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, January 25, 1955, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Robertson
Mr. Williams
Mr. Vardaman, Alternate for Mr. Szymczak
Mr. C. S. Young, Alternate for Mr. Sproul

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. R. A. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Before this meeting there was distributed to the members of the committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period January 11 to January 20, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed January 21-24, 1955, inclusive. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse noted that there had been no transactions in the System account since the report covering the period ending January 20 was prepared, although there had been a net increase in repurchase agreements in the amount of $1 million. In general, he felt the accound had been able to carry out the instructions of the executive committee in accordance with the policy adopted by the full Committee at its meeting on January 11. The market had gotten to a point toward the end of last week where it was tight but not too tight. Mr. Rouse stated that a negative free reserve position might possibly develop during the next day or two and it might be necessary to replace some of the bills that had been sold or permitted to run off recently; as the figures looked now, purchases of perhaps $100 million, together with making repurchase facilities available, might take care of the market's needs within the limits of the general policy indicated at the meeting on January 11.

Mr. Rouse also commented on the magnitude of operations during the past two weeks in which period System holdings of bills had declined by almost $700 million. A change of this amount might have been expected to have provoked unfavorable comment in the press, he said, but this had not developed and the market seemed to have taken a very wholesome attitude toward operations for the System account recently.

Mr. Rouse called to the attention of the committee recent developments abroad, particularly the increase in interest rates in London in relation to rates in the United States, stating that some funds had moved from the United States to London.

Chairman Martin referred to Mr. Rouse's comment that the market had been "tight but not too tight", and he inquired whether it would also be correct to say that it had been "easy but not too easy".

Mr. Rouse responded that this statement also would apply, that banks were borrowing some but that they were not having any difficulty in meeting the situation.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the transactions in the System account during the period January 11 to January 24, 1955, inclusive, were approved, ratified, and confirmed.

Mr. Robertson then made a statement substantially as follows:

> Two weeks ago a dealer in bank acceptances offered us several millions of prime short-term acceptances at 1-1/2 per cent, which had been our "effective rate" for many months. We declined to purchase those acceptances and promptly raised our rate to 1-5/8 per cent. In my opinion, our action in that case was unwise.
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> Although there has been considerable divergence of view regarding appropriate procedures, there is general agreement among us that the System should encourage the use of bank acceptances as instruments for financing of international and domestic trade. About a year ago, when demand for acceptances far exceeded supply without producing the expectable drop in rates, the suggestion was made that System account purchases of bank acceptances at the market, and discontinuance of the posted rates, might contribute to a more self-reliant market as well as to greater flexibility in acceptance rates and thereby to broader use of acceptances. Since that time, actual changes in rates and--more recently--a marked shift in the relative strengths of acceptance supply and demand, have changed the status of that particular proposal. However, the underlying objective, as I understand it, has not changed; it continues to be System policy to encourage and support the acceptance market in appropriate ways. For the time being, at least, this objective outweighs the desire to minimize our role in determining money market rates.

The increase in our "effective rate" was not in accord with the basic objective I have mentioned. In so far as it had any effect, that effect would be to weaken rather than strengthen the acceptance market.

For many months we had in effect informed the financial world that the Federal Reserve stood ready to buy 90-day prime acceptances at 1-1/2 per cent. We published that effective rate month after month in the Bulletin.

If a posted rate has any function or merit, it is as a floor--or at least as a catwalk--that provides a temporary footing for the market and saves it from a shattering fall into the cellar. To put the matter more prosaically, the publication of a definite effective rate has the effect of assuring the market that, in the event the supply of acceptances suddenly becomes "excessive", the Federal Reserve is prepared to absorb the excess and thus prevent violent fluctuations in acceptance rates, with consequent heavy loss to dealers or others forced to unload in such a market. It is undeniable that dealers will be more willing to take positions in acceptances when protected by the backstop of a posted rate than they would be in the absence of such protection, and willingness of dealers to take positions readily is the core of an active and vigorous acceptance market.

Action such as the one we took two weeks ago can hardly fail to affect dealer confidence adversely. To them it must appear that the System's effective rate is practically meaningless. It is there as long as no one wishes to utilize it, but it is withdrawn at the first actual offering. In the 1920's the development of the acceptance market was based, in part at least, on willingness of the System to absorb acceptances at the posted rates. Our recent action would justify the market in concluding that the posted acceptance rate has lost its former meaning and that the Federal Reserve System is not greatly concerned with supporting and encouraging a broader use of the bank acceptance.

Some suggestion has been made that the action was compelled by our desire to avoid increasing at that time the volume of outstanding Federal Reserve credit. However, any such argument overlooks the fact that this very moderate extension of reserve credit could have been readily neutralized by an offsetting outright sale of bills. In fact, during the week when we refused to buy a few millions of acceptances, we furnished a much larger volume of reserve credit via repurchase agreements, balanced by offsetting outright sales.

Mr. Rouse stated that the System had no posted buying rate for bankers' acceptances; the Federal Reserve Bulletin contained an effective minimum buying rate as of a past date, but this was not a posted buying rate. He also referred to the procedure authorized on June 19, 1952, under which the Federal Open Market Committee sets a minimum buying rate and the Manager of the System Account specifies the effective rates at which the Reserve Banks may purchase acceptances, in the light of market conditions and developments and in accordance with any directives or limitations prescribed by the full Committee or the executive committee for the purpose of carrying out the current policies of the Federal Open Market Committee. Mr. Rouse stated that he did not know about an actual offering of acceptances to the Federal Reserve Banks such as Mr. Robertson had referred to. One dealer who planned to raise his rates had called him on the telephone to discuss the situation in an exploratory manner and for the purpose of finding out whether there were any factors that the dealer should take into account before he took the action. In the course of that discussion the dealer asked him, Mr. Rouse said, more in a joking way than otherwise, if the New York Bank would care to buy $1 or $2 million of acceptances, and Mr. Rouse said that he responded that he did not think so. Mr. Rouse went on to say that had there been a formal offer of bills, he would have felt that he was governed by the fact that System policy with respect to acceptances was in process of being formulated, the executive committee having recommended on January 11, 1955, that the full Committee consider certain changes in the procedure to be followed so as to bring about a more freely functioning acceptance market. His action in increasing the effective rate had been taken in accordance with and under the terms of the committee's authorization of June 19, 1952.

During a discussion that followed, Mr. Robertson expressed the view that if the committee wished to encourage and foster the growth and use of acceptances, the best way to do that would be to establish a posted rate and to stand ready to buy any bills offered at that rate at any time (such rate to be low enough to encourage the use of acceptances as compared with other types of financing) unless it appears that (1) the facility is being misused, or (2) the demands placed upon it are so great that they threaten the effectiveness of System monetary policy to an extent that cannot effectively or wisely be offset through operations in the open market.

Chairman Martin suggested that inasmuch as the executive committee had made a recommendation to the full Committee, further discussion of the procedure to be followed in connection with acceptances be deferred until the meeting of the full Committee to be held during the first week of March. He stated that he could understand Mr. Rouse's action in increasing the rate earlier this month since he (Mr. Rouse) did not wish to get ahead of action that might be taken by the full Committee in connection with the executive committee's recommendation of January 11.

Governor Robertson stated that he felt it would be desirable at this meeting to instruct the Manager of the System Account to restore the effective buying rate to the level that existed before it was increased on January 13, his feeling being that such action would indicate interest on the part of the Federal Reserve in fostering the growth of acceptances.

This suggestion was discussed briefly, Chairman Martin expressing the view that it would not be desirable to experiment with a different operating procedure in the acceptance market in the absence of consideration by the full Committee at its next meeting of the proposals that had been made. He felt the matter was too small to be important in terms of either open market policy or its effect on the acceptance market; even if there had been a mistake made in increasing the rate on January 13, he did not think action by the executive committee now to reduce it would correct the situation. In further discussion, some of the members of the committee expressed interest in additional study of Mr. Robertson's suggestion that the best way to stimulate the use of bankers' acceptances might be for the Federal Reserve Banks to adopt a posted buying rate and to stand ready to take all bills at that rate, which would be set sufficiently low to encourage financing through acceptances; however, it was the consensus that no action to change the rate at this time would be desirable and that a reduction might be confusing and result in misinterpretation of System policy, especially in view of the forthcoming Treasury financing. At the conclusion of the discussion it was understood that the committee would not act to reverse the increase which had been made in the rate on January 13 and that the suggestions made by Mr. Robertson would be considered at the meeting of the full Committee during the first week of March along with the recommendation made by the executive committee at its meeting on January 11, 1955.

Members of the Board's Division of Research and Statistics entered the room at this point for the purpose of assisting in the presentation of a review of the economic situation, illustrated by chart slides. The presentation, which Mr. Ralph A. Young stated was being given in this form in view of the fact that the charts had been prepared for another meeting on the previous day, conveyed substantially the same views as to recent and prospective economic and financial developments as were contained in a staff memorandum distributed under date of January 21, 1955. This memorandum stated that consumer and business demands in early January were maintained or increased further from the advanced December levels, that some further rise in industrial activity was indicated for January, that department store sales which had been in record volume during the Christmas season continued upward through mid-January after allowing for seasonal influences, and that consumer takings of automobiles during January remained close to the advanced levels reached in December. Residential construction contracts increased sharply further in December as did nonresidential awards. Industrial output abroad recently has continued at advanced rates. Exports from the United States in November were maintained at close to the sharply higher level of October. Prices of industrial materials continued strong during January following further increases in late December, and prices of farm products have shown recovery from the seasonally-reduced mid-December average.

Chairman Martin stated that the discussion of open market operations at this meeting necessarily would be colored by the requirements of the

Treasury in connection with the refinancing program to be offered in the immediate future, and he asked Mr. Rouse to comment on that situation.

Mr. Rouse said that there had been a great deal of discussion in the market during the past month regarding the $15 billion of Treasury securities maturing in February and March. There was general acceptance that the present was an appropriate time for the Treasury to do some long-term refinancing. Mr. Rouse also noted that the liquidity of the banking system had been reduced substantially as a result of the refunding last year and that it was believed that the Treasury could not now go much farther than three years in bank financing. There were differences of opinion as to whether the entire $15 billion of February and March maturities should be refinanced at one time, and also as to the rate that should be offered on a long-term bond and the mechanics by which it should be issued. However, the Treasury was proceeding with discussions with interested groups and Mr. Rouse said he anticipated a decision would be reached later this week.

Chairman Martin inquired of Mr. Rouse as to operations that might be followed for the System account to provide a minimum disturbance to the market during the immediate future, so that whatever the decision of the Treasury with respect to the financing, its offering would not be influenced by actions taken by the Federal Reserve.

Mr. Rouse responded that his suggestion would be to maintain free reserves around $200-250 million, to have as little activity as possible in the System account, and to utilize repurchase agreements so that dealers' operations would be facilitated during the period of the financing. Mr. Rouse also said that while projections of the volume of free reserves changed from day to day, estimates for the current statement week indicated a daily average of a little over $300 million, to be followed by a fairly sharp drop during the following week. He felt that under the circumstances it probably would be desirable for the System to put some reserves--perhaps $100 million--into the market through outright purchases and to be reasonably free with repurchase facilities in order to assist dealers in fulfilling their function during the Treasury financing.

Chairman Martin expressed the view that, whatever the course the account had been pursuing in the market lately, at the moment it should serve as a stabilizing influence. He emphasized that estimates of free reserves were at best approximations. It would be difficult to pinpoint a figure for the level of free reserves or for operations, and he noted that Mr. Riefler thought that a level somewhat higher than $250 million might be desirable during the next two weeks. Chairman Martin felt that the sense of the committee might be that if it were to "resolve any errors" it resolve them at this time on the side of "maximum assistance to the market in this period". The account should not do anything in its current operations that would appear to interfere with the success of the Treasury's forthcoming financing.

Mr. Robertson stated that the groundwork for such a program had been laid during the past few weeks through a reduction in System holdings of securities and that in his view the objective ought now to be to "keep an even keel" throughout the period of the Treasury financing.

In response to Mr. Vardaman's inquiry as to the volume of free reserves that would be maintained under a program such as had been suggested, Chairman Martin said he thought the $250 million level of free reserves would be a minimum.

Mr. Rouse stated that he would have in mind leveling off around the current volume, although he would not care to pinpoint a target level of free reserves. There would be a decline in free reserves during the current week and in his view it would be desirable to show to the market that for the present the System was through with reducing the volume of free reserves. This could be done by making actual purchases for the System account of perhaps $100 million of securities early in the next statement week. As indicated before, Mr. Rouse stated that the amount of such purchases would depend on whether free reserves got down closer to the zero level during the next few days than was now indicated by the projections. He also reiterated the view that repurchase facilities would help dealers fulfill their function during this period.

Mr. Mills commented that the maintenance of a "status quo" policy could be the antithesis of a flexible monetary policy. He noted that System operations resulting in withdrawals of reserves from the market since the beginning of this month (a policy with which he was in agreement) had taken place at a time of normal contraction of credit and deposits. Mr. Mills thought it quite possible that the import of the reserve withdrawals had not been comprehended as fully by the investment fraternity as had been the rapid rise in bill rates. In England, there had been steady pressure on the market in a more volatile situation than we were experiencing, and the results had been acceptable. In the United States, the System had been so drastic in its policy and rates had moved up so fast that the commercial banking system was suffering from a lack of liquidity. Mr. Mills went on to say that when the season of normal expanding demand for credit began to be felt--especially if this were to be when the System was maintaining a "status quo" policy--the banks might be alarmed and the System might find that it had gone much farther than any expressed desire to slow down, if possible, credit expansion in the securities field and in the mortgage field. The period of the Treasury's financing would be an ideal time to reappraise the situation with a view to determining what should be done immediately thereafter. Mr. Mills suggested that, with the completion of the Treasury's refunding, the System would be in a very delicate situation as to formulating future policy. In addition to the lack of liquidity in the banking system, which could provoke an unwanted situation if policy moved further in the direction it has been going recently, Mr. Mills noted that the rise in bill rates has acted as a magnet in attracting buying of bills by corporate investors at the expense of deposit withdrawals from commercial banks. At the same time, the banks have been under pressure and have not benefited by the compensating declines in required reserves. Under the circumstances, Mr. Mills suggested that the committee look very carefully to its operations over the next three or four weeks.

Chairman Martin said that he did not think the committee was contemplating a "status quo" program: it was shooting at an "even keel" during the period of the Treasury's financing. The Treasury's offering should not appear either to be floated by the Federal Reserve or hindered by the Federal Reserve. In other words, the Federal Reserve should be "in absentia" as far as possible. As to how to achieve this ideal, Chairman Martin said that he had no precise answer.

Mr. Williams said that he understood Mr. Mills' point to be that if the suggested program were followed during the period of the Treasury's financing, it would sharpen the problems that would confront the committee immediately after that period.

That was the conclusion, Mr. Mills responded. It seemed to him that, with the conclusion of the Treasury's financing, the committee should have an "agonizing reappraisal" of its policy and should not set its mind on a policy that would shrink bank reserves too far.

Mr. Vardaman said that he would dislike anything in the way of tightening at this time. He felt that banks were still "dragging their feet" in credit extensions in comparison with the plans and hopes and beliefs of industry. It would be dangerous, he said, to tighten in a way that would indicate that the committee felt that recovery had gone so far as to become a boom. He did not think the economy had reached this stage yet and he would concur in Mr. Riefler's thought that free reserves should be kept above $250 million in the immediate future.

Chairman Martin stated that he had not suggested that the committee tighten conditions in any sense of the word, that his comments turned in quite the reverse direction. He had been suggesting that the program during the Treasury's financing period be one of resolving error on the side of ease. He did not think the committee wanted to take the Treasury refunding as a period in which it would try to develop policy in either direction. The "agonizing reappraisal" to which Mr. Mills had referred was on the committee now and had been on it for some time, the Chairman said, but he did not believe the committee could take any action at the time of the Treasury's financing whereby it either assumed responsibility for what the Treasury was trying to do or the reverse. Chairman Martin wanted to make it clear that he thought the committee's operations during this period should be directed toward as little upset of the general market as was possible. He did not wish to pinpoint any figure of reserves, and he did not take Mr. Rouse's comments as suggesting the pinpointing of any figures. As he saw it, the committee wanted to make it clear to the market that in so far as Federal Reserve policy is concerned, it is one of letting market forces prevail. It was not going to influence the market either way, although it would be necessary to put some reserves into the market so as to get a minimum of free reserves during the period of the Treasury's financing. If the committee was to be accused of error one way or the other during the refunding, Chairman Martin would prefer that it be accused of erring on the side of ease. He did not know what the committee would wish to do after the Treasury's financing had been completed: that would be partly dependent on the policy followed during the past few weeks and partly dependent on the terms of the Treasury's financing.

Mr. Robertson expressed the view that the committee had been "dragging its feet" during the past few weeks in supplying reserves; but that it should not drag them more during the period of the Treasury's refunding.

Chairman Martin then inquired whether any of the members of the committee wished to spell out the program further and, in the absence of response, Chairman Martin stated that he would consider that there was a meeting of minds on a program along the lines of the foregoing discussion as one to be followed between now and the next meeting of the committee.

Mr. Rouse stated he understood this to mean that in general operations would try to keep the free reserve position on an even keel in the immediate future. He also stated, in response to Chairman Martin's question, that he had no suggestion for change in the directive to be issued to the Federal Reserve Bank of New York at this 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 fostering growth and stability in the economy by maintaining conditions in the money market that would encourage recovery and avoid the development of unsustainable expansion, 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.

It was agreed that the next meeting of the executive committee would be set for 10:45 a.m. on Tuesday, February 8, 1955.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary