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, July 22, 1952, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Vardaman
Mr. Mills, Alternate
Mr. Young, Alternate for Mr. Leach

Mr. Szymczak, Member, Federal Open Market Committee

Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Mr. Ralph A. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Ralph F. Leach, Acting Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Willis, Securities, Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee held on June 6 and June 19, 1952, were approved.

Before this meeting each member of the executive committee received a copy of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period June 19 to July 17, 1952, inclusive. At this meeting Mr. Rouse submitted a supplementary report covering commitments executed on July 18 and July 21, 1952. Copies of both reports have been placed in the files of the Federal Open Market Committee. In a brief statement supplementing his report, Mr. Rouse commented on indicated plans of business concerns and public bodies to invest the proceeds of new security issues in short-term Government securities in substantial amounts.

> After a brief discussion, upon motion duly made and seconded and by unanimous vote, the transactions in the System open market account for the period June 19 to July 21, 1952, inclusive, were approved, ratified, and confirmed.

In connection with the study now in progress of the scope and adequacy of the Government securities market, Chairman Martin stated that the discussions with representatives of securities dealers had been substantially completed, that a summary of the discussions was now being prepared, and that copies of the summary would be placed in the hands of the members of the Federal Open Market Committee as promptly as possible.

In summarizing the economic outlook, Mr. Ralph A. Young stated that largely because of the steel strike production, employment and income were now lower than for some months past, that the outlook seemed to be for an early rise in production beyond previous high levels and probably to year-end levels higher than were projected five weeks ago, that wholesale commodity prices had changed very little since the beginning of June and retail prices had risen somewhat, and that while influences were mixed it appeared likely that monetary and debt management policies over the remainder of the year would be operating in an environment in which upward price pressures were somewhat stronger than those experienced during the past year or so. A copy of Mr. Young's statement has been placed in the files of the Open Market Committee.

Mr. Thomas stated that developments in the money market since the last meeting of the committee had been about as were forecast at that time, that since May 14, 1952, there had been an increase in required reserves of some $750 million and an increase in currency in circulation of about $450 million, and that this drain on reserves had been met by increases in System holdings of securities of some $450 million and further increases in Federal Reserve Bank discounts. He stated that on July 18 member bank borrowings were at a level of approximately $1,260 million, while excess reserves were something less than $900 million. He commented on the movement of Government securities in the market and particularly the movement of short-term securities into the hands of nonbank investors and stated that it was clear that the general tendency during the next few months and probably for the rest of the year would be for a tight money market unless there was more liquidation than there was any reason to expect at the present time.

Following a discussion of the effect on the money market of purchases of short-term Government securities by nonbank investors, Mr. Sproul made substantially the following statement. His comments were in the light of a memorandum prepared by the staff under date of July 21, 1952, with respect to possible programs for Treasury refunding:

> The outlook would seem to call for continuance of the so-called policy of neutrality and, if it were not for the steel strike, for a policy of outright restraint. If and when in the absence of total war the Government finds it necessary at a time of high level production, employment, income and savings, to finance a cash deficit through the banks, there should be pressure for an offsetting decline in private credit. In other words there should be a diversion of resources from private use to Government use. If we could be so tight as to make no additional reserve funds available to the banks, or to make them available only through the discount window (and repurchase agreements) this in effect is what would happen. But when the Treasury actually must borrow a substantial amount from the banks, and when seasonal private demands for credit are mixed up with the Government's demand and marginal or fringe private demands, it is hard to be that tight and to take the consequences in substantially higher interest rates including discount rates.
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> This is particularly so at a time, such as the present, when inflationary pressures are not dominant, although they may become so, and when we have a strike in the nation's basic industry on our hands. If we were fighting strong inflationary pressures a policy of strong credit restraint would be the indicated prescription. But the present situation does not clearly call for such a change in our policy and it would be hard to make it understood by the public and the banking and business community, in terms of the economic situation, and by the Treasury in terms of debt management.
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> Events have already overtaken us, to some extent, and our policy of neutrality, so called, has already started to become a policy of restraint. The recent Treasury issue of $4.2 billion of 2-3/8 per cent bonds, of which the major part have been and will be purchased, directly or indirectly, by the banks has inevitably put the banking system under pressure. The natural result

has been tightness in the money market and a rise of interest rates. There could be no other outcome unless we were willing to flood the market with reserves to support this increase in bank investments. Actually we put about 300 million net into the market in connection with the June financing, and we still have about 160 million net in the market as a result of our purchases of 300 million to relieve acute stringency over July 1. The member banks were borrowing about $1 billion, and on July 16 we had over 100 million out on repurchase agreement, which together exceeds by 500 million aggregate excess reserves on that date.

