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, July 7, 1954, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Robertson
Mr. Williams
Mr. Vardaman, Alternate for Mr. Szymczak

Mr. Mills, Member of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Garfield, Adviser on Economic Research, Division of Research and Statistics, Board of Governors
Mr. Koch, Chief, Banking Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the executive committee on June 24, 1954 authorizing, effective that day, each Federal Reserve Bank to enter into repurchase agreements with nonbank dealers in United States Government securities at a rate of 1-1/2 per cent, subject to the conditions provided in the authorization approved by the Federal Open Market Committee regarding such agreements at its meeting on June 23, 1954, was approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the executive committee on June 28, 1954 authorizing, effective June 28 and continuing through July 1, 1954, inclusive, Federal Reserve Banks to enter into repurchase contracts at a range of rates of 1-1/4 per cent to 1-1/2 per cent, subject to the other terms and conditions of the arrangement authorized by the members of the executive committee on June 24, 1954, was approved, ratified, and confirmed.

Before this meeting there had been sent to the members of the committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period June 23 to July 1, 1954, inclusive, and at this meeting Mr. Rouse presented a supplementary report covering commitments executed July 2 to July 6, 1954, inclusive. Mr. Rouse commented briefly on the reports, noting that the System Account holdings of July 8 Treasury bills had been rolled over on Friday, July 2, when it was learned that foreign accounts intended to redeem $180 million of bills. It was feared that redemption of the System holdings, in addition to this large redemption, would place undue pressure on the money market and on dealers' positions. Copies of the reports 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 account during the period June 23 to July 6, 1954, inclusive, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Garfield made a statement with respect to recent economic developments, substantially in accordance with the staff memorandum sent to the members of the committee under date of July 2, 1954. Mr. Garfield summarized the situation by stating that during June economic developments continued to show mixed trends with further indications that recessionary tendencies were abating but no clear evidence that an upturn was under way. In commenting upon various fields of economic activity, Mr. Garfield called attention particularly to the continued high level of activity in markets for real estate and construction during May and June, noting that mortgage funds were readily available on terms attractive to borrowers, terms for both conventional and Federally-aided loans having eased recently. Mr. Garfield stated that almost 25 per cent of all VA-guaranteed home loans closed during May had been made with no down payment toward the purchase price, compared with 8 per cent in the spring of 1953 and about 12 per cent during the past winter. In addition, VA loans bearing a 30-year maturity have also increased considerably in recent months.

Mr. Koch reviewed developments in the money markets, stating that these markets had continued rather firm during the latter part of June despite the additional reserve funds provided by reductions in reserve requirements and open market operations. Mr. Koch also presented tables showing an estimated pattern of reserve changes and the amount of free reserves that would exist, by weeks, during July and August.

In response to Chairman Martin's inquiry, Mr. Sproul stated that the review of the business situation and the estimates presented by Messrs. Garfield and Koch were generally in line with information compiled at the Federal Reserve Bank of New York. Mr. Sproul went on to say that the figures and information on building and construction had begun to seem almost too good to be true. The amount of home building being done with no down payment and with lengthened loan-maturity could, Mr. Sproul felt, spell some later difficulties if the funds were being loosely lent or if the construction covered by such loans was being loosely done. Mr. Sproul stated that there appeared to be some concern about these aspects of the situation on the part of insurance companies and savings banks which were large lenders in the field. He thought that if difficulties developed in the mortgage situation during the second half of this year, there might be presented a difficult problem for the whole economy. Mr. Sproul felt the System did not have enough information regarding mortgage lending and he raised the question whether it might be feasible and desirable to make a special inquiry which would cover not only the amounts of credit outstanding and the amounts of commitments, but would also attempt to develop information on the quality of credits, including information as to the general character of borrowings which underlay the high level of construction. It was one thing if the borrowers were people of steady employment and with an ability and inclination to meet their obligations, whereas it was another thing if no-down-payment loans were being made in substantial number and volume to persons not having the prospect of steady income or any substantial volume of liquid assets and who might quickly become problem borrowers causing damage to the home construction and mortgage market. The volume of no-down-payment loans on VA-guaranteed mortgages highlighted the situation he was pointing to, Mr. Sproul said.

Chairman Martin stated that he felt this was a very pertinent inquiry. During the ensuing discussion he suggested that Mr. Riefler and Mr. Garfield look into the situation with a view to developing additional information along the lines suggested by Mr. Sproul.

There was agreement with this suggestion.

Mr. Vardaman stated that he understood a substantial volume of trading in listed corporate stocks was taking place outside the regular securities exchanges and he inquired whether there was any way in which information might be developed on the volume of such trading. Messrs. Riefler and Rouse stated that they were not familiar with the volume of trading of the sort Mr. Vardaman referred to and it was understood that they would look into the situation in an effort to obtain further information regarding the matter.

Turning to the question of open market operations and the general atmosphere in the money market, Chairman Martin inquired of Mr. Sproul whether he thought the situation was now on the easy side or about right.

Mr. Sproul stated that if the committee were not to allow bills to run off and if it were not in a position to sell some additional holdings of bills from the System account during the next few weeks, he felt the market would be on the too-easy side. He felt that the general volume of free reserves we had tried to maintain for some time was about right and suggested that in order to remain in this general area, sales of bills (in addition to those which might be permitted to mature without replacement) might have to run as much as $300 to $400 million in the next two weeks. In response to Chairman Martin's question as to how he arrived at the conclusion that the recent level of free reserves was about right, Mr. Sproul stated that in his opinion the performance of the money market and of the economy generally seemed to indicate that monetary policy was doing all that it could do to foster whatever tendencies there were toward recovery and to combat whatever downward tendencies existed in the economy, without at the same time piling reserves on reserves and thus merely bringing down the level of rates on short-term credit instruments. Mr. Sproul thought that an increase in the amount of free reserves on top of what has existed would bring further declines in short-term rates without contributing to a better actual or psychological situation in production, employment, and distribution.

Chairman Martin said that he was in agreement with the general position indicated by Mr. Sproul. He called attention, however, to the tendency for the level of free reserves to increase and, as they built up, for persons in the money market and in banks to become accustomed to the higher level in terms of the System's policy of active ease. This might lead to the committee's getting frozen into a higher and higher level of free reserves, if the market came to think that the committee's policy required increasing amounts.

Mr. Sproul did not think that the market had gotten into that frame of mind. He cited the figures of free reserves during the month of June which had fluctuated on a weekly average basis between $424 and $816 million, adding the comment that he did not believe the market thought the System was raising its sights as to the quantity of reserves that would promote active ease when the volume went up, nor did it think the System was abandoning its policy of active ease when the volume of free reserves went back down. Mr. Sproul did not feel there had been any undesirable psychological effects from these fluctuations.

Mr. Vardaman expressed the view that the committee could now hold the volume of free reserves a little closer than was desirable before the reduction in reserve requirements announced by the Board in the latter part of June without creating any feeling that the System was abandoning a policy of active ease, and Chairman Martin expressed concurrency in this view.

Mr. Robertson inquired whether Mr. Sproul was suggesting that something like $300 million of bills be sold from the System account during the next two weeks, to which Mr. Sproul responded that if the market permitted, it would look, on the basis of estimates of free reserves, as though it would be necessary to sell from $300 to $400 million in addition to permitting a run-off in bills maturing during the week of July 21. Mr. Sproul also said, in response to a question from Mr. Vardaman, that he would think it desirable if the level of free reserves dropped somewhat below a $700-800 million range but that he was not certain that the System account would be able to sell a sufficient volume of securities to bring this about without disturbing the market.

