

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, April 26, 1955, at 10:45 a.m.

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

Messrs. Fulton, Robertson, and Shepardson,
Members of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Messrs. Daane and Young, Associate Economists
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

Messrs. Mangels and Thompson, First Vice Presidents, respectively, of the Federal Reserve Banks of San Francisco and Cleveland

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee held on March 29 and April 12, 1955, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action taken by the members

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of the executive committee on April 14, 1955, authorizing the Federal Reserve Banks, effective April 15, 1955, to enter into repurchase agreements with nonbank dealers in United States Government securities in accordance with the conditions prescribed by the Federal Open Market Committee, as amended March 2, 1955, with the understanding that such agreements in no event shall be at a rate above the discount rate or 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, was approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period April 12 to April 21, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed April 22-25, 1955, inclusive. Copies of these reports have been placed in the files of the Federal Open Market Committee.

In commenting on the reports, Mr. Rouse said that the period since the last meeting of the executive committee had been primarily one of adjustment to the change in discount rates at several of the Federal Reserve Banks and of preparation by the money market, in the light of that situation, for the Treasury financing expected to be announced within the next few days. Whether these adjustments had been completed was difficult to say at this time, Mr. Rouse said, although, for reasons which he stated, it appeared that there was still some further adjustment to be made.

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Mr. Rouse also commented on Treasury bill rates, noting that yesterday they reached approximately 1.70 but that they had dropped sharply to around 1.60 this morning in response to efforts by dealers to secure bills for which they had bid for the account of customers but which were not awarded yesterday because of an unexpected concentration of bids in the 1.69-70 price area.

Mr. Rouse also commented that this was the end of the eighth week in which the System open market account had had no outright transactions in Government securities.

Following a discussion of recent developments in the Treasury bill market, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period April 12 to April 25, 1955, inclusive, were approved, ratified, and confirmed.

At Mr. Sproul's request, Mr. Young made a statement with respect to economic developments, concerning which a staff memorandum dated April 22, 1955, had been sent to the members of the committee. Mr. Young said that most of the recent information showed that strong advances continued to be the most outstanding feature of the economic situation. Output at factories and mines for April will certainly reach 136 per cent of the 1947-49 average and may possibly attain 137 per cent, the 1953 high. A special sign of strength in industrial output has been the failure of steel production to show the usual March to April decline. Automobile sales and output have held at very high levels, with stocks still below a year ago.

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Used car stocks continue to accumulate, but high sales are keeping them under a month's supply. Sales and output of diversified household goods continue to climb gradually, with retail stocks about holding even or working down a bit. High levels of sales of consumer durable goods are finding their counterpart in a resumed sharp rise in instalment credit outstandings. Department store sales in April are showing a brisk rise from the February-March levels. In construction, records are being maintained and applications for mortgage guarantees and insurance are still on the increase, suggesting that high levels of new housing starts will reach into the coming months. Mortgage funds seem abundant enough for existing high demands. No-down-payment and 30-year GI mortgages were in record volume in March. Mr. Young said that one of the most important items of recent news is the indication given by the McGraw-Hill survey of business plant and equipment plans, which indicated a much more optimistic prospect for business expenditures for that purpose than data obtained by the SEC-Department of Commerce survey of a month earlier. The labor market also has improved further, Mr. Young said, with continued claims for unemployment benefits down considerably from early March and from a year ago. Average wholesale prices have continued fairly stable in recent weeks. Available information confirms continued gains in industrial output in Western Europe, and recovery is taking place in Japan and Canada from the setbacks experienced last year. World trade figures generally show a rising trend.

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In response to a question from Mr. Vardaman, Mr. Young said that total unemployment in the United States at the end of March on a seasonally adjusted basis was approximately 2,800,000. The recent decrease in continued claims for unemployment benefits was interpreted as indicating an improvement in the employment situation, Mr. Young said.

Mr. Leach stated that comments from financial institutions recently had indicated that many lenders were reluctant to make 30-year no-down-payment GI loans, whereas the staff memorandum stated that loans with such terms increased sharply during March and represented about 45 per cent of total GI loans closed during that month.

Mr. Young commented that statistical data furnished no evidence that lenders were not making 30-year no-down-payment GI loans, and he added the statement that such mortgages were selling generally at a fairly substantial discount with the result that they became attractive to many lenders on a yield basis.

Mr. Sproul noted that in the staff memorandum reference was made to discussion of a "guaranteed annual wage" and he suggested that the increased wage payments which might be made in certain industries might create serious problems for some industries where profits were not running at such high rates as in those settling for higher wages. Mr. Sproul also expressed the view that the rigidities being built into the industrial economy might create problems for the future.

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Mr. Koch then made a statement with respect to capital markets and developments in the stock market. He also commented on Treasury financing, indicating that the large income tax receipts during April and funds to be paid in connection with new Treasury borrowing expected in May would help maintain the Treasury balance during the next several weeks. With respect to bank credit, Mr. Koch stated that loans and investments at reporting member banks had increased by almost a billion dollars in the three weeks ending April 13, compared with a decline of a half billion dollars in the corresponding period of 1954. Demand for loans of all types—business, real estate, consumer, and on securities—has been quite strong. Mr. Koch referred to a tabulation, copies of which were distributed at the meeting, showing a pattern of recent and projected reserve changes which indicated that during the current week free reserves might be around \$150 million. He anticipated that a decrease would take place during the next two weeks due mainly to a currency outflow and to an increase in Treasury balances at the Reserve Banks, but that free reserves would increase again during mid-May.

Mr. Sproul suggested that there might still be some delayed adjustment in the capital market to the adjustment in interest rates. Rates in the capital market for corporate securities have shown little change during the past three or four months, he said, and it seemed to him that, as Mr. Koch had indicated, the immediate reaction of the stock market to the increase in margin requirements effective April 23 may have been a little

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too "graceful". It is reminiscent of the attitude that "what the Federal Reserve does, will not make much difference. The economic outlook is good, prospects for profits are good, and we are going ahead."

Mr. Sproul then turned to a discussion of open market operations, stating that at this meeting the problem was to discuss primarily operations to be carried on during the next two weeks. He noted that the projections of free reserves during that period as estimated at the New York Bank and at the Board were in general agreement.

Mr. Leach stated that he was in general agreement with the summary of the economic situation given by Mr. Young. As to credit policy, Mr. Leach referred to the recent increase in the discount rate at eleven of the Reserve Banks, the increase from 60 to 70 per cent in margin requirements, and the general tightening in the money market that had taken place as indicated by the recent rapid rise in bill rates. His question was whether, for the time being, the market was not tight enough. Mr. Leach said that he felt all of the actions taken recently had been desirable but he would dislike a further rapid increase in the rate on Treasury bills. He noted that the discount window had been used successfully in recent weeks to relieve further tightening. The fact that repurchase agreements had been paid out showed that funds had not been needed except on a temporary basis, Mr. Leach said, but he felt that it soon would be necessary for the System to put some additional funds into the market on a more or less permanent basis. For the present, Mr. Leach said that he would

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follow along with what the committee had been doing, using the discount window to adjust reserve positions, making repurchase agreements available for temporary needs, and considering additional action if that were needed. However, if the market should get much tighter or if bill rates should go up much further, he thought that the committee should take some action so as not to permit any substantial increased tightening in the market.

Mr. Mills said that on the basis of the projections of free reserves presented in the staff memorandum, it did not appear that there would be any need for positive System action during the next two weeks. He also suggested that if some unexpected need occurred, funds could be made available through repurchase agreements.

Mr. Robertson said that his views accorded with those already expressed except that if the projections of free reserves were accurate, he would be in accord with taking no action to supply additional reserves. He would dislike seeing any steps which would offset the existing degree of tightness in the market. He would like to see the market held just about where it is and would see no need for action during the next two weeks based on the projections made by the staff.

Mr. Shepardson said that he was generally in agreement with the views expressed by Mr. Robertson.

Mr. Fulton said that he was in agreement with the expressions made thus far. He thought there was sufficient tightness in the market and

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that for the present a continuation of about the existing situation would be desirable. Mr. Fulton also suggested that it might be helpful to look ahead for the remainder of this year, to the means by which the usual expansion in currency demand during the second half of the year and the increase in demand deposits that would then occur would be taken care of. He thought that open market policy might be directed toward relieving tension which would build up during this period.

Mr. Sproul stated that the broad question of what would be needed during the remainder of this year was something that would have to be decided by the full Committee. If it was felt that the situation warranted such action, it might be necessary to call a meeting of the full Committee before the week of June 20 at which time it was now scheduled to meet.

Mr. Koch stated that some rough estimates of the magnitude of demand for bank reserves during the remainder of this year based on certain fixed assumptions had been prepared by the staff and that these indicated there would be a need for approximately \$1-1/4 billion of additional reserves if demand deposits were to show no increase for the year as a whole. However, an increase of 3 per cent in demand deposits for the year as a whole would call for the System to supply something in the neighborhood of \$2 billion of reserve funds, and an increase in the money supply at a rate of from 5 to 7 per cent, such as had been going on since mid-1954, would call for around \$3 billion of additional reserve funds.

Mr. Sproul commented that it would look as though discussion of

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such projections could be in terms of an increase of not more than \$2 billion in reserve funds and perhaps less.

Mr. Balderston said that he feared he was in some disagreement with other views expressed at the meeting as to the direction of operations during the next two weeks. He noted that the recovery in economic activity had been broad, and that there had been a gratifying reduction in the volume of unemployment. The indications that recovery was proceeding according to expectations had been accompanied by release of corporate financial reports covering the first quarter of 1955, a large majority of which indicated improvement in earnings as compared with the corresponding period of 1954. Such reports were stimulating interest in the stock market both by investors and speculators. The construction industry was continuing to be stimulated by an apparently almost unlimited amount of mortgage funds and might be approaching a "run-away" stage. Mr. Balderston said he could not remain unconcerned about such a situation, not only in residential building but also in nonresidential construction. Loans were being made not only for consumer purchases but also to carry inventory by businessmen. He felt that if developments continued in this direction, another increase in the discount rate might be called for by, say, mid-June. In the interim, Mr. Balderston said that he would like to see a gradual but perceptible tightening in the situation, including a rise in the bill rate. Instead of a neutral position, he would like to lean in the direction of further tightening. This seemed to him to be

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desirable on the basis that current developments appeared to represent a repetition of much of what took place in the 1920s.

Mr. Vardaman said that Mr. Balderston had expressed the feelings that he had been developing on the basis of recent visits to different parts of the country. He was not fully prepared at this point to say what should be done and he was in doubt as to whether action was called for by the Open Market Committee or by the Board of Governors. However, the general increase in the volume of credit seemed to him to be undesirable and he feared that, if the prognostications of economic activity were correct, a tightening in the situation was now necessary. This, he noted, was contrary to the views he had expressed two weeks ago when he felt that the System had moved to too tight a position too fast. However, he had been impressed with what he had heard on some of his visits since that meeting, both with comments as to credit extensions on new houses and schedules for production of automobiles. He agreed with Mr. Balderston that the time had come for serious consideration of further tightening moves, and that if an inflationary potential showed too strongly in the economy, the next consideration should be a possible increase in reserve requirements. Mr. Vardaman also said that he was inclined to agree with what he took to be the suggestion of Mr. Sproul that some persons in Wall Street had made up their minds that no matter what the Federal Reserve did about margin requirements, stock prices were not too high.

Mr. Robertson said he was not in disagreement with most of the

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views expressed but that, as had been suggested by Mr. Sproul, there might be a delayed reaction to the steps which have already been taken by the System looking toward further tightening. For the next two-week period, he said, natural forces would bring about some tightening on the basis of the staff projections of free reserves. On the whole, he felt that during this period a continuation of about the existing situation was desirable from the standpoint of open market operations.

Mr. Sproul said that he had not intended to give the impression that Wall Street or the money market would pay no attention to the recent increase in margin requirements but that it was true that the immediate reaction of the market to the increase from 60 to 70 per cent had been too "graceful". The more astute individuals in the market realized that the action was significant in terms of the general credit situation, however, and he felt there would be gradual increase in the appreciation by the market of what the general tightening in that situation meant. Mr. Sproul said that he would express his views as being somewhat more moderate than those of Mr. Balderston, and more in accordance with the views expressed earlier in the meeting by some of the other members of the committee. He felt it was fair to say, as had been recorded in the minutes of the meeting of the executive committee held on April 12, that we are now out of the recovery phase and in the expansion or growth phase of the economy. There is nothing to be afraid of in that--growth is what we want--unless speculative or inflationary developments become threatening. We should not be

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stampeded into further credit restriction by growth. Mr. Sproul then made a statement substantially as follows:

