments, and I believe that a generally sidewise movement of the economy is more likely during the next few months than a pronounced and cumulative movement either up or down.
6. This hopeful view is supported by the prospect of deficit financing by the Federal Treasury. The recent mid-year review of the budget estimated a cash deficit of 1.8 billion in fiscal 1955. We estimate that it may be nearer 4 billion, with lower receipts and higher expenditures than in the official figures. These net figures for the fiscal year as a whole are the result of a much larger deficit in the July-December 1954 period and a surplus in the January-June

- 1955 period.
7. The Treasury has already borrowed 4 billion of new money in this half-calendar year and will need to borrow about 6 billion more, including the 4 billion offering just announced. The rest of the program might call for 1 billion of cash financing in late November and the sale of 1 billion of CCC participation certificates, or the Treasury might be able to get by with no additional direct new money financing. The present new money financing is directed toward the commercial banks, and the banks will need additional reserve funds in order to play their part, if the amount of bank credit available to the private economy is not to be restricted.
 8. Adding this need growing out of Treasury financing to the needs of a moderate seasonal expansion of private business, and the reserve effects of usual fall increase in currency circulation, suggests that the member banks will require about $3/4$ billion to 1 billion of additional reserve funds between now and the end of the year if our policy of "active ease" is to be continued. The first substantial injection of reserve funds will be needed during the statement week ending October 6, when payment for the new Treasury issue falls due. The next big drain will be during the months of November and December when seasonal factors will gradually absorb reserves and another Treasury offering or CCC certificates may be expected to come to the market. In order to carry on existing credit policy, I would provide these reserve funds as needed, by open market operations.
 9. For the immediate present, we have just passed a peak of excess reserves and free reserves well above the usual range. These additional reserves evidently were considered temporary by the market, as, of course, they were. Consequently they did not express themselves in a sloppy money market. While they will be substantially reduced during the coming statement week by ordinary market factors, their presence has relieved some of the strain of meeting the reserve demands of the Treasury financing in the following week.
 10. I should say we shall have to make some purchases during the statement week ending September 29 to maintain our position, and more substantial purchases during the week ending October 6.

Chairman Martin expressed the view that the Committee had successfully been operating on a policy of active ease. His own thinking was

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that the Committee wanted a flow of money and credit that was like a stream with a ripple on it; it wanted to maintain a flow so that the water would not go over the banks and when the flow built up in force, to have had a chance to build an adequate channel in which to retain the volume of water without having it flow over the banks. Chairman Martin did not think the Committee should give too much attention to minor fluctuations over short periods of time. He thought the Committee's policy and operations had more or less generated confidences in the business and financial world and in the community at large. The Committee now had before it the problem of how to achieve a continuation of the policy of active ease which it had been pursuing, unless there was a view that this policy should be changed.

In response to Chairman Martin's question, none of the members of the Committee indicated that there should be any modification of the general policy of active ease which was being pursued by the Federal Open Market Committee.

Chairman Martin then said that for the guidance of the executive committee it would be his thought that in the immediate future it should continue to supply reserves to the market in accordance with the general policy of active ease, and that any errors it might make in the period of the next few weeks should be on the side of ease rather than the reverse. Chairman Martin also recalled that in August he had felt that if the Committee were to err in supplying reserves, it was wiser to lean on the side of tightness, whereas his view now was that with the seasonal

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developments ahead, operations should be shifted so that they would lean on the side of ease. Without guaranteeing any particular prices in the Government securities market, there should be an adequate supply of reserves available to assure that the current Treasury financing would be successful.

In response to a question from Mr. Bryan as to the difference in the situation in August when Chairman Martin would have leaned on the side of tightness and at the present time when he felt the Committee should lean on the side of ease, the Chairman stated that he felt the difference in timing was of real importance. This related to the delicate area of business psychology. In August, it was generally expected that the business situation would be in the doldrums, a common occurrence for that time of year, and as long as there was no clear indication that things would be going hog-wild in either direction there was no serious psychological impact on the economy in carrying on operations as had been done. On the other hand, as September receded into October and October into the general fall pickup of activity in many lines, it was Chairman Martin's judgment that a definite degree of ease in the market would exert a favorable psychological impact on the situation.

Mr. Szymczak felt that the full Committee should continue the policy of active ease under which it had been operating. There should be no change in the discount rate at this time nor should there be a further reduction in reserve requirements at present. To the extent additional reserves were required during the latter months of this year, they should

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be supplied through open market operations or through the discount window.

Mr. Sproul said that he was in general agreement with Chairman Martin's statement as to policy and the way it should be carried out in the immediate future. He felt that the risk of erring on the side of greater ease in this immediate future period was less than the risk if errors were made on the side of tightness. He would not contemplate aiming toward tightness in any case, he said, and not having an exact science to work with, that meant the Committee's operations should be directed so that to the extent errors were made they would be on the side of ease.

There was general agreement with the views expressed by Chairman Martin and Mr. Sproul.

Mr. Mills added the comment that he would hope the open market account would not intermittently interfere in the market in a way that would upset the play of natural factors, and that interference by the Committee would solely be to cover the longer run need for reserves which could be expected to follow during the next three months.

Mr. Sproul felt that Mr. Mills overemphasized the effect of buying and selling securities for the System account. He had not been able to observe any misunderstanding growing out of that procedure on the part of businessmen or bankers. The principal criticism had come from those who were playing in the market and who had attempted to make profits out of market moves. When they had guessed wrong they attempted to create a misunderstanding as to the Committee's policy. Mr. Sproul reiterated that he did not see evidence of the misunderstandings to which Mr. Mills

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referred growing out of the Committee's purchases and sales.

Chairman Martin said that he shared Mr. Sproul's views on this point, based on talks he had had with people in the business and financial community; the only misunderstandings he had observed were those based on wilful misunderstanding.

Mr. Mills responded that if the Committee was going to be continually in and out of the market it was going to create a misunderstanding as to policy.

Mr. Rouse stated that the recent period of operations for the account had been unusual, resulting from an over-supply of reserves in the market as a consequence of the reduction in reserve requirements and the need to absorb that supply until there was a need for the additional reserves.

Chairman Martin said that he favored the minimum intervention of the account in the market at all times in order to achieve its objectives.

Mr. Robertson felt the Committee should continue to follow a policy of active ease but that it should not intervene unnecessarily in the market. During the period immediately ahead, he felt the Committee should resolve doubts in favor of ease rather than tightness in the market.

Mr. Bryan said that he was, of course, in favor of a policy of ease in the market. He wished to say again, however, that he felt discount rate policy at the present time was out of gear with open market policy so that in effect the System was saying to the financial community that its reserves could be replaced only through the investment account

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of the Open Market Committee. He felt that the policy of active ease applied only to those banks who could receive reserves through the flow of the market. If there were to be a policy of ease generally applicable to member banks the discount rate should be reduced, preferably to 1 per cent and at least to a level of $1-1/4$ per cent.

Chairman Martin suggested that there be a discussion of the views expressed by Mr. Bryan as to lowering the discount rate.

Mr. Williams stated that Mr. Bryan's earlier discussion of the role of discounting and of the relationship between the discount rate and open market rates raised important questions that were being considered by the Special System Committee on the Discount and Discount Rate Mechanism. With respect to a reduction at this time, he felt that such a reduction could be misinterpreted as indicating that the System judged economic developments to be weaker than the System actually believed them to be.

Mr. Fulton agreed completely that the discount rate should come down, especially since this would give smaller banks access to reserve funds other than through the open market.

Mr. Szymczak felt that a reduction at this time would be misunderstood by everybody and he did not think that the banks, particularly the smaller ones, were in need of additional funds.

Mr. Sproul said he could not understand what is the obstacle to banks securing funds through the discount window at a rate of $1-1/2$ per cent if they had a demand for loans or wanted to make investments, or if they felt they needed access to more reserves in order to assure their

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liquidity. He felt that the Committee's policy of maintaining a substantial volume of excess and free reserves—not the level of the discount rate—had relegated the discount window to a minor position in terms of actual use. So long as banks as a whole have substantial free reserves, maintained through open market operations, most of the reserve adjustments may be expected to take place in the money centers and in the market for Government securities, Mr. Sproul said, and in these circumstances and with existing market rates, the present discount rate may be said to be effective: it is close enough to market rates to keep banks on the threshold of borrowing but it encourages them to make most of their adjustments in the market. It isn't possible to pin down exactly the relative costs of borrowing and making adjustments through the market in all transactions, Mr. Sproul said, but the advantage now seems to be only slightly on the side of market adjustments. It was his view that if the present discount rate is fairly well adjusted to market rates, if reserve funds are readily available either by reason of open market operations or through the discount window, and if the System had no emphasis or change of policy it wished to signal or symbolize, it should reserve this major policy instrument for more effective use at a more appropriate time.

Mr. Erickson said that banks in the Boston District were reluctant to borrow and he could see no reason for reducing the discount rate at the present time.

Mr. Irons did not favor a reduction in the discount rate now and

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had not favored the reduction made last April. His reason for not favoring a reduction now was the possibility that the differential between the market rate (i.e., the bill rate) and the discount rate might reappear as was the case when the discount rate was lowered in April. In his view, the actual level of the discount rate was not so important as was the spread between the discount rate and the market. He said, in response to a question from Chairman Martin, that if the discount rate were reduced to 1 per cent and the bill rate remained at its present level of just under 1 per cent, borrowing at the Dallas Bank might be expected to increase, but that if the bill rate remained appreciably below the discount rate, borrowing would probably not increase.

Mr. Leedy could see no purpose to be served by reduction in the discount rate at this time. There was no evidence that banks were hesitating to use the discount facilities because of the possible cost relationship and he felt that by making a further reduction in the discount rate at this time the System might be helping to get the level of interest rates down to a point where it would not be healthy for the credit situation. Mr. Leedy also thought such action might be misinterpreted as indicating concern on the part of the System regarding the economic outlook.

Mr. Earhart felt that, while in the past discount rate policy had not been kept fully in line with open market policy, at the present time the discount rate was at a sufficiently low level and he would prefer to reserve any further lowering of that rate for a time when a reduction might do more good.

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Mr. C. S. Young thought that a reduction in the discount rate at this time would be misinterpreted and he would not now favor taking action.

Mr. Leach did not think the discount rate should be changed now to implement an active ease policy, his concept of the policy of active ease in the bank credit field being a situation where any reasonably eligible borrower could go to a commercial bank and readily obtain a loan at a reasonable rate. That condition now existed and lowering the discount rate would not make bank credit more readily available; on the other hand, if it resulted in other rates moving downward, this would produce inequities without being of benefit to the economy.

Mr. Powell could see no immediate reason for lowering the discount rate, feeling that banks would borrow at existing rates if they had any real need for funds.

Mr. Johns concurred in the views expressed by Mr. Bryan for about the same reasons as had been stated by Mr. Bryan.

Mr. Vardaman felt it would be bad policy to reduce the discount rate at the present time since he could see nothing in recent developments which required such a reduction over the entire System. However, he stated that a reduction in the Atlanta District might possibly be advisable, and that conditions in the southern half of the St. Louis District were such as might require consideration of a reduction in that District. The same might apply to the Dallas District, but he was not sufficiently informed as to current conditions there.

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Mr. Thomas referred to the situation that exists when additional reserves are needed for short periods of time. He noted that the discount facility was one device for taking care of those temporary needs without making outright purchases or sales for the System account, and that another device was the use of the repurchase agreement. For these methods to operate smoothly, however, he said it was essential that rates be not too far above the market rate. Hence, some reduction in the discount rate or the repurchase rate might be helpful.

Mr. Robertson said that he was very much in favor of revitalizing the discount facility as an instrument of monetary policy and that he did not feel it to be essential that the discount rate be uniform in all Federal Reserve districts.

The discussion of this matter closed with the statement by Chairman Martin that it would be desirable for members of the Committee and Presidents of Federal Reserve Banks who were not currently members of the Committee to continue to study the comments made by Mr. Bryan regarding the discount facility and discount rate, and with the understanding that the Committee's general policy of active ease would be continued along the lines suggested by Chairman Martin earlier during this meeting.

Messrs. Sproul and Rouse stated in response to Chairman Martin's inquiry that they had no suggestions for change in the directive to be issued by the full Committee to the executive committee concerning open market operations.

Thereupon, upon motion duly made and seconded, the following directive to the executive committee was approved unanimously:

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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 (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, (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for 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 direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) 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 at any one time by the Federal Reserve Banks shall not exceed in the aggregate \$2,000,000,000.

Chairman Martin referred to memoranda on bankers' acceptances which had been distributed during the spring of this year and which had been included on the agenda for consideration at this meeting. He suggested that, for reasons he stated, consideration of these memoranda be deferred until the next meeting of the full Committee.

Mr. Szymczak suggested that it would be of assistance to the Federal Open Market Committee if the Special Committee on Foreign

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Operations of American Banks (Mr. Alfred E. Neal, First Vice President of the Federal Reserve Bank of Boston, Chairman) be asked to look into the question of bankers' acceptances and the suggestions made in the several memoranda prepared by members of the staff, and there was agreement that Mr. Neal be asked to have his committee study the matter, and that the subject be placed on the agenda for the next meeting of the full Committee.

Mr. Sproul stated that in view of the fact that a situation might arise early in October in connection with the Treasury's financing when the System would wish to put funds into the market on a temporary basis, he contemplated proposing at the meeting of the executive committee to be held immediately following this meeting that that committee authorize the Federal Reserve Banks to enter into repurchase agreements at a range of rates of $1-1/4$ to $1-1/2$ per cent for a temporary period. This action, he felt, would support open market policy and would not do damage to the discount facility. The discount facility, he noted, was one under which banks could obtain a relatively unlimited amount of reserves at a price (with reluctance on the part of borrowers to remain continuously in debt a limiting factor); whereas the open market window, including the repurchase facility, represented a means by which the banking system obtained the amount of reserves the Committee wanted to give it, for as long as the Committee saw fit, at going market rates. Mr. Sproul could see no inconsistency, when policy is one of credit ease, in providing these reserves, either through open market purchases, or infrequently and temporarily through

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repurchase agreements, at a rate below the discount rate; and he felt that such a relationship might be desirable in the course of the next two weeks.

Mr. Robertson stated that he did not agree with this position, and it was understood that the matter would be considered at the meeting of the executive committee to be held later today, inasmuch as the executive committee was authorized by the action of the full Committee at its meeting on June 23, 1954 to direct the Federal Reserve Banks to enter into repurchase agreements at such rates or rate ranges as the executive committee might prescribe, subject to certain conditions established by the Committee.

Reference was made to a draft of letter which had been prepared at the Federal Reserve Bank of New York relating to the procedure to be followed for securing Federal Reserve notes by the pledge of participations in obligations held in the System Open Market Account, in the event a Federal Reserve Bank other than New York were appointed to operate the System Open Market Account in an emergency. Copies of the letter from Mr. Tiebout, Vice President and General Counsel of the Federal Reserve Bank of New York, and of a draft of letter which might be sent by the Board of Governors to the individual Federal Reserve Banks had been distributed before this meeting. In response to a question from Mr. Leedy, Mr. Riefler stated that the draft of letter had been distributed for information only and that it was a matter to be considered by the Board of Governors and, if the Board so agreed, to be sent to the individual Federal Reserve Banks for their consideration.

In a discussion of the time for the next meeting of the Federal Open Market Committee, it was tentatively agreed that such meeting would be

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held during the period December 6-8, 1954, subject to change if it seemed desirable to change the meeting to another date.

Mr. Sproul stated that at the next meeting of the Committee he would like to call up for discussion the actions taken in December 1953 and in March of this year when it was voted that transactions of the System Open Market Account shall be entered into solely for the purpose of providing or absorbing reserves (except for disorderly markets). Mr. Sproul said he thought this represented much too narrow a view of central banking, was misleading to the public, and should have the Committee's early consideration. He did not believe that open market operations could be entered into without concern for the costs and availability of credit. This was well stated, he said, in a recent stimulating memorandum on the discount mechanism which said that open market "purchases and sales were made in the full knowledge (of the Open Market Committee) that they would have noticeable effects upon (a) the volume of member bank borrowing, (b) the level of rates in the money market, and (c) on the margin between those rates and the discount rate."

Mr. Bryan suggested that Mr. Sproul circulate a memorandum on the subject between now and the next meeting of the full Committee, and Chairman Martin stated that the members of the Committee would be glad to receive such a memorandum if Mr. Sproul wished to distribute it.

Thereupon the meeting adjourned.


Secretary