

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, May 7, 1957, at 10:00 a.m.

PRESENT Mr. Martin, Chairman
Mr. Allen
Mr. Balderston
Mr. Bryan
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Vardaman
Mr. Williams
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Fulton, Irons, Leach, and Mangels,
Alternate Members of the Federal Open
Market Committee

Messrs. Erickson, Johns, and Deming, Presidents
of the Federal Reserve Banks of Boston, St.
Louis, and Minneapolis, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Atkinson, Popp, Marget, Mitchell, Tow,
and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Re-
search and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section,
Division of Research and Statistics, Board
of Governors
Mr. Roosa, Vice President, Federal Reserve Bank
of New York
Mr. Gaines, Manager, Securities Department,
Federal Reserve Bank of New York

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Mr. Daane, Vice President, Federal Reserve Bank of Richmond; Messrs. Balles and Einzig, Assistant Vice Presidents, Federal Reserve Banks of Cleveland and San Francisco, respectively; Messrs. Ellis, Parsons, and Coldwell, Directors of Research, Federal Reserve Banks of Boston, Minneapolis, and Dallas, respectively; and Mr. Robertson, Financial Economist, Federal Reserve Bank of St. Louis.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on April 16 and 24, 1957, were approved.

Upon motion duly made and seconded, and by unanimous vote, Mr. Merritt Sherman was elected an Assistant Secretary of the Federal Open Market Committee to serve until the election of his successor at the first meeting of the Committee after February 28, 1958, with the understanding that in the event of the discontinuance of his official connection with the Board of Governors of the Federal Reserve System he would cease to have an official connection with the Federal Open Market Committee.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period April 16 through May 1, 1957, as well as a supplementary report covering commitments executed May 2 through May 6, 1957. Copies of both reports have been placed in the files of the Committee.

Mr. Rouse reported that a fairly steady degree of restraint had been maintained in the money and securities markets since the last meeting in spite of the aberrations that had affected bank reserves.

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One of these was the unexpectedly large increase in float resulting from the strike of Railway Express Agency employees. The other was the unanticipated reduction in the Treasury's balance at the Reserve Banks which had had an effect upon bank reserves over a period of two or three days. Currently, the money market was quite tight, a condition that had been confirmed by several weeks of pressure on the market prior to the Treasury refunding. The Treasury's announcement of a refunding offering for the \$4,155 million of 1-5/8 per cent notes maturing on May 15 had been taken by the market with neither surprise nor disappointment at the terms offered, Mr. Rouse said, but it was expected that there would be substantial attrition. On the other hand, the bidding for Treasury bills in the weekly auction yesterday resulted in an average yield of 2.91 per cent and this made the 3-1/2 per cent eleven-month certificates of indebtedness offered in exchange for the maturing securities look quite attractive. There was now some feeling in the market that attrition would be no greater than had been anticipated earlier (20-25 per cent) and that it might be somewhat less.

As far as the next period was concerned, Mr. Rouse said that the Account Management was faced with a fairly even reserve situation except for the expansion that was anticipated in float in the middle of the month.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period April 16 through May 6, 1957, were approved, ratified, and confirmed.

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At Chairman Martin's request Mr. Young made a statement on the economic situation as follows:

Over all, the movement of economic activity in this country continues sidewise but with a slight upward tilt for both GNP and prices. In industrial countries abroad, the most recent information points to resumed advance in activity and up-creep in prices.

Domestically, modest further rise in the average wholesale prices has reflected mainly a seasonal rise in farm products and foods which are now about 3 per cent higher than a year ago. Wholesale prices of industrial goods remain stable, both for fabricated and finished items and for basic materials. After a sharp decline, the price of steel scrap has leveled off and strengthened some recently; the price of nonferrous metal scrap has shown some strength, and prices of other basic materials have shown only small change. Trade speculation on the expected increase in steel prices this summer continues active, with \$7 a ton at the lower range of estimates, but hedge buying of steel does not appear particularly noteworthy. Consumer prices for April are expected to show some further advance.

For April, the Board's index of industrial production is estimated to be down one point from March to 145. Output of steel ingots, sheet, auto assemblies, zinc, and petroleum was down. Output of producers' equipment and ordinance, which currently have a weight of about one-third in the index, was up. Output of nondurable industries was about maintained.

Manufacturers' sales in March, while off slightly from February, were still up 6.5 per cent over a year ago, with a good part of the increase in prices. One element of strength in first quarter industrial sales was a 9 per cent further rise in exports to a \$27 billion annual rate. While agricultural exports were at a high level, the increase in foreign shipments was largely in petroleum and manufactured products.

Manufacturers' inventories rose about \$850 million book value in the first quarter, but distributors' inventories declined by nearly \$350 million. Since higher prices were a factor in the manufacturers' inventory accumulation, it now appears that there was a significant decline over-all in physical inventory holdings of business in contrast to a fairly substantial rise in the preceding quarter and over

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the preceding two years. A large part of the inventory expansion of the past year has been in work-in-process in equipment and ordnance industry, so that inventory-sales ratios elsewhere seem to continue on the prudent side. With a more ample capacity situation in key material areas and also for fabricated items other than structural and equipment goods, incentives for inventory accumulation beyond short-run sales needs appear greatly diminished.

Auto sales for April have run a bit below March, and, with assemblies down further, dealer stocks have been additionally reduced. Used car sales have strengthened, thus holding down a further rise in used car stocks. Prices on late model used cars continue to hold about 7 per cent higher than a year ago; older model car prices have risen recently and are now about 15 per cent above mid-spring of last year.

Output of furniture and other household durables has been steady since early in the year at a level about a tenth under early 1956. Sales in physical units are about the same as last year and stocks, after a bulge from spring through summer of last year in relation to sales, are now back to about the sales relationship of early 1956.

Department store sales in April were apparently off sharply from March and about the same level as April of last year. The average for March and April was about 2 per cent ahead of last year, which, at higher prices, would suggest a lower physical volume of merchandise sales.

Instalment credit outstandings expanded at a slower rate in March and evidently again in April, with the monthly increase for these two months \$50 to \$75 million under the \$200 million rise of January-February. While downpayments in auto financing are improved from a year ago, the proportion of longer maturity contracts written continues to rise month after month.

Although residential construction activity was down further, total construction in April continued close to a record rate. Outlays for industrial, commercial, utility, and public construction were up. Contract awards so far this year have been running above last year, with strength notable in areas just mentioned.

In residential financing, supply conditions for construction and mortgage funds in most areas are reported modestly easier, and builders and lenders both anticipate some further easing. Home builders' plans for the second quarter, as reported in two Reserve districts, are indicated to be up sharply from the first quarter. Builders'

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inventories of finished houses are generally at low ebb and the first quarter vacancy rate for the whole country was reported by the Bureau of the Census to be very low--just over 2 per cent.

The labor market continues active, with mainly seasonal changes reported. More persons are working part time for economic reasons than last year, and unemployment claims are running above a year ago. This seems mainly to reflect widely distributed employment attrition in manufacturing, together with scattered layoffs, notably in the lumber and consumer durable goods industries. About 1.4 million workers--about a million in the railroads, machinery, and aircraft industries--will receive automatic cost-of-living wage increases in May. Discontinuance of overtime work has recently been a cost-cutting measure with many industrial concerns and the Defense Department has just discontinued overtime work as an allowable item of defense contractors. These developments are being reflected in the work week and in weekly earnings, with declines in the work week about offsetting recent wage gains.

Business failures have risen each month of this year, in March establishing a postwar high. The increase in failures has been sharpest for companies with liabilities in excess of \$100,000 and for companies in the construction industry. While the number of failures in retail trade and service activities was up from a year ago, the number of manufacturing failures showed no increase, and the number of wholesale failures was down.

Three items of business expectation information have recently been released. The first is a marked drop in businessmen's optimism concerning sales and profits two quarters ahead, reported by the quarterly Dun and Bradstreet survey taken in late March. The second item is the strength of the latest McGraw-Hill survey of plant and equipment expenditure plans, which would indicate growth in these expenditures through the year rather than a rise in the first half with some decline following. The third expectations item pertains to farm income. The USDA expects net realized income of farmers to rise modestly further in 1957, mainly because of Soil Bank Payments; the rise from 1955 to 1956 was an estimated 4 per cent.

Abroad, in Western Europe, there are further indications of renewed economic expansion and some further up-drift in wholesale and consumer prices. Inflationary demand pressures in Western Europe are a matter of wide concern, and policies to restrain excess demands have been re-enforced in several countries, with several more having actions under consideration.

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Canadian economic trends have broadly paralleled those in this country. Outside Europe and North America, inflationary pressures remain dominant, but with considerable variation from one country to another in intensity and incidence.

In conclusion, the over-all situation continues to be one of rolling adjustment but of general strength, with active demands from abroad giving support to domestic developments. Total national product prospects for the second quarter are for a further gain of \$3 billion to a total annual rate of \$430 billion, again partly reflecting rising prices, though to a lesser extent than in the first quarter. This outlook would envision relatively stable industrial and construction output and further rise in output of services.

In response to a question from Mr. Vardaman, Mr. Young said that the reported vacancy factor of about 2 per cent in housing during the first quarter of the year was low historically. In Mr. Young's opinion the 2 per cent figure represented a fairly small vacancy margin and suggested a rather strong over-all residential building picture.

Mr. Thomas then made a statement on recent credit developments substantially as follows:

Credit markets have continued under the pressure of large borrowing demands during recent weeks. New securities issued by corporations, though at a slower rate than in the first quarter, have continued relatively heavy. An unusually large volume of issues by state and local governments in April created some congestion in the market. Total loans and investments of banks, which increased sharply as a result of the Treasury cash financing at the end of March, have subsequently continued on a high plateau.

A particularly significant development in the period has been the fact that as the Treasury has drawn down its balances built up during March, the funds have gone to swell private deposits rather than to reduce bank credit. Total loans increased about half a billion in the four weeks ending May 1, a little less than last year and about the same as in 1955, but investments decreased less than in the earlier years. U. S. Government deposits were reduced by 1-1/4 billion, and demand deposits adjusted increased by the same

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amount. The decline in Treasury deposits and the increase in other deposits were both greater than in 1956 and 1955--periods when expansionary pressures were strong. The money supply showed a greater than seasonal increase during April.

Pressures of credit demands resulted in a sharp runup in bond yields. Yields on all categories of bonds increased. Seasoned corporate issues, which were relatively stable for about two months, showed the smallest rise, but yields on new offerings showed a more pronounced increase. Yields on tax-exempt securities have risen most sharply. Treasury bond yields also turned up in April, after a period of relative stability in March. Long-term issues rose close to the 3-1/2 per cent peak reached in December. The shorter term issues still sell at higher yields than long-term bonds, but the margin has narrowed considerably since December.

It appears that money and capital markets are still in the process of reaching a level and structure of interest rates appropriate for a period of full utilization of resources with large investment demands. We cannot be confident that long-term rates are yet high enough to bring investment and savings into balance in such a situation.

In contrast, yields on Treasury bills, which rose somewhat early in April, have again declined to below 3 per cent. The difference between the movement of yields on bonds and those on bills reflects to some extent prevailing uncertainty with respect to the prospective trend of long-term interest rates--or rather a growing feeling that such rates might rise further. One aspect of this uncertainty relates to the imminent announcement of terms on new Treasury financing. Another factor producing lower bill rates was the marked easing in the reserve position of member banks, but the tone of the money market continued to be one of greater tightness than would be indicated either by the reserve situation or by bill rates.

The easier reserve position was reflected in a reduction of member bank borrowing from around \$1 billion in the first half of April to an average of \$700 million in the latest statement week. This was in part accidental and has already been partly corrected. The principal influence was the higher level of float resulting from the Railway Express strike at airports, which added some \$300 million additional reserves beyond the usual seasonal trend. Other factors were the deliberate, though temporary, reduction in Treasury balances at the Reserve Banks and a more than seasonal decline of currency in circulation. These sources of reserves

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more than covered the greater than expected increase in required reserves, resulting from the expansion in private deposits. A reduction in System holdings of securities held under repurchase contract and recently a run-off of Treasury bill maturities, also absorbed some of the reserves made available.

Reserve needs in the weeks ahead will depend in part upon how fast float returns to a more normal level and more fundamentally upon the course of bank credit made available to meet demands for money. The money supply should not be expected to continue to increase at the April rate, and might reasonably contract some on a seasonally adjusted basis. Projections based on the assumptions of a gradual return of float to a more normal level by early June and a normal seasonal movement in private deposits and currency, indicate a relatively easy situation until the end of June, with average net borrowed reserves ranging from less than \$100 in mid-May to over \$500 million in Memorial Day week. These estimates allow for retirement of System repurchase contracts outstanding, but for no other System account operations.

In view of the recent expansion in money, it is questionable whether this prospect will be adequately restrictive. Probably some outright sales by the System would be appropriate in the latter part of next week. Repurchase contracts could then be used to meet the regular and temporary increases in reserve needs. Any growth in reserve needs beyond these projections would indicate an expansionary development, and banks should be forced to meet them through borrowing at the Reserve Banks, in order to keep an element of restraint on continued credit expansion.

Solicitude for the Government securities market should not interfere with a policy of this nature. If attrition is large on the refunding operations now in process, additional funds will be supplied to the market by the Treasury. Amounts made available for private credit needs should be correspondingly reduced. I do not intend to suggest that an aggressively restrictive policy will be in order. The degree of restraint needed will depend upon the course of credit demands. The trend of events so far, however, does not provide any basis for relaxation.

Chairman Martin noted that Mr. Treiber was attending the meeting in Mr. Hayes' place and asked that he comment on the economic situation and credit policy. Mr. Treiber made a statement as follows:

The business situation continues strong, but not expanding. Business sentiment, however, is more optimistic. While indicators of current business remain strong, a number of those which anticipate future trends continue to exhibit weakness.

Employment remains high. Over-all consumer buying continues high. Retail sales continue on a plateau. Total business inventories are no longer being accumulated.

Auto production schedules have been adjusted to avoid a piling up of inventories. Steel production has been easing off, reflecting a decline in demand extending beyond the auto industry. The steel industry, however, is not concerned about the outlook. Construction outlays continue at a high rate; declines in residential building are being offset by a rising volume of public construction and private nonresidential construction.

Over all, wholesale prices are leveling off. The consumer price index, however, continues to rise. While an increase in farm prices is not anticipated, other retail prices are likely to continue to rise. The rise seems to be a delayed reaction to the cost increases of last year rather than a reflection of increasing consumer demand.

Plant and equipment expenditures continue at record levels.

As costs rise and market competition intensifies, profit margins will be subject to pressure that may lead to a reappraisal of investment plans. Reports of corporate earnings for the first quarter of 1957, however, do not indicate any general intensification of the pressure, nor does the most recent McGraw Hill survey for the next three years suggest such a reappraisal.

Business opinion is becoming more optimistic in the light of the current strength and the ability of the economy to continue to operate close to record levels without support from major new expansionary forces.

The demand for bank credit continues strong, but apparently at lesser intensity than last year. The liquidation of investments this year has been small compared to the heavy liquidation occurring in the corresponding period of 1956.

Federal Government expenditures are increasing, thus reducing the Treasury cash surplus for the fiscal year. Attrition on the current refinancing is expected to be larger than usual. The Treasury will have to borrow for cash by July; it may need to do so in June, or in late May.

The policy of monetary and credit restraint should be continued in order to resist remaining price pressures. We should not make an overt move toward either more or less

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restraint through open market operations or through a change in the discount rate. In the present setting and in the midst of a Treasury refunding operation it is desirable for the System to maintain a steady degree of restraint at about the levels of pressure sought in the last two weeks.

In the period between now and the next meeting of the Committee it would not seem necessary to make any substantial amount of outright purchases or sales. Maturing Treasury bills should be run off, but it should not be necessary otherwise to offset the midmonth float expansion which will last only a few days. A continuation of repurchase agreements to assist the dealers to carry the 1-5/8 per cent Treasury notes maturing May 15 is in order. Such action promises to assist the Treasury refunding and would not be inconsistent with the overriding objective of credit restraint.

While too much emphasis should not be placed on statistics, we would think in terms of net borrowed reserves in the neighborhood of a half billion dollars and member bank borrowings of about \$1 billion.

At this point, Mr. Treiber referred to Item 4c on the agenda relating to the responsibilities of the Treasury and the Federal Open Market Committee in the area of open market operations. He stated that he was also prepared to comment on this subject, and Chairman Martin suggested that he do so at this time. Mr. Treiber's statement was as follows:

The current Treasury refunding operations have raised again the question of the Committee's responsibilities in connection with Treasury financing.

The policies of the Federal Government with respect to income and spending are determined by the Congress. The Committee is bound by those policies. While Federal Reserve policy may at times seek to discourage or postpone private borrowing and the anticipated expenditures in connection with the borrowing, such a purpose is inapplicable to Government borrowing. The Government must be financed.

There is, of course, some latitude in the details of Government financing, and the Treasury has the primary responsibility for determining those details. The

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Government securities market, however, is the principal medium for the adjustment of the reserves of banks and others. We create and extinguish reserves through operations in that market. We administer credit policy by operating, or by refraining from operating, in that market. It seems to me that we cannot administer credit policy without regard to the Government securities market and to the financing requirements of the Treasury.

It has frequently been said that the Federal Reserve has primary responsibility for credit policy and the Treasury has primary responsibility for debt management. There must be a maximum of coordination between the System and the Treasury consistent with the primary responsibilities of each. Each must avoid as much as possible interfering with the other in the performance of its duties.

In pursuance of these principles, the Treasury should price its securities in line with market rates. When it does so--when it submits itself to the discipline of the market--the System has a responsibility to avoid action that may jeopardize the financing. We should then, as we have consistently since the accord, recognize that the initial impact of an operation as large as a Treasury financing may create temporary digestive disturbances with which we need be concerned.

Within the last couple of weeks our attention has focused on the administration of Treasury balances. Their administration affects the amount of bank reserves, and it is by influencing the amount of bank reserves that the Federal Reserve carries out credit policy. The Treasury has the responsibility for administering its balances so as to be able to pay its obligations; such administration must be part of its program for handling receipts and disbursements. Within that program there may be fluctuations in the Treasury's balances at the Reserve Banks. The Treasury and the Federal Reserve try to project those fluctuations and conduct their respective functions in the light of the projections. When, however, the Treasury manages its accounts for the specific purpose of increasing, or otherwise influencing, bank reserves, it is engaging directly in an act of credit management for which the Federal Reserve has primary responsibility. That we do not want.

To avoid the Committee and the Treasury working at cross purposes and undertaking important steps in the primary sphere of responsibility of the other party, there must be a willingness to consider carefully and sympathetically the problems of the other party.

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Last month, Norman Davis of the Federal Reserve Bank of New York and I returned to the United States after a ten-week trip around the world, during which we visited the central banks in a number of countries in the southern hemisphere. In most of the countries the governor and the directors of the central bank are appointed by or upon the recommendation of the Minister of Finance, and the degree of responsibility (or subservience) of the central bank to the Minister varies. In most of the countries the government has a special pipeline to the central bank. The government can borrow directly from the central bank, in some cases merely by drawing checks and creating an overdraft. The absence of a well-developed government securities market is, of course, an important factor leading to arrangements for direct loans by the central bank to the government. But the desire to escape the discipline of a market is also an important factor. In none of the countries is the Treasury subjected to market discipline the way it is in the United States where direct accommodation of the Treasury by the Reserve Banks is in practice granted only infrequently in small amounts for very short periods and for the limited purpose of smoothing out the impact of large money movements at tax payment dates.

The central banking system in the United States is, indeed, fortunate. Not only does the Federal Reserve System enjoy a structural independence within the government, but also present Treasury officials are personally sympathetic to Federal Reserve problems and objectives. This great privilege that we enjoy creates a corresponding duty on our part to consider carefully and sympathetically the problems and views of the Treasury. If we are arbitrary and aloof--if we do not give adequate consideration to the Treasury's problems--a justifiable reaction may undermine our independence; indeed, the results could be drastic.

It now appears that there will shortly be a new first team at the Treasury. It may not be much longer before the Senate Finance Committee will begin a new study which will include the inter-relations between Treasury debt management and System monetary and credit policies. In these circumstances, would it not be well for us to consider and prepare for possible discussions with the Treasury--both at the staff and the policy level? Would it not be to the interest of both agencies to review together the aims and impact of the actions which each should be expected to take, in discharging its respective responsibilities?

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Chairman Martin said that he wished to propose that the Committee have a staff study made of the problem to which Mr. Treiber had just referred and that it plan to discuss the problem at its next meeting. It would be desirable to furnish the members of the Committee with data regarding the operations of the Treasurer's account preparatory to a full discussion of the matter, he said, adding that it would be appropriate to have preliminary comments this morning.

Mr. Johns said that he was in agreement with the recommendations concerning credit policy made by Mr. Treiber, as he understood them. His view concerning the present state of the economy was quite in agreement with the staff review presented this morning. Perhaps the degree of restraint should be somewhat although not drastically greater than in the recent past, Mr. Johns said. He concurred with Mr. Treiber's comment that it might not be necessary to attempt to offset the mid-month bulge in float to be expected within the next couple of weeks.

As a member of the Committee of three appointed to conduct a study of Federal Reserve float, Mr. Johns said that he had had the privilege of reading the report by the staff group on the subject. He had discovered that, if the staff group was correct, most of what he previously thought he knew about float was not correct. His tentative conclusion was that the Committee should not attempt through open market operations to offset relatively short-run fluctuations in

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float. This view had some implications regarding the usefulness of net borrowed reserve figures as indicators of Committee policy, Mr. Johns said, and he would hesitate to name any net borrowed reserve figure at which the Committee might aim. He agreed that the degree of pressure should be somewhat greater. Mr. Johns said that he would make no change in the discount rate at this time.

Mr. Bryan stated that the Sixth District situation seemed to be mixed. There had been a slight increase in nonfarm unemployment. However, contract awards had taken another spurt. In general, there seemed to be no distinct trend in economic activity in the Atlanta District. The banking situation seemed to be a little better, and borrowing at the Federal Reserve had gone down sharply. Mr. Bryan's impression of the national picture was much as Mr. Young had outlined it; if there was an upward tilt to the economy at the moment it was a very modest tilt. He did not believe, particularly in view of longer run considerations, that any easing of credit restraint at the present time would be justifiable. Accordingly, Mr. Bryan agreed with the statements so far made that the System should not take the dramatic step of reducing the discount rate. His feeling was that open market operations should be continued with a view to keeping the bill rate from moving too far below the discount rate. This was because he felt there would be unfortunate implications for the long run, if progressively lower yields developed in that area. Mr. Bryan said that he would be inclined, if there seemed to be a continued lowering of

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yields in the bill market, to effect sales from the System account. He was increasingly concerned about the long-run problem of equilibrium in the interest rate which he had mentioned in the past. He referred to a recent book by Peter Drucker, America's Next Twenty Years, which he felt pointed up the problem. The net of his feeling was that he would not like to see easing at the present time that would complicate the Committee's longer-run problem of getting equilibrium in this area.

Mr. Williams said that the Philadelphia Bank had rechecked capital expenditure plans and conferred with some twenty economists of business concerns since the preceding meeting of the Committee. One of the strong factors brought out was the high level of capital expenditures expected. Many plants were revising their plans upward, and current plans for expenditures during 1957 are about 6 per cent higher than were anticipated in the fall of 1956. If these plans are realized, Mr. Williams said that expenditures during the current year would be about 20 per cent above the 1956 total.

The staff of the Philadelphia Bank found in its meeting with industrial economists a general attitude of "tempered optimism," Mr. Williams said. Prospects were reported good for the next several months, with new orders running about the same as last year. There were some soft spots, for example, freight carloadings continued below last year, perhaps reflecting the growth of commercial and private trucking, Mr. Williams said. Manufacturing employment continued

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steady. Department store sales for 1957 to date were up 2 per cent from last year, and in some recent weeks the increase had been as much as 10 per cent. Automobile registrations continued well below last year.

Loans of reporting member banks declined in the most recent weeks, Mr. Williams said, mainly because of decreases in real estate and business loans, whereas last year there was an increase in total loans. Borrowings at the Federal Reserve declined, although Philadelphia banks continued to be net purchasers of Federal funds in three of the four weeks of April. Mr. Williams said that the conclusions to be drawn from the review by the Philadelphia Bank were about the same as from the economic review presented by the staff at this meeting. On the basis of current developments, he felt that a continuation of substantially the existing degree of restraint would be appropriate.

Mr. Fulton said that Fourth District industrial activity continued strong despite some downward movements in activities associated with the automotive industry. Employment was holding up well. Retail sales were being well maintained and anticipated capital expenditures continued high. Loan demand was strong. There was no indication of inventory accumulations and, as a matter of fact, there was a likelihood that inventories were being liquidated because of the greater availability of goods. New orders for machine tools were about equal

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to production. The backlog of orders was no longer increasing as it had been over the past two years, but there was still a good working backlog. The steel industry reported some softening in demand for sheet, strip, and continuous welded pipe, as well as for certain types of plate. Companies using steel strip were reducing inventories quite rapidly. It was expected that automobile manufacturers, who were now consuming more steel than they were ordering, would be in the market for steel by the third quarter of the year. The road building program had a good potential but had been very slow in getting started. Mr. Fulton noted that the contracts between automobile manufacturers and unions expired in June 1958 and this might be a factor causing manufacturers to operate at high rates of production during the last quarter of this year in order to build up inventories of dealers in anticipation of a possible prolonged strike in 1958.

Mr. Fulton said that there seemed to be no reason for any relaxation of the Committee's policy of restraint. Funds were being utilized at a high rate and, if additional funds were supplied, the inflationary potential would become more active. Mr. Fulton felt that perhaps there should be some tightening. He would not change the discount rate at this time but he agreed with Mr. Bryan that if the bill rate as an index of the use of funds declined too far below the discount rate, the Committee should bring it more into consonance with the discount rate.

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Mr. Shepardson said that he was generally in agreement with the comments made thus far. The economic outlook was still on the optimistic side even though conditions varied in different industries. The point mentioned by Mr. Bryan as to the long-run picture and the prospective need for capital funds in the future made Mr. Shepardson feel that this was no time for easing. Rather, he would favor a little increase in pressure. This need not be the result of overt action, but the Committee should keep the market "snugged up." Mr. Shepardson noted that Mr. Bryan had said he would not recommend a reduction in the discount rate. Mr. Shepardson's feeling was that, if anything, the System should expect to be considering a little later on whether the rate should be increased. He certainly would not favor a reduction now. As to the bill rate, Mr. Shepardson felt it would be desirable if it were brought back closer to the level at which it had been in the recent past.

Mr. Robertson said that he had prepared a memorandum of his views and that they followed closely what had been said at the meeting this morning. He agreed that this was no time for easing the situation. The Committee should maintain restraint, and he hoped it would do so during the next three weeks in accordance with the tone of the discussions at the preceding two meetings of the Committee.

Mr. Robertson went on to say that it seemed to him that Mr. Treiber's points with respect to the relationship between the Committee and the Treasury were well taken, and he agreed as far as the

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comments went. He felt that the attempt of the Treasury to interfere with open market policy was unjustified. This should be a matter of real concern to the Committee and he hoped the Committee's feelings would be presented to the Treasury. This should not be done on an "off-the-cuff" basis but only after staff study and full discussion of the matter. There should be a definite understanding between the Committee and the Treasury of the fields of operations of each. The Committee should not be unsympathetic to the Treasury's problem; on the contrary, it should be very sympathetic. However, the Treasury also should be sympathetic to the Federal Reserve's problem. In summary, Mr. Robertson said that he would hope the Committee would find a means of bringing about a better understanding between the Treasury and the Committee with respect to the functions and responsibilities of each.

At Chairman Martin's suggestion, it was understood that the memorandum that Mr. Robertson had prepared in anticipation of the meeting would be placed in the minutes. The memorandum was as follows:

Since the last regular meeting of the Federal Open Market Committee, net borrowed reserves of member banks have declined sharply, suddenly, and unexpectedly from a weekly average level of over \$600 million in the first half of April to an average of around \$300 million. In the meantime, the Treasury bond market has been generally weak with yields tending to rise, while the bill market has been strong with declining yields.

1. On the basis of the discussion at the last regular meeting of the Committee and the minutes of the special telephone conference meeting held in the interim, the aims of System operations in this period were, in view of the

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prospective Treasury financing, to prevent the development of undue tightness that might arise from the high level of borrowings previously prevailing, but not to create a condition of ease that would indicate any reversal of restraint on credit expansion.

2. The unexpectedly sharp decline in member bank borrowing was due primarily to a substantial increase in Federal Reserve float during the Railway Express strike. This accounted for the supplying of some \$300 million additional reserves in this period. Another temporary factor supplying reserves was the deliberate reduction by the Treasury in its balance at Reserve Banks which, accidentally, was ill-timed because of the concurrent increase in float. There was also during these weeks a more than seasonal decline of currency in circulation that added a moderate amount to the supply of reserves. An offsetting factor was a contraseasonal increase in required reserves and some moderate sales of securities from System account.

3. The somewhat anomalous developments in the money market were the result of various crosscurrents. On one hand, there was a continued strong credit demand both at banks and in the capital market and the outlook for continued large capital market borrowing, as well as a more bullish attitude toward the general economic outlook. These forces tended to reduce bond prices. At the same time, uncertainties as to the terms of the prospective Treasury financing and the outlook for long-term interest rates led investors to place funds in Treasury bills, thus tending to reduce the bill rate.

4. One of the most significant developments in this period was the more than seasonal expansion in private deposits, which is indicated by the rise in required reserves. This expansion in private deposits resulted largely from a reduction in Treasury deposits which had been built up during March by tax receipts and by Treasury cash financing. Funds expended by the Treasury apparently went into the building up of cash balances rather than into the liquidation of bank credit. They are thus available for further use and represent an expansionary influence.

5. In essence, the current situation is one in which borrowing by the Treasury and by Government agencies is contributing to credit and monetary expansion that has gone beyond the aims of Federal Reserve policy. Under these circumstances, the Treasury should be obliged to compete with other borrowers for available funds and the System should avoid as much as possible making things easier for the Treasury with the result of creating a situation inconsistent

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with the System's broad objectives. Whether or not the terms of the current Treasury refunding offerings are realistic will depend upon the future course of expansion in the volume and use of the private money supply.

The situation prevailing today is not one that calls for relaxation in the System's policy of restraint on expansion and I would recommend that we "hold the line" until the next meeting--in accordance with the expression of opinion contained in the minutes of the last two meetings.

However, it seems to me that the Treasury's operations during the period, in one respect at least, represented an obvious and unjustifiable attempt to interfere with Federal Reserve credit policy. This should be a matter of real concern to the Open Market Committee. Our concern should be clearly expressed to Treasury officials.

Mr. Mills said that to some extent at the last meeting of the Committee and even more so at today's meeting he had been struck by the tone of the discussion which, in his opinion, tended to confuse what was theoretically desirable in the field of economics with what was practically attainable in the area of markets. He referred to a statement by Mr. Thomas this morning to the effect that the long-term rate of interest had not yet risen to the point that would bring about a balance between the supply of available savings and the uses to which those savings could be practically put. The implication that would derive from that statement, Mr. Mills suggested, was that the objective of System policy would be to seek a long-term rate of interest that would realize the desirable equilibrium. In so doing, he said, the System's fundamental responsibility to the economy for maintaining a proper degree of credit availability would of necessity be discarded. Furthermore, marching along that path would raise the complications to the Treasury that were voiced very ably by Mr. Treiber.

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To put the case in a little different way, Mr. Mills said that in his opinion the present market for U. S. Government securities registered the availability of credit in a very real way because it was having to absorb the securities that the pressure of System policy properly compelled the banks to sell in order to care for the legitimate demands for credit that were made upon them at a time that its absorptive capacity had already been reduced by the previous effects of the heavy demand for bank credit. Therefore, as viewed by Mr. Mills, price movements in a U. S. Government securities market that System policy had made extremely sensitive registered the availability of bank credit in line with the volume of necessitous bank sales of U. S. Government securities. Considering the System's responsibility for maintaining a reasonable degree of credit availability and also considering the desirability of avoiding actions that would throw roadblocks in front of the Treasury's financing program, Mr. Mills expressed his belief that a System credit policy belligerently seeking a higher interest rate structure would force the prices of U. S. Government securities down rapidly and their yields up in a manner contrary to the best interests of all concerned. Accordingly, it was his thought that the Manager of the Open Market Account should have latitude for gauging the feel of the market and for supplying or withdrawing reserves to the end that a degree of pressure would be exerted sufficient to prevent any overexpansion of credit while at the same time the Treasury's reasonable needs

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could be accommodated. Such a policy should presumably produce an interest rate structure consistent with the System's general policy objectives.

Mr. Vardaman said that on the basis of statistics it might appear that more pressure should be applied. However, his impression based on conversations with many persons during the past six weeks suggested the contrary. He had gotten the impression that the "boom was off the rose." Psychologically, the economy seemed to be in a very touchy period, he said, and he did not think the boom would continue. Stress could easily develop quickly if there were undue tightness in money markets. Mr. Vardaman said that his view would be to maintain about the same course that had been maintained recently. He certainly would not tighten the situation at all. Neither would he loosen it, nor would he reduce the discount rate, because the psychological effect of any dramatic action might be unfavorable. He would emphasize through System educational publications that the economy was sound, that the System expected it to develop satisfactorily, and that the Federal Reserve would supply the reserves necessary to maintain the economy. Mr. Vardaman reiterated the statement that he would not tighten the situation at all and would not commit any overt act to change the present level of pressure, but he would be prepared to supply whatever reserves were needed. He would let the public know that the System was prepared to do this.

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As to Treasury relations and the study proposed by the Chairman, Mr. Vardaman raised the question whether relations between the two institutions were such that a unilateral study should be carried out. It would be preferable, he suggested, to have a joint study made by the Federal Reserve and the Treasury. He thought this especially desirable in view of the fact that a Committee of Congress would be studying monetary and credit policy in the course of the next few months.

Mr. Leach said that the Fifth District economy continued in balance. Evidence of further weakening in manufacturing was offset by signs of strength in other sectors. Employment in virtually all nonmanufacturing categories had shown recent increases as well as gains from a year ago. High construction contract awards in March brought the first quarter to a total nearly two-fifths above 1956. Cotton textile operations continued a downward adjustment with more mills cutting back to a five-day work week. Prices were holding steady, and once again it was felt that an improvement should not be far off. Bituminous coal production was down somewhat from the high level of March, but the underlying strength of demand was unchanged. Automobile dealers within the district reported disappointing new car sales in April. Used car sales were said to have shown a satisfactory gain from March. A spot check of a few real estate lenders indicated that mortgage money was becoming more available with some effect on conventional loan interest rates and on prices of FHA loans.

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Mr. Leach said that in his judgment over-all economic activity was continuing on a plateau at very high levels. He saw no evidence of the development of a cumulative downward spiral in activity. In the hope that a healthy readjustment at present high levels might be brought about, he would continue the degree of restraint that had existed during the current statement week. Having that view of the immediate economic outlook, he thought that the Committee might expect net borrowed reserves around the \$500 million level to be appropriate. Mr. Leach made it clear that this figure was merely an indication of his thinking at the moment, and he was not setting it as a fixed goal.

Mr. Leach went on to say that it was difficult for him to understand the statements that had been made to the effect that the Committee should take no overt action during the next few weeks. He felt that if net borrowed reserves declined to \$38 million in the week of May 22, as indicated by the staff projections prepared at the Board, the Committee might need to take some action in order to maintain the existing degree of restraint.

Mr. Vardaman commented that his statement that he would not take overt action to change the present level of pressure did not mean he thought there should be no purchases or sales for the System account. He meant that nothing should be done that would be inconsistent with present policy.

Mr. Treiber said that his remarks contemplated that there might be some small operations for the System account but that it

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was not expected that there would be substantial operations.

Mr. Leedy said that Tenth District agricultural conditions continued to improve. Recent rains were in sharp contrast to the conditions that had existed for several years, and growing conditions for the wheat crop at this time were favorable with expectations of a good winter wheat crop. These conditions, plus the sizable amount of soil bank payments being made, should place agriculture in a favorable position during the current year. Mr. Leedy went on to say that he had been surprised at the strength shown by statistics thus far this year for most parts of the district in the face of the widespread drought that had been experienced. Retail sales were at the same level as a year ago. Employment was stable and, although there was variation from area to area, the over-all situation seemed strong. There had been no evidence of pressure on bank reserves in recent weeks. This situation probably had been influenced by large payments made at the end of March by the Commodity Credit Corporation on wheat loans, and there also had been a sizable increase in bank deposits flowing into the district, particularly in the oil area in Oklahoma.

As to System policy, Mr. Leedy would continue to exercise restraint. Statistically, perhaps there should be greater restraint than had existed on the average since the preceding meeting of the Committee.

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With reference to relations with the Treasury, Mr. Leedy said that he did not differ with the suggestion for a study of the ability of the Treasury to counteract policy of the Committee. He felt that the recent Treasury action of reducing its balances for the purpose of putting funds into the market was an act that was intended to circumvent the program being followed by the Committee. Mr. Leedy said that while he would not attempt to summarily resolve the issue with the Treasury, he wished to make the point that from the very nature of the operation the Treasury should have discussed the action it had in mind with the Chairman of the Committee before undertaking to carry it into effect. Mr. Leedy felt, accordingly, that it would be appropriate for the Treasury to be promptly informed to that effect and at the same time advised that the Committee expected to go further into the matter and to discuss it with the Treasury at a later date.

Mr. Allen said that business activity in the Seventh District continued at a high level. Total construction was about the same as a year ago despite the fact that Midwest awards for both residential and nonresidential construction had been weaker than in the nation. The job market in the Seventh District had continued to ease somewhat. In March and April, a number of Midwest centers failed to experience employment gains that had been anticipated by the local analysts. In no case, however, was there any significant deterioration expected in the months to come, and many centers expected some improvement.

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The major development in Seventh District business loans during recent weeks had been a slowing in the rate of increase in loans to metal and metal product firms. From the start of the year through March 20 and the final spurt in corporate borrowing to meet tax payments, the rise in outstandings of metals companies at district reporting banks matched the gain recorded a year earlier. In the seven succeeding weeks from March 20 through May 1, however, such loans registered a \$14 million decline compared with a \$49 million rise last year. Time deposits at Seventh District member banks made further gains during March, bringing balances to a level 6-1/2 per cent above a year ago. Recent gains had been at an increasing rate. In general, cities where banks had boosted interest rates paid on savings deposits showed the largest gains in balances. The increase in savings deposits reflected both a rise in savings inflow and a decline in withdrawals.

With respect to credit restraint, Mr. Allen said that he believed the program should be continued with roughly the same degree of restraint as we have had. He considered that feel of the market was more important than any figure to be used as a guide, but he would consider that net borrowed reserves around \$500 million might be indicative. If that degree of restraint were to be maintained, the Committee would either have to sell securities or permit present holdings of bills to mature without replacement, on the basis of the projections of reserves.

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Mr. Allen then referred to the comments he had made at the telephone conference meeting on April 24 regarding the Treasury's action in reducing its balances in order to put more reserves into the market. The Treasury does a good many things that offer difficulty for the Committee, Mr. Allen said. The reduction in balances was a minor action compared with many other things that cause difficulty for the Committee. While it would be appropriate to discuss this matter with the Treasury, he felt that the Committee should not complain about everything the Treasury did that caused the Committee difficulty.

Mr. Deming said that in the Ninth District employment was up from a year ago in both manufacturing and nonmanufacturing activities. Farm prospects were better than they had been for the last several years. Credit demand continued extremely strong. At city banks, this was in the face of a seasonal loss in deposits. These influences had resulted in a sharp increase in borrowings from the Federal Reserve Bank in recent weeks.

Nationally, Mr. Deming said that he was impressed more with the factors of strength in the economy than with the factors of weakness. This argued for a continuation of a policy of restraint. He would not disagree with the estimate of around \$500 million of net borrowed reserves. He shared with Mr. Bryan the feeling that the bill rate might be higher than the discount rate, and he hoped that a continuation of pressure would be reflected in a somewhat

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higher bill rate than at present. Mr. Deming said that he also felt that during the week of May 22 when projected net borrowed reserves would be low, it would be desirable to take some action to keep the level of net borrowed reserves in rough line with the \$500 million average level suggested.

Mr. Mangels said that there seemed to be some evidence of a change in pace of activity in the Twelfth District. In past years the increase in nonagricultural employment during the first quarter of the year had been somewhat above the increase nationally, and in 1956 each quarter had showed a rise over the preceding quarter. During the first quarter of 1957, the figures of employment showed practically the same level as during the last quarter of 1956. For two months in succession now, nonagricultural employment had shown a slight decline with most of the decline coming in manufacturing, mining, and construction. Total manhours worked in manufacturing industries declined from January through March, Mr. Mangels said, although the total at the end of the quarter was 6 per cent higher than a year earlier. There had been a slight increase in building and March was above February, although residential permits were still down. Public construction was expected to show some increase during the next few months and there had been indications of an increase in heavy construction. Steel production, contrary to the national picture, was about 100 per cent of capacity and there were

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plans for expansion of steel facilities on the West Coast. Lumber production was still below 1956, but Mr. Mangels said he sensed a little more optimistic feeling on the part of lumber people than a few weeks ago. Some of the plywood mills had gone to a five-day week and there were indications of some strengthening in prices.

Retail sales in the Twelfth District were up 6 per cent during the Easter period. Automobile registrations in California in the first three months of this year were 6 per cent above the first quarter of last year, although in other States declines were reported. A decrease in the volume of work at automobile service establishments was also indicated.

Twelfth District reporting member banks showed an increase in loans during the four weeks ending April 24, Mr. Mangels said. Banks expect that loan totals will be held below the figures of a year ago. There continued to be a runoff in mortgage loans and an increase in savings accounts, Mr. Mangels said, and those funds are not being fully reinvested in mortgages.

As to policy, Mr. Mangels said that he had in mind a figure of about \$500 million for net borrowed reserves as a maximum. He would not be concerned if they fluctuated between \$400-500 million. Neither would he be concerned if some variations in float created some temporary easing. Mr. Mangels thought the present directive was satisfactory, and he would propose no change in the discount rate at this time.

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Mr. Mangels said that he agreed that the Committee must consider not only the needs of commerce and industry and the general credit condition of the country, but it should also give sympathetic consideration to Treasury needs.

Mr. Irons said that the national situation seemed to be one of improving strength with still some uncertainty in the picture. This was about the picture in the Eleventh District also. Employment was up in manufacturing. Construction activity was also up. There was considerable plant expansion in the Dallas, Fort Worth, Houston, and Gulf Coast areas. Agricultural conditions were better than for some time. Automobile sales in Dallas and Houston were running counter to most reports and showed an increase of 11 per cent during the first four months of this year as compared with the same period a year ago. In April they were well above April a year ago.

Mr. Irons said that he considered impressions of businessmen to be important, and he observed them now as reflecting a cautious optimism. He knew of no pessimism. More and more businessmen were becoming fearful of the steady inflationary rise in business costs. They feared that they might not be able to continue to pass on the rise in costs in higher prices. Businessmen more or less accepted the necessity of a restrictive credit policy, Mr. Irons said, and they were trying to decide what that meant to their own businesses.

Mr. Irons said that he would continue a policy of firm credit restraint with any deviation from the normal being on the side of

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greater restraint rather than on the side of ease. As to net borrowed reserves, he thought the Account Management should be guided by the behavior and feel of the market. That might be the guide whether net borrowed reserves were \$800 million or \$300 million. He did not think the average of net borrowed reserves was too significant, feeling that it was a resultant of forces that of themselves might not be too significant. The Account Management must take the responsibility of appraising the feel and the tone of the market.

With respect to the Treasury problem that arose in the last three weeks, Mr. Irons said that while this was an important issue, he doubted the wisdom of making it a major issue. As Mr. Allen had indicated, handling of the Treasury balance was within the province of the Treasury. It was not within their province to handle credit policy. With the two institutions each having important and basic responsibilities, he believed it desirable to try to bring about understanding by contact between the Chairman of the Committee and the Secretary of the Treasury. He doubted that a statistical study of the Treasury balance or that making a major issue out of movements in that balance would provide the answer to the problem.

Mr. Erickson said that conditions in the New England District were not materially different from the national picture outlined. He found the same feeling of cautious optimism that Mr. Irons had reported, along with concern about future inflation. Mr. Erickson said

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that ordinary life insurance sales in the First District in March were substantially ahead of March 1956. Construction in all classifications also was ahead of March last year except in the case of public works, in which the total a year ago had been especially high. Residential building in the first quarter of this year was also only 4 per cent below last year. For the first time in some months there had been evidence of optimism in the textile industry, Mr. Erickson said, and he reported the comments of wool and worsted dealers last week who said that business was very good. Mr. Erickson reported a semi-annual conference held last week with economists from insurance companies, banks, and other businesses. He summarized their views as recognizing the deceleration of growth, which might continue during the second and third quarters of 1957. However, they anticipated that the last quarter of this year would show an upward movement.

As far as policy was concerned, Mr. Erickson said that he would suggest no change in the discount rate or in the Committee's directive at this time. He agreed that the present degree of restraint should be maintained. He would hesitate to name a figure of net borrowed reserves as a guide, although he would accept the \$500 million mentioned as a rough indicator.

Mr. Balderston said that he was much impressed by the comments made by Mr. Irons regarding the concern in the Eleventh District as to creeping inflation. He had had the feeling that it was the mission of the Federal Reserve to control the money supply so effectively that

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inflationary tendencies might be curbed until such time as excess capacities served as a brake on cost increases and wage advances. Mr. Balderston said that this led him to a problem for which he was not prepared to suggest a fully developed solution. He mentioned it now because June might be the only nearby time for the introduction of a remedy on account of the Treasury's recurrent approaches to the market.

He then made a statement substantially as follows:

The problem has to do with facilitating the administration of the discount window. I fear that we increased the money supply inadvertently during the month of April through member-bank borrowing, some of which has been described as complacent. The total of member-bank borrowings rose to \$1 billion 50 million in the week of April 3, \$1 billion 205 million in the week of April 10, \$1 billion 122 million in the week of April 17. Chiefly because of the Railway Express strike it then dropped to \$704 million for the week of May 1. At the end of the borrowing bulge, however, 107 Central Reserve and Reserve City banks had borrowed continuously for 7 weeks or more and 338 country banks for 4 or more borrowing periods. In short, the member banks seem to have taken care of the Treasury cash offer of March 28 and the Chicago tax situation of April 1 by borrowings at the discount window which had the effect of increasing the money supply by perhaps \$1 billion. This estimated increase, if accurate, carried the money supply (that is currency plus demand deposits, excluding those of the U. S. Government) from \$133.8 billion at the end of March to \$134.8 billion at the end of April. I point to this increase with some hesitation because, although seasonally adjusted, one cannot be sure of the accuracy of the seasonal correction and of the influence of random causes. The year-ago figures also increased between the end of March and the end of April, and by \$1 billion 3 million. Moreover, the current estimate of \$134.8 might be looked upon by some as so close to the April total of a year ago of \$134.4 as not to cause concern.

However, I am concerned that our instruments of control need to be perfected and that June may offer the only nearby opportunity in which to do it.

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Those districts that have experienced trouble with continuous borrowers might wish to think of a penalty discount rate $1/2$ per cent higher than the regular discount rate for those borrowers who come to the window for the third, or perhaps for the fifth successive discount period. Governor Coyne of Canada told us recently that he has used a penalty rate for banks that borrow more than once within a month. Such a penalty might help make Federal Reserve or federal funds borrowing intermittent, and thus reduce the difficulties of discount-window administration. I am not suggesting that this device would be needed by all districts or that it would be appropriate for those banks having heavy seasonal loan fluctuations associated with cotton and other agricultural products.

I do not know whether a change in the discount rate will be indicated by the state of business and of business psychology in June. If, however, some action at that time is needed, it might take the form in one or more districts of a penalty discount rate of $3-1/2$ per cent for continuous borrowing, thus giving the System an opportunity to test out a new instrument of control while leaving the present discount rate unchanged for the majority of member banks.

Chairman Martin said that he was gratified with the thoughtful and interesting way in which the members of the group had been approaching the problems before it. He thought there was no great problem of a consensus this morning.

The Committee, the Chairman said, was struggling with the most difficult and the only fundamental problem that the System faced-- the medium of communication and how to handle the over-all problem. Mr. Mills had mentioned theory and practice. Chairman Martin was convinced that the answer was somewhere in the middle ground: if the Committee ignored theory completely, it would be in trouble, and if it ignored practice, it also would be in trouble. He agreed

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completely with Mr. Vardaman that a joint study of the institutional relations with the Treasury was the way to approach that problem. However, it must be recognized that under the present structural setup the Management of the Account had a very real problem. It was dealing constantly with the Treasury, handling its balances, its trust accounts, and other operations under the fiscal relationship on a day-to-day basis. A good many of the Committee's critics believed that the present arrangement was too cumbersome and that it should be changed. A special committee was now reviewing the work that had been done by the Ad Hoc Subcommittee several years ago on the question of internal operations, the Chairman noted. It was also necessary to do some work on the problem that Mr. Treiber had so adequately and clearly raised this morning concerning the Treasury, about which there could be honest differences of opinion. However, the Chairman expressed his judgment that the present, with the possibility of a change in the management of the Treasury, was not a particularly good time for a joint study.

Continuing, Chairman Martin said that it was important that the Committee know exactly what it was to study. He suggested that Mr. Rouse, as Manager of the Account, with the assistance of Messrs. Treiber and Riefler, bring together for all of the members of the Committee as much information as possible regarding this problem.

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He thought that it would be necessary for all members of the group to do considerable reading and thinking about the problem.

The Chairman went on to suggest that the Committee had not in the past been in a position to speak to the Treasury as a Committee. The Treasury would discuss its problems with the Manager of the Account, or with the Chairman of the Committee, when neither Mr. Rouse nor the Chairman or any other member of the Committee was in a position to say that the Committee had discussed the matter and that it had reached a judgment as a Committee. The Committee should try to work toward a broad study and to get in a position where it would be possible to say what the Committee's judgment was. None of the members of the group should underestimate the complexity or the nature of this problem, the Chairman said, noting that it was not a stationary problem and not one that could be resolved at a given time--rather it was one that was continuously with the Committee.

This was the problem the Manager of the Account was struggling with constantly, Chairman Martin said. The Committee should hammer out more clearly than it had to date just what procedures it wanted to follow. As Mr. Johns had suggested this morning in connection with the study of float, if all of us studied this problem individually we might not be quite as certain that we had the answers when questions arose. The Committee should work toward the joint

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study with the Treasury but what was needed fundamentally was a review of the ideas raised in the Ad Hoc Subcommittee report regarding the position of the Manager of the Account, the New York Bank, and the operations for the Treasury. All of these should be put in focus, not as they were working at the moment but as they were likely to work over the next few months. The Chairman said that he felt the Committee had been making progress and he was not expressing dissatisfaction on what had been done thus far. The Committee should be encouraged that it had done as well as it had with a difficult credit problem.

Chairman Martin then referred to the comments of Mr. Balderston regarding a penalty discount rate. This should be considered in terms of public relations and public understanding as well as technicalities. Inflation is the most serious problem confronting the countries of the Western World today, the Chairman said. He reported recent inquiries by two senators and a congressman as to whether he could name any products that were in short supply. Personally, Chairman Martin said, he knew of nothing in short supply at the moment but the essence of the problem was whether the market was going to create the demand or whether we were going to use borrowed money to take the products that were in supply; whether short-term credit would be used for long-term purposes to create demand where there seemed to be temporary

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overcapacity or overproduction of some products. Mr. Young had presented the Committee with a paper on the basic economic problem. The Chairman said that he might not be able to name products that were now in short supply, but monetary policy could not be used to restore a price level that had been lost through inflationary processes. The country was now operating at an inflated price level and adjustments were taking place. The difficulty of passing higher costs on to the consumer had increased, Chairman Martin said, and we were at the juncture where pressures would become increasingly great for creating demand by simply pumping up credit. This was the basic problem in the struggle against inflation. The Committee could expect a good deal of questioning on this problem by Senator Byrd's Senate Finance Committee in its forthcoming study. None of us believe that money and credit policy can do the whole job of restraining inflationary developments, the Chairman said, but a posture of monetary and credit policy that was set to counter such developments was infinitely more important in present circumstances than at any other time. If the general posture of the Committee was right, the Committee would then be discharging its responsibility.

Chairman Martin then referred to the directive, stating that it seemed clear that the consensus was to maintain essentially the status quo. There was no intention overtly to ease or overtly to tighten the situation. The Manager of the Account would have to exercise his judgment. Since this was partly an institutional

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problem, the Committee should bear in mind that if the Treasury should run, say, \$2 billion of attrition on its current refunding, the Treasury would have to obtain additional money somewhere. While he was not forecasting such a development, he felt it important that the Committee see both sides of the problem. Chairman Martin then inquired whether there was any disagreement with the consensus as he had stated it.

Mr. Vardaman asked whether the Chairman's remark that he knew of no products now in short supply suggested that demand for these goods would be increased if policy were relaxed and negative free reserves were permitted to go to par.

Chairman Martin responded that he didn't know but in his judgment such action would increase the inflationary pressures.

Mr. Rouse said, in response to the Chairman's inquiry, that he (the Chairman) had stated clearly the consensus as indicated at this meeting. He would interpret this as giving him clearance to continue to assist dealers in the refunding through repurchase agreements, if there should be a need for such assistance. However, he added that dealers were not buying "rights" in volume and he would not expect a substantial need for repurchase agreements to emerge. Mr. Rouse noted that there had been several suggestions as to the Treasury bill rate. While the System account did not now have enough Treasury bills to influence the rate, Mr. Rouse felt that the present level of bill rates was principally a reflection of

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the desire for liquidity at the present time. It also reflected System policy. He would not expect to attempt to influence the bill rate, but he would attempt to maintain the current level of pressure until the next meeting of the Committee.

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 while recognizing uncertainties in the business outlook, the financial markets, and the international situation, 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;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate \$500 million;

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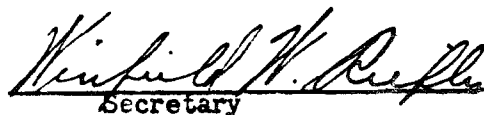
(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate \$500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

The Chairman then referred to items 4b and 4c on the agenda, 4b relating to guides for open market operations to carry out Committee policy, and 4c relating to the responsibilities of the Treasury and the Committee in the area of open market operations. He suggested that the general discussion of these matters that had already taken place might be sufficient for this meeting, and there was no disagreement with this suggestion.

Mr. Robertson stated that the Committee on Float (Messrs. Erickson, Johns, and Robertson, Chairman) had received from the subcommittee a report dealing with the subject. He suggested that copies of the report be distributed to each Reserve Bank President and to each Board Member, and it was understood that this procedure would be followed.

It was agreed that the next meeting of the Committee would be held at 10:00 a.m. on Tuesday, May 28, 1957.

Thereupon the meeting adjourned.


Secretary