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 26, 1960, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Bryan
Mr. Fulton
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson

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

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

Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Brandt, Eastburn, Hostetler, Marget, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Adviser, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Ellis, Baughman, Jones, and Einzig, Vice Presidents of the Federal Reserve Banks of Boston, Chicago, St. Louis, and San Francisco, respectively

Mr. Garvy, Adviser, Federal Reserve Bank of New York
Messrs. Parsons and Coldwell, Directors of Research at the Federal Reserve Banks of Minneapolis and Dallas, respectively
Mr. MacDonald, Assistant Vice President, Federal Reserve Bank of Richmond
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 6, 1960, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period July 6 through July 20, 1960, and a supplementary report covering the period July 21 through July 25, 1960. Copies of both reports have been placed in the files of the Committee.

With further reference to developments since the Committee meeting on July 6, 1960, Mr. Rouse made the following comments:

> In the period since the last meeting of the Federal Open Market Committee, the money market has reflected about the same over-all atmosphere as in other recent periods despite the higher free reserves. If anything, the money market has been a bit tighter due largely to the impact of Treasury borrowing operations with resulting churning and dislocations which created pressures centering on the New York City banks. The New York banks took sizable amounts of both the new tax anticipation bills and the new one-year bills during the period and were called upon to finance a substantial portion of the enlarged bill holdings of Government securities dealers. Although bill rates fluctuated widely during the period, the swings were less extreme than previously, relating early in the period to expectations of higher rates of discount for the two special bill auctions but in the past week moving up as the dealers found difficulty in reducing their swollen portfolios. In the last day or two the dealers have been able to move bills and yesterday's auction went quite well, the average rates being 2.40 and 2.70 per cent, respectively, for 3 and 6-month bills.

Market expectations have leaned toward easier money or at least no higher interest rates. The figure of $210 million free reserves for the statement week ended July 13 inspired considerable talk of a sharp shift in credit policy toward more ease and some speculative activity developed. With the publication of the lower average of $93 million free reserves for the week ended July 20, the market seemed to place less emphasis on policy change. Nevertheless, prices of intermediate and long-term issues continued to move up, with gains in various issues running to more than a point. The strength in the long-term area has continued despite growing expectations of an advance refunding in the area of the 2-1/2 per cent optional or "tap" issues.

Several members of the Committee have been especially interested in the trend of the total money supply. It is encouraging to see that so far in July required reserves, total reserves, and "non-borrowed" reserves have all increased, suggesting that possibly a modest growth of the money supply is taking place.

According to the statement issued yesterday afternoon, the Treasury has made public its plan to do its August refunding through a cash offering. In addition to the $9.6 billion of Treasury notes maturing August 15, 1960, $800 million of Federal National Mortgage Association notes maturing August 23 will be refunded. However, as against this aggregate of $10.4 billion maturing issues, the Treasury will only borrow about $9 billion, relying on its unusually large cash balances for the remainder. The exact terms of the offering will be announced on Thursday, with the subscription books opening next week. The cash refunding technique is a new departure and, as the Committee is aware, arrangements are being made to permit the roll-over of the $5.5 billion of maturing August notes in the System Account. The arrangement will be that full allotment will be made on all subscriptions from States, political subdivisions, or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign states, Government investment accounts, and the Federal Reserve Banks. The maturing notes will be accepted at par in payment for the new securities allotted. This will be consistent with the understanding reached with the Treasury in May when a cash refunding was considered. Applying the full amount of the paydown of about $1.4 billion to the amounts remaining after allotting the above holders in full should put the new issues in a very favorable position marketwise. The market is expecting that the offering will consist of an 11-1/2 month certificate and a bond, perhaps in the 7-10 year area. If that is the case, the Manager plans to limit the System Account subscription to the certificate.

Finally, I should like to call your attention to the fact that in addition to the $79.5 million Treasury bills purchased in the market yesterday, as reported in paragraph three of the supplementary report, the Account also purchased $500,000 from a foreign account for cash. This purchase was included in the total purchases set forth in the written report but was omitted in the more detailed description of yesterday's operations.

Thereupon, upon motion duly made and seconded and by unanimous vote, the open market transactions during the period July 6 through July 25, 1960, were approved, ratified, and confirmed.

Supplementing the staff memorandum distributed under date of July 22, 1960, Mr. Koch made the following statement with respect to economic developments and related matters:

At the last meeting of this Committee, I concentrated on recent economic developments. Since only limited new information has become available over the past three weeks, and since numerous questions have been raised about the current inventory and unemployment situations, I shall say a bit more than usual about these matters today and only touch base briefly on the new information.

As for the current economic situation, it looks to me a little weaker today than it did three weeks ago, although part of this seeming weakness can probably be attributed to an inadequate discounting of the summer doldrums. Economic activity continues at a high level, but with sizable amounts of unutilized plant capacity and labor, and without exhibiting any significant upward thrust.

As for evidences of weakness, our industrial production index in June turned out to be 109 per cent of the 1957 average, as compared with 110 per cent in May and 111 per cent in January. The July figure is not likely to be any higher and may be a bit lower. The seasonally adjusted rate of unemployment, about which I shall have more to say later, rose to 5.5 per cent in June, up from 4.9 per cent in May and from 5.0 per cent a year ago. No significant improvement seems likely to be taking place in July on the basis of weekly data on claims for unemployment insurance. New orders for durable goods fell off further in June to a new low for the year, and the unfilled order backlog for these goods declined to a level near the 1958 recession low. Liabilities of business failures increased very sharply last month, and stock prices have declined since early June. Several of these signs of current weakness are components of the leading indicator series but the significance of short-run movements in these series for current cycle analysis is by no means clear.

Looking at the brighter aspects of the current economic scene, the consumer continues to make good news. Retail sales in June approached the April record level, and sales for the second quarter as a whole were 3 per cent above the previous record level reached in the first quarter of this year as well as in the second quarter a year ago. Department store sales in July appear to have increased somewhat further. The nation's personal income increased again in June to a record seasonally adjusted annual rate of $406 billion, and income receipts correlate closely with personal consumption expenditures. Housing starts apparently ceased their decline in the second quarter, and applications to the FHA for mortgage insurance, and to the VA for appraisals of new homes, both barometers of consumer spending on housing, increased in June. Also, net exports continue strong, and State and local as well as Federal government expenditures are stable or rising.

Turning now to the special problems I have chosen for somewhat lengthier discussion, in the case of inventories our staff feels that although they are ample, they are not generally high in relation to sales unless one assumes the imminence of recession. When one looks at inventory/sales ratios for particular industries, he finds them high only for industries producing durable industrial materials like metals, lumber, stone, clay, and glass, and for auto dealers and other retail outlets for durable goods. In most of these areas, output of the product concerned has been curtailed substantially since the beginning of the year in an effort to correct the inventory situation.

In judging the appropriateness of the current level of inventories, one has to take account of the fact that there are many differences between the current economic situation and that prevailing in the recent past, say in late 1956 and early 1957. Thus, the supply and delivery situation is much easier now; industrial prices have not been increasing; the cost of borrowing has been higher; and techniques have been flowering which permit the economizing of inventories. Under these circumstances and with dampened sales and price prospects, there has been little incentive to expand inventories, and businesses have been pursuing a cautious policy.

In view of this caution, some part of the recent rise in inventories can no doubt be considered involuntary, and in that sense, excessive, but this development in itself has induced efforts to curb such accumulation. The seasonally adjusted monthly rate of accumulation of all durable goods inventories at manufacturers, for example, was reduced from almost $700 million in January to an average of less than $200 million in April and May. Since the end of May, steel consumption has apparently been well above steel output and auto sales have remained favorable, suggesting that whatever excess in current inventories exists in these lines is likely to be dealt with successfully.

As for unemployment, the sharp jump in the unemployment rate in June to 5.5 per cent occurred despite an accompanying rise in total employment. This June development empahsizes the fact that a continuing high level of unemployment for this phase of the business cycle is one of the most worrisome aspects of the current economic situation. As a matter of fact, when one looks at a chart of the rate of unemployment over the past decade, it is not difficult to see in the configuration a striking step-up effect, with a somewhat higher rate of unemployment occurring in the prosperous phase of each of the last three business cycles.

Turning back to the June figures, perhaps half or more of the one million increase in the unemployed can be explained by the usual seasonal influx of students seeking employment. This year's influx was larger than usual for two reasons. First, the week in which the survey was taken occurred somewhat later than normal and consequently found more teenagers out of school and looking for work. Second, it also reflected a longer-run upward trend in the teenage population which is not adequately taken account of in the seasonal adjustment factors.

But even after taking these considerations into account, there remained a greater than seasonal rise in adult unemployment in June. The current level of adult unemployment is perhaps 600,000 persons higher than in 1957. It reflects both the growth in the number of middle-aged women in the labor force and lower employment levels in manufacturing, mining, construction, and transportation.

On a somewhat more pleasant, even if less significant note, total unemployment rates usually reach their seasonal high in June and then decline each month until the seasonal low is reached in October. If changes over the next four months were to be influenced only by seasonal factors, total unemployment would decline from 4.4 million persons in June to 3.1 million in October. This decline would not, of course, affect the seasonally adjusted rate of unemployment.

Since this is my last substitute appearance before this Committee for the present, let me indulge in a concluding personal comment on the relevance of current economic developments for monetary policy. Assuming the evidence that is accumulating is not solely due to the summer doldrums, we may be facing another period of limited economic growth. In such a situation, a further easing of monetary policy would seem to hold little hazard. There may be more question, however, as to how much a further easing in monetary policy in itself would contribute to a speeding up of growth.

Staff memoranda on the outlook for member bank reserve positions and on the outlook for Treasury cash requirements had been distributed under date of July 22, 1960.

With further reference to the current financial situation, Mr. Thomas presented the following statement:

In financial markets during July, the most striking developments have been a further decline in long-term interest rates along with a sharp drop in stock prices. Credit demands are not particularly vigorous and may have slackened somewhat. Whether these movements are indicative of the true state of the underlying economic situation or merely the views or uncertainties that exist in the minds of market participants remains to be seen. The review of economic developments gives some basis for the conclusion that the changes reflect real and not imaginary influences.

The decline in stock prices in the past two weeks has so far been the largest since the early weeks of this year, when the drop started from a higher level and extended over a longer period. Price averages are again close to the low level reached early in March. Volume of trading has also declined from the fairly high levels reached in late May and in June when prices were rising, but some drop in activity often occurs in July. These movements can be explained as the result of a growing realization that corporate profits have not increased commensurately with stock prices in recent years and have little prospect for enough increase to provide adequate returns at current prices.

Yields on long-term Treasury bonds, which declined sharply in June, have fallen further this month and are now lower than at any time since 1958. Corporate bond yields have declined only moderately, and those on State and local government issues have continued firm, reflecting the recent large volume of new issues and the increase in dealer inventories. The calendar for new issues, however, indicates some seasonal falling off in the weeks ahead and dealers seem content with their holdings.

Yields on medium-term Treasury securities have declined below those on long-term issues and are likewise at the lowest levels since late 1958. This may reflect the prospect that the Treasury might reduce the supply of such issues by advance refunding or at least will not have to increase the supply as it did in the past year or more. Treasury bill rates, which declined sharply in June, have been steady or higher this month, particularly in the longer-term issues. This change in trend reflects in part additions to the supply of longer-term bills by offerings in July. It may also reflect the effect of an increase in dealer holdings of the longer-term issues of bills to a relatively high level. Banks also have increased their bill holdings in the past three weeks. Thus market absorption of the longer bills is yet to come.

Results of the Government's budget for the fiscal year just ending and prospects for the year beginning indicate that the dramatic shift from large deficit to moderate surplus has probably been completed. Indications are that the cash surplus for fiscal year 1961, though somewhat larger than that for the past fiscal year, will be no greater than for the current calendar year--between $2.5 and $3 billion. Seasonal borrowings needed in the last half of this calendar year, however, are much less than those for the same period last year, largely because of the build-up in the Treasury cash balance to an exceptionally high level at the end of June. The Treasury is in a position to retire debt on balance in August. With the present state of the market, it could also effect an advance refunding operation into long-term securities sometime soon without exceeding the interest rate ceiling.

Bank credit continues to show little tendency to expand. The record for the first half of this year now reveals that total loans and investments of all commercial banks, which declined more than usual in the first quarter of this year, increased in the second quarter about in accord with the usual seasonal pattern. City banks showed a larger decrease in the first quarter and also a larger increase in the second quarter than did banks outside leading cities, according to estimated data for the latter. In fact, at the banks outside leading cities there seems to have been a net decline in total loans and investments for the first half of the year as a whole, whereas some increase is usual; loans increased about as usual, but these banks continued to reduce their holdings of U. S. Government securities in the second quarter. City banks increased their holdings of Governments, along with their loans in the second quarter, after showing marked declines in both during the first quarter.

The position of banks outside the cities is also indicated by the sustained level of borrowings at Reserve Banks by country member banks during the first half of the year, in contrast to the sharp reduction in the borrowings of city banks during the period. There are also some regional differences in this respect that may be significant. Explanation for these differences between city and other banks and their significance is not clear. They may relate to the change in the Treasury position. When the Treasury has a deficit and is a substantial net borrower, funds seem to move from the large cities to smaller places throughout the country. A Treasury surplus, however, accompanied by debt retirement and particularly by a build-up in the Treasury cash balance, tends to draw funds from all areas. Perhaps as the Treasury reduces its balance and needs to borrow during the months ahead, the funds will become more widely distributed away from financial centers.

Partial data for city banks for the first three weeks of July show a marked increase in total loans and investments, reflecting bank purchases of the new Treasury bill offerings. Loans on Government securities also increased as banks helped to finance the larger additions to dealer holdings. Business loans, in contrast, declined, as did real estate and other loans. These types of loans all increased during the same period of 1959. Data for other years, however, indicate that some decrease in business loans is customary for the period, though perhaps not as large as that occurring this year. Loans to finance companies changed little in the three weeks, in contrast to declines in other recent years except 1959.

Deposits at city banks, after increasing more than seasonally in June, show no pronounced trend during the first three weeks of July. Daily average data for all member banks show a further increase, seasonally adjusted, in the first half of July over June. U. S. Government deposits increased further at the time of the cash financing but are now in the process of declining rather sharply. It is still too early to determine whether these Treasury payments are going to enlarge private deposits or to provide funds to be used to reduce loans or purchase Government securities from banks.

Banks have needed additional reserves in July to meet the increase in required reserves related to Treasury financing, to cover a larger and more prolonged than usual currency drain early in the month, and to cover an accelerated gold outflow. These needs have been covered by an increase in the System portfolio of about $400 million. Most of these purchases were made, however, at the beginning of the month, and later large reserve needs were covered by the post-holiday return flow of currency and the mid-month float increase. There were some reductions in System holdings. The supplies and the needs did not mesh completely and many banks found it necessary to borrow at times from the Federal Reserve and to purchase Federal funds. The money market continued to have a feeling of pressure, notwithstanding the maintenance of an average level of free reserves of close to $100 million or more.

Seasonal factors will necessitate supplying rather substantial amounts of reserves during the next two statement weeks, in addition to those already provided by operations in the last few days. In the middle weeks of August reserves will become available from the usual float increase and from a reduction in Treasury tax and loan accounts which will result in a decline in required reserves. At the end of August and early in September reserve needs will increase and again be followed by a temporary increase in reserve availability in mid-September and a drain at the end of the month.

In summary, reserve demands, though erratic, will mount on balance during the remainder of the year. The projections presented allow for a gold drain of about $100 million a month, which would build up to a substantial amount by the end of the year. They make no allowance, however, for any more than seasonal growth in the money supply.

A number of important decisions will need to be made in the period ahead. One question to be faced is whether in supplying reserves some allowance should be made for greater than seasonal growth in the money supply. In view of the moderate pace of economic activity and the clear evidence of lack of speculative or inflationary tendencies, not to mention the possibility of undue slackening, a strong case can be made for making reserves more freely available. If credit demands do not expand accordingly, such a policy would probably result in further interest rate declines, but that result should not be feared under the circumstances.

Decision also has to be made as to how these reserve needs will be supplied--whether entirely through open market operations adjusted to the weekly variations in reserve needs or whether some reserves shall be made available through release of vault cash, together with alterations in reserve requirement percentages.

It may be desirable, in order to foster moderate credit expansion, to increase somewhat the average amount of free reserves and permit member banks to reduce borrowings somewhat further. Perhaps free reserves of as much as $200 million would be appropriate until there is evidence of credit expansion.

In view of the wide spreads that have again developed between bill rates and the discount rate, which make banks more reluctant to borrow for temporary reserve adjustments, and particularly in view of the reduced liquidity position of banks which makes it difficult for them to obtain reserves by selling bills, consideration may also need to be given to a further reduction in the discount rate.

One factor in the situation that has elicited some discussion and question is the renewed gold outflow. It is evidently due in some part to a movement of capital attracted by higher interest rates in other markets. It is doubtful that the movement for this reason alone will be sufficiently large to justify failure to adopt a monetary policy called for by domestic considerations. Such a decision would be appropriate only if a tighter policy were essential to bring about more fundamental adjustments that may be needed to keep our international payments in balance. Under existing circumstances, it is doubtful that such a policy is needed or desirable. The adjustments that should be made lie mostly outside the financial area, they seem to be in process, and they will take a long time to complete.

Mr. Marget presented the following statement with respect to the United States balance of payments:

A week ago today there was a meeting of a group of technicians who assemble at fairly regular intervals for the purpose of forecasting probable developments in the U. S. balance of payments. This is the Balance of Payments Group of the National Foreign Trade Council. The group is generally very highly regarded, and I think rightly so, since it includes virtually all the individuals of standing, inside and outside Government circles, who are working continuously on the problem. All the more reason, however, for prefacing a report on the current forecast of this group as to what is likely to happen to our balance of payments for the rest of the calendar year with a report on how accurate their forecasts have turned out to be in the recent past.

The first thing to be said about the forecasting record is that it really hasn't turned out to be very accurate so far as the concrete figures are concerned. This is not said in criticism--if for no other reason, because there is no other comparable group I know of who have done any better. The first conclusion, I think, should therefore be rather one of humility with respect to this business of forecasting or "projecting," in the field of balance-of-payments projections, as in the field of economic forecasting generally. One does the best one can; but one retains, it is to be hoped, a saving sense of awareness that one might, after all, turn out to be wrong.

The second comment to be made about the forecasting record is that, during the period to which I have reference, the forecasts erred almost invariably on the side of pessimism: that is, the balance of payments almost invariably turned out better than the forecast said it would. Specifically, for example: the forecast of the Group for the calendar year 1959--as I duly reported to this Committee at the time--was for a balance of payments deficit of $4.5 billion. Actually, as you know, it turned out to be around $3.8 billion.

The third comment I should like to make about the forecasting record may throw some light on why, during this particular period, the errors seemed so consistently on the side of pessimism. My comment is simply this. Quite apart from differences in temperament and the kind of bias which may derive from nothing more basic than a general conviction that observers are likely to be less bitter in their comments if a pessimistic forecast goes wrong than they are likely to be if an optimistic forecast goes wrong, most "forecasts" and "projections" tend to assume that what has been happening will continue to happen, simply because the factors that will make for change are not yet discernible. Thus, in calendar 1959, what was happening in the first part of the year was that our balance of payments was deteriorating: as you know, in the second quarter it reached a low of a deficit of $5 billion, annual rate. Taking into account the relatively better performance of the first quarter of last year, the projection of $4.5 billion for the calendar year 1959, as against the $3.4 billion deficit realized in calendar 1958, really amounted to a missing of the turn for the better which, despite all the fog which the steel strike created at the time, we now see occurred around mid-year in 1959, while we were still belatedly receiving the delayed statistics telling us that our balance-of-payments position was still deteriorating.

This was no longer true, of course, by January of this year, when the Balance of Payments Group made its first projection for calendar 1960. At the time, one was a little amused by the air of precision which was given by the announced figure for the projection--$2.9 billion; but the general order of magnitude was clear enough: around $3 billion, as against the $3.8 billion deficit realized in calendar 1959 and the $3.4 billion deficit realized in calendar 1958, the first of the big deficit years. The latest projection of the Group for calendar 1960 represents a further revision downward of the expected deficit: it is now expected to be around $2.5 billion, instead of around $3 billion as forecast last January.

It is interesting to observe--apropos, at least, of my comment on how projections in economics tend to assume that what has been happening will continue to happen--that this figure of $2.5 billion is just about the level, in terms of annual rate, at which our balance-of-payments deficit will probably turn out to have been running for the first half of the current calendar year. But it is much more interesting, I think, to ask just what part of the earlier projection went wrong. What was it that had not been adequately foreseen?

Mainly, it would appear, the degree of improvement in our exports. The January forecast had, to be sure, assumed an appreciable rise in our exports above the $16.2 billion level realized in 1959, to a figure just over $18 billion. Actually, however, by April and May of this year our exports had reached a seasonally adjusted annual rate of around $19-1/2 billion. It will be interesting to see whether the new projection for 1960, at $18.8 billion (again it is easy to be amused at the degree of precision suggested by that decimal figure) will also turn out to have been on the somewhat pessimistic side, particularly in view of the replies to one of the questions circulated to National Foreign Trade Council members before the meeting, according to which over a third of the respondents reported that they had already revised upward their expectations with respect to their company's exports in the course of the past half year, while fewer than one-tenth had revised their expectations downward.

But I have said enough, I think, about the perils of forecasts and projections in the field of balance-of-payments figures, as throughout the field of economic statistics, to make it clear that I am not prepared to substitute a private guess as to the actual magnitudes that are likely to be realized in 1960 for the collective guess of this able and extremely well-informed group of expert specialists. I do think that the record of adjustment in our balance of payments that we have had since the low point in the second quarter of last year--from a merchandise export surplus of zero to the current annual rate of around $3.5 billion--is ground for a reasoned optimism as to developments in the near future, particularly if the cyclical constellation as between this country and abroad continues to remain as favorable to the improvement of our trade position as it seems to be likely to on the basis of present evidence. But in the and the basis for optimism here, as in any field involving economic policy, is not so much what the statistics of the moment happen to show as it is a belief in the efficacy of market processes in bringing about adjustment, provided that our policies are such as to favor, and not hinder, the working of those market processes. Danger comes when this proviso with respect to policy is forgotten. To judge by the degree of adjustment we have had thus far, the proviso has not yet been forgotten. But the adjustment itself is still very far from being complete.

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

This is unquestionably a period of low visibility with respect to the business outlook. While there has been little change in the statistical position of the economy in the last three weeks and business activity continues strong in most sectors, there has been a marked deterioration in business sentiment. This reflects such factors as the lag in new orders, the dwindling orders backlog, a considerable involuntary accumulation of inventories, and signs of a squeeze on profits--besides concern over domestic and international political developments. The steady 10-day decline in stock prices may be considered both a contributory cause and a reflection of this growing disappointment with business prospects.

Purchases of final users actually increased from the first to the second quarter (according to the preliminary GNP estimate made by the Council of Economic Advisers).

The trend of consumer buying is favorable but not exuberant. Construction may have bottomed out, and aggregate Government expenditures are more likely to rise than to decline in the coming months. But despite these factors, and in view of the fact that the rate of inventory accumulation will probably decline further, there seems to be less and less likelihood of a strong new forward surge in the economy. The prospect appears to be for an economy moving along on a high plateau, but with a considerable volume of unemployed human and physical resources.

There is more encouragement to be found in bank credit statistics, which suggest that our policy of relaxation over the last six months is beginning to bear fruit. Although the banks' liquidity is still very low and their loan-deposit ratios exceptionally high, bank borrowings have been sharply reduced and the banks are no longer being forced to liquidate Government security holdings rapidly in order to meet loan demands. Demand for business loans and for total loans has been running a little behind seasonal expectations; but total bank credit (loans and investments) showed a larger growth in the second quarter than in any recent year, whereas the comparison with earlier years was unfavorable in the two preceding quarters. As for the money supply, the rise in June was accomplished in spite of the fact that Government deposits remained at a very high level. The potential for a further money supply increase is strong as Government deposits are drawn down from present levels. Over the year ended June 30, the money supply would have shown virtually no decrease had it not been for a $2 billion rise in Government deposits.

In contrast with the money supply itself, other nonbank liquid assets declined in May after increasing for many months. This, together with the possibility that the improved Federal budget may lead to further declines, suggests that we may not be able to rely in the future as much as we have in recent months on upward flexibility in the velocity of money, accompanied by an increase in the volume of money substitutes, to permit rising over-all expenditures on goods and services. Under these circumstances it would become all the more important to encourage a rise in bank credit and the money supply. It is distinctly encouraging to note that during the last few weeks total reserves, nonborrowed reserves, and required reserves rose substantially more than in the same period in recent years other than 1959. And if free reserves are kept around their present level, I would expect nonborrowed reserves to drop much less in the first three weeks of August than in recent years.

It seems to me that we are fully justified in maintaining a policy tilted toward ease, symbolized by free reserves of $100 to $200 million, with any errors on the side of ease and with ample leeway to the Manager to take into account the feel of the market. Another way of expressing this objective would be to instruct the Manager to provide reserves a little in advance of seasonal needs.

Although I feel very considerable concern over the still-unsolved balance-of-payments problem, I believe that this problem runs much deeper than the mere flow of short-term funds in response to rate differentials; and while I would hope to avoid any forcing of interest rates to still lower levels, in the final analysis we should give priority to the needs of the domestic economy. However, on neither domestic nor international grounds do I think it advisable to reduce the discount rate any further for the time being. An increased willingness and ability of the banks to lend represents our major goal, and this can be attained better through affecting their reserve position than by cutting the discount rate. The imminence of the Treasury's refunding announcement also points to the wisdom of deferring any consideration of a lower discount rate until the next meeting.

The tight reserve position of country banks and the reduced liquidity of banks in general might appropriately be dealt with through a further release of vault cash and through a reduction in central reserve city requirements. By reducing the need for open market purchases, such measures might minimize downward pressure on bill rates. It might be well to announce in advance a schedule of reserve requirement changes to provide for seasonal expansion of credit in the autumn and to avoid any seeming change of policy in the midst of the Presidential campaign.

I see no need to make any change in the directive at this time.

Mr. Hayes also presented a statement, as follows, on the question of open market operations in other short-term securities in addition to bills:

I read with a great deal of interest the staff analysis of July 13 of the suggestion made by several people, including myself, at the last Open Market Committee meeting, and elaborated upon in a memorandum subsequently distributed by the New York Bank, that the Committee authorize the Account to conduct open market operations in other short-term securities in addition to bills. It seems to me, however, that the staff analysis answers questions that were not raised, for I do not suggest that a major proportion of open market operations required during a given period in any substantial size be conducted in securities other than bills. Yet this is apparently what the staff analysis assumes the proposal to have been, as indicated at several points throughout the analysis and as further indicated quite explicitly in the first sentence of the conclusion on page 7, which says that "Under existing circumstances System purchases of certificates or notes rather than bills to supply reserves for seasonal needs in any substantial amount would seem inadvisable."

The staff analysis reviews many points about the long-run, ultimate effects of large-scale purchases of securities other than bills. While I do not agree with many of those points, I do not propose to debate them here, first because they have been debated many times before, but most importantly because our suggestion was addressed not to the ultimate effects of large-scale operations in securities other than bills, but rather to immediate advantages to be gained through limited operations in such securities under certain kinds of conditions.

Specifically, we had in mind that, as on many occasions in the past, there will be periods when the market supply of bills is temporarily scarce, and to supply all reserve needs at such times through purchases of bills would tend to drive bill rates sharply lower. We have in mind that if on such occasions there is available in the market a supply of other short-term securities--and this is often the case--it would seem to make good sense to avoid concentrating all our purchases in bills, and to purchase some amount of these other securities in addition to bills. Furthermore, there is no reason to assume that other short-term securities, which would be purchased in modest amounts on such occasions, could not be sold in modest amounts on other occasions when we wished to absorb reserves and when the market was showing a good demand for such issues, as is usually the case in the early part of the year. They may also be allowed to run off in reasonable amounts at maturity. We do not have to roll over total holdings of certificates or notes any more than we do Treasury bills. Moderate run-offs of such securities, in addition to outright sales under appropriate conditions, should be quite in order.

Our suggestion is thus a modest one, and indeed fits quite well the language of the conclusion stated on page 8 of the staff analysis: "Purchases of securities other than bills to cover seasonal needs might be undertaken if purchases were made in relatively moderate amounts and only at times when bills were temporarily stronger than usual and in case similar securities would be sold to absorb releases of reserves in January and February or at other times." Our suggestion also fits the language of the staff analysis in the second part of paragraph 8 on page 6: "To be sure, it would be appropriate to conduct System operations in other securities so as to avoid adding to market distortions due to temporary influences. If operations in other securities than bills are conducted with this point in mind they need not be harmful and might be beneficial, but they would probably be relatively small and in any event should be reversed at times to avoid a gradual distortion of the portfolio."

This, again, is what we have in mind.

Mr. Johns made a statement substantially as follows:

I am gratified to observe that in the week ended July 20 total reserves of member banks, on a seasonally adjusted basis, were $300 million more than in the five preceding weeks.1/ This increase put reserves for the moment back to the level where they were at the beginning of the year. This was, in my opinion, in accord with the action of the Committee on May 24 when the directive was changed to provide for "fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion." I entertain the hope that this new level of reserves will not be permitted to fall off and that continued growth will be achieved.

The trend of business and employment conditions is, and has been, I think, such that we have need of stimulative or, if you will, less restrictive monetary policy and policy action. In order to stimulate economic activity I think we need to increase reserves and the money supply. With respect to the money supply, it appears that there was an increase in June, but the figure at the end of June, about $138 billion, was well below the figure of $139.5 billion at the end of April and the end of March. It was also below the $140 billion of early in the year, and below the $141 billion of a year ago. In the period from last summer through March of this year the money supply was declining at a rate of about 2 per cent a year. Since March, the decline has been at a rate of about 3 per cent a year.

It seems to me especially desirable to increase reserves and money in view of recent developments with respect to near monies or liquid assets. The amount of U. S. Government

1/ In deriving these figures, we used our own seasonal adjustment; although it differs somewhat from those of the Board's staff and the Atlanta Bank, the differences are not significant.

securities maturing within one year, held by the public, which rose so rapidly during much of 1959, increased little after the beginning of this year, declined greatly in May, and, I expect, declined again in June. The public's holdings of total liquid assets, which increased rapidly from mid-1958 to mid-1959, have risen but moderately in 1960, and most recently have declined. In mid-August the Treasury has a $9.6 billion issue maturing, of which about $4.0 billion is held outside the Federal Reserve System and Government investment accounts. Expected lengthening of maturities of the Federal debt incident to this refunding would of course reduce further the public's holdings of close-money substitutes. Considering all this, it seems to me that proper economic stabilization policy calls for a somewhat greater supply of money than might otherwise be considered appropriate.

The turnover of money, which increased so greatly in the first part of this year, now appears to be rising at a much slower rate, if at all. Possibly, it may be said that a decline in reserves and money was appropriate when near monies and velocity were increasing rapidly, but, if the growth of near monies and the increase in velocity have greatly slackened, it may be imperative that we strive to bring about growth of reserves and money.

During the second quarter of 1960 the Federal Government operated at a cash surplus of about $4.4 billion. By contrast, in the April-June quarter of 1959, there was a cash deficit of about $0.4 billion. In view of the magnitude of this shift, which is a significant depressing factor on economic activity, it would seem to me appropriate that monetary policy actions be more expansionary than would otherwise be necessary.

Interest rates on money market instruments have declined sharply in recent months, it is true, but this need not cause us concern in view of the current lack of ebullience in the business situation. The decrease has probably reflected a contraction in the demand for borrowed funds, chiefly by the Federal Government. Had the monetary authorities not permitted the money supply to contract, or, if they had increased the supply moderately, interest rates might have fallen even further. I question the System's taking a position of deliberately dampening the downward adjustment of market rates of interest at a time when business activity is not ebullient and total demands for credit are slackening.

After all, the recent and current levels of interest rates are not particularly low when viewed in perspective. Despite declines, interest rates are still quite high to borrowers.

Current rates on long-term Government, corporate, and municipal bonds, as well as on mortgages, are higher than at any time between 1945 and 1959. The prime bank rate has not been changed from the peak rate of 5 per cent reached last fall. It seems to me that interest rates might well be permitted to adjust to an even lower level than has occurred up to now.

Coming back to the increase of reserves which took place last week, I observe that it was similar to the increase which took place at the time of the Treasury financing in April. At that time the loss of total reserves which had occurred since January was largely restored, but attrition was subsequently resumed and continued until early July. I hope that now there will not be another such attrition, but rather some further increase. I hope we will not let some preconceived notion of a level of member bank borrowing or of free reserves deter us from maintaining the level of total reserves which we have achieved or from continuing to increase reserves.

The difficulty of getting and keeping an increase in reserves and money in recent months has been the greater, I think, because of a penalty discount rate. Since the cost of borrowing from us has been greater than the return on liquid short-term assets, banks have had a motive to avoid borrowing from us. Accordingly, borrowings from Reserve Banks have continued to decline and this has been an offset to our open market purchases. Even now we might somewhat arrest the decline of borrowing and enable further open market purchases to increase reserves if we were to reduce the discount rate substantially, e.g., by one percentage point, to 2-1/2 per cent.

But if we do not reduce the discount rate, we can still maintain our new reserve level and achieve a further increase in reserves and money if we have the resolve to do so. Borrowings have recently been about $400 million. If they were to decline to $150 million, a figure which has been about the seemingly irreducible minimum since the accord, open market purchases of about $250 million would be necessary to prevent total reserves from declining further. Purchases beyond that would probably increase reserves, and I propose that if such purchases are necessary to maintain an increase in total bank reserves they should be made.

Not only do I believe that recent and current business and employment conditions call for monetary expansion, but I believe it may be that the failure of reserves and money to increase during the past year may have a cumulative effect upon the economy which we are yet to feel in full.

There is opinion to the effect that monetary action may act with a lag of varying and uncertain length. While this idea may not be so well established or precise as to have great weight in our decisions, I think it needs to be borne in mind. Reserves and money have declined for a year. If there is anything to the lag idea, we may discover later that we have been more restrictive than we thought we were being or wanted to be. This, I think, furnishes a further consideration arguing for bringing about some monetary expansion. Certainly, I see no reason for any fear that the increase of reserves last week was too great or that moderate bank credit expansion, in accordance with the directive, should not continue to be our policy objective.

Mr. Bryan presented substantially the following statement:

The Sixth District is still operating at a high level of economic activity, but considerable diversity of movement is exhibited by various economic indicators, with few, if any, showing much strength in upward thrust. Borrowings from the Federal Reserve Bank remain disproportionately high, although commercial bank loans indicate a stable to declining trend, and bank investments are being rapidly liquidated. It can only be concluded that the banking situation in the District is far from easy. If there is banking ease anywhere in the country, the Sixth District is not the place.

As for the national scene, it seems obvious that the economy is still operating on a high plateau and has thus far shown a remarkable facility for taking some massive adjustments in stride. It seems equally obvious that the economy is not currently in a boom-like phase of an expansion cycle. Indeed, we are bound to note that nearly all of our expanding statistical measures have in recent months been recording diminishing rates of change. Many others have recorded figures well below the peaks of the present cycle or are below year-ago comparisons. We may note in one or the other category: manufacturing employment, department store sales, bank debits, construction contracts, construction employment, money supply, average hours worked, industrial production, new orders; and, to the same tenor, we have insured unemployment and unemployment as a per cent of the labor force at levels that are substantially above a year ago. All of these figures, plus many others, add up to the conclusion that the economy is presently underemployed, both with respect to manpower and material; and, in recalling that the present expansionary cycle is now old when measured by historical precedent, we must bear in mind, I think, the quite real possibility that the underemployment of manpower and material might get worse before it gets better.

In my judgment, no dramatic measures of policy are now called for; and, in order to reduce the chances that dramatic policy measures might later on be required at some tragic point in time--say middle October--I believe, as has been my view at recent meetings, that we should steadfastly adhere to the intention expressed in our current, recently changed directive, wherein we recorded our considered intention of fostering:

> ". . . sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion. . ."

That is what we have done in a modest way and that is what I believe we should continue to do.

Now, since the resultant of Account actions and market factors is a reserve figure, I will try to state a figure that, with appropriate allowance for the practical administration of the Account, would seem to me--as of now but subject to modification as the meetings of the Committee roll around--a reasonable level of total reserves to aim for. This effort to state a figure will at least--or, rather, it would if the effort became general around the table--have the merit of assisting the Account Management in understanding verbally-expressed intentions of the Committee without the Account Management's presently necessary resort to exhausting exercises in intuition, revelation, and auto-suggestion.

I start with a daily average of total reserves for June of $18,294 million (revised). Thus far in July we have attained a daily average figure of approximately $18,511. Last year in August the daily average of total reserves was $18,613, a difference of roughly $100 million of reserves between present levels and August levels of last year. I can see no reason in the present state of the economy and the present banking situation for our heading in this August for a daily average of total reserves less than the same figure last August, so that the first component of the target figure I would assume to be reasonable would be an addition of, roughly, $100 million of reserves to our present level of approximately $18,511 million. Then, I believe we should have a component for the secular expansion of the economy, say $47 million--at a 3 per cent annual rate. This brings me out with a reasonable daily average target of $18,658 million for August.

I wish to express congratulations and appreciation to the Board's staff for the recently-issued seasonal adjustment figures on total reserves. Atlanta will hereafter use the

> Board's figures rather than its own series. We are glad that, while there are some conceptual differences between the Atlanta series and the Board's series, the figure differences are essentially small and do not affect significantly any conclusions that might be made regarding the recent reserve situation.

Mr. Bopp said there was little new to report from the Third District. Business activity continued much the same as it had been recently; one of the Reserve Bank directors characterized it as sluggish at a high level. Employment was looking a little better, but the unemployment picture still was not good. New claims for unemployment compensation were above 1959 and 1958, and continued claims were above 1959. So far as the banking situation was concerned, there had been some suggestion of slightly reduced pressure on reserve positions, and some evidence of a slow upswing in the total of loans and investments. However, Philadelphia banks were still under considerable pressure as to their basic reserve position.

Mr. Bopp expressed the view that on balance there was less danger of a renewed burst of inflation than of continuation of the current lull or a turn downward. Therefore, he said, he would favor a slightly greater provision of reserves. As to the discount rate, he rather wished the System were operating under a procedure similar to that discussed by Mr. Knipe in recent papers whereby the discount rate would be lower without the necessity of an overt move. Under existing procedures, however, he would go along with a reduction after the current Treasury financing was out of the way. He would not change the directive.

Mr. Fulton said there was little of a happy nature in the Fourth District that he could report. The expected increase in steel orders had not yet materialized, and the date when it might materialize was being pushed further ahead into the year. In fact, it appeared that the year might end before any real improvement actually got under way. Buying on the part of the auto industry had not made its appearance as yet. An increasing variety of quality steel was being shipped abroad, but on the other hand imports of the garden variety were still running at the rate of 4.5 to 5 million tons a year. The outlook for use of steel by the auto industry in 1961 was not too heartening on the basis of confidential estimates of production and in the light of the anticipated higher proportion of compact cars. Steel prices had begun to soften in terms of discounts to distributors and charges for extras being waived. One manufacturer of steel pipe had notified its customers that it would carry substantial inventories of all sizes and types and would promise delivery in four days. Wage costs in the steel industry were to go up between 10 and 11 cents an hour in December, and probably there would be no increase in prices at that time, so the effect on profits would be substantial.

Mr. Fulton went on to say that shipments of the machine tool industry were now in excess of the volume of new orders, which suggested that a new look was being taken by many of those who had contemplated plant and equipment expansion. The stock market decline had had an effect on the decisions of businessmen, and there were indications that plant and equipment expenditures were being postponed, or at least scaled down, in the light of adequate capacity at the present time.

Mr. Fulton said that the unemployment situation in the District had worsened. Insured unemployment had increased sharply and contraseasonally in the past few weeks, while total employment had increased less than expected. Electric power output for industrial use had slipped further below a year ago. New car sales, which were running well earlier in the year, had continued to slip back in comparison with a year ago. Department store sales were well maintained, but sales of consumer durables were in the doldrums.

Summarizing, Mr. Fulton said there seemed to be little about which to be heartened. In his view, there had been an actual deterioration in the economy that must be faced by the Open Market Committee. There seemed every reason to expand the reserve base, and he felt that this should be done as quickly as possible. In his opinion, the easing of the banking situation should come more through reduction of reserve requirements than through purchases of bills in the open market because of the pressure that would otherwise be put on bill rates. Also, the sooner bank reserve positions were eased, the less would be the prospect of having to make massive moves later in the year because of having waited. He would be favorable to reducing the amount of pressure on the banks by making available to them reserves in greater quantity than the Desk had been providing. He thought it would be appropriate to reduce the discount rate, which was out of touch with the bill rate and had been for some time. This might also have a favorable effect on bringing down other money rates.

Mr. Shepardson noted the comments that had been made about the low visibility at the present time. He suggested that this was inherent in the season of the year and that the situation was aggravated in an election year. Thus, the difficulty of trying to estimate what might happen in the future was compounded. Some factors admittedly were not too favorable, for example, the underemployment of both manpower and material, and everyone would like to see some improvement in that situation.

Mr. Shepardson said he had been concerned over a period of time that when there was some easing of inflationary pressures and movements there had been a failure to obtain desirable corrections. However, in the present situation he felt that some corrections were being achieved. For instance, Mr. Fulton had mentioned certain unofficial price adjustments. While there had not been much change in list prices, he (Mr. Shepardson) had seen several accounts of fringe adjustments in prices, and he felt this indication of response to market forces of supply and demand was constructive. Also, Mr. Thomas had mentioned adjustments in the stock market in terms of price-earnings relationships, and this might not be a bad thing in the long run. Such factors tended to dampen the prospect of further inflationary pressures in the foreseeable future. Thus, it seemed to him that the System could properly provide for some further growth in the availability of reserves. The question of the most appropriate method was, of course, a matter of concern.

As to the discount rate, Mr. Shepardson said it had been correctly stated that the rate was technically considerably out of line. However, it seemed to him that it would be well to defer any discount rate action until after the Treasury financing, at which time it might be desirable to consider a change. The directive seemed appropriate and he would not favor any change in it.

Mr. Robertson said it seemed to him that in the light of the economic picture System policy had been about right recently. However, since it seemed fairly evident that inflationary tendencies were dormant for the most part, he agreed with those who suggested that the System could afford to move further in the direction of ease without untoward results. He thought it advisable to do so through open market operations, in the absence of other System actions to provide reserves, to a point where the banking system as a whole could show a free reserve position in the neighborhood of $200 or even $250 million during the next three-week period. He hoped that this would be done on a gradual basis and not in a way that would seem to indicate backing and filling without rhyme or reason; rather that the System was moving steadily toward an easier, but moderately easier position. This would seem to be in line with the outstanding directive, and therefore the directive would not need to be changed.

Mr. Robertson suggested that serious consideration should be given to moving the discount rate down so that it would be more nearly in line with the bill rate, and thus preclude any sense of reluctance on the part of banks in borrowing to meet loan demands. Since the discount rate was out of line with other market rates, there was an encouragement for banks to meet their needs through other means, with less desirable effects than would flow from use of the discount mechanism. Then too, if the economy, which now seemed to be moving on a high plateau, should begin to move forward in the fall on a basis which indicated a resumption of inflationary tendencies, the System should have the discount rate in such a position at that time as to permit upward adjustments to be made not only rapidly but, if necessary, in quite large jumps so as to be effective in resisting inflationary pressures. In other words, this would seem to be a time in which the System could get into a position from which it could effectively use adjustments of the discount rate. However, since Treasury financing plans involved an announcement on Thursday of this week, with payment on August 15, it was unlikely that any discount rate action could be taken before then. Accordingly, it would appear that the System should wait until after the financing had been completed and move on the rate at the appropriate time thereafter.

Mr. Mills said he believed the Committee could take reasonable satisfaction from the results of policy actions in recent weeks. Those actions had, of course, been through the open market and, such being the case, they had focused their effects on the money market banks. Those effects had been particularly evident in the picture of the central reserve city banks, who had been able to expand substantially their holdings of United States Government securities and to increase their loans to a degree, while at the same time experiencing an increase in their deposits. An important collateral effect of recent policy actions had been to bring back as participants in the Government securities market a considerable number of banks who, due to tightness of their positions, previously had been foreclosed from that type of participation. Now they were again factors in the market, and they were a stimulating and stabilizing market influence at a time when such influences were needed.

The question that arose, Mr. Mills said, was whether, in moving toward a further injection of reserves into the commercial banking system, it would be inadvisable to be too aggressive in moving in that direction through the open market. The question was whether, as had happened in the past, the injection of reserves through open market purchases at a time like this would not reflect itself too largely in an interest rate reduction rather than in an expansion of bank loans. With the economy apparently sliding off from earlier levels, and with banks continuing to have high loan-deposit ratios and obviously having become reluctant lenders until they have worked themselves into a position of improved liquidity both by adding investments in Government securities and curtailing loan commitments, it was quite probable that further stimulating injections of reserves through the open market could, undesirably, drive short-term interest rates down to an unrealistically low level. This would perhaps hold back the adjustment which would come through more moderate actions and which, in due course, might be expected to work into a lower rate structure in the long end of the market and bring about whatever stimulus might come from long-term borrowing at lower rates.

Question had been raised, Mr. Mills noted, whether the actions taken to this point in supplying reserves could be expected to permeate from the money market banks into the reserve city and country bank categories and serve as a stimulus to the expansion of loan and investment positions. There was persuasive logic in the point that had been raised that when the Treasury comes into a surplus position, this has a centrifugal influence on the money supply and tends to draw funds out of the more remote areas to the central areas. This logic could be extended, in the light of recent experience, to conditions where, with a slackening of business activity, there is a tendency toward reduction of borrowings on the part of the more important industrial and commercial entities. If those entities should reduce their loans--and there was some indication that this was occurring--very probably the effect in the near future, as it had been in the past, would be to draw funds out of the more remote areas of the country into the money market banks. If there was substance to that reasoning and one could not expect a permeation of reserves and a movement of deposits brought about by open market operations to flower out into the reserve city and country bank areas in the same way that beneficial effects were induced by actions in past weeks to inject reserves into the money market, with effective results on money market banks, the application of that same kind of reasoning would give at least a foundation for arguing that action in supplying reserves to reserve city and country banks should preferably take the form of some type of adjustment in their reserve requirements.

Mr. Leedy said there had been one important local development in the Tenth District in the past three weeks; namely, settlement of the paralyzing construction strike in the Kansas City metropolitan area. As he had previously reported, about 17,000 workers were involved. During the first five months of the year, total District residential and nonresidential construction awards were down about 20 per cent from last year, some of this having been due to the strike. However, public works and public utility construction showed an increase of about 50 per cent over the same period last year.

Mr. Leedy went on to say that the winter wheat harvest had about been completed. As forecast earlier, production was estimated to be about 20 per cent greater than last year. Country bank deposits had been affected materially by the harvest. Figures of the country banks for the period were not yet available, but interbank deposits at weekly reporting banks rose $130 million during the two weeks ended July 13, and were about $100 million above the peak Wednesday figure in June. Loan demands had remained moderate in the past three weeks; real estate and consumer loans showed little change, and a slight increase in business loans was counterbalanced by a reduction in loans to nonbank financial institutions. Borrowings of weekly reporting member banks had declined sharply with the pickup in their deposits and had reached the lowest level on a reporting date since January. Department store sales during the four weeks ended July 16 showed a 3 per cent increase, perhaps reflecting the harvest in some part, but sales since the first of the year continued under the same period last year, the cumulative figure being 1 per cent.

Mr. Leedy said he assumed that for the period between now and the next meeting the so-called even-keel policy would be required in view of the Treasury financing. However, he subscribed to the view that, to the extent it could be done, additional reserves should be injected into the banking system. In view of the fact that free reserves had reached a level around $200 million, he would surmise that some figure in that area might be regarded as maintenance of an even keel. He subscribed to what Mr. Mills had said about the matter of injecting reserves through an adjustment of reserve requirements. In his opinion, this should be given serious consideration, along with some further adjustment in the use of vault cash. For the time being, it seemed to him that no change in the discount rate was called for, although he would assume that unless the picture should change the System would want later to give some consideration to a further downward adjustment.

Mr. Allen reported that Seventh District department store sales in the four weeks ended July 16 were 2 per cent higher than a year ago, compared with one per cent for the nation. This showing was regarded as favorable because sales of last year were at a high level and thus far the summer had been relatively cool. The higher temperatures of the past week were said to have provided a strong stimulus to sales. Prospects for crop production were not as favorable as in other recent years because of cold, wet weather. The only exception was Indiana, where the corn prospects were excellent. On the other hand, cash receipts for farm marketings in May were substantially higher than last year and brought total cash receipts for the first five months to slightly above last year's figures in each State in the District. New claims for unemployment compensation in the six weeks ended July 9 were 48 per cent above last year in Seventh District States, compared with 24 per cent for the nation.

With respect to automobiles, Mr. Allen said that a few assembly lines had stopped the 1960 model run. Most lines would be down by August 15, and production of 1961 models would start shortly thereafter. On July 10, inventories were 1,056,000 cars, not far below the record high in June. The drive now was to clean up the stocks of 1960 cars and, based on sales and production forecasts in Detroit, it was hoped that inventories on October 1 would be down to 780,000 cars, divided 255,000 in 1960 models and 525,000 in new models.

Mr. Allen commented that rates on home mortgage loans in the Chicago market began to show definite signs of easing in June. Two of the largest lenders reported 1/4 point reductions in their rate schedules toward the end of the month. Loans equal to 80 per cent of appraised value were being offered at 6 per cent, 75 per cent loans at 5-3/4 per cent, and 50 to 60 per cent loans at 5-1/2 per cent. The most active demands, however, were in the low down payment categories.

The trend toward lower rates might act as a stimulus to home building, Mr. Allen noted. For the first five months of 1960, home building permits were below last year by 21 per cent in the Chicago area, 23 per cent in Detroit, 5 per cent in Indianapolis, and 32 per cent in Des Moines. Milwaukee reported a 6 per cent increase.

Business loans had again shown three consecutive weeks of decline in the weekly reporting banks. Chicago banks reported a net decline of $46 million by business borrowers in the period ended last Wednesday, the biggest single week's drop since the fall of 1958. The large banks as a group continued to show a substantial basic deficit position, but the group figures are heavily affected by a large increase of bill holdings by one dealer bank.

Mr. Allen said that although he would not favor changing either the discount rate or the directive at this time, he would suggest that monetary policy in the next three weeks trend in an easier direction, with the goal for net free reserves in the area of $200 to $300 million.

Mr. Deming said that contrasting trends in the Ninth District added up to a somewhat better average picture, particularly in relation to a year ago and in relation to the country as a whole. In both cases, however, these developments must be viewed as favorable only when qualified by recognition that the District entered a weakened economic situation about this time last year and that the rate of expansion nationally had weakened somewhat. The District had about caught up with the nation, partly because the national picture was not as exuberant, and showed gains against last year partly because last year in the District was not so good.

At the same time, the favorable developments should not be minimized, Mr. Deming said. As of July 1, the official estimates for the 1960 District small grain crop were excellent. Much of the winter wheat had since been harvested or was in process of being harvested. Spring wheat production might be cut back by a developing drouthy situation since July 1, but total wheat production should be at near-record levels in most areas. The 1960 District wheat crop on July 1 was estimated at 34 per cent above that of last year, with oats and flax production up an estimated 48 per cent. This situation, along with favorable livestock marketings this summer and fall, might soon, if it had not already, push farm income to the plus side compared with the year-ago statistics. This would be a stimulus to business generally. In fact, some of the economic data just becoming available for June and early July showed modest improvement. Department store sales in Minneapolis, for example, in the four weeks ended July 9, were up 6 per cent from the comparable period a year earlier. For the United States, the figure was a plus 2 per cent.

District employment in June also showed a healthy improvement, and the number of insured unemployed dropped from 35,134 in May to 25,527 in June. This latter comparison represented a greater improvement from May to June than for the country as a whole. Personal income in Minnesota during June showed a 4.4 per cent gain from a year earlier, and farm income in May was only about 5 per cent less than a year ago. In previous months of 1960 the decline from year-ago levels was substantially larger, ranging up to a minus 15 per cent in February.

The major depressing developments of recent weeks were associated with iron ore mining. A Reserve Bank visitor who had just returned from extensive calling in the iron range reported greater pessimism than he had encountered in a long time, and the reasons were not hard to find. Ore shipments in June were smaller than in May for the first time since prewar days, except for 1952 when there was a strike. They were likely to be down in July and August. Presently, there were 45 ore carriers laid up, out of a total fleet of 232.

The District banking picture seemed to be getting somewhat easier at last. The seasonal deposit upswing finally seemed to be developing, borrowing from the Reserve Bank had fallen fairly sharply, and loan-deposit ratios showed some slight improvement. This was quite a welcome development.

Turning to credit policy, Mr. Deming said it seemed to him that the summer doldrums had been with us a bit too long. Thus, he felt that the weight of evidence argued for further ease in monetary policy. Perhaps this might be accomplished, as had been suggested, by attempting to anticipate some of the seasonal needs and supplying reserves more freely through open market operations. Perhaps it would be well to prepare to take some action via further release of vault cash. In any event, he would like to see further ease--accomplished undramatically but accomplished effectively.

As to the discount rate, Mr. Deming stated that he had mixed feelings. It was as much as, or more, out of touch with the bill rate now than when action last was taken to reduce it. He felt the current rate did exercise a more restrictive effect than he would like, and he could argue that it should be reduced now. At the same time, with the Treasury financing coming up, he had some question about action now, and on balance he believed he would prefer to wait for a bit. He saw no reason to change the directive at this time.

Mr. Mangels said there was little evidence of an increase in Twelfth District business activity in the past three weeks, while there were some signs of a slackening pace in several areas. The unemployment picture was not very good, with unemployment at the highest level since 1958. Perhaps this was due to the large influx of teenagers into the labor force and the situation was temporary, but in June unemployment figures were 5.6 per cent in California, 7 per cent in Oregon, and 7.8 per cent in

Washington. Lumber production was down further, and steel production was at the rate of 57 per cent of capacity in the second week of July, although one mill in Utah was operating at 95 per cent.

Turning to the banking picture, Mr. Mangels reported that loans declined in the three-week period ended July 13 and that, while the total decline was not large, there were decreases in all categories except for modest increases in agricultural loans, loans to sales finance companies, and loans to Government securities dealers. Holdings of securities increased about $166 million. Bank deposits had gone up for seasonal reasons, and there also had been some unexpected increases because of the run-off of bills held by customers which were redeemed at maturity. For the District, savings deposits increased about $39 million. The expected loss of savings deposits in California apparently did not materialize to the extent that the bankers thought it might. For the first six days of July, losses were about $200 million, approximately half as large as those suffered in the same period in January. District banks were net sellers of Federal funds in rather substantial amount, while borrowings at the Reserve Bank were nominal, the average for the two weeks ended July 19 being under $2 million per day.

Mr. Mangels said that for reasons others had indicated, he could go along with extension of further ease in the coming period. Free reserves of $200 million, $250 million, or even $300 million would be acceptable to him. He felt that a change in the discount rate should not be made at the present time because of the Treasury financing, but that at the first clear period consideration should be given to a reduction in the rate. He regarded the directive as satisfactory.

Mr. Irons said there had been little change in the Eleventh District during the past three weeks. The pattern was not too dissimilar from the national pattern, except that the factors affecting the District might be somewhat different from those affecting other parts of the country. In general, economic activity was moving along sideways at a high level. There was, of course, some question as to how long a sideways movement might prevail, but at the moment most of the major economic indicators except those directly associated with petroleum were within a couple of percentage points, plus or minus, from record levels.

Mr. Irons reported evidence of less restraint on the position of District banks than had prevailed a few periods back. During the most recent period there was a decrease in loans, an increase of holdings of Government securities, and a net increase in bank credit. Borrowings from the Reserve Bank had been averaging about $25 million, a bit lower than they had been. The use of Federal funds by large city banks was considerably lower than it had been running earlier.

Mr. Irons said he did not detect reluctance on the part of banks to use the discount window. The country banks needing to borrow were borrowing, and he had heard of no reluctance. Some large city banks that were using the Federal funds market might be doing so to protect their position at the discount window.

Mr. Irons went on to say that the psychology and attitude of bankers and businessmen with whom he had had contact recently was certainly not one of pessimism. It was a sort of acceptance of an attitude that during times like these, with all of the various factors that are at play, there is a period of watchful waiting and cautiousness. The general feeling was that there would be a slight increase over the months ahead, perhaps in the fourth quarter. There was no attitude of rank optimism or real pessimism.

Turning to policy, Mr. Irons said he came out a little differently in degree than those who had spoken thus far. He was quite satisfied with open market operations during the past three weeks. The Desk had made some reserves available and had followed a moderate and cautious approach. He would much prefer to continue in that manner during this period of unsatisfactory outlook insofar as forecasting was concerned. The visibility was low because of many factors, and at a time when visibility was low he would not be inclined to take off in either direction. Instead, he would prefer to follow the basic policy that had been followed, permitting a moderate increase in bank credit and a moderate increase in bank reserves. For the period immediately ahead, he would favor no change in the discount rate or in the directive. When one talked of going to free reserves of $200 million or even $300 million, that to him (Mr. Irons) was more than a moderate and cautious approach, and he would rather stay around $100 million. He would prefer to permit funds to move into reserves cautiously and moderately, while meeting seasonal requirements. While errors might be on the side of ease, he certainly would avoid anything in the nature of aggressiveness. If free reserves should be moved up to $250 million or $300 million, he felt that this would be taken by the market as a clear change in policy.

In summary, Mr. Irons said his thinking was in terms of a cautious relaxation of reserve pressures, and that he would avoid being aggressive. He would meet seasonal requirements, and if it seemed desirable to err a little on the side of ease he would be agreeable to that. However, the Treasury would be in the picture during the next three weeks; August 15 would be the settlement date, and the Treasury was attempting a new form of financing. Therefore, for the time being, he would be careful and cautious. To go a little beyond seasonal needs, if necessary, would be all right, but he would not favor anything that could be construed as a basic change in policy.

Mr. Erickson noted that several expressions had been used around the table to describe the current situation and that Mr. Ellis, at yesterday's meeting of the directors of the Boston Bank, had used the phrase "coasting uphill" in referring to the situation in the First District. Mr. Erickson went on to say that there were still many favorable factors in the District picture. The New England production index, which held at 117 in February, March, and April, rose to 119 in May, while every week this year electric power production had been ahead of last year, when allowance was made for weeks with holidays. Department store sales in June were 4 per cent above last year; in the four weeks ended July 16, they were 5 per cent ahead. New car registrations in May were 18 per cent ahead of last year. As to nonagricultural employment, the monthly year-to-year comparison had narrowed since the first of this year, but the situation was still fairly close to the national picture. Insured unemployment in July was higher than last year, but not as high as nationally. Construction contracts through May were lower than nationally, but residential construction was better than nationally.

Turning to the June survey of mutual savings banks, Mr. Erickson said that year-to-year comparisons of deposits are made monthly. The year-to-year improvement reached a high point of 6.5 per cent in February 1959 and the figure then decreased until May of this year, when it stood at 4.4 per cent. In June the improvement was 4.5 per cent. While the figure for this one month might not be too significant, it did mark the first turnaround.

In the past three weeks, Mr. Erickson said, District banks were net purchasers of Federal funds. Commercial loans were higher, both at Boston and country banks, than at the first of the year. The loan-deposit ratio for Boston banks had risen from 60 per cent at the first of the year to 63 per cent in July, and for country banks the ratio had risen from 56 to 58 per cent. In July to date, District banks had used the discount window less than in other months, the average being less than $10 million. It would have been even lower if there had not been one or two days when Boston banks could not get Federal funds. In this connection, Mr. Erickson said he had found the same sort of situation as Mr. Irons, that is, no real reluctance to come to the discount window if the banks needed funds. Businessmen also appeared to have about the same point of view as described by Mr. Irons; all seemed to feel that the fourth quarter of the year was going to be on the upside.

As to policy, Mr. Erickson said that he considered the directive entirely satisfactory. In view of the fact that the Treasury was in the market, he would favor no change in the discount rate at this time. By the time of the next meeting, however, the situation might be more favorable to a change in the rate. He felt that the Desk should supply reserves for seasonal requirements, but that the Desk should not be too aggressive. He would favor free reserves somewhere around $200 million. Mr. Erickson expressed the hope that, since it would be necessary to provide reserves later in the year, some part could be made available through adjustment of provisions relating to vault cash and through a change in the reserve requirements applicable to central reserve city banks.

Mr. Balderston said it seemed to him that at the Committee meeting on July 6 the question was whether the summer slackness represented merely a pause to refresh the economy or fatigue of greater duration. The answer now seemed more clear, despite one's fear of deception on account of the seasonal summer doldrums. In his view the decline that one might expect at this phase of the cycle was now evident and should be countered actively by such means as were available to the System. There were fundamental domestic trends affecting the state of business which might have an effect for a long time to come. First, there was the price decline stimulated by excess productive capacity. It would tend to bring about continued reduction in the rate of inventory building, which he suspected by this time had dwindled to zero. And very soon there might be an actual decline in inventories, if that had not occurred already. Then there was the profit squeeze stemming from inability to pass cost advances along to the customer. This, he found, was worrying not only chemical and other manufacturers but even utility executives. The profit squeeze would induce more labor saving, thus aggravating the unemployment problem.

In the face of this situation, which he now believed to be long-lasting and not seasonal, Mr. Balderston said he would favor the following actions. First, he would remove the word "moderate" from clause (b) of the policy directive. In the preliminary draft of policy record entry for the Board's Annual Report covering the July 6 meeting of the Committee, he had found the phrase "marking time", and this was a phrase he did not like to see in the record. He did not believe that the Committee's policy was one of marking time. This sounded like waiting for the inevitable, and it was not something he would relish. Since he did not believe that the present posture of the Committee was one of trying to bring about a moderate increase in bank reserves, but rather that the Committee had been struggling to do better, he would eliminate the word "moderate" from clause (b) of the directive. Second, he would adopt a free reserve target of $250 million, as suggested by some others. Third, he would reduce the discount rate to 3 per cent. In this connection, he raised the question how long after the close of the books next week on the pending Treasury financing it would be necessary for the System to wait if it desired to take action on the discount rate. He did not think anyone would be injured by a decrease in the discount rate as they would by an increase. He then asked Mr. Rouse whether dealers might be likely to receive a windfall if a change in the discount rate were made within a week or so after the closing of the books.

Mr. Rouse replied that he thought this would depend on the terms on which the dealers would be allowed to subscribe. It could be that what Mr. Balderston had referred to might happen. Ordinarily, one would think in terms of a little time after the delivery date, in this case August 15, before making a move on the discount rate.

Chairman Martin said he did not propose to cover in his comments the ground that had already been covered. He wished, however, to make the observation that the adjustments now going on had long been needed and were necessary if there was to be any real revival of business and any real improvement in prospect. Price adjustments, and adjustments such as now taking place in business thinking and speculative psychology, are always painful, he noted. For example, reference had been made at this meeting to the price-earnings ratios of common stocks. It was fine to say that the adjustment was a good thing, but anybody who was caught in those stocks certainly felt terrible today. From personal experience, he could say that it is a painful period when adjustments long deferred come about. However, these adjustments were going on in an orderly way. It might be that the summer doldrums had been exceeded but, particularly in view of the long-deferred adjustments, he was by no means convinced that the situation was serious.

The Chairman said he was inclined somewhat toward the approach of Mr. Irons, although not to the same degree. This approach suggested that the System be cautious in what it was doing and not show any sign of panic. The discount rate had been out of touch with market rates, technically, for some time; the situation was not new at this meeting. The Treasury financing was now right on top of us, a situation which always creates a problem for the System. Assuming, hypothetically, that it was possible to change the discount rate without having to go through the twelve Federal Reserve Banks and the Board of Governors, and if it had been decided to act on the rate, the proper time would be tomorrow morning. However, it would not be feasible for the System to act by tomorrow, even if it wanted to act. The System is caught constantly in this type of thing, the Chairman noted, and one should not worry about it unduly. Since it was general policy to take into account Treasury operations, obviously the even-keel approach was the correct one at the present time.

The Chairman noted that, as Mr. Leedy brought out, free reserves had already been up to a $200 million average. If they ran somewhere in that area, he continued, no one would think that the even keel was being changed substantially.

It appeared that the Committee unanimously wanted to trend toward an easier reserve position, Chairman Martin commented, whether by Mr. Bryan's formula or some other formula. He went on to suggest supplying reserves in an orderly way and maintaining a posture of ease, adding that when the appropriate time came he felt that the System should not hesitate to lower the discount rate.

Chairman Martin cautioned about projecting too far into the future and about being influenced unduly by such things as conversations. However, after noting that projections were involved and that one must be careful, he expressed the view that if the System was going to adjust the discount rate, it might be better to do so before September.

The Chairman then commented on reserve requirements, saying first that he hoped all would study the problem actively. Thus far, he had found himself confused. As to vault cash, he did not think there was any real way of measuring what action in that area would do in terms of reserves. Also, the Board was under a mandate to equalize the reserve requirements of central reserve and reserve city banks, and this was complicated by the fact that at the moment, at least, the greater pressure appeared to be in the reserve city and country bank sector. If it was simply a matter of trying to supply reserves to the economy, one would look there first.

The problem, the Chairman said, was not easy to handle on a piecemeal basis. A schedule of actions over a period of time would be desirable, and the Board had spent some time on this, but the problem was not easy. The Board had not come up with anything as yet that it would want to try to sell. A general impression outside the System seemed to be that this was something that could be turned on and off like a faucet, but it was not that simple a problem. The Board must continue to wrestle with it, and he did not know whether it would be possible to work out a package operation.

Chairman Martin said he did not think he would want to change the directive at this meeting, although that was something for the Committee to consider. As he saw it, the Committee ought to continue trend in the direction in which it had been moving. Its posture ought to be clear, and at the first opportunity, assuming the present situation continued, the System should lower the discount rate. That would be several weeks away, the visibility might become greater in the interim, and he did not think anything precipitate should be done now. As a matter of fact, he did not think action would be feasible from a practical standpoint. The earliest possible date would be Thursday, which would be when the Treasury announced its financing, and action would not be appropriate at that particular juncture. The payment date would be August 15, he noted, and there would be a meeting of the Open Market Committee the following day. These were dangerous things to talk about in a large group, but at the August 16 meeting there would be an opportunity to consider whether a move on the discount rate would seem desirable.

In the meantime, the Chairman said, it was his view that the System should be supplying reserves at every opportunity. Certainly, the odds were in favor of trending toward ease. There was nothing to lose, and the trend could be reversed quickly. If there should be a big upswing in the fall, the problem could be met when it came.

The Chairman said that he felt the Committee was remarkably unanimous in its thinking this morning. He then referred again to the matter of the directive and asked Mr. Balderston whether the latter had any further comments.

Mr. Balderston said he now thought that perhaps the next meeting would be an appropriate time to change the directive. He did not believe that switching from net borrowed reserves of $200 million to free reserves of $200 million represented a moderate increase. However, he was sensitive to the fact that this was a week of Treasury financing.

Chairman Martin commented that this was one of the things in his mind as a reason for continuing the present directive.

Mr. Balderston then repeated that he had now concluded that a change in the directive at the next meeting might be more appropriate.

Accordingly, the Chairman stated that if there was no objection the directive would be renewed without change. He went on to say that it seemed difficult to provide much more guidance for the Desk on the volume of reserves than was available from the go-around at this meeting. He then inquired whether there were other comments regarding the discussion, and no disposition toward further discussion was indicated.

Thereupon, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York, until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion, 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.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, August 16, 1960, and that the succeeding meeting would be scheduled for Tuesday, September 13, 1960.

The meeting then adjourned.

Assistant Secretary