With prospects for continuing tight money markets (the staff memorandum foresees the need of additional member bank borrowing of as much as half a billion in the next three weeks, and further seasonal need of reserves in subsequent months) the present situation is rapidly becoming one of credit restraint rather than neutrality. It is not only the actual amount of member bank borrowing, but the cumulative effect of continued and increasing high level borrowing, which will make it so.

It seems to me that we have three alternatives: (a) attempt to restore the status quo ante by releasing substantial reserves through open market operations although still presumably trying to keep the banks under some pressure to borrow, (b) do nothing by open market operations (except repurchase agreements) to relieve the situation growing out of increased demands for credit; this would force the banks further and further into debt and would take no account of the effect on interest rates which would be substantial, or (c) from here on provide some controlled relief through open market operations while forcing member banks to increase their borrowing also. I would discard alternatives (a) and (b). I would discard (a) because even if it were possible to force the market back to a 1-7/8 per cent one year rate--which is doubtful, we would be running the risk of getting caught in a spiral of deficit financing through the banking system, and of unrestrained private credit expansion, which would put us back where we were before August 1950 or March 1951. I would discard (b) because it would be a major policy move toward severe credit restraint which would not be understood and could not be strongly supported at a time when inflationary pressures are potential rather than active.

I would accept the technically more difficult third alternative because it seems to me a desirable middle way to keep a necessary measure of restraint on credit expansion, while awaiting settlement of the steel strike, and the unfolding of the economic situation during the last half of the year.

What this might mean in terms of current credit policy, and recommendations to the Treasury would probably be such release of reserves through open market operations during the next two or three weeks as would serve to maintain stability around present levels in the money market, and in interest rates, so that the Treasury could refund its August 15 and September 1 maturities with a 9-1/2 month certificate (June 1, 1953) at about 2 per cent. And I would no longer be controlled by eighths in fixing the coupon. It is time debt management went on the decimal system like the rest of the market.

Mr. C. S. Young stated that he concurred in Mr. Sproul's third alternative but would prefer a 2-year 2-1/8 per cent note rather than the suggested 9-1/2 months certificate for the coming refunding.

Mr. Mills stated that his view would subscribe entirely to Mr. Sproul's third alternative except that he felt the refunding should be done with a 12 months 2 per cent certificate, this for the reason that the difference in yield in the present market was insignificant and the 12 months certificate would be better understood by the public. He added that the 9-1/2 months certificate might be misinterpreted as a signal from the Treasury of higher interest rates and that a 12 months certificate would avoid that possible interpretation. He preferred a certificate to a note for the reason that at the present time when we were "in midstream" the policy of the System would be much better served if it recommended a completely orthodox refunding so that if there were any differences of opinion they could be focused on the rate and not on the type of instrument to be offered. He made the further statement that it might be argued that new types of issues might best be reserved for offerings when the Treasury needed to raise new funds as it would have to do later in the year and to do refunding operations with existing orthodox issues.

Mr. Rouse expressed the view that it might be ill advised to offer a 12 months certificate at this time because it would add to the refunding difficulties in the last half of next year at which time additional amounts of new funds would also have to be raised. For that reason he preferred a 9-1/2 months certificate for the August and September refundings.

Chairman Martin stated that his thinking had been along the line that the recommendation of the committee to the Treasury should not be too precise as to the refunding of the maturing issues, that the committee should state the background against which its recommendation was made which would point out that the current one-year market rate was 2 per cent, that anything longer than one year would be a mistake, and that it should be left to the Treasury to reach its own decision as to the maturity of the refunding issue.

Mr. Youngdahl stated that the committee had in effect been following Mr. Sproul's third alternative since the middle of May and had about offset the seasonal currency movement and that if that alternative were adopted the committee presumably would want to continue to offset factors such as currency drains and to supply through the discount window the reserves required to meet the bank credit expansion that it was felt should be allowed to take place.

Mr. Sproul did not think that the reserves that would be supplied could be related directly to changes in currency in circulation or in float, or to any single factor affecting bank reserves although taking account of the net of all the factors involved might have substantially that result. He felt that any System purchases of securities should be in the very short area of the market so that they could be allowed to run off or sold if future conditions should make such action appropriate.

Mr. Szymczak commented that the situation might arise in which it would be desirable to increase the discount rate.

Mr. Youngdahl said that as he understood the policy being discussed, the System would not purchase maturing August 15 or September 1 certificates. Mr. Sproul said that with such a small refunding operation the System might well experiment with the issues that the System would purchase and that it would be a good time to carry out System policy by the purchase of issues other than the "rights". He thought that, while it might be desirable to purchase some of the maturing certificates, the general intention would be instead to purchase bills and other short-term certificates wherever possible. There appeared to be general agreement with this view.

Mr. Vardaman expressed the opinion that a decision should be made at this time on the financing program for the rest of the year. Mr. Sproul responded with the comment that he could see nothing which should cause us to depart from the policy of advocating refundings which would fall on quarterly maturity dates, that conditions in the money market later in the year would depend on the outcome of the steel strike and whether inflationary forces reasserted themselves, and that Treasury financing policy including the October financing should be carried out in the light of those developments and should occasion no difficulty at that time.

Chairman Martin observed that there was agreement with Mr. Sproul's third alternative, and that a statement of the committee's over-all view of the situation might be given to the Treasury in connection with the recommendation on Treasury refunding.

In the ensuing discussion Mr. Thomas raised a question as to guides in carrying out the policy suggested by Mr. Sproul in his earlier statement. He indicated two possible specific guides: (1) the committee might try to keep the bill rate from rising above, say, 1.85 per cent, or (2) it might aim to keep member bank borrowing from rising above, say, $1 billion. Mr. Sproul commented that System policy should look to stability of interest rates during the refunding, but that thereafter member bank borrowing might go up as much as an additional $500 million and that interest rates might be allowed to reflect that situation. It was his thought that System operations would try to moderate movements but would not attempt to hold rates after the forthcoming refunding operations were out of the way.

There was further discussion of whether October refunding should be included with the August and September refunding and of whether the rate used in the earlier refunding would be expected to apply also to the later operation. In this connection, Mr. Sproul was of the opinion that the October refunding should be determined in the light of conditions at the time.

Chairman Martin suggested that Messrs. Thomas, Rouse, and Young draft a letter to the Treasury which would set forth the executive committee's views as to the prospective economic situation and as to monetary policies that would be appropriate and which would also present the recommendation of the committee with respect to the August and September refunding. Based on this recommendation, such a letter, he said, would amount to a tacit commitment on the part of the System to stabilize the market during the refunding.

In a discussion of this suggestion and of the question whether the Treasury might offer a refunding issue of up to two years at a rate of 2-1/8 per cent, it was agreed that the letter to the Treasury should include a recommendation that the refunding of the August 15 and September 1 maturities be done in one operation with a 2 per cent issue maturing in not to exceed one year, and that no reference be made in that letter to the possibility of a 2 year 2-1/8 per cent note.

At the conclusion of the discussion, upon motion duly made and seconded, it was voted unanimously that the letter above referred to would be sent in a form approved by the Chairman and Mr. Sproul.

Secretary's note: The letter, dated July 23, 1952, and reading as follows, was handed to Secretary Snyder by Chairman Martin on the morning of July 24, 1952:

"The Executive Committee of the Federal Open Market Committee, in a meeting on July 22, considered the policies of the Open Market Committee and the needs of Treasury financing in the light of recent and prospective economic developments. The Executive Committee concluded that, aside from current dislocations due to the steel strike, the inflationary threat is real and calls for monetary measures which will help to minimize this danger.

"The more important factors supporting this view include the sharp readjustment in the supply of steel resulting from the strike, the existing large programs of capital expenditures, particularly by public utilities, the continuing boom in residential building, the large municipal and State expenditures, the Federal cash deficit growing out of the expanding defense program, the steady spread of wage increases, and reviving consumer spending. Factors that may tend to relieve price pressures are prospective large crops and possible slackening in foreign demands for U. S. products. All of the foregoing influences are being reflected in current markets.

