

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, December 28, 1954, at 10:45 a.m.

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

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, 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. Miller, Chief, Government Finance Section,
Division of Research and Statistics,
Board of Governors
Mr. Gaines, Securities Department, Federal
Reserve Bank of New York

Before this meeting there had been sent to the members of the executive committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period December 7 to December 22, 1954, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed December 23 - 27, 1954, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

12/28/54

-2-

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period December 7 - 27, 1954, inclusive, were approved, ratified, and confirmed.

Mr. Riefler referred to the preliminary draft of the minutes of the meeting of the executive committee held on December 7, 1954, stating that a question had been raised concerning the wording of the understanding regarding procedures to be followed in carrying out open market operations between that date and the next meeting of the committee. Mr. Riefler then read the sentences concerning which a question had been raised as follows:

"It was also understood that open market operations should be carried out in line with the general understanding at the meeting of the full Committee earlier today, that is, that it would be desirable to have in mind a volume of free reserves ranging somewhat lower than had existed recently but that operations should not be modified so as to bring about any sudden change in the state of the market and that they should be continued in a manner to provide ease in the market. It was understood that factors to be taken into account in carrying out this understanding would include not only the volume of free reserves and changes in interest rates, but also 'feel' as to conditions in the market."

Governor Robertson stated that he had raised the question, particularly with respect to the last sentence of the part quoted above. It was his feeling, for reasons which he stated, that the executive committee did not arrive at an understanding that in carrying out operations consideration would be given to "feel" of conditions in the market.

After discussion, it was agreed that the last sentence of the quoted part should be deleted and that the first sentence should be changed to read as follows:

"It was also understood that open market operations should be carried out in line with the general understanding at the meeting of the full Committee earlier today, that is, that it would be desirable to have in mind a volume of free reserves ranging somewhat lower than had existed recently but that operations should not be modified so as to bring about a condition of restraint, and should be continued in a manner to provide ease in the market."

Mr. Riefler then called attention to an insertion in these minutes which had been suggested by Mr. Sproul reading as follows:

"Mr. Rouse mentioned that free reserves during the balance of December might average around the middle to the upper half of the reserve range but funds in this volume probably would be necessary to facilitate the mid-December and end-of-the-year adjustments in the money market.

"Chairman Martin commented that it was the normal practice to facilitate the year-end adjustments to which Mr. Rouse referred, and none of the members of the committee indicated disagreement with having a volume of reserves such as Mr. Rouse suggested might be necessary.

"Further to facilitate the year-end adjustments, Mr. Rouse indicated that repurchase agreements might have to be used. However, he stated that he would not suggest a rate lower than the 1-1/2 per cent prescribed in the existing authorization to the Federal Reserve Banks to enter into repurchase agreements with nonbank dealers in United States Government securities."

Thereupon, 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 December 7, 1954, were approved.

Mr. Young then made a statement with respect to the economic situation using as a basis for his comments the staff memorandum dated December 23, 1954, which had been sent to members of the committee before this meeting. In opening his comments, Mr. Young pointed out that data becoming available made it clear that a vigorous economic recovery was now visible

12/28/54

-4-

and tangible. He went on to say that there was unusual agreement in forecasts now being published that there would be a further rise in activity, at least for the first half of 1955. Mr. Young stated that the recent improvement had been sharp in industrial production, particularly for automobiles, steel, and other durable goods. Gross national product was expected to increase to an annual rate of about \$360 billion for the fourth quarter of 1954, following a rate of about \$356 billion during the preceding three quarters. Mr. Young said that this rise reflected continued expansion in consumer outlays, residential construction activity, and State and local expenditures, and a shift in business inventories from substantial liquidation to little or no liquidation. He also commented that defense outlays declined further in the fourth quarter of 1954, as also did business expenditures for fixed capital.

In response to a question from Mr. Williams, Mr. Young stated that a great many important collective bargaining agreements were coming up for review during the next few months and that there were strong indications that the unions would be very insistent and aggressive in their determination to obtain some gains for their membership in negotiating new agreements.

Mr. Young also stated, in response to a question, that the recently announced reduction in the size of the armed forces was important to the economy because it would result in a reduction of approximately \$1-1/2 billion in the annual rate of expenditures. However, this reduction would not be reflected during the current fiscal year.

Mr. Sproul said that he was in agreement with the general content

12/28/54

-5-

of the staff memorandum and Mr. Young's report. However, he felt there was more and more feeling of uncertainty regarding the economic outlook after the first half of 1955, particularly because of uncertainties with respect to sustained activity in the automobile and residential building industries. His comment, Mr. Sproul said, suggested that despite the strength of the present recovery there might not be so much "ebullience" concerning the more distant future as was thought to be the case a month ago; that as we passed from the fall optimism into the winter season of more sober estimates the earlier tendency toward optimistic forecasts may have been modified somewhat.

Mr. Young stated that he did not yet see a development such as Mr. Sproul suggested might be taking shape; that so far this looked like a very classical pattern of recovery which would continue upward as seasonal adjustments were taking place into March. Further increases in the level of output might then come a little more slowly.

Mr. Thomas commented that he felt any sharp adjustment downward was several years ahead, that he thought the general public including the business community was not yet aware how "really good" the situation was.

At Chairman Martin's request, Mr. Thomas made a statement with respect to credit developments in which he stated that the capital markets were continuing to show considerable activity. Although corporate issues for 1954 as a whole would be about a billion dollars less than in 1953, State and local government issues would be about a billion and a quarter above last year's issues. The calendar for State and local government

12/28/54

-6-

issues is very large for next month, Mr. Thomas said, and a large volume of refunding of corporate issues is also indicated for the purpose of reducing interest costs. After commenting on stock market developments, the outlook for defense expenditures, and changes in the Treasury's cash balance, Mr. Thomas referred to a tabulation which was distributed showing an estimated pattern of reserve changes between December 2 and February 9. Mr. Thomas also referred to a staff memorandum dated December 22 on "Guides for Open Market Operations, January - April 1955", copies of which had been distributed before this meeting, in which it was suggested that if reserve demands during the coming months corresponded approximately to the amounts projected, free reserves could be maintained generally close to \$500 million and rarely below \$300 million, by a reduction of about \$1 billion in the System portfolio during the first three or four weeks of January, and by subsequently refraining from any operations at all (except perhaps occasional repurchase transactions). He felt that if the committee believed such a program desirable, it might not be necessary to begin selling securities from the System account until the latter part of the next calendar week, but that moderate sales in the week ending January 12 with substantial sales in the week ending January 19 would appear to be called for; and that further sales in the week ending January 26 would be necessary in order to keep free reserves in the \$500 million area. Mr. Thomas stated that if it was believed desirable to keep reserves within the \$300-500 range, one procedure would be to make sales from the System

12/28/54

-7-

account only around the middle of the month and to permit a situation to develop toward the end of the month in which banks would meet their temporary needs by borrowing from the Federal Reserve Banks and dealers would make use of repurchase facilities.

Chairman Martin stated that he felt the committee should do what it could to prevent a recurrence of the situation that developed in January 1954 at which time there was a "sloppy" condition in the market which went much too far on the side of ease. He then called upon Mr. Sproul who made a statement substantially as follows:

1. I might use as a basis for my comments, the memorandum dated 12/22/54 prepared by the staff on Guides for Open Market Operations, January-April 1955, on the assumption that it has been prepared to facilitate discussion, not for acceptance or rejection - and that, therefore, we don't have to weigh every word, whether it is the exact meaning of sustainable growth or the use of a 3 per cent growth factor in making projections.

2. General qualifications

- (a) "Growing ebullience in the business and financial community." Whatever ebullience there may have been - and canvass of the twelve districts at the recent meeting of the full Committee didn't indicate that ebullience was widely degenerating into speculation - has been undergoing some shrinkage as we come out of the fall period of expansion of ideas and hopes and enter the winter period of contraction. There seems to be growing concern about the economic situation during the last half of 1955 and about the growth of the labor force versus the growth of job opportunities.
- (b) We must also remember that Government "puts in" money during the second half of the calendar year and "takes it out" during the first half of the calendar year. We have just had the advantage of a substantial cash deficit during the last half of 1954, in terms of the economic stimulation.
- (c) Our New York estimates of reserve demands and requirements are in general agreement with estimates

in the memorandum for the next two weeks - but we don't think there will be the need to sop up a billion of reserve funds in the later weeks of January. That situation will become clearer, however, as we get closer to it.

3. I would say the Committee might accept a range of \$300 to \$500 million in free reserves as a guide to open market operations, for the present, provided we recognize, as we have in the past

- (a) that actual figures may vary, at times, from the target range by substantial amounts (for example, if the seasonal contraction of loans is mostly outside the money centers, we may have another case of mal-distribution of reserves which could take a week or more to unwind), and
- (b) provided that we try to avoid making errors or resolving doubts on the side of restraint, even though we no longer want to make errors or resolve doubts on the side of ease.

4. It is still just as important to avoid nipping a real recovery, as it is to avoid an unsustainable speculative burst. We shall want to continue to watch the visible pressure points - interest rates, attitudes of lenders and borrowers, capital markets-as well as free reserves. It is the whole economy, not just the banking position, which is important.

Mr. Szymczak said that the staff memorandum of December 22 on guides for open market operations was very helpful. The problem, however, was one of watching very carefully the developments during the first quarter of the year looking not only to the amount of free reserves, but to all other factors. Mr. Szymczak felt that in order to keep the situation as stable as possible it might be necessary to sell securities from the System account during January but that this was something which would depend on how the situation developed in the next few weeks. His view was that the executive committee should continue to go in the direction of ease but that it should not provide too much ease in the market, and it should prevent the recurrence of what took place a year ago when undesirable

12/28/54

-9-

sloppiness developed in the market.

Mr. Robertson said that he was impressed a little more with developments on the optimistic side than either Mr. Sproul or Mr. Szymczak seemed to be. He felt the general tone of the staff memorandum on guides for open market operations was good and that a target of from \$300-500 million free reserves was all right. However, he would not veer on the side of ease as had been done during the past year and, in using such a target, he would look toward the lower end of the range rather than the middle or higher side. The volume of free reserves was not the sole measure, Mr. Robertson said, and he was satisfied that a condition of ease such as was contemplated by the directive from the full Committee could be had without maintaining free reserves at the middle or upper end of the suggested range. With the strong indications of optimism in the economic picture and with the possibility of sloppiness developing in the market, therefore, Mr. Robertson was perfectly willing to use the \$300-500 million figure as a very flexible target: if free reserves went below the \$300 million figure he would have no concern, but on the basis of the present economic picture, he would be concerned if free reserves got above the \$500 million level.

Mr. Williams said that he would accept the \$300-500 million range as a general target. However, he would not try at this stage to determine a program for a period as long as three months and would watch the situation carefully as it developed from week to week. Mr. Williams stated that one of the factors which he felt to be important was the indication

12/28/54

-10-

of rapid growth in speculation in the stock market, and it was his view that this was an element which should be studied closely during the next few weeks.

Mr. Mills said he saw the general pattern about as indicated by the comments of Messrs. Sproul and Williams. He felt the committee must look at the whole miscellany of economic events as they unroll and should not be too preoccupied with any range of reserves either on the lower side or on the higher side. The more he looked at changes in reserves the more distrust he had of projections, he said, and because revisions in estimates made only a few days earlier were now found to be necessary, he felt that too much reliance could not be placed upon them as a guide to operations. Rather, he would have the Committee watch developments in the economy and take into account the feel of the market as judged by L. Rouse and Chairman Martin. Mr. Mills also commented on developments in the long-term capital market and on the problems that could be expected as the impact of Treasury deficits was felt, along with a growth in commercial bank credit.

Mr. Balderston said he shared the concern expressed by Mr. Sproul regarding the longer-term future, adding that the automobile and building industries might be borrowing from future demands to a degree that might cause trouble in the summer or autumn of the year. In the meantime, if there was a speculative interest in the stock market and if a more widespread speculative attitude flowed from that, the System might be caught

12/28/54

-11-

in a dilemma where, on the one hand, it would need to dampen stock market activity and, on the other, would need to stimulate general business. Considering all the circumstances, he would have in mind operations which would prevent any sloppiness in the money market during the next month. If by the end of January the stock market continued to show the same tendency as in the past two months, Mr. Balderston felt that "some little flag should be waved," if that could be done without disturbing confidence in the general situation.

Chairman Martin commented that, as usual, the situation was a difficult one. He said that he was more optimistic than Mr. Sproul seemed to be and he leaned more to the view expressed by Governor Robertson. He thought that recovery had a full head of steam and, while he was sceptical of forecasts in any event, he was delighted that some of the forecasts for the second half of 1955 showed more soberness than a few weeks ago. Chairman Martin questioned whether anything the Federal Reserve was likely to do would "nip the recovery in the bud." This would require forces more fundamental than were likely in the System's open market operations. He reiterated the view that the System should follow a course which would not make it subject to the criticism that he felt it justifiably was subject to a year ago of having sloppiness in the market; the committee now should watch the situation very carefully to be certain that there was not too much ease. Further, if the committee should find it necessary to do something later in the year on the side of ease, it was important that it have an operation in the first half of 1955 which would avoid flooding reserves

12/28/54

-12-

into the market. Chairman Martin did not feel that the views expressed by the different members of the committee were far apart: he would cast his weight on the side of having free reserves in the lower part of the \$300-500 million range suggested, and when it came to resolving errors he would not be worried much about nipping the recovery in the bud if reserves were to stay in the lower part of the range or to fall below.

Mr. Sproul noted that in adopting its policy directive in December the full Committee contemplated a gradual reduction in the amount of ease in the market without approaching a policy of restraint. He felt that the foregoing discussion indicated a meeting of minds that operations should aim toward a level of free reserves near the lower part of the suggested range of \$300-500 million, and that doubts should not be resolved on the side of ease. The executive committee was, however, still disposed to maintain "ease" and not to go into a policy of "credit restraint".

Chairman Martin said that he thought Mr. Sproul had stated the situation very clearly, and there followed a general discussion of what operating procedures might be pursued to carry out the program indicated and of the specific instructions that might be given by the executive committee to the Federal Reserve Bank of New York. In this discussion, Mr. Sproul referred to the statement made by Chairman Martin at the preceding meeting regarding the need for avoiding public disclosure or discussion of actions taken by the Committee and, instead, letting the market learn what open market policy was from actual operations. Mr. Sproul agreed with this view but said it seemed to have been honored in the breach after the last meeting. He said

12/28/54

-13-

it must be realized that the market, as usual, was now trying to anticipate what the Committee was going to do, and that offhand statements might well result in a misinterpretation of the aims and objectives of the Committee.

Chairman Martin responded that he felt action to disclose any shift in committee operations should be taken in the market and that the market should be allowed to put any interpretation on the System's actions that it desired.

Mr. Rouse said that during the past few weeks there had been a large range of reserves in the market, but there had not been a sloppy situation when there were high reserves, and there had not been a really tight situation when there were low reserves. Looking ahead, Mr. Rouse felt the market was anticipating that the System would attempt to avoid sloppiness, but not in such a way as to bring about credit restraint. The expectation is that Treasury bill yields will tend to remain at about their present levels and that bond prices will generally fluctuate within 1/4 of a point of their present levels. The market expects the System account to sell and redeem bills during January to absorb the funds flowing into the banking system, and there is a general feeling that observers will not be able to conclude too much about policy objectives at this time from week-by-week statistics. Mr. Rouse said he felt that the System could continue to maintain the \$250 to \$500 million of free reserves that had been outstanding during the past ten days. Year-end adjustments may make it necessary for the New York Bank to enter into a few repurchase agreements

12/28/54

-14-

during the balance of this week, and these would run off early in the new year. On the basis of present projections he would then plan to redeem a relatively small volume of the January 6 bills, and a large volume of January 13 bills. By so doing, Mr. Rouse said he thought it should be possible to hold free reserves in the neighborhood of \$300 million.