The prospect or possibility of inflationary developments is always present in an expansion phase, but I don't think it can be said to be here or in immediate prospect, unless we are willing to project the present line of growth further into the future than I am yet willing to do. There are, perhaps, two or three things to be remembered:

- (a) There are still some soft spots and some unknowns in the economy. The likelihood of a decline in automobile production and steel output during the latter months of the year; the reduced level of agricultural income, the clinging figures of unemployment despite rising production; and the effect of increased costs, growing out of probable labor-management strike settlements, on prices and consumption.
- (b) There is the unpredictable cumulative effect of the actions we have already taken combined with the market's anticipation of what those actions may suggest for the later months of the year, when increased private demands for credit will coincide with Treasury borrowing of new money of perhaps \$9 or 10 billion.
- (c) There is the fact or possibility that capital markets have not yet adjusted to the changes in the credit situation which have taken place since the first of the year, and to the possibility that demand for capital funds may be outrunning savings. There has been relatively little change in yields of corporate obligations, and they have continued to seek markets at rates which seem to me to be too close to the rate on long-term Governments—for example, a recent triple A issue offered on a 3.12 basis compared with a yield of 2.98 on the Treasury 3's.

For the next two weeks, both the reserve outlook and the needs of Treasury financing suggest a largely passive role for open market operations, with free reserves usually on the plus side of zero and interest rates generally steady.

We shall have to begin to watch out, however, for a credit policy chain reaction. Open market operations neutral in the face of expanding credit demands, pushing up market rates

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of interest, which makes an increase in the discount rate seem appropriate, which leads to anticipation of further credit restraint, which leads to a further rise in market rates, and so on. That may or may not be the kind of pattern we shall want to follow in the light of the emerging economic situation.

In any case, for the immediate future, open market operations, if they become necessary, should be used to validate the present discount rate and to maintain an even keel for Treasury financing. That was a persuasive reason for the timing of the increase in the discount rate--to clear the market of rate uncertainty in the face of the Treasury's financing needs. This will require freedom in use of repurchase agreements during the financing and around payment time, but nothing more if present reserve projections are near the mark.

As to the next two weeks, Mr. Sproul said that he gathered there was general agreement that during this period the System should play a relatively passive role in its open market operations, partly as a means of continuing the existing situation and partly because of the anticipated Treasury financing. This would mean that free reserves would remain on the plus side but not very much on the plus side, and interest rates would remain about steady. To maintain an even keel during this period, it might be desirable in addition to use of the discount window to make some use of repurchase agreements.

Mr. Sproul inquired whether any of the members of the committee disagreed with this statement, and none of them indicated a different view. He then said that it would be understood that for the next two weeks the committee would instruct the New York Bank to pursue a passive program of operations in the open market designed to maintain the existing situation.

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In response to a question from Mr. Leach as to whether this would include an authorization for making outright purchases of securities, in the event the market became too tight, Mr. Sproul responded that it would be his understanding that in view of the fact that we were now entering into a period of Treasury financing with stability in the market a desirable objective, it would be understood that operations for the System account could include use of the existing authority for either repurchase agreements or outright purchases, if tightness developed to the point where such operations seemed desirable.

In this connection, Mr. Sproul referred to the directive to be issued by the executive committee to the New York Bank, and he raised the question whether clause (b) in the first paragraph of that directive, providing that operations for the System account shall be with a view, among other things, "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" should be changed to eliminate the reference to fostering recovery. He went on to say that since the present wording was patterned after the wording of the directive from the full Committee to the executive committee, it could be changed only by action of the full Committee. His reason for mentioning the matter was to consider whether it might be desirable to have the members of the full Committee indicate whether they felt a change in wording such as proposed would be desirable.

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During the ensuing discussion, Mr. Robertson expressed the view that consideration of such a change should be made at a meeting of the full Committee rather than by telegram or telephone, and Mr. Sproul suggested that the minutes of this meeting indicate that the question was raised as to whether it was now time to change the directive in some way. He also suggested that the Secretary might discuss with Chairman Martin upon his return next week the question whether it would be desirable to arrange for a meeting of the full Committee two weeks hence on Tuesday, May 10, 1955.

There was agreement with Mr. Sproul's suggestion.

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

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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 \$750 million;

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate \$500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

It was understood that the next meeting of the executive committee would be held on Tuesday, May 10, 1955.

Thereupon the meeting adjourned.


Secretary