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, July 9, 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. Johns and Deming, Presidents of the Federal Reserve Banks of 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, Bopp, Marget, Mitchell, Roelse, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Robinson, Adviser, Division of Research and Statistics, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Volcker, Securities Department, Federal Reserve Bank of New York

Mr. Freutel, First Vice President, Federal Reserve Bank of St. Louis; 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; Mr. Litterer, Business Economist, Federal Reserve Bank of Minneapolis; and Mr. Walker, Economic Adviser, Federal Reserve Bank of Dallas.

Chairman Martin suggested that Mr. Robinson, Adviser, Division of Research and Statistics, Board of Governors, and Mr. Volcker, Market Specialist, Securities Department, Federal Reserve Bank of New York, be invited into the meeting. There being no objection, Messrs. Robinson and Volcker entered the room.

Chairman Martin then referred to the luncheons that had been attended by some of the Committee members and staff and by Treasury representatives at frequent and fairly regular intervals over the past several years. He stated that today Under Secretary of the Treasury Burgess, Mr. Wren, Assistant to the Secretary, and Mr. Heffelfinger, Fiscal Assistant Secretary, were coming to lunch and that all members of the Federal Open Market Committee were invited to attend the luncheon if they were able to do so.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 18, 1957, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action by the members of the Federal Open Market Committee on July 2, 1957, in authorizing the furnishing of information requested by Senator Albert Gore relating to transactions in Government securities during the week ending June 26, 1957, was approved, ratified, and confirmed.

Secretary's note: The letter sent by Chairman Martin to Senator Gore on July 8, 1957, copies of which were also sent to Secretary of the Treasury Humphrey and Under Secretary Burgess, read as follows:

"This is in response to your letter of July 1, 1957 requesting information concerning transactions in Government securities on behalf of the Federal Open Market Committee consummated during the week ending June 26, 1957. In accordance with the provisions of the Committee's by-laws and its Rules on Procedure, I have taken up this request with the Federal Open Market Committee which has authorized me to make available to you the information asked.

"The accompanying memorandum includes a statement of outright sales and purchases each day showing the issue bought or sold and the price received or paid. It also covers U. S. securities bought and sold during the week under repurchase agreements. The totals account for the week-to-week changes shown in the published Statement of Condition of the Federal Reserve Banks as of June 26, 1957. The figures do not include such purchases or sales as may have been effectuated through the Federal Reserve Banks acting as agents for other principals, i.e., the execution of orders on behalf of the U. S. Treasury, foreign central banks or governments, international institutions, or member banks.

"I appreciate your understanding that this information in the detailed form shown in the memorandum is not normally made public."

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 June 18 through July 2, 1957, as well as a supplementary report covering commitments executed July 3 through July 8, 1957. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that the Account Management had been rather fortunate in scheduling operations during the period since the June 18 Committee meeting. A reasonably tight money market had been maintained throughout, in spite of difficulties imposed by wide swings in reserve positions and other potentially disturbing factors in the money and securities markets. As discussed at the last meeting, the corporate, municipal, and Government securities markets were then being rather severely wrenched, and the situation appeared to be developing somewhat as it did in the spring of 1953. Since that time, however, these markets have been experiencing something of a rally. At the time of the last meeting, an AAA-rated telephone issue had just reached the market at a reoffering yield of 4.85 per cent, marking a further upward step in the rapid yield adjustments then taking place. That offering, which included a nonrefundable-for-five-years clause, proved to be successful, as the reflex action of the market following sharp adjustments over previous weeks resulted in a rapid distribution of that and other new corporate issues over the period, with prices subsequently moving higher in the secondary market.

Municipal offerings have been rather light since the last meeting, but the experience in that sector of the market has been rather similar. The improved atmosphere in the corporate and municipal markets, in turn, was an important factor in the moderate recovery of Government security prices. However, special influences on the Government market, including in the short-term area a reinvestment demand by holders of the tax anticipation obligations maturing on June 24, were also partly responsible for the improved tone in the Government securities market since the last meeting.

All in all, Mr. Rouse commented, the atmosphere throughout the securities markets now seemed definitely better despite the fact that the money market had remained tight and reserve positions had been under greater pressure.

The period since the June 18 meeting has included the successful $3 billion offering of March tax anticipation bills and the July 3 payment date, prior to which there was considerable when-issued distribution by the banks. In the absence of serious strain in the money market up to that time, operations to provide reserves in connection with that operation could be deferred until the payment date itself. At that time, the Account Management was able to handle the situation largely through sizable repurchase agreements.

Mr. Rouse indicated that revised projections now suggest that reserve positions may turn relatively easy before the forthcoming Treasury refunding, for which an announcement is expected on July 18 and 19. Earlier projections had indicated a much tighter reserve position this week and in the weeks following, justifying the provision of a substantial volume of funds through repurchase agreements and through outright purchases. Since the reserve outlook had been modified by the new projections (those of the staffs of the New York Bank and of the Board of Governors are reasonably close), a commitment was made yesterday to run off the System's holdings of bills maturing this week, and market conditions may make it possible to sell additional bills through the midmonth period to counter the usual float expansion at that time. The reserve projections still suggest tightness for the remainder of this statement week, but then some easing, at least in the sense of lower net borrowed reserves.

In conclusion, Mr. Rouse remarked that one feature of the recent period had been heavy member bank borrowing at the start of each statement week. This was particularly marked just before the midyear statement date, but it was also true again at the start of the current week. Overborrowing in New York and elsewhere subsequently contributed to a greater availability of Federal funds in the market after the calendar weekend, helping to take the sting out of the tightness indicated by the daily reserve data.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period June 18 through July 8, 1957, were approved, ratified, and confirmed.

Chairman Martin called upon Mr. Koch for a statement on the economic situation, supplementary to the information contained in the staff memorandum distributed under date of July 5, 1957. Mr. Koch's statement was as follows:

> At mid-year, over-all economic activity is being maintained at about the high level of the past winter. Downward adjustments have been going on in a number of lines but the

areas of weakness have not widened significantly and upward adjustments have been taking place in other areas.

The general sidewise movement is similar to the trend of business during the first half of last year. In 1956, easing tendencies through July were followed by strong expansion later in the year. A like course of events is widely anticipated in business and financial circles today.

Aside from the recent steel price increase, price changes, the most direct measure of demand pressures, have continued small and generally offsetting in the case of industrial commodities. The steel price rise is estimated at slightly more than 4 per cent for all steel mill products. Altogether since mid-1955 the price of steel has gone up 25 per cent compared with a rise of 8-1/2 per cent for all commodities other than farm products and food.

Among farm products meat prices have continued strong in recent weeks. Over-all consumer prices advanced further in May owing mainly to higher food prices, and another increase seems likely for June. Government spokesmen, however, have recently stated that they expect the index to level off by August, presumably in large part because of the seasonal topping off in food prices by that time.

Turning to the over-all measure of economic activity, the gross national product, the growth from the first to the second quarter of the year may have been at a seasonally adjusted annual rate of $4-5 billion rather than the $3 billion anticipated earlier. This larger estimated growth is due partly to the fact that it now appears likely that the moderate rate of inventory liquidation of the first quarter may have been replaced by slight accumulation. In terms of book value, total business inventories seasonally adjusted rose about $400 million in May, slightly more than April. Total business sales also rose slightly in May as contrasted to small declines in the previous three months.

Despite a possible turn-around in the inventory situation from liquidation to slight accumulation, the Board's seasonally adjusted index of industrial production may have edged off somewhat further since May, reflecting among other influences more extensive vacation curtailment than usual in some lines. Steel mill operations, which were up to 88 per cent of capacity in early June, subsequently fell below these higher schedules and for the month as a whole averaged 86 per cent, about unchanged from May. There was a notable lack of extensive forward buying in anticipation of the steel price increase posted July 1. Thus far in July steel production has declined seasonally to about 79 per cent of capacity.

Automobile assemblies were up more than seasonally in June, though not as much as scheduled at the beginning of the month. Tentative production schedules for the third quarter have been revised upward to almost 1.3 million cars, or more than a fifth above a year ago.

One of the strong factors in the current review of economic developments is construction. Outlays on residential building increased in June, the first rise in seven months. Total construction contracts rose sharply in May--the last month for which these data are available. In the first five months of the year, contracts were 10 per cent above a year ago. One of the current disturbing elements in construction is the renewed rise in construction costs after six months of relative stability.

Another factor of potential strength in the current situation is the rise in new orders of durable goods manufacturers that occurred in May. This was the first rise since November last year. Moreover, it was widely distributed among all major groups of producers except those of primary metals. May new orders remained below the rate of sales, however, indicating some further decline in unfilled orders.

In the labor market average weekly hours worked in manufacturing increased slightly in June following several months of decline. In nonmanufacturing, as in manufacturing industries, hours of work have been somewhat lower this spring than a year earlier. There were increases in the number employed as well as unemployed in June but the changes were mainly seasonal and due to the usual influx of students to the labor market in the summer months. Unemployment claims declined seasonally but remained slightly higher than a year ago.

In the field of consumer credit, outstanding instalment credit has been expanding at a seasonally adjusted rate at about $200 million a month since the third quarter of last year. Personal loans and automobile credit have accounted for most of the increase. A noteworthy development in the consumer credit field recently is the fact that the proportion of 36 month contracts on new cars has been increasing steadily this year, but there has been no tendency for maturities longer than that to rise.

Finally, economic activity abroad remains buoyant with further expansion in Britain and Germany. In most other countries strong inflationary pressures continue to be felt. Recently, France, Japan, and several other countries adopted additional measures to restrain demand.

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

Notwithstanding adjustments in various areas, views as to the future generally continue more confident than cautious. Inflationary pressures are still being felt. The cost-price push, which is a manifestation of inflation as well as a contributor to the spiral, is still in evidence. At the same time the cost-price-profit squeeze, which might be relied upon to check the inflationary spiral, does not appear to be developing.

Financial markets, which appeared to be on the verge of a crisis for various reasons at the time of the last meeting of this Committee, have shown surprising stability and strength during the past two weeks. Banks extended a record-breaking volume of loans during the tax payment period; an exceptionally large volume of new corporate bond issues has been floated with unexpected success; the Treasury has sold a $3 billion issue of March tax notes, which are being absorbed by the market without undue pressure; and the early July enlargement of member bank reserve needs has turned out to be less than expected and has been adequately covered by System operations. Bond yields and interest rates have levelled out and in fact declined somewhat after reaching new peaks. The ominous speculative upward spurt in the stock prices was followed by a downward reaction, but more recently the rise has been resumed, and a new high average for this year was reached yesterday.

Although moderation has continued to characterize changes in total loans and investments of banks and in the money supply, which are the credit elements directly affected by Federal Reserve policies, it can not be said that credit availability has been unduly restricted. Corporate capital issues have been in record volume; state and local government indebtedness continues to increase at a substantial pace; increases in consumer indebtedness and in mortgage credit, although slower than the record of 1955, continue at rates of around 8 per cent a year, which could hardly be sustained indefinitely. The Federal Treasury is finding it necessary to borrow more than it did last year owing in part to a smaller surplus and in part to more cash redemption of outstanding issues.

The Treasury surplus, both for the fiscal year as a whole and for the last six months, was somewhat less than had been previously expected, owing primarily to increased expenditures. In addition redemptions of savings bonds have been quite large and promise to continue so, even though maturities of F and G bonds will not be as large as in May and June. Unless attrition on the August maturing issues is unusually small, the Treasury will probably need to borrow again early in September. There is question whether the $275 billion debt limit will be large enough to permit all borrowing that is likely to be needed before the season of large tax returns early in 1958.

The increase in bank loans during the June tax-payment period was larger than in March and than in June, last year, notwithstanding a somewhat smaller corporate tax liability. Nearly all business increased their borrowings, but the biggest change from a year ago was this June's large increase in finance company loans at banks, compared with a decrease in the same month last year. Tendencies noted during recent months for the increase in loans and the decrease in bank holdings of Government securities each to be less than in the previous year were reversed in June. The decrease in holdings of Governments reflected substantial bank holdings of the tax anticipation securities retired in June. Bank subscription for the new tax bill, for which payment was made on July 3, however, will probably more than wipe out the decrease in bank holdings of Governments during the preceding weeks. Unless a marked loan contraction follows along with reduction in the newly created tax and loan accounts, bank credit expansion will be excessive. Last week's figures for New York show considerable reduction in loans.

As measured by changes in privately owned deposits and currency, the money supply has conformed closely to the customary seasonal pattern during most of this year. Needed reserves have been supplied in part by System open market operations and in part by member bank borrowing. There are indications that some of the borrowing by member banks may not be as restraining as might be desired. Some banks in a few of the reserve cities continue to be rather heavy steady borrowers, and there has been an increase in the amount of such borrowing in recent weeks, as well as in the volume of in-and-out borrowing at the Reserve Banks. Because of the volume of willing borrowing, System purchases, until the last few days, were somewhat smaller than it had been thought would be needed.

The stabilizing of money rates, and in fact some decline in yields, is an indication that the recent volume of member bank borrowing has not been as restraining as might have been expected. To some extent, no doubt, the settling down of money rates reflects the effect of the higher rates in attracting funds to the market. The large redemptions of savings bonds are probably an indication of the tendency to shift holdings and help to account for the improvement in the corporate bond market in the face of heavy new issues.

Estimates of future reserve needs, based on customary seasonal factors and expected changes in Treasury deposit balances, indicate that measures to meet the early July squeeze have been fully adequate. In fact, it appears likely that without reverse action restraints during July and August might be insufficient in the view of the current credit demands and the apparent willingness of many banks to borrow to cover their needs. To maintain member bank borrowing at a restraining level--probably at least $1 billion--System sales of $200 or $300 million of securities will be appropriate next week. If credit demands show a tendency to expand beyond normal seasonal amounts, a discount rate increase would be in order. In view of the prevailing tone of confidence in the economy, consideration might be given to the advisability of raising discount rates, at least in districts where steady borrowing has been evident, or of establishing a penalty rate on such borrowing, as a precautionary measure to forestall anticipatory borrowing by bank customers.

Mr. Hayes then presented his views on the business and credit situation, and his suggestions as to the credit policy that should be followed. His statement follows:

As was true three weeks ago, we are still confronted with a generally strong business situation, but one which is moving sideways and which gives no clear evidence as to the trend to be expected in the latter part of the year. While the steel price rise is unquestionably disturbing, it remains to be seen to what extent resistance to higher prices by consumers and business may check the spread of price increases for many metal products which would normally tend to result from the increase in steel prices. A further element of uncertainty has to do with future inventory policy. Will the cautious policy of the past six months be encouraged by price resistance or perhaps by the rising trend of interest rates, or will it give way to a new wave of heavy buying in the belief that additional price rises are inevitable?

Borrowing from banks in the June tax period was considerably larger than had been expected and seemed to confirm earlier evidence of a sharp decline in the liquidity of corporations as a whole over the last year or so. Some satisfaction is to be found in the fact that total loans and investments increased less rapidly in the three weeks ending June 26 than in the corresponding period of 1956. Preliminary figures on income velocity of money for the second quarter of 1957 provide additional evidence that credit restraint is proving effective. These figures indicate that income velocity failed to increase appreciably for the first time in nearly three years, during most of which period velocity has scored substantial gains, thus offsetting much of the restraining effect of a relatively stable money supply.

The continuing threat of inflation, whether defined as "cost-push" inflation or as any other variety, clearly calls for maintenance of a policy of restraint. On the other hand, current business and credit conditions do not, in my view, justify increasing the present degree of tightness-- and our responsibilities to the Treasury lend strong support to this conclusion. With the terms for refunding the large August maturities due to be announced within ten days, one of our major objectives should be to preserve as steady an atmosphere as possible to facilitate this financing without of course attempting in any way to establish an artificial interest rate level. At the last meeting it was agreed that the Manager of the Account should have ample leeway to exercise his judgment rather than to be tied to a specific target of net borrowed reserves. This leeway turned out to be useful, as it has been possible recently to maintain a constant degree of restraint while allowing net borrowed reserves to average well above the $500 million mark we had looked upon as more or less a norm. By the same token I think the Manager should be free to adjust to the feel of the market in the next three weeks and should not consider himself obliged necessarily to offset temporary availability of reserves attributable to market factors such as float.

Rumors of impending changes in the discount rate and in the prime rate have been a disturbing element in the market at a time when success of the coming Treasury refunding hinges to a considerable extent on market expectations in relation to the rates set by the Treasury. It could therefore be argued that an immediate rise in the discount rate, which would dispel these uncertainties in large part, would be beneficial to the Treasury's program. I find it hard to accept this argument, since it is more than possible that action of this kind, instead of "clearing the air" would merely set off a series of new increases in short-term market rates which would leave the Treasury in no better position to compete with other demands for funds. Moreover, there would seem to be much merit in trying to maintain something like the present spread between short and long-term rates to lend impetus to whatever modest funding the Treasury might attempt to accomplish at this time--perhaps encouraged by the tendency of longer term rates to find at least temporary stability. Finally, and more importantly, just as I see no justification in the business situation for appreciably greater restraint through open market operations, I also believe that a higher discount rate is not warranted by the present economic outlook, nor is there, it seems to me, such a wide spread between the discount rate and market rates that the discount windows of the Reserve Banks are in grave danger of abuse. I would therefore be opposed to a discount rate change at this time.

Mr. Irons commented briefly on the national situation, summing up his remarks with a statement that high levels of activity were being maintained as a net of offsetting movements in individual areas. In the Eleventh District, the over-all picture was substantially similar to the national picture, he said, with high-level activity continuing without much change from the situation reported three weeks ago. Department store sales recently had picked up and construction was strong, while there had been some further decline in the petroleum industry. Automobile sales on a cumulative basis this year were running 10-12 per cent ahead of a year ago. The agricultural outlook, particularly as to cotton, was very favorable in terms of crop production. Bank reserve positions were not under great pressure except perhaps at two or three banks, although borrowing at the Reserve Bank recently had increased a little.

Mr. Irons felt that inflationary forces and the high-level economic activity continued to call for restraint at least of the degree that had existed during the past three weeks. The Treasury refunding was a factor, and the Manager of the System Account should have considerable leeway and should be watchful of the Government securities market. While Mr. Irons would favor maintaining as strong a degree of restraint as consistently could be maintained in the light of the situation in the Government securities market, he would not favor an increase in the discount rate at this time nor would he favor a change in the Committee's directive.

Mr. Mangels said that the Twelfth District situation had not changed markedly in the past three weeks. Some of the savings and loan associations had increased dividend rates to 4 per cent and he anticipated that during the next few months banks would discover whether the gain in their savings deposits during the first half of this year would be retained. Discontinuance of overtime work at aircraft plants in Southern California had had important effects on payrolls for large numbers of employees; it was estimated that this factor would reduce Southern California payrolls by $75 to $125 million a year. The Pacific Northwest continued to reflect the unfavorable situation in the lumber industry. Some reports indicated that collections were slowing although delinquencies were not yet particularly high. The agricultural outlook was fairly good with normal pea and wheat crops expected in the Pacific Northwest. Over-all employment had been maintained at a satisfactory level and department store and automobile sales were holding at the level of recent months. The housing surplus that had existed in Southern California and Oregon was being worked off and by the year-end the situation might again indicate a need for construction of substantial numbers of housing units. Twelfth District banks reported that corporate tax borrowings in June had not been as large as anticipated. Bank borrowings had been quite high and banks were buying more funds than they were selling in the Federal market.

The pressure that had been maintained seemed to Mr. Mangels to be about as great as it should be. He felt that the Committee should continue about the degree of pressure that had existed recently but that it should not make it more intense. The Manager of the Account should have considerable leeway during the period immediately ahead. Mr. Mangels would make no change in the discount rate at this time, but he noted many rumors about a change in the prime rate and suggested that if the prime rate should increase, the System would be compelled immediately to take some action on the discount rate. If commercial banks initiated an increase in the prime rate, considerable sting would be taken out of a discount rate increase, but in the absence of some such development, Mr. Mangels would not now recommend an increase in the discount rate.

Mr. Deming said that Ninth District conditions tracked those of the nation. The farm situation was favorable, although there had been too much rain in some areas. Business sentiment was still generally cautiously favorable, and loan demand was strong. Some of the directors of the Minneapolis Bank were thinking in terms of an increase in the discount rate, Mr. Deming said, but his personal feeling was that this would not be the time to change that rate, primarily because of the Treasury financing situation. However, open market operations should be continued about as they have been recently.

Mr. Allen said that business sentiment appeared to remain optimistic, perhaps cast in terms of an expected continuation of the recent high level of activity rather than any vigorous rise from the present level. Construction employment in the Seventh District showed a gain over a year ago. Farmers were doing better. Motor car manufacturers were in good spirits. The used car situation seemed to be in excellent shape. Automobile dealers as a group were making pretty good money this year, and the manufacturers still expected to turn out 1,300,000 cars during the current quarter, compared with a million in the third quarter a year ago.

As to monetary policy, Mr. Allen said that in view of the continuing high level of economic activity and the optimistic sentiment which he felt prevailed, he had nothing to suggest other than continuance of the restraint that the Committee had practiced for some time now. He occasionally had nostalgic longings for the days when it seemed appropriate to use the discount rate and reserve requirements as instruments of monetary policy, rather than to have constant concern with and operations in the bill market, but he did not at this time advocate use of either of those so-called "blunt" tools. He suggested that the Open Market Committee should continue about as it had been doing, at least until the next meeting.

Mr. Leedy stated that rains had persisted in the Tenth District during recent weeks and had interfered with threshing with some resultant losses of wheat. The rains had benefited growing corn and other crops, and improved pasture conditions had contributed to considerable strength in the cattle market, particularly for stockers and feeders. Nonagricultural employment was up slightly as a result of increases at aircraft plants and in defense work. Residential and nonresidential construction were down slightly. Retail sales had barely held their own since the first of this year, although recently there had been some indication of an upturn. The Tenth District shared with the rest of the country the substantial increase in business loans over the June tax period, he said, although since the first of this year there had been less growth in Tenth District business loans than in the rest of the country and they were running at about the same level as a year ago. Borrowings from the Reserve Bank had increased lately largely from reserve city banks which had lost deposits, especially those of country correspondents. Mr. Leedy said that he had observed little reluctance on the part of many banks to borrow.

For the period immediately ahead and until the Treasury refunding was out of the way, Mr. Leedy said that he would continue the program that had been followed by the Committee during the past three weeks.

However, he felt that when the refunding was out of the way the System should attempt to do something more than it has done in applying pressure. He was impressed with the performance of the capital and securities markets during recent weeks and with the strength shown during a period of a substantial financing by the Treasury. These provided evidence of great underlying strength which perhaps called for more pressure than the Committee had been applying. Mr. Leedy said he would not favor an increase in the discount rate immediately, but he wondered whether it might be desirable to let borrowed reserves creep up further. He noted that earlier this year there was a feeling that net borrowed reserves of about a half billion dollars might give suitable pressure, but perhaps we had found out that borrowed reserves might go much higher without producing results that were unwelcome. Similarly, he wondered whether the figure of around a billion dollars of member bank borrowings might be too low. He felt that when the Committee was in position to do so, it might undertake to test how far the figures of net borrowed reserves and member banks borrowings might go without producing unwanted results.

Mr. Leach said that the principal piece of economic news in the Fifth District was the failure of the slight improvement in the cotton textile industry to be sustained. Sales were again largely on a spot basis. Furniture production was continuing at a lower level, and there were no indications of an immediate improvement. Somewhat more optimistic signs were, however, apparent in other leading district industries.

Bituminous coal output and shipments were running higher than a year ago. The lumber industry reported increased orders. Cigarette production also was above a year ago, and both shipbuilding and aircraft continued to evidence marked strength.

Mr. Leach said that preliminary reports from automobile dealers indicated no improvement in new car sales during June, with sales continuing below expectations. There was no evidence of further relaxation of credit terms for automobiles.

In the Fifth District, as in the country as a whole, there was a large temporary increase in borrowings from the Reserve Bank for several days near the end of June. Daily average borrowings for June totaled slightly less than in May, and there was no indication that member banks were taking advantage of the spread between the discount rate and other short-term rates.

Mr. Leach felt that in determining Committee policy, it was incumbent on the System to be as restrictive as it could be without causing a downturn in the economy or a disorderly Government securities market. This would be a difficult objective to attain even if the Treasury financing were not in the picture, he noted, and the refunding now facing the Treasury was unusually large. Mr. Leach felt that the Committee should follow an even keel policy until the refunding was over. That is, it should endeavor to maintain the same degree of pressure that we had been achieving in recent weeks. The Manager of the System Account should be instructed to give even more consideration to the feel of the market than in periods when no Treasury financing was in the offing. This did not mean, Mr. Leach said, that open market policy should be subordinated to the needs of the Treasury, but it recognized that the Committee had an inescapable obligation to the Treasury with respect to the timing of its actions. Consideration of further tightening in policy, which in Mr. Leach's opinion should initially take the form of an increase in the discount rate, must await completion of the refunding. Noting that demand for loans in the Fifth District continues strong, Mr. Leach suggested that after the summer doldrums are past and when the Treasury financing is out of the way, serious consideration should be given to increasing the discount rate.

Mr. Vardaman said that, speaking for the three weeks that would intervene between now and the next meeting of the Committee, he would continue the present wording of the Committee directive, would continue the present policy of restraint without any increase in it, and would even lean toward the side of less restraint. He would not vote at this time for an increase in the discount rate.

Mr. Mills said that the economic conditions that had been described to the Committee this morning and the movements in the securities market confirmed, in his judgment, the desirability of continuing a firm policy of credit restraint. The degree of credit restraint that he would conceive and that he would believe to be attainable would be to continue to endeavor to have the 3 per cent discount rate not only effective as reflected in the interest rate structure, but also foreshadowing to the investment community the possibility of an increase in the discount rate at a not far distant date. A policy of that sort presumably would be such as to compel a continued divestment from the commercial banks of their holdings of the March 1958 special Treasury tax anticipation bills and their redistribution to other classes of investors in a manner that would have the effect of freeing reserves at the commercial banks. If that were done the banks would be in a position to supply reserves needed to support the seasonal demands for credit without the necessity for the System to supply new reserves that could produce an abundance of reserves. Mr. Mills felt it essential that the reserve pressures be applied in a manner that, if possible, would achieve this purpose. If the pressures were applied too severely and if reserves were not freed to the banks as they divested themselves of their Treasury bills, the effect might be to invite a far higher amount of attrition on the August Treasury refunding than would be desirable. If this policy objective could be attained, Mr. Mills said that he would judge that as a sequel to the Treasury refunding, and assuming that economic conditions at that time had the life and optimism they now have, an increase in the discount rate would be in order. He felt very strongly that such an increase should have been made over the last five or six weeks but that it would be impossible to make it under the present conditions.

Mr. Robertson said that he thought there could be no doubt that the biggest problem facing the country today was the inflationary pressure. Hindsight was much better than foresight, of course, but he did not feel the System had been as restrictive as it should have been. At this moment he did not see what could be done other than to maintain the degree of restrictiveness that the Committee had tried to maintain in recent weeks and to hope that the cumulative effects of that policy would increase. Mr. Robertson felt that Mr. Mills was correct in saying that the discount rate should have been raised earlier but he did not see how such action could be taken now. He agreed with Mr. Leach that the matter should be considered in August. He hoped that the Committee could do something to evidence its intent to stop the economic inflationary spiral before it got out of hand. He would not permit any ease to come into the picture during the next few weeks and would not attempt to offset the effects of changes in float that caused an increase in tightness nor would he attempt to offset such effects on the side of ease. Over the next three weeks, Mr. Robertson hoped that the System Account would do everything possible to tighten the situation in the hope that when the Treasury refunding was out of the way an increase in restraint would be brought about.

Mr. Shepardson expressed the view that the country was very definitely confronted with the problem of inflation. The present sidewise movement, as Mr. Hayes had expressed it, presented a situation of seasonal summer slack, but there was every evidence of confidence and optimism that would make for an upswing in the fall. If the Committee were to wait until this upswing gained momentum, far more drastic action would be required to cope with the situation than if action were taken before the rise. Mr. Shepardson noted that discussions often suggested that the time was not opportune to take a given action. He recognized that there were problems connected with the forthcoming Treasury financing, but he wondered whether the Treasury might not be in a better position to face its problems if the System took action promptly on the discount rate and thus "cleared the air," rather than to have uncertainty and speculation as to when an increase might occur. Mr. Shepardson said that he did not believe the Committee could afford any easing, advertent or inadvertent, during the next few weeks. Personally, he would much prefer to see the situation tightened. He felt that now was the time to increase the pressure in order to avoid setting up conditions that would allow the fall boom to get under way. His inclination would be to take action more restrictively than the Committee had taken up to the present time.

Mr. Fulton said that the Fourth District picture was about the same as three weeks ago: high-level activity, with some weaknesses accompanied by other evidences of strength. Businessmen seemingly were optimistic for the future, allowing for some seasonal adjustments during the next few weeks because of the heat and vacations. The fall months were expected to bring a high order of business. With reference to the machine tool industry, Mr. Fulton pointed out that although new orders are running about 50 per cent of last year, men in the industry felt that 1957 would be a good business year. About $600 to $700 million of new orders for machine tools are anticipated, while shipments during the year would total around $900 million, reducing the backlog. Their views on the profit outlook were much more optimistic than those of the statisticians. Mr. Fulton reported that employment in the district was good and, while department store sales in June were down about 4 per cent from a year ago, for the year to date they were about even. Discussions with businessmen indicated that about two-thirds of them anticipated increases in prices up to 10 per cent within the near future; about 20 per cent indicated they would not increase prices because they had already done so; and very few indicated any expectation of reductions in prices.

Loan demand continued large in the Fourth District, Mr. Fulton reported, and delinquencies remained low. Banks were borrowing heavily at the Reserve Bank despite discussions with bankers who seemed to have no reluctance to show borrowings in their statement. Mr. Fulton stated that he agreed completely with the views expressed by Mr. Shepardson. The Committee should give no indication of easing but should maintain firm restraint during the next few weeks, and in August the Federal Reserve should give serious consideration to a change in the discount rate.

Mr. Williams indicated that changes in the Philadelphia District's economy in recent weeks had been minor. He reported discussions at a recent meeting of licensed small loan companies, all of whom made it clear that they were feeling the effects of the tight money policy. They were paying higher rates both on bank lines and for money market funds and were finding that banks and investors were not eager to extend lines or to increase the funds made available for consumer financing. The smaller independent finance companies reported they could now find very few country banks with any loanable fund capacity, whereas last fall they were able to get lines of credit from smaller banks in units as low as $25,000. Mr. Williams also stated that the loan companies had observed the new device used by one of the large finance companies whereby the investor could select his own maturities for the debentures the company was selling, adding that other large companies which financed through the open market planned to follow this procedure with interest.

Mr. Williams went on to say that the chief banking development recently was the increase in borrowing from the Philadelphia Reserve Bank, an increase that was large both in amount and in relation to total borrowing from all Reserve Banks. Part of the increase was seasonal, but discussions with bankers indicated that they now anticipated no diminution in demands upon them. On the contrary, rising demands were expected. Under these conditions, consideration had been given to increasing the discount rate at the Philadelphia Bank, Mr. Williams said, so as to establish a differential between the rate at that Bank and other Reserve Banks. The decision, however, was not to make such an increase because (1) a higher rate did not seem warranted by national developments; (2) a higher rate at Philadelphia would create uncertainty in money and capital markets already in delicate balance; (3) the added uncertainty would be prejudicial to prospective Treasury financing; (4) the borrowing at the Philadelphia Reserve Bank was concentrated in a few institutions. As a consequence, Mr. Williams said that the decision was to deal with the problem through firmer administration at the discount window. In his view, firmer credit restraint might be coming and the System should be getting mentally adjusted to that possibility, but he did not think the present was a propitious time for such action.

Mr. Bryan said that the Sixth District condition was one of boom, the only exception being in the textile industry where there were some signs of stability. Minor reductions in lumber and steel output had been counterbalanced by other gains. Consumer spending had great strength. Bank debits were high and department store sales were strong in June. Mr. Bryan said that he had not recommended an increase in the discount rate to the directors of the Atlanta Bank, chiefly because of the almost unanimous opinion expressed in a recent open market meeting that such action would be unwise. However, in his view an increase in the rate should be made and there might now be a few days when that could be done. He agreed with practically everything Messrs. Mills, Robertson, and Shepardson had said although he perhaps went a little further than some of their comments.

While there was apparent stability in the current situation, Mr. Bryan said that the System would have to supply a great amount of reserves during the remainder of this year to take care of seasonal borrowings and Treasury needs. With the traditional signals calling for an increase in discount rate, failure to make such an increase would inject into the capital markets an element of uncertainty that could be expected to increase attrition and cause difficulty. Mr. Bryan stated that he was keenly alive to the responsibility of the Federal Reserve to the Treasury, but he wished to raise a question as to how that responsibility could best be discharged. If the inflation continued, the Treasury would be maneuvered into the classical pattern of a Government whose expenses were increasing faster than revenues. An attempt to assist the Government through easing its financing problems would only add to the difficulties. Mr. Bryan felt that the System should do nothing that would encourage the issuance of Government securities that would promptly go to a discount in the market. He suggested that the argument that the discount rate should not be raised now but that it might be increased in August was, in effect, one for supplying reserves through open market to help a Treasury issue go over at a rate, and shortly thereafter signaling the market for an increase in the rate that would cause the Treasury issue to show a loss to investors. Mr. Bryan suggested that this had happened on several occasions; he did not think the Committee should risk a repetition.

Mr. Johns indicated that Eighth District conditions did not differ materially from the general picture described for the nation as a whole. District banks did not seem to be under great pressure, and discounts at the Reserve Bank were nominal. Notwithstanding the apparent ease of district banks, Mr. Johns reported some indications that corporations were doing anticipatory borrowing for seasonal and other future needs, although he did not think the banks were rushing to accommodate such borrowers. Mr. Johns stated that he did not contemplate recommending to the directors of the St. Louis Bank a change in the discount rate at this time, although this did not imply what hiw view might be three weeks hence. He would not favor any relaxation of pressure at present by the Open Market Committee or otherwise. He would not resolve doubts on the side of relaxation but would try to maintain an even keel for the next three weeks.

Mr. Szymczak referred to the memorandum prepared at the New York Bank under date of July 3, 1957 regarding relations between the System and the Treasury, stating that this memorandum indicated the difficulties that the New York Bank had in carrying on operations at the same time for the Treasury and for the Open Market Committee. This presented a difficult problem for the Manager of the System Open Market Account. Mr. Szymczak expressed the view that the economy was now at a high level and all indications were that it would continue at a high level. However, he felt there was nothing that the Committee could do at this time other than to pursue the policy that it had been following during the past three weeks. If an opportunity presented itself to do something about the discount rate, it would be desirable to discuss the matter with the Treasury. His recommendation for the present would be to continue the program that the Open Market Committee has been following in recent weeks but to watch the situation carefully.

Mr. Balderston said that he had been taught that monetary policy faced the ultimate dilemma when we had rising prices on the one hand and rising unemployment on the other. It seemed to him clear that we were moving up a canyon with ever-rising walls and without the benefit of significant support from fiscal policy such as we had last year. Mr. Balderston said that he was concerned because the escalator clauses in certain manufacturing industries were giving rise to wage advances that were spreading out through the service industries. He was concerned at the moment not only with continuing plant expansion but with the heavy demand upon commercial banks which signified to him that inventory reduction may have ceased, and that short- and intermediate-term money was continuing to be used for long-term purposes. He felt that the System and the commercial banks had been complacent. The 1 per cent increase in the money supply over last year in which we took comfort had been negated in large part by increased velocity of demand deposits. This brought him to the question for which he had not found the answer. He liked the way in which the Desk had handled its problems during the last three weeks which had resulted in quite appropriate pressure. He disliked the fact that we might have an increase in the prime rate which would catch us without our own guns being cocked. If an increase in the prime rate were to come shortly, he felt that the System should respond almost immediately. In commenting further on this possibility, he suggested that if one or more Reserve Banks found themselves ready to recommend an increase in the discount rate, such recommendation might be laid before the Board of Governors hoping, of course, that no such recommendation would leak. The Board would then have something before it on which action could be taken if that seemed important. Because of the scheduling of the Treasury's financing, there was not much time in which to take action on the discount rate. If, however, the System were to delay for long after a rise in the prime rate it would seem as though it were abdicating its responsibilities.

In response to a question from Mr. Bryan as to whether it would be preferable for the commercial banks to take action on the prime rate first or for the Federal Reserve Banks to take leadership by changing the discount rate, Mr. Balderston stated that under existing circumstances he would prefer that the commercial banks act first.

Mr. Shepardson stated that he would take a view opposite that expressed by Mr. Balderston, adding that Mr. Bryan had expressed effectively his feelings as to why the System should not be in the position of tightening the market immediately after a Treasury financing.

Mr. Szymczak interjected that the System did not operate in a vacuum, and that an ideal policy from all standpoints is not always possible. In the current circumstances, the Treasury's needs must be considered.

Mr. Hayes also referred to the comments Mr. Bryan had made, stating that he did not believe that the material gathered in the memorandum of July 3, 1957, on relations with the Treasury supported the contention that regularly or quite often the System had misled the Treasury by following one policy before and a different policy immediately after a Treasury financing. He also said that he felt that rates in the market were the major factor that influenced the Treasury in pricing its securities. Reflecting the recent rise in rates, the Treasury officials were quite aware that they had to price the securities in the forthcoming refunding much more attractively than on the recent refunding, Mr. Hayes said, and he doubted that a movement of the discount rate would be a crucial factor in the Treasury's pricing problem. Rather, an increase in the discount rate would signify a strong feeling on the part of the Federal Reserve that general credit policy should be considerably tighter than it has been. If this were not the intent, he would think an increase in the rate would be quite inappropriate at this time. Mr. Hayes said that his feeling was that sufficient doubt existed as to the economic justification for an increase in the discount rate so that he would prefer to see the commercial banks take the lead in a change in rates, as Mr. Balderston had indicated.

Chairman Martin stated that he had in mind placing on the agenda for consideration at the next meeting of the Committee the memorandum distributed with Mr. Rouse's letter of July 3, 1957, regarding relations between the Federal Reserve and the Treasury. He felt that there were many facets to that document and that it would not be profitable to get into a discussion of its content at this meeting since some of those present had not had adequate opportunity to study the material.

Chairman Martin then commented that the Committee today had had a repeat performance of the preceding meeting, except that Mr. Balderston was not present three weeks ago. He felt that it was not desirable for the Committee to get too far in advance of itself in projecting what might be done several weeks hence. The important thing for the Treasury at this time was to face up to the current market. In retrospect, it was clear that the Treasury underpriced the rate on its offering in May. Chairman Martin said that he felt the Treasury recognized this and that it felt it must not underprice the forthcoming issue. From the standpoint of the Committee, he felt it important to give as good an atmosphere to the market during the refunding as was feasible.

Chairman Martin went on to say that he believed there was danger in thinking that the Federal Reserve was the only agency that could stop inflation. We were at the crucial period in the fight against inflation, he said, and the country would have to "fish or cut bait" in the next few months in his opinion. He was not speaking of the Federal Reserve, but of the Congress and the business community and the whole public. He had come more and more to the view that the Federal Reserve was the only group that had been actively fighting inflation. This position could become untenable. The Chairman said that he agreed with virtually everything that had been said here today, and he then referred to the summary statement of policy recorded in the minutes for the meeting of June 18, 1957, in which he stated that

> he had come to the conclusion that we could not simultaneously increase the flow of reserves and raise the discount rate effectively under present conditions; that the Treasury was about to make an offering of securities for which payment would be made when we were going into a seasonal demand for reserves; that in his view the Committee should give the Manager of the Account as much latitude in the execution of policy as consistently could be given; that we were in a period of prosperity as well as of inflation; that the consensus seemed to be that there should be no change in the directive for the next three weeks; and that we should not deviate from the present general policy but that we should give the Manager of the System Account whatever latitude was needed to try to adjust around the feel of the market, recognizing that in a period such as this net borrowed reserve figures were very difficult to determine.

Chairman Martin stated that the June 18 summary of policy seemed to apply to the situation today, and he inquired whether there was any disagreement with this view. In the absence of an indication of disagreement, he suggested that the Committee approve a renewal of the directive to the Federal Reserve Bank of New York in its present form.

Mr. Shepardson inquired whether this contemplated a continuation of the existing degree of pressure and, after the Chairman commented that this seemed to be the consensus, Mr. Shepardson stated that he disagreed with such a policy because he believed that the pressure should be increased.

Following a brief discussion as to whether the summary statement the Chairman had made represented a consensus or a majority view, Mr. Vardaman stated that he felt it undesirable for these meetings to include projections of potential actions for more than three weeks in the future.

Chairman Martin then called on Mr. Rouse and Mr. Hayes, mentioning that the matter of swaps had come up yesterday in a discussion with Under Secretary of the Treasury Burgess. The Chairman said he had not encouraged him to believe that the Committee would be favorable to swaps, but he had stated that he would bring the question up at this meeting.

Mr. Rouse responded that the question of swaps had not been mentioned to him recently.

Mr. Hayes stated that Mr. Burgess had mentioned this question to him, and Chairman Martin said that while Mr. Burgess was not proposing a definite action, he was wondering whether anything could be done at this particular juncture which might help in connection with the Treasury refunding to be announced shortly.

Mr. Rouse expressed the view that the value of any swap would depend upon the particular circumstances prevailing at any given time, but that at times it would be possible to utilize swaps to some extent to assist the Treasury without harming general open market policy. While the Committee was aware of his general views on this matter, authority for such operations in Treasury bills had not seemed vital to him recently, although such operations could occasionally be useful; he could not suggest any specific swaps that would be useful currently but would be glad to look into the question.

On the general situation, Mr. Rouse said that as Mr. Bryan had indicated the market had felt from time to time that "the rug had been pulled from under it" by reason of changes in the System's actions. This was not necessarily because of changes in the discount rate but because of changes that tightened the reserve position of banks, whether fortuitous or deliberate, so soon after a Treasury offering that the dealers and underwriting banks had not had an adequate opportunity to work out of commitments that had been taken. This had resulted in considerable feeling that whatever the new Treasury issue proved to be, purchasers might be buying into a loss, Mr. Rouse said, adding the comment that to his way of thinking this was not correct.

On the rate situation, Mr. Rouse said that he had learned of reports by dealers that many banks outside New York City had received telephone calls from New York suggesting that some banks other than those in New York take the lead in raising the prime rate. There was general discussion among the principal banks that as soon as it was decently possible after the Treasury financing, the rate should be raised. It was expected also that the discount rate would be increased by 1/2 of 1 per cent. This was gossip, Mr. Rouse noted, and was talked to customers as well as bankers.

One other point Mr. Rouse mentioned had to do with a position he had taken. The Treasury and the market felt that the refunding announced in May was priced on the market. In trying to appraise the results of that offering, Mr. Rouse felt that almost everybody had been influenced by the record of the past fifteen years in that there had been support for Treasury issues by the Federal Reserve during the war period and the pattern of rates could be played, so that there was not really any point in pricing securities under the market. It had been difficult to get away from this type of thinking, Mr. Rouse said, and it was now necessary for the Treasury to take all of these factors, including the possibility of increases in the prime rate and the discount rate, into consideration in pricing the forthcoming issue. Mr. Rouse said that he had taken this position fairly strongly in discussions with Mr. Burgess and others at the Treasury over the past two months, emphasizing that the new issues must stand on their own feet.

Mr. Robertson asked for clarification of Mr. Rouse's statement that he did not think dealers were correct in feeling that whatever the

Treasury issue might be, purchasers might be buying into a loss.

Mr. Rouse responded that there had been occasions when that had happened in the past but that he did not think the fear was justified on the present occasion.

Mr. Hayes commented that it was well to bear in mind that in a rising trend of interest rates, any financing was likely to be in danger of going to a discount shortly after it was announced. This had happened in many corporate issues and was considered not abnormal.

Mr. Hayes then referred to the discussion of swaps, stating that all that Mr. Burgess had mentioned to him was the possibility of some kind of direct buying by the Federal Reserve of an issue of one-year or longer maturity and selling of shorter-term securities in order to satisfy the liquidity needs of holders of rights. The general intent is to avoid a necessity for the Treasury offering a very short-term security which might tend to cut off demand for the other new issues.

Mr. Allen suggested that this would not be a swap as he understands swaps.

Chairman Martin said that he did not think the Committee would wish to exchange some of its shorter securities for longer securities, and Messrs. Robertson and Allen indicated they would not favor such an arrangement. The Chairman then inquired whether anyone present would favor such action and, in the absence of any affirmative response, stated that the matter was thus disposed of.

Chairman Martin asked for other comments in connection with the renewal of the Committee's directive, in response to which Mr. Rouse stated that he had no suggestions for change in the amounts.

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.

Mr. Rouse stated that net borrowed reserves had been running in excess of $700 million for about 10 days and that the market appeared very calm although he sensed some turbulence underneath the surface. He also sensed less unwillingness on the part of banks to borrow. Mr. Rouse also referred to a report this morning of another AAA rated thirty-year utility bond issue that was being re-offered at 4.43 per cent, stating that that illustrated the rapidity with which the recent movements in bond prices had taken place. He expressed the view that the decline a few weeks ago had been faster and had gone farther than was warranted and that the recovery during the last few days reflected the same situation.

It was agreed that the next meeting of the Committee would be held at 10:00 a.m. on Tuesday, July 30, 1957.

Thereupon the meeting adjourned.

Secretary's note: Immediately following the meeting, Governor Robertson reviewed plans for Operation Alert 1957, during which Mr. Leonard, Director, Division of Bank Operations, and Mr. Allison, Special Consultant, entered the room.

Winfield W. Riefler

Secretary