FORTIETH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1953

RECORD OF POLICY ACTIONS FEDERAL OPEN MARKET COMMITTEE

MARCH 4-5, 1953

1. Authority to Effect Transactions in System Account.

The following directive to the executive committee was approved:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to correcting a disorderly situation in the Government securities market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the 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 2 billion dollars.
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> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) of 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 2 billion dollars.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Evans, Johns, Mills, Powell, Robertson, Szymczak, and Young. Votes against this action: none.

This directive was in the same form as the directive adopted at the preceding meeting of the Federal Open Market Committee on December 8, 1952 except

for a change to provide that the Committee should arrange for transactions in the System open market account with a view, among other things, "to correcting a disorderly situation in the Government securities market," rather than as previously, "to maintaining orderly conditions in the Government security market." The reasons for this change in wording will be given later in this record.

At the time of this meeting, economic activity was continuing at a very high level. Industrial production had increased further since the meeting in December, and gross national product had continued to expand, partly on the basis of further substantial inventory accumulation. Commodity prices, generally, both on consumer goods and at wholesale, had been stable. Total employment had reached a new high and unemployment had decreased to new postwar lows, and some industries were operating on an overtime basis. Marked gains in personal incomes beginning in the late summer of 1952 had contributed to expansion in consumer buying, as had more liberal credit terms and a greater consumer willingness to incur debt.

For some months, credit policy had been directed toward the general objective of keeping the supply of credit and money adjusted to the needs of a growing and high-level economy in which there was no immediate evidence of price inflation. This policy called for some expansion in the supply of reserves although, in view of the large demand for credit in excess of savings, it resulted in modest restraint on credit growth. During the preceding two years, the Federal Reserve had moved toward greater reliance on influencing the cost, availability, and supply of credit through the discount mechanism, that is, by making it necessary for member banks to borrow from the Federal Reserve Banks a portion of the additional reserves required to meet credit growth. This mechanism limits credit expansion, puts pressure on banks, and makes them more responsive to changes in the discount rate. Under the conditions that existed during 1952 when there were strong demands for credit from both private and Government sectors of the economy, this policy resulted in bank reserve positions being under pressure throughout most of the year. Bank credit expansion with its resulting monetary growth, though adequate to meet the needs of the economy, was thus kept within bounds in order to discourage inflationary developments.

In these circumstances and in accordance with the policy approved by the Federal Open Market Committee on December 8, 1952, the Federal Reserve purchased substantial amounts of Government securities during December 1952 to assist the banks in meeting the sharp pre-Christmas currency outflow and an increase in required reserves. A large part of these purchases was made subject to agreements by Government securities dealers to repurchase the securities after a specified period and thus, when money market conditions permitted, to extinguish automatically the reserves that were created through the original purchases by the Federal Reserve. During the last week of December 1952, Federal Reserve purchases of Government securities under repurchase agreements rose to almost 900 million dollars, compared with just over 300 million a year earlier. After the close of the year there was the customary large return flow of currency to the banks which, along with other seasonal factors, eased their reserve position, with the result that by the third week in January of 1953, all of the securities sold to the System under these agreements had been repurchased. Member bank borrowings at the Reserve Banks, which were generally over 1.5 billion dollars during December, were also reduced somewhat in January.

The discount rates of the Federal Reserve Banks were increased from 1¾ per cent to 2 per cent around the middle of January 1953. Nevertheless, demand for credit continued strong during February, and it was the consensus of the Committee when it met in March that there was still reason to feel concern about the possibility of inflationary developments. The Committee agreed, therefore, that it would pursue a policy which would maintain about the same degree of restraint on credit expansion that had been followed in recent preceding months, a policy consistent with a stable price level and a high level of economic activity.

In adopting the above directive, the Committee did not have in mind a change in its credit policy. Thus, the change in wording of the clause to provide that the executive committee should arrange for transactions with a view, among other things, to "correcting a disorderly situation in the Government securities market" rather than for the purpose of "maintaining orderly conditions in the Government security market" represented a change, not in credit policy, but in policy as to operating techniques for the System open market account.

In addition to the change in the directive, the Federal Open Market Committee also unanimously approved (Mr. Vardaman, who was not present when the foregoing directive was approved, was present when the following actions were taken) the following policies with respect to operations for the System account:

(1) Under present conditions, operations for the System account should be confined to the short end of the market (not including correction of disorderly markets);

(2) 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);

(3) Pending further study and further action by the Committee, it should refrain during a period of Treasury financing from purchasing (1) any maturing issues for which an exchange is being offered, (2) when-issued securities, and (3) outstanding issues of comparable maturity to those being offered for exchange.

Adoption of the changed wording of the directive and of the three accompanying statements of operating procedures, which were to be effective under the conditions then present or pending further study by the Committee, grew out of a report to the Federal Open Market Committee by a special subcommittee which had made a comprehensive inquiry into the techniques of Federal Reserve operations in the Government securities market. The subcommittee found that a disconcerting degree of uncertainty existed in the Government securities market with respect both to the occasions which the Federal Open Market Committee might consider appropriate for intervention and to the sector of the market in which such intervention might occur—an uncertainty that was detrimental to the development of depth, breadth, and resiliency of the market. The subcommittee recommended that, as a means of eliminating this uncertainty, the Committee henceforth intervene in the market, not to impose on the market any particular pattern of prices or yields, but solely to effectuate the objectives of monetary and credit policy, and that it confine such intervention to transactions in very short-term securities, preferably bills.

The Federal Open Market Committee recognized that general credit policies adopted from time to time by the Committee, which would involve either putting reserves into the market or withdrawing them from the market, would affect prices and yields on Government securities. It was believed that a more self-reliant market in United States Government securities would develop if its intervention were solely to effectuate the objectives of monetary and credit policy and were carried out by making purchases and sales in the short end of the market, unless a situation developed which made it necessary for the Committee to operate in other sectors in order to correct a disorderly market.

The Committee felt that, under existing conditions, a procedure of confining operations to short-term securities would allow adequate flexibility in open market operations with a minimum of disturbance to prices and yields on longer term securities. The impact of System transactions in the short end of the market, where dollar prices of securities react least in response to a change in yield and where the asset value of securities is least affected, could be considered a normal market risk. The market would still reflect natural forces of supply and demand and thus furnish a signal of the effectiveness of credit policy aimed primarily at the volume and availability of bank reserves. (Mr. Sproul voted for the actions but does not agree with the statement of reasons given in this paragraph.) In adopting the procedure of confining operations to the short end of the market, the Committee did so under existing conditions, recognizing that it could not give a contractual assurance to the Government securities market as to the framework within which it would continue to operate. For similar reasons, and with the understanding that the procedure would be effective pending further study and further action by the Committee, the Committee decided to refrain during a period of Treasury financing from the practice that had been followed on previous occasions of purchasing "rights" evidenced by maturing issues, when-issued securities, and outstanding securities of comparable maturity to those being offered for exchange.

To put these operating procedures into effect under conditions then present or pending further study, the wording of the directive to the executive committee was changed, as stated above, to eliminate the provision that operations should be with a view "to maintaining orderly conditions in the Government securities market." In the past, this clause had provided the authority for intervention in other than the short-term sector of the market. It was felt that it should be changed since intervention "to maintain orderly conditions" might add to or subtract from reserve funds available to the market for purposes other than the pursuit of monetary and credit policies directed toward economic stability. Accordingly, in conjunction with the approval of the procedures with respect to operations for the System account set forth under (1), (2), and (3) above, the foregoing clause was eliminated from the Committee's directive and replaced by the authorization to intervene in the market for the purpose, among other things, of "correcting a disorderly situation in the Government securities market."

2. Minimum Buying Rate on Bankers' Acceptances.

At this meeting the Committee increased the minimum buying rate on prime eligible bankers' acceptances from 1¾ per cent to 2 per cent, subject to change from time to time by the Committee in order to carry out its policies.

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Johns, Mills, Powell, Robertson, Szymczak, Vardaman, and Young. Votes against this action: none.

This action was taken pursuant to a procedure adopted by the Committee at its meeting on June 19, 1952, under which the minimum buying rate on prime eligible bankers' acceptances is fixed by the Committee with the understanding that the effective rates shall be specified from time to time by the Manager of the System Open Market Account in the light of market conditions and developments and in accordance with directives or limitations by the full Committee or the executive committee for the purpose of carrying out current open market policy. At this meeting (March 4, 1953), the Manager of the System Open Market Account reported that the currently effective rate on the shortest term acceptances was 2⅛ per cent, and the Committee therefore increased the minimum rate from 1¾ per cent to 2 per cent as a means of reflecting more accurately existing market conditions and also of bringing the rate into line with the changed interest rate structure, including the increase to 2 per cent in Federal Reserve Bank discount rates in January 1953.

3. Abandonment of Statement of Terms upon which Federal Reserve Bank of New York Would Transact Business with Brokers and Dealers in United States Government Securities for the System Open Market Account.

Effective as of a date to be fixed by the executive committee of the Federal Open Market Committee, the system of qualification for dealers with whom the System open market account would transact business was abandoned, with the understanding that transactions would be carried on with any persons or firms actually engaged in the business of dealing in Government securities, and that price would be the main criterion for such transactions.

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Evans, Johns, Mills, Powell, Robertson, Szymczak, Vardaman, and Young. Votes against this action: none.

In February 1944, the Federal Open Market Committee adopted a statement prescribing the terms on which the Federal Reserve Bank of New York would transact business with brokers and dealers in United States Government securities for the System open market account. To qualify for this purpose it was required that a broker or dealer meet certain standards and agree to certain conditions. This statement of terms was published in the record of policy actions of the Federal Open Market Committee contained in the Annual Report of the Board of Governors of the Federal Reserve System covering the year 1944.

Pursuant to the decision reached at this meeting that the dealer qualification system was no longer needed, the following statement with respect to the action was released on April 15, 1953:

> The Federal Open Market Committee has discontinued, effective today, its requirement that transactions with the open market account be confined to dealers in Government securities who meet certain specified qualifications. The requirement, adopted by the Committee in 1944 to meet wartime conditions, is no longer deemed necessary or desirable now that open market operations of the Federal Reserve Banks are divorced from support of any pattern of prices or yields in the Government securities market. Discontinuance of the requirement was recommended by the Open Market Subcommittee appointed in 1952 to make a technical study of the operations of the System account.

4. Repurchase Agreements.

At this meeting the Committee amended, in the respects indicated below, the authority which had been given to the Federal Reserve Banks by the Committee's action on October 4, 1951, and amended on September 25, 1952, whereby the Federal Reserve Banks were authorized under certain conditions to enter into repurchase agreements with nonbank dealers in United States Government securities for the purpose of aiding temporary money market adjustments.

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Johns, Mills, Powell, Robertson, Szymczak, Vardaman, and Young. Votes against this action: none.

Prior to this meeting, such repurchase agreements were authorized only with nonbank dealers qualified to transact business with the System open market account. In view of the decision to discontinue the system of qualifications for dealers, referred to in the preceding entry, the Committee eliminated the requirement that repurchase agreements be only with nonbank dealers so qualified. In addition, the Committee modified the condition which previously limited such repurchase agreements to "short-term Government securities selling at a yield of not more than the issuing rate for one-year Treasury obligations," and provided that such agreements "cover only short-term Government securities maturing within 15 months." This change was made because it was felt that it would be preferable to relate the repurchase agreements to short-term Government securities of a specified maximum maturity, rather than to those bearing a certain yield.

JUNE 11, 1953

1. Authority to Effect Transactions in System Account.

The Committee adopted the following directive to the executive committee:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), 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 avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market), (c) to correcting a disorderly situation in the Government securities market, and (d) 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 2 billion dollars.
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> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) of 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 2 billion dollars.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Erickson, Evans, Fulton, Johns, Mills, Powell, and Robertson. Votes against this action: none.

In terms of credit policy, the foregoing directive placed emphasis on "avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market)," rather than "exercising restraint upon inflationary developments," as provided in the directive issued by the Committee at the preceding meeting in March.

The general objective of credit policy under both the March and June directives was one of keeping the supply of credit and money adjusted to the needs of a growing and high-level economy; the change in policy at this meeting reflected recent developments in the economic and credit situation. Commodity prices had remained fairly stable for some months, while output had continued at a very high level and had actually increased slightly further since March. Financial markets, on the other hand, had been unsettled at times during the spring months, particularly during late May, and throughout the period since March there had been an undertone of concern about potential declines in economic activity. Doubts had related to the strength of underlying conditions, concern having been expressed lest measures designed to limit credit expansion had become more restrictive than was desirable, setting in motion forces of decline which would be difficult to check. In recent weeks uncertainties had been increased by new developments in Korea. While attention was focused on the sharp advances in interest rates since mid-April, the cumulative effectiveness of monetary restraints had become evident in the financial and business community to such a degree that credit was more difficult to obtain than was considered to be desirable in terms of the Committee's policy approved at the March meeting—a policy of exercising restraint upon inflationary developments but at the same time keeping the supply of credit adjusted to the needs of a growing and high-level economy. Whereas the money supply, after adjustment for seasonal variation, had shown a rising tendency through April, there appeared to have been a greater than seasonal decline in May.

In considering the credit policy to be pursued henceforth, the Committee also gave attention to recent developments in the market for United States Government securities which had been subjected to a series of pressures that had resulted in generally lower prices and higher rates. Important among these influences was the failure of Treasury cash receipts to meet earlier expec-