Chairman Martin commented that a level of free reserves and operations such as Mr. Rouse described would seem to be in accord with the sense of this meeting, and none of the committee members disagreed with this comment. Chairman Martin also said, in response to a question from Mr. Mills, that the committee was not setting any precise amount of free reserves to be maintained in the market but that it was indicating that it would be desirable to move in the direction of a level of free reserves in the lower part of a \$300-500 million range. His own view was that the figure might be lower, but he felt the committee was close to a meeting of the minds and that instructions could be issued to the New York Bank in the light of the foregoing discussion.

Mr. Rouse stated that he had no suggestion for change in the limitations in directive at the present time.

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 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.

Chairman Martin suggested that the next meeting of the executive committee be held on Tuesday, January 11, 1955. There was agreement with this suggestion.

Chairman Martin then referred to earlier discussions of bankers' acceptances and to the several memoranda which had been distributed in March, May, and June of this year concerning that subject, as well as to the report on bankers' acceptances which had been prepared by the Special Committee on Foreign Operations of American Banks under date of December 3, 1954, in accordance with the understanding at the meeting of the Federal Open Market Committee on September 22, 1954.

At Chairman Martin's request, Mr. Robertson then opened discussion of this topic by reading a memorandum substantially as follows:

A memorandum of March 25, 1954, from the Federal Open Market Committee staff to the executive committee, pointed out the desirability of improving the financing techniques of international trade. That is unquestionably a sound objective. As one means of advancing that program, it was suggested that the Committee "give the Manager of the Open Market Account instructions to purchase bankers' acceptances up to, say, \$20 or \$30 million at the market". Therefore, I assume the question before the Committee is whether to adopt this course of action.

The Committee must be in agreement that no proposal should be adopted unless its basis and its practicality have been explored and the Committee is satisfied that the proposal is workable, that it will accomplish the objectives we have in mind, and that the benefits to be gained are sufficient to outweigh any disadvantages. With this in mind, members of the Board's staff made a study in May 1954 of present conditions and practices in the bank acceptance market and each of you has received a copy of their memorandum on the subject. In a memorandum dated June 1, 1954, I presented several specific questions intended to ascertain whether the proposal before us is feasible, whether it is capable of achieving the stated objectives, and whether it is needed to achieve those objectives. For convenient reference, the June 1 memorandum is attached.

On June 16, 1954, memoranda by Mr. Riefler and Mr. Rouse were presented to the FOMC, apparently intended as answers to the several questions presented; these memoranda also are attached. Either a casual or a thorough reading will reveal that they do not meet the fundamental questions regarding the proposal. With respect to whether the program is feasible, it is said that it is feasible to try. With respect to whether the program is capable of achieving the stated objectives, the answer is given that "we would have to try in order to find out". As to whether the program is needed, it is merely said that "this is certainly not a life-and-death matter".

More recently, the special committee on Foreign Operations of American Banks has submitted a brief report on bankers' acceptances, dated December 3, 1954. One and one-half pages relate to "System Open Market Acceptance Policy", and the committee recommended "that the System effect part of its open market operations through the medium of bankers' acceptances". A new reason is suggested for this action--namely, that the failure of the System to "hold a portfolio of bankers' bills... gives to the private bill a secondary status...." This seems to mean that the System should hold a portfolio of bank acceptances in order to enhance the prestige of that type of

paper. But the demand for bank acceptances already exceeds the supply, and the prime quality of bank acceptances is unquestioned.

The memorandum of the special committee mentions that the "preferred position" occupied by bank acceptances in past years "would not have been held in the same degree without heavy System support". However, the situation referred to was the reverse of the present situation; at that time the supply of bank acceptances exceeded demand, whereas at present the supply is insufficient to satisfy demand. As pointed out in the Federal Reserve Bank of New York's "Money Market Essays" (1952):

Traditionally, Reserve Banks never sought actively to buy acceptances for their own account; instead, they stood ready to purchase, at specified rates, all prime, eligible, endorsed acceptances offered by banks....

When private demand for acceptances was strong, open market rates tended to fall below the buying rates of the Reserve Banks. But throughout the period from 1916 to 1931, private demand was generally insufficient to clear the market. Market rates therefore rose toward Federal Reserve buying rates, and the Reserve Banks were offered large quantities of acceptances.

The December 3 memorandum also mentioned the objective first advanced for the proposal before us, stating that "It seems quite reasonable to hope that with such a catalyst (i.e., "an effort by the Open Market Account to effect part of its operations in the acceptance") the market would move to a more flexible rate basis." However, this opinion is presented with no indication of reasoning to support it, and the memorandum makes no effort to answer the basic, specific questions aimed at ascertaining whether the proposal is practicable, even though those questions were brought to their attention.

Like other members of the Committee, I am prepared ordinarily to give considerable weight to the views of our experienced and expert staff, particularly with respect to technical matters. In this case, however, the difficulties are not technical. The questions raised in the June 1 memorandum are down-to-earth questions regarding the actual modus operandi of the existing and prospective bank acceptance market. If there are satisfactory answers to those questions, it is to be presumed that our staff would supply them. The failure to do so compels the conclusion that the

questions cannot be satisfactorily answered, and that the tentative proposal, even if it could be put into mechanical operation, which is doubtful, would not accomplish the stated objective.

This in itself is sufficient ground for not adopting the pending proposal, at least until a sound basis for its adoption is presented to the Committee. However, there is another reason, at least equally important, for the Open Market Committee to hesitate to adopt the program, particularly in view of its questionable soundness. The proposal is that the Reserve System intervene in order "to bring about a more freely functioning bankers' acceptance market", to attempt to break the so-called "administered rate" and make that rate "closely responsive to money market conditions"; in short, to force down the market rate on acceptances by exercising our open market power. Action taken for this purpose would be in direct conflict with the philosophy of the ad hoc subcommittee report and the policies adopted by the FOMC in 1953 and confirmed this year, on which our operations presently are founded. We have been adhering to the principle that open market operations should be designed to keep the supply of reserve credit at a level suited to the needs of a stable and growing economy, in order that money and credit shall be available at all times in adequate volume to permit the national economy to progress without being hampered by credit shortages, but never available in such excessive volume as to encourage inflation and speculative excesses that inevitably detract from our economic welfare by destroying stability and impeding effective long-range business planning.

In accordance with this guiding principle, our actions in no event should be for the direct purpose of influencing or controlling money market rates on short-term or longer-term paper. But the program we are considering admittedly would be for this purpose; its proponents espouse its adoption explicitly for the objective of lowering market rates on bank acceptances. Consequently, adoption of the program would be a departure from our guiding principle.

It cannot validly be argued that the departure is tolerable because it would be relatively small in dollar magnitude-- a matter of some \$20 or \$50 million in a portfolio of \$25 billion. If, in the absence of the equivalent of a disorderly market, the Open Market Committee were justified in dealing in bank acceptances in order to raise or lower market rates, it would be equally justified in dealing regularly in long-term Government securities for the same purposes. The Committee should not authorize the adoption of this procedure with respect to bank acceptances any more than it would do so with

respect to Treasury securities in similar circumstances.

To sum up, I believe the executive committee should not recommend adoption of this proposal, for two equally compelling reasons: (1) it has not been established that the suggested program is feasible or capable of achieving the stated objective; and (2) its adoption would constitute a departure from one of the most important principles underlying the present policy of the Federal Open Market Committee, would serve to confuse the public as to our intentions, and would tend to counteract much of the progress that has been made in recent years in developing appropriate central banking techniques.

All who have considered this matter agree as to the desirability of broad utilization of bank acceptances. A first step might be the review and revision of our regulations and interpretations in this field. Thereafter, we could consider to what extent it is advisable to seek to familiarize bankers and bank customers with the techniques and procedures of acceptance financing; this might prove to be increasingly worth while as progress is made toward fuller currency convertibility, although the fact that the volume of acceptances has doubled in the last five years suggests that merchants and bankers are already becoming more aware of the advantages of this financing device. Another field for study might be the status and functions of Reserve Bank buying rates on acceptances, and means of enhancing their effectiveness as an aid in encouraging more widespread use of bank acceptances in international commerce.

In response to an inquiry from Chairman Martin, Mr. Rouse commented briefly upon the background of the proposal. He mentioned that at the time commercial banks lowered the prime rate on customer loans last spring, the rate on bankers' acceptances declined simultaneously to a point where the effective rate to borrowers was below the prime rate. The administered rate in the bankers' acceptance market was effectively broken at that point, and acceptances outstanding have since increased by more than 200 million dollars. It is significant that dealers are now seeking new customers for their paper for the first time in a long while, although there is still some reluctance to seek new customers. Mr. Rouse added

12/28/54

-20-

that discussions he has had with people in the market show that some professionals would like to see a freely moving rate reestablished; one of them added that the market had thought that the rigidly administered rate was what the System wanted. Some banks would be critical of any action that would result in lower acceptance rates for fear of pressure on the prime loan rate, but this fear is not as important now as it might have been a few months ago. In response to a question, Mr. Rouse went on to say that the net effect on reserves of operations in bankers' acceptances is the same as in the case of operations in Government securities, but that acceptances purchased for System account should not be considered eligible for resale in the market. He also said that during the period when the System was actively trading in bankers' acceptances, these transactions had proven useful in meeting seasonal needs for Reserve Bank credit since the supply of acceptances ordinarily expanded in the fall when the System wished to supply reserves to the market.

Mr. Sproul added that open market operations in the past had always been in the domestic market although when dollar exchange was provided to foreign central banks, it had usually taken the form of purchase from those banks of acceptances drawn in their own currencies.

There followed a general discussion of the subject, including comments on the increased demand for and volume of bankers' acceptances since last spring, rates in the acceptance market, and the purpose that might be served if the Federal Reserve were to re-enter the acceptance market under an experimental and exploratory program along the lines suggested in the

12/28/54

-21-

staff memorandum dated March 25, 1954.

During this discussion Mr. Sproul made a statement substantially as follows:

1. I do not think it is possible to answer the questions Governor Robertson has asked, in the way he wants them answered. The real purpose or underlying purpose as I see it, however, is not to fix rates although it is to be hoped results would be obtained by influencing rates.
2. The real purpose of an experimental venture into the acceptance market would be to assist in the revival of a less rigidly administered market in bankers acceptances in this country, which would help to promote a revival of international short-term money markets and, in turn, would promote international trade and facilitate further progress toward currency convertibility. It seems to me to be particularly important, in terms of these objectives, that there be active growth of the acceptance markets in New York and London.
3. I don't think we can accept the suggestion of the special committee on foreign operations, that open market dealings in bankers acceptances be geared to open market operations in Treasury bills, on some ratio basis, because of differences in the nature of the paper and its mechanical handling, but I do think the special committee is right in recommending that we begin to conduct some open market operations in acceptances, when consistent with general credit policy.
4. For this purpose, as suggested in an earlier memorandum submitted to the Open Market Committee, it would be enough to vatch the acceptance market and, if the acceptance rate appeared to be too sticky in relation to other rates, to instruct the Manager of the System Account to purchase some bankers acceptances at rates which would try to bring some bills into the System Account. If acceptances were not forthcoming at a rate somewhat above the then current Treasury bill rate, the attempt to activate the market could be postponed. It would be a case of experimental probing rather than of fixed objectives in terms of amount or rates.
5. The only changes in practice, if this procedure were adopted, would be
 - (a) the elimination of the presently fixed minimum buying rate on bankers acceptances, and the substitution of general instructions as to the scope of rate flexibility to be authorized, in relation

- to the Treasury bill rate, and the volume of acceptances that might be purchased;
- (b) making bankers acceptances eligible for repurchase agreement.
6. The next several weeks will be a period of seasonal contraction in acceptance market, and it might not be consistent with general credit policy to buy acceptances in any case, but I think we should recommend to the full Committee that the executive committee be authorized to take the actions that have been suggested. I do not see what we have to lose. It isn't an earth shaking proposal, but it is consistent with our general responsibilities in the fields of domestic credit policy and international financial relations. To avoid taking action, is to be unprepared to do something we might do to promote the desirable objective of stable national and international economic growth.
 7. I do not think we shall get any further by passing memoranda back and forth. I think we should study again the memoranda that have been prepared, and Governor Robertson's statement this morning, and come to the next meeting of the executive committee prepared to vote on a recommendation to the full Committee.

Mr. Robertson said that he felt Mr. Sproul's suggestion for reaching a decision was excellent. However, he felt that a decision must be based on reasons related to open market operations and he questioned whether the proposal which had been made would result in any real gain in terms of open market policy, especially since he interpreted the proposal as being intended to bring about lower rates on acceptances. He also raised the question whether, instead of a proposal for experimenting with bankers' acceptances in the manner suggested in the staff memorandum, it might be better to attempt to familiarize borrowers with the advantages of acceptance financing through various educational means.

Mr. Sproul responded that he was somewhat dubious about the effectiveness of educational campaigns in a matter such as this, and that he

12/28/54

-23-

felt some action on the part of the Federal Reserve System which would give some "shove" to the acceptance market would be worth while. Mr. Sproul emphasized that the principal point of the suggestion was that the Federal Reserve be willing to buy acceptances in some modest amount; such purchases would be made only if they were consistent with the general monetary and credit situation and when purchases would be made for the purpose of injecting bank reserves into the market in any event.

Chairman Martin commented that he understood Mr. Sproul's position to be that, from the standpoint of world factors, the mere holding of some acceptances in the System portfolio would be helpful as a move toward convertability of other currencies, and Mr. Sproul replied that this was correct, that the mere indication of an interest on the part of the System would assist in a revival of the acceptance market. This in turn would contribute to the ultimate objective of more convertibility.

Mr. Riefler expressed the view that the mere fact that the System held in its portfolio a volume of acceptances would broaden the market for such instruments. He noted that this was a market in which margins were very small--1/16 of 1 per cent. This was one of the good things about the acceptance, he said, but at the present time only very large firms made much use of it. In his judgment, if the Federal Reserve gave an indication that it would assist in restoring the acceptance market, that fact would make other concerns more willing to go through the various steps necessary in using acceptances with the resultant advantages that would flow from an increased volume of such instruments.

12/28/54

-24-

Mr. Sproul agreed with Mr. Riefler, adding the comment that an indication of Federal Reserve interest in the acceptance would encourage banks and dealers to make more of a market for such instruments.

Mr. Williams stated that as he saw it this would have the objective of promoting growth in the domestic economy via growth of the international economy, and that in his view the System would have ample justification for entering the field.

After further discussion, Mr. Szymczak moved that each member of the Federal Open Market Committee be furnished with a copy of the memorandum Mr. Robertson had read at this meeting, as well as with copies of the several other memoranda on acceptances distributed earlier this year, and that the members of the executive committee come to the next meeting of that committee prepared to take action with respect to making a recommendation to the full Committee regarding the suggestions contained in the memoranda.

Mr. Szymczak's motion was approved by unanimous vote.

Thereupon the meeting adjourned.


Secretary