"Credit availability will play an important role in influencing the course of these developments. The Executive Committee recognizes that some expansion in bank credit during this year is necessary to meet seasonal and other essential demands. The credit and monetary expansion which has occurred in recent weeks should suffice to cover a large part of these financing needs.

"In view of the probable strength of demands for credit and in order to avoid contributing to inflationary pressures, the Open Market Committee is continuing its policy of providing needed reserves primarily through Federal Reserve Bank advances to member banks. At the same time, limited open market purchases by the System have been and may be needed from time to time in order to moderate undue strains on the money market, particularly during periods of Treasury financing operations. Under this policy, the volume of credit demand that develops is reflected in the level of interest rates.

"With respect to the immediate Treasury financing the Executive Committee is of the opinion that the Treasury could refund the certificates maturing August 15 and September 1 in one operation and that current market conditions indicate that a rate of 2 per cent would be appropriate for an issue maturing in twelve months or less."

Reference was then made by Mr. Rouse to the problem of the rate on repurchase agreements which was raised by the increase in short-term market rates. He stated that one of the original purposes of these agreements was to provide an arrangement under which dealers would be willing to carry substantial positions in short-term Government securities, and that after considering the matter carefully he had come to the conclusion that during a period of higher short-term rates such agreements should be made at the discount rate, recognizing that while this would result in some profits to dealers these would be offset by losses on other transactions.

Mr. Thomas raised the question whether under the existing instructions of the Federal Open Market Committee repurchase agreements could continue to be made at the discount rate or, whether the current instructions, which tied the repurchase rate to the average issuing rate on the most recent issue of Treasury bills, would not require an increase in the repurchase rate should the bill rate continue above the discount rate. He also questioned whether, in view of existing Committee policy, the rate on repurchase agreements should be raised, particularly before the forthcoming Treasury refunding was out of the way.

Mr. Rouse stated that he had come to the conclusion that the procedure with respect to repurchase agreements should be the same as was recently approved by the Federal Open Market Committee with respect to purchases of bankers' acceptances whereby the minimum rate is fixed by the Committee and effective rates are fixed by the Manager of the System Open Market Account subject to limitations prescribed by the full Committee or the executive committee.

A discussion of Mr. Rouse's suggestions brought out the fact that if paragraph 1(a) of the letter of October 9, 1951, to the Presidents of all Federal Reserve Banks relating to repurchase agreements were changed to read substantially as follows, it would (a) avoid the necessity of raising the repurchase rate above the discount rate when the issuing rate on Treasury bills was above the discount rate, (b) permit more flexibility in response to market conditions in changing the effective rate on repurchase agreements, and (c) eliminate the provision that the rate must be expressed in fractions of one-eighth of one per cent:

> "(a) Are at a rate which shall be specified from time to time by the Manager of the System Open Market Account 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, but in no event shall the effective rate be below whichever is the lower of (1) the discount rate of the purchasing Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of three-month Treasury bills."

At the conclusion of the discussion, it was voted unanimously to recommend to the members of the full Committee that, effective immediately, paragraph 1(a) of the letter of October 9, 1951, be changed to the form set forth above. This action was taken with the understanding that if the change in the letter were approved by the members of the Federal Open Market Committee any change in the effective rate on repurchase agreements with dealers would be reported by the Manager of the System Account to the Federal Open Market Committee and to the Federal Reserve Banks.

Mr. Rouse stated that there was no need for any change in the direction to the Federal Reserve Bank of New York to execute transactions for the System open market account, and that the direction might be renewed in its existing form.

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, either in the open market or directly from, to, or 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 to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the total amount of securities in the account at the close of this date shall not be increased or decreased by more than $1 billion exclusive of special short-term certificates of indebtedness purchased for the temporary accommodation of the Treasury pursuant to paragraph (2) of this direction;

(2) To purchase direct from the Treasury for the System open market account 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 in the account at any one time (including purchases made in connection with week-end transactions under the special authorization of the Federal Open Market Committee dated June 19, 1952) shall not exceed $1 billion.

In taking this action it was understood that the limitations contained in the direction include commitments for purchases and sales of securities for the System account.

It was understood that the next meeting of the executive committee would be subject to the call of the Chairman.

Thereupon the meeting adjourned.

Winfield Thurston
Assistant Secretary.