

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, August 24, 1954, at 10:50 a.m.

PRESENT: Mr. Sproul, Vice Chairman
Mr. Szymczak
Mr. Williams
Mr. Vardaman, Alternate
Mr. Mills, Alternate

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Garfield, Adviser on Economic Research,
Division of Research and Statistics,
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 on August 3,
1954, were approved.

Before this meeting there had been sent to the members of the committee copies of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period August 3 through August 19, 1954, and at the meeting copies of a supplemental report were distributed covering open market commitments executed on August 20 through August 23, 1954. Copies of the reports have been placed in the files of the Federal Open Market Committee. In commenting on the supplemental report, Mr. Rouse stated that the New York Bank was successful yesterday in

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rolling over the System's holdings of \$142 million of Treasury bills maturing this week and that the new issue of bills sold at an average rate of .9834. He also said that it was expected that conditions in the money market centers would continue to be tight and that free reserves might decline as much as \$300 million through the next statement week, and that in view of this possibility and the possible continued immobility of free reserves held by country banks the Federal Reserve Bank of New York was making repurchase agreements freely available to dealers in the event there should be demand for that kind of accommodations. He made further brief comments with respect to most recent developments in the Government securities market.

Mr. Sproul stated that the operations in the period since the meeting on August 3 appear to have been in accordance with the instructions of the committee to work down toward the low limit of the area of free reserves which the committee had been trying to maintain.

Upon motion duly made and seconded,
and by unanimous vote the transactions in
the System account during the period July
20 to August 23, 1954, inclusive, were ap-
proved, ratified, and confirmed.

In commenting on a memorandum of recent economic and financial developments which had been sent to the members of the committee before this meeting, Mr. Garfield stated that the current economic situation was very much the same as existed at the time of the last two meetings of the committee except that there were now in the picture the additional

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weeks of economic stability. He referred particularly to the situation in the construction industry and, in that connection, to a memorandum, which had been prepared in the Board's Division of Research and Statistics under date of August 20 and which had been distributed to the members of the committee, giving the results of the recent survey made by the Federal Reserve Banks of the real estate mortgage market. The memorandum stated, among other things, that few instances were cited of lenders relaxing standards to accept borrowers not acceptable earlier, and that where records were examined there was no perceptible change in the credit quality of loan applicants over the last nine months to a year. Mr. Garfield stated that there was always the question of to what extent reductions in down payments and lengthening of terms constituted lowering of credit standards and at what point credit terms ceased to prevent overbuilding and pushed the volume of building beyond a level that could be sustained.

In a discussion of the latter point, it was suggested that the present terms on Government-insured and -guaranteed housing loans, by borrowing more and more from the purchasing power of the future, might be propping up the economy now at the cost of construction that would otherwise be undertaken in future years. Mr. Riefler commented that this point had been raised in discussions with Federal housing authorities, and that it was recognized in the Board's offices as constituting a real danger. He added that it was appearing from at least one investigation

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that had been made that existing housing in outlying areas probably would provide a more satisfactory risk for mortgage lending than had been thought would be the case.

Mr. Gaines related a conversation which he had had with an official of the Home Loan Bank Board in which the latter made the statement that there was an increasing tendency on the part of the public to feel that it was cheaper to purchase a house than to rent, and that if a softening in the rental market developed there could be a serious break in the demand for housing.

Mr. Riefler stated that the housing shortage had been almost entirely eliminated, but that as long as incomes remained high with financing readily available, the public would have a tendency to absorb the better housing with the obsolete housing moving down the scale. If there should be a sharp firming of money and a substantial business setback which resulted in lower incomes it might disclose a condition of overbuilding that would prove troublesome to reverse.

It was agreed that this is a matter which the System should continue to watch for the purpose of determining whether any situations were developing which might have an effect on general credit policy. In response to a statement by Mr. Riefler that commercial construction was going forward very rapidly apparently on a much thinner equity margin than residential housing, Mr. Sproul suggested that the staff look into the possibility of making inquiries which would produce information from

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the various districts of the country which might disclose to what extent, if any, unsound developments might be taking place in this field. It was agreed that this should be done.

Mr. Youngdahl reviewed the capital markets, the Treasury cash position, and bank credit and reserves as outlined in the memorandum of August 20 previously referred to, on the subject of economic and financial conditions. He also distributed a tabulation showing estimated patterns of reserve changes during the period ending September 29 which indicated that on the basis of estimates of required reserves of member banks and without further open market operations, free reserves would decline sharply in the weeks ending August 25 and September 1 and at the end of these weeks would average approximately \$600 million and \$350 million, respectively, would remain at the latter level during the succeeding week, would increase to approximately \$550 million in the following week, and would be in excess of \$1 billion at the end of the week of September 22.

In the discussion which ensued, Mr. Sproul stated that while there was a difference in the estimates of free reserves made by the staff of the Board and the staff of the Federal Reserve Bank of New York during the next two weeks, the general magnitude and direction of changes were substantially the same in both estimates so that the committee was faced with substantially the same problems regardless of which estimate proved to be most nearly correct.

During the above discussion Mr. D. C. Miller joined the meeting.

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Mr. Sproul then made a statement substantially as follows:

1. The economy appears to be moving sidewise with some signs of improvement notably in consumer buying and in employment although the latter figures are still open to question. Construction continues to be a strong factor and the inventory situation shows signs of stabilizing. There is nothing at present, however, to indicate a strong upsurge and modest seasonal increases this fall is the most likely outcome.
2. Consumer spending has been considered perhaps the most important and least predictable factor in appraising the economic outlook. It is notable that improved levels of such spending in recent months more than offset a continuing decline in national security outlays. Improvement in consumer spending stemmed, in part, from further expansion of outlays for services but, more significantly, reflected also a rise in outlays for durable goods for the first time since the first quarter of 1953, and a sizable increase in outlays for non-durables which had been approximately stable for the preceding six months. In addition, this increased consumer spending came at a time when repayments on the high level of installment debt had first call on a sizable amount of consumer funds - repayments exceeding new credit extensions throughout year until June.
3. Even this encouraging appraisal must be qualified, however, since improvement in sales of durable goods represented largely sales of automobiles during June, and special sales efforts and inducements to buyers in this field during June and July may have borrowed from future sales. Automobile industry, directly and by reason of its effect on steel industry, is still a critical factor.
4. We should also be watchful of the construction industry, as longer maturities and lower down payments may give impetus to speculative building and weaker loans which could have later unfavorable reactions.
5. Estimates of Treasury cash requirements for the rest of the year are little changed. With a cash income of about 25 to 26 billion during the last half of calendar 1954 and cash outgo of about 38 billion, the Treasury will have to borrow an additional 6.5 billion (already borrowed 3.7 billion) to maintain its balance in the neighborhood

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- of 3.5 billion at the year end. Some of this financing will have to be done by early October - directly or through CCC certificates of interest, or both. Under the present temporary debt ceiling, the Treasury should have a margin of about \$1 billion - or more if CCC certificates are sold.
6. An increase in the money supply of about the usual seasonal proportions during the remainder of the year will be needed to meet private and Treasury needs, and will require an expansion of Federal Reserve credit to offset the resultant increase in required reserves and currency circulation. The amount of such needed Federal Reserve credit appears to be around 1-1/4 billion, if the present open market policy of aiming toward free reserves in the neighborhood of 400 to 700 million is continued.
 7. The expectation that general business conditions may improve seasonally during the rest of the year, and the related expectation that demand for bank credit, both private and Treasury, will require only a modest increase in the money supply, suggests continuation of the present Federal Reserve policy - no further changes in reserve requirements at this time, no present change in discount rates, and continuance of existing open market policy.
 8. On the basis of present estimates, open market operations may be small during the remainder of August and most of September, since market factors have brought free reserves down to the lower half of the flexible range toward which we have aimed and some purchases would seem to be necessary during the next two or three weeks to maintain our policy. Major drains on bank reserves, requiring substantial open market purchases, however, do not come until the last three months of the year. It might be possible during the next two or three weeks, if we are in a position where we want to put funds into the market not only for a temporary period but also looking forward to the needs later in the year, to experiment further with purchases for cash delivery.

Mr. Mills stated that before consideration was given to the policy to be followed during the next two or three weeks he would like to discuss operations since the last meeting of the committee as he had a differing

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view as to how the instructions of the executive committee might have been interpreted during that period. He said Mr. Sproul had stated earlier that the instructions pointed toward reducing the supply of free reserves to a level lower than had existed in recent weeks which undoubtedly was the instruction of the executive committee, but that he felt it was important to determine how the committee's instructions could be flexibly acted upon and how they could be applied in the event of a change of conditions during the period in which they were outstanding, and that in order to make his point he had written a statement of his views with respect to recent operations which also led into the policy that might be followed during the next two or three weeks. He then read a prepared statement which was as follows:

It has been the present objective of open market policy to prevent the occurrence of "sloppy market" conditions in consequence of the large volume of reserves that were released upon the reductions that were made in reserve requirements. In pursuance of this objective, Treasury bills held in the System Open Market Account have been allowed to run off over successive weeks and minor sales of Treasury bills were also made.

Question can now be raised whether this policy overshot its objectives. It has at no time been contemplated that the money market would be reduced to a situation approaching stringency, which is the opposite of a "sloppy market." In my opinion, the effect of the System withdrawal of reserves in the last reserve week, following upon the withdrawal of reserves in the previous reserve week, which was open to marginal question, has been to deliberately produce a degree of money market tightness that is not consistent with the System's declared policy of active ease.

It is not argued that there has not been an adequate overall supply of free reserves since the last meeting of the Executive Committee. It is argued that account should have been taken of their maldistribution in ways so as not to have penalized the money market as severely as has been the case.

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If the function of System open market policy is to maintain a supply of reserves in keeping with the needs of the economy, it should not be deterred from doing so by aberrations in their distribution even though performance of this fundamental function may bring the total supply available temporarily above or below some predetermined level.

Largely in view of the usual summer letdown, there has been little recent need of positive reserve support to the commercial banking system and there have been no seriously adverse effects because of recent System actions, except as a false impression may have been gained in some quarters of a change in policy direction away from active ease. Should that impression increase in currency, undesired reactions might occur in the market for longer-term U. S. Government, public, and corporate securities.

Now that natural factors are expected to reduce further the supply of reserves in the present reserve week, System policy will be tested by the alertness with which it proceeds to repair the potential damage done over the last two reserve weeks. If withdrawals of reserves had been less aggressive and the supply had been allowed to taper down to a level from which future induced increases would be less conspicuous, there would have been less need to purchase Treasury bills in the rather substantial amounts that is now the case and the New York money market would not have been subjected to severe tightness. In any event, purchases of Treasury bills, both to correct the present situation and for seasonal purposes, should commence promptly. In the meantime it is to be hoped that recent reserve withdrawals will not have drawn down the supply at country banks to a point that will handicap the performance of their seasonal credit duties.

Mr. Mills then proposed that during the present statement week the System purchase \$150 million of bills which would slightly more than offset the \$142 million of bills which were redeemed last week, and thus avoid the impression when the Federal Reserve statement is published on Thursday that the committee had permitted a further run-off of bills. He added that he hoped that there could be a discussion of making further

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purchases in the next statement week in the range of \$100 million to \$175 million.

Mr. Szymczak stated that while on the whole he concurred in the actions that had been taken in recent weeks, in view of the indications that without further System action free reserves would decline substantially in the next two weeks he would tend in the direction of easing the situation to the extent necessary. He recognized the difficulty presented by the immobility of free reserves in the hands of country banks and stated that if that factor continued in the picture some further action should be taken to meet it and to that end he would favor some purchases of bills for the System account.

Mr. Rouse stated that the consensus at the meeting of the committee on August 3 was to move toward the lower limit of the range of free reserves which had been regarded by the committee as providing desirable levels but that in System account operations it had been necessary to consider the general objective of System policy rather than the range because of the maldistribution of free reserves. In view of that situation, he said, total free reserves had been maintained well above the maximum of the range contemplated by the committee, in fact free reserves during most of the period were above \$800 million and in some weeks were \$900 million. Throughout the recent period, there had been the prospect that in a free market somewhat higher rates on Federal funds and Treasury bills would tend to draw reserves from the areas where they were. It had been anticipated, he said, that the general tightness

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might continue until the unwinding of the Treasury financing and on August 16 dealers loans did drop sharply and there was some contraction in other loans. Some free reserves, consequently, had come into the money centers, but the accumulated deficiencies at central reserve city banks had given an atmosphere of greater tightness than actually existed. In that situation the Federal Reserve Bank of New York had tried to keep within the spirit of the committee's instructions and had maintained more free reserves in the market than had been anticipated at the time the last meeting of the committee was held.

Mr. Sproul stated that the decision not to bring free reserves down to the level anticipated by the committee at the previous meeting was taking account of the fact that reserves were less available in the money centers than they were elsewhere.

That situation, he said, raises the question considered in earlier discussions whether the System could avoid temporary periods of lesser ease in the money markets without maintaining at all times such a volume of reserves that sloppy conditions rather than easy conditions would exist most of the time. It seemed to him that these periodic concentrations of demand in the money market showed that the market was performing its function of financial shock absorber in the monetary system, and for the System to try to prevent such variations from taking place would be unwise. He could not agree that transactions during the past two weeks had done any damage to the economic situation or to System policy or that

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there was need for specific steps in terms of specific purchases to restore free reserves to specific figures. He did not see that any damage had been done by the temporary lessening of ease and said he could not conceive of the public thinking, either for the right or the wrong reasons, that there had been any change in System policy.

Mr. Sproul made the further statement that there was no difference of opinion as to the desirability of putting funds into the market to keep the level of free reserves from going below the range within which the System had been attempting to work, but that there could be a question as to whether the committee wanted to act on the basis of a specific amount of purchases on the assumption the damage had been done or that sentiment had been affected so adversely that something had to be done to correct the situation.

Mr. Williams inquired as to the source of tightness in the central money markets and whether action by some of the money market banks was aggravating the problem.

Mr. Rouse stated that during the last two or three months a few money market banks had increased their loans and investments beyond the amounts justified by increases in their deposits with the result that they were substantially over-invested.

Mr. Sproul said that an additional point was that the money system may not always be as fluid as we would like to think and during this period the flow of funds from the outer areas to the central money

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markets, which might have been expected to take place promptly, was in fact occurring more slowly. In that situation, he said, the free availability of repurchase agreements was a useful and effective instrument until the distortion had had a chance to work out and it could be determined whether it was more than a temporary situation.

Mr. Mills suggested that the committee was now faced with a prospective loss of reserves of a more lasting character which would seem to be capable of remedy only by putting in reserves of a more permanent character through the purchase of Treasury bills rather than by the use of repurchase agreements.

Mr. Sproul said he did not question the need for outright purchases during the next two or three weeks, but that he had been referring to the past three weeks and he pointed to the fact that during the week of August 4 free reserves averaged about \$1 billion, in the next week about \$800 million, and in the week of August 18 over \$800 million. He thought that with reserves at these levels repurchase agreements were an appropriate means of meeting the situation.

In a further discussion, Messrs. Sproul and Williams expressed the opinion that it should be made clear that action taken by the committee at this meeting was not to correct a condition caused by actions taken since the last meeting but rather to meet a changed situation.

Mr. Vardaman stated that there was no implied criticism in Mr. Mills' proposal, and Mr. Mills added that his statement was for the purpose

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of expressing a difference of opinion as to what should have been done during the past two or three weeks.

Mr. Vardaman expressed agreement with the proposal presented by Mr. Mills except that he disliked to set a precedent in the present period of directing the purchase of a specific amount of securities. He preferred to continue to set a goal of free reserves and then through the medium of an understanding with the agent leave to him the manner in which the understanding should be carried out.

During consideration of the action to be taken in the light of the discussion at this meeting, Mr. Rouse stated that a purchase of a moderate amount of securities today would have a wholesome effect and that a substantial additional amount could be purchased tomorrow for cash so that it would be reflected in the current weekly statement.

Mr. Sproul inquired whether it would be satisfactory if the decision of the committee did not require the purchase of a specific amount of securities but provided for purchases for "regular delivery" today and purchases tomorrow for cash with the understanding that transactions will work toward the maintenance of free reserves of around \$600 million during the next two weeks.

Mr. Mills stated that, with country banks holding free reserves ranging from \$700 to \$750 million and the experience that reserves held by these banks have not gravitated to the money centers, if free reserves were pushed down to the levels of around \$600 million the committee could

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be confronted again with a problem similar to the one existing during the past week or so.

Mr. Rouse commented that there should be some leeway in the \$600 million figure. Mr. Sproul stated that repurchase agreements would be available and he would assume that the committee would agree that while it would set up a goal of around \$600 million it was seeking an objective rather than an arithmetical figure, and that if in the opinion of the Manager of the Account the situation in the money market was such that an attempt to maintain a \$600 million level of free reserves would be undesirable in terms of general policy he would be free to act accordingly.

Mr. Vardaman stated that \$600 million would be a minimum figure, and he would prefer \$800 million. Mr. Sproul said that at the last meeting of the committee it was agreed that an attempt should be made to get back into the lower level of the previously agreed range of free reserves.

Mr. Riefler commented that the opinion was also expressed at that meeting that it would be better if the volume of free reserves were on the lower side during August with a view to moving up the volume during September, and that the proposed understanding would be completely in line with that opinion.

It was agreed that the understanding as set forth above would not call for any change in the directive to be issued to the Federal Reserve Bank of New York.

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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 \$750 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 on Wednesday, September 8, 1954, at 10:45 a.m.

Thereupon the meeting adjourned.


Secretary