

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 Wednesday, October 22, 1952, at 10:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hugh Leach
Mr. Mills, Alternate
Mr. Robertson, Alternate for Mr. Vardaman
Mr. C. S. Young, Alternate for Mr. Sproul

Messrs. Evans and Szymczak, Members of the
Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Thomas, Economist
Mr. R. A. Young, Associate Economist
Mr. Rouse, Manager, System Open Market
Account
Mr. Sherman, Assistant Secretary, Board
of Governors
Mr. Youngdahl, Assistant Director, Divi-
sion of Research and Statistics,
Board of Governors
Mr. R. F. Leach, Acting Chief, Government
Finance Section, Division of Research
and Statistics, Board of Governors
Mr. Willis, Assistant Secretary, Federal
Reserve Bank of New York
Mr. Solomon, Assistant General Counsel,
Board of Governors

Upon motion duly made and seconded, and
by unanimous vote, the minutes of the meetings
of the executive committee held in Washington
on September 25 and October 8, 1952 were
approved.

Before this meeting there had been sent to the members of the com-
mittee a report on open market operations prepared at the Federal Reserve
Bank of New York covering the period October 8 to October 17, 1952,

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inclusive. At this meeting Mr. Rouse presented a supplementary report covering the period October 18-21, 1952, inclusive, and commented briefly on both reports, copies of which have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period October 8 to October 21, 1952, inclusive, were approved, ratified, and confirmed.

Chairman Martin referred to a memorandum on recent and prospective changes in bank reserves prepared by Messrs. Thomas and Youngdahl under date of October 21, 1952 and distributed before this meeting. The memorandum stated that since the meeting of the executive committee on October 8 there had been some pressure on the money market but that the pressure had not been as great as expected, that member bank borrowing had averaged close to \$1 billion during the period, and that on some days excess reserves of member banks had exceeded borrowings. It noted that the immediate outlook was for a tightening of the money market during the next few weeks and stated that the volume of borrowings at the Reserve Banks would probably be between \$700 million and \$1 billion above excess reserves during November and December, but that by the use of repurchase agreements borrowings might be reduced and the total kept to around \$1 to \$1-1/4 billion without any outright purchases in the market.

In commenting on the memorandum, Mr. Thomas stated that it appeared

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likely that needs for bank reserves could be taken care of without any direct purchases of securities by the System account between now and December.

Chairman Martin noted that the projection of probable needs for reserves as given at the meeting of the executive committee on October 8 had been revised so that it looked as though the committee would not have to make any purchases until mid-December, if then. He then called upon Mr. Rouse, who said that the psychology of the market was very different from what it had been last July. At that time, he noted, there was an expectation of a discount rate increase as a means of holding down further credit expansion whereas now there was considerable feeling that there might be some recession in business activity. Mr. Rouse said that the money market was tight but that the nonbank demand for Federal securities had given a stronger tone to the market. In connection with the change in psychology in the market, he also commented that a statement which appeared in a recent issue of one of the weekly Government bond letters had given the impression that there had been a relaxation in the Federal Open Market Committee's policy of restraint on credit expansion.

Chairman Martin stated that he felt developments in the market were rather worrisome and that, while the situation was not serious at the moment, a condition in which excess reserves of member banks at one time exceeded borrowings of a billion dollars at the discount window should

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be studied carefully by the committee.

Mr. Youngdahl described the situation as one in which we are looking toward a period of downward adjustment next spring or after mid-1953, while rather strong business activity is indicated for the period immediately ahead. To the extent restraint might be applied now, he said, any downward adjustment next year might be lessened. Mr. Youngdahl noted that an analysis of member bank discounts at the Reserve Banks showed that a surprisingly large proportion of the borrowers also fell in the group of banks subject to the excess profits tax, which suggested that some banks were borrowing for the purpose of increasing their tax base so as to reduce the excess profits tax payments. This raised the question, he said, of the extent to which the System might be supplying bank reserves through the discount window for a purpose which was not self-corrective.

Mr. Ralph Leach stated that he was not greatly concerned about the situation. He noted that corporations have been borrowing money in the capital market which the Treasury had failed to borrow during the past year and that such money had been sustaining the demand for short-term Government securities. This demand, Mr. Leach felt, would not be continued for long and might be reversed in a week or two. The decisive thing in the longer run, he said, would be debt management policy. While it might be expected that the Treasury would take advantage of any strength in the intermediate- and long-term market for issuing such securities, no such issues could be anticipated until it was determined who would be

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Secretary of the Treasury next year. Mr. Leach felt that any increase in commercial loans during the next few weeks would have a dampening effect on demand for Government securities. In response to a question from Chairman Martin, Mr. Leach also expressed the opinion that the market had abandoned any idea of a change in the prime commercial loan rate or in the Federal Reserve discount rate in the near future.

Mr. C. S. Young stated that bankers in his district felt that loans would not increase as much this fall as had been anticipated and that they did not feel that prime loan rate or discount rate would rise. Mr. Young did not believe the situation was serious and he stated there was little or no borrowing at the Reserve Banks for the purpose of increasing the excess profits tax base, adding that his Bank turned down discount applications whenever it appeared that the purpose of the borrowing was not appropriate. He felt that bankers were more cautious in making loans than they have been in many years.

Mr. Hugh Leach said that he saw nothing in the picture to be particularly worried about, and he cautioned against generalizing too much on the basis of the total volume of discounts: some individual banks might be finding it necessary to borrow while others had substantial amounts of excess reserves, and some banks might borrow in preference to selling securities while others might prefer to take a loss on securities rather than to borrow from the Reserve Bank. An increase in discounts would not concern him provided it did not reflect a desire to increase the excess

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profits tax base and did not result from banks becoming more and more willing to borrow day after day. Such an attitude, if it developed, would tend to break down the restrictive effects which were expected to result when banks were forced to discount.

Mr. Riefler said that borrowing from the Reserve Bank for the purpose of increasing the excess profits tax base presented a very serious problem. He felt that banks would not, for the most part, admit they were borrowing for that purpose, but that by establishing loose operating procedures enough occasions to borrow from the Reserve Banks on normal banking grounds could arise over a period of time so as to increase the excess profits tax base of an individual bank. A tendency to borrow for this purpose could destroy the effectiveness of the present restrictive credit policy.

There followed a discussion of the extent to which banks might be borrowing at the Reserve Banks for the purpose, directly or indirectly, of increasing their excess profits tax base, and of steps that might be taken to discourage or eliminate such use of Federal Reserve credit.

During the discussion, Mr. Mills suggested that if a greater than seasonal rise in borrowings developed during the next few weeks there would be created an automatic tightening, and that to this should be added the effect of the next sale of tax anticipation bills by the Treasury at which time the Federal Reserve, by withholding funds from the market, could bring back whatever tightening in the situation might

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be lost as a result of the situation today.

In response to a question from Mr. Mills, Mr. Ralph Young stated that expansion in commercial loans this fall was turning out to be following a pattern consistent with a strong economic situation and that while the seasonal peak in borrowing might be a little later in November than had been anticipated, loan demand now appeared to be rising with the full momentum expected at this period. If this were the case, Mr. Young felt it might be difficult to reduce so-called "seasonal" credit extensions after the year-end and as a result some concern about the present credit expansion might be warranted.

Mr. C. S. Young noted that over the past year or so, an impression had been created in the financial press that the Federal Open Market Committee hoped banks would obtain needed reserves by discounting with the Reserve Banks rather than by selling securities in the market, and he wondered whether steps to discourage borrowing might be interpreted as being in conflict with this view.

In discussion of this point, it was stated that the Federal Open Market Committee had taken the position that it was preferable for banks to borrow to adjust their reserves rather than to sell securities which the Federal Reserve would have to purchase; none of the members of the executive committee indicated that a Federal Reserve Bank should discount for a member bank when the purpose of the borrowing would not be appropriate under the Federal Reserve Act.

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In response to a question from Mr. Robertson, Mr. Hugh Leach and Mr. C. S. Young both expressed the view that Reserve Banks had the duty to tell any over-extended banks seeking to discount at the Reserve Banks that they should meet their needs in some other way, adding that it had been customary to decline applications for discount for this and for various other reasons or to require banks to repay borrowings when it appeared that the bank was discounting over too long a period.

Chairman Martin expressed the view that while there appeared to be no need for action at this time concerning the matters discussed, it was important for the committee to observe market psychology and to watch closely credit demands during the next few weeks, including any situation in which borrowings of around a billion dollars were matched by excess reserves of the same or a larger amount.

With respect to the general instruction to be issued by the executive committee to the New York Bank, Mr. Riefler stated that Mr. Solomon had suggested a minor change in wording of the existing instruction to make it clear that the Federal Reserve Bank of New York acting as agent for the Open Market Committee was not authorized to purchase securities direct from the Treasury for the System open market account except in connection with exchanges of maturing securities. There was a discussion of wording of the direction, and Mr. Rouse stated that no change in the limits contained in the direction appeared necessary at this time.

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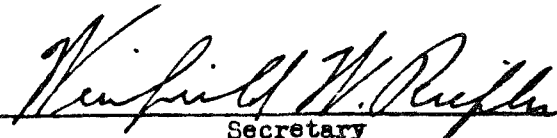
Thereupon, upon motion duly made and seconded, the executive committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the executive committee:

(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 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 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 \$1 billion;

(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 \$1 billion.

It was agreed that the next meeting of the executive committee would be held at 10:30 a.m. on Wednesday, November 5, 1952.

Thereupon the meeting adjourned.


Secretary