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, November 25, 1952, at 10:35 a.m.

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

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

Mr. Riefler, Secretary
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. Sherman, Assistant Secretary, Board of Governors
Mr. Youngdahl, Assistant Director, Division 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. J. Dewey Daane, Monetary Economist, Research Department, Federal Reserve Bank of Richmond

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee held on October 22 and November 5, 1952, and the insertion of the word "sufficiently" in the first line on page 7 of the minutes of the October 8, 1952 meeting, were approved.

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 November 5 to November 21, 1952, inclusive, and at this meeting Mr. Rouse presented a supplementary report covering the period November 21 to November 24, 1952, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

In commenting on the reports, Mr. Rouse stated that the market had been increasingly sensitive and tight, that outright purchases of bills had been made for the System account anticipating not only tightness this week but also next, when it was expected that the market would be considerably tighter than it had been, and that operations were being carried on in the light of the understanding of the executive committee that there should not be "knots" in the market but that it should be kept tight.

Upon motion duly made and seconded, and by unanimous vote, the transactions in the System open market account for the period November 5, 1952 to November 24, 1952, inclusive, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Thomas commented on a memorandum on economic and financial conditions and prospects dated November 24, 1952, copies of which had been distributed before this meeting. The memorandum stated that expansive developments in the economy reported to the executive committee on November 5 had been confirmed by data becoming available since then, that record levels reached by most indexes of economic activity in September were maintained or moderately exceeded in October and apparently in November as well, that private demands continued to be the major expansive factor but some step-up in the rate of national security spending also may have developed in November, and that at the same time prices had remained relatively stable with wholesale prices of farm products and foods easing further while other wholesale and consumer prices had remained steady. The memorandum also stated that there was some evidence that inventory accumulation had been resumed at both manufacturer and distributor levels and that inventory and business loan developments will need to be watched closely over coming weeks. In his comments, Mr. Thomas stated that the credit and monetary expansion that had occurred during the past month had been in excess of earlier expectations or of what was considered a seasonal need at this time of year. This, he felt, would justify a continuation of the System policy of restraint and perhaps some strengthening of that policy. Mr. Thomas said that need for Federal Reserve credit through discount and repurchase agreements might total $2 billion or more around December 10; after that date, the situation would ease rapidly so that borrowings were likely to be below $1.5 billion by Christmas time.

Mr. Ralph Young felt that an encouraging part of the picture was that the strength in the business situation was largely from civilian demand. The worrisome part of the whole development, Mr. Young said, was the acceleration that had taken place in bank credit expansion in recent weeks which would result in a total expansion in demand deposits and currency this year of about 3 per cent which would be a substantial increase in relation to the present liquidity of the economy.

Chairman Martin suggested that the main point on which the discussion should focus at this meeting was the question whether the committee should continue to purchase bills to meet the tight situation during the next two or three weeks, or whether the expansion going on would warrant a procedure which would force the banks to come to the discount window for any additional reserve funds needed. The situation involved the question of what expansion in lending is likely to take place over the next few months, the Chairman said. Although he thought the election results were no doubt contributing to the current upswing, he wondered whether in the light of the recent expansion in loans and the high level of business, the committees should revise its sights in terms of supplying reserves to the market and let the market take care of itself.

Mr. Mills recalled that early in the fall it was felt that modest purchases of bills for the System open market account plus use of repurchase agreements would enable banks to meet seasonal requirements without forcing them to borrow too heavily, after which there would be a natural easing in the situation as the seasonal credit was repaid. As it had turned out, however, there apparently had been more than a seasonal expansion recently, in addition to which there had been an increase in municipal security issues and mortgage credit of a more permanent character.

He wondered whether the System had provided more reserves than had been expected or needed to take care of autumn seasonal needs.

Mr. Thomas responded that reserves supplied to the market had been close to the projection but that the growth in deposits had been less than expected at city banks and much more than expected at country banks where reserve requirements were lower, with the result that the total money supply had increased more than anticipated.

