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 28, 1957, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Bryan
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman
Mr. Williams

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. Thomas, Economist
Messrs. Atkinson, Bopp, 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 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

Messrs. Hostetler and Wheeler, Vice Presidents, Federal Reserve Banks of Cleveland and San Francisco, respectively; Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis; Messrs. Willis and Meigs, Financial Economists, Federal Reserve Banks of Boston and St. Louis, respectively; and Mr. Walker, Economic Adviser, Federal Reserve Bank of Dallas.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 7, 1957, were approved.

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 May 7 through May 22, 1957, as well as a supplementary report covering commitments executed May 23 through May 27, 1957. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse stated that Mr. Erickson recently suggested that some elaboration of the report of open market operations at the meetings of the Committee would be helpful. He went on to comment on the money market during the past three weeks, stating that in this period developments had worked out about as had been expected. The principal problem was the Treasury financing, which had been an unhappy experience for the Treasury and had resulted in attrition of $1,167 million. Float had climbed to its usual monthly peak during the past week and had been only partly offset by System account sales, but the effect of the reserves released by float had been confined to day-to-day money market rates. Basic rates remained unchanged, and investors did not want to follow the bill rate under 3 per cent. Reinvestment of the $1,167 million attrition did not generate the expected demand for bills, Mr. Rouse said, and the bill rate yesterday had climbed back to 3-1/4 per cent. He added that the easier situation that had developed in the money market a few days earlier might not have been entirely the result of the rise in float but could have reflected the distribution of reserves in the banking system. For the first time in some period, the New York banks had found themselves in a somewhat easier position.

Looking ahead for the next three weeks, Mr. Rouse said that the projections of reserves prepared at the New York Bank and by the Board's staff were substantially in line with each other. He did not anticipate any material change in the present situation until the tax period and the rise in float in June.

Mr. Rouse also said that he had been asked about the sale of $300 million of gold by the International Monetary Fund to the Treasury, which transaction was taking place today. When he first heard of this transaction, he requested the Treasury to arrange that it take place on the day on which the effect on member bank reserves of the payment for the Treasury tax anticipation bills would take place. In this manner, the System account could avoid the problem of putting in a large amount of reserves for a brief period and withdrawing them a few days later. He noted that the Treasury would make large payments for redemptions of F and G bonds next Monday.

Mr. Rouse stated that the major problem during the past week had not been directly related to the reserve situation but had been the fact that capital markets had been under extreme pressure. New financing issues had been in record volume in the first quarter of the year, and the calendar ahead was increasing so that the backlog was being maintained. This had resulted in a rate situation in the market which had been attributable in part to delays by the Treasury in offering refunding securities to holders of F and G series savings bonds. Perhaps a more fundamental factor was the basic supply and demand situation. The 3 and 3-1/4 per cent Treasury bonds had remained where they had been for some time, while yields on new corporate offerings had risen to as much as 5-1/4 per cent. This suggested, Mr. Rouse said, that there would have to be a rather substantial adjustment in Treasury bond yields if they were to go along with the rest of the market. We were dealing with a very delicate situation, he said, one that would require the Trading Desk to be constantly alert. A serious situation could develop although Mr. Rouse said he thought it more likely that the present situation would continue. However, if a large offering should be pressed for sale on the market by investors, there could be a sudden and marked effect.

Mr. Vardaman entered the room during the course of Mr. Rouse's comments.

Mr. Robertson said that he wished to compliment the Management of the System Account on the way in which it had handled operations during the past three weeks. He still had a little doubt about the tendency to offset such a matter as float on the tight side and not to do so when it tended to ease the market.

Mr. Leach noted that the report of open market operations that had been prepared at the New York Bank commented on purchases and sales of Treasury bills during the past three weeks and made the statement that these purchases and sales were achieved without any overt intervention in the market. Mr. Leach expressed the view that any sale of securities by the System account would represent an overt action.

Mr. Rouse responded that the securities were not sold with any splash, that purchases were being made at substantially the same time, and that it appeared that the net effect of whatever was being done was substantially a wash operation.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period May 7 through May 27, 1957, were approved, ratified, and confirmed.

A staff memorandum on recent economic and financial developments in the United States and abroad had been distributed to all members of the Committee under date of May 24, 1957. This memorandum stated that business indexes continued to show mixed tendencies, with some measures edging up and others drifting down. The industrial production index seemed likely to be off another point in May but to continue above a year ago. Inventory adjustments were continuing in consumer durable goods industries and in some other industries such as steel. Wholesale prices had been showing little change while retail prices advanced somewhat further in April. Consumer buying appeared fairly strong, particularly for nondurable goods and services. Private housing starts rose in April from the reduced rate in March. Labor market demands and supplies seemed in reasonable balance, with no strong uptrend or downtrend in employment and with fluctuations in unemployment reflecting mainly seasonal changes. Demand for credit continued heavy and interest rates had risen again recently. The review indicated that concern about a cyclical decline in business apparently had diminished, and stock market prices had been advancing. Abroad, demand pressures remained generally dominant and new anti-inflationary measures had been announced this month in several important countries.

Chairman Martin called upon Mr. Young at this point, and Mr. Young stated that the staff would make a chart presentation at this meeting giving background material on recent Federal Reserve policy problems. This presentation had been prepared, Mr. Young said, with the thought that it might be used in furnishing information to the Senate Finance Committee in its forthcoming inquiry into monetary policy and other matters. Members of the staff then entered the room to assist in the presentation, after which they withdrew.

The presentation pointed out that for two years, since recovery from the minor recession of 1953-54, economic activity in the United States had been at record levels with resources generally being used intensively. Thus, the recent economic policy problems of Government had been the problems of a period of high production and employment, not those of a period of curtailed production and widespread unemployment. Widespread price increases over a considerable period of time had been disturbing. Greatly increased demands for short-term credit and also for long-term credit had been reflected in an increase during the past two years of $18 billion, or about one-fourth, in the volume of loans outstanding at commercial banks. Banks had obtained more than half the funds needed to increase their loans by reducing holdings of Government securities, however, and the growth in total bank credit had thus been much less than the growth in loans. Savings as well as demands for funds had increased over the past two years, but even with some growth in total bank credit demands for funds had been so strong relative to the amount available that interest rates had risen substantially. Even with this substantial rise, the level of rates now prevailing was not high by historical standards or by comparison with rates prevailing in other countries. The review also pointed out that gross national product had risen from an annual rate of $387 billion in the second quarter of 1955 to a rate of $427 billion in the first quarter of 1957. About half of this increase of 10 per cent represented a rise in prices and half a rise in volume of output. In concluding this presentation, it was stated that one of the possibilities in the period ahead was a situation characterized by growing capacity and high production, with credit expansion restrained and price changes held within relatively narrow limits. A period of "rolling readjustments," with fairly stable prices, could be expected to last much longer than a speculative boom based in any substantial part on hope of gain from perpetually rising values.

A copy of the script of the foregoing presentation was sent to each member of the Committee following the meeting, and a copy has been placed in the files of the Federal Open Market Committee.

Chairman Martin stated that since the preceding meeting of the Committee, Senator Byrd had called him on the telephone and outlined to him the course of the proposed hearings before the Senate Finance Committee on Governmental financial and monetary policies. It was contemplated that, if Senator Bryd agreed, the presentation that had been made by the staff this morning would be used at the hearing. The current plan, Chairman Martin said, was that Secretary of the Treasury Humphrey would appear as a witness at the hearings in mid-June, that Under Secretary of the Treasury Burgess would appear after the Secretary, and that he (Chairman Martin) would appear following testimony by the Secretary and Under Secretary.

Chairman Martin noted that the Committee had been trying to find a better procedure for communication with the Treasury in the hope of being more certain that each understood the problems of the other. Along this line, he and Mr. Balderston met with Secretary Humphrey, Under Secretary Burgess, and Mr. Wren, Assistant to the Secretary, last Thursday, May 23, to discuss problems of mutual interest. The Treasury representatives were anxious that the Federal Open Market Committee understand the nature of their problems. They recognized that they would have to pay the market rate for any financing that the Treasury might do, but at the same time they emphasized the difficulty of their position and the delicate problems that were being caused by the higher interest rates, including the increase in rates on series E and H savings bonds. They pointed out that the Treasury had secured the maximum increase in the savings bond rate that could be gotten from the Congress at this time, and it was out of the question as a practical matter to secure any further increase in that area. This meant that, with a large volume of series F and G savings bonds outstanding in the form of demand obligations, the Treasury officials were apprehensive regarding possible developments. They desired that the Committee be fully aware of these problems and of their apprehensions. Chairman Martin expressed his feeling that the Committee had a delicate problem with respect to the underpinning of the Government securities market generally.

Mr. Balderston added the comment that Secretary Humphrey had referred in this discussion to the expectations of businessmen as a factor creating some of the current difficulties confronting the country.

Chairman Martin then called upon Mr. Hayes for a statement on the economic situation and open market policy, in response to which Mr. Hayes made a statement substantially as follows:

The economic situation continues fundamentally strong and essentially unchanged since the last meeting. Business optimism seems to have increased perceptibly, even though most current indices of physical production and distribution indicate a sidewise movement at best, and perhaps a slight downward tilt.

Instead of enumerating all the major elements of strength and weakness, which are well known to all of you, I should like to stress a few rather confusing elements in the picture. For example, it is difficult to reconcile the failure of retail sales (seasonally adjusted) to record any progress since November with the rising trend of consumer income and of the consumers expenditure component of gross national product. Another surprising development has been the upward revision in estimated corporate profits for the last quarter of 1956 to an annual rate of 46.7 billion dollars and the maintenance of about this level in the first quarter of 1957. Apparently the widely held view that business generally has been subjected to a profits squeeze is not based on a firm statistical foundation, although such a squeeze may yet develop, and some industries have no doubt experienced it. The profit trend suggests greater gains in productivity than had been generally expected. It may account in part for the growing business optimism and for the maintenance of capital spending programs at very high levels despite the loss of momentum in consumption.

In the area of prices we also find rather mixed trends. On balance the upward pressures on prices may have subsided somewhat, with some basic material prices again tending downward after a period of hesitation. Wholesale prices in the aggregate are no higher than a month ago, but consumer prices rose again in April and will probably increase further in May. In sharp contrast with the recent trend of basic material prices is the widely expected increase in steel prices in July which could have pervasive effects in the economy, and upward wage pressures also are still certainly in evidence, in part as a result of provisions for automatic increases embodied in existing contracts.

A good deal of comfort is to be found in the latest figures on bank credit. In the first place, the growth in business loans in the four weeks through May 15 was much less than a year ago, and there was an actual decline in total loans as compared with a sizable increase in 1956. Even with a substantial allowance for June tax borrowing it seems likely that the rise in bank loans for the second quarter may be only about half as great as last year. Secondly, the last four weeks have witnessed a sharp drop in bank holdings of Government securities, following the large gain occasioned by the bank underwriting of the cash offering late in March. As a result, whereas privately held demand deposits had expanded by some $1.2 billion in the four weeks ended April 24, this rise was more than wiped out by a drop of $1.6 billion in the following three weeks. Thus it would appear that maintenance of steady pressure on bank reserves has succeeded in preventing any lasting addition to the money supply in connection with the recent bank underwriting of the new Treasury issues. This is particularly gratifying in view of the fact that Treasury cash borrowing has been so much larger in 1957 to date than in any spring period of recent years.

In contrast with this modest easing of demand for bank credit, the demand for long-term capital remains extremely high and apparently well in excess of available savings. Personal savings are reported to have turned downward in the first quarter, reversing the trend of the preceding year, although these statistics are admittedly none too reliable. There is some circumstantial evidence to confirm this result, however, in the reduced rate of deposit expansion at mutual savings banks in the first quarter. If the rate of savings has actually fallen, this is still another confusing element in view of the failure of retail sales to expand as personal incomes have risen. Even after the past month's substantial upward adjustment of yields on new corporate and municipal issues, there are still signs of indigestion in this area, and the feeling of uncertainty in the capital markets is enhanced by the prospect of a new Treasury cash offering of $3 to $4 billion within the next month or two, together with the large refunding required in connection with the Treasury's August maturities.

The very fact that the economic indicators are somewhat mixed and confusing suggests that it should not be too difficult to determine sound credit policy at this juncture. Until the business outlook is further clarified, I would think it unwise to make any overt change in policy, and I would therefore favor maintenance of about the same degree of pressure on the money market as has obtained for

> the past several weeks, with no change in the discount rate or in the directive. Additional justification for a policy of cautious steadiness in applying restraint may be found in the recurrent waves of uneasiness that have characterized the capital markets, as each new rate plateau has proved too low for a sustained equilibrium between supply and demand. The demand pressures will soon produce even greater stresses as repeated Treasury refunding operations are interspersed with cash borrowing of \$8 to \$9 billion over the summer and autumn, while the usual seasonal demands of business will be crowding upon the banks. Indeed, expectations of that coincidence of heavy demands may already be exerting new unstabilizing influences in the capital markets. Subject to the usual reservations as to our trying to set any specific statistical target, I would think that net borrowed reserves of somewhere around \$500 million and member bank borrowings around \$1 billion, would be entirely reasonable. If our present projections for the next three weeks turn out to be at all accurate, this would mean that a minimum of open market operations would be required to accomplish our objectives, although it is conceivable that a moderate volume of repurchase agreements and outright bill purchases might be called for during the coming week, especially if the atmosphere in the capital markets should show any further deterioration.

Mr. Erickson said that during the last three weeks there had been no significant changes in the economy of New England. Employment was still high. April 30 figures of purchasing agents indicated that expansionary forces were not now as strong as they were earlier but they were still present. It was expected that expenditures for research and development would be 20 per cent greater in 1957 than in 1956. Figures covering mutual savings banks as of the end of April indicated the same tendency that Mr. Hayes had reported, namely a continuing decline in the rate of growth of deposits at such banks. Mr. Erickson said that he would recommend no change in the discount rate or in the Open Market Committee's directive at this time. He would suggest a continuation of the same policies and operations that had been followed during the past three weeks.

Referring to the comments that Mr. Rouse had made concerning recent open market operations, Mr. Erickson stated that he suggested such a report by Mr. Rouse with the thought that it would be helpful to the Committee in reaching its judgments to have a brief oral resume of salient factors at the beginning of each open market meeting. This would be in addition to the excellent written reports that each member of the Committee received from the New York Bank each week and before each meeting.

Mr. Erickson also referred to the daily wire that was sent to each member of the Committee and each Reserve Bank President before lunch, immediately following the morning telephone conference. He suggested that if, after reading the wire, any of the members of the Committee had questions as to what the desk should do, they discuss them with the Trading Desk at the New York Bank to see if the situation could be clarified. They should also talk with the Chairman of the Committee and in that way attempt to have a continuous understanding of what was going on.

Chairman Martin said that these were excellent suggestions, adding that having Mr. Rouse comment on the general situation at the beginning of each meeting would be helpful to all of those present. He then called upon Mr. Irons.

Mr. Irons said that there had been no new developments of significance in the Dallas District during the past three weeks. The district was moving along at a high level of activity with tendencies similar to those in the national picture. The outlook and confidence were strong. Department store sales had not come up to expectations, and petroleum production was down a little, although it was still high. These were about the only indicators showing declines in the area at the present time. Employment was up; construction was up. Residential awards had been larger during the first quarter of this year than a year ago while nonresidential construction was very strong. New automobile sales during the first four months of 1957 were 10 per cent above the comparable period last year. The agricultural situation had been favored with ample moisture but the rains had delayed planting of some crops. Reserve city banks were in a moderately comfortable reserve position and country banks had excess reserves. Borrowings had not been heavy although there were three or four continuous borrowers with whom the Dallas Bank was keeping in touch.

Mr. Irons said that Mr. Hayes had expressed his view as to credit policy: to try to maintain during the next three weeks about the degree of restraint that had been maintained recently. This was called for by the economic situation, but at the same time the very delicate situation in the capital markets meant that the details of the operation must be left to the judgment of the Management of the

System Account. Mr. Irons would not favor a discount rate change at this time or any overt action to alter conditions in the money market.

Mr. Mangels said that West Coast conditions paralleled closely those described thus far. There had been a little improvement from the situation reported at the preceding meeting. Nonagricultural employment had increased slightly. Contrary to the pattern of the past two years, residential building permits were higher in April than in March, and they were also higher than in April of either 1956 or 1955. Requests for VA and FHA appraisals had risen, indicating that building conditions might improve in future months. Steel furnaces of the district were operating at 100 per cent of capacity, and finished steel was being produced at 95 per cent of capacity, rates somewhat better than the national figures. Automobile sales during the first quarter of 1957 were 5 per cent above the first quarter of 1956, improved sales in Arizona and California having more than offset slower sales in other parts of the district. Twelfth District bank loans increased during the latest four-week period by more than the national increase. Borrowings at the Reserve Bank were nominal, and Twelfth District banks were still net sellers of Federal funds.

As to policy, Mr. Mangels said that he would go along with what had been said thus far, believing that the Committee should continue about the same policy that it had had in recent weeks.

There should be no change in the discount rate. Mr. Mangels said that he would have no objection to modification of clause (b) of the Committee's directive so as to eliminate the reference to the international situation; he did not believe that a change was necessary at this time although the Committee might wish to consider a change in the directive soon.

Mr. Deming said that the situation in the Minneapolis District was about the same as in the districts for which comments had been made. Agricultural prospects were better than in the past two or three years, with producers of both crops and livestock feeling that the outlook was very good. Farmers generally were optimistic. Iron ore shipments had risen in April. Credit demand continued strong. With respect to the national picture, Mr. Deming said that he would not disagree with the comments made at this meeting. There should be no overt action taken at this time to change policy and there should be no change in the degree of restraint.

Mr. Allen reported that Seventh District business sentiment had made a further swing in the direction of greater optimism. The over-all situation was still one of high level stability. Retail sales revealed reasonably aggressive consumer demand, with department stores reporting a sales gain of 5 per cent in the four weeks ending May 18 compared with a year earlier, and a 4 per cent gain for the year to date. Total employment was slightly higher than last year in most district centers. Salaries and wage payments were up 5 or

6 per cent as in the nation and were expected to show further gains. Mr. Allen said that residential construction in the Seventh District was slow and gave no evidence of a pickup. However, employment in construction was higher than last year in all large Seventh District cities and in many smaller communities. Hiring plans in most cities of the district were fairly optimistic, with shortages of engineers, machinists, draftsmen, clerical workers, stenographers, and typists continuing. The Chicago Reserve Bank currently had 250 unfilled requisitions.

Commercial banks reported a continued strong demand for loans. The smaller rise in business loans thus far in 1957 than in corresponding months of 1956 had been caused primarily by a larger volume of repayments. The volume of new loans had been either higher or virtually the same as last year for all industries except construction. Automobile credit terms had been easing, Mr. Allen said, and the proportion of loans on new cars written for more than 30 months to maturity had been rising in recent months. In April, 29 per cent of such loans in Indiana were for more than 30 months maturity; in Southwest Michigan the proportion was 19 per cent, and in other areas 43 per cent. Farm income in the Seventh District had been gaining, Mr. Allen stated, and cash receipts in March were 8.6 per cent ahead of a year earlier, compared with a gain of 4.5 per cent for the country as a whole. It was not expected that this margin of gain would continue for the entire year of 1957, but it was expected that enlarged Government payments would more than offset any decline in income from marketings, with the result that total cash farm income and net farm income as well would show modest gains over 1956. Farm spending apparently had increased in recent months, with gains at country stores greater than at city stores. Farm machinery manufacturers reported improved sales. Another evidence of optimism on the part of farmers was provided by the continued advance in farm real estate prices, Mr. Allen said. There was a very strong demand for farm land to be added to existing farms, very little land was being offered for sale, and country bankers reported a substantial amount of funds awaiting opportunity for investment in farm land. Mr. Allen summed up the Seventh District farm situation by stating that agriculture had shifted position from that where it provided some drag on the over-all level of economic activity to one where it was now providing a mild expansionary force.

Mr. Allen stated that he was in agreement with what had been suggested by others regarding monetary policies to be followed during the next few weeks.

Mr. Leedy said that the Tenth District had had continuing improvement in moisture conditions since the preceding meeting. Surface moisture was more than adequate in some sections and there had been a very material improvement in subsoil moisture. Rains had delayed planting of corn in parts of the district. Excessive moisture in some areas and cool weather had affected the wheat crop, but it was estimated that yield per acre would be up from last year even though the total crop would be down because of a 20 per cent reduction in the acreage planted in the district. Mr. Leedy referred to the recent severe tornado in Kansas City which had destroyed about 750 small houses. It was expected that these would be rebuilt by workers who had been on strike, but who were returning to work to help in alleviating the situation in the stricken area. Employment, which usually increased in the spring, had not shown a rise this year, reflecting to some extent cutbacks in automobile assemblies. There also had been some lessening in production of oil. Retail trade in the past three weeks showed that the Tenth District was doing less well than the balance of the country. Borrowings from the Reserve Bank had increased sharply in the past several weeks. Mr. Leedy said that the rise had come from city banks which had experienced a drain from interbank deposits. Country banks were expanding their loans seasonally, and correspondent banks were coming to the Reserve Bank to help meet the added demands.

Mr. Leedy said that he concurred in the comments already expressed as to credit policy. He believed that the Committee should continue to apply about the same pressure as had been exerted in the past three weeks.

Mr. Leedy concluded his remarks by referring to the delicate situation with which the Treasury was faced. If we were moving toward a higher level of interest rates, he suggested that the so-called new plateau might raise the question whether the Treasury Department had made a mistake in attempting through the savings bond device to encourage the public to place their savings in that form. In view of the large volume of savings bonds outstanding, further indications of a higher level of interest rates might make it necessary for the Treasury to consider whether this whole program should be revised.

Mr. Leach said that divergent trends continued in the Fifth District economy. Shipbuilding, aircraft manufacturing, and non-residential construction were strong. On the weak side were automobile sales and residential building. Businessmen and bankers in the Baltimore area were optimistic, but sentiment in the tobacco growing districts of eastern North and South Carolina were slightly pessimistic.

In reviewing industries in more detail, Mr. Leach said that textile mills were still maintaining curtailed schedules of operations, although there had been recent indications of a more favorable outlook. There had been selected improvements in orders and firming of some prices. Production of bituminous coal was above a year ago, reflecting particularly foreign shipments from January 1 to May 4 of this year, which had been 37 per cent above the same period in 1956. Prospects for that industry were somewhat less promising than earlier, partly because steel mill requirements were lower, foreign orders had receded, and the April price increase was not sticking.

Mr. Leach said that the most striking recent change in the

Fifth District was in the outlook for the furniture industry. The Southern Furniture Market was disappointing; attendance was poor, business written was small and the influx of orders usually received after the market did not materialize. Industry expectations were that the situation would get worse before it gets better.

Member bank borrowing at the Richmond Bank had averaged $43 million thus far this month, Mr. Leach said. Approximately half of this amount was concentrated in a few large North Carolina banks which had been forced to absorb the impact of a gradual withdrawal from banks throughout the State of $90 million in State funds.

In view of the continued crosscurrents in the Fifth District and in the country as a whole, Mr. Leach said that he would favor continuing as the Committee goal the same degree of tightness that it had been attempting to achieve. As far as he could see now, this would be reflected in net borrowed reserves of around $500 million. Mr. Leach added the comment that he thought the New York Bank was right in not offsetting the temporary ease during the last statement week which was caused by an increase in float. He would not recommend a change in the discount rate at this time.

Mr. Vardaman said that in the circumstances, he would make no change in the present policy of the Committee.

Mr. Mills next made a statement substantially as follows:

The most pressing problem in my judgment that confronts the Federal Reserve System today is the condition of the capital markets where financial developments have brought the capital markets almost out of contact with the markets for bank credit. This is a situation which might deserve radical and bold Federal Reserve System action by way of bringing our influence to bear on the capital markets so as to hasten adjustments that appear to be in the making and to be imminent. Obviously what I refer to would be an increase in the discount rate by the Federal Reserve Banks, the thought being that the adjustment of the capital markets to an increase in the discount rate would clear the general atmosphere in the capital markets and in doing so also facilitate the Treasury's financing operations. In theory, an increase in the discount rate through the interest-cost factor, should tend to ration the supply of investment funds only to those prospective borrowers who are able and willing to pay the going market rate of interest. In that process, less credit-worthy borrowers or borrowers who could postpone their claims for the time being would fall out of line and some degree of pressure on the capital market would be relieved.

Under such circumstances, the Treasury might then be in a position to come to the market with a long-term offering at an interest rate conforming to whatever structural interest rate adjustment had been reflected by the higher discount rate. This kind of policy would be a departure from general Federal Reserve System thinking and action, in that we would direct our influence to the capital markets and recognize a responsibility in that area as well as our fundamental responsibility for assuring the commercial and banking community that credit will be available in adequate supply for legitimate needs. Along with an increase in the discount rate, it would of course be necessary for the System also to determine its policy in the general area of the availability of bank credit. In that connection, we know that an increase in the demand for bank credit is in prospect over the middle-June tax period and that some uncertainty has already been voiced as to whether the System will provide the reserves to carry that situation over without undue restrictiveness.

The discussions thus far around the table have reached the conclusion that the general scheme of policy that has been in effect over the last three weeks should be continued. The question can be raised whether we should press our restrictive credit policy to the same degree that has been in effect recently if a structural interest rate adjustment

> in the capital markets is imminent and, especially, if the adjustment should be induced by a Federal Reserve discount rate action. In the light of the last two weeks, I would judge that a level of negative free reserves of around $400 million and a level of Federal Reserve Bank discounts ranging from $700-800 million had effected about the right degree of pressure. If so, a level of discounts of a billion dollars and of negative free reserves of $500 million could subject the market to heavier pressures than would be desirable at the present time. Again, I would feel that the Manager of the Account and the Desk should have very wide latitude in their operations and in the feel of the market to prevent kinks and unnecessary pressures.

In concluding his remarks, Mr. Mills said the subject he had presented was very broad. If the type of policy he had suggested could be rationalized, it not only would forward the objectives of the Treasury but would also be conducive to the appropriate objectives of credit restraint on the part of the Federal Reserve System.

Mr. Robertson said that he was concerned with the inflationary pressures that existed, and he thought similar concern was implied in the remarks of those who had preceded him this morning. He was more concerned for the long run than for the short run but felt that the pressures were very real now. Mr. Robertson asserted that the Committee had not taken into account sufficiently the increased velocity of money in adjusting the volume of money; if he could do it over, he would be in favor of reducing the volume. In that connection, he stated that he too had been thinking of the discount rate, principally because it seemed to him that the only feasible time for an early increase would be in June; if action were not taken then, the next opportunity would be in August. Mr. Robertson said that he had come to the conclusion that such action in June would probably be too much of a jolt. He hoped that the System would continue to think about the discount rate and be in a position to act when feasible and desirable. In the meantime, he hoped the Committee would strive toward a degree of tightness no less than had been achieved at the moment. He wished to think of the suggested $500 million of net borrowed reserves for the next few weeks not as the top but as the bottom, on an average basis. Mr. Robertson said he hoped the Committee and the Manager of the Account would be no more concerned about offsetting temporary tightness than about offsetting excessive ease that might arise, for example, through float. If we are to take offsetting action on one side, we should act on the other side as well. He hoped that the tightness to be achieved over the next three weeks would be as restrictive as that achieved up to now and, if anything, he would prefer to be on the tighter side.

Mr. Shepardson said that he was in substantial agreement with the comments made thus far to the effect that the economy was generally in a sidewise movement. He was in accord with Messrs. Mills and Robertson in feeling concern about the latent pressures that might break out with the change to a greater feeling of optimism on the part of the public that had been reported this morning. Even though at the moment the economy might be static, it seemed to him that there was considerable danger of an outbreak of further upward pressures. The question in Mr. Shepardson's mind was when the

System should move to do something about such pressures. He realized that, with the Treasury activities in prospect during the next few months, the Committee might be more or less precluded from taking action at certain times. However, he felt that the System should be thinking very definitely of the possibility that additional upward pressures might develop and it should be considering when it could best move to check them. Mr. Shepardson said that he was not certain that now was the time for a discount rate change, but some little time might be required to get ready for such a change and in his opinion the present was not too early to begin this process. Mr. Shepardson said that he would not favor any easing in the situation and if there were any deviation from the present situation, it should be toward tightness rather than toward ease.

Mr. Fulton described Cleveland District employment as high with a diminishing number of unemployed. The steel operating rate was down but the industry expected that inventories would be worked off and that the operating rate would improve rather shortly. Mr. Fulton felt there was no doubt that steel prices would rise. There had been some reduction in manufacture of appliances. The wage cost problem was facing industry but profits were quite substantial. The business community was optimistic. There was a consensus that inflation was actively with us and that it must be controlled.

Mr. Fulton said that he had come to the conclusion that there was no reason for easing the reserve situation now despite the reduced steel rate. Rather, the System should maintain the posture it now had. New capital offerings in June were expected to be large and demand for credit was growing. He would go along with the comments of Messrs. Mills and Robertson regarding the possibility of an increase in the discount rate in the somewhat near future, Mr. Fulton said, adding that if the System did not take action prior to the Treasury's refunding it would be hemmed in again as it had been on other occasions. He felt that we could not live indefinitely with a constantly increasing short-term interest rate, with the bill rate constantly above the discount rate. If the market was thus reflecting a demand for funds, the System should recognize it through the discount rate. Mr. Fulton expressed the feeling that at least by July closer consideration should be given to an increase in the discount rate.

Mr. Williams said that business activity in the Third District continued to move sidewise. Department store sales were just about equal to a year ago. Automobile sales were slow. New housing starts were running well below last year. The Third District situation was comparable to that outlined by others. Loans and investments of reporting member banks increased in the three weeks ending in mid-May but by a smaller amount than last year. Business loans were up somewhat less than a year ago. Total deposits were off about $75 million in the three-week period. Banks met this drain of deposits by liquidation of Government securities, substantial net purchases of Federal funds, and borrowings from the Federal Reserve Bank. Preliminary approaches to the persistent borrowers from the Reserve Bank had been made and they had indicated that demands on them would be quite heavy in the period ahead. Mr. Williams remarked that several months ago the statistics were outrunning sentiment, whereas now the attitude of the business public was outrunning the statistics.

As to credit policy, Mr. Williams said that he would suggest no change in either the objectives or the procedures being followed. The Philadelphia Bank had not taken into consideration the suggestion made by Mr. Mills of a possible change of the discount rate in anticipation of developments in the capital market. Personally, Mr. Williams said, he felt that the System would need more evidence on this suggestion before it was ready to move on the rate.

Mr. Bryan said that Sixth District employment was staying steady or moving slightly upward. In the financial field, there had been a rather sharp drop in deposits at some of the larger banks with the result that borrowing had increased. The district seemed to be again in a movement in which it was losing funds to other parts of the country.

Mr. Bryan noted that Mr. Allen had commented on farm land prices. He said that he sensed a very substantial speculative fever in all States of the Sixth District with regard to land and property transfers.

On the national picture, Mr. Bryan stated that he had come to this meeting with a greater sense of alarm than had been generally expressed. The country had had another increase in the price level. The persistent and large increases that had been occurring for a good many months had been exceeded in amount in recent years only by the increases during the Korean period. Mr. Bryan felt that the Committee must face certain facts. One was that the depreciation of 4 per cent in the value of the dollar during the past year, if not a galloping inflation, was certainly more than a creeping inflation. Secondly, Mr. Bryan felt that we were still confronted with a rip-roaring capital goods boom, and he could see no reason for this boom stopping either in the immediate future or in the fairly long run. The System was confronted with the problem of what to do about both the near term and the longer run prospects. It could decide that it would fight it out with the present level of rates, or it could try to exercise further restraint on the situation.

Mr. Bryan said that he was belatedly convinced that the System had a moral responsibility to exercise further restraint in this situation. In the second half of the year the volume of bank credit was almost certain to go up. This would also be a period of a major Treasury problem. Mr. Bryan said that it seemed a foregone conclusion that the System would supply reserves in the second half of the year, and in considerable amount. The sole question that the System had to decide was whether it was to supply these reserves at the present level of interest rates or at a higher level. Mr. Bryan felt that the Committee would do better to supply the reserves at a higher level of interest rates. The present level had not stopped the inflation, and he did not believe that we had yet reached an equilibrium in the demand and supply of money savings for the economy. He believed, therefore, that the System should increase the discount rate, and he followed the line of reasoning that had been set forth by Mr. Mills. This increase should be made fairly promptly. If we were to go far into the second half of the year without doing something, the System would be frozen with the present rate. Mr. Bryan said he shared to some extent the thinking that Mr. Robertson had expressed that an increase in the rate might be a shock to the market if it were to come suddenly. He had the idea that the System might approach this problem advertently as it had another time inadvertently, namely with one Bank raising its discount rate and thus warning the market that the System was fundamentally concerned with this problem and that it was not committed to the existing level of discount rates. To that end, Mr. Bryan said that he had asked his staff to examine the situation in the Sixth District in order to determine the validity of some of the signs that indicated that the Atlanta Bank might be justified in having at this time a differentially higher discount rate.

Mr. Johns said that he was not ready to take a position with respect to the matter that had been raised by Mr. Mills. He had come to this meeting believing that inevitably the System was going to supply some reserves in the coming months and that perhaps it would have to take into account in that process the desirability of maintaining the structure of interest rates at about the present level, believing that to be a good level and where the System wanted to keep it. That would have implications for open market policy in coming weeks. Mr. Johns said that he still had some slight fear that for the System to tolerate or even encourage an increase in the level of interest rates might entail more restriction than it wanted. He was not so sure of that as to argue vigorously for it, however. He had come here prepared to say that he thought the System should maintain about the degree of restraint it had recently had. That would have involved supplying reserves in such quantities and at such times as needed.

Mr. Szymczak said that normally he would favor an increase in the discount rate, perhaps now or sooner than now. Under the circumstances, however, he was afraid that any increase in discount rate would hurt the very markets we were talking about, that is, the capital market and the market for Government securities. One could not tell how such action would be interpreted, but Mr. Szymczak said that he had the feeling that the market would interpret it to mean that the System not only intended to be as restrictive as it had been but more restrictive. An announcement of an increase in discount rate by one Bank or by twelve of the Reserve Banks could be construed to mean that the System felt that the rate generally should be higher and that the System would not make available reserves. Mr. Szymczak felt that the System would have to provide some reserves, perhaps beginning early in the second half of the year. Therefore, he would favor negative free reserves between $400 and $500 million and borrowings by member banks below $1 billion. He would also give the Manager of the System Account as much latitude as required to meet the situation that might arise. Mr. Szymczak commented that the Treasury's problem was our problem because it must go to the market and the capital market is a part of our problem. Whatever happens to either affects the reactions of the public and of members of the Congress to System actions regarding monetary policy.

Mr. Balderston then made a statement substantially as follows:

> I share much of the concern that Mr. Szymczak has expressed about the need for not unsettling the capital markets right now. On the other hand, I have a continuing concern about what is happening not only in this country, but throughout the world. We had the news last week of certain wage contracts in California that will run for five years and give a raise of 18 cents per hour each year to laborers in the construction industry. Such developments increase the tendency for people to want to buy now rather than later. The wage price spiral is about to receive another twist of built-in escalator clauses. As a result, steel prices will apparently increase, and perhaps freight rates as well. I mention steel and freight rates because they are such pervasive influences.
>
> Utilities and local governmental units will have to come to the capital market to an increasing extent. The

margin between the present discount rate and the rate on Government securities seems to me likely to widen. Already it is wide enough to present some technical difficulties. This means that I now regret our discount rate was not raised earlier this year. Incidentally, our rate is the second lowest among the developed nations of the world, the Swiss alone having a lower one at 2-1/2 per cent. The French have a 4 per cent rate and the British 5 per cent. Ours remains at 3 per cent.

In the face of the world-wide inflationary tendency, I am not too comfortable with this rate. But if and when we do move up our discount rate, the timing would require very careful attention so that the market could be gotten into a steady state before the Treasury's August refinancing. That will be a difficult financing: $8 billion outside of the Federal Reserve System, of which only $3 billion is in the banks and $5 billion in the hands of nonbank holders. We not only have the big August financing ahead, but we also have the real risk that too much turbulence in the capital markets may cause the more rapid redemption of F and G bonds. If these are redeemed at a faster rate, enough of these are outstanding to accentuate the Treasury's problem.

In short, I think that discount rate action may need to be taken even at this late date; but any action taken ought to be so timed as not to make the Treasury's financing problem more difficult. That means that unless taken right away, it would have to wait until fall.

Mr. Bryan commented that one of the difficulties that was beginning to appear and that would continue to be present in the capital markets arose from the fact that, as short-term interest rates moved well above the discount rate, there was speculation as to the future of the discount rate; and in consequence of this many persons would not make commitments because they believed that the present level of rates had no stability. Thus, the System would either have to adjust the discount rate or give assurance to the market that it would not increase the rate. Mr. Bryan said that his preference would be to adjust the discount rate.

Chairman Martin said that he was alarmed about the picture; and "alarmed" was the correct word to use. At the same time, he did not know the answer. He had been mulling the situation over for the last couple of weeks and still did not see the answer clearly. The Committee had been dealing with some psychological aspects of the situation for a couple of years and it might well be that there had been miscalculations. It might have been wiser if the System had raised the discount rate earlier. The Committee had been uncertain as to what the business situation would be earlier this year. As Mr. Williams had said, the statistics were then outrunning sentiment, whereas now sentiment seemed to be outrunning the statistics.

The Chairman said that he was inclined to think that the System must supply reserves and supply them quite actively during the second half of this year. Regardless of Mr. Robertson's point that the System may have miscalculated as to the velocity of money, it had restrained the volume of credit and the velocity had been taken into consideration. In terms of the growth of the economy, additional reserves would be needed and needed actively in the second half of this year. As he had said before, in this situation the System must have a posture of reducing spending and increasing savings. If what Mr. Hayes had said about the reduced rate of growth in savings in the first quarter of this year was correct, this made the picture even more alarming. The Chairman said that the only thing he knew of that was seriously short in supply was savings. After errors have been made, he said, it becomes very easy in retrospect to see them. Without stating that errors had been made, Chairman Martin said that all of us would have done many things differently if we had been able to know how the situation would develop.

Chairman Martin went on to say that the System had a very real obligation to consider the Treasury's problem, as Mr. Szymczak had pointed out. While he would not go as far as Mr. Johns had indicated in saying that the System would have to supply the reserves to maintain the interest rate structure, the Chairman said that he had not changed the judgment that he held when he came to the meeting this morning. Perhaps we should consider an increase in the discount rate, but to take such action immediately would, in his opinion, compound the System's and the Treasury's difficulties. It was difficult to gauge what were legitimate fears and apprehensions, and what was just idle speculation. However, anyone looking at the capital markets today and seeing the volume of issues and the sort of situation mentioned during the meeting this morning with new issues selling as high as 5-1/4 per cent yield--anyone observing that situation must realize that we were faced with a delicate operation. The Treasury too had a problem with the large volume of demand debt in the form of savings bonds.

Chairman Martin said that we were talking in this room and that we must be extremely careful about comments on the subject. However, we were dealing with what could amount to a run on a bank. Runs on banks can start for no good reason, he noted, adding that the Treasury could be faced with that sort of a problem because of the large volume of savings bonds outstanding. While he was not suggesting that this would happen or that this was the Committee's controlling obligation, nevertheless, if the Treasury should have a "run on the bank" the System would be faced with a very difficult problem. In order to achieve the maximum pressure against credit expansion, it was necessary for the System to handle its market operations very carefully.

Chairman Martin said that he would lean in the direction that Mr. Mills had suggested because he believed that if the System could raise the discount rate and supply the reserves that it was going to have to supply at a little higher level of interest rates, this would be the most effective action that the System could take. However, he was inclined to think that the present would be a little too early to raise the discount rate in view of the psychology that was swinging around. The suggestion for an increase in the rate was something all of those present should study very carefully in terms of the most effective timing. If the action were misinterpreted, it could result in widespread misunderstanding throughout the country. By and large, the Chairman said he was convinced that in many small communities the discount rate change was a major item. Many of the E and H savings bonds were held in areas where that attitude existed.

The Chairman expressed the view that this was a most critical juncture in the battle against inflation and that anyone who minimized the alarm he had indicated as to the possibility of an ultimate flight from the dollar was making a serious mistake. On the other hand, if there were anything that tended toward a run on the Treasury, such a development could become one of the elements in a flight from the dollar. Chairman Martin did not see how we could fail to recognize the elements in the picture. His own feeling was that the Committee should maintain the present degree of restraint, taking overt action in neither direction, and letting the Manager of the Account have the maximum latitude to feel his way in this market. All of the members of the Committee should bear in mind the problem of reserves and of levels of interest rates and the possibility of a change in the discount rate at some time in the near future. We should also bear in mind the problem of the Treasury: the Treasury may have taken the wrong course, as Mr. Leedy had suggested, but the fact was that at the present time the Treasury had $55 billion of demand obligations outstanding in the form of savings bonds. Considering the entire picture, Chairman Martin said that he came out at the point that the Committee should maintain the directive without change. He did not feel that the change in the international situation had been such as to warrant deleting the reference to it in clause (b) of the directive. The aim of the Committee during the next few weeks should be to maintain as even a keel as possible and to let this psychology work itself out. Perhaps the advertent method which Mr. Bryan had suggested could be used, but at the present juncture Chairman Martin said that he would not wish to take a positive position as to that suggestion.

Mr. Shepardson inquired whether the Chairman's comments implied that June might be a month when the System could put reserves into the market and at the same time increase the discount rate without undesirable consequences.

The Chairman responded that this could be the case but that he was not taking a position at the moment.

Mr. Hayes commented that he understood on the strength of the projections that float would probably take care of most of the additional reserve needs in June. Thus the System would not be in the position of having to put reserves into the market at that time.

On the larger question, Mr. Hayes said that if there were to be an increase in the discount rate the System should be very clear as to why the increase was being made. He noted that two reasons had been given for such an increase, and he was not sure that the two were consistent. One of these was the obvious reason that there were serious inflationary threats and that the System should increase the discount rate to combat these threats. This, he felt, was the essence of the statement made by Messrs. Robertson and Shepardson. The other was the suggestion he understood to be implied in Mr. Mills' comment, that is, a rise in the discount rate would provide greater settlement and stability in the capital markets on the theory that the existing uncertainty as to rates was a drawback in the capital markets and that perhaps elimination of that uncertainty would help provide a better equilibrium. With respect to the second objective, Mr. Hayes said that he had very grave misgivings as to whether an increase in the discount rate now would produce an equilibrium, because of the whole atmosphere in the securities market. It was very much open to question, he said, whether dealing with such a delicate problem ratewise might not have an effect just the opposite of that desired. Personally, Mr. Hayes said that he had misgivings as to whether such a move was needed strictly as a monetary measure. He had not reached a conclusion that the inflationary forces were very definitely and strongly in the ascendency. He stressed the confused and mixed character of the picture, as he and some of his colleagues saw it. It was true that sentiment had improved, Mr. Hayes said, but he was impressed by the statement Mr. Williams had made that sentiment has improved but statistics have worsened. He thought it very questionable whether this was a desirable time to make an overt move toward greater restraint. He did not believe such action was called for, with the business picture looking the way it does. There was wide room for judgment on that, of course.

Mr. Erickson said that it seemed to him that business sentiment in the spring of each year following a good year was always tending down early in the year, and later on it improved. He would like to be sure that we did not overemphasize such developments this year.

Mr. Vardaman said that he was wholly in agreement with the comments Mr. Hayes had made. Without meaning to be presumptuous, he noted that there were some forty persons in the room, and he suggested that if word of this discussion got outside the room it would have almost as disturbing an effect on the market as though the discount rate were raised.

Chairman Martin said that he had already commented on the latter point and that he was glad that Mr. Vardaman had reiterated the need for not commenting about discussions in this room. On the other hand, it was essential that the Committee discuss these problems, and it must rely on the intelligence and discretion of the persons attending the meetings.

As to policy, the Chairman said that he would gather that the consensus was that the Committee should maintain the status quo and that it should continue to study the problems that had been discussed at this meeting.

Mr. Shepardson said that he had no objection to that statement. However, the comment Mr. Hayes had just made regarding the difficulty of judging the business situation was one that always faced us; the Committee would always be behind the figures, and it was part of the Committee's job to reach a judgment before the figures reached it.

Chairman Martin inquired of Mr. Rouse whether he had any suggestions regarding the directive, and he responded that he had none.

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;

(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.

It was agreed that the next meeting of the Committee would be held at 10:00 a.m. on Tuesday, June 18, 1957.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary