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 in Washington on Tuesday, May 11, 1954, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Robertson
Mr. Szymczak
Mr. Williams

Messrs. Evans and Mills, Members of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Mr. Young, Associate Economist
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. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the executive committee of the Federal Open Market Committee held on April 27, 1954 were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the executive committee on May 5, 1954 authorizing the exchange of System account holdings of Treasury certificates of indebtedness maturing June 1, 1954, and of Treasury bonds maturing or called for redemption on June 15, 1954, for one year 1-1/8 per cent Treasury certificates of indebtedness dated May 17, 1954, was approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period April 27 to May 6, 1954, inclusive, and at this meeting there was distributed a supplemental report covering commitments executed May 7 to May 10, 1954, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse commented briefly on recent changes in the atmosphere of the Government securities market which had been influenced importantly by the Treasury financing operation announced April 30, on a somewhat unexpected tightening in the reserve position of banks toward the end of last week, and on the addition of $100 million to total System holdings of United States Government securities on Monday, May 10, as a result of a purchase of Treasury bills by the Federal Reserve Bank of New York under repurchase agreement.

> Upon motion duly made and seconded, and by unanimous vote, transactions in the System account during the period April 27 to May 10, 1954, inclusive, were approved, ratified, and confirmed.

Mr. Young presented a review of recent economic and financial developments, commenting along the lines of a staff memorandum dated May 7, 1954, copies of which were distributed before this meeting. He stated that the general economic picture was not much different than two weeks ago, that the latest data indicated that the economy had continued to be influenced by liquidation of business inventories and curtailment of national security outlays and commitments, and that it appeared that the economy was still drifting slightly downward but that the forces which had been pulling it down appeared to be losing their earlier strength. It was Mr. Young's view that unless the downward drift was reinforced by fresh contractive factors, activity might be approaching a balanced position at current moderately reduced levels. While the foundations of revival might be taking shape, the sources of revival impetus were not yet clear.

Following a brief discussion of Mr. Young's remarks, Chairman Martin called upon Mr. Thomas who commented upon the Treasury cash position and banking and credit developments. He stated that with the $2 billion which the Treasury was receiving from the cash financing announced last week, it appeared that it would end the current fiscal year without additional borrowing. He reviewed the bank credit situation on the basis of comprehensive figures that had become available for the month of April, noting that there had been less decline in total loans and investments this year than in the comparable period of 1953. Demand for loans had declined, but banks had shown a continuing tendency to keep funds which became available to them invested in Government securities. Private demand deposits increased in April of this year more than in April a year ago, and the increase appeared to be more than seasonal. For the year to date there had been an increase on a seasonally adjusted basis in demand deposits with the result that required reserves of member banks had declined less than had been projected in estimates of reserve needs. The reserve position of banks continued fairly easy during April, Mr. Thomas said, and although there was some temporary tightening last week it appeared on the basis of an estimated pattern of reserve changes prepared by the staff that daily average free reserves during the next two weeks would range around $500 to $700 million, but in the last week of May would decline below that level.

In response to Chairman Martin's question, Mr. Sproul stated that the review of the economic and credit situation presented by Messrs. Young and Thomas was generally in agreement with information compiled at the Federal Reserve Bank of New York. There were many encouraging signs in the situation as suggested in the staff economic review. Mr. Sproul would emphasize that a cumulative decline is not so likely after nine or ten months of gradual decline and readjustment. He noted that, taking statistics for what they are worth, disposable income was less than 1 per cent below its peak, and gross national product was only 3 per cent below its peak. The international situation has shown surprising strength in view of the decline in the United States and fears of such a decline abroad. Capital markets continue active at lower rates of interest and business sentiment is still generally good. Mr. Sproul also noted that the money supply at the end of March was about the same as a year earlier despite the business decline. He felt that it could be said that credit policy had done more than the mildness of the decline required, if we were not seeking to make our errors on the side of ease. Mr. Sproul went on to say that the committee could not rely altogether on what appeared to be the situation now and on the surface, however. For the first time in a long while we were coping with seasonal influences in interpreting figures. Steel production might not go much higher and auto production might turn down in late summer. Inventory decline so far had not been enough to clear the decks for a vigorous upturn. Profits might not hold up to first quarter levels, with the increased competition, and unemployment might go up as new workers came into the market. Mr. Sproul thought that the committee might say that the decline had begun to level off but whether it is a U or a V bottom, or just a ledge in a downward drift we can not yet know. On the basis of present forecasts of reserves and with nominal bank borrowing, the most appropriate course of action in his opinion was what the committee has been doing--letting the market alone as much as possible, meeting temporary situations with repurchase agreements, not being concerned about an absolute figure of reserves picked out of a hat.

Mr. Williams concurred in Mr. Sproul's analysis and said that he would agree with the suggestions made by Mr. Sproul with respect to the program for open market operations during the next two weeks.

In response to a question from Mr. Robertson, Mr. Sproul stated that he would have in mind a level of free reserves within the range of approximately $400-$700 million but that he would not feel concerned if reserves fell a little below or rose above that range.

Mr. Szymczak stated that he agreed with this general approach to System operations for the period until the next meeting of the committee.

Mr. Mills stated that while he was not a member of the executive committee and was therefore somewhat hesitant to express views, he would have a different approach to System operations in the immediate future. He felt that the figures presented by Mr. Thomas and developments of the past few weeks strengthened his conviction that the System should be maintaining a higher level of free reserves than has been the case. In Mr. Mills' opinion, the temporary tightening in central reserve cities toward the end of last week demonstrated that estimates of reserves could not be depended upon, and he would urge that the executive committee's program be directed toward maintaining a level of free reserves that would be a cushion against any uncertainty that might develop on the down side. It was Mr. Mills' view that a period of seasonal demand for bank credit was approaching which deserved the encouragement of positive Federal Reserve support; if the System did not act promptly there might be a scarcity of free reserves which would not only be disheartening but might be alarming to the financial community.

Mr. Evans commented on prospective needs for credit in connection with the harvesting of crops, expressing the view that such financing should be handled so far as possible by local banks.

Mr. Robertson felt that the increased need for credit to which Messrs. Mills and Evans had referred was not likely to develop during the next two weeks.

Mr. Sproul noted that even with the decline in free reserves toward the end of last week, free reserves for the week as a whole averaged over $500 million. He called attention to the projections for the next two weeks which indicated that free reserves would average a little under $600 million during the week of May 12 and $750 million during the week of May 19. Mr. Sproul also noted that the period of increased seasonal loan demand is still some weeks away.

Mr. Mills stated in response to a question by Mr. Robertson that even if the projections of free reserves were correct he would add to the amount of reserves, starting in during the current week, so that they would reach a level of at least $700 to $800 million.

There followed a general discussion during which Chairman Martin suggested that the committee needed a projection of the amount of reserves that might be needed by the banking system as a whole between now and the end of this calendar year, similar to the projection that it had in the spring of 1953. It was his view that the current situation was certainly one reflecting an easy money atmosphere, but he stated that one thing the committee should try to do was to avoid the development of "knots" in the market such as tended to develop toward the end of last week. He felt that authority to follow a course which would avoid such "knots" was included in the existing instructions of the committee to the Federal Reserve Bank of New York. His general approach was that the committee should have in mind the staff projections of free reserves, and that it should aim at having free reserves of about the amounts projected or a little bit more. He noted that Mr. Mills would prefer to have free reserves substantially higher than the projections of $600-$750 million indicated for the next two weeks, and that Mr. Evans would concur in that view.

Mr. Robertson inquired whether Chairman Martin's suggestion would mean that the goal of System operations for the next two weeks should be to have free reserves somewhere in the range of $400-$700 million which would continue about the present situation.

Mr. Riefler stated that a range of $400-$700 million would be somewhat lower than had existed recently, and there was a discussion of this point during which it was suggested that any errors in operations should be on the side of ease having in mind the projections of average free reserves of $600-$750 million.

Mr. Mills thought that if no positive action were taken by the System account (it not having made any additions to its holdings of securities for some weeks) this would be interpreted to an increasing degree by the financial community that System policy was one of "staid neutrality" in a period of tightening conditions growing out of increasing demands for credit.

Mr. Sproul reiterated that this is not a period of increasing demand for credit and said he felt that the interpretation that would be placed on System action would be that, whereas early in 1953 the System took steps to offset reserves that would have come into the market because of natural forces, it was now doing nothing to offset additions to reserves from natural forces and it was maintaining a policy of active ease. He though that in the period between now and the next meeting of the executive committee the natural forces would add to free reserves.

Chairman Martin suggested that it be understood that the existing program of the executive committee be continued with a broad understanding that it would pursue the policy of active ease followed in recent weeks. He also suggested that it would be desirable to continue discussion of the suggestions made by Mr. Mills at the next meeting of the committee.

These suggestions were approved unanimously.

Mr. Rouse recommended that the directive to the Federal Reserve Bank of New York be renewed with the same limitations contained in the existing directive.

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 (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, and (c) 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 $500 million;

(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 $500 million;

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate $500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

It was agreed that the next meeting of the executive committee would be held at 10:45 a.m. on Tuesday, May 25, 1954.

At this point all of the members of the staff withdrew from the meeting and the committee went into executive session.

Secretary's note: Following the meeting, Chairman Martin informed the Secretary that during the executive session there was a discussion of the desirability of instituting a scheduled program of liaison between the Federal Reserve Bank of New York and the members of the executive committee at Washington and Philadelphia which would result in a more systematic and perhaps more helpful exchange of information regarding the reserve position of the Banks, actual and prospective market developments, and open market operations. It was agreed that beginning June 1, 1954, arrangements should be made to have a three-way telephone communication early each business day among members of the staff located in Washington, at the Federal Reserve Bank of New York, and at the Federal Reserve Bank of

Philadelphia (during the period Mr. Williams was a member of the executive committee), and that the staff representatives would be expected to keep the members of the executive committee at the respective offices informed of these discussions. It was understood that unusual or unanticipated developments in the money and Government security markets during the day, which might have an important bearing on open market operations, also might call for similar three-way conversations, and that these conversations would be in addition to and not in lieu of the present recurrent factual market reports transmitted to the Government Finance Section of the Board's Division of Research and Statistics by the Securities Department of the Federal Reserve Bank of New York. In approving these arrangements in principle, it was understood that Chairman Martin and Messrs. Sproul and Williams would designate individuals and their alternates to serve as staff representatives for the conversations.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary