FORTIETH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE

FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR
THE YEAR

1953

be directed with greater flexibility and versatility to meet any situation that might develop. While it would not necessarily be the objective to go into the long-term market (transactions for the System account since March had been confined to Treasury bills), it was felt that, in carrying out the Committee's credit policy, the executive committee should have discretion, particularly at times of Treasury financing, to make purchases in whatever areas of the market were under pressure so that there would not be unnecessary erosion of rates, affecting adversely investor and banking psychology and intensifying the restrictive effects of credit policy at the wrong time. Although it was recognized that purchases of Treasury bills would put reserves into the market, it was thought that such purchases might not be as effective as would be desirable in avoiding unwarranted changes in the Government securities market and that, since changes in that market might affect investment conditions generally, they were a factor to be considered in carrying out the aims of monetary policy. It was also believed that, so long as it was the policy of the Committee to put funds into the market, freedom to put them in where the pressures were greatest might minimize the amount the Committee would have to put in and thus help to achieve the purposes of monetary policy most effectively.

The members of the Committee who voted for the first motion, by Mr. Mills, and against the second, by Mr. Sproul, felt that it was better, as a general policy, to confine System account operations to the nearest thing to money, that is, short-term Treasury securities—preferably bills—except in the case of correcting a disorderly market. Their concept of the open market operation was that a minimum burden should be put on the open market account or the Open Market Committee for determining what the market should be; and that, therefore, there should be some general rule for the guidance of the Manager of the System Account. While they recognized that conditions had changed in recent months, they did not feel that the procedures approved at the March meeting had had a test. They were opposed to changing the policy which the Committee recently had been following because they felt such a change would not benefit the Government securities market but might actually harm it through deviating from a policy toward which the Committee had been working over a period of two years, and because they believed that purchases of Treasury bills would be equally as satisfactory as purchases of longer-term securities in carrying out the monetary and credit policy approved at this meeting.

September 24, 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 (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to avoiding deflationary tendencies, (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, Robertson, Szymczak, and Vardaman. Votes against this action: none.

This directive provided that transactions in the System open market account should be with a view "to avoiding deflationary tendencies" rather than, as had been agreed at the meeting on June 11, 1953, "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)." This change in wording reflected a policy that the Committee described as "active ease" under which reserves would be supplied to the market to meet seasonal and growth needs, recognizing that open market operations should be flexible in relation to the volume and timing of supplies of reserves from other sources. At the time of the September meeting, adjustments taking place or in prospect in the economy caused the Committee to believe that the danger of further inflationary tendencies was much less than the possibility of deflationary developments.

General economic activity had continued close to peak levels since the last meeting of the Committee on June 11, and average commodity prices had shown little change. Total output had been maintained at about the advanced levels of the spring, and unemployment had continued exceptionally low. Yet recent adjustments in the economy, although not supported by firm evidence in current statistics pointing to imminent decline in general activity and prices, had caused business and financial opinion to be uneasy about prospective business trends. There had been moderate declines in real estate and construction activity, in personal incomes, and in retail sales, and there was some evidence of increasing inventories. The economy appeared to be entering a new phase in which it would be called upon to absorb resources freed by reductions in defense outlays and inventory accumulation, and there was a question about the ability of other demands to expand sufficiently to maintain current record levels of activity. There was also the possibility that the softening that had developed in an increasing number of markets could be a forerunner of a more general reaction, unless offset by expansion elsewhere.

With respect to bank credit, total loans and investments had declined somewhat in the period immediately preceding this meeting, reflecting partly sales of Government securities as well as less than the usual seasonal expansion in business loans. Increases in private holdings of demand deposits and currency since midyear had been below usual seasonal expectations. This reduction in bank credit had not resulted from tighter money conditions; recently there had been a much easier credit situation than had existed during the spring months, owing to both an increased availability of and a less urgent demand for credit.

These easier credit conditions resulted primarily from the reduction in member bank reserve requirements which was announced by the Board of Governors of the Federal Reserve System on June 24, 1953 and which released around 1.2 billion dollars of reserves, and from the addition by the System open market account of a little over 1 billion dollars of reserves to the market through security purchases during the period June 10-September 23. The addition of these reserves was more than enough to offset drains of funds that had resulted from various factors during the period. Reflecting these conditions, yields on long-term securities of various types receded during the summer after reaching peaks in June and they continued stable at the lower yield levels during August and early September. Prices of United States Government securities advanced sharply during the three-month period.

Despite the much easier credit conditions that had developed in the open market since the June meeting, it appeared in September that, in general, credit was not as readily obtainable as would be desirable and that further easing would be needed to assure ready availability of credit during the fall months when customary seasonal factors would be accentuated by additional Treasury financing. Under these circumstances, the Committee authorized the pursuit of the policy of "active ease" referred to above, and changed the wording of the directive as indicated.

Further consideration was also given to the action taken at the meeting of the Committee on June 11 rescinding the understandings approved at the March meeting that operations for the System account be confined to the short end of the market (not including correction of disorderly markets) and that during a period of Treasury financing the Committee should refrain from purchasing (1) maturing issues for which an exchange is being offered, (2) when-issued securities, and (3) outstanding issues of comparable maturities to those being offered for exchange. (Following the meeting of the full Committee on June 11, the executive committee decided by majority vote to confine operations, under the first paragraph of the directive set forth above, exclusively to Treasury bills.) At the September 24 meeting, the following action was taken by the Committee:

> Mr. Mills moved that the Federal Open Market Committee take the position that operations for the System account in the open market 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.
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> After discussion, Mr. Mills' motion was put by the Chair and carried.
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> Votes for the motion: Messrs. Martin, Chairman, Erickson, Evans, Fulton, Johns, Mills, Robertson, Szymczak, and Vardaman. Votes against the motion: Messrs. Sproul, Vice Chairman, and Powell.

The reasons for the approval of this action were substantially those stated in opposition to the action taken by the Committee at the meeting on June 11 in rescinding the policies adopted in March regarding these two points—the confining of operations to short-term securities and refraining from purchases of certain securities during a period of Treasury financing. It was felt that the Committee should have some general rules for the guidance of the management of the System open market account in conducting operations to carry out the general credit policy of the Committee; these general rules should not leave too much discretion to the executive committee; and if such rules relating to broad operating procedures were to be changed, any change should be authorized by the full Committee. Specifically, it was the view of those voting for Mr. Mills' motion that, to assist in the development of a self-reliant market, it was desirable to confine operations for the System account in the open market to the nearest thing to money, such as Treasury bills, and that if there were to be any change from this position, such a change should be determined upon by a meeting of the entire Federal Open Market Committee, not by the executive committee. It was also the view of those voting for this motion that to assist in the development of depth, breadth, and resiliency in the Government securities market, the practice which had been followed for some months of refraining from purchases of certain Treasury securities during periods of Treasury financing was desirable. It was noted that the adoption of this practice had not been reflected in an unfavorable experience on the part of the Treasury in its refunding operations.

In adopting the policies stated, which were to be followed until such time as they might be superseded or modified by further action of the Federal Open Market Committee, it was made clear that the Committee could change these policies at any time it might wish to do so in the future in the same way that it could change any other policy which it had adopted; and it was noted that a meeting of the Federal Open Market Committee could be convened on 24 hours' notice if necessary for the purpose of considering a change in these or other policies.

The members of the Committee who opposed adoption of the policies embodied in this action expressed substantially the views that had been stated in favor of the action taken at the June meeting in rescinding similar policies that had been adopted in March. There was a concern that the Committee was trying to write into a "constitution" of the Open Market Committee a prohibition against actions deemed undesirable by the Committee at a particular time; that the resolution put into the form of a continuing directive a matter which should be considered, in the light of existing conditions, at each meeting of the Committee and its executive committee. They felt it preferable for the executive committee of the Federal Open Market Committee to be free to use its judgment, within the limits of the Committee's general credit policy at the time, as to the best method of achieving the objectives of credit policy, in whatever circumstances might arise between meetings of the full Committee.

December 15, 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 (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to promoting growth and stability in the economy by actively maintaining a condition of ease in the money market, (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, Robertson, and Szymczak. Votes against this action: none.

This directive was changed to provide, as the central objective of current credit policy, that transactions for the System open market account should be with a view "to promoting growth and stability in the economy by actively maintaining a condition of ease in the money market." The corresponding clause of the directive issued by the Committee at its meeting on September 24, 1953, provided that transactions be with a view "to avoiding deflationary tendencies"; at the June 1953 meeting, the instruction read, "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)"; and in March 1953, the Committee had directed, in this respect, that transactions be with a view "to exercising restraint upon inflationary developments."

These clauses in the directives issued by the Federal Open Market Committee at its meetings in 1953 indicate the adjustments made in credit policy to adapt it to the unfolding economic situation. The opening months of the year were characterized by a very high level of economic activity, a strong demand for credit, continued growth in the money supply (seasonally adjusted), and, despite fairly stable commodity prices, more reason for con-