Mr. Mills stated that he thought the committee had gotten over the hurdle in distinguishing to the investment fraternity what the Federal Open Market Committee's policy was. In line with the views expressed by Messrs. Sproul and Vardaman, Mr. Mills thought there was less occasion to be so dominating in providing free reserves to the market than he had felt was called for a few weeks ago. He agreed it would be desirable to let bills run off from the System account but felt it might not be desirable to sell additional bills from the account if there was a possibility of having to buy them back a little later. Mr. Mills also said that there was still a problem in judging the significance of free reserves: maladjustments in free reserves as between central reserve or reserve city banks on the one hand, and country banks on the other, were not immediately corrected. He thought that if the System sold bills too rapidly it might skimp the market of reserves and bring about a maladjustment which preferably could be avoided.

Mr. Sproul expressed some sympathy with Mr. Mills' approach, although not too much. He added the comment that while the estimated figures of reserves prepared at the New York Bank were of the same order of magnitude as the projections prepared in the Board's offices, they were somewhat lower; and in any case since neither estimate can be relied upon completely, operations would have to be carried on in terms of day to day developments.

Chairman Martin expressed the hope that the amounts of reserves coming into the market would be less than the projections indicated, and Mr. Rouse commented that with some $900 million of bills now being held by dealers there might be difficulty in selling large amounts from the System portfolio in order to hold down the level of free reserves.

In response to a question from Mr. Williams, Mr. Mills said that his idea of the level at which free reserves should be maintained would depend on how fast they would be picked up by the banking system generally. He judged from the discussion that there was a conclusion that if excess reserves at country banks fell below the $600 million figure, a feeling of tightness began to be felt, and central reserve city banks quickly reacted to this feeling. It appeared that at least $100 million or possibly more of free reserves was needed at reserve city and central reserve city banks to prevent tightness.

Mr. Williams stated in response to a question from Chairman Martin that he had no particular level of free reserves to suggest as an objective of the executive committee but that he concurred in general with the view that distribution of reserves as between central reserve city reserve city, and country banks was important and maladjustments in those reserves should be watched carefully in carrying out System operations.

Mr. Robertson said that he would favor selling from the System account $300 to $400 million of bills during the next two weeks, although he would doubt the ability of the System to do this. However, on the basis of projected figures of reserves, he thought that at least this amount would have to be sold (plus run-offs of maturing bills) in order to avoid having too large a volume of free reserves in the market during this period. His own inclination would be to push down the level of free reserves from that which had existed recently.

Chairman Martin inquired of Mr. Rouse what instructions would be needed in order to carry out the views indicated during the foregoing discussions.

Mr. Rouse said that he gathered from the discussion that it indicated a continuation of about the same instruction as that issued at the last meeting of the executive committee, namely, free reserves in the range of $400 to $700 million without, however, any fixed limits, and with a recognition that it might not be feasible to hold them down to that range. In an effort to hold down the level, it was contemplated that maturing bills would be permitted to run off and, in addition, bills would be sold from the account if that was feasible. Mr. Rouse felt that the formal directive to be issued needed no change in wording in order to carry out an understanding along these lines.

It was understood that Mr. Rouse's statement represented the views of the committee as to the operations to be carried on until its next meeting.

Mr. Sproul suggested that it would be desirable if the limitation in the first paragraph of the directive be increased from $500 million to $750 million since, if it proved feasible marketwise, the change in total holdings in the System account might exceed the $500 million figure.

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 promoting growth and stability in the economy by actively maintaining a condition of ease in the money market, 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 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 Bank shall not exceed in the aggregate $500 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.

In reply to a question from Chairman Martin, Mr. Rouse said that he anticipated no need for a rate on repurchase agreements below the current 1-1/2 per cent rate prior to the next meeting. It was understood that the existing authorization to the Federal Reserve Banks to enter into repurchase agreements with nonbank dealers in United States Government securities at a rate of 1-1/2 per cent, subject to the conditions provided in the authorization approved by the Federal Open Market Committee on June 23, was continued without change.

It was agreed that the next meeting of the executive committee would be held at 10:45 a.m. on Tuesday, July 20, 1954.

Chairman Martin referred to the discussion at the meeting of the full Committee on June 23 of the date for its next meeting and suggested that it be set tentatively for Wednesday, September 22, 1954.

There was agreement with this suggestion.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary