A meeting 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, July 12, 1955, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Robertson
Mr. Shepardson
Mr. Vardaman
Mr. Powell, Alternate for Mr. Earhart

Messrs. Treiber and Johns, Alternate Members of the Federal Open Market Committee

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Messrs. Daane, Hostetler, Rice, Wheeler, 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. Gaines, Securities Department, Federal Reserve Bank of New York

Messrs. Williams and Bryan, Presidents of the Federal Reserve Banks of Philadelphia and Atlanta, respectively

There was presented for the approval of the Committee a revised draft of minutes of the meeting of the Federal Open Market Committee held on Wednesday, June 22, 1955, copies of which had been distributed to the members of the Committee before this meeting.

Mr. Robertson suggested that the last sentence of the first full paragraph on page 10* of the revised draft of minutes be changed to delete the word "should" and to insert in its place the words "be invited to" so that the sentence would be modified as follows:

> Mr. Robertson also suggested that the point mentioned by Mr. Leedy might be covered by providing specifically that all Presidents of the Federal Reserve Banks ~~should~~ BE INVITED TO be present at meetings of the Open Market Committee.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 22, 1955, revised to include the foregoing change, 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 June 22 to July 6, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed July 7-11, 1955, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period June 22-July 11, 1955, inclusive, were approved, ratified, and confirmed.

Chairman Martin referred to the discussion at the meeting on June 22 of Mr. Robertson's suggestion for rewording statements of certain

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* Refers to mimeographed copy. In the typed copy, reference should be made to page 11.

continuing operating policies of the Committee relating to support of Government securities, intervention in the Government securities market, operations in the short end of the market, operations during a period of a Treasury financing, and operations for the purpose of providing or absorbing reserves. The statements had been approved at the meeting of the Committee on March 2, 1955, and a memorandum had been sent to the members of the Committee by the Secretary under date of July 7, 1955, presenting Mr. Robertson's proposed rewording, as well as alternative language suggested by Mr. Sproul at the June 22 meeting.

The statements as approved March 2, 1955 and as presently in effect read as follows:

> It is agreed that it is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).
>
> It is agreed that operations for the System account in the open market, other than repurchase agreements, be confined to short-term securities (except in the correction of disorderly markets) and that during a period of Treasury financing there be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturity to those being offered for exchange; and that these policies be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.
>
> It is agreed that transactions for the System account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the

maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Mr. Robertson's suggested revision read as follows:

It is not now the policy of the Committee to support any specific pattern of prices and yields in the Government securities market, and transactions in the System Open Market Account shall be undertaken solely for the purpose of influencing the volume of bank reserves and thereby the costs and availability of credit, in order to promote economic growth and stability (including correction of disorderly markets).

Transactions for the System account in the open market shall be confined (except in correction of disorderly markets) to short-term securities, preferably bills, and shall not include offsetting purchases and sales of securities of different maturities.

During periods of Treasury financing there shall be no purchases for the System Open Market Account of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturity to those being offered for exchange.

Mr. Sproul's proposed alternative language would change the first two paragraphs of Mr. Robertson's suggested revision as follows:

It is not now the policy of the Committee to support any specific pattern of prices and yields in the Government securities market, and transactions in the open market shall be undertaken ~~solely~~ TO EFFECTUATE THE OBJECTIVES OF MONETARY AND CREDIT POLICY (INCLUDING CORRECTION OF DISORDERLY MARKETS) BY ~~for the purpose of~~ influencing the volume of bank reserves and thereby the costs and availability of credit, in order to ~~promote~~ FOSTER economic growth and stability ~~(including correction of disorderly markets)~~.

Transactions for the System account in the open market shall be confined (except in correction of disorderly markets) to short-term securities, preferably bills, and shall not include offsetting purchases or sales of securities of different maturities EXCEPT BILLS.

Mr. Robertson stated that his proposal for rewording of these statements of continuing operating policies, which had first been adopted by the Committee in 1953, was for the purpose of clarifying the existing statements and eliminating language which may have caused misunderstanding or misinterpretation of the intent of the statements in the past. He then commented briefly on the proposed language of the statements and on reasons why he preferred language he had suggested to that suggested by Mr. Sproul at the meeting on June 22.

Mr. Sproul said that, as he had indicated three weeks ago, his suggestions were made in the interest of clarity, since he would have to vote "no" on the statements in anything like their present form. In explanation of his specific suggestions, he said:

1. It is desirable to retain the positive or affirmative statement of intent included in the policy statement of March 2, 1955, and to place it in immediate opposition to the negative statement. It is also desirable to tie in the correction of disorderly markets with the objectives of monetary and credit policy.
2. We should not seem to deny, by use of the word "solely", a secondary responsibility to coordinate credit policy with debt management, a responsibility which we actually respect whenever it is possible to do so without running wholly counter to credit policy.
3. The permissive swaps of bills would facilitate the practical administration of the account, contribute to the functioning of the bill market, and not transgress the general principle which led the majority of the Committee to prohibit swaps.

Several other suggestions for change in language were made by other members of the Committee and there followed a general discussion of the various suggestions made.

Chairman Martin commented that there had been a great deal of discussion of the wording of the Committee's directive and of language of the continuing operating policies. As he had indicated before, he did not feel it was practicable to convert meetings of this size into "drafting sessions". In his view, the language changes being suggested did not make a great deal of difference and to a considerable extent represented only a shifting of words.

Mr. Bryan stated that, as indicated by Mr. Sproul's comments, it would seem to be important to debate the substantive matter in the statements of continuing operating policies rather than the language. If the Committee reached a decision that it wished to follow certain policies, Mr. Bryan felt that the matter of language could be taken care of fairly readily.

Chairman Martin agreed with this point of view. He referred specifically to the prohibition in the existing statements of policy against "swap" transactions and asked Mr. Sproul under what circumstances he felt this prohibition should not apply to bills.

Mr. Sproul cited the example of the need of the System account, at times, for January and February bills which could be allowed to run off after the turn of the year, and he also cited a situation in which a corporation might have a need for bills maturing on October 21 in order to meet cash needs that day, but which found that the market was bare of bills maturing October 21 although bills maturing October 28 were in good supply. He could not see how the System account in swapping such near-money instruments would be interfering with arbitrage of the market and the relationships between Government securities of different maturities. To him, this would appear to be making the System portfolio contribute to the functioning of the bill market. In response to Chairman Martin's question as to how the System account would find out that the corporation needed the October 21 bills, Mr. Sproul stated that this information would come through dealers who were experiencing a demand for the October 21 bills. The System account would not be taking care of individual corporations; rather, the swaps would be for the purpose of improving the operation of the market. The transaction would, of course, be tied in with the operations of the System account under the credit policy in force.

Chairman Martin said that if the Committee was trying to acquire bills with specific maturities that aided in carrying out policy and an offer to sell such bills came to it through dealers, swapping from one maturity to another could be justified under some conditions. For example, if it wanted January maturities so that they could be permitted to run off when banks would need less reserves because of a return flow of currency and other seasonal factors, swaps might be all right. If, however, the swapping was a result of an attempt on the part of the System account to accommodate dealers or, through dealers, to accommodate individual corporations in adjusting their portfolios, he felt such transactions would put the Committee on dangerous ground. The central bank should keep its transactions on an impersonal basis. It was necessary for the Committee to keep this point in mind all the time, Chairman Martin said, and the Committee should be very careful about any approach which a dealer or a corporation might make for the purpose of showing how a transaction would benefit the System account or the Committee's operations. As Mr. Sproul had said, swaps of bills seemed to be a very small matter from the standpoint of affecting the rate relationships, but when it came to using the account to accommodate dealers the Committee would not be justified in risking the criticism that might result. In other words, the advantages of such transactions from the standpoint of monetary policy would be so slight that they might be much more than offset by the violation of the principle involved. It was Chairman Martin's thought that the discussion got back to Mr. Bryan's point that perhaps the Committee should have another full-dress debate on the entire substance of the principle involved in the prohibition against swaps.

Mr. Robertson stated that, as he had indicated earlier, his whole purpose in suggesting a revision in the wording of these statements was to eliminate some of the language which had been misunderstood or misconstrued before, and he had not intended to change the substance of the statements.

If the revision as suggested or as modified in discussion did not achieve this purpose, he would be disposed to continue with the statements in the form in which they were approved at the meeting on March 2, 1955.

Chairman Martin said that there was enough disagreement in emphasis and in words to indicate that the Committee should pass over the matter for today and, if it desired, take another look at the statements at a later meeting with a view to deciding whether it desired any change at all in the wording approved at the meeting last March. He suggested, further, that if any of the members of the Committee or other Reserve Bank Presidents wished to have a further discussion of the matter and wished to suggest language for the statements, such suggestions be submitted to the Secretary in writing in order that the language could be made available for study prior to the meeting at which the matter was to be discussed.

No disagreement with Chairman Martin's suggestion was indicated.

Chairman Martin then referrred to the suggestion that had been made by Mr. Robertson at the meeting on June 22, 1955, that the Committee fix a rate at which repurchase agreements covering Government securities could be made by the Federal Reserve Banks, concerning which suggestion the Secretary distributed a memorandum dated July 7, 1955, as a part of the agenda for this meeting. He noted that prior to abolishing the executive committee on June 22, 1955, the full Committee had given to the executive committee general authority for directing the Federal Reserve Banks to enter into repurchase agreements and for fixing the rate or rate range on such agreements. The matter was on the agenda for today's meeting in order to determine the rate or rate range for such agreements and to consider a proposed revision in the language of "Conditions for Repurchase Agreements." The proposed revision, which had been presented in the Secretary's memorandum attached to the agenda, would eliminate reference to the executive committee and would make it clear that authority for directing the Federal Reserve Banks to enter into repurchase agreements and for fixing rates on such agreements was centered in the full Committee.

Mr. Robertson stated that he had raised two questions regarding repurchase agreements at the meeting on June 22. One of these related to the fixing of the rate at which such agreements should be made, which subject was referred to in the Secretary's memorandum of July 7. The other question that he had raised and which he felt should be decided prior to the fixing of a rate had to do with the general procedure to be followed regarding repurchase agreements. His suggestion as originally made at the meeting on March 2, 1955, and as repeated at the meeting on June 22, 1955, was that the use of repurchase agreements be continued, where considered advisable, not as a supplementary technique in the regulation of credit, but for the purpose of enabling dealers in Government securities to maintain broad and ready markets. Mr. Robertson felt that such agreements could be utilized in a manner similar to rediscount operations--an open window for carrying dealers at rates preferably above but in no event below the discount rate--in order to assist them in sustaining a closer and more continuous market. Under this arrangement, dealers should feel assurance that the facility was always available to them within reasonable limits, as the discount window is open to member banks.

> Mr. Robertson then moved that the Committee adopt a procedure for repurchase agreements along the lines he had indicated, under which an open window would be established at the Federal Reserve Banks for use in financing dealers at rates preferably above but not lower than the discount rate, such procedure to supersede that now being followed.

Chairman Martin said that he would vote against a proposal such as that made by Mr. Robertson. He felt the proposal would require more study than had been given to the question to date. The Chairman then asked for discussion of Mr. Robertson's proposal, but none of the members of the Committee indicated that they wished to comment.

> Mr. Robertson's motion was put by the Chair and lost, Messrs. Martin, Sproul, Balderston, Fulton, Irons, Leach, Shepardson, Vardaman, and Powell voting "no" and Mr. Robertson voting "aye".

> In connection with the foregoing action, Mr. Robertson made a statement substantially as follows:

I dissent from the action taken today because it is likely to encourage unnecessarily frequent and extensive use of repurchase agreements in order to affect the level of short-term rates in the money market, and to do so by giving dealers differentially advantageous access to Federal Reserve credit at times when short rates in the money market are below the discount rate. In such circumstances, if Federal Reserve credit is to be supplied at rates lower than the discount rate, it seems to me preferable that the supply be accomplished directly through purchases of bills rather than by "loans" to dealers.

In recent months I have tried to clarify for myself the justification for, and benefits from, use of repurchase agreements generally. Up to the present, I have not received what have seemed to me to be satisfactory answers to the inquiries I have made; consequently, I am inclined to assume that the basic positions developed in my memoranda of October 20 and December 9, 1954 are sound and no valid answers can be made.

We are making frequent use of repurchase agreements with dealers in Government securities. Pending eventual clarification of the basic questions referred to, I do not object to a continuation of the use of repurchase arrangements where considered advisable to further the objective, not of providing or absorbing reserves, but of enabling dealers to maintain broad and ready markets by protecting them at the discount rates or slightly above against the inaccessibility of credit except at penalty rates. That is, I should raise no objection if this procedure were utilized and policed in a manner similar to rediscount operations - an open window for financing dealers at rates preferably above but not lower than the discount rate. Dealers should know that the facility is always available to them (within a specified range, e.g., a dollar or percentage figure), as the discount window is open to member banks, subject to such policing as may be necessary to avoid its abuse by any dealer or a use of it which unduly interferes with our credit policy.

Mr. Bryan stated that while he was not a member of the Committee he would like to indicate that he concurred in the general approach taken by Mr. Robertson.

Mr. Sproul said that he did not want to repeat all that he had said about repurchase agreements at the last meeting of the Committee, which was included in the minutes of that meeting. He did say, however,

1. That he does not believe that repurchase agreements should be used only as an aid to Government security dealers, at their initiative, and he does believe that repurchase agreements should be used as a supplementary means of making open market policy effective, at our initiative.

2. The arrangement suggested by Governor Robertson with respect to continuing dealer facilities, at their initiative, would seem to have a maximum potential for offsetting the intentions of open market policy. There would ordinarily be little inducement for dealers to use the facility. They would use it only when money market conditions, presumably in line with System policy, became tight enough to bear down on them as they would bear down on the rest of the money market. This would mean that a sheltered corner had been created for Government security dealers, and that release of credit to them on repurchase agreement would to that extent, and perhaps to a greater extent, undermine general credit policy.

3. This is not to argue against making our open market operations as impersonal as possible. That is the aim of the administration of the present repurchase authority. But impersonal dealing is only one objective, and cannot be pursued as an end in itself to the detriment of over-all policy. It must also be remembered that the Government securities market is a negotiated market, not a public auction market, and that there is an element of the personal in all transactions which take place within it.

Chairman Martin next turned to the question of the rate to be established on repurchase agreements under the existing procedure, and he called upon Mr. Sproul for a suggestion as to the rate to be authorized by the full Committee.

Mr. Sproul stated that he would leave the existing range of rates in effect, that is, he would authorize the Federal Reserve Banks to enter into repurchase agreements with the understanding that in no event shall they 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. Mr. Sproul said that the effect of Mr. Robertson's second proposal (that repurchase agreements be entered into only at a penalty rate equal to or above the discount rate) would be to limit the scope of effectiveness of this device as a supplement to other open market operations and to credit policy in general. The Committee would then only be able to use this device when repurchase money could usefully be put into the market, on the Committee's initiative, at a rate equal to or above the discount rate. There have been situations in the past and will be in the future when a repurchase rate below the discount rate can make possible a desirable temporary release of credit to meet an unusual and concentrated need for immediate bank reserves. Mr. Sproul felt that a Federal Open Market Committee meeting every three weeks should be able to keep this operation under control. It would seem paradoxical if the Committee denied itself this privilege of making repurchase agreements at rates below the discount rate while it continued regularly to buy and sell Treasury bills outright at such rates.

Mr. Robertson said that his proposal was intended to retain in the full Committee the power to fix or change rates on repurchase agreements. In other words, he wished to have the Committee, rather than the individual Federal Reserve Bank, decide whether during a given period repurchase agreements should be made and whether they should be at rates below the discount rate.

Chairman Martin noted that the proposal before the Committee was to fix for the next three weeks (pending the next meeting of the Committee) a rate or range of rates on repurchase agreements.

Mr. Sproul repeated his suggestion that the existing range of rates be continued by the Committee as a range of rates at which repurchase agreements could be entered into by the Federal Reserve Banks between now and the date of the next meeting of the Committee.

In response to a question from Chairman Martin, Mr. Vest stated that the existing authority for repurchase agreements, including the rates on such agreements, was currently outstanding as an authority of the full Committee, the setting of rates having been taken over as full Committee authority at the meeting on June 22, 1955, when the executive committee was abolished and the authority previously granted to the Federal Reserve Banks by the executive committee became an authority of the full Committee.

Chairman Martin suggested that it be understood today that the authority previously granted to the Federal Reserve Banks by the executive committee, pursuant to the authorization of the full Committee as renewed on March 2, 1955, had been revoked. In its place, the full

Committee would now authorize the Federal Reserve Banks to enter into repurchase agreements in accordance with the general conditions previously specified by the full Committee, it being understood that hereafter the full Committee would specify at each meeting the rate or range of rates for such agreements and when and to what extent Reserve Banks should enter into them. The Chairman then read the proposed revision in language of the "Conditions for Repurchase Agreements" approved at the meeting on March 2, 1955, which revision would eliminate reference to the executive committee.

Mr. Sproul said that his thought was that the full Committee should consider at each meeting what authority should be granted to the Federal Reserve Banks to enter into repurchase agreements and at what rates.

Mr. Robertson said that this would meet his suggestion that the Committee, rather than the individual Federal Reserve Banks, determine the rate or rate ranges for repurchase agreements. He also inquired whether there was any expectation at the present time that there would be a need for entering into repurchase agreements at rates below the discount rate during the next three weeks.

Mr. Sproul responded that he did not think the Committee could forecast for even three weeks in advance whether a situation might arise where the Committee would wish to put funds into the market, at its initiative, at rates below the discount rate.

Mr. Robertson said that he would not object to authorizing repurchase agreements at the range of rates previously specified for such agreements, if it was understood that a rate below the discount rate would be used only if such procedure seemed essential as a means of carrying out Committee policy.

Mr. Sproul stated that this was the way in which the range had been used in the past. At this time, he did not know whether a need would arise within the next three weeks for repurchase agreements at a rate below the discount rate.

Chairman Martin said that his sentiment was in accordance with Mr. Robertson's suggestion that repurchase agreements be at a rate below the discount rate only in case that seemed essential for the purpose of carrying out Committee policy. This was the way in which he understood the authority had been used in the past, and he felt it should continue to operate that way in the future. However, his view was that a situation might well arise within the next three weeks in which the Committee would wish to put funds into the market through repurchase agreements at a rate below the discount rate.

Mr. Robertson replied that he would not object to authorizing the range of rates proposed if it was understood to be the sense of the meeting that a rate below the discount rate would be applied only in case of need, and if it was also understood that the repurchase authority would be used sparingly.

Mr. Bryan inquired what kind of a situation might be envisaged which would call for repurchase agreements at less than the discount rate.

Mr. Rouse responded that the tightness during the last several days had been centered in New York City, and that there may be continued pressure on the central money market. Under these circumstances, it is possible that a degree of tightness more severe and more pervasive than the Committee contemplated might develop.

Mr. Bryan stated that he interpreted this as meaning that a situation might develop where a sudden tightening in the market was indicated which might bring about a rapid upward movement in the bill rate toward the discount rate, which would have a tightening effect on the entire money market.

Mr. Rouse said that there might, in addition, be psychological pressures affecting money and capital markets.

This raised the whole question in Mr. Bryan's mind of the substance of the procedure--it went beyond the questions raised by Mr. Robertson and to the problem of the management of the short-term rate in relation to the discount rate.

Mr. Leach stated that the question of repurchase agreements was tied to the question of whether it was desirable for the Open Market Committee to be in the market frequently, making direct purchases and sales of Government securities for the purpose of attaining credit policy objectives. Mr. Leach thought that repurchase agreements had a very useful purpose in keeping the Federal Reserve from having to make frequent outright purchases and sales of securities. Such frequent purchases and sales were undesirable, he said, because they had an effect upon the securities market itself and because they might confuse the public as to what the Committee was trying to attain. Mr. Leach felt that the Committee's basic policy should be agreed upon, and that actions should of course be taken to carry that policy out. He recalled that it had been suggested earlier during this meeting that the Committee might attempt to operate more precisely toward an objective of some amount of free reserves. In the absence of repurchase agreements, the only way to operate more precisely, Mr. Leach said, would be to make more frequent purchases and sales in the open market. For the reasons which he had indicated, this was not desirable, and it was his view that there was much to be said for authorizing repurchase agreements in a manner which would permit the Committee to carry out its policy objectives more effectively.

There was a further discussion of the use of repurchase agreements and of the rate at which such agreements might be authorized during which the suggestion was made that clause 1(d) of the statement of conditions that had been approved on March 2, 1955 should be changed by deleting the words "with care and discrimination" from the provision which formerly had provided that such agreements "Shall be used with care and discrimination as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis."

During this discussion, Chairman Martin stated that he agreed with much of the comment made regarding repurchase agreements, adding that he felt the Committee could well give further study to the use of the repurchase instrument. For the present, it was Chairman Martin's suggestion that the full Committee issue an authorization, in terms of the "Conditions for Repurchase Agreements" revised to eliminate reference to the executive committee and to delete from 1(d) the words "with care and discrimination." If this suggestion were approved, it would be with the understanding that (a) the authority would apply to the period between today and the next meeting of the Committee; (b) such agreements would in no event be at a rate 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; and (c) the authority would be used sparingly in entering into agreements at rates below the discount rate.

Chairman Martin's suggestion was approved unanimously.

Secretary's Note: The "Conditions for Repurchase Agreements," as revised by the foregoing action, were as follows:

In lieu of all authority previously granted by the Federal Open Market Committee with respect to repurchase agreements, each Federal Reserve Bank is hereby authorized to enter into repurchase agreements with nonbank dealers in United States Government securities at such times, in such amounts, and at such rates (or rate ranges) as the Committee shall prescribe, subject to the following conditions:

1. Such agreements

   (a) In no event shall be at a rate 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;

   (b) Shall be for periods of not to exceed 15 calendar days;

   (c) Shall cover only Government securities maturing within 15 months; and

   (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.

2. Reports of such transactions shall be made to the Manager of the System Open Market Account to be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.

3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by a Federal Reserve Bank shall be sold in the market or transferred to the System Open Market Account.

Mr. Robertson stated that the action just taken authorized all Federal Reserve Banks to enter into repurchase agreements but that, as he understood it, the authority actually had been used recently only by the Federal Reserve Bank of New York. He suggested that a statement of the reasons why the authority should be extended to all Federal Reserve Banks, rather than to the New York Bank only, be prepared and that the Secretary distribute the statement to all members of the Committee for discussion at a later meeting.

This suggestion was approved unanimously.

Before this meeting there had been sent to the members of the Committee a memorandum from Mr. Riefler dated July 7, 1955 suggesting that in the future the daily telephone call between the New York Bank, the Board's offices, and one other Federal Reserve Bank relating to the market situation as it appeared at the opening include, on a rotating basis, the four Federal Reserve Banks other than the New York Bank which were currently represented on the Open Market Committee. This procedure would replace that followed since the call was originated in May 1954 when only one Reserve Bank, other than New York, was included because only one other Reserve Bank was represented on the executive committee. The memorandum also suggested that the summary prepared in the Board's offices on the basis of the 11:00 a.m. telephone call be sent by telegram to the Presidents of all Federal Reserve Banks.

After discussion, there was unanimous agreement that the procedure recommended in Mr. Riefler's memorandum be adopted, effective immediately, with the understanding that the detailed arrangements would be worked out by the Secretary.

At this point Mr. Shepardson withdrew from the meeting to keep another appointment.

Chairman Martin called upon Mr. Young, who made a statement regarding the economic and credit situation with respect to which a staff memorandum had been distributed to the members of the Committee under date of July 8, 1955.

The outstanding feature of the over-all economic situation, Mr. Young said, is underlying strength and further advance, domestically and abroad. While stability of average prices can be said to continue, markets for industrial materials and products and construction components are under pressure from high levels of demand and income. Markets for agricultural products on the other hand are under pressure from very large supplies. Business and financial expectations as to sales and profits are decidedly optimistic and confidence in future prospects is pervasive.

The Board's index of industrial production was probably about the same in June as in May--138. Manufacturers' orders are generally running ahead of sales. Unfilled orders are rising further, although they are still considerably under 1953 highs. Business inventories rose sharply in May at both manufacturer and distributor levels, after a period of relative stability since last fall. Despite this rise, inventories of business are substantially below the levels of early fall of 1953 and, with sales at or above 1953 peaks, ratios of inventories to sales appear conservative.

Automobile sales (both new and used) continue impressively high. Consumer instalment debt has been rising at the rate of about a half billion dollars a month recently. Credit terms for new automobiles have been extended to a point where 30 months appears to be the most common maturity in most areas and 36 months is not an uncommon maturity--it is very common in the

Boston, New York, Philadelphia, and San Francisco Districts. Over-allowances on trade-ins with phantom delivered prices have been resulting in low actual down-payments on new automobiles. Credit terms on used automobiles do not seem to have been liberalized as much as on new cars.

Construction activity appears to be stabilizing at peak levels, mainly reflecting a leveling out of residential building while business and other private construction continue to rise gradually. Nonfarm employment, seasonally adjusted, rose somewhat further in June and unemployment declined. Crop and pasture developments have been generally good: prospects are for crop output in 1955 about 3 per cent above last year's large total, and for large output of livestock products. United States exports have leveled off this spring following an upswing late last year and early in 1955, while imports have continued to advance. Industrial production in most industrial countries abroad is still on the rise, and world prices of many basic materials have recently advanced somewhat.

Credit demand at city banks continues active, with loans expanding substantially further during June offset largely by sales of Government securities. Growth in the privately held money supply since January has been at an average annual rate of about 2 per cent whereas the annual rate of growth in the preceding 5 months was about 6 per cent. Deposit turnover at banks outside leading financial centers has risen further and is at a new postwar high. Reflecting the strong credit demands and Federal Reserve policies, both short- and long-term interest rates have moved upward moderately in recent weeks.

Mr. Koch commented briefly on the outlook for bank reserves, referring particularly to a sheet showing a pattern of recent and projected reserve changes prepared in the Board's offices under date of July 11, 1955, and to similar figures contained in the supplemental report of open market operations prepared at the Federal Reserve Bank of New York and distributed at today's meeting. Mr. Koch noted that the projections prepared at the New York Bank and the Board indicated about the same amounts of free reserves for weeks ending July 20 up through Labor Day. During the week ending July 20, a moderate amount of free reserves was anticipated, while during the week ending July 27 negative free reserves averaging around $100 million were projected and during the week ending August 3 average negative free reserves might run closer to $200 million. Thus, if the Committee wished to have free reserves of around zero level during the week of August 3, it might be necessary to put some funds into the market through repurchase agreements or otherwise. The Committee might, however, feel that this would be an appropriate time to permit the development of average negative free reserves in moderate amounts, assuming Treasury refinancing operations permitted. Following a rise in free reserves during the weeks ending August 17 and 24, owing largely to the usual mid-month influences, there would be a substantial decline around Labor Day when holiday demands for currency and other factors would draw down reserves.

Chairman Martin stated that the Committee appeared to have been reasonably successful in its operations during the past three weeks and that the projections of factors affecting free reserves presented at the meeting on June 22 had been borne out reasonably well. In his opinion, the economic situation required little comment other than to say that it was such as to call for thought on the part of the Federal Reserve regarding the possibility of increasing the discount rate when the Treasury's financing operations would permit--perhaps during early August.

Mr. Sproul noted that the Treasury might soon announce an offering of securities to take care of its August 15 refinancing which would call for payment around August 1. In that event, it might not be desirable to experiment with a lower level of free reserves between now and August 1. He then made a statement substantially as follows:

1. The strength and breadth of the present upward movement in the economy, as reported to us today, suggests that whatever check to rate of growth may take place during the present quarter will be less than might previously have been anticipated. The economy appears set to continue to expand at high levels of employment and production for the next few months.

2. Bank credit thus far has followed the course of business. There was a contra-seasonal advance in bank lending during the first half of the year, while bank investments in Government securities declined. Private demands for bank credit during the remainder of the year are expected to be substantial, and to these will be added a sizable Treasury demand. The money supply, which declined 3.1 per cent (from $134.5 billion to $130.3 billion) during the January-May period of seasonal decline, is estimated to increase over the year as a whole by perhaps 5%. To prevent viewing this latter figure too seriously, however, it should be related to an estimated increase in the country's Gross National Product of more than 6% during the year.

3. The total amount of bank reserves needed to meet prospective private and public demands for bank credit during the second half of the year, without relaxing present credit restraint, is estimated to be between 1 3/4 and 2 billion. Our previous discussions have indicated that we would provide these reserves, and that we would do it through open market operations, supplemented by increased borrowing of member banks to meet seasonal needs. The problem, of course, is to supply the right amount of reserves to foster stable growth without encouraging speculative excesses which would endanger such growth.

4. We are obviously nearer than we have been since early 1953 to full utilization of plant, equipment, and manpower; prices which have been stable, in the aggregate, for

two years may be about to get a push on the up-side due to pressure from costs and from anticipation of price rises by businessmen, purchasing agents, and consumers; and there is a prevailing feeling of optimism in the community about economic developments during the next six months which in some of its manifestations, as in the stock market, cannot help but cause concern.

5. On the other hand, we don't want to get scared by prosperity; our present record level of economic activity doesn't exceed the bounds of normal growth as compared with two or three years ago. We don't want to underestimate the power of the productive competitive forces in our economy to counteract some of the tendencies which may now be causing us concern. And we don't want to overlook the possibility that a diminishing rate of growth during the third quarter may cool off some over-speculative tendencies.

6. On balance, it now looks to me to be a question of the timing and degree of pressure we may want to exert in order to deter possible speculative excesses which would jeopardize sustained growth, or would promote its continuance only temporarily, and then at the cost of a depreciating dollar.

7. I see nothing in the immediate situation which demands that we embarrass the Treasury in its management of the public debt by further restrictive credit moves during its July-August financings. We are not at a point where the dangers of inflationary developments clearly outweigh all other considerations. The danger signals of inventory accumulation outrunning sales expansion, upward price movements, production, material and employment bottlenecks, and excessive increases in bank credit and the money supply have not yet flashed red. Meanwhile, we shall not be standing still if we do nothing more during the next few weeks than maintain the pressure we have already applied. What we have already done will have a continuing and probably increasing effect. The general banking situation is now tight including the money centers. Bank liquidity is low as a result of a really massive liquidation of Government securities by the banks during the past six months; the banks are having to continue to sell securities (or to borrow) to make loans, and now they usually take a loss on the sales. Treasury bill rates are rising and presumably will continue to rise as the weekly increase in offerings and the new Tax Anticipation Certificates

add to the supply of short-term securities. There is beginning to be some tightness in the long-term market which ought to be increased somewhat by the Treasury's offering of 3% bonds. A substantial volume of flotations of state and municipal securities is in prospect and the market recently has been backing up.

8. I would say that we should maintain open market policy as is for the rest of July and until our next meeting in August, which would mean free reserves ranging around zero, a continued higher average level of member bank borrowing, and some further rise in Treasury bill rates. Some further purchases of Treasury bills, during this three week period, will probably be necessary under such a policy directive.

I would hope that the Treasury would proceed with plans to get its August refunding out of the way by the end of July so that we would then have a clear field until late September in which to decide what to do next. As I see it now, if the business and credit situation during the first half of August suggests further action, our next move might well be an increase in the discount rate. It could serve as a cautionary signal while still permitting ready access to the reserves needed to support necessary private and public demands for bank credit.

Chairman Martin called for comments on the general economic situation and on any changes in credit policy that seemed to be merited.

Mr. Leach stated that he agreed in general with the views expressed by Mr. Sproul on the economic situation and on credit policy. He had a question as to the target for free reserves during the period ahead, however, stating that if borrowings of member banks were to rise to, say, the $800 million level compared with the average of around $400 million that had existed during June, a change in the target would seem necessary since the significance of free reserves ranging around zero would be different if member bank borrowings increased substantially.

In other words, reserves supplied through borrowings by member banks did not have the same easing effects that might result from reserves supplied through open market operations because banks do not like to be in debt. It would not seem necessary to move the target for free reserves by as much as the change in member bank borrowings, but Mr. Leach was of the opinion that some change in the target would be in order if there was a large increase in borrowings.

Chairman Martin said that he would agree with the view expressed by Mr. Leach, but he noted that the Treasury was still in the "middle of the stream" and that the Committee should be very careful about altering its course during the period of the Treasury's operations.

Mr. Leach responded by stating that he felt a change in the target for free reserves might be necessary as member bank borrowings increased in order to keep from changing the degree of pressure on banks, since, with a larger volume of member bank borrowings, zero free reserves meant something different than it did a few weeks ago.

Mr. Robertson agreed that the level of free reserves took on a different meaning as borrowings changed. He went on to say that, while it appeared to be the consensus that the Committee should not change the degree of restraint during the period when the Treasury was in the midst of its financing, he felt that we were rapidly reaching the point where a change in the degree of restraint would be desirable. For example, he felt that an increase in the discount rate should be considered at the earliest possible time.

Mr. Balderston inquired as to the amount of change that might be made in the discount rate if one were made soon after the first of August. Such a change might be 1/4, 1/2, or 3/4 of one per cent, he said. While the Federal Reserve should try to hold a steady situation in the market so long as it was under obligation to the Treasury, he personally would favor an increase of at least 1/2 per cent in the discount rate as early in August as the Treasury's position would permit. It was Mr. Balderston's view that the Committee should get in a position to deal more effectively with the situation when a down-turn in activity developed.

Mr. Sproul said that the amount of any change in the discount rate should be based on the situation as it existed when the action was taken, and not on how the situation appeared as of now. As of today, he felt this was not the time when the Federal Reserve should take <u>dramatic</u> action, such as increasing the discount rate by 1/2 or 3/4 per cent after a long period of 1/4 per cent changes, which would indicate that it thought signs of inflation were more serious than we actually think they are. As for "laying in nuts for the winter" by getting the discount rate up substantially now so that there would be room to lower it later, he expressed the opinion that the System would have ample means through open market operations and discount operations to deal with a changed situation that might develop.

Mr. Bryan said that he thought the economic situation in prospect was such that it might need further restraint. At the same time, he would like to approach this position in stages. He could see no point in a further increase in the discount rate--certainly not in an increase by a dramatic amount--until the Committee had taken full advantage of the possibility of permitting or forcing a movement in the short-term rate up toward the discount rate, and at that point, of permitting or forcing a further increase in member bank borrowing. He also would dislike to see any massive additions to reserves until a further rise had taken place in the short-term rate.

Chairman Martin said that he would like to return to Mr. Leach's point regarding the relationship between borrowings of member banks and the level of free reserves, and whether the amount of pressure on banks should be changed. It was the Chairman's understanding that none of the views expressed at this meeting indicated a desire to ease the situation at the present time. Rather, the objective appeared to be to continue the present policy of "mild restraint." Whatever action or emphasis was necessary to "keep the situation on an even keel" should be the goal of the Committee for the next three weeks. It was very difficult to measure degrees of tightness, Chairman Martin said, but the Committee should not be carried away with any particular level of free reserves as a goal.

He felt it important to know whether there was any disagreement with this approach.

None of those present indicated disagreement with the approach Chairman Martin had indicated, that is, that the aim of the Committee until its next meeting should be a continuation of the present policy of "mild restraint" and of "keeping an even keel."

Chairman Martin also asked if there were further comments regarding his suggestion that consideration be given to an increase in the discount rate when the Treasury's refinancing was out of the way, perhaps early in August.

Mr. Robertson said that he would assume that, along with any increase in the discount rate that might later be decided on, corresponding tightening actions would be taken by the System "across the board."

Mr. Fulton said that in his opinion there was more inflation in the wind than the figures indicated. He cited instances of persons getting into the stock market as hedges against inflation and of their buying stocks having unattractive yields, not for investment but for speculation. Mr. Fulton said that he would look with favor on a good-sized increase in the discount rate, at least as a psychological influence.

Mr. Irons said that he would not favor a dramatic action but would favor an increase in the degree of restraint on the market as soon as the Treasury situation permitted. In his opinion, the situation did not call for an increase of 1/2 or 3/4 per cent in the discount rate, which would be a startling change. A gradual increase in the discount rate as short-term rates moved up, along the lines Mr. Bryan had indicated, would serve to increase restraint.

Chairman Martin said that he would not wish to take a position on these points at the present time. He thought the System should feel its way. However, it was his view that insofar as the Committee may have erred in attaining its objectives in recent months, the error had been on the easy side rather than on the too-tight side. He commented further that, when explosive factors occur in the credit situation, they move just as fast as they do in the stock market. It was the Chairman's thought that there might be more "explosive tinder" lying around at this juncture than any of us realize. We would all know when it had exploded, but the problem the Committee was struggling with was to project the past into the future.

Mr. Powell inquired as to the effect of the slowing down in automobile production that was predicted for the next few weeks. Would such slowing down affect business volumes sufficently to slow down the inflationary tendencies that have been discussed at this meeting?

Chairman Martin stated that he had heard well-informed persons argue both sides of the question, some feeling that changes in automobile output would have a slowing effect while others took the view that momentum in other parts of the economy would increase. For himself, he had no firm view.

Mr. Fulton said that he had heard the view expressed in steel circles that the anticipated slowing down in automobile output during the next few weeks would help the steel situation because of the loss in steel output that had taken place during the recent short-lived strike.

Chairman Martin inquired whether there were other views or factors bearing on the policy of the Committee for the next three weeks that should be considered at this time, and none of the members of the Committee indicated additional factors should be considered in determining policy for the immediate future.

Chairman Martin then called upon Mr. Rouse for suggestions as to the directive to be issued to the New York Bank, and Mr. Rouse proposed that the limitation in the first paragraph of the directive be reduced from $1 billion to $750 million.

Thereupon, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the 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 Open Market 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 avoid the development of unsustainable expansion, and (c) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $750 million;
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> (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 $500 million;
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> (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.

Mr. Sproul stated that the Federal Reserve Banks have been examining their programs for operations in the event of an emergency. He suggested that it might be desirable for the Federal Open Market Committee also to review its program for emergency operations, which is now largely based on the supposition that if the Federal Reserve Bank of New York were unable to operate another Federal Reserve Bank would be designated to carry on operations for the System Open Market Account. Mr. Sproul went on to suggest that it would be appropriate and desirable for the Chairman to be authorized to appoint a subcommittee to study the problem and to suggest any revisions that should be made in the present plan.

Thereupon, by motion by Mr. Sproul Chairman Martin was authorized to appoint a subcommittee to reappraise the emergency plans for open market operations.

It was agreed that the next meeting of the Federal Open Market Committee would be held at 10:45 a.m. on August 2, 1955.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary