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 12, 1955, at 10:45 a.m.

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

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, 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

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the executive committee held on March 2 and 15, 1955 were approved.

Before this meeting there had been sent to the members of the committee a report of open market operations covering the period March 29 to April 7, 1955, inclusive, and at this meeting there was distributed a

supplementary report covering commitments executed April 8 to April 11, 1955, inclusive. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse stated that the most significant development since the last meeting of the executive committee had been the sharp rise in the rate on Treasury bills, and he commented briefly on factors which he felt had a bearing on this rise. In the background of the rise, he said, was the assumption on the part of the money market that there would be a change in the discount rate at one or more of the Federal Reserve Banks within the next ten day period. In Mr. Rouse's opinion, this had been the main factor in the movement in bill rates.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period March 29 to April 11, 1955, inclusive, were approved, ratified, and confirmed.

Chairman Martin called upon Mr. Young for a statement on the economic situation concerning which a staff memorandum had been distributed under date of April 8, 1955. Mr. Young summarized highlights of the economic situation with a statement that the recovery phase of this business cycle now seemed to be in process of being succeeded by a high-level expansion phase. The upward movement had broadened out with many more lines of activity sharing in the upswing. In all likelihood, total national product during the second quarter of 1955 would break through the 1953 peak of $370 billion by at least $5 billion, although at this juncture such a figure

could be nothing but a guess. Mr. Young went on to say that the Board's March index of industrial production was finally set at 135 per cent of the 1947-49 average, and the April index is expected to reach at least 136 and perhaps the 137 high of 1953. These index numbers are on the basis of a revised seasonal adjustment for automobile output which allows for 57 per cent of automobile production during the first half of the year. Mr. Young stated that strength featured activity in most consumer durable lines, and uptrend has begun to feature producers' durable lines, such as electrical equipment and other machinery, trucks, and farm equipment. Output of nondurables has been exceeding earlier peak levels over-all, although for textiles and apparel, production is not yet back to these peak levels.

After commenting in more detail upon various phases of domestic economic activity, Mr. Young stated that activity in Europe is continuing to expand, with February indexes of industrial production up 6, 14, and 16 per cent, respectively, for Britain, France, and Germany. Following Britain's recent monetary actions, he said, there had been marked improvement in her external position.

All in all, the picture of production and trade is one of vigor and strength, Mr. Young said. With the momentum attained, further rise in activity is to be expected, but some slowing down in the pace of rise shown by the over-all indicators should make itself evident before too long. After mid-year, the automobile and housing markets will come under test

and also there will be labor negotiations which may result in work stoppages of some importance.

Mr. Thomas stated that there had been a number of erratic movements and special factors affecting the credit situation recently. The money market had adjusted to these influences in recent weeks with a minimum of Federal Reserve assistance, and the System had stayed out of the market except for some repurchase agreements during the latter part of March. Capital issues continued in large volume during March, Mr. Thomas said, and it appeared that the April volume of new issues would be somewhat smaller, particularly in the case of State and local government issues. The Treasury showed a larger increase in both receipts and expenditures in March than had been expected and it ended the month with a balance slightly larger than had been projected; however, it was still too early to determine how individual income tax receipts would come in during April. National security expenditures seemed to be leveling out at a rate of around $43 billion a year.

Mr. Thomas also reviewed developments in the bank credit field, stating that the usual seasonal increase in loans and decrease in Government securities took place during March and early April, although holdings of Government securities increased sharply in the first week of April, reflecting in part bank purchases of the new tax certificate. The increase in total loans during the past five weeks was larger than last year and about the same as in 1953, but business loans increased somewhat less than in the two previous years. Substantial increases have occurred in loans

on securities and on real estate. For the year to date, total loans and investments have decreased more than in 1954 but less than in the corresponding period of 1953. Demand deposits adjusted fell somewhat less than is usual in March and in the first quarter as a whole, but this difference may reflect the later payment of individual income taxes this year. Mr. Thomas also referred to a tabulation of projections of reserve changes during the next two months, copies of which were distributed, stating that it appeared that free reserves would be close to the zero level during most of the period, with temporary increases around the middle week of each month.

In response to a question from Chairman Martin, Mr. Rouse stated that projections of free reserves made at the Federal Reserve Bank of New York were in substantial agreement with the projections prepared in the Board's offices.

Chairman Martin then made a statement substantially as follows:

> The problem we are facing today is one we have to come to from time to time. I gave serious consideration to calling a meeting of the full Committee for today. It is periods like this that make me feel that ultimately perhaps we should abolish the executive committee. If this is the heart of the System as I think it is, there are a great many factors that ought to be considered by the full Committee. In my judgment, the level of reserves is not so important as the discount rate at the moment. Soon the Treasury will face the problem of going to the market for $2 to $2.5 billion of new money, in addition to refunding $3.9 billion. We have to "fish or cut bait" in the next 10 days or two weeks, in considering the problem of what to do with the discount rate. I understand that the Treasury hopes to make an announcement of its financing around May 1, which means that we don't have too much time if we are going to do anything about changing the discount rate. Granting the reasons Mr. Rouse

gives for the recent rise in the bill rate, we have not been leading the market in bills. We have now passed the 1-1/2 per cent discount rate by a substantial amount. I am not personnally so much concerned with the level of reserves--I think they will tend to go up--but I am concerned whether the expectations of the market, which have worked to our advantage in the last couple of weeks, may now begin to work in the reverse if we do not do something about the discount rate. This morning, I want a general discussion on all aspects of the problem--the volume of reserves, the discount rate, stock market margins, and a number of other things that ought to be considered by all of us.

If we are going to make any move on the discount rate, my feeling is that it will have to be done not later than April 21. The more time we give the Treasury the better, if we are to make a move. That is the background of the economic information we have been given. I fully recognize that at some point the business statistics are likely to "fall away" but I think we may be perpetuating something we don't want if we let the situation get out of hand by not taking action in this period.

Chairman Martin then called for comments, and statements substantially as presented below were made by the individuals indicated, in the order in which they are set out:

Mr. Leach: I agree substantially with what has been said about the business situation. It does seem to me that we have enough strong factors in the economy so that a falling back in automobile production will be compensated. I think we are due for a strong second half of the year unless serious strikes occur. I think what has been happening in the market has been all right and what we wanted. I don't think we have authority in the executive committee to adopt a restrictive policy in the light of the full Committee's directive, and I don't want to adopt a restrictive policy. I said at the last meeting that I would not object to rates going a little higher, and I would not object to their going a little higher still; but I don't think we want to take too strong restrictive measures. We have been using repurchases, and we should take a look to see if there is any need for putting more permanent reserves into the market. I don't see any need for that at this time myself. So the whole thing comes down to the discount rate and the question whether to do something on Thursday of this week or to wait until June.

In thinking of how the discount rate fits into the scheme of things, it is necessary first to have an opinion as to the desired use of the discount window. I should like to see more use of the discount window rather than in-and-out open market operations to meet seasonal and other temporary needs, but this still does not necessarily mean a tremendous volume of discounts. The question might be asked why, with these views, I don't favor a low rate for discounts. On this point my feeling is that we have let the discount rate lag too much in the past. If we were to put the rate up now by 1/4 per cent, it would not stop banks from borrowing; they will continue to borrow to meet their needs unless we supply reserves in some other manner. I have had an analysis made in our district of the extent to which banks have depreciation in their long-term Government bonds, and I find that since early January about 75 per cent of the banks examined have had some depreciation. It is small, but it means that it would work toward their discounting to adjust their reserve needs. I believe, therefore, I could hold my theory of having discounting take care of temporary situations and still be in favor of raising the discount rate 1/4 per cent at this time. I am personally in favor of it. I think such an increase has already been pretty well discounted in the market. I think it would be unwise to let two more months go by and to assume that market rates will not stay up or go on up further.

Mr. Vardaman: I have a feeling which obviously cannot be substantiated by the data Mr. Young has given us, and I don't know whether it can be substantiated by other logical arguments. But I feel we have been getting too tight too quick. It is obvious we have to do something either about the bill rate or the discount rate. I don't like the rapidity of the rise in the bill rate. I still have the feeling there are weak spots in the economy that make it impossible to tell what will happen in the next six months. I would hate to see us raise the discount rate now, although I agree that if it is to be done it has to be done immediately--within the next 10 days. I have more concern about the volume of reserves than the Chairman indicates, and I am concerned about the zero position of reserves and would like to see a safer margin. My present inclination is that we are getting too tight too fast.

Mr. Mills: If I may pick up where Governor Vardaman left off, I generally share those opinions he has expressed. We have moved faster than the economic circumstances would justify.

There are differences of emphasis, but I have the feeling that technically we are in a position of credit restriction, more than restraint. There is good reason we should have restraint but we have moved fast in reaching that objective and have produced the problem that I sense has concerned Mr. Rouse, that is, the market at this present day. The market is a thin one, as I understand him, and in the reports of the New York Federal Reserve Bank the significant word was used that we may now be experiencing the "cumulative" effects of past actions. If that is true, we may have something more to conjure with. If it proceeds, we may have a more difficult market to contend with. But to find the answer, if it goes beyond here, would seem more difficult than to decide on a discount rate change. I judge we have put in about $100 million through repurchase agreements and purchases of bankers' acceptances and repurchase agreements on bankers' acceptances. But even having done that, we still have a negative free reserve position. We now have a very sensitive market. If we replace what we now have in the market on a temporary basis with a positive purchase of Treasury bills, it would have a psychological effect that might improve the price structure of the market to the point we would lose some of the benefits that have been gained by the depreciation of bond accounts, which is a measure of restraint. The opposite of that is that if, rather than to bring further measures of positive restraint--which I imagine there is no disposition to do by letting the reserve position tighten further--but if we increase the discount rate, that action will be interpreted in a variety of ways, and would bring the market price structure on Government bonds down below the present level. Essentially, our Government bond price structure is a reflection of the reserve position that we have produced through withdrawal of reserves. I think you can "have your cake and eat it" too. I think you can have restraint and at the same time not run the risk of a too scant supply of reserves. If there are these cumulative pressures, I can not find the answer. My impression would be that our least risk is to put back in the market on a permanent basis the roughly $100 million which are now on a temporary basis. If that gives a lead to the market that we are not deliberately pursuing a policy of restriction, if it gives some measure of assurance, then there might be a case for increasing the discount rate which would be regarded as bringing it into alignment with rates for short-term money.

Mr. Robertson: I think we have reached a point of restraint, for which I am very glad. I think we have made a mistake in the past in not applying restraint--I am avoiding the use of the word

restriction--faster than we have. It seems to me that all the information provided on the economic picture shows signs of great strength. I would like to be in a position from which we can go down, rather than always to be in a position from which we can only go up, and my preference would be to abide with the present degree of restraint. I would not replace present repurchase agreements but would let them run off, and I would use them as infrequently as possible and only to offset unforeseen factors. I would not dictate from here an increase in discount rates but would be delighted to see such action. I think it is important to fix a pattern on which the Treasury can prescribe rates for its new issue. It should be stable for the immediate future. I think that could be fixed if a few Reserve Banks increased their discount rates, without uniformity throughout the land. That would give an indication of restraint. I would be inclined toward an increase of 1/4 per cent, as Mr. Leach suggested, but would not be upset if it was 1/2 per cent.

Mr. Fulton: As Mr. Rouse has said, this present increase in bill rates has been an artificial occurrence connected with the Chicago situation. Another thing that would lead me to feel that the rediscount rate is fair enough at the present time as it is, is that the Treasury has decreased the liquidity of banks by withdrawing $16 billion of short-term securities. Banks are not inclined to get into debt. While the use of the discount window is more active in the last few weeks than it has been, it does not seem to me that it is being over-used or that the banks will stay in debt because of lessening liquidity in their own shops. I agree with Mr. Robertson that we are in need of some restraint, and it is better to have it in the beginning before the tide gets out of hand. However, I believe the psychology of raising the discount rate, even though market rates due to a temporary situation are above the discount rate, would only give credence to what the market has been saying--that the rate is being raised because bill rates have advanced above the discount rate. I would favor leaving it as it is.

Mr. Irons: As far as the general situation is concerned, I still feel it shows signs of a broad and real strength. I have leaned toward a degree of restraint in recent months. At the same time I have felt the situation we have been passing through is one that lends itself to discounting, with banks coming in as they need funds and getting out when they have met their requirements. Therefore, until a little less than a week ago, I

definitely have not favored an increase in discount rate. I don't know whether I do now. The thing that bothers me is that a week ago the discount rate and the bill rate were in pretty close touch with each other, the bill rate being a little bit below the discount rate. Now the bill rate has moved up quickly and sharply. I would agree with Governor Robertson's statement that in view of what we have ahead of us in the Treasury financing, we ought to start establishing a pattern. But is this move in bill rates to 1.65 a result of temporary factors that will change if we change the discount rate? Will we then have a discount rate out of line with the market? Or, is there a likelihood that this situation in the market, which is one of restraint, is likely to prevail over a period of several weeks or months? If we did move the discount rate up, are we establishing a pattern? Or, if we move the discount rate, would the bill rate in a couple of weeks drop down? I realize that these are questions to which we don't have the answer. So far as our district is concerned, discounting is coming from a few banks and I don't know that it would make much difference whether we increased the rate or not, so far as borrowing is concerned. If I felt reasonably confident that the present degree of restraint and rate level in the market were more than a result of some temporary factors, I would be inclined to recommend raising the discount rate. If that were not the case, then I would be inclined not to raise it. Our Board of Directors meets on Thursday and I would like to hear from some of those who are more intimately tied into the money market than we as to what they feel about the recent bill rate move: is it a result of some peculiar circumstance, such as the Chicago situation, which might reverse itself soon?

Chairman Martin asked Mr. Rouse to comment on this point, and he made a statement substantially as follows:

Mr. Rouse: The officers of the New York Bank have had the matter of the discount rate very much in mind because we feel as the Chairman has expressed it, that if there is to be a change in discount rate, it should take place either "last week" or this week. There have been active discussions, both before Mr. Sproul left for the West Coast and since, among the officers of the Bank. In general, they are fairly unanimous in appraising the economic situation about the same as Mr. Young: There is still unemployment, we are still not up to 1953, things are going along and broadening out and are quite healthy, but we are not seeing exuberence or ebullience. As the rate situation has developed, we have felt it was pretty much in line with

just the degree of restraint the committee had ordered, with a little plus or minus in reserves and with rates working themselves out for longer periods. We would like to go along as we are so far as discount rate is concerned, and with about the same reserve position we now have. We recognize that that means a postponement pretty much until June so far as discount rate is concerned. Assuming there is restraint, I should think the bill rate would be around the discount rate, that is, around the 1-1/2 per cent level. As far as the psychology or tone of the market is concerned, we have these continued demands for long-term capital and an increasing demand for credit with an expanding business situation. There would be a tendency for the bill rate to go above the discount rate which prompted some of us to suggest in our discussion that when a time for a rate change comes, you might want to make it 1/2 per cent, as Governor Robertson has suggested, rather than 1/4. So that if the market had gone part of the way toward 1-3/4, you would be taking a different action than that which had been discounted by the market when you made your move. This is something that Mr. Roelse and Mr. Treiber and I have all discussed.

Mr. Szymczak: Listening to the report by Mr. Young and considering the credit factors in the market--particularly real estate credit and consumer credit and stock market credit--I think the time has come that we have to move on the discount rate. I would do it by an increase of 1/4 rather than 1/2 per cent, and would rely on repurchase agreements as much as possible, but also would buy if the market gets too tight. I think the economic level is high and going higher. Demands of the Treasury in May will be very high. The sooner we move on the discount rate and continue to pursue our present policy on reserves and keep the market in that position, the better the Treasury will be able to do its financing. I would not wait until June to increase the discount rate but think that it should be done now.

Mr. Balderston: Like Governor Szymczak, I have been hoping we could use less obvious instruments than the rediscount rate for sometime yet. But I have the feeling we are caught in a time trap which is not of our making. Metal prices have begun to rise; also, some significant wage negotiations will be consummated later this spring and may induce a wage-cost spiral. Not only will the automobile industry tend to set a pattern for others but the wage arrangements settled upon in it and other industries are likely to be reflected in price advances in steel and other materials. I say the time-schedule is not of our making because the next Treasury financing forces us to act now or get "locked in" to

> the present discount rate for some time to come. With the strength and breadth of the present recovery, which is moving in accordance with one's expectations, we ought not to become locked in. Then, I sense that the psychology of the market has been one of anticipation of a change in the discount rate. That psychology has probably been beneficial so far, but not to act now might lead the market to think that we are not on top of our job and the resultant uncertainty might make the Treasury's financing operations more difficult. So I would hope that one or more of the districts would propose an increase of 1/4 per cent in the discount rate right away. I would be happy also if the Treasury gave us another long-term issue, or perhaps reopened the 40 year 3's of '95. Some long-term financing would absorb part of the credit that is going into the construction industry. In any case, I assume that the boom will have strength throughout this fall regardless of some decrease in automobile production, but that sooner or later this Board will need to have some strong weapons in its arsenal, and when that time comes the discount rate should be higher than at present so that there can be several downward adjustments when business needs to be stimulated.

Mr. Vardaman inquired how long the System would be "locked in," if it did not act now on the discount rate; whether it could act in about 60 days, around June 15. Mr. Balderston said that he assumed that would be too soon.

Chairman Martin commented that the situation would be very difficult, that the Treasury does not have an easy "row to hoe" and is going to be affected by the reserve position. He also suggested that the Treasury would like a reduction in reserve requirements to help in its financing, such as we had in each of the past two years. However, the Chairman thought that was out of the question this year. Consequently, he said that he thought the phrase "locked in" was quite correct.

Chairman Martin also said that this had been a very useful discussion. He thought it illustrated the advantages of having the full Committee

in session more often than in the past. In terms of open market operations, for which the executive committee is responsible, he thought it clear that maintenance of about the present level of reserves during the near-future was the majority position.

> There was unanimous agreement with Chairman Martin's foregoing statement with respect to the majority views of the members of the executive committee regarding transactions for the System open market account during the next two weeks.

Chairman Martin went on to say that he would like to be recorded in the minutes of this meeting as favoring (1) the maintenance of approximately the same level of free reserves that had existed recently and (2) an increase in the discount rate at any one of the Federal Reserve Banks or at all of them, as early as possible, prior to the announcement of the Treasury's financing in May. In response to a question from Mr. Fulton, Chairman Martin said that he would prefer a discount rate of 2 per cent if a Reserve Bank had justification for it but that an increase to 1-3/4 per cent would be the more orderly way to proceed. Chairman Martin felt that we are going to need to be able to give some assistance at a later date. There are psychological elements in the picture, he said, which make it very difficult to get much effect from a reduction in the discount rate from a level of 1-1/2 per cent to, say, 3/4 per cent. Such a reduction would not do very much in terms of psychological effects. Chairman Martin said the discount rate had not been used flexibly. He did not

think the recent rise in the bill rate to 1.60 or so was of any particular significance except that it had been long overdue. The fact that it came suddenly was not surprising: it always came suddenly as far as the inflationary picture was concerned. There could be an enormous rise in the inventory picture within 60 days, he said, commenting that that was the strength and the weakness of our economy; when it is unloosed, there are no limits to which it can go. His reason for wanting to be recorded as favoring a continuance of the same approximate level of reserves and of an increase in the discount rate was that he felt very strongly about the point Governor Balderston had made, that the System was in danger of being locked in. There would always be differences of opinion but in his judgment, an increase in the discount rate at the present time would not create a ripple. Under other conditions, an increase in the discount rate might have a good deal of effect. The significance of a change in discount rate would not be measurable in terms of the volume of borrowing at the discount window. That was a negligible factor. The significance of the act was that it would give an indication of the System's awareness of the implications of the credit situation. During the last few weeks there had been indications that the System was alert, and this feeling had itself been a salutary retarding influence. But we have now reached a position where, if we do nothing with respect to the discount rate, and if nothing is to be done until June, a great part of the community would think the System had "missed the boat completely" and that it was operating on a perpetually easy money philosophy.

Chairman Martin inquired of Mr. Rouse what instructions were needed to carry out the program indicated by the majority view of the executive committee, and Mr. Rouse raised the question whether it might be desirable to indicate operations in terms of market rates rather than reserves. Mr. Rouse did not think the directive needed to be changed in order to continue with about the present reserve picture.

Mr. Mills raised a question with respect to whether there should not be a range of rates specified by the executive committee for repurchase agreements. During a brief discussion of this question, it was the consensus that if a change in the rate on repurchase agreements became necessary, such a change could be made effective almost immediately by a telephone hook-up or by telegraph communication among the members of the committee.

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 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 agreed that the next meeting of the executive committee would be held at 10:45 a.m. on Tuesday, April 26, 1955.

Thereupon the meeting adjourned.

Secretary