

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 8, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman  
Mr. Hayes, Vice Chairman  
Mr. Balderston  
Mr. Fulton  
Mr. Irons  
Mr. Leach  
Mr. Mangels  
Mr. Mills  
Mr. Robertson  
Mr. Shepardson  
Mr. Szymczak  
Mr. Vardaman 1/

Messrs. Allen and Johns, Alternate Members of  
the Federal Open Market Committee

Messrs. Bopp, Bryan, and Leedy, Presidents of  
the Federal Reserve Banks of Philadelphia,  
Atlanta, and Kansas City, respectively

Mr. Riefler, Secretary  
Mr. Thurston, Assistant Secretary  
Mr. Hackley, General Counsel  
Mr. Solomon, Assistant General Counsel  
Mr. Thomas, Economist  
Messrs. Daane, Hostetler, Marget, Walker,  
Wheeler, and Young, Associate Economists  
Mr. Rouse, Manager, System Open Market Account  
Mr. Carpenter, Secretary, Board of Governors  
Mr. Kenyon, Assistant Secretary, Board of  
Governors  
Mr. Koch, Associate Adviser, Division of Re-  
search and Statistics, Board of Governors  
Mr. Keir, Economist, Government Finance Section,  
Division of Research and Statistics, Board  
of Governors  
Mr. Stone, Manager, Securities Department,  
Federal Reserve Bank of New York

1/ Withdrew from meeting at point indicated in minutes.

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Messrs. Mitchell, Jones, Strothman, and Tow, Vice Presidents of the Federal Reserve Banks of Chicago, St. Louis, Minneapolis, and Kansas City, respectively; Mr. Coombs, Assistant Vice President, Federal Reserve Bank of New York; and Messrs. Anderson and Atkinson, Economic Advisers, Federal Reserve Banks of Philadelphia and Atlanta, respectively

Chairman Martin stated that Mr. Deming, Alternate Member of the Committee, was on vacation and that in the absence of objection Vice President Strothman of the Federal Reserve Bank of Minneapolis would attend the meeting in Mr. Deming's place as an observer. There being no objection, Mr. Strothman joined the meeting.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 17, 1958, 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 June 17 through July 2, 1958, and a supplemental report covering commitments executed July 3 through July 7, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Reporting on open market operations since the last meeting, Mr. Rouse stated that reserve availability has been maintained, with free reserves averaging between \$550 and \$600 million. This figure is somewhat higher than in the preceding three-week period, and reflects

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primarily the situation in the Government securities market. Bill purchases totaled \$797 million during the past three weeks, but \$184 million bills will run off next Thursday, July 10. The average issuing rate in yesterday's bill auction was .93 per cent and the stop-out was just under 1 per cent.

Mr. Rouse reported that the Government securities market has been in a poor state in recent weeks, superficially because of the heavy volume of speculation in the new 2-5/8 per cent bonds of 1956, but more fundamentally because of the feeling of investors that economic conditions are improving and that recovery is in the making. While there has been a good deal of selling of the new 2-5/8s as well as of other issues during the past three weeks, there has been a notable lack of buying, except on the part of the Treasury (which is retiring a good part of the 2-5/8s that it purchased). Mr. Rouse said that the recent sharp declines in Government bond prices were triggered by the press story that appeared on June 19, stating that there had been a shift in System policy. He observed that the declines would very likely have occurred in any event and would have been triggered by something else even if that story had not appeared. The Treasury has difficult problems ahead and must make its decision next week as to the terms of the forthcoming refunding operation. Since indications are that the Treasury will have to borrow cash in August and October, there will be a particularly heavy calendar ahead

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unless it is decided to combine the refunding of the called September issues with the refunding of the August certificates or with the August cash operation.

Mr. Mills observed that he had seen a good many comments concerning the purchases by the Treasury to cushion the decline in the bond market and noted that, since there had been no System purchases, the buying by the Treasury had been virtually the only source of support to the market. He wondered about the extent of the overhang of securities remaining in the market, and inquired if this overhang was of such size as to indicate that System purchases might at some point be necessary to supplement those of the Treasury.

Mr. Rouse replied that back in May a New York money broker convinced many that there was a quick profit to be made in participating in the June refunding operation. He stated that only small margins were required against the rights when they were purchased in May, but that larger margins were required after the exchange on June 16. There has apparently occurred, in many cases, almost a forced liquidation which may now be about completed; such forced liquidation, he pointed out, was probably a large part of the total liquidation of the 2-5/8s that has occurred. Mr. Rouse noted that Government securities dealers held large positions--around \$2.5 billion-- at the time of the last meeting, but that such positions have now been reduced

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by somewhat over \$1 billion and that a good part of the liquidation represents 5- to 10-year bonds. He stated that it was difficult to say how much speculation there was in the 2-5/8s. It had been expected that the exchange into that issue would be in the neighborhood of \$3.5 to \$4 billion, but actually the exchange turned out to be about \$7.4 billion. Mr. Rouse added that during this period of sharp price declines in the bond market, there have been comments that conditions were at times disorderly. He said that he disagreed.

Mr. Rouse concluded his remarks by noting that there have been wide differences between the reserve projections of the Board staff and those of the New York Bank. He reported that the staffs are working on the problem of developing explanations of such wide differences in projections, in the hope that the estimates will be more useful to the Committee.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period June 17 through July 7, 1958, were approved, ratified, and confirmed.

In supplementation of the staff memorandum distributed under date of July 3, 1958, Mr. Young made the following statement on the economic situation:

Most recent economic intelligence points to better performance for the economy in this period than observers

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anticipated earlier. May and June together have shown a two-point rise in the index of industrial production and the present likelihood is that the final record will show a rise of three points. Total national product for the second quarter is currently estimated to be at least modestly higher than in the first quarter.

Whether an abrupt turnabout of activity is taking place or whether evident improvement merely reflects a temporary rebound of production too far below consumption is yet to be determined. But barring some unexpected jolt to business and investor psychology, the odds would seem to favor a better than rebound movement. Probably the most important feature of the recent strengthening is that it is without dominance of improvement in one or two major areas. Rather, it represents a composite of small improvements over a wide range of activities.

The important highlights may be briefly summarized: Substantial gains in industrial production over May and June were made by steel, autos, household durables, textiles, apparel, leather and rubber products, paper and paper products, coal and petroleum.

For the first time in eleven months, manufacturers' sales in May were up modestly and the inflow of orders, although still below shipments, rose moderately. Sales from inventory continued, so that manufacturing inventory liquidation was maintained at about the same high rate as the preceding four months, bringing still closer the point when inventory buildup would be a stimulus.

Construction activity in dollar volume in June also showed lift, the first such indication since December. Residential, commercial, and public (including highway) construction constituted the strong elements; industrial construction was off further. Contract awards for these strong areas were up sharply.

Reflecting improved industrial and construction demands for labor, initial claims for unemployment compensation have stabilized and continued claims have declined. From May to June, unemployment rose from 4.9 to 5.4 million, entirely resulting from the increase in summer workers seeking employment. The seasonally adjusted unemployment rate fell from 7.2 to 6.8 per cent. From mid-May to mid-June manufacturing employment showed its first gain in 15 months and there were also employment gains in services, State and local government, trade, and construction. Hours worked per week in manufacturing rose both in May and June, the average reaching

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39.2 in June compared with 38.3 in April. The increase in hours worked was widely spread.

Personal income in May rose further and, at \$344 billion, was less than 1 per cent below its peak in August of last year. Personal income for June is expected to reach a new high.

With improved personal income, retail sales in May rose slightly further, with all major lines of durable goods showing some increase and nondurable sales holding at record levels. In these circumstances, retail inventories declined further, although at a slower rate than earlier in the year. June department store sales increased slightly further from May.

New automobile sales in the first twenty days of June about matched the improved May rate, and used car sales were even better. With sales strength maintained, both new and used car stocks declined further. Continued liquidation of instalment debt for automobile purchases in May apparently reflected in part a fairly sharp decline in credit sales. Credit sales of new cars in that recent month apparently ran about 57 per cent compared with average credit sales of around 60 per cent for preceding months of this year.

Activity in the housing market continued to pick up in May and June. Low and moderately priced new houses required less time to sell and existing houses also sold somewhat better, though with some shading of prices. In response to stronger demand conditions, and reflecting also the pressure of a growing supply of mortgage funds, mortgage lending by all lenders has increased. Mortgage rates are apparently still declining.

Wholesale prices have receded a bit recently, mainly because of lower farm prices, particularly for livestock and vegetables. Wholesale prices of industrial products have been edging off, while prices of industrial materials have been relatively firm after strengthening in late May and early June.

While the index of consumer prices rose slightly to mid-May, recent indications for food prices, especially, would point to no change or slight decline to mid-June.

One big uncertainty in the unfolding situation is the possibility of cyclical downturn in European business activity and a new surge of inflationary forces in Latin American and Far Eastern countries whose export earnings have been cut back in recent months. For more than a year, industrial output in major European countries has shown leveling out and some recent indications suggest the onset of recessionary drift. But with statistical data less adequate and timely than in this country, it is difficult to gauge the generality

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of these signs. Certainly there is not yet enough evidence to warrant inference that European recession is likely to become a force affecting adversely U. S. and world trade developments. At the same time, there is this hazard and European market developments will need close watching in the months ahead.

A memorandum on the outlook for Treasury cash requirements and bank reserves, prepared by the Board's staff, had been distributed under date of July 3, 1958. With further reference to financial developments, Mr. Thomas made the following statement:

Since the last meeting of the Committee, the most striking financial development has been the severe pressure on the Treasury bond market. This rather spectacular episode and its causes have been described in written reports submitted to the Committee by the staff and by the Manager of the Account. These events contain lessons not only for speculators and for the Treasury, but also for Federal Reserve policy.

It is evident that the underlying factors were the very large commitments in Treasury bonds made by temporary holders, many for pure speculation, induced by expectation of further declines in interest rates, and the attempt to close out these commitments at a time when the money market was under severe pressure because of exceptionally heavy seasonal liquidity demands. These liquidity demands were larger than usual because of the absence of a maturing Treasury tax anticipation security, together with the additional cash raised by the Treasury through a long-term bond issue.

The Treasury's deposit balances increased to over \$9 billion. Funds to make payments to the Treasury were raised largely by the sale of Treasury securities--particularly the new 2-5/8 per cent bonds--or by calling loans that had been made to dealers to carry large amounts of securities they had purchased earlier as rights. The effect on bank credit was phenomenal. Bank loans to businesses increased only moderately but their holdings of securities and loans on securities showed exceptionally sharp increases. Total deposits at banks also increased sharply, as did their required reserves.



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In the three weeks ending June 18, total loans and investments at banks in leading cities increased by \$3.9 billion, of which \$2.5 billion came in the third of these weeks. In the next week there was a smaller decline than usual. Altogether in the four weeks ending June 25 the net increase was over \$3.7 billion, many times more than in the corresponding period of other recent years.

The pressure of these exceptionally heavy credit demands came mostly through the U. S. Government securities market. Business loans increased by little over a half a billion dollars--much less than in other recent years. Holdings of Government securities by these banks increased by \$1.5 billion, holdings of other securities by nearly \$500 million, and loans on securities by about \$1.0 billion; these items have generally declined or shown little change in June of other recent years.

Most of these funds went to enlarge Treasury balances, which increased by \$3.8 billion in four weeks at these city banks, and by \$1 billion at all banks to the exceptional total of over \$9 billion. In the corresponding weeks of the three previous years, U. S. Treasury deposits had fluctuated widely but showed little net change for the period as a whole. Time deposits at banks continued to increase at a fast pace--about half a billion dollars at weekly reporting banks alone. Demand deposits of businesses and individuals rose sharply in the first three weeks of June but subsequently declined equally sharply, reflecting the large tax payments in cash in the absence of a maturing tax anticipation security, as well as cash payments for nonbank purchases of the new Treasury bonds. The total for all banks in June probably showed a contraseasonal decline estimated at half a billion dollars.

Meeting these exceptional credit demands has called for exceptional amounts of Federal Reserve credit. In the five weeks ending July 2, System open market operations have supplied about \$1.4 billion of reserve funds. About half of this amount covered currency demands of \$350 million and a gold outflow of \$300 million. Most of the remainder--over \$660 million--was added to member bank required reserves. This has been one of the largest monthly increases in required reserves on record. Free reserves of member banks, which declined from over \$550 million in the latter half of May to less than \$450 million in the first half of June, increased to a level of close to \$600 million in the past three weeks, including the current week.

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Notwithstanding this large addition to the reserve supply, interest rates rose under the pressures of the vigorous credit demands. The Treasury bill rate increased somewhat from the low level of around  $5/8$  per cent reached at the end of May to about one per cent in the third week of June. After declining somewhat, the rate has again approached one per cent in the last few days. The Treasury bond market was notably weak under the influence of the closing out of speculative commitments, and yields rose by nearly  $1/4$  of a percentage point. Yields on corporate and municipal bonds showed somewhat more moderate increases, while new issues moved slowly. Yet the market continued to absorb a substantial volume of new issues, particularly when the long-term Treasury bond is included.

This episode raises many questions about recent System policies and more particularly about appropriate policies for the near future.

In the first place, it needs to be kept in mind that System policies have made possible the provision of very large amounts of credit to the economy during the past five to seven months. Total loans and investments of commercial banks increased by probably as much as \$12 billion from the end of January to the end of June--much more than ordinarily occurs within a whole year--even though this period has been one in which there is usually little or no seasonal growth. To be sure, one third of this growth occurred in June and is presumably largely temporary. This temporary aspect is an important consideration for future policy to be discussed later.

This credit expansion has resulted in a growth in required reserves of nearly \$1.2 billion, which, together with a currency drain of half a billion and a gold outflow of \$1.4 billion, called for exceptionally large additions to reserve availability. Reserves were supplied by reserve requirement reductions aggregating \$1.5 billion and by System open market operations of \$2 billion.

In addition to the temporary character of the large June increase, another important qualification of the recent bank credit growth has been pointed out by some commentators. That is that the bulk of it reflects a shifting of liquid funds and savings from U. S. Government securities and perhaps other assets to time deposits at banks, attracted by rates paid on such deposits in contrast

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to the lower market yields on securities. From January to May commercial bank and Federal Reserve holdings of U. S. securities increased by about \$6 billion, while holdings of other investors declined by about \$5 billion. In this same period time deposits at commercial banks increased by \$5 billion, and those at mutual savings banks increased by nearly \$1 billion. It cannot be assumed, however, that all of these changes, though similar in amount, reflected a direct shift from Governments to time deposits. Some of the funds obtained from the sale of Government securities went into other uses, and some of those that moved into time deposits no doubt came from demand deposits, thus slowing down the growth in demand deposits. Even if only one-tenth represented the latter shift, the amount is not an insignificant addition to demand deposits.

A substantial part of the growth in bank credit also has gone into deposits of the United States Government, as already pointed out, and has not been added to available funds of business and individuals. The growth amounted to \$3 billion from January to the end of May and another \$4 billion was added in June. Most of this is temporary.

Demand deposits adjusted have declined by nearly \$2 billion since January, but the normal seasonal decline for this period would be about \$4.5 billion. Hence, notwithstanding the large growth in time and U. S. Government deposits, demand deposits adjusted have increased by close to \$2.5 billion in five months, an annual rate of growth of nearly 6 per cent. If some allowance were made for a shift to time deposits, the effective increase in active demand deposits would be even greater. In any event the increase shown is by no means an inconsiderable growth in a period of declining economic activity.

For purposes of System policy, the significant point is that a very large amount of liquidity has been supplied to the economy. If demand deposits adjusted show no more than the usual seasonal expansion for the rest of the year, the net growth for the year would be over 2-1/2 per cent, even without allowance for any shifting into time deposits. It may be said, moreover, that in many respects time deposits are more liquid than holdings of Government securities in that they are payable at face value and would not have to be converted into cash through market offerings that might be made difficult by a changed monetary policy.

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That conversion has already been made. Finally the large volume of U. S. Government deposits will be drawn down and the funds become available to the public for additions to deposits or payment of debt. Bank credit has already been provided to build up those balances; it does not have to be provided again.

Projections of reserve needs for coming months, presented by the Board's staff, are based on the assumption that as the Treasury reduces its deposits the funds will be used, in effect, partly to reduce bank credit and partly to make additions to the money supply of no more than usual seasonal amounts. On this basis total deposits at banks and correspondingly total loans and investments should decline substantially in the next two months. Increases in September and October would be less than the previous decline. These figures allow for additional Treasury cash financing in August and October, but on balance over an extended period Treasury borrowing should add only temporarily to the cash needs or cash supply of the economy.

Other factors, including possibly a moderate further gold outflow, are expected to exert some drain on reserves. When allowance is made for them, as well as for normal monetary needs, these projections imply that to avoid further increases of more than normal seasonal amounts to the liquidity of the economy, System holdings of Government securities should be reduced by more than \$600 million in July. If this were done, moderate increases at the end of August and in October, at times of Treasury cash financing, would be appropriate. In the last two months of the year substantial operations would be needed for seasonal purposes.

It should not be assumed that these indicated operations would result in the credit developments projected. The strength of credit demands and the desires of the public for cash holdings will also be determinant factors. If credit demands are stronger or if banks should be more active in putting funds to use, expansion could be greater. If free reserves were maintained at a high enough level, such might be the result. On the other hand, reserves might be supplied but not be put to use. For these reasons, the ultimate test of policy is not the level of free reserves provided, but the response as reflected in credit developments.

Projections presented by the Federal Reserve Bank of New York pose the problem facing the Committee in another

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and highly significant manner. If I understand correctly, they are based on the assumption that the maintenance of free reserves at the current level will be a stimulus to credit expansion, which in turn will require additional reserves. These estimates predicate a growth in total deposits of all member banks of \$6.6 billion in the next 18 weeks--on top of the expansion that has already occurred in June. Some \$5 billion of this increase would be in demand deposits, and the projected increase in required reserves exceeds \$800 million. If Treasury tax and loan accounts are reduced, as they presumably will be, by over \$4 billion, the resulting growth in other demand deposits would be close to \$9 billion. The normal seasonal growth for this period is about \$2.5 billion.

To make possible this result and maintain free reserves at \$500 million, the System would have to add about \$1 billion to its portfolio in the next 18 weeks--much of it in August. The Board's staff projection, which may be said to indicate minimum requirements, would call for little net change in System holdings for the period as a whole.

It is useful to have a projection of this sort as a warning as to where policies might lead. Two questions need to be considered: (1) Is it reasonable to expect that the public's monetary desires will be so large or that banks will want to expand their loans and investments by any such amount if free reserves are maintained at above \$500 million; (2) Does the System want to follow a policy that will encourage or make possible such a result?

The experience of June is an example of the pitfalls that may be encountered in following a path of forcing down interest rates and stimulating credit commitments regardless of current needs. Resulting speculative excesses may lead to crises that in turn raise demands for relief measures. Is economic recovery aided by such false and temporary movements? Finally, isn't the liquidity of the economy already more than adequate to support recovery for a long time ahead?

Mr. Hayes presented the following statement of his views on the business outlook and credit policy:

Business activity during the second half of June suggests a mixture of diverse movements. While the downtrend has been arrested for the time being at least, there are

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no convincing indications of an incipient recovery. The immediate outlook is for a summer in which economic indicators will move in both directions, perhaps showing as many losses as gains, and expansionary tendencies may not show their force until the fourth quarter at the earliest.

A good many of the encouraging elements in the last few weeks have been connected with Government activity. Thus the record level of construction awards for May was in large part attributable to gains in the public sector; manufacturers' orders improved primarily in the area of defense contracts; and personal income was sustained to a considerable extent by higher transfer payments. Higher Government salaries and other payments will be increasingly helpful in June and July, especially in the latter month when retroactive salary payments and extension of unemployment insurance will accentuate this tendency. Finally, much of the price strength for certain metals in recent weeks reflects Government policies with respect to tariffs and stockpiling.

Contrary to earlier expectations, inventory liquidation by manufacturers in May apparently proceeded at the same high rate as earlier in the year. On the other hand, consumer spending has continued to hold at a very satisfactory level, with June retail sales apparently almost as good as those of May. Consumer credit in May did not continue the decline of the preceding months, as noninstalment credit rose more than instalment credit diminished.

In general, price developments in recent weeks, especially in industrial raw materials, have reflected the improvement in business sentiment, although no predominant trend has been established. Farm prices have continued their downward tendency of the last month or two, with the result that the over-all wholesale price index for June will probably be lower than for May. The consumer price index has apparently stabilized.

Such corporate profits data as are available for the first quarter make poor reading and cast renewed doubt on the performance of the stock market. With dividends well sustained, the shrinkage of retained earnings helps to explain the continuing heavy corporate demand for long-term financing at a time when plant and equipment expenditures are declining.

In considering policy for the next few weeks, we should have in mind not only the general business outlook but also the important prospective Treasury financing operations and, closely interrelated with both of these factors, the degree

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of restoration of liquidity which has been already accomplished and that which should be our goal in the next few months.

With respect to the Treasury, terms of the major August refunding are due to be announced next week, and the exchange will have been effected by the time of our next meeting. In the present disturbed atmosphere of the Government bond market, there is some danger that the capital market in general might not be as encouraging to new investment as we would like to see it over the coming weeks. In addition to the refunding, our calculations suggest that the Treasury will have to raise some \$2.5 billion of cash by early September at the latest, and possibly by early August. Over the last six months of 1958 cash financing may total about \$8 billion, with the commercial banks doubtless taking a major proportion of this amount.

As for bank and nonbank liquidity, June witnessed an important further increase in bank holdings of securities and continued growth in nonbank holdings of liquid assets. Loans and investments of all commercial banks rose by \$4 billion in the four weeks through June 25, with securities and security loans accounting for most of the rise. By the month-end, security holdings of all commercial banks were roughly \$10 billion above the level of last October, while loans had increased only slightly. Since mid-May loan-deposit ratios of New York banks have averaged around 58 per cent as against 66 per cent early last October, with the comparable ratio for banks outside New York dropping from 55 per cent to 51 per cent. Yet it is worth noting that these ratios are still at a higher level than in any recent period prior to 1956 and are ten percentage points or more above the 1954 lows. While the increase in money supply has been rapid in the last few months, the present level is about equal to that of a year ago. If we compare the sum of the money supply, time deposits and other highly liquid holdings with gross national product, we find a rise in nonbank liquidity of about 5 per cent between the third quarter of 1957 and the first quarter of 1958, and this trend probably continued in the second quarter. Total required reserves (after adjusting for changes in required reserve ratios) are now running close to \$1 billion ahead of last year. All of these measures taken together suggest that we have achieved a gratifying improvement in liquidity, wholly appropriate to a period of recession--but they also

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suggest that we might begin to think about future moves to damp down this growth of liquidity, especially if business should fare reasonably well in the coming months.

Turning to specific credit policy, I would hope that we could achieve a de-emphasis of the free reserve figure as an objective of monetary policy. We have often talked about this in the past, and we have not had much success in getting away from this measure--but I believe we should give increasing attention ourselves to the underlying statistics on money supply and other liquidity measures, and we should try to get the market and the public to give them increasing attention.

Substantial free reserves should be maintained as a stimulus to recovery, at least until we see a more imminent risk than is now visible of excessive liquidity developing in the economy--but this does not rule out the desirability of some cautious probing toward slightly lower levels of free reserves than we have seen recently, provided we can do so without causing too much disturbance in the capital markets. I am troubled over the basic dilemma of trying to stimulate recovery through additional investment while at the same time avoiding the creation of too much liquidity. I would hope that we could keep free reserves at \$500 million or less in the next three weeks, subject to the usual reservations as to the distribution of reserves and the feel of the market. At the same time it is highly desirable that we avoid any action that would be likely to set off a trend toward higher long-term interest rates or to create a public impression of a basic change in credit policy. Admittedly this poses a delicate problem for the Management of the Account for the next three weeks.

I can see no need at this time for a change in discount rates or in the directive.

Mr. Irons said it seemed to him that the national picture, as presented by Mr. Young, continued to indicate improvement and was encouraging. It appeared that more and more factors were pointing to the up side and that there was an accumulation of small movements indicative of a gradual development of strength in the economy. In the Eleventh District, Mr. Irons said, conditions continued about as



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they had been, with activity at quite a high and stable level. The petroleum situation was gradually showing improvement, with the stock situation better and prices a little firmer as the stock situation improved. Allowables had been moved up to nine days in June and possibly there would be further gradual increases. There was some feeling that allowables might move up to eleven or twelve days by the latter part of the year, which would represent a marked improvement.

Mr. Irons said that the agricultural situation in the district continued to be very favorable, with rains at the right time and the crop outlook good. Retail trade was holding up well; in June it was just a shade under the very high level of June a year ago. In the banking picture, recent call report data showed an increase somewhat in excess of \$650 million from the roughly comparable date of a year ago in total deposits of weekly reporting banks, and more than half of this increase was in time deposits. There had been reports of a shifting out of Treasury bills into time deposits by corporations and others, and apparently there was quite a strong demand on the part of holders of funds to get into time deposits at a favorable interest rate. This led him to believe the time deposit movement was something to be watched carefully for it might contain a fairly substantial amount of funds which could prove to be "hot money." Loan demand in the district was good, Mr. Irons said, with loans up over a year ago.

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As to policy, Mr. Irons said it seemed to him from a study of the available figures that the problem over the next few weeks would be one of avoiding too great an availability of reserves. The projections, he noted, indicated fairly easy reserve positions. Also, it appeared that the expansion in the money supply might be substantial, with a shifting of funds into private hands from the Treasury, so that the problem was likely to be one of guarding against too great expansion and too much liquidity rather than the reverse. The Treasury would be in the market almost continually, or at least several times in any event, over the next few months and it might be necessary to make a decision between the tighter credit policy required by the unfolding economic situation and support of the Treasury. Mr. Irons felt that it would be a mistake to permit an ease to develop that could not be sustained as conditions moved ahead over the next month or so, and he did not feel that anything would be gained by such a course. Altogether, the circumstances indicated that the Management of the Account was going to have a difficult time. The use of judgment and a feel of the market would be required in trying to restrain further availability of reserves and hold a checkrein to the extent possible.

Mr. Irons concluded by saying that he would not favor a change in any of the implements of System policy such as the discount rate or reserve requirements. That point, he felt, had been

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passed for the time being.

Mr. Mangels said that the Twelfth District had experienced about the same degree of improvement as reported nationally. Lumber reports indicated a little better than seasonal improvement, both in new orders and production, in May and early June, and there had been an increased demand for plywood, accompanied by a price advance. Residential construction was holding up very well; in May it was reported that residential construction contracts were at the highest point since 1956. However, nonresidential construction awards had declined slightly from April and early May figures. Steel production, which was up early in June, declined by the end of the month and the decline was expected to continue in July because there had been forward buying in anticipation of a price increase. Removal of the freight tax at the end of July had resulted in efforts to defer shipments.

Agriculture in the district was progressing favorably, Mr. Mangels said, with the fruit and vegetable canning industry looking forward to good prospects. The inventory carryover was not as large as in 1956 or 1957 and some improvement in profit margins was expected this year. Employment had been rising, and the slight increase in manufacturing employment was significant because previously there had been uninterrupted declines for the past ten or twelve months. On the other hand, unemployment had increased slightly.

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There continued to be cutbacks in aircraft employment in Southern California but this was offset to some extent by gains in other areas. At the Boeing plant in Seattle, employment in May was around 63,000, a figure 2,500 higher than a year ago. While automobile sales in May were below the 1957 level, in California they were up somewhat in April. In other States from which reports were available, it was indicated that May sales were about the same as those for April, whereas normally a little decline might be expected. Department store sales showed little change in May from the preceding month.

Mr. Mangels continued by saying that for the three-week period which ended June 26, loans at banks in the Twelfth District were up \$17½ million, which included an increase of \$30 million in real estate loans. Time deposits continued to rise, the increase of \$16½ million more than offsetting the decline of \$156 million in demand deposits. Mr. Mangels recalled that at the last meeting of the Committee he had reported indications of a possible reduction in the rate of interest on savings deposits. As the end of June approached, however, the banks found that savings and loan associations were not going to reduce the dividend rate so they decided, rather reluctantly, not to change the savings deposit interest rate. With one or two exceptions, the banks had announced that they were going to keep the rate until the end of this year. There was practically no borrowing from the

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Reserve Bank by member banks, and Federal funds transactions were running at somewhat lower than normal levels, with purchases slightly exceeding sales.

In terms of the over-all situation, Mr. Mangels said that the principal question seemed to be whether the present indications of encouraging developments in business were going to persist and bring about actual recovery. Even if the most optimistic expectations were realized, however, he felt that rather substantial unemployment must still be expected at the end of the year.

As far as monetary policy was concerned, Mr. Mangels expressed the view that the Management of the Account had done an excellent job under trying conditions. He agreed with Messrs. Hayes and Irons that the System ought not to liberalize its attitude and provide more ease. As to free reserves, he had in mind a level somewhere around \$500 million, and he would have no objection if the level were to drop somewhat below that figure. The System, he felt, should not be influenced too much toward extending its position of ease because of the Treasury financing ahead, but the Account Management must continue to have some degree of discretion in its operations for there was another three-week period ahead which would not be easy.

In conclusion, Mr. Mangels referred to the meeting of the San Francisco directors to be held tomorrow and said he was quite sure that the directors would not be inclined to make any change in the discount rate.

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Mr. Allen said that the Seventh District continued to provide a contrast between the farm and industrial sectors. Crop conditions remained favorable over most of the district, with pasture conditions in Michigan and Wisconsin having been improved by rains and moisture very good in the corn belt. Hog prices had continued to increase and were nearly 20 per cent above a year ago, but farmers reported plans for substantially increased production which, if accomplished, should bring about a sharp drop in hog prices next spring. In the industrial sector, the district continued to run behind the nation in most respects. In the matter of employment, for example, the larger centers continued to register less satisfactorily than the country as a whole, and Chicago and Flint had been reclassified by the Labor Department to reflect worsening conditions. District experience in construction and housing starts likewise was running behind that of the nation, and builders and lenders in the residential field in both the Chicago and Detroit areas expected a second half generally resembling the first. Department store sales for the district for the four weeks ending June 21 were 6 per cent below a year ago compared with a drop of about 2 per cent nationally.

Mr. Allen observed that the practice of scheduling vacation shutdowns and interruptions for model changeovers in July and August-- a practice common in the automobile business and growing in other

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industries--added to the difficulty of estimating whether or not this was a period of recovery from recession. It was understood that the automobile people planned unusually low production for the third quarter--680,000 cars--but their sales were better in June. While official figures were not available, informed sources estimated that 400,000 cars were retailed during the month of June, which meant that this was the best month so far this year, although 27 per cent below June 1957. Unofficial estimates placed the June 30 inventory of unsold new cars at around 695,000, while the figure last year was 735,000. With that inventory figure and with the low production program for the third quarter, it would not take much of a sales performance to reduce inventories to quite a modest level by the first of October. The target for that date was 400,000 and it could be achieved by a daily sales rate of 12,500 through the third quarter. If the daily rate were that of June--16,000--the inventory on October 1 would be down to 143,000.

The large Chicago banks, Mr. Allen said, had been in an easy position. While moving to improved reserve positions the Chicago banks, and also those in Detroit, had continued to enlarge their holdings of Treasury bills and the volume of bills held by those banks had more than doubled in the last four weeks. At the same time, loans against securities had not increased relatively as much in the banks of the district as in the country as a whole.

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Turning to policy, Mr. Allen said he agreed with those who had already spoken at this meeting. He felt that System policy had amply accommodated commerce and industry and that "hewing to the line" was indicated. While he disliked to use free reserves as a gauge, those who had spoken thus far had mentioned a level around \$500 million. With this he agreed, even if it meant sales out of the System portfolio in the next few weeks. In his opinion, the System should stick to its trade and not worry too much about the Treasury. The Treasury, he felt, would be very fortunate if it could borrow longer-term at anything like the rates which it had been paying. With most people feeling that this is an inflationary age, and with the record of inflation over the past ten years, it would be remarkable if the Treasury could stay near those rates.

Mr. Leedy said that the Tenth District continued to do better than the nation generally. The winter wheat crop had worked out about as forecast and the district would have a near record crop. Last week was the peak of the harvest and conditions were ideal. With something like 2,000 cars on the track, there had been a short strike of workers at the terminal elevators in Kansas City, but fortunately the strike was quickly settled. Wheat yields per acre were reported to be quite high and the quality of the wheat



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was satisfactory, although the protein content was a little lower than that of last year's crop. Other crops in the district likewise were reported to be in excellent condition and the same kind of report was prevalent as to pastures and ranges. The favorable situation with regard to farm income in the district, which he had previously reported to the Committee, continued to show up as additional monthly figures became available. Cash farm receipts for the first four months of the year were 19 per cent higher than for the first four months of last year, compared with an increase of 7 per cent nationally. Department store sales for June were slightly higher than in June of last year and for the first half of the year sales were virtually unchanged from the same period of 1957.

Mr. Leedy went on to say that nonfarm employment continued to improve in the district in May. While data were not yet complete, it appeared that further seasonal gains in nonmanufacturing activities were widespread. Also, manufacturing employment in most of the States of the district had increased slightly. Although employment levels were running substantially below last year's figures, insured unemployment continued to fall in response to the seasonal upturn in nonfarm jobs so that in mid-June it was about 15 per cent lower than a month earlier. By States, the range had been from 4.9 per cent in Missouri and Oklahoma to around 3 per cent in the other

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States, which compared with the national figure of around 6.4 per cent. Construction contracts awarded in the district in May were one-fifth higher than a year ago, with substantial gains in all major types of construction; for the first five months of the year the total of construction awards was about 8 per cent above the similar period for last year. The banking picture in the district conformed generally to that which had been reported for the country. There had been an increase in all major categories of loans over the last three weeks, with tax borrowing the principal reason for the expansion in business loans. Deposits were up, reserve positions easy, and the reserve city banks had been supplying some funds to the Federal funds market.

As to policy, Mr. Leedy said he subscribed to what had been said previously at this meeting. As he understood the views expressed, they were quite uniform. He felt that the System had gone far enough in providing ease in bank reserve positions and, as Mr. Hayes had suggested, there might be some probing for a lower level of free reserves. He also subscribed to what had been said about the course which should be pursued in the event of a conflict between the System's objectives and those which would best serve the Treasury. Should conflict necessitate a choice, he would follow a course that would give precedence to effective monetary policy.

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Mr. Leach said that in recent weeks some of the major Fifth District economic indicators had remained unchanged but many had shown improvement. The recently announced pay increase of 10 per cent for Federal employees retroactive to January was expected to provide a substantial stimulus to consumer spending because military installations and the presence of the Nation's Capital combine to give the district nearly one-fifth of total Federal civilian employment within the United States. While there had been little change in the textile industry, construction contract awards in May showed a substantial increase over April, as well as over May a year ago, to provide the most optimistic note. There were others, however. Bituminous coal production improved noticeably in May and June; cigarette production was up; lumber production was at a good level; department store sales were doing well; employment had stabilized or shown gains in most areas; and insured unemployment rates had fallen, though the rate for West Virginia was still above 13 per cent.

Turning to credit policy, Mr. Leach expressed the view that despite the continuing signs of improvement in economic conditions it would clearly be premature to think in terms of abandoning the present policy of ease at this juncture. He believed, however, that there should be a change in emphasis. Further additions to the liquidity of the banking system and the economy should be

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avoided as far as practicable because they would serve no useful economic purpose and would make the future task more difficult. While the System must, of course, supply the reserves needed for the Treasury's deficit financing, this inevitably would add substantially to liquidity in the months ahead and made it all the more important to avoid unnecessary additions in so far as possible. This, he felt, should be the Committee's objective under current economic conditions. Although he realized that such an objective would be extremely difficult to attain in view of Treasury financing, the unsettled condition of the Government securities market, and the importance which the market and the public now attach to changes in the level of free reserves, current economic conditions might continue for some time without substantial change and he thought that the System should gradually back down from the \$500-\$600 million level of free reserves as market conditions and Treasury financing permitted.

Mr. Leach said that although he could not tell what banks would do with additional reserves, bankers are paid to invest money and he could not imagine that they would let reserves lie idle. Therefore, it appeared that they would use additional reserves until the bill rate was lower than at present. He felt that the Committee should get away from free reserves as too important an indicator of policy and that it must get away from the present

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level of free reserves. Perhaps, however, it could not do better than \$500 million until the next Treasury financing, and any shift should be made gradually without attracting too much attention.

While the Committee could continue to use the same policy directive, Mr. Leach noted that there had been quite a change in conditions and prospects since that directive was adopted on March 5. He suggested, therefore, that the following language might be considered for clause (b): "to contributing by monetary ease to resumption of stable growth of the economy without creating excessive liquidity." It was dangerous, he felt, to keep allowing liquidity to increase.

Mr. Vardaman said that national psychology was such, and the national economy as reported here too unsteady and uneven to tolerate without undue disturbance any change in Federal Reserve policy to the tight side. Therefore, the System should continue about as is--around \$500 million free reserves--and hope to de-emphasize any fixed amount of free reserves at some future date. Excessive liquidity in the money market should be avoided if possible, but not at the risk of a change to a pattern of tightening money. He would not change clause (b) of the policy directive at this time.

Mr. Mills said that the explanation by Mr. Thomas of the mechanical results of System policy in past weeks raised in his

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mind the thought that the Committee had allowed itself to work on a treadmill when, by attempting to reach some set level of free reserves, an expansion in bank loans and investments was generated that had produced the dangers and the difficulties seen by Mr. Thomas in overliquidity. He shared the concern that he sensed was felt by Mr. Thomas, and also by Messrs. Leach and Irons, which suggested that temporarily the development of System policy should be concerned predominantly with financial rather than economic factors. In so doing, an attempt should be made to reduce the System's portfolio of Treasury bills, However, in setting that objective--and without doubt it should be a System objective--there was also the quite different question of what could be realistically accomplished. This involved whether it would be possible for the System to educate and condition the investment fraternity to a policy that would not contemplate continuing injections of reserves and whether it would be possible to accustom the market to some reduction in reserves. Because the objectives to be sought would entail difficult problems, a great deal of latitude would have to be vested in the Manager of the Account to judge the feel of the market so that in seeking a more moderate policy in the provision of reserves he would not in the process create alarm in the market or unduly impair the Treasury in its financing problems, which must have very first consideration in the development of System policy.

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Mr. Robertson said that he shared the views expressed at this meeting with regard to excessive liquidity. By vigorously trying to establish ease, he felt that the System had gotten into a situation from which it could not easily extricate itself. In his opinion, the System should start moving toward tightness faster than indicated by the comments around the table--as fast as possible without unduly upsetting the market--and it should pay more attention to the formulation of monetary policy in line with the economic situation than to the objectives of the Treasury or any special interests.

For the next three weeks, Mr. Robertson said, the Committee ought to avoid pushing ease, in fact should restrict it, and in the absence of any better criterion he would use free reserves as a target and try to move toward \$100 million. This would not be an ironclad target but one with flexibility on either side depending on conditions that prevailed during the period. He would work with as much vigor toward reducing the ease which had created excessive liquidity as had been shown in bringing about a condition of ease.

Mr. Robertson went on to say that he was favorably inclined toward the suggestion for amendment of the directive. He thought that a change in the directive would not be misunderstood. Instead, it would be a very slight signal, a little flag for the Manager of the Account in carrying on activities during the next three-week period.

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Mr. Shepardson said that his views were very much like those expressed by Mr. Robertson. It was his impression that the Committee had been aiming at free reserves on the lower side of \$500 million rather than the upper side, and consequently he was a little disturbed when the level of free reserves got as high as it did. In his opinion, System policy should be moving back toward a little less ease.

Mr. Shepardson said he was rather concerned about some of the comments one heard and read regarding the lack of investment in plant and equipment for he did not see what was gained in trying to push additional investment of that kind at a time when there was a surplus of plant capacity. He also questioned the advisability of efforts to encourage increased demand for goods and services by means of easier consumer credit terms which might further impede needed price adjustments. Adjustments now going on in many businesses seemed to be increasing efficiency and cutting out some excesses. There were also some indications of price adjustments, and those things were all to the good.

This meant to him, Mr. Shepardson said, that the System should not be in the position of trying to push too fast on recovery and that necessary adjustments should be allowed to take place and work through. While he had reviewed the directive and felt that perhaps it should be amended, he had not developed any specific



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wording. It appeared to him that the language suggested by Mr. Leach might not be inappropriate.

In summarizing, Mr. Shepardson said that he would like to see monetary policy a little less easy than it had been. This suggested that it might be time for a change in the directive, particularly to eliminate the word "further" in clause (b), as mentioned by Mr. Irons at recent meetings of the Committee.

Mr. Fulton said he could only describe conditions in the Fourth District by saying that the economy was quite soggy. At present there were no developments of such a nature as especially to engender a hope that the fourth quarter would be better than now. On the agricultural side, crops and prices were good and farmers were buying cautiously, but in the industrial sector there were further layoffs of workers, particularly in the machine tool and heavy electrical industries. Steel had experienced a little upswing during the past month but that had now subsided and nothing much was looked for until August when the automobile companies would take delivery on some sheet steel. There was apprehension about acceptance of the new models by the public and it was understood that the automobile people were not going to inventory much in the line of steel or parts until the extent of acceptance had been determined. If the new models did not go over well, there would be a substantial downturn in all industries allied with the automotive industry. Construction in the Fourth District was not up

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as in some of the other districts; residential construction had a slight revival but then a relapse. Over all, therefore, there was nothing to forecast a sharp upturn, at least from present indications in the Fourth District.

Mr. Fulton said he subscribed to the thinking that the System had gone a little far in supplying reserves and that free reserves were on the high side at a level of \$600 million. What he envisaged at the last meeting, he said, was a top of around \$500 million. Despite the relatively slow state of conditions in the Fourth District, he felt that more firmness could be brought into the picture rather than to keep reserves as high as at present and thus contribute to a basis for inflation. He would like to see the word "further" eliminated from clause (b) of the directive because the directive would then state more clearly the current attitude of the Committee, at least to judge from the expressions around the table at this meeting, but he had no convictions about the rest of the language.

Mr. Bopp said that he interpreted the national data a little bit less optimistically than most of the others at this meeting and that his interpretation was influenced only in part by developments in the Third District, which were rather on the gloomy side.

Mr. Bopp then made substantially the following statement:

The Manager of the Account has done an outstanding job under trying circumstances in a period marked by

extraordinary complexity and unanticipated developments.

One important complicating factor was that the market saw signals the System did not intend to give. This raises the age old question of whether we can give clearer signals--particularly to correct a market misinterpretation. My own view is that direct operations in the longer sector of the market at such strategic times would be the most effective way for the System to signal its intentions.

If we move to the short sector, relatively wide spreads between the discount rate and short-term rates in the open market are likely to lead to periodic misinterpretation. Persistence of a wide spread may be interpreted as indicating that the System believes market rates are too low or that it will not resist some tightening in the market. Under these circumstances, a rise in short-term market rates, especially if accompanied by a reduction in the net free reserve position of member banks, may be interpreted as a movement away from an easy money policy.

Since it is so difficult to estimate the magnitude of necessary "defensive" operations, which comprise the largest volume of purchases and sales, open market operations are not well adapted to give unmistakable signals to the market. At the present time, to give a clear signal to the market that the policy of ease is being maintained, I would recommend a reduction of 1/2 per cent in the discount rate. An ancillary but not unimportant advantage of this move is that it would put us in better position to give a clearer and earlier signal when a change in the direction of policy is intended.

I wish to report that we had extensive discussion of economic and financial developments at the meeting of our Board of Directors on Thursday. There was agreement that we are still in a recession and that the probabilities of a sharp snapback by August or September are extremely small. In terms of the economic and financial merits of the case, the directors were disposed to vote a reduction in the rate, but in the light of this early meeting of the Federal Open Market Committee and of my own recommendation--which parenthetically was influenced by the decisions at the last meeting of this

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Committee--they were willing to renew the existing rates on Thursday--but with a divided vote.

It is possible that they may take the initiative to establish a lower rate at the next meeting of the Board.

In concluding his comments, Mr. Bopp said he realized that his views on the discount rate placed him distinctly in the minority around the table.

Mr. Bryan said that the Sixth District was experiencing almost exactly the same trends and changes in figures as the nation. On the basis of the year-to-year comparisons, the district had shown lesser declines than the country as a whole, but rather curiously recent month-to-month comparisons were more favorable for the nation than for the Sixth District. Some of this apparently could be explained by the recent improvement in durable goods of the kind not manufactured in the Sixth District.

Turning to the national economic picture, Mr. Bryan said that he had almost completely changed his views in the last three weeks. It seemed to him that there was being accumulated a good deal of evidence that the country was going through this recession with much the same sort of rolling adjustment that had taken place before the postwar period, and there was little evidence of accumulating recessionary tendencies. He had only one reservation, Mr. Bryan said; namely, that the country was not yet in a vigorous recovery and there was still a possibility that the economy might be experiencing sort of a false bottom.

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As to policy, Mr. Bryan recalled that earlier he had been an advocate of further ease but said that he had now reversed himself. Looking at the total picture on a year-to-year basis, and making adjustments for the difference in reserve requirements, he now concluded that the System had done an ample job of providing ease. Even the money supply figures, however taken, suited him a good deal better than they did earlier. Therefore, he could not find a basis for advocating further ease and he was rather sympathetic to the idea that the System should avoid further ease. Nevertheless, there were one or two things that the Committee might keep in mind. First, there was evidence of considerable congestion in the capital markets for a variety of reasons, not all of them due to the false signal of a change in System policy or to the speculation in Government securities, and there was going to be a heavy calendar in July. Also, the Treasury at some point must come in for cash. Accordingly, he had come to the conclusion that there might very well be considerable tightening in the capital markets unless the System maintained a fair degree of ease. By this he meant continuing just about what the System had been doing and maintaining a level of free reserves in the neighborhood of \$500 million for the next three-week period.

Mr. Bryan went on to say that a discount rate change at the present time would seem to him to be a mistake, for it would contain

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the grave danger of conveying to the public a message precisely opposite to that which the System wanted to convey. In other words, it might be interpreted as meaning that the System had no confidence in the current move toward recovery. As to the directive, he would be inclined to support striking the word "further" from clause (b).

Mr. Johns recalled that he had been among the small minority who argued for further ease at recent Committee meetings but said that he did not desire to make those arguments again because his position had changed somewhat. At this juncture he was inclined to agree that the System should not actively pursue a policy of further ease. Mr. Hayes had suggested that it might be appropriate to do some cautious probing of a lower free reserve level, if and when that could be done without repercussions, and Mr. Johns said that he was inclined to agree, although he had reservations as to whether this could be done without repercussions. He felt that the System should not signal any change of policy at this time and that certainly it should not encourage a trend toward higher long-term rates. While he had been on vacation since the last Committee meeting, he had reviewed open market operations from the reports of the New York Bank, and this review led him to conclude that operations in the Account during the last three weeks had been thoroughly satisfactory. While, as he had said, he felt that it would be premature at this time to

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signal any change in policy, on the other hand he did not wish to repeat the arguments he made at the last two meetings regarding a reduction in the discount rate since he agreed with Mr. Bryan that a change in the rate might be misinterpreted.

Turning to the policy directive, Mr. Johns said he would not object to eliminating the word "further", but that he had reservations about using the word "excessive" in the clause suggested by Mr. Leach because the Committee ought not to give the impression that it or its Agent Bank or the Manager of the Account were given to excesses.

In substance, Mr. Johns said, he would like to continue about as at present for the next three weeks.

Mr. Szymczak said that he has favored a reduction of the level of free reserves. However, he was fully aware of the fact that the Treasury would be in the market for a considerable period of time, and he was concerned also about the situation with respect to all issues, Government, corporate, and municipal. Furthermore, although he hoped there would be some signs of an upswing in the fourth quarter, the doldrums of the summer months were ahead.

In a further explanation of his views, Mr. Szymczak said that the System, having provided reserves--perhaps too many--up to this point, should try to vary the reserve position of the banks, not only because of the excessive liquidity that had developed but

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also because the market gets accustomed to having a certain volume of free reserves available. He was mindful of what Mr. Mills had pointed out, however, and he would adopt a realistic point of view with the Treasury coming into the market.

As to the directive, Mr. Szymczak said that although he would not recommend a change, on the other hand he would not object.

Mr. Balderston inquired of Mr. Rouse whether, if the Treasury went into the market shortly, its needs could be reconciled with a reduction of \$600 million in the System Account portfolio.

Mr. Rouse replied that as of the moment it did not appear likely that this could be done. However, the projections refine themselves from week to week and the Account might not be faced with the same problem that appeared to exist today. In this connection, he observed that \$184 million of bills would run off this week, another \$150 million would mature next week, and a similar amount the week after that. At present the Account was faced with a nasty situation in the market, prices had dropped noticeably this morning, and in that kind of atmosphere it was not possible for him to give a categorical answer to Mr. Balderston's question. The situation this morning, he said, did not seem to have any relationship at all to reserves, and the same thing had been true the last two weeks. In other words, the availability of reserves seemed to have no effect marketwise. In the kind of a situation which had



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prevailed, he just did not know the answer to the question of reducing the System portfolio.

Mr. Balderston then said that he had asked this question because of the dilemma pointed out by Mr. Mills and because of his own view that Mr. Irons had correctly described the policy that the Committee should be following. As he saw it, the conflict between those two positions might make policy decisions very difficult indeed. There were evidences of speculative responses both to the System's monetary policy and to the Governmental spending and stock-piling programs; in short, the economic field that should have been irrigated carefully in the last two or three months seemed to him to have become flooded. Looking back, he felt that excessive liquidity explained the failure of the System's policy of monetary restraint to become effective early in 1955 and he viewed any repetition of that situation with great concern. On the other hand, it had been pointed out that no matter whether free reserves were kept above or below \$500 million, the level might be regarded as a signal to the financial community of the System's intentions. All of this indicated to him how careful the System must be, in view of the Treasury financing ahead, not to disturb the bond market unduly. It appeared that the System should take no overt action but that, as indicated by Mr. Hayes, it might be desirable for a lower level of free reserves as the opportunity permitted.

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Mr. Balderston said he would not favor a reduction in the discount rate. He had had the feeling in 1955 that the discount rate level at that time was too low, and that mistake should not be repeated. Neither would he favor a change in reserve requirements. If the directive were changed, he would not only eliminate the word "further" but also try to develop some new wording in place of "stable economic growth" because to him that phrase was lacking in definition.

Chairman Martin said that he found it difficult to express his thoughts on this type of a situation. In general, however, it was his feeling that the System ought not to push either in the direction of easing or tightening at this time. However commendable it might be in theory to talk about probing, the changes in fundamentals that occur whenever there is a turning point may make that impossible. At such times forces are at work that are bigger than the System or the Treasury, and if one tries to play with them he is apt to get into serious difficulty.

Continuing, Chairman Martin said he had found it difficult to keep his own sense of balance recently. The week end after June 19 was one of the worst that he had spent since coming into the System, with many persons who were stirred up about rumors of a change in System policy calling him with various kinds of stories.

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Such stories, he observed, are always symptoms of a turning point. Of course, he did not know for certain whether there actually had been a turning point but many elements were making for it. Personally, he was inclined to be optimistic, recognizing that one should not be prematurely optimistic. One should recognize the Treasury's problem at this kind of juncture and keep in mind that movements in rates never come gradually, much as that might be desired. He noted that one person at this meeting still thought that the discount rate ought to be reduced, so there was not yet a unanimity of belief that a clear turning point had developed.

Chairman Martin then commented that in the realm of speculation in which the System and the Treasury must deal there are many factors to be taken into consideration. If it had not been for the story in the press on June 19 which suggested that there had been a change in Federal Reserve policy, he felt that there would have been some other story or comment. He noted from the comments at the Committee meetings over the past three months that the views had shifted back and forth in both directions. When it comes to the public putting their money on the line, he said, the System must deal with the actual situation as it exists. The System must try to be right, but the story of the man killed crossing the street on the green light who was "dead right" seemed to apply to the situation with which the System was now dealing.

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The Chairman said he thought that, if the System was going to change policy, some thought should be given to what happened in the November 1957 period and the System ought to do something that would really be clear-cut. This did not mean necessarily that there could not be any probing, and actually probing had been done in the market over the last ten days or two weeks. The whole situation, he reiterated, should be viewed in the light of a fundamental change. Also, the System ought not to do anything to create more difficulty for the Treasury than necessary unless it thought that it was really right, for the Treasury had real problems and should not be asked to perform a miracle. If the System were certain of the basic situation, that would be one thing. However, as Mr. Robertson had said, the System probably had contributed to the difficulties of the Treasury by going overboard in the direction of easy money, if a turning point was really here.

In further comments Chairman Martin again said that the System ought to try to keep its balance at this time. It seemed wise, he suggested, to give wide latitude to the Manager of the Account, who had had a difficult period in which to operate. He would not be strongly opposed to taking the word "further" out of clause (b) of the directive, but he recalled that on the eve of a Treasury financing the Committee changed policy last November and

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the change caused about as much trouble as anything that could have happened. It must be remembered that the problem of the Treasury in a period of uncertainty might become impossible if it appeared that the System was contemplating a change in direction of policy. While it might be, therefore, that a change in the directive ought to be made, by and large he felt that it would be better not to have it appear in the next three-week period for that would needlessly create problems. While perhaps he did not reflect the view of the majority in saying that, it appeared that the majority was in favor of only a moderate change in the directive, if any. Most of those around the table had talked about \$500 million in free reserves and he felt that such a target was all right. However, the Manager of the Account was up against the feel, color, and tone of the market and little shifts were going to be very difficult to gauge.

Chairman Martin again stated that the Committee ought to be extremely cognizant of the difficult position of the Treasury. When the time came to make a definite policy change that was one thing, but to play around with the market was playing around with fire. The Treasury had had a difficult problem already with the 2-5/8 per cent bonds and might be saddled with nearly the whole issue, although that was a matter of judgment.

Mr. Vardaman asked Chairman Martin whether he felt that the difficulty of having the word "further" in the directive was

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serious enough to warrant a change, and the Chairman replied that he did not think it was a very big point. In his view, it would be better on balance not to change the directive at all.

Mr. Shepardson commented that although he recognized the problem involved in the forthcoming Treasury financing, there would be a series of Treasury operations throughout the rest of the year. He inquired, therefore, whether it was the Chairman's view that System policy would be frozen during all of those periods.

Chairman Martin responded that until the System was certain what its policy ought to be, there would be a difficult period. It was the problem of financing a deficit; namely, whether the money was going to be printed to finance it. He hoped not, but some money probably would have to be printed, depending on the size of the deficit.

Mr. Shepardson commented that he had raised this question because he was ready to take the position of wanting less ease, and Mr. Leach said that in his view the System ought to stop adding to liquidity.

Mr. Mills suggested that in a sense Mr. Leach's position would represent a confession of error on the part of the System

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which it could be undesirable to incorporate in the policy directive. If excessive ease had been created, he said, the System had been responsible for it.

In responding, Mr. Leach referred to the language of the directive adopted by the Committee in January 1955 and said it had never occurred to him that the language carried the implication suggested by Mr. Mills. He went on to say that he did not want to emphasize unduly a change in the directive since he was primarily concerned with actions. If, however, the present wording of the directive is interpreted in the future, as it has been in the past, as requiring free reserves in the \$500-\$600 million range, he did not know how the System could escape from furnishing additional reserves, which in turn would lead to additions to deposits and short-term investments of banks. He would like to see no further unnecessary additions to liquidity.

Mr. Hayes said he was glad that the Chairman had stressed the difficulties of the ensuing period. Under such conditions he considered it advisable that the System avoid signaling any overt change in policy. Much as he agreed with the desirability of not having further ease, he felt that it would be better not to change the directive at this point.

Mr. Irons recalled that he had not spoken at this meeting in favor of deletion of the word "further" from clause (b) of the directive and said that he had had a reason; namely, the possible

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damage to the Government securities market on the eve of a Treasury financing. He thought that the System was wrong in shifting policy last November just before a Treasury financing and that it would be wrong in making any change now. The matter could be deferred until there was a little more solid situation in the Government securities market and a more solid feeling in people's minds.

Mr. Mangels indicated that he agreed with Mr. Irons, but Mr. Allen stated that he would favor eliminating the word "further" from the directive on the basis that the directive would then reflect better the attitude of the Committee today.

There ensued further discussion of the directive and of policy in the period immediately ahead, following which it developed from a show of hands that the majority of those around the table would prefer not to make any change in the directive at this time.

Consideration then was given to the target that should be set for free reserves and the difficulties involved in the use of any specific figure were again pointed out.

Mr. Hayes suggested that the objective might be stated as \$500 million of free reserves or less. By this he meant that the Management of the Account would try to go below the \$500 million figure rather than above it, but that in conducting operations in the Account the Management would recognize all of the implications of going below \$500 million.



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Chairman Martin then said that there appeared to be agreement on the part of all that the feel, color, and tone of the market must be an element. In terms of the level of free reserves, he suggested that "around \$500 million" was probably as well as the matter could be stated.

In further discussion, Mr. Irons raised the question whether it would be possible to avoid entirely the use of a target figure for free reserves. If a figure is mentioned, he said, there is an inclination to maintain that figure. What was wanted, he felt, was the concept of maintaining an availability of reserves that would not contribute to excessive liquidity or to a deficiency of funds, rather than the maintenance of a free reserve figure per se. He suggested that considerable leeway must be given to the Manager of the Account and that the objective might be put in terms of leaving it to the Manager to carry out the concept of maintaining an availability of reserves which would not be disruptive to the market.

Mr. Hayes said that he would not disagree except to point out that the public has grown accustomed to looking at the level of free reserves. If an attempt to bring about the kind of situation the Committee would like to see prevail should result in a smaller volume of free reserves, the System might be inviting a very difficult situation from the standpoint of public reaction to its policy.

Mr. Irons agreed that this was an element that the Account Management would have to take into consideration.

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Mr. Rouse commented that the System was in a box which it would have to get out of at some time by a decisive move. At present he had no suggestion for resolving the problem, but the Account could try to bring down the free reserve level of the last couple of weeks. Pointing out how certain possible actions could just lead to more complicated situations, he noted that a reduction of reserve requirements might disabuse the market of its idea about a shift in policy and that sopping up the reserves simultaneously would possibly "get us off the hook." On the other hand, it might develop to be the secondary thinking that the sopping up was the essence of the action and that the market had been right the first time.

The discussion concluded with a statement by Chairman Martin that he doubted whether the Committee could do any better than to leave the free reserve target at "around \$500 million" and to give maximum discretion to the Management of the Account at a time like the present.

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

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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 contributing further by monetary ease to resumption of stable growth of the economy, 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.

Mr. Vardaman withdrew from the meeting at this point.

At the request of Mr. Rouse there had been distributed to the members of the Committee a memorandum suggesting an increase from \$50 million to \$75 million in the limitation on outright holdings of bankers' acceptances by the Federal Reserve Bank of New York. On November 27, 1956, this limit was increased to the lesser of \$50 million or 10 per cent of total acceptances outstanding, as shown by the most recent bankers' acceptance survey, and since that time the New York Bank had held a minimum of about \$15.5 million on October 26, 1957, and a maximum of \$45.7 million on June 17, 1958. Holdings as of June 30, 1958, were \$44,796,000.

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The memorandum explained that in recent weeks the New York Bank had gradually increased its holdings of acceptances by \$1 million or more a week, to be consistent with increases in System holdings of United States Government securities. As long as open market policy remained one of maintaining a posture of ease, acceptance holdings therefore could quickly reach the limit if the New York Bank were to continue to coordinate acceptance activities with other market operations.

Following supplemental comments by Mr. Rouse concerning the matters referred to in the memorandum, Mr. Allen commented that according to his recollection the reason for granting the present authority was to show friendliness to the acceptance market. He recalled that, although he was not at the time a member of the Committee, he questioned increasing the purchase authority because it seemed to him that the way to build up the market was to get people accustomed to buying acceptances. If the Committee should conclude that holdings of acceptances ought to be increased proportionately to System holdings of Government securities, as suggested in the second paragraph of Mr. Rouse's memorandum, he would have nothing further to say. If, however, as indicated in past discussions the purpose of the Committee was to promote the acceptance market, he would not agree that increasing the present limitation would work toward that end.

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Mr. Mills said that he agreed completely with Mr. Allen's reasoning. He sensed that the Committee might drift into another position from which extrication might be difficult due to the New York Bank's having built up a portfolio of acceptances for open market purposes rather than to foster the acceptance market as such. Reports submitted by the New York Bank had indicated repeated inability to fill orders from foreign accounts for bankers' acceptances, which puzzled him as to why a portfolio of acceptances was being developed in the face of an investor demand for their acquisition. However, market conditions are now unsettled, and as bankers' acceptances are a vehicle for open market conduct that works on the edge of the total securities market, the System must be prepared, if needed, to render assistance to the acceptance market. Such being the case, he felt that the limit for acceptance purchases should be temporarily raised to \$75 million as an emergency measure.

Mr. Allen said that he had no quarrel with Mr. Mills' statement. However, he hoped that the New York Bank would meet requests for acceptances because that seemed necessary to build up the acceptance market.

Mr. Hayes commented that the New York Bank could get out of acceptances very easily within a few weeks. He stated that there was nothing irreconcilable between the two objectives of fostering a wider acceptance market and conducting acceptance operations in a manner consistent with activity in the System Open Market Account.

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On the point of helping the acceptance market, he suggested that it was of assistance over a period of time for the New York Bank to be in that market, and that the Bank was properly using the acceptance authority as a money market instrument. The fact that customers occasionally were unable to obtain all the acceptances they wanted did not mean to him that the Reserve Bank should get out of the market. If it was going to be in the market, it should be a more or less reliable factor. Sometimes, he pointed out, foreign correspondents want to sell acceptances but the New York Bank should not be prepared necessarily to take them; rather, it should be a steady and encouraging factor in the market.

Mr. Robertson said he was inclined to feel, as he had before, that the System had no business in this field at all. When the matter came up previously, he understood that the purpose of purchasing acceptances would be to show an interest in this area of financing, and to participate actively in the acceptance market seemed to him to be an entirely different thing. This, he said, was the first time he had seen any indication that what the New York Bank was trying to do was to increase acceptance holdings consistent with increased holdings of Government securities, and he could see no relationship at all between the two types of holdings. He suggested that a moving up of the limitation to \$75 million might result in substantial control of the acceptance market, and he

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saw no merit in it. The trend, he said, should have been in the other direction, using \$50 million not as a target but as a ceiling. It was his view that holdings of the New York Bank should be reduced and that competitive factors should be allowed to determine the extent of acceptance financing.

Mr. Hayes said he differed strongly from the view that holdings of 5 per cent represented control of the market. Holdings of \$50 million, he pointed out, represented a much larger share of the acceptance market when the existing authority was given than it represented now.

Chairman Martin said he had not changed his own view that the System should be friendly to the acceptance market. He would like to see that market promoted and developed in any way possible. In view of the differing opinions expressed during this discussion, he suggested that the topic be held over for another meeting of the Committee, and there was agreement with this suggestion.

There had been distributed at the beginning of this meeting copies of a letter addressed to Chairman Martin by Congressman Wright Patman under date of July 2, 1958, in which Mr. Patman referred to the record previously furnished him showing each transaction in the System Open Market Account during the period from March 1951 to the end of 1956 and requested that a similar record be furnished covering transactions during the calendar year 1957. Mr. Patman noted that

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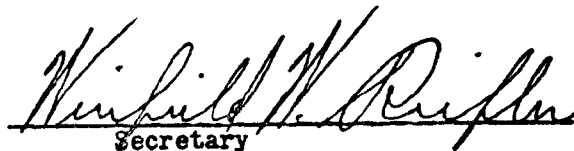
in a letter dated January 7, 1958, Chairman Martin had stated that the Open Market Committee felt that it should withhold such information until after the Board's Annual Report for the year 1957 had been issued, but offered to supply the data thereafter.

Following a brief discussion, it was agreed that the information should be prepared and transmitted to Congressman Patman pursuant to his request.

At the suggestion of Chairman Martin, Mr. Riefler, who had recently returned from England, commented informally on the new liquidity control system announced in the House of Commons last week. Under this relaxation of the British Government's credit control policy, banks would not have to restrict the total level of their advances to any given figure after the end of this month. However, control of total advances would be retained by normal monetary measures, reinforced by a new arrangement under which the Bank of England would, if necessary, restrict the liquidity ratio of the banking system by calling for special deposits.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, July 29, 1958, at 10:00 a.m.

Thereupon, the meeting adjourned.

  
Secretary