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ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1953

Prior to this meeting, such repurchase agreements were authorized only with nonbank dealers qualified to transact business with the System open market account. In view of the decision to discontinue the system of qualifications for dealers, referred to in the preceding entry, the Committee eliminated the requirement that repurchase agreements be only with nonbank dealers so qualified. In addition, the Committee modified the condition which previously limited such repurchase agreements to "short-term Government securities selling at a yield of not more than the issuing rate for one-year Treasury obligations," and provided that such agreements "cover only short-term Government securities maturing within 15 months." This change was made because it was felt that it would be preferable to relate the repurchase agreements to short-term Government securities of a specified maximum maturity, rather than to those bearing a certain yield.

June 11, 1953

1. Authority to Effect Transactions in System Account.

The Committee adopted the following directive to the executive committee:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), 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 avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market), (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than 2 billion dollars.
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> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) of 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 2 billion dollars.

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Evans, Fulton, Johns, Mills, Powell, and Robertson. Votes against this action: none.

In terms of credit policy, the foregoing directive placed emphasis on "avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market)," rather than "exercising restraint upon inflationary developments," as provided in the directive issued by the Committee at the preceding meeting in March.

The general objective of credit policy under both the March and June directives was one of keeping the supply of credit and money adjusted to the needs of a growing and high-level economy; the change in policy at this meeting reflected recent developments in the economic and credit situation. Commodity prices had remained fairly stable for some months, while output had continued at a very high level and had actually increased slightly further since March. Financial markets, on the other hand, had been unsettled at times during the spring months, particularly during late May, and throughout the period since March there had been an undertone of concern about potential declines in economic activity. Doubts had related to the strength of underlying conditions, concern having been expressed lest measures designed to limit credit expansion had become more restrictive than was desirable, setting in motion forces of decline which would be difficult to check. In recent weeks uncertainties had been increased by new developments in Korea. While attention was focused on the sharp advances in interest rates since mid-April, the cumulative effectiveness of monetary restraints had become evident in the financial and business community to such a degree that credit was more difficult to obtain than was considered to be desirable in terms of the Committee's policy approved at the March meeting—a policy of exercising restraint upon inflationary developments but at the same time keeping the supply of credit adjusted to the needs of a growing and high-level economy. Whereas the money supply, after adjustment for seasonal variation, had shown a rising tendency through April, there appeared to have been a greater than seasonal decline in May.

In considering the credit policy to be pursued henceforth, the Committee also gave attention to recent developments in the market for United States Government securities which had been subjected to a series of pressures that had resulted in generally lower prices and higher rates. Important among these influences was the failure of Treasury cash receipts to meet earlier expectations, requiring the Treasury to step up its new-money financing in the market. At the same time, the Treasury was competing for available funds with heavy private and municipal demands for new capital, which continued to exceed the supply of new long-term funds in the market, and with persistently heavy demands upon commercial bank credit facilities in the face of restrictive Federal Reserve credit policy.

Treasury financing operations during the period since March had included an offering for cash of about a billion dollars of 3¼ per cent fully marketable bonds due in 1978-83, and the Treasury also had borrowed new money by increasing certain weekly bill issues and by the sale of September tax anticipation bills. Treasury refunding operations involved 4,963 million dollars of 1⅞ per cent certificates of indebtedness maturing June 1, 1953 and 725 million of partly tax-exempt 2 per cent bonds of 1953-55 called for redemption on June 15, 1953, and an exchange offer of 3¼ per cent bonds to holders of Series F and G savings bonds maturing from May through December 1953.

Market operations for the System account since the March meeting included the purchase of over 450 million dollars of Treasury bills, offset in part by redemptions of about 122 million. During May and early June alone, net purchases for the System account totaled 375 million dollars for the purpose of providing sufficient funds to the market to prevent further accentuation of the credit tightness that had developed early in May and to forestall the possibility that Treasury borrowing operations would result in unwarranted pressures upon the money market.

While it did not appear in June that the restraints on credit expansion had yet reduced the flow of funds to a point where resources of the economy were not being fully utilized, there had been a dampening of strength of the capital goods boom and a postponement of some capital projects, even though there had been a large increase in capital flotations during May and June, partly reflecting the fear that funds would be harder to obtain later on. There was also growing difficulty in finding takers for Government guaranteed and insured mortgages even at the higher interest rates that had been permitted.

Indications were that, in order to supply normal seasonal and moderate growth demands for credit and keep the situation from getting tighter than was believed to be desirable in view of prospective needs for funds from private and Treasury sources, there would have to be put into the market something like 2.5 to 3.5 billion dollars of reserves between May and the end of 1953. It was the view of the Committee, therefore, that policy should be one of aggressively supplying reserves to the market during the near future on a sharply rising scale and, accordingly, the instruction to the executive committee was changed in the manner indicated.

In connection with the discussion of current credit policy, there was a further discussion of the operating techniques adopted at the March meeting and the suggestion was made that the Committee rescind the decisions approved at that meeting instructing the executive committee that (a) under present conditions, operations for the System account should be confined to the short end of the market (not including correction of disorderly markets) and (b) pending further study and further action by the Committee, it should refrain during a period of Treasury financing from purchasing (1) any maturing issues for which an exchange is being offered, (2) when-issued securities, and (3) any outstanding issues of comparable maturity to those being offered for exchange. This suggestion would have left these matters to the discretion of the executive committee.

In a thorough exploration of the reasons for and against such action, question was raised whether the proposal to rescind the March decisions, which was regarded as a proposal for a possible important change in operating policy, was of sufficient urgency to require action in the absence of two members of the Committee. A vote was requested on the grounds that not to vote would be the equivalent of reaffirming the March action without a vote.

Thereupon, Mr. Mills moved that the two understandings referred to be reaffirmed by the full Committee and that the executive committee be instructed to continue to operate accordingly.

This motion was put by the Chair and lost.

Votes against the motion: Messrs. Sproul, Vice Chairman, Erickson, Fulton, Johns, and Powell. Votes for the motion: Messrs. Martin, Chairman, Evans, Mills, and Robertson.

Mr. Sproul then moved that the understandings relating to confining operations for the System account to the short-term sector of the market and to refraining from certain purchases during periods of Treasury financings, as approved at the meeting of the Committee on March 4-5, 1953, be rescinded, with the understanding that the executive committee would be free to determine how operations should be carried on in the respects mentioned, in the light of the current general credit policy of the Federal Open Market Committee.

Mr. Sproul's motion was put by the Chair and carried.

Votes for the motion: Messrs. Sproul, Vice Chairman, Erickson, Fulton, Johns, and Powell. Votes against the motion: Messrs. Martin, Chairman, Evans, Mills, and Robertson.

The votes against the first motion and in favor of the second were on the grounds that conditions had changed since the meeting of the Committee in March 1953 and that the present situation and the likely situation during the next three months urgently required the removal of these prohibitions so as to restore greater freedom of action. By restoring greater freedom of action to the executive committee, those voting for the motion believed that, within the limits of the full Committee's general policy, open market operations could be directed with greater flexibility and versatility to meet any situation that might develop. While it would not necessarily be the objective to go into the long-term market (transactions for the System account since March had been confined to Treasury bills), it was felt that, in carrying out the Committee's credit policy, the executive committee should have discretion, particularly at times of Treasury financing, to make purchases in whatever areas of the market were under pressure so that there would not be unnecessary erosion of rates, affecting adversely investor and banking psychology and intensifying the restrictive effects of credit policy at the wrong time. Although it was recognized that purchases of Treasury bills would put reserves into the market, it was thought that such purchases might not be as effective as would be desirable in avoiding unwarranted changes in the Government securities market and that, since changes in that market might affect investment conditions generally, they were a factor to be considered in carrying out the aims of monetary policy. It was also believed that, so long as it was the policy of the Committee to put funds into the market, freedom to put them in where the pressures were greatest might minimize the amount the Committee would have to put in and thus help to achieve the purposes of monetary policy most effectively.

The members of the Committee who voted for the first motion, by Mr. Mills, and against the second, by Mr. Sproul, felt that it was better, as a general policy, to confine System account operations to the nearest thing to money, that is, short-term Treasury securities—preferably bills—except in the case of correcting a disorderly market. Their concept of the open market operation was that a minimum burden should be put on the open market account or the Open Market Committee for determining what the market should be; and that, therefore, there should be some general rule for the guidance of the Manager of the System Account. While they recognized that conditions had changed in recent months, they did not feel that the procedures approved at the March meeting had had a test. They were opposed to changing the policy which the Committee recently had been following because they felt such a change would not benefit the Government securities market but might actually harm it through deviating from a policy toward which the Committee had been working over a period of two years, and because they believed that purchases of Treasury bills would be equally as satisfactory as purchases of longer-term securities in carrying out the monetary and credit policy approved at this meeting.

SEPTEMBER 24, 1953

1. Authority to Effect Transactions in System Account.

The following directive to the executive committee was approved:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), 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 avoiding deflationary tendencies, (c) to correcting a disorderly situation in the Government securities market, and (d) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than 2 billion dollars.
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Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Evans, Fulton, Johns, Mills, Powell, Robertson, Szymczak, and Vardaman. Votes against this action: none.

This directive provided that transactions in the System open market account should be with a view "to avoiding deflationary tendencies" rather than, as had been agreed at the meeting on June 11, 1953, "to avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market)." This change in wording reflected a policy that the Committee described as "active ease" under which reserves would be supplied to the market to meet seasonal and growth needs, recognizing that open market operations should be flexible in relation to the volume and timing of supplies of reserves from other sources. At the time of the September meeting, adjustments taking place or in prospect in the economy caused the Committee to believe that the danger of further inflationary tendencies was much less than the possibility of deflationary developments.

General economic activity had continued close to peak levels since the last