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 Tuesday, May 10, 1955, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Earhart
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Roelse, and R. A. Young, Associate Economists
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Roosa, Assistant Vice President, Federal Reserve Bank of New York
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Messrs. Erickson, Johns, and Powell, Alternate Members of the Federal Open Market Committee

Mr. Williams, President of the Federal Reserve Bank of Philadelphia

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 2, 1955, 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 March 2, March 15, March 29, April 12, and April 26, 1955, 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 March 2, 1955 to May 4, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed May 5-9, 1955, inclusive. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote the open market transactions during the period March 2 to May 9, 1955, inclusive, were approved, ratified, and confirmed.

At this point members of the Board's staff entered the room for the purpose of assisting in a review of the economic and credit situation, presented with chart slides. A copy of the script of this review subsequently was mailed to all members of the Committee.

In opening the review, Mr. Young stated that business recovery is an accomplished fact; activity is at new high levels. In the current quarter gross national product is estimated at an annual rate of $375

billion, nearly $20 billion above the low of last year and $5 billion above the mid-1953 peak. Abroad, strong expansion in activity generally continues. Notwithstanding rapid expansion in industrial production, price averages have remained steady. Some industries are operating at or close to capacity, and supply shortages have appeared in some industrial materials and prices of metals have advanced both in domestic and world markets. Manpower and industrial resources in this country are generally ample for growth. Unemployment, although lower than a few months ago, continues at a high level. Farm markets continue under pressure from large supplies and excess capacity. Reflecting advances in consumer buying and in business orders and output, demand for credit has strengthened and money rates have risen. Business, financial, and consumer confidence is extraordinarily high--possibly too high for sound growth. At this stage, the task of monetary and credit policy is to foster stable growth in line with expanding manpower and industrial resources, at the same time restraining financial over-commitments and dampening speculative excesses.

In commenting on credit and monetary policy, Mr. Thomas said that the problems are first, how much restraint to impose on the developing credit expansion; and second, what instruments of policy should receive emphasis. He noted that the System's policy instruments of regulation are largely concerned with quantities and with interest rates, but matters of credit quality may also need to be considered. The System's policy problems are complicated by heavy borrowing requirements of the Treasury. Usual seasonal expansion in credit and money for the remainder of 1955 would

require over $1-1/4 billion of additional bank reserves, and still more reserves would be needed to foster growth. As in 1952, the System might meet the problem of strong pressure for bank credit and monetary expansion by holding discount rates stable but requiring that a substantial portion of member bank reserve needs be met by increases in borrowing from and repurchase contracts with the Federal Reserve Banks. An alternative policy would be to keep member bank borrowing at a relatively low but still restrictive level, to supply increased reserve demands through open market purchases, and to exercise restraint through more active use of the discount rate.

Chairman Martin stated that the economic and credit review presented by the members of the staff provided an excellent background for the Committee's discussion of its policy and operations. He noted that he had been unable to attend the meeting of the executive committee held on April 26, and he called upon Mr. Sproul for a statement with respect to the discussion at that meeting which had resulted in the calling of a meeting of the full Committee for today, and for a statement of his (Mr. Sproul's) views on the current situation.

Mr. Sproul said that the executive committee meeting on April 26 included a discussion of the directive issued by the full Committee, particularly of clause (b) instructing the executive committee to arrange for transactions with a view, among other things, "to fostering growth and stability in the economy by maintaining conditions in the money market that would encourage recovery and avoid the development of unsustainable

expansion . . . ." It seemed clear at that time, Mr. Sproul said, as it had in the economic presentation this morning, that recovery had been completed. The Committee was no longer in the stage where it should be directing policy toward encouraging recovery; its problem now was to conduct open market operations and to administer credit policy so as to foster growth and stability in the economy by maintaining conditions in the money market which would avoid the development of unsustainable expansion. That was a shift in emphasis rather than in direction, but the executive committee had felt, Mr. Sproul said, that a meeting of the full Committee was needed to consider the situation for the immediate future and perhaps for the more distant future, and to consider the possible adoption of different wording for the instruction from the full Committee to the executive committee for carrying out open market operations.

Mr. Sproul then made a statement concerning the current situation substantially as follows:

1. The facts we have to face, or the assumptions we have to make, as I see them, and excluding war and major strikes, are about as follows:
   (a) The economic situation, which improved quite rapidly during the winter and early spring, as recovery from the 1953-54 recession was completed, continues to show strength but may go forward less rapidly during the next three or four months. Demands for credit, in the aggregate, given such orderly economic expansion, would be largely related to seasonal requirements and secular growth, with the usual speculative fringes. There is, of course, the alternate possibility that inflationary pressures may build up in a situation such as the present, but as yet there is no

convincing evidence of a spiralling upward movement of a speculative character. The ability of the economy to produce a larger volume of goods and services--and leisure--representing less than full current utilization of all available men and machines is some insurance against such a spiral.

(b) There are still the same question marks about the third quarter of the year (although they are smaller than they were), related primarily to shifting seasonal patterns--or possible temporary overproduction--whichever you want to call it, in automobiles, steel, and housing. Some decline in these industries might be healthy, removing froth in the economy, if the decline is offset by strength in other areas as now seems likely.

(c) The particular areas in which credit expansion has caused and may cause some concern, are consumer credit, mortgage credit, and stock market credit. And we shall have to be on the watch, now, for diversion of too much credit into the area of inventory accumulation.

(d) Except for this latter use of credit, which does not yet seem to have done more than keep pace with expanding business, however, these are areas which ordinarily are difficult to reach by general credit restraint, unless you are willing to carry that restraint quite far, and then often there is a considerable lag between cause and effect. The risk of such vigorous restraint, in the absence of more general misuse of credit by the economy and of clear evidence of substantial misuse in these areas, is semi-paralysis of capital markets at a time when we are counting on active capital expenditures by private industry and state and local governments to help maintain economic growth--to help offset possible declines in those sectors of the economy which have been the driving force in the upturn of the past few months.

(e) Another complication in formulating the general outlines of credit policy at this time is the need for deficit financing by the Treasury. The

Treasury will be coming to the market, possibly in July and October, for approximately $9 billion of new money, in addition to substantial refundings to be managed as of August 15 and December 15.

(f) This unfortunate Treasury cash borrowing at a time of high level economic activity and high level income, so far as can be seen with any certainty now, will probably cause a substantial net increase in bank credit and may be the principal inflationary influence on the credit side during the last half of the year. In other words, if the Treasury were not going to have to come to the banking system for funds, we might well have nothing more, in the aggregate, than the credit demands of seasonal and secular growth in the private economy.

(g) This poses a difficult but not unfamiliar problem. Since the Treasury is a necessitous borrower and cannot reduce its demands, credit restraint to offset the possibly inflationary effects of Treasury borrowing must fall most heavily on the private economy where such restraint may or may not be needed.

(h) Finally, we have the possible consequences of market lags and market anticipations. So far as lags are concerned, we know that a market and an economy which may have seemed to pass by the amber lights we have flashed so far, may actually be in process of heeding our signals after a time interval. So far as anticipations are concerned, we know that a market and an economy, seeing the cumulation of private and Treasury demands for credit during the second half of the year, and projecting our past policy into the future, may see red before we intend to flash red.

2. These facts and assumptions suggest to me that we should hold steady for the next month or six weeks. This does not mean reversing policy; it does not mean relaxing pressure; it means preventing further intensification of pressure for the present. We have had some success in a slow steady application of the brakes through open market operations followed by a change in the discount rate. An accentuation of pressure at this time, however, may cause the brakes to begin to grab.

3. Holding steady would mean free reserves ranging around zero and interest rates in line with the present discount rate. In the face of the outlook for reserve funds this would mean that we would have to become buyers of short-term Treasury securities,

on balance, after the end of the month. And unless there is a change in this situation and in our policy, that would be pretty much the outlook over the remainder of the year. The situation which, under an easy money policy, we took care of by large injections of reserve funds by way of reductions in reserve requirements in 1953 and 1954, will have to be met, to the extent that we believe it necessary to meet the pressure of demand for bank credit, by modest and gradual open market operations in the changed circumstances of 1955. We can then get more tough if the situation seems to require it.

4. Such a policy would not rule out some further increase in market rates of interest later on if and as demands for credit and capital continue to press on supply. And it would not rule out later consideration of another increase in the discount rate, even though we may then be net buyers of Treasury securities. But it would rule out, for the present, positive steps to increase credit restraint, or permitting it to increase by inaction. It would require positive steps to prevent the pressure of demands, and of anticipation of future demands, from making policy more restrictive than the present economic situation requires.

Mr. Vardaman said that he noted Mr. Sproul's reference to three areas of credit which might cause concern--real estate credit, consumer credit, and stock market credit--and he inquired whether Mr. Sproul implied that these areas of credit could not be influenced through general credit controls.

Mr. Sproul responded that these areas of credit could be reached by general controls but that the use of general controls to reach them might have to be more restrictive, and might have more effect on the general economy, than might be required in the absence of more general misuse of credit in the whole economy. Mr. Sproul went on to say, in response to a further question from Mr. Vardaman, that his comments did not indicate that the System should be considering the use of selective credit controls at this time, that the Federal Reserve had only one selective credit control--

margin requirements--at present, and that while he personally felt that it might be useful to have other selective credit controls, there was no need to consider their use at this stage since the System had no authority for making them effective.

Chairman Martin stated that Mr. Sproul had given an excellent presentation of the problem that was pointed up by the economic review and the charts presented by the staff this morning. He suggested that the discussion be divided into two parts, the first to be consideration of Mr. Sproul's suggestion regarding a change in the wording of the directive from the full Committee to the executive committee so as to eliminate the instruction to encourage recovery, and the second to be consideration of the policy to be followed with respect to open market operations between now and the next meeting of the Committee.

Mr. Fulton referred to the wording of the directive and inquired whether the word "stability" was compatible with "fostering growth" in the economy; that is, whether "growth" was consistent with the objective of maintaining a stable level of economic activity.

Mr. Sproul responded that he felt "stable growth" was the kind of growth the Committee was trying to maintain, that it was not seeking a "static" economy. He could see nothing inconsistent between "stability" and "growth", if that meaning were given to the directive.

Chairman Martin suggested that "orderly growth" would mean a stable economy, and he added the comment that it was partly a matter of the meaning

that the Committee wished to read into whatever words it used in writing its instructions.

Mr. Robertson stated that, in his opinion, we were not now in the stage where the Committee ought to be fostering growth. Growth was inherent in the whole situation, he said, and the Committee would be better off if it were to take out of its directive words indicating that operations should foster growth and were to leave only the direction that operations should foster stability. He agreed with Mr. Sproul's suggestion that words indicating that the Committee now wished to "encourage recovery" should be deleted from the directive, since this was no time for the Committee to be encouraging recovery. He also suggested that some other words in the present directive were unnecessary. Mr. Robertson then read a suggested revision of the first paragraph of the full Committee's directive to the executive committee which would instruct the executive committee to arrange for such transactions for the System account "as may be necessary or appropriate in the light of current and prospective economic conditions with a view (a) to relating the supply of funds to the needs of commerce and business, (b) to fostering stability in the economy by maintaining conditions in the money market which would avoid unsustainable expansion, (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account . . . ."

Chairman Martin invited other suggestions for change in the directive and Mr. Leach suggested consideration be given to amending clause (b) of the first paragraph of the Committee's directive to provide that the

executive committee should arrange for such transactions for the System account "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 fostering growth and stability in the economy by maintaining conditions in the money market that would be consistent with a high level of economic activity and that would avoid the development of unsustainable expansion, (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account . . . ."

Following a rereading of the suggestions by Messrs. Robertson and Leach, Chairman Martin stated that he would dislike removing from the directive the concept of "growth." This concept, he said, was inherent in stability, but his view was that it was desirable to have it set forth explicitly in the full Committee's directive.

Mr. Sproul stated that he too would be reluctant to see the policy directive leave out any reference to growth in the economy. He felt that a retention of some word to indicate that the Committee was conscious of the need for growth in the economy--a word which would reflect the Committee's concern with and interest in that aspect of economic activity--would be desirable.

Mr. Balderston stated that in view of the present amount of unemployment in the economy, he felt the Committee should look on growth as one of the problems with which the Committee was concerned, although he

was not greatly concerned with the particular words used so long as the idea was in the directive. He also suggested that clause (c) of the full Committee's directive indicating that operations should be with a view "to correcting a disorderly situation in the Government securities market" implied the existence at this time of a disorderly situation, and he felt it would avoid any such implication if it were changed to read "to correcting disorderly situations in the Government securities market."

Mr. Shepardson agreed with the latter suggestion, stating that this clause had struck him as implying the current existence of a disorderly situation in the Government securities market which needed correction.

During the foregoing discussion Mr. Vardaman withdrew from the meeting.

Chairman Martin stated that the Committee should not overlook the fact that the directive of the full Committee would be published in the open market policy record. He also cautioned that changes should not be made which might be construed as having more significance than was intended.

There followed a further discussion of the suggestions that had been made during which Mr. Earhart inquired whether much if any change of policy was contemplated in the Committee's operations at the present time.

It was the consensus that little or no change in policy was contemplated at the present time but that a change in wording would be for the purpose of adapting the directive to the existing situation which no longer called for encouraging recovery.

After some further discussion, Chairman Martin suggested that each of the suggestions made seemed to be driving at the same point but that it was difficult for the Committee to rewrite a directive which had been carefully developed over a period of years, on the basis of various considerations, some of which were of a legal nature. The present directive, he noted, might contain implications which the Committee would not wish to change without thorough consideration, including advice of counsel and other members of the staff.

Mr. Thomas referred to Mr. Robertson's suggestion which would remove from the first part of the full Committee's directive the provision that operations be in the light of "the general credit situation of the country" leaving as a general standard only a reference to "current and prospective economic conditions." It was Mr. Thomas' view that the phrase referring to the general credit situation was put in the directive intentionally to indicate that consideration was to be given to qualitative factors in the credit picture, and he felt it might be unfortunate to remove from the directive the specific indication that the general credit situation was a consideration in determining operations for the System Account.

Mr. Mills concurred inthis view, adding the comment that the phrase was a recognition of the statutory responsibilities of the Open Market Committee.

There was a further discussion of the several suggestions made, at the conclusion of which Chairman Martin suggested that the least change

feasible be made in the language of the directive at this meeting, which would mean taking Mr. Sproul's suggestion that the words "encourage recovery and" be deleted from clause (b) of the directive that would be issued today, to make that clause read "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion . . . ." He also suggested that Counsel be asked to consider the several suggestions made during this discussion, with a view to submitting for consideration at the next meeting of the full Committee whatever suggestions for change might seem to be desirable.

Chairman Martin's foregoing suggestions were approved unanimously.

Chairman Martin suggested that the Committee next consider the policy to be followed during the immediate future. He referred to a sheet distributed at this meeting showing a pattern of recent and projected reserve changes which indicated a volume of free reserves during the statement weeks ending May 11 and 18 averaging a little over $400 million, to be followed by a fairly rapid decline in the level of free reserves to a negative position during most of the month of June. Chairman Martin inquired of Mr. Sproul whether his suggestions as to open market operations were essentially that the Committee should maintain an "even keel" during the next several weeks.

Mr. Sproul responded that his suggestion would mean allowing market forces to have their effect in rapidly taking free reserves out of the market, following the present temporary surplus of such reserves in the market.

Mr. Thomas stated that the projections indicated a very easy situation during the current and next succeeding week, and then a gradual tightening through the next several weeks, building up to a negative free reserve of around one-half billion dollars early in July and again at the end of August. Mr. Thomas also referred to differences between the estimates prepared at the Board's offices and those prepared at the New York Bank, which showed a much greater increase in needed reserves. The widening margin of "negative free reserves" between the two estimates is mainly attributable to a fundamental difference in method. The projections at the Board are based on rigid assumptions of only the customary seasonal variations with an estimate allowing for growth in deposits at a 3 per cent annual rate; whereas the figures prepared at New York are forecasts based on factors which the Bank expects to occur, such as a more than seasonal increase in bank credit, deposits, and currency in circulation. The result is that the figures prepared at the New York Bank indicated that about a half billion of additional reserves would be needed to cover the growth in reserve requirements.

Chairman Martin commented that he wished the swings in the actual volume of free reserves were not so great, and he inquired of Mr. Roosa as to the possibility of trying to smooth out some of these swings.

Mr. Roosa stated that the Committee had just had a clear indication of the problem of smoothing out the swings in free reserves and that the management of the System account would like to have guidance from the Committee on this particular point. Yesterday, he said, it was decided to roll

over the System account's holdings of bills in the amount of $74 million even though it was realized that at this time free reserves were higher than the Committee wished them to be. This was a difficult decision to make, he said, for the reason that the Committee previously had indicated that System account operations might confuse the market as to System policy if the account were to be in and out of the market too frequently. Consequently, since the projections made it appear that the System account would be back in the market making outright purchases by the end of May, it was felt that it would be confusing if the account showed a runoff in bills and a reduction in holdings during the current week, when market conditions had not changed broadly, to be followed later on this month by purchases of bills. The choice was, on the one hand, whether the account should be in and out and risk the confusion and the possibility of seeming to buffet the market from side to side; or whether, on the other hand, it should not attempt to avoid swings such as had taken and were taking place. Mr. Roosa pointed out that one of the difficulties in using repurchase agreements is that they can not be used to take up slack unless there previously has been a purchase. Otherwise, it would be necessary to make an outright sale. Last week, he said, the Treasury had agreed to "juggle its calls" and by cancelling one call, had avoided bringing a large volume of funds into the Treasury which would have tightened the situation at a time when it was already tighter than desired. Mr. Roosa stated that the present situation highlighted the complexity of the problem. From such indicators as the rates on Treasury

bills, Federal funds and dealer loans, the market did not appear to be easy. On the other hand, the current level of free reserves might be considered much too high according to the executive committee's instructions. The System account could have run off bills yesterday or it could now sell bills, and it might be that the executive committee today would wish to instruct the New York Bank to sell bills with the knowledge that it would be necessary to buy bills back toward the end of this month. Mr. Roosa's question was whether the smoothing of operations was of enough importance to warrant the System account being in and out of the market on an outright basis at the risk of confusing the market as to System policy, or whether the Committee would rather permit the wider swings to occur so long as there was no decided change in the market atmosphere.

Chairman Martin stated that he favored minimum intervention in the market but that he also thought the System account should try to minimize the sweeping moves indicated by the projections of free reserves. If the Committee was going to look to a level of reserves, it ought to try to exercise its influence to bring about that level.

Mr. Earhart said that he generally favored as little intervention as possible. However, he wondered why at the time the Committee was finding it necessary to buy some bills, it provided a favored rate for repurchase agreements.

Mr. Roosa responded that the fundamental point in the lower repurchase rate--1.65, compared with a discount rate of 1-3/4--was the feeling of the New York Bank, in the light of the executive committee's general

instruction, that as far as possible the account should avoid intervention on an outright basis, and the indication at the meeting of the executive committee on April 26 that it would be preferable to do as much as possible in adjusting market conditions through the use of repurchase agreements. The account management did not wish to go to the dealers and notify them that it was policy to take repurchase agreements; it seemed preferable to approach them through the market price. Mr. Roosa then described the changes in volume of repurchase agreements on May 4 and 5 which resulted after the rate was lowered to 1.65, stating that the total repurchase account in those two days came up to around the $200 million level. Mr. Roosa expressed the judgment that few, if any, of these additional repurchase agreements would have been in the account toward the end of last week if the lower rate had not been made available. Making funds available through repurchase agreements meant that the funds furnished to the market would automatically be taken out through the repayment of the repurchase agreements, and Mr. Roosa felt that this was a case in which the use of the lower rate on repurchase agreements had avoided or minimized intervention by the System account. Even so, he said, it was the account management's feeling that the volume of repurchase agreements that had been gotten was not as large as would have been desirable on some days.

Mr. Thomas noted that the yield on bills last week was low because of two special factors: the demand for bills by persons who did

not wish to exchange maturing Treasury securities into the new 15-month notes, and the general shortage of bills in the market. In order to put reserves into the market through repurchase agreements at that time, it was necessary to put them in at the lower rate since dealers would not borrow from the Federal Reserve and carry bills or other securities at 1-3/4 per cent when bills were yielding less than 1-1/2 per cent. He also noted that outright purchases of securities were made at rates lower than the repurchase rate of 1.65.

Mr. Mills stated that he would like to suggest reasons why it would be undesirable and unnecessary to cause the withdrawal of reserves from the market over the next two weeks, even though the level of free reserves will rise to a higher level for a few days than might be otherwise desired. The reasoning, he said, went back to a fear that the actions of the Committee might become an unstabilizing influence in the market. There had been an admirable discussion of the state of the economy this morning, Mr. Mills said, but any discussion of the economic situation was of necessity at a static point. The Committee might wish to bear closely in mind the "cause and effect" of its policy, as Mr. Sproul had put it, and particularly the sensitivity that seemed to be developing in the market which might cause a broader range of swings than was desired. Mr. Mills then made a statement substantially as follows:

> Determination of an appropriate short-run open market policy is being complicated by a combination of market conditions and extraneous influences. As to the latter, one needs only to read the current flow of financial and business news

letters to be aware that investors' thinking is troubled by the past course of System actions and their interpreted foreshadowing of future System policy actions.

A cumulative investor judgment seems to be in the making that the System foresees enough inflationary danger in the rapid pace of the business recovery as to deserve both a continuing and a mounting policy of credit restriction. This attitude also seems to have been abetted and aggravated by short-selling on the part of U. S. Government security dealers as well as by comment from financial market news writers that a restrictive credit policy carries only the meaning of higher interest rates and lower prices for U. S. Government securities.

The unsatisfactory reception given to the Treasury's new issue of 2 per cent bonds of August 15, 1956, has further disturbed investment sentiment by raising the thought that the new issue will not be able to hold its par price on the market. Furthermore, market analysts apparently have been in doubt whether the System's direct purchases of $97 million of U. S. Treasury bills were intended to represent support of the Treasury's financing operation or a signal that the System was indicating its readiness to supply, within reason, such new reserves as will be necessary to support legitimate credit growth through the remainder of 1955.

To resolve the doubts that have arisen, it would seem best that the System should sit tight for the near future and ride along with the volume of reserves now in the market, even though natural factors may raise the supply over the next two to three weeks to a level higher than might otherwise be considered suitable to a System policy of credit restraint. It is fitting that presently outstanding repurchase agreements be allowed to drain that volume of reserves from the market, but any action beyond that to withdraw reserves would be ill-considered in that the market would be led to the conclusion that the reserves previously supplied through direct Treasury bill purchases had only been intended to give support to the Treasury's financing operation and not as a signal of the System's future policy intentions. In fact, it is fortunate that the $97 million of Treasury bills that were purchased outright will be disclosed in two rather than in one of the Weekly Condition Reports of the Federal Reserve Banks, in that such action will be taken as confirming the System's intention to supply the market with new reserves as needed and not to subject the market to any further reserve pressure at this time and unless business expansion should unexpectedly tend to get out of hand.

During this period that any action is withheld from withdrawing the reserves previously supplied by direct Treasury bill purchases, natural factors will on estimate introduce a considerable volume of new reserves into the market. Inasmuch, however, as alert market observers will be able to trace such additional reserves to temporary factors, there is only a minimum possibility of any erroneous interpretation of System policy suggesting a change toward ease and, consequently, there would seem to be little likelihood of any important price reaction in the U. S. Government securities market to the temporary appearance of a relative surplus of reserves. As a practical matter, it is quite probable that such surplus of reserves as develops will serve a worthwhile purpose of lubricating the market over the May 17th payment date for the new Treasury 2 per cent notes of August 15, 1956.

Relatively plentiful reserves available to the market at that time should assist the adjustments to be made by investors in the reinvestment of the proceeds of maturing U. S. Treasury savings notes and the proceeds of the maturing 1-1/8 per cent Treasury certificates of indebtedness that also come due on May 17th and are not offered for exchange into the new 2 per cent Treasury notes. A heavy attrition has occurred in the maturing 1-1/8 per cent Treasury certificates of indebtedness and, as indicated, plentiful reserves available to the market as of May 17th should be helpful in smoothing out reinvestment programs even though the impact of the attrition for a very brief period might inject a substantial amount of new reserves into the market via a rapid reduction in Treasury balances at the Federal Reserve Banks. Here, too, alert market observers will not be apt to misinterpret the situation but, instead, will regard it as a normal phenomenon and one which the System has permitted as a means of facilitating reinvestment programs.

All told, therefore, there are seemingly good and sufficient reasons for the System to have a hands-off policy in the market over the next two to three weeks, other than allowing repurchase agreements to terminate without renewal.

Chairman Martin said that the thing he questioned in Mr. Mills' statement was whether the market was really as alert to these changes as Mr. Mills seemed to think. Even if it was, Chairman Martin said, he thought the Committee should try to do something to get the market more

accustomed to a more normal type of operation. It was hard for him to read into the modest changes that had taken place in the supply of free reserves as much as Mr. Mills seemed to read into them.

Mr. Williams stated that information coming to his attention indicated that the market was interpreting the situation about as Mr. Mills had suggested.

Mr. Earhart stated that he had had several comments to the effect that the System account's purchases of bills last week and the lower rate on repurchase agreements represented "support of the Government securities market."

Mr. Robertson doubted the need for a reduction in the repurchase rate, but he approved purchases of bills in order to get free reserves back on "an even keel" in line with the thinking of the executive committee at its meeting on April 26. If the policy was still one of maintaining an even keel, which he thought it should be, Mr. Robertson stated that the only solution at this stage was to sell securities and to absorb reserves. This course would be easily understood by anyone trying to understand System policy. If what the committee was trying to do was to maintain approximately a zero level of free reserves in order to maintain modest restraint, its actions ought to speak for it. Therefore, he advocated that the Committee now absorb some of the free reserves in the market.

Chairman Martin stated that that got back to an analysis of the

projections of free reserves. If the System account had been more active in the market there would not have been such wide swings, he said. The justification for stepping in--no matter what the interpretations as to policy--was that the Committee had tried to maintain an even keel during the period of Treasury financing. Stepping into the market did not make the Treasury issue a success, Chairman Martin said, and the psychological influence of the action could not be accurately evaluated. However, in his view the action was intended to restore to the market the free reserves that the committee had anticipated would be in the market at the time the decision was made at the meeting on April 26 to maintain an even keel during the period of the Treasury financing.

Mr. Roosa stated that the swings in free reserves recently had been so great as to make us tend to forget the timing. At the time the repurchase rate was lowered to 1.65 on May 4--and the System account in determining how it should proceed throughout the day was trying to read the Committee's mind--the management of the account was aware of the fact, on the basis of developments on Monday and Tuesday, that the statement for the week ending May 4 would show negative average free reserves well in excess of $100 million. This situation had developed largely out of unexpected swings in the Treasury's balance. As indicated before, the Treasury had been persuaded to cancel one of its calls for $283 million of funds which otherwise would have been taken out of the market. This factor helped reduce the $100 million figure but it still appeared that there would be less than zero free reserves for the week ending May 4

although in the end the average for the week was plus $12 million. Mr. Roosa went on to say that this small plus of free reserves resulted only after action had been taken to lower the repurchase rate to 1.65, in order to do as much as possibly could be done in a very temporary way.

Mr. Robertson inquired of Mr. Roosa what were the factors that had led to the judgment that repurchase agreements would not have been entered into if the rate had been maintained at 1-3/4 per cent instead of having been reduced to 1.65 on May 4.

Mr. Roosa responded that this was just a matter of judgment at the time. As the System account saw the situation from dealers' reports coming in, telling their money position and what they might be doing, it was the account's understanding that during the day on May 4 repurchase agreements would largely be taken up. Also, that dealers would not be ready to make any new repurchase agreements on rights (which was the form of securities they had most readily available) at the 1-3/4 per cent rate. This was because dealers could get funds at out-of-town points at rates as low as one per cent.

Chairman Martin stated that the Committee could learn a great deal from a study of this period. A number of contributing factors such as the Treasury's calls had caused difficulties. He felt it desirable to have had a discussion of the projections of free reserves which have been so wide. He again said that, if the Committee were to talk about some level of free reserves, it probably should assume more responsibility for evening out these wide fluctuations than it has at times in the past.

Mr. Thomas stated that the actual day to day fluctuations had been in the past, and would be in the future, much wider that the figures shown on the projection sheet, which were weekly averages and also that actual weekly fluctuations would be wider than projections, which assume no change in Treasury balances and only average changes in other items. He also commented that efforts were being made to work out with the Treasury a means whereby the influence of erratic changes in the Treasury's balance on the volume of reserves could be reduced.

Chairman Martin then reverted to the policy to be followed during the next few weeks. He said that he did not share the apprehension of Mr. Mills regarding signals given to the market by changes in the volume of free reserves. He did think it true that if the Committee was in the middle of the stream, it should not change signals. Chairman Martin suggested that all members of the Committee study the period we had just been through and think about the suggestion that, if some level of reserves was desired, the System should try to smooth out wide fluctuations so as to come closer to having that desired level of reserves.

Mr. Sproul stated that as he saw it, the Committee was now aiming at a level of reserves around zero, not expecting to be able to pinpoint any particular figure. During the week ending May 4 we ended up with average free reserves of $12 million, which was as near as possible to coming out where the Committee aimed. He thought that the Committee could say that the mistake or error in the projections was due to unforeseen developments. Mr. Sproul then referred to projections for the weeks

ending May 11, May 18, and May 25. After the end of May, it was anticipated that there would be almost a continuous negative free reserve position, sometimes in substantial amounts. Mr. Sproul said that he would prefer to have reserves taken out of the market during the next statement week from repayments of repurchase agreements, and to allow market factors to do what they could to reduce reserves during the following week. By the end of the month, the projections indicated that free reserves might be down to the range of around zero.

Chairman Martin stated that this program seemed appropriate for the immediate future. He noted that this discussion was in a meeting of the full Committee and that the policy to be set would apply for a period of approximately six weeks until the next meeting of the full Committee.

Mr. Sproul stated that on the basis of the projections prepared at the Board's offices as well as those prepared at the New York Bank, it should be contemplated that some purchases of bills might be necessary during the period between now and the next meeting of the full Committee. He suggested that the instruction from the full Committee include that possibility even though no positive direction were to be given.

Mr. Mills stated that he would concur in Mr. Sproul's reasoning.

Mr. Robertson said that he was in general agreement but that he thought the Committee should get the level of free reserves down. If natural forces would do this, fine. If not, he would favor selling securities from the System account in the immediate future. The main thing, he said, was to keep in mind that the Committee's policy was one of moderate restraint. He inquired whether there was any thought that repurchase

agreements should be made available from here on out at a rate below that of the discount rate.

Mr. Sproul responded that he did not think so, that he thought the repurchase agreements at the lower rate would go off today except with respect to repurchase agreements based on "rights", and that after today, if the repurchase window is open, the rate would be 1-3/4 per cent.

In response to Chairman Martin's inquiry as to what additional instructions were needed, Mr. Riefler stated that he thought nothing additional was required from the full Committee.

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

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 fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion, (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.

Mr. Robertson suggested that the Committee bear in mind the possibility of an increase in the discount rate, if additional pressure on the market was needed during the next few weeks.

Mr. Balderston stated that he shared this view.

Mr. Riefler noted that in accordance with the action of the full Committee at its meeting on March 2, 1955, a procedure had been made effective by the executive committee at its meeting on March 29, 1955, whereby the Federal Reserve Bank of New York was authorized to purchase bankers' acceptances up to an amount of $25 million. It was understood that the authorization for this procedure would continue in effect until changed by the Committee.

Mr. Sproul stated that he would like to make one fact clear. All of us, he said, including himself, were inclined to get into the habit of thinking that we controlled the whole situation when actually the Federal Reserve controlled only a part of the picture. The Federal Reserve, with its monetary and credit controls, was not in control of the whole economic situation, and it should not get into the habit of thinking that it was.

Chairman Martin concurred heartily with this statement.

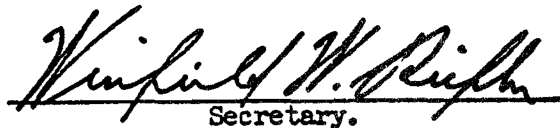
Mr. Leach inquired whether the executive committee had any authority to take any action in a period of Treasury financing which would be intended solely to assist in making a Treasury offering a success, or whether that would require action by the full Committee, as was his understanding.

Chairman Martin responded that his understanding was the same as Mr. Leach's.

Mr. Riefler stated that in accordance with the understanding at the meeting of the full Committee on March 2, Mr. Vest, General Counsel, had prepared a draft of a resolution which dealt with actions that would have to be taken in the event the full Committee were to decide to abolish the executive committee, and a letter transmitting this draft of resolution was being distributed to all members of the Committee today.

Mr. Robertson suggested that at the next meeting of the full Committee, further study be given to the form of certain continuing policies relating to operations for the System open market account, along the lines discussed at the meeting on March 2, and it was understood that this matter would be placed on the agenda for consideration at the June meeting.

Thereupon the meeting adjourned.



Secretary.