A meeting of the executive committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System on Tuesday, May 26, 1953, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Evans
Mr. Mills
Mr. Johns, Alternate for Mr. Erickson

Messrs. Robertson and Szymczak, Members of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Ralph F Leach, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Tilford C. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee of the Federal Open Market Committee held in Washington on May 6 and May 13, 1953 were approved.

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 May 13 to May 22, 1953, inclusive. At this meeting Mr. Rouse distributed a supplementary report covering commitments on May 25, 1953 and commented briefly on both reports,

copies of which have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period May 13 to May 25, 1953, inclusive, were approved, ratified, and confirmed.

In accordance with the understanding at the meeting of the executive committee on May 13, there had been placed on the agenda for consideration at this meeting a proposal for revision of the general directives of the Federal Open Market Committee and of the executive committee, prepared pursuant to the understanding at the meeting of the full Committee on March 4-5, 1953.

Mr. Riefler outlined the suggested revisions in the directives to be issued by the full Committee and the executive committee, stating that they dealt with form only and did not include substantive changes.

During the ensuing discussion, questions were raised as to whether the directive to be issued by the full Committee to the executive committee should be in two parts (a general instruction, to be issued once a year, and a specific directive to be issued at each meeting of the Committee), or whether the present single directive should be retained; whether there was need for having an annual review of operating authorizations of the type that ordinarily had been reviewed at the organization meeting of the Committee in March of each year or whether these authorizations

might be taken up for consideration only when a change was contemplated; and whether in view of the understanding at the meeting of the full Committee on March 4-5, the executive committee should make any recommendation to the full Committee concerning a proposed revision in the form of directives. In this connection, Chairman Martin expressed the view that it would be preferable for the executive committee not to make a recommendation to the full Committee.

Mr. Sproul stated that he saw no objection to this procedure, and in response to Mr. Sproul's question as to whether the full Committee would be expecting a draft of revised form of directive at its next meeting, Mr. Riefler said that it was assumed that some consideration would be given to the form of the directive at the June meeting in view of the fact that a number of recommendations which had been made in the ad hoc subcommittee report had become effective since the meeting of the full Committee in March.

Mr. Mills suggested that, inasmuch as a relatively short period had elapsed since the changes in procedure approved at the March 4-5 meeting had become effective, consideration of a revision in the form of the directive might be postponed until more experience had accumulated under the general type of operation now being followed.

There was a further discussion of the matter during which Chairman Martin suggested that the proposed revision of the directives, changed to delete certain phrases in accordance with a comment by Mr. Sproul, might be sent to all members of the full Committee for their information, with the

understanding that the executive committee had no recommendation to make but that the matter would be placed on the agenda for the next meeting of the full Committee.

In this connection Mr. Robertson suggested that, whereas the present proposal for revision represented a change in form only, it might be desirable for the staff to prepare for the consideration of the members of the full Committee any substantive changes which it felt should be made in the directives, and Chairman Martin stated that the staff should feel free to submit drafts of any such proposals.

At the conclusion of the discussion, it was understood that Chairman Martin's suggestion with respect to handling of the matter would be followed.

At this point Mr. Leonard, Director of the Division of Bank Operations, Board of Governors, joined the meeting.

Before this meeting there had been sent to each member of the committee a copy of a memorandum dated May 21, 1953, prepared in the Division of Bank Operations of the Board of Governors, with respect to allocation of securities in the System open market account. The memorandum had been prepared pursuant to the understanding at the meeting of the full Committee on March 4-5, 1953.

Mr. Riefler stated that the memorandum prepared in the Division of Bank Operations contained no recommendations but was simply a statement

of various methods that might be used for allocating securities held in the System account. The present formula, he said, based allocations primarily on the expense and dividend requirements of the Reserve Banks. The view had been expressed that with current large earnings of the System and with strong interest in economy of operations, it was inconsistent to allocate securities on the basis of expenses since, whenever expenses of one bank rose, it merely meant a re-allocation of securities to provide that bank with more earnings. Therefore, several alternative methods had been described in the memorandum which would allocate securities (1) according to size of the Reserve Banks as indicated by various measures, (2) to equalize reserve ratios, (3) to tend to equalize ratios of section 7 surplus, and (4) according to district, financial, and other economic data.

During a brief discussion of the memorandum, Mr. Szymczak suggested that inasmuch as copies had been sent to the Presidents of all Federal Reserve Banks, it might be expected that there would be a discussion of the matter at the Presidents' Conference to be held in the week beginning June 8. He suggested, therefore, that the topic be placed on the agenda for discussion at the meeting of the full Committee to be held on June 11, without recommendation on the part of the executive committee, and this suggestion was approved unanimously.

Mr. Leonard withdrew from the meeting at this point.

Chairman Martin then called upon Mr. Thomas for comments on the economic and credit situation which had been reviewed in a staff memorandum

prepared under date of May 22, 1953 and distributed before this meeting.

Mr. Thomas stated that the economy was continuing to operate at a very high level with some selective adjustments in the price structure, but with no striking movements either up or down. Although the staff had been watching for signs of weakness in the economy, it had been able to find very little indication that actual weakening was taking place. Probably the only evidence of weakness, Mr. Thomas said, was that dealers' stocks of used automobiles seemed to be building up a little and there were some declines in used automobile prices, but these changes were still relatively small. In the credit and capital markets, the chief concern seems to be about finding funds to meet the heavy borrowing demands, rather than any slackening in the demand for credit. Finance companies are having some difficulty in getting funds and there have been some reports of proposed issues of securities being withdrawn. An important recent development, Mr. Thomas said, was some clarification of Treasury financing needs. It now looks as though the Treasury cash deficit for the fiscal year ending June 30, 1953 will total between $4 and $4-1/2 billion. The latest official estimate of the cash deficit for the fiscal year ending June 30, 1954 is about $3 billion, with an indication that during the last half of the calendar year 1953 the cash deficit will be nearly $9 billion. There will be fairly heavy Treasury borrowing during the next 5 or 6 weeks, Mr. Thomas said, and it appears likely that the Treasury balance at the end of the current fiscal

year will be below $4 billion, including $1 billion of gold--a relatively low figure. Between now and that time, it is probable that the Treasury will find it necessary on occasions to borrow from the Federal Reserve on special certificates of indebtedness. Total loans and investments of member banks have continued to decline, Mr. Thomas said, reflecting continued sales of securities by banks to nonbank investors. Loans have declined somewhat but not as much as ordinarily would be expected at this season. Both Government and private deposits have declined substantially in recent weeks compared with a small increase in the total during the same period last year. The banks' reserve position continued tight until mid-May, but has been much easier recently owing largely to a decline in Treasury balances at the Federal Reserve and to System purchases of securities. With the likelihood that Treasury balances will continue low until the latter part of the month, member bank borrowings at the Reserve Banks may remain below a billion dollars for most of the next four weeks.

Mr. Rouse stated, in response to a question from Chairman Martin, that the tone of the Government securities market had been quite upset recently because of the reaction to the Treasury refunding of $5,688 million of certificates and bonds maturing in June. He hoped this situation had been relieved as a result of the announcement by the Treasury this morning that attrition on the refunding was only about $850 million or 15 per cent, whereas estimates had been running as high as $1-1/2 billion. As

to the bond market, Mr. Rouse said, there is a moderate supply of bonds in the market including the longer partially exempt issues and in the case of Treasury 2-1/2s, demand is slow. In the case of the new Treasury 3-1/4 per cent bonds, while there is a relatively small volume of trading, buying by public funds and trust accounts is good and these bonds have behaved well marketwise recently. Mr. Rouse felt that these bonds were having a good influence on the tone of the market. Mr. Rouse went on to say that he did not consider the 15 per cent attrition on the Treasury's current refunding as particularly heavy in view of the fact that the exchange period allowed insufficient time to effect redistribution and in view of the absence of a market premium on the "rights"; in fact some persons would feel that attrition of as much as 20 per cent would not be unduly heavy in these circumstances.

Mr. Sproul then made a statement substantially as follows:

I agree in general with Mr. Thomas' report on the economic situation, that is, that economic activity is still at high or record levels. Nevertheless, sentiment is growing and becoming more widespread that some tapering off will begin soon, and possibly before the end of this year. In view of these expectations, it is unlikely that Treasury deficit financing, through banks, will recreate serious inflationary pressures.

Regardless of the accuracy of this forecast, there would seem to be no need for further intensification of credit restraint on the basis of the existing situation, nor for relaxation of that restraint. Maintenance of the present degree of restraint will require substantial increases in Federal Reserve credit over the balance of the year during which there will be heavy Treasury demands plus seasonal demands from private borrowers.

Implementation of policy will require increasingly difficult judgments as to the timing and amount of market intervention,

and will call for constant review of credit effects of action. The System is now operating in an already tight and extended money market, which may have become too used to sustained restraint to show an immediate response to injection of reserves by the System. The market appears to have gained little comfort or assurance from purchases made so far. Sentiment is still focussed on the influence of Treasury borrowing and forthcoming seasonal drains on reserves.

Currently this might suggest erring on the side of ease rather than intensification of pressure, relying on sluggish response to allow time for compensatory action if needed. In the period immediately ahead, however, the Treasury will probably have to borrow from Federal Reserve Banks on special certificates, and open market operations should be geared to this prospect. It would seem to me that a continuation of our present policy is desirable for the next two or three weeks.

Chairman Martin recalled that at the last meeting of the committee there was a discussion of the discount rate, with Messrs. Robertson and Johns expressing the feeling that it should be increased. He inquired of Mr. Sproul as to his views in this connection at the present time.

Mr. Sproul said that eventually, a policy of stabilized restraint such as the Committee was now following in the face of heavy Treasury and private borrowing, would probably result in some rise in interest rates, but that any such rise might be slow and irregular. It may later be desirable to increase the discount rate as a technical adjustment to market rates. Or, if System open market purchases should later create an easier situation than is desired, discount rate action might reaffirm a policy of credit restraint. These future situations can not be prejudged, Mr. Sproul said, and as of now in the present state of the market and of market sentiment, an increase in the discount rate would inject a new element of uncertainty in the market

and jeopardize the success of open market policy. Mr. Sproul added that he would be unwilling to recommend to his Board of Directors an increase in the rate at this time.

Mr. Johns stated that for the moment he was not in disagreement with the views Mr. Sproul had just expressed. This was not to be taken, he said, as an abandonment of the views he had expressed at the two previous meetings of the executive committee. His comment at this time was directed to the matter of timing for an increase in the discount rate. He had not recommended such an increase at the last meeting of the executive committee of the Federal Reserve Bank of St. Louis nor did he now intend to recommend it at the next meeting. Mr. Johns still felt, however, that as a matter of policy it would be desirable for the System to be considering an increase in the discount rate. He noted that the reaction on the part of bankers to what the committee had done in the way of injecting reserves into the market recently had been pretty sluggish and he was disposed to favor a liberal continuance of the policy of outright purchases of securities for the System open market account for the immediate future.

Mr. Mills stated that he was impressed with the statements of both Mr. Sproul and Mr. Johns and with the sensitivity of the money market at present, but it was his view that the reassurance which the committee had wanted to give to the market had already been provided by the recent injections of reserves. These effects may not yet have been transmitted to the less sensitive money markets, but it was Mr. Mills' belief that restraint

should still be the note in these outlying money markets, if it were possible to carry that note and still provide some reserves in the central money markets. He felt that with Treasury bills having sold at yields of around 2.08 and 2.09 for the last couple of weeks there may be a feeling developing in the market that the Reserve System is again supporting a pattern of rates, which would be undesirable. Mr. Mills suggested that, under all the circumstances, the committee should decelerate its program for injecting reserves into the market during the next two weeks.

Mr. Evans felt that serious consideration should be given to making the discount rate a penalty rate, although he did not suggest an immediate change. With respect to the injection of reserves into the market, Mr. Evans said that he would like to see a little experimentation taking place, that purchases for the System account might be increased as a means of giving a more positive indication of what the committee has in mind. He also thought the Board of Governors should give immediate consideration to a lowering of reserve requirements across the board since such action would be readily understood by member banks throughout the country. In general, Mr. Evans said, he agreed with the position taken by Mr. Sproul and he disagreed with the position taken by Mr. Mills.

Mr. Robertson stated that his views would fall somewhere between those expressed, that he believed the discount rate should be increased although he did not think this was the time to do so, that the present program of putting reserves into the market should be continued, and that in

the event of an indication of too much easing in the market the System should immediately take advantage of the opportunity to increase the discount rate. He would not decelerate the additions of reserves to the market, and while consideration must be given to funds that will be made available during the next few weeks through reductions in the Treasury's balance including funds obtained by the Treasury from sales of special certificates to the Federal Reserve Banks, he would watch this situation with a view to increasing the discount rate at the first opportunity. He hoped this would come when member bank borrowings were low, rather than after the volume had increased substantially from present levels.

In response to a question by Mr. Evans, Mr. Rouse stated that the amount of funds to be put into the market would necessarily have to depend on the projected losses and gains of reserves to the money market, that in his opinion it now appeared that a little too much had been put into the market in the past two weeks, that central reserve city banks in New York had gotten practically out of debt to the Federal Reserve, and that for the country as a whole excess reserves had been approximately equal to borrowing from the Federal Reserve. Within the next two weeks, Mr. Rouse assumed that the policy of keeping the market tight but not letting it get tighter would call for some additional reserves but at this time he could not estimate the amount that would be needed.

Chairman Martin said that he felt the effects of recent committee operations had probably sifted out into the market more than had been

appreciated in the initial stages of the current program, and he emphasized the problem of a lag between these operations and recognition of their effects--a factor which the committee must bear in mind at all times.

Mr. Szymczak stated that he felt purchases should be continued on the basis of the program agreed upon by the committee on May 13, and this should be carried out through purchases of short-term securities. He felt it would not be desirable to decrease reserve requirements at this time either in central reserve cities or in reserve cities. If it later should seem desirable to reduce reserve requirements, Mr. Szymczak felt that should be done first in central reserve cities but this should be done only if there were signs of a down-turn in business.

During a further discussion, Mr. Rouse stated that it would be helpful to him in operating the System account to know whether the basic program of keeping the market tight but of keeping it from getting tighter was still to be pursued, and Chairman Martin responded that this was the intent of the committee, that it could be used as a guide to operations between now and the next meeting of the committee. In commenting upon a suggestion by Mr. Evans that injection of funds into the market during the next two weeks should be on the liberal side, Chairman Martin stated that this appeared to be a matter of degree, that some of the members of the committee felt less reserves should be injected while others felt more reserves should be injected than during the past two weeks. He suggested, therefore, that the committee renew the direction to the New York Bank on the same basis that

had been agreed upon at the meeting of May 13, namely, to keep the market tight but to keep it from getting any tighter, with the understanding that the New York Bank would "feel its way" in carrying out the instructions of the committee. Mr. Mills suggested that the limitation in the instructions to be given to the New York Bank be increased from $500 million to $1 billion.

Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the executive committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities and allowing maturities to run off without replacement) for the System account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the total amount of securities in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $1 billion.

It was agreed that the next meeting of the executive committee would be held on Thursday, June 11, 1953, on which date the Federal Open

Market Committee was also expected to meet.

Thereupon the meeting adjourned.

Secretary.