Mr. Riefler added the comment that since August, the money market had been about as tight as anticipated but that the money supply had expanded more than expected; whereas it was expected the tightness of the market would keep credit growth to around seasonal needs, as a matter of fact, there had been much more than seasonal expansion during the past few weeks.

Mr. Hugh Leach said that, in his opinion, the situation was not at a point where it would call for any such action as raising the discount rate even though member bank borrowings had increased more than seasonally in recent weeks. He felt that the committee should follow a procedure which would cause banks to rely primarily on discounts and use of repurchase agreements in order to obtain additional reserves for temporary periods of tightness, and that it would also find it desirable to make some purchases of bills.

Mr. Sproul noted that the estimates of normal seasonal credit expansion were just estimates; it would be a mistake to base System operations on an exaggerated assumption as to the accuracy of the estimates. He felt there was no occasion to revise the current policy on the basis of figures of bank credit expansion during two or three weeks, particularly since the greater than seasonal expansion noted during November had followed a less than seasonal rise in earlier weeks of the autumn so that the over-all expansion might not be far above the estimated seasonal. Taking account of the use being made of bank credit and having in mind that the committee's job should be somewhat anticipatory in order to avoid the mistake of being "too late and too little", Mr. Sproul felt that during this week and for the next two weeks when other factors would bring about a substantial decline in reserve funds, open market operations should contemplate some further rise in bill holdings as well as in discounts but should not be geared to relieve the whole decline in reserves. This would continue the Committee's policy of letting market factors have a restraining effect, but it would call for some additional purchases of bills, some increase in discounts, and some increase in use of repurchase agreements. In response to a question from Mr. Mills, Mr. Sproul agreed that the weight of this procedure would be on the tight side, and in response to a question from Mr. Vardaman, he stated that while he had no particular goal in mind he felt borrowings at the Reserve Banks would probably stay within the $2 billion figure under such a procedure.

Replying to an inquiry from Mr. Robertson as to just how this procedure would be carried out, Mr. Sproul cited figures which indicated a total of something over $600 million would be needed in the next three weeks and he contemplated that the reserves would be supplied through a combination of purchases of bills, use of repurchase agreements, and rise in discounts of around that magnitude, all to go on concurrently.

Chairman Martin expressed the view that use of all three methods of supplying reserves would have to go on concurrently and added that he assumed purchases of bills would continue to be in terms of avoiding "knots" in the market. The Chairman felt that under such a procedure it would be important not to give the impression that the System was carrying out any definite program of purchases but rather that it was trying to operate both in bills and discounts in an orderly way so as to keep stability in the market.

Mr. Vardaman wondered whether, in discounting at the Reserve Banks, member banks were taking advantage of the differential between the discount rate and their lending rates in order to relend at a profit.

Chairman Martin commented that there had been considerable discussion of this question at the last meeting of the executive committee at which time Mr. Hugh Leach reviewed member bank borrowings in the Fifth District. This review had given Mr. Leach the impression that while excess profits tax considerations had influenced somewhat the amount of borrowing and the differential in rates had caused some banks to meet increased needs for reserves by borrowing rather than selling short-term Government securities, these were not major factors in member bank borrowings.

Mr. Vardaman wondered whether the situation might call for an increase in the discount rate, adding that he was not suggesting such an increase at this time.

Chairman Martin stated that he had had some feeling that an increase in the discount rate might have been considered a few weeks ago but that it was probably late to make such an increase at this time. He suggested, however, that the question be discussed and called upon Mr. Sproul for his v'ews.

Mr. Sproul then made a statement substantially as follows:

I have reviewed the discussion record at the last meeting of the executive committee and had some discussion of this question at the New York Bank during the past couple of weeks. From reading the report of the executive committee's discussion and from our own discussions, I gather there are various reasons advanced to advocate or suggest a discount rate increase:

1. It has been frozen too long--since August 21, 1950.
2. It is not appropriate to the present structure of interest rates.
3. The alternative to an increase in the discount rate is an undesirable and increasing job of policing bank borrowing.
4. Borrowing from the Federal Reserve Banks as a deterrent to bank credit expansion is losing its force because of (a) the profit spread, (b) the excess profits tax, and (c) the idea that banks are finding it difficult to sell Government securities to adjust their reserve positions and therefore borrow.
5. There is the factor that in the last two or three weeks there has been an accelerated expansion in bank credit.

Taking these up in order, I think the rate may have been frozen too long. Maybe our advance in August 1950 was too late and too small. Maybe at some intervening time we should have increased the rate. But I don't think the fact that it has been at one level too long should allow the itch to do something to be the reason for our doing something now if now is not the time to do it. As to the relation of the discount rate to the interest rate structure, if you consider that borrowing from the Federal Reserve Banks is very short term borrowing, the most accurate rate to compare the discount rate with is the rate on short-term bills. One month bills are now 1.20-1.35, two month bills 1.70-1.79, and three month bills 1.90-1.95. In the last couple of weeks the discount rate has gotten somewhat out of line with those rates but over the longer period the relationship has been a fair one. Furthermore, if the discount rate were increased there is the question whether these short market rates would not increase further and leave about the same relationship.

On the third and fourth points mentioned, we will have a difficult policing job until we get rid of the excess profits tax on banks. Some banks will try to abuse the discount privilege. However, some degree of administrative authority with respect to borrowing is part of the "tradition against borrowing". I think the fact that we can pull strings on individual banks is part of that tradition. While I would hate to see us get into a wholly personal attitude rather than to use the over-all instruments of credit control, some administrative activity with respect to individual banks is necessary and desirable. So far as New York City banks are concerned, they have liquidated Government security holdings to adjust their reserve position and have not abused the borrowing privilege. Something like 90 per cent of their needs have been met through liquidation of Government securities to 10 per cent through borrowing.

On the question of difficulty of selling Government securities, the difficulty of selling them is a difficulty of selling at a price; if the market rate moves up the difficulty might be greater because of the greater losses the banks would face on sales.

As to the fifth point, the rise in credit is something to be watched. My own opinion is that we want to take stock of the present and prospective economic situation and then see what developing credit factors may indicate as to possible future developments. It has been said we have a strong economic situation. I see no criticism to be leveled at that if it is healthy. The economic situation at the moment does seem to be in rough balance even though at a high level. The Treasury deficit seems to be a declining item and it now looks as though it will be considerably less than had been anticipated. Much of the deficit financing that has been done has been done away from the banks. The increase in private debt of all kinds including increased consumer and mortgage debt is worrisome, but I don't think it can be corrected at the particular moment by a small increase in the discount rate when we are still in the midst of what is largely a necessary seasonal expansion of bank credit. In my opinion, this does not yet give the impression of a boom spurt: production may be increasing, inventories may be tending to move up, prices are steady. While there has been some temporary growth in optimism which the Chairman says is a result of the Republican victory in the election, the background is that there is a growing feeling of a set-back some time in 1953. I would say the present time is not the time to increase the discount rate, but we ought to watch closely and if bank credit does not decline as expected after the seasonal increase, then we should take a careful look as to whether the discount rate should or should not be increased.

Chairman Martin said that Mr. Sproul's statement was very persuasive and covered the situation extremely well.

In response to a question from Mr. Vardaman as to whether use of credit for inventory loans would be affected by an increase in the discount rate, Mr. Sproul said that if we have confidence in the use of quantitative credit controls he would have to say that there would be some such restraining effect, at least if prices were moving upwards.

Mr. Riefler stated that he agreed strongly with Mr. Sproul's presentation; however, he was bothered by the fact that large refundings would be necessary by the Treasury next spring and if the present boom continued it would be difficult to find a time for an increase in the discount rate after mid-January without interfering with the Treasury refunding operations.

Mr. Mills felt that if an increase in the discount rate were delayed until February, the change would come as a shock to the market and, if it reacted on the long-term bond sector, would result in setting a long-term rate in advance of an announcement by the new Secretary of the Treasury who is being prepared by the financial community to refund maturing Treasury securities into a long-term issue. He wondered, therefore, whether there might be a case for increasing the discount rate before the turn of the year in order to let the market and the economy adjust to what would be a logical refunding rate.

Mr. Sproul responded that it was not yet known whether an increase in the discount rate was desirable; the fact that there might be difficulty in January in making such an increase because of an early Treasury refunding should not force the System to take action now when there was no clear and convincing reason for raising the rate. He did not feel that the accumulation of inventories had reached a point calling for such action.

Mr. Young emphasized that the inventory position was not clear, that comments in the staff memorandum of November 24 were based on press reports and the total of bank loans. He went on to say that inventory increases were usually of two types, i.e., they either grew out of the anticipation of larger volumes of business, or they came about because sales were slacking off and goods which previously had been ordered were accumulating. The present apparent increase in inventories does not seem to be of the second variety, Mr. Young said, but is rather more the result of anticipation of larger volumes of business arising from the bullish atmosphere of recent weeks.

Mr. Youngdahl expressed the view that the discount rate should be used somewhat more flexibly than in the past few years. He also felt that if credit continued to expand during December, it might not be necessary to wait to increase the rate until detailed developments in the economic situation were known.

Mr. Sproul responded that it was not necessary to wait for detailed figures on the economic situation, that he would take a look at the broad economic situation not just the narrower picture in bank credit figures; a move in the discount rate might be suggested before there had been a liquidation of bank loans.

There followed a brief discussion of the question whether the discount rate should be used more flexibly, of the factors that would signal a change in the rate, and of the possible effects of a change during the next several weeks on the Treasury refunding to be announced early next spring.

Chairman Martin commented that he thought it unfortunate that the System had to cope with Treasury refundings in considering its policies but that at some point it would be necessary to meet head-on the problem of whether the System should act on the basis of credit needs or on the basis of Treasury needs. He did not feel that the System should be forced into increasing the discount rate in advance of a conviction that it was the right action in order to act in advance of a Treasury refunding; even if System action "killed" a Treasury refunding operation next spring, such a result would be better than to move in advance of a time when the System was convinced that it was taking the right action.

Mr. Vardaman doubted that it would be good psychology to raise the discount rate after December 15, until such time as the new Secretary of the Treasury had taken office and after subsequent consultation between him and the Board. Mr. Vardaman stated that he felt the discount rate was of material importance and that if a raise were warranted, it should be made now and not after the 15th.

Following a further discussion, there was unanimous agreement that, in issuing its instruction to the Federal Reserve Bank of New York, the committee did so with the understanding that operations should be carried on in the light of the discussion at this meeting which would include use of repurchase agreements and modest purchases of bills in the market during periods of tightness, in addition to such discounting as member banks might do with the Federal Reserve Banks. In this connection, Mr. Rouse stated that he had no changes to suggest in the wording or limitations in the direction to be issued to the New York Bank.

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.

Mr. Rouse then presented a brief summary of the results of the Treasury exchange offering in connection with the issue of 1-7/8 per cent certificates which matured December 1, 1952 in the amount of $1,063,000,000, stating that it looked as though attrition on the issue was a little under 18 per cent, all of it going to the Treasury. The only assistance which the committee gave in connection with the refunding, Mr. Rouse said, was in connection with bill operations.

Chairman Martin commented that while the issue was a small one, he thought the procedure that had been followed of handling this refunding as a debt management decision under which the System would not give support although it might minimize fluctuations in the bill market, was a step which had advanced the general program of the Federal Open Market Committee.

It was agreed that the next meeting of the executive committee would be held on Monday, December 8, 1952, following the meeting of the full Committee scheduled for that day.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary