

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, September 11, 1956, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Erickson
Mr. Johns
Mr. Mills
Mr. Powell
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Fulton, Alternate

Messrs. Bryan, Leedy, Treiber, and Williams,
Alternate Members, Federal Open Market
Committee

Messrs. Leach, Irons, and Mangels, Presidents of
the Federal Reserve Banks of Richmond, Dallas,
and San Francisco, respectively

Mr. Riefler, Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Abbott, Parsons, Willis, and Young,
Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Sherman, Assistant Secretary, Board of
Governors
Mr. Miller, Chief, Government Finance Section,
Division of Research and Statistics, Board
of Governors
Mr. Gaines, Manager, Securities Department,
Federal Reserve Bank of New York

Mr. Mitchell, Vice President, Federal Reserve
Bank of Chicago

Upon motion duly made and seconded,
and by unanimous vote, the minutes of the

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meeting of the Federal Open Market Committee held on August 21, 1956, were approved.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations during the period August 21, 1956, through September 5, 1956, and at this meeting a supplementary report covering commitments executed September 6 through September 10, 1956, was distributed. Copies of both reports have been placed in the files of the Committee.

Mr. Rouse called attention to projections prepared by the New York Bank and by the Board's staff which indicated that a fairly easy situation would develop during the next ten days, largely because of a mid-month rise in float, and which might require some selling of bills by the System account. He thought that the relative ease that might develop need not concern the Committee especially, believing that the situation in the capital markets, including uncertainties in the minds of underwriters and the general atmosphere this would create, would offset any statistical ease that might develop during this period.

In response to a question from Mr. Shepardson, Mr. Rouse stated that he still would contemplate that an occasion for selling some securities from the System account would arise, perhaps beginning tomorrow, in addition to permitting maturing bills to run off during the current week as well as next week.

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Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period August 21 through September 10, 1956, were approved, ratified, and confirmed.

Mr. Young made a statement on the economic situation substantially as follows:

The composite of most recent economic data confirms a rising trend for aggregate demand and supply, sustained vigor in the demands for credit and capital, and a confident business and financial psychology. The wholesale price drift of fabricated industrial products appears still to have an upslant, but for materials and farm products a levelling-off tendency has been evident. Upward drift of consumer prices has been further extended. Abroad, although rates of output expansion have been slackening because of resource limitations, the situation remains generally strong, with price levels firm or rising. International markets continue alert to possible worsening of the Suez crisis.

Recent developments meriting highlight comment include the following:

(1) The Commerce-SEC survey of business plant and equipment expenditures for the fourth quarter shows a further rise of about the same average quarterly amount as during the past year and a half. These expectations, if realized, will result in an annual rate of expenditure for the fourth quarter of about \$38 billion and in an annual expenditure for the year as a whole of \$35.5 billion, one-fourth higher than for the year 1955. The indicated further rise in expenditures will be general for all industry groups except mining which expects to about maintain a record volume of investment.

(2) The Board's index of industrial production for August is now estimated to have about recovered its May-June level and in September is expected to exceed it. Steel output is pressing against rated capacity; minerals output is close to earlier advanced levels; producers' equipment activity (except farm machinery) is rising; automobile parts manufacturing is expanding; and nondurable goods output, which has been stable at reduced levels for some months, is reported to be under stimulus of an increased flow of orders.

(3) Retail markets except for new automobiles have been showing considerable strength. Sales of household durable goods at retail reached a new high in July and were at least close to

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the June rate in August. New auto sales in August were down 6 per cent further from July to 27 per cent under a year ago, but used car sales continued at the July rate (about 15 per cent under last year) and used car prices after allowance for depreciation rose slightly further. Department store sales over-all in August held at a seasonally adjusted rate of 127, down 1 point from the record July level but well above August a year ago. Consumer instalment credit has apparently continued to rise in the third quarter at about the same monthly rate, seasonally adjusted, as in the second quarter.

(4) Construction activity in August maintained but did not exceed the record annual rate of July. Industrial construction held steady for the first time this year. Commercial construction rose, but was under its spring peak. Residential construction continued stable at about 12 per cent under the record level of last year.

(5) Employment for August showed a record high and unemployment showed more than the usual seasonal decline. The level of unemployment was about at the year-ago level--2.2 million. Average hours of work remained close to the level of the past three months, but average hourly earnings and weekly earnings were up.

(6) Price increases of finished industrial items and some manufactured materials have been numerous in recent weeks and further markups, notably an increase of perhaps 7 per cent on new model cars and trucks, are soon to be announced. Outside of metal lines, further price increases for cement and a few industrial chemicals are worthy of note. Industrial material prices, after rising in early August, have been offsetting in recent weeks. Farm prices, reflecting sharp declines in vegetable and fruit prices, have been off from July, but reflecting strength in livestock, grains, and dairy products have averaged above a year earlier.

(7) Farm price developments, with larger marketings and soil bank payments, still point to a higher net realized income for farm operators than last year.

(8) The consumer price index rise of .7 per cent for July so surprised the Bureau of Labor Statistics that a complete double check of data was felt necessary before release of the figures. The rise particularly reflected higher food prices but other prices also edged up. Since mid-July, prices of many fabricated consumer items and services have advanced further so that additional increases for the index may be expected to mid-September.

(9) Abroad, demand continues to press against resource limitations, and both central bank and fiscal actions to cope

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with financial pressures continue to be reported. In such key countries as Germany and Great Britain the evidence of recent data suggests that financial actions to contain inflationary pressures have been progressively effective in bringing about a better balanced demand-supply situation domestically and a better balanced payments position internationally.

Mr. Thomas said that financial markets have now crossed the threshold of fall seasonal demands which will be added to already existing large cyclical and growth demands for credit. The interest rate structure as well as the level of interest rates is close to that characteristic of a high level economy, the first time such a relationship has existed except for temporary emergencies in twenty-five years or more. The 3 per cent Federal Reserve discount rate is more a manifestation of this situation than a factor in bringing it about. In fact, it is questionable whether, with the economy threatening to burst at the seams, so low a bank rate can be justified. There is no evidence that restraints are too severe, Mr. Thomas said, noting that credit demands are being met although there are indications that the restraints may be keeping down expansion. The current policy questions are how much restraint should be maintained during the fall period of seasonal demands and how should this restraint be exerted.

Mr. Thomas noted that prospective Treasury borrowing needs are now estimated to be a little larger than was expected earlier; it now appearing that the Treasury will need an additional \$3 billion of new funds in October and perhaps a total of \$6.2 billion for this half

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year, compared with \$9 billion in the 1955 period. The Treasury will be in position to retire perhaps \$8 billion of marketable debt in the period from January to June 1957, and the careful planning of current borrowing as to types and maturities of issues will have a bearing upon the program of debt retirement that will be possible.

Capital markets continue under pressure of past, current, and prospective offerings, Mr. Thomas said, and there is a heavy schedule for the remainder of the current month. Corporate issues for the third quarter of this year will total about a third more than in the third quarters of 1954 and 1955, although State and local issues are expected to be less than in previous years. Interest rates have not risen much further since discount rates were increased in late August although long-term bond yields have continued a tendency to rise. Long-term Treasurys are now yielding about 3-1/4 per cent and high grade corporate bond yields are above 3-1/2 per cent, with new offerings bringing close to 4 per cent. Treasury bill yields recently have fluctuated between 2.65 and 2.80 per cent, with this week's auction at 2.77 per cent.

Total loans and investments at city banks increased during the past six weeks following a decrease in July. Taking the ten weeks since the end of June as a whole, total loans and investments showed little change, whereas this total declined during the corresponding period of 1955. Loan expansion has been much less than last year, when banks sold

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large amounts of Government securities to make loans. They have been unable or unwilling to effect such sales in any quantity this year. This change probably reflects the impact of restraint measures. The money supply appears to have declined in August this year, Mr. Thomas said, contrary to the usual seasonal lack of change, but the decline followed seasonally adjusted increases in June and July. Over the past year, growth in the money supply has been barely 1 per cent, but velocity has been at an increased level and continued high through July and apparently also during August. Time deposits increased by 5 per cent and U. S. Government deposits are temporarily higher.

Mr. Thomas noted that the System has made substantial purchases of United States securities during the past three weeks in order to supply reserves to meet seasonal needs for currency and credit expansion. Net borrowed reserves have ranged around \$350 million but pressures on banks have not been especially severe.

Mr. Thomas then presented chart slides showing weekly variations in reserves and the principal factors that have affected them over the past three years, with projections covering the remaining weeks of this year. Comparison was also shown with the monthly projections that had been made by the staff in March of 1956, and the variations of the actual from the projected figures indicated both reasons for and consequences of policies followed in the period. The projections for the remainder of this year indicated that seasonal

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needs along with some growth in deposits and currency would call for around three-fourths of a billion dollars of reserves to meet additional reserve requirements and for about the same amount to meet added currency demands, including a growth factor of around \$300 million. To maintain net borrowed reserves at around \$350 million and to provide for the seasonal and growth demands assumed, Mr. Thomas suggested that System purchases of securities of around \$1.1 billion would be needed after allowing for a considerable expansion in float during November and December. He felt that it was neither necessary nor desirable to offset completely the mid-month or end-of-month increases in float that would be expected.

Policy questions presented, Mr. Thomas suggested, were: Whether these demands for bank reserves should be met entirely through open market operations? Whether in view of the strength of demand pressures banks should be required to borrow more to cover their reserve needs? Whether the reduced liquidity of banks might make them more sensitive to a small volume of borrowing? If complacent borrowing is evident, Mr. Thomas expressed the view that a further increase in the discount rate would be appropriate.

Chairman Martin then called upon Mr. Hayes, who made a statement substantially as follows:

1. Nothing has occurred in the last three weeks to alter fundamentally our appraisal of the business and credit outlook. Inflationary tendencies still appear to be dominant.

2. Indications are that demands from business, consumers, and governmental bodies will continue to increase through the remainder of 1956. With the labor force already at a record level, and with many industries operating at near-capacity rates, it is not surprising that we have seen so many price increases, not only for basic raw materials and for capital goods in general, but also for many consumers' items.

3. Our most recent estimates of Treasury financing indicate a smaller cash surplus than was expected earlier. In addition the redemption of Series F and G Savings Bonds and Investment Series A Bonds has been accelerating rapidly as the yields on marketable issues have advanced. It now appears that the Treasury will have to borrow a minimum of \$3 billion additional in 1956. If there is high attrition on the December certificate refunding and if the redemption of nonmarketable issues increases further, the Treasury may have to borrow more. We expect that they will have to borrow early in October, and possibly again in December.

4. While it is impossible to gauge accurately the fall demand for bank credit, the latest figures on bank loans suggest gains at least equal to normal seasonal expectations, and in addition there is some tendency for borrowers to shift from the capital markets to the commercial banks. At the same time the backlog of new corporate and municipal bond offerings remains very large. Parenthetically, we have been told by a number of leading New York bankers that they are fully aware of the need, under present conditions, to resist the trend toward use of bank credit for capital purposes. However, they have also stressed the difficulty of turning down good customers, especially in view of competitive considerations. Some of the bankers would apparently like more moral support from the System to meet this problem, but we feel that such support has been given adequately by our actions themselves.

5. Evidence of the general effectiveness of the Federal Reserve System's policy of credit restraint may be found in the relative stability of the total money supply, and in the continuing upward trend of medium- and long-term interest rates.

6. The market's reaction to the recent increase in Federal Reserve discount rates was about as expected. There was some "settling" effect, which has not, however, prevented a continued expectation of lower bond prices and higher interest rates.

7. While another increase in the discount rate would not seem to be called for at this time, the inflationary outlook

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warrants a policy of continued credit restraint, with a gradual probing approach toward increased restraint. This could take the form of permitting seasonal needs to emerge first at the discount window and then to be replaced only partially through open market operations. Recognizing that the current needs for reserves are in large part seasonal, the banks might be less reluctant to borrow than at other periods of the year. In this way additional restraint could be developed through the natural activities of the banking system itself.

8. The next two weeks present some difficulties in getting started with such a program, chiefly because very large gains in float will tend to cut net borrowed reserves to about zero, in the absence of open market operations, as compared with a recent level of around \$350 million of net borrowed reserves. Sizeable sales of Treasury bills for System account will probably be necessary in the next week or so. The extent and timing of these sales will of course have to depend to a considerable extent on the "feel" of the market. Recognition of the temporary nature of the bulge in float may make it possible to maintain the present degree of restraint even with a lower figure of net borrowed reserves, but in any case additional member bank borrowing is not likely under these conditions. After this two-week period of above-average float has been dealt with, there may be opportunities for application of gradually increasing pressure in the form of larger member bank borrowings, subject of course to the need for considering the Treasury cash financing which is expected in October.

Mr. Johns said that much of what he had in mind to say had already been suggested this morning. He recalled that three weeks ago he had expressed the opinion that it would be undesirable to attempt under existing circumstances to apply more pressure by further restrictions on credit availability and that he hoped added pressure could be brought about through increasing the cost of credit. The net result of his study of the situation during the past three weeks had led him to the conclusion that in the period between now and the end of this

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year, the figure of net borrowed reserves would be less reliable as an indicator of the degree of pressure under which the commercial banking system should be placed. The liquidity of the banking system has been impaired and bankers are concerned about that factor, Mr. Johns said. In addition, the proportion of loans to deposits and of loans to assets has reached such a stage that bankers are actively concerned about that situation. As a result, there is a very substantial amount of restraint at present and a considerable reluctance on the part of banks to make loans and to do the things that are necessary unless banks can count on additions to their reserves. Mr. Johns noted that his conclusion that the net borrowed reserve figure would not serve as a satisfactory indicator of restraint for the banking system did not solve the Committee's problem. However, discussions with members of his staff had brought him to the conclusion that there is a seasonal loan demand that should be accommodated during the rest of this year and which the System should not fear to accommodate. It was difficult to sort out credit that represented desirable expansion from that which should be inhibited, particularly the spillover of bank credit into the capital markets. Nevertheless, he felt that the Committee should observe closely the behavior of loan volume and that pressure should be gauged partly by the loan volume that developed. The Committee should be careful that it not inadvertently apply more pressure than wanted.

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Mr. Johns also noted earlier comments regarding fluctuations in float and, while he did not wish to minimize the importance of studying that question, he suggested that officers of commercial banks either consciously or unconsciously make allowance for float and, for the most part, rule out brief monthly increases in its volume as a source of reserves for credit extensions, recognizing them as temporary additions only. The Committee should not make frantic attempts to offset these fluctuations in float, Mr. Johns said, lest it attempt to adjust for something that the commercial banking system adjusts for in stride. He therefore would concur with the suggestion that the Committee not be too concerned about the bulge in float that would come in the next two weeks, and he would not be too eager to offset such a bulge through open market operations.

Mr. Bryan made a statement substantially as follows:

The major economic shift in the Sixth District has been a quickening pace of consumer spending, reflecting record-breaking payrolls. This development has been aided by the settlement of scattered labor disputes, which in August probably sent nonfarm employment to a new high. Earlier gains over a year ago in agriculture, however, have been reduced by lack of moisture in many areas. There are also increasing reports that the restraining monetary policy is having the desired effect of slowing down planned investment expenditures.

On the financial side, total loans increased slightly in August, but the rise was probably less than seasonal. District security and real estate loans were the only types to gain significantly, and we have the impression that a considerable amount of real estate speculation is continuing--despite the fact that mortgage credit is scarce and builders generally report difficulty in arranging permanent financing and construction loans as well.

Borrowing from the Federal Reserve Bank has declined and excess reserves have risen. Unborrowed reserves in August averaged a small positive figure.

With regard to the problem of policy, Atlanta is impressed by the following considerations:

1. Recent news continues to confirm the mid-summer price bulge; and the weight of logical expectation is for a further upward slant in final-user prices during the next few months.

2. The appearance of other background factors that may be of importance:

a) An apparent dampening, as it seems to us, of the wildly ebullient mood so universally in evidence some weeks ago;

b) Some evidence that capital expansion plans are being cancelled in a few cases, fringe items eliminated in other cases, and fulfillment stretched out in still other cases;

c) The declines in new orders for heavy equipment and an apparent hesitation in construction and residential building.

3. An apparently weak, as it appears thus far, fall expansion in loans. This appears to us related to the fact that total reserves of the banking system in August were, practically speaking, identical with the reserves a year ago; and, hence, an expansion of loans can only be accomplished by means that are becoming increasingly distasteful to the banking system. At the same time, the privately held money supply, as distinguished from bank reserves, is apparently now no higher than it was a year ago.

In trying to evaluate the foregoing and other considerations, some of them largely intuitive, I come to the following conclusions:

1. There is no adequate, present evidence justifying a change of monetary policy. For the immediate present, monetary policy should remain as is, neither easing or tightening its money-rate effects, and being especially careful to guard against an inadvertent easing or tightening.

2. Monetary policy has by now placed the economy in a situation of genuine rather than illusory restraint. I believe that present policy, by its dampening effect on the economic boom, is serving the public interest.

3. I also believe that failure to meet a developing seasonal need for reserves could easily place the economy under a degree of restraint that is undesirable and that we do not presently intend. There is at the moment, in my view, no reason to supply reserves in such quantity as would weaken the

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general structure of money rates and there likewise is no present reason to contemplate so niggardly a supply of reserves that money rates, by an increase in yields, would signal an increased tightening.

In the light of these ideas, and the substantial estimated changes in float, first increasing and then decreasing in the weeks immediately ahead, and in the light of the imponderable reactions of the money market to a given level of negative free reserves, it would seem to me wise not to aim at a particular level of negative free reserves nor to base the account's sales or purchases on our statistically adept, but so often mistaken, estimates of float behavior.

Instead, it would seem to me wise to base account action, not on preconceptions--if I may be forgiven for so calling them--of float or negative free reserves, but on the actual behavior of the market. The consensus of the market, by the behavior of price changes over the whole range of the yield curves, is likely to be a more revealing guide to a developing ease or tightness than are our seasonal derivations of float or our aimed-at level of free reserves. It seems to me that we may want in the next weeks or months to shift policy in the light of developing economic conditions, either easing or tightening as a developing complex of economic and financial factors may indicate; but we will want to avoid inadvertence in our action; and so it would seem to me best to keep in mind the fact that money availability and money demand take effect in money rates, which are the equating price that clears the supply and demand sides of the market.

Thus, if float makes it necessary to sell bills from the portfolio in the next few weeks, I would wait until the consensus of yield changes in the yield curve tells us that money rates are easing and that, if we do not want ease, which I do not at this time, we should be taking countervailing action. Likewise, if purchases are called for later on, it would seem to me prudent to wait until the consensus of the market, by the behavior of price changes throughout the yield curve, tells us that money rates are tightening and that, if we do not want tightening, we should take countervailing action. By pursuing policy in that way it would seem to me possible to avoid in a measure the risk that we will create an ease or a tightness that we do not intend, that we have sometimes effected in the past, and that I think could easily occur in the next weeks and months.

In closing, I would like to bring up for further consideration a suggestion that I have previously advanced, and that is not, I know, before this body. That is, I should like to raise again the question of whether or not, beginning sometime in the next few weeks, it might be wise to schedule a one-percent reduction in reserve requirements on time deposits. The following thoughts occur to me in that connection:

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1. The seasonal requirements for reserves are going to be massive. The reserves released by the suggested reduction on time deposits, about \$400,000,000, would leave ample room for Open Account maneuver, so that we would in no sense lose command of the reserve situation.

2. The reductions could be announced but scheduled a quarter of a per cent per week over a four-week period, or even at longer intervals, thus putting no large volume of reserves in the banking system at one time.

3. Over forty-eight per cent (48.4 per cent) of the reserves thus released would be placed in country banks, which account for only 27.5 per cent of the seasonal loan expansion.

a) There would thus be no sudden easing in the market;

b) The reserves would not go in major part into the banks where the capital loans of large corporate borrowers are coming to rest;

c) The reserves would eventually become available to the banking system; but the process would require a good deal of scrambling by the commercial banking system to get the reserves to the places most needed. This factor, coupled with the modest amount of the reduction, and the scheduling of the reduction over a period of time would give double assurance that no sudden ease would appear.

4. The action would be taken as an approbation of those banks that are struggling to maintain their place in the savings field. I believe, for a variety of reasons not here pertinent, that that struggle on the part of many banks is in the long-run best interest of the banking system and in the national interest.

5. The account, what with its present portfolio and additional necessary purchases of bills through the fall season, would seem to possess sufficient bills to restrain an excess easing tendency after the year-end if monetary restraint still seems called for by economic conditions at that time.

Mr. Williams said that the evidence available in the Third District was at variance with that presented by Mr. Bryan for the Sixth District. He noted that a few days ago U. S. Steel Corporation had made known plans for an additional \$95 million expansion in its Fairless plant during the next eighteen months, and a smaller steel company also had announced an additional expansion of \$16 million in its plant.

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Mr. Williams said that the Philadelphia Reserve Bank had made another of its quick surveys of firms that sell industrial equipment. His report of the information thus received indicated that, except in the case of a textile firm, these companies were going ahead with capital expenditure plans, that backlogs were still large, that one important supplier's orders now on the books are sufficient to make the company's 1956 sales budget, and that a pickup in activity during the fourth quarter of this year is anticipated. However, the thought was expressed by one individual that the peak of new orders may have been passed. Mr. Williams stated that in agriculture this year's results were turning out better than anticipated somewhat earlier; production would be very good and income might rise 5 per cent above that of last year. Factory construction contracts were up substantially during the first seven months of this year as compared with last. Taking the situation as a whole, Mr. Williams said that the economy of the Third Federal Reserve District was at a high level, that demand for bank credit was continuing strong, and that borrowings from the Federal Reserve Bank continued high. He was concerned about their participation in the seasonal credit demands that could be anticipated from other districts. One of the large Philadelphia banks which over the years has participated in moving the cotton crop, recently notified its Memphis correspondent that it would not have funds available to meet those needs this year. Some

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of the country banks that had been steady borrowers but which had gotten out of debt are now back at the discount window on a seasonal basis. Seasonal demands plus demands for other than seasonal requirements indicate a need for the Reserve Bank to increase pressure, Mr. Williams said, and he had in mind calling in some of the country banks to discuss the situation with them, the outlook having reached a point where discounting must be tailored to the individual bank's needs. The Reserve Bank is watching the situation carefully to avoid affecting adversely the seasonal demands, he said, since failure to create such credit might result in a public press that could make more difficult the handling of the total situation.

Mr. Fulton said that if there were any pessimists in the Cleveland District they were very quiet at the present time. The whole tone of business is one of expectation for a very high fourth quarter. Steel mills in the area are operating at a very high capacity and are reluctant to take additional orders. He also noted large capital expenditure plans recently announced in the Cleveland District. Mr. Fulton said there was a large and continuing demand for loans in the Cleveland District which bankers had described as insatiable. Many of these loans classed as commercial loans are for fixed asset purposes for long terms, he said, noting that some of the borrowers had been continually in debt to the banks for as much as five years. In other words, the so-called commercial loans in some cases did

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not have liquidity because they were in fact for fixed asset purposes, and he felt this a dangerous aspect of the situation. The question of what was a reasonable way in which to handle the kind of demands that were coming up, along with the seasonal expansion which necessarily must be met, was thus presented, Mr. Fulton said. His view was that between now and the next meeting reserves should be supplied rather reluctantly. Seasonal factors should be permitted to tighten the situation and banks should be permitted to borrow to obtain needed reserves--he could see no evidence that banks were reluctant to come into the Reserve Bank to borrow for that purpose. If the System supplied the reserves to meet these various demands without restraint, it would be adding to the forces making for price increases. The major source of any added reserves in this situation should be the discount window rather than open market operations.

Mr. Shepardson said that it seemed to him that the general picture was much the same as it has been for some time and that there was still need for the same level of restraint that has existed recently. In fact, he had wondered whether the restraint had been as great as it should have been. Some of the comments this morning indicated an encouraging situation in his view by suggesting that perhaps the restraint was beginning to take hold; it would be unfortunate if the System now let the complaints as to restraint lead it to any easing in the situation. Upward price pressures were still

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strong and probably would increase, and the System should try to curb those pressures and to keep bank credit from going into the capital markets. Mr. Shepardson agreed that normal seasonal demands should be met, but there should be sufficient restraint in doing so to try to avoid having the credit dissipated into other areas. He felt there was merit to the suggestion that reserves be supplied at least in large part through the discount window rather than through the System account. Whatever could be done to bring further pressure and to discourage continuous borrowing by banks at the discount window should be done. Perhaps there should be closer screening of discount window activities, and consideration should be given to a differential discount rate that would discourage continuous borrowing.

Mr. Robertson said that it seemed to him that the biggest factor in the picture today was the increase in inflationary pressures. The System has not been tight enough, he said, and it is continuing to make too much credit available. The economy is reaching a point where the mass of people over the country as a whole are inclined to want to buy things for fear prices are going higher and higher. At the moment, the situation has not become too bad, but we are edging further towards it. The System has been too easy in its policy for a long time, he felt, and he was very glad to hear the cries of bankers with respect to the degree of tightness that now exists. He hoped that in the future, at least during the period between now and the next meeting, nothing

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would be done to ease the situation. He agreed that the Committee need not offset the entire amount of float that would arise during September but it should offset a sufficient part of it to maintain the degree of tightness that exists at the moment. As soon as this period of ease has passed the Committee should tighten up the situation. Tightening should develop through permitting increased borrowings at the Federal Reserve Banks, with the pressures that that would bring. Perhaps we were approaching the point where a shock treatment was needed. Mr. Robertson said he did not care what criteria were used in judging the situation, so long as the System did not make so much money available as to feed the inflation that is taking place. He did not feel that we were near the point where the Committee should consider a turn about, believing that the great fear now is that too little action will be taken and that the public will become frightened with respect to inflation and will increase its buying activity.

Mr. Mills said that his view of the situation was decidedly at variance with the views expressed by Mr. Robertson and was in complete agreement with the analysis submitted by Mr. Johns. There is a restrictiveness in the present banking situation that does not show up through any level of free reserves or through any other criterion. That being the case, Mr. Mills said that he had welcomed what seemed to be a moderation in System action over the past two weeks, during which the level of negative free reserves fell. He was still

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fearful of an overly severe monetary and credit policy which could ultimately place a heavy burden on the consumer elements in the economy through failure to take into account the lag between System action and economic reaction. Such an overly restrictive credit policy could result in shrinking the very markets that must be relied upon to pick up the output of the increased productive capacity that is coming into operation. Without that output going through the markets and on into the hands of consumers, we could aggravate a problem that would be difficult to handle through future policy actions. Therefore, the attempted correction of any potentially surplus productive capacity might better be left to itself rather than risk unduly shrinking markets by means of restricting the availability of credit.

Mr. Mills said that he shared the opinion that the Committee should not allow itself to be greatly concerned about fluctuations in the volume of float. The banking fraternity understands those changes and the Committee should not seek fully to offset fluctuations in either direction, especially at present when we are on the threshold of a new Treasury financing program. The Committee must take some responsibility for the indifferent success of the last two Treasury financing operations, he said, and if we try too hard to offset float fluctuations we might handicap the Treasury's financing plans by confusing investors as to System intentions. We should follow a policy of moderation, keeping a watchful eye on the general condition of the money markets.

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In that connection, Mr. Mills felt that the Committee had a special obligation, within the limits of a policy of prudent credit restraint, to foster stability in the U. S. Government securities market.

Mr. Leach said that economic conditions in the Fifth District have been following about the same pattern as in the country as a whole. Production of bituminous coal is running about 11 per cent above a year ago. Shipyards at Newport News and Baltimore have recently received new contracts for six tankers and three ammunition ships. Department store sales for August approximated the new high reached in July. On the other hand, the textile industry which is very important in that district continues to evidence no boom. Informed people in the industry state that new orders during the next three weeks will be crucial for the state of the industry during the remainder of this year.

Mr. Leach referred to the action taken by the Richmond Bank in increasing the discount rate last month, noting that the directors at that time had asked that the First Vice President (in Mr. Leach's absence) convey to the Board of Governors the suggestion that the Board consider including in its announcement of approval a statement to the effect that there was a limit to what this change in the rate could be expected to accomplish. Mr. Leach said that the directors were concerned over any possible implications that this discount rate change by itself could or was intended to reverse the probable price pressures resulting from recent labor cost increases. Mr. Leach went on to say

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that he personally did not think the announcement of the discount rate increase would have been the best occasion for such a statement although he agreed that the System might intensify its informal efforts to dispel the idea that monetary policy by itself could correct any and every distortion in the economy. Mr. Leach emphasized that this did not mean that either the directors of his Bank or he had a defeatist attitude. To the contrary, they favored continuing a restrictive credit policy directed toward dampening expansion. The System's present policy was having that effect, Mr. Leach said, and he was convinced that member banks, particularly the larger ones, are quite aware of the importance of screening loans and are actively doing so. At the same time, he recognized that some of the reserves being furnished for seasonal needs inevitably are being channeled into additional capital loans and other types of undesired loans. Mr. Leach did not think this could be avoided because the System could not carry restriction to the point of demoralizing the Government securities market or of permitting conditions to develop under which funds for appropriate purposes could not be secured at some price.

As to policy for the next two weeks, Mr. Leach favored continuing the same degree of pressure, using "feel" of the market as a guide in maintaining a consistent and obvious posture of market restraint. Under these circumstances he would have no objection to in and out operations in the market, if necessary, although ordinarily

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he did not like to see such operations for the System account.

Mr. Leedy said he saw no signs whatsoever of any abatement of inflationary pressures. Capital expenditures during the last quarter of the year are indicated at an unprecedented level. A very large volume of capital issues still apparently would be offered in the market, despite the fact that rates have increased and that there has been ample publicity as to the tight money situation. Many companies seem to feel that in order to retain what they consider their share of competitive markets they must go ahead with plans for capital outlays. At the same time, there is virtually full employment and, most disturbing, Mr. Leedy said, the price level is increasing. Against this background, he felt that the System was called on to whatever extent it could do so to attempt to exercise further restraint. In the next couple of weeks, projections indicated that ease would be substantial in the market unless action was taken to offset it. Mr. Leedy said he would subscribe to the view that the System need not completely offset this ease, but if his feeling that the net borrowed reserve figure is being watched closely is correct, he felt the System should attempt to continue to indicate clearly a policy of restraint. Mr. Leedy said he liked Mr. Hayes' suggestion that there be probing with respect to having some of the seasonal requirements met by an increase in borrowings through the discount window. His conclusion was that the System should be applying some additional pressure to the extent that could be done without too much

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risk of doing unintended damage, while at the same time responding to seasonal needs.

Chairman Martin noted that Mr. Mitchell had attended this meeting on behalf of the Chicago Bank, and called upon him for a statement at this point.

Mr. Mitchell said that economic conditions in the Seventh District were good. He could not say very good because the district still has two problems, namely, the automobile situation in Michigan and the general farm situation. The farm outlook has improved considerably during the current year, and in Eastern Michigan automobile manufacturers are now filled with great expectations believing that there will be a 10 per cent increase in sales next year rather than a loss of better than 25 per cent as had occurred during 1956. The 25 per cent decline during the current year has had important secondary effects in Eastern Michigan, Mr. Mitchell noted, having affected total retail sales to the extent that a decline of around 12 per cent was indicated during the first five months of this year and probably a greater decline had occurred during June and July. Booming sections of the Seventh District, if there are any, are in the Milwaukee and Peoria areas, he noted, which are centers of capital goods production. Mr. Mitchell mentioned particularly steel and earth moving machinery manufacturers, noting that one large farm implement company had merged with a manufacturer of earth moving equipment as a means of improving its position in the future.

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Turning to agriculture, Mr. Mitchell said that the improvement in farm prices, including cattle prices, had encouraged farmers. A seasonal decline in hog prices is in the offing but farmers do not expect anything like the 40 per cent decline in prices that occurred last year. Mr. Mitchell also commented upon agricultural loan figures available for four types of farming areas in the Seventh District, expressing the opinion that a decline in loan renewal rates did not necessarily indicate that farmers were being denied credit that they needed.

Bank loans to seasonal borrowers (retail and wholesale trade, commodity dealers, textile, food, liquor, and tobacco firms) were not being extended by Seventh District banks in as great volume this year as last, Mr. Mitchell said, and the evidence as to whether seasonal borrowers are demanding less accommodation or being cut back by lenders is still not clear.

Mr. Powell commented on agricultural conditions in the Ninth District, stating that while this had not been a bumper crop year generally and while the wheat crop was quite small, agricultural income would prove to be fairly satisfactory. Industrial employment is very strong and retail trade is running at a higher rate than the national averages. Unemployment is very low. Mr. Powell said that he was in agreement with the views expressed by Mr. Mills that the System might do itself and the United States economy a real disservice

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if it tightened conditions too much in the face of seasonal demands for credit. He was more concerned about the need for meeting seasonal factors than he was about excesses in the use of bank credit in attempting to provide capital goods. Mr. Powell said that he would favor the System supplying part of the reserves that would be needed to meet these seasonal demands through a reduction in reserve requirements against time deposits, such as Mr. Bryan had mentioned. This would be a way of supplying reserves to most of the banks of the country without their going through the discount window or through the open market account, neither of which would supply reserves to all banks except indirectly. The timing of such a reduction was important, however, and Mr. Powell recognized that this was not a decision within the scope of responsibilities of the Open Market Committee.

Mr. Powell stated that the price increases taking place were partly in the agricultural field, which he felt to be good, and partly due to factors over which the System had no control and which are not monetary in their origin. He felt that the System had had its effect in ameliorating these price increases last spring when a firm monetary policy tended to soften wage demands. Now that the wage demands have been granted, the economy is inevitably in for price increases and the only way that they can be offset would be to create a condition of unemployment which, in his opinion, the System was not prepared to undertake. For these reasons, Mr. Powell said that while he was

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concerned about the price increases he felt it was necessary to accept them, and to recognize that there will be more and that there is nothing that the System can expect to do to offset them. Under these circumstances, the System should do what it could to permit the seasonal factors to have their normal play and it should not be too ready to put additional pressure on the money market at this time. The Committee might wish to change its policy to one of greater restraint when the seasonal rise in need for reserve funds has passed.

Mr. Mangels said that the Pacific Northwest was still bothered by softness in the lumber situation. Demand is still down, and prices have consistently declined for several months due in no small measure to a reduction in residential housing construction. There is no evidence yet of improvement in that demand. On the other hand, the general economy of the Twelfth District continues strong. Retail trade is progressing quite satisfactorily and over-all employment is at high levels with some areas reporting an acute employment situation. The over-all anticipation is for a booming fourth quarter this year. Demand for bank credit continues extremely heavy and reports are that seasonal demands for the rest of this year will be heavy. Nevertheless, member bank borrowings from the Reserve Bank continue at a reduced level, he said, and one of the large member banks recently informed him that it would hope to get through the remainder of this year with only intermittent use of the discount window.

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Mr. Mangels said that he was glad that Messrs. Powell and Mills had commented as they had since he, too, felt that the inflationary situation with increasing costs was pretty well frozen into the economy until there could be an increase in productive capacity. The increase in credit needs that goes with a normal seasonal demand for goods faces us, and everything indicates that trade during the rest of this year, including the holiday business, will be extremely heavy. This will require more credit even though it does not represent an expansion in business other than seasonal. An additional credit demand on top of all other so-called legitimate purposes also can be expected when the 1957 automobile models come on the market. Over all, Mr. Mangels felt that the System would be well advised to modify the degree of restraint that it has exercised during the past several weeks, and he would be inclined to be a little more liberal in furnishing reserves to member banks in the period immediately ahead because of the several factors he had mentioned.

Mr. Irons said he had nothing to add to the comments of Messrs. Young and Thomas on the national economic picture, his appraisal being about the same as theirs. In the Dallas District, tendencies are toward further strength in the petroleum, construction, and other industries for which data are available. Unemployment is low and the labor situation is tight. Retail trade is very favorable. Housing

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starts are holding about steady at the level that has existed for the past few months. Automobile sales have been slightly on the slow side lately. While some crop production is off because of the drought in certain areas, there is a tendency for the more favorable conditions in irrigated sections to help average out total farm income. Bankers continue to report strong loan demands, Mr. Irons said, with some indication that some out-of-district firms would now like to obtain loans from Texas banks that would be in the nature of capital credit. Unfortunately, some of these demands are coming from concerns that the Dallas District banks have been trying for years to get as customers. The banks express the hope that the System will make available the reserves to meet seasonal and essential and legitimate requirements, Mr. Irons said, and while a reasonably satisfactory definition of seasonal needs might be arrived at, the "essential and legitimate" requirements are not so readily recognized. While it could be said that the discount window is always open for appropriate and discontinuous use, this did not make a satisfactory answer to banks wishing assurance that they could obtain funds they might need. Banks are heavily loaned and Mr. Irons said that there was a considerable amount of term credit included in the so-called commercial loan figures and, as indicated earlier in the meeting, banks are in an illiquid position because of such loans.

Mr. Irons said he agreed with the policy of restraint, and that,

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although the discount window should be open for appropriate and discontinuous use, the discount policy should be administered firmly toward the end of helping to meet seasonal requirements, but avoiding inappropriate or continuous use of the privilege. In terms of policy, he felt that the System should continue the degree of restraint that it has been maintaining. If anything, he would be inclined, at least during the next few weeks, to be persistently and gradually moving toward more restraint with respect to bank reserves, recognizing that the System could not be wholly accurate in supplying reserves that might be needed in the market. His inclination, however, would be to resolve doubts on the side of reluctantly supplying needed reserves or of being almost niggardly. There should be judicious use of the discount window on a case-by-case basis. He would place the System account management in the position of following closely all factors that might be indicative of the needs of the market, without use of any figure of net borrowed reserves or any other specific figure as a guide.

Mr. Erickson said that conditions in the Boston District remain very strong in almost all lines. In July, nonagricultural employment was the highest July on record, and this covered all areas except textiles and leather; leather in July is between the spring and fall runs. Construction is still very strong with a 13 per cent increase in August over August 1955, and a 7 per cent increase in residential

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construction in August over last year. Mr. Erickson commented on the recent increase in the prime rate of the First National Bank of Boston to 4 per cent, stating that that bank had hoped that some of the demand for credit would be shifted from it to other areas at the time the increase in the rate was announced.

Mr. Erickson said he would not make a change in reserve requirements of member banks at this time, and that he agreed with Mr. Irons that the same degree of restraint that has existed recently should be maintained; if anything, there should be an increase in the next few weeks, although seasonal requirements should be supplied. Mr. Erickson suggested that financial writers and others might misinterpret actions of the System if it permitted net borrowed reserves to get down to the zero figure through failing to offset the mid-month rise in float, and his inclination would be to do enough in this period to keep the net borrowed reserve figure somewhere around the \$300 million level. He would have no objection to going in and out of the market when that seemed desirable to the management of the account.

Mr. Szymczak said that since all of the facts and figures presented at this meeting indicated a high level of economic conditions at least for the balance of this year, since prices were continuing upward, and since the System had taken action to offset the influences of a shift in float when it declined, he felt it quite natural that the System should now take action to offset float when it went up. The market would expect it. Otherwise, it would assume that the

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System only intended to offset float on the one side. By the very nature of the situation, he felt that the account should sell securities at least for the next two weeks and observe the market in order to get a better perspective. The System would, of course, have to supply some reserves during October and no doubt during November and December to take care of the seasonal needs that would arise, but Mr. Szymczak would rather not supply these through the discount window so much as through the open market. If banks get the impression that the System expects them to borrow in order to make loans, difficulties might be presented for administering the discount function later on.

Mr. Balderston said that it seemed to him that the policies of commercial banks are becoming less and less sound. On the one hand, they are permitting short-term money to be used for capital expansion which should be financed from savings; on the other hand, they are losing sight of the importance of liquidity. He was concerned that the banks were now pledging collateral on their own initiative when they should be retaining it to protect their deposit liabilities. This tendency and the level of the loan ratio, which had risen to 60 per cent or above in some cases, led him to believe that the System should vigorously tackle the problem of credit availability by seeking effective means of discouraging the use of bank funds for long-term uses.

Turning to the Committee's policy, Mr. Balderston said he had sympathy for the problems of timing that Mr. Mills had brought to our

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attention. However, it seemed to him that the price rises were in part the result of mistaken policies by corporate borrowers a year ago and in part the result of a too lax credit policy by the System at that time. As we approach the crest of this wave of economic activity, the problem of timing would become more and more of concern to the System; what we do now will of course affect business a year hence. Despite that, consumer prices are rising as a result of cost increases that have taken place since June a year ago, and these may trigger another crop of wage advances. Moreover, plans for capital expansion are now pressing both on supplies of critical materials and on manpower resources, as well as on capacity of capital goods industries. The Treasury will have to come to the market in October in the face of a very strong corporate demand for credit. In sum, his feeling was that short-run policy of the Committee should be that expressed by Mr. Leach. While the System should not permit positive reserves to develop and in the main the decisions should be left to the desk, he hoped that operations could prevent outside interpreters of System policy from being deceived and that, in general, the same degree of tightness would be maintained that now exists. Mr. Balderston said that he had a feeling that we dare not become less tight because of the price rises that are occurring and are going to continue to occur this fall. On the other hand, he was not sure that the System should move toward greater tightness until the picture became clearer later on.

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Chairman Martin said that it encouraged him a great deal to observe the amount of thought and time and effort that each of the members of the group had been putting into the problems facing the System, as evidenced by this morning's discussion. The forces we are dealing with are large, and we must try to keep in perspective what the System is trying to accomplish. We must also constantly keep in mind the question of how much money and credit policy can do in dealing with these forces. They are as large in their nature as the tides, and monetary and credit policy can possibly not do more than wave a red flag at the dangers presented. The Committee should wave this red flag, the Chairman said, but against the Juggernaut of Government spending, and against the Juggernaut of inflationary prices, it should not persuade itself that monetary and credit policy will be successful in halting what is occurring. And, he added, this is not defeatism.

The Chairman went on to say that he thought it would be a mistake for the Committee to reduce the pressure on the market substantially by overt action, but he likewise thought it would be a mistake to increase the pressure in the market by overt action. The System should recognize the problems we are facing and should endeavor to develop as reasonably stable conditions as is possible within the framework of the situation that is developing, for example, as a prelude to what will probably be the most difficult Treasury financing

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in years to come. That is something all of us should consider. Mr. Mills had mentioned the two preceding Treasury financings, and the Committee should recognize a certain degree of responsibility.

There should be no misunderstanding of the situation the Committee faces. We are within eight weeks of an important political decision, the Chairman said, and while it is the Committee's duty to be uninfluenced in either direction by that fact, it is also its duty not to ignore it. However much the System might wish to avoid mentioning that fact, it could not avoid recognizing that it existed and that it colored whatever the System may do. Chairman Martin thought this should be brought out on the table.

Chairman Martin referred to letters of criticism that he received from time to time, stating that one of the things he was hearing was that the System lived in an ivory tower, that it was not completely aware of the forces that are developing around us. This point of view irritated him: the System and its staff are not isolated, and we do not live in an ivory tower. Nevertheless, there is a tendency not to mention politics because of the possible implications. While the System is not political in its actions, it should recognize the political situation in the spirit that he had mentioned.

Reverting to policy, the Chairman reiterated the view that the System should not by overt action move either to tighten credit or to loosen it at this time. The degree of probing that Mr. Hayes had suggested with respect to further tightening had to be evaluated against

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the feel of developments in the market and would have to take into account the Treasury's financing which would total roughly \$3 billion, probably early in October. It was his hope, although it was not his expectation, that that financing would be out of politics. While there were shades of difference to be recognized in the comments at this meeting, the Chairman said that his appraisal of the group's feeling was that no one wished to change the Committee's directive at the present time, either as to wording or as to amount, and in the absence of comment to the contrary, he suggested that the Committee approve the directive to the Federal Reserve Bank of New York.

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 restraining inflationary developments in the interest of sustainable economic growth, 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 \$1 billion;

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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;

(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.

Turning to the consensus as to guides to be given to the trading desk, Chairman Martin said that some of the comments tended toward ease, others (which he thought represented a majority) would stay somewhat in the middle ground, some would stay on the side of tightness in resolving doubts, and one or two would overtly move toward greater tightness.

Mr. Hayes suggested that a good deal of the discussion and a good deal of the difference in views pointed out by Chairman Martin involved suggestions relating to a somewhat longer run than the next two-week period. Most of the program that he (Mr. Hayes) would contemplate as desirable during the rise in seasonal demands for credit would be deferred until after the next meeting of the Committee. He doubted whether as a practical matter the System account could do enough selling during the next two weeks while float is supplying reserves, to create the tightness that would lead to the probing actions he had

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suggested--probably most of the probing would have to be deferred until the October Treasury financing is out of the way.

Following some discussion of Mr. Hayes' comments, Chairman Martin suggested that until the next meeting of the Committee, which would be held on September 25, 1956, it would appear to be the majority consensus that the Committee wished to maintain a degree of stability in the market with doubts being resolved on the side of tightness rather than of ease, but with the understanding that the Account Management would not make conscious moves on the side of tightness. In response to a question from Mr. Shepardson, the Chairman stated that this would contemplate some selling of bills in the near term but that such sales would be with the idea of not permitting negative free reserves to go to the zero level.

None of the members of the Committee indicated disagreement with Chairman Martin's statement as to the policy guides to be followed until the next meeting.

Chairman Martin called upon Mr. Hayes in connection with the proposal that had been made by Mr. Sproul in his memorandum of May 3, 1956, and discussed in subsequent memoranda that had been referred to at a number of meetings of the Committee since that date under which proposal the Committee would give limited authority to the Account Management to make swaps in Treasury bills.

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Mr. Hayes noted that a memorandum had been distributed by Mr. Rouse under date of August 14, 1956, covering interviews held with representative dealer firms in accordance with the suggestion made at the meeting of the Committee on August 7, 1956, regarding the possibility of making swaps in Treasury bills for the System account. He stated that, as Mr. Rouse's memorandum pointed out, not only did these dealers have no objection to the proposal but they indicated considerable optimism as to the assistance the suggested procedure might give to the functioning of the Treasury bill market. Mr. Hayes stated that since the August 7 meeting he had taken occasion to review the whole proposal and to consider further the reasons why it was believed to be desirable. While it was not a matter of major significance, Mr. Hayes said he had concluded that benefits would obtain from the proposal and he hoped the Committee would act favorably on it.

At Mr. Hayes' suggestion, Mr. Rouse commented on the proposal, stating that if it was approved, he would expect to notify the market initially of its adoption by the Committee with the thought that dealers would come to the System account when they desired to engage in swaps, although very occasionally the System account might wish to go to the market.

Chairman Martin said that he would like to reiterate for the record his thinking on this proposal. He still thought that as a

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matter of principle the Committee would be wiser not to engage in swaps. However, he certainly did not want to stand in the way of anything that under certain circumstances might be helpful in carrying out the Committee's objectives. His judgment on principle might be wrong in this particular instance, he said, but if swaps were to be undertaken it was important that it be in a way that would not lead to misunderstanding; the procedure should make it clear that the swaps were at the initiative of the Committee and not at the beck and call of the dealers who might take the initiative away from the Committee.

Mr. Szymczak said he had no objection to the proposal for swaps in Treasury bills, that he thought it was something the Committee should engage in eventually. He questioned the advisability of undertaking it at this time, however, and suggested that it might be deferred until next January.

Mr. Rouse stated that the proposal had been made sometime ago and that he would prefer to have the matter settled one way or the other.

Mr. Mills said that to him adoption of the proposal except under unusual circumstances when the Committee's holdings of bills were reduced to a very minimum would be putting a foot in the doorway to opening the System open market account to general trading. He recognized that was an extreme point of view but felt the action would

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represent a step in the direction stated. He could not reconcile such a step with the idea of a free market, and he did not think it a policy that the System should countenance.

Mr. Robertson said he held exactly the same views that the Chairman had stated and that he also had some of the feeling expressed by Mr. Mills. However, he did not think the matter of principle of sufficient importance one way or the other to throw road blocks in the way of the management of the System account in trying to make the Committee's operations more effective. He did think, however, that the Committee should do everything possible to see to it that the initiative for swaps remained in its hands. Consequently, he had prepared a draft of a resolution which he felt would assure that the initiative remained with the Committee, and he read the resolution as follows:

If at any time it appears to the Manager of the Open Market Account that a different maturity distribution of Treasury bills in the account would facilitate future action in supplying or absorbing reserves, the Manager may make exchanges of Treasury bills of different maturities. Such transactions shall be undertaken only for the purpose indicated above and only if, in the Manager's judgment, they will not distort the functioning of the market. Before effectuating any such transactions, the Manager shall give notice to all dealers in Government securities with whom the account regularly transacts business of the purpose and proposed extent of such transactions.

In discussing Mr. Robertson's proposed resolution, Mr. Rouse said he felt that prior notification to the market before every swap

transaction would not be feasible for several reasons.

First, to present swaps to the market as suggested would create operational problems. Some dealers would bid on one side of the proposed swap, some on the other side, and other dealers would bid for both sides on the understanding that either price would hold only if both sides of the transaction were done with him. In short, attempts to determine best prices would involve endless negotiation by the staff of the Trading Desk.

Second, by advising the market of the swap it intended to work out, the System would call unnecessary attention to its particular interest in certain maturities and would encourage a movement of interest rates on these maturities to its own disadvantage (not only on the swap but perhaps on subsequent outright purchases as well). Mr. Rouse added that, as a general principle, the more nearly the System account handles its operations on the basis of best prices and without regard to maturity, the less distorting effect it will have on the structure of rates. The authority to enter into piecemeal swaps in response to the opportunities that arise daily in the market--without forcing the securities we want out of the market--would make it possible for the Trading Desk to be less interested in maturity at the times it is buying Treasury bills outright for reserve purposes.

Third, dealers for purely business reasons supply the Trading Desk with valuable information on transactions they are attempting to work out in the market since there is a possibility that the Trading Desk might react to this information by executing one side or another of the transaction in filling a foreign account or Treasury order. If the System account were able to respond to bill swapping opportunities, this flow of information could be increased, but not if the full go-around technique were used since this would demonstrate to dealers that failures to keep the desk informed would not cost them any business.

Fourth, if an attractive swap should be presented to the Trading Desk by one dealer and the Account Management, rather than executing the swap directly, first showed it to the rest of the market, the System would be guilty of a serious breach of confidence and it might be assumed that such swap would not be shown to the desk in the future.

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In summary, Mr. Rouse said that if it were necessary to employ the go-around technique in doing a swap, the resulting disturbance to the market and distortion of rates would probably offset the modest operating advantages that swaps are intended to achieve. On the other hand, if the management were allowed to react to swap propositions coming to it from the market, it should be possible to work toward an orderly attainment of particular maturity distribution objectives while at the same time facilitating the functioning of the market by providing maturities that dealers need to complete transactions. In the latter case the Trading Desk would simply react to situations as they develop and there would be no forcing of the market to promote System portfolio objectives. In closing, Mr. Rouse said that although he would prefer that most swaps originate in the market--with final initiative resting, of course, with the Trading Desk--he would like to leave open the possibility that swaps might occasionally originate with the System. Even in the latter case, however, it would be better business practice for the Trading Desk to direct swap inquiries to dealers known to hold the maturity the System account wanted, rather than to direct them into the market on a full "go-around". In all cases it would be contemplated, however, that no swap would be executed unless the price involved were in line with quotations currently being reported to the Trading Desk, and unless several dealers were specifically canvassed for bids and offers on the maturity involved, with transactions actually executed on a "best price" basis.

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Mr. Robertson responded by stating that on the basis of the comments Mr. Rouse had made, he would be completely opposed to authorizing swaps on the grounds that they really would prevent a free market.

Chairman Martin noted that under Mr. Rouse's proposal, the initiative for swaps would be in the market.

Mr. Rouse concurred, stating, however, that the fact that a dealer might initiate a proposal for a swap did not mean that the System account would follow the market.

Mr. Hayes stated that this was a very cogent point. It seemed to him that it was necessary to clarify what was meant by "initiative." The opening move might be by a dealer but the Account Management would have every right, and would certainly use it, to refuse a given transaction if it felt that should be done. Mr. Hayes did not think the Committee would be giving up its initiative because a given transaction originated in the market. The entire proposal before the Committee was an operating matter, he said, to be used as an operating tool, and if the Committee were to implement the idea, if the idea had merit, the details of it should be worked out largely by those who were on the firing line and who would have to apply the tool. He still felt that the proposal was desirable and that it would be handled sensibly without any damage to the market. He believed that the way in which the tool should be used probably was along the lines Mr. Rouse had in mind,

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rather than with the restrictions that Mr. Robertson had proposed.

Mr. Robertson said that he would not attempt to force on the Management of the Account the proposal he had made because if it appeared that swaps would distort the market, the Committee should not deviate at all from principle.

Mr. Hayes said that he was not arguing the question on the basis of general principle but was thinking of the proposal entirely as a useful tool to be considered on its merits.

Chairman Martin suggested that copies of Mr. Robertson's proposed resolution be made available to the Committee for further study and that the matter be taken up again at the next meeting, and there was agreement with this suggestion.

Chairman Martin said that he wished to bring to the attention of the members of the Committee a letter dated August 28, 1956, that he had received from Congressman Wright Patman, Chairman of the Subcommittee on Economic Stabilization of the Joint Economic Committee, in which Mr. Patman recalled the hearing held in December 1954 on recent and current experience with monetary policy at which members of the Board of Governors and Presidents of the Reserve Banks met with the committee. Chairman Martin said that Mr. Patman's letter was for the purpose of informing him that he proposed to arrange a similar meeting next December at a time that would fit in with a meeting of the Reserve Bank Presidents in Washington and that he hoped the members of the Board and the Presidents could meet with his committee at

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that time. Chairman Martin also said that Senator Robertson and members of the staff of the Senate Banking and Currency Committee meet with the members of the Board tomorrow in connection with the proposed hearings on banking legislation.

Mr. Young noted that it was customary for members of the staff to give an economic review in the form of a chart-slide presentation at meetings of the Federal Open Market Committee held in conjunction with meetings of the Conference of Presidents of the Federal Reserve Banks four times a year. This would call for such a presentation at the meeting to be held on September 25, and Mr. Young inquired whether it would be satisfactory to defer such a presentation until October. None of the members of the Committee indicated any objection to postponement of the review as suggested.

It was understood that the next meeting of the Committee would be held at 10:00 a.m. on September 25, 1956.

Thereupon the meeting adjourned.


Secretary.