

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, September 22, 1959, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Deming
Mr. Erickson
Mr. Johns
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Bopp, Fulton, Bryan, and Leedy, Alternate Members of the Federal Open Market Committee

Messrs. Leach, Irons, and Mangels, Presidents of the Federal Reserve Banks of Richmond, Dallas, and San Francisco, respectively

Mr. Riefler, Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Jones, Parsons, Roosa, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Mr. Scanlon, First Vice President, Federal Reserve Bank of Chicago

Messrs. Ellis, Hostetler, Daane, and Tow, Vice Presidents of the Federal Reserve Banks of Boston, Cleveland, Richmond, and Kansas City, respectively

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Mr. Einzig, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia
Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Economist, Federal Reserve Bank of Atlanta

Mr. Knipe, Consultant to the Chairman, Board of Governors

Chairman Martin stated that, unless there was objection, he would like to have Mr. James L. Knipe, Consultant to the Chairman, attend the meeting. There being no objection, Mr. Knipe entered the room.

Upon motion duly made and seconded and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on August 18 and September 1, 1959, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period September 1 through September 16, 1959, and a supplementary report covering the period September 17 through September 21, 1959. Copies of both reports have been placed in the files of the Committee.

Mr. Rouse supplemented the written reports with a statement as follows:

The most significant development of the past three weeks has been the deterioration in the atmosphere of the Government securities market. This reached a climax early last week. At that time rates on Treasury bills reached new high levels, with the longest outstanding bills bid at above 5 per cent. Also at that time it was reported to us that some dealers were reluctant

to make good markets in bills and were operating on an order basis. This was an extreme, and there has been some improvement in the market since that time. Indications are, however, that the improvement is mainly technical since there has been no real change in the basic factors that underlie the widespread pessimism that characterizes the market.

The market's pessimism grows out of the interrelation of two basic factors. The first is the heavy current and prospective demands for credit by the private sector and by the Treasury, and the second is the fact that the Treasury's needs will have to be met through resort to short-term financing. Credit demands of the private sector of the economy have already been extraordinarily large, and we are just entering the period of a seasonal buildup of such demands. There is a widespread belief that the economy shows sufficient underlying strength to surge ahead rapidly at the conclusion of the steel strike and that this will bring with it further unusual demands for credit by the private sector. The Treasury's needs for funds will be substantial over the next few months, beginning with about \$3.5-4.0 billion in October. Furthermore, and quite apart from these immediate needs, there is a growing concern over the fiscal situation generally, since indications point to continuing, if reduced, budgetary deficits. The midyear budget review should be released shortly in view of the adjournment of Congress a week ago. Against the background of these heavy current and prospective demands for credit, the failure of Congress to come to grips with the interest rate ceiling on marketable Treasury bonds has had a pervasive influence. First, as I noted earlier, the failure of Congress to act means that the Treasury will have to resort over the next few months to the short end of the market to meet its needs. Secondly, that failure has raised fundamental questions as to whether this country is really capable of keeping its fiscal affairs in order.

While the market anticipates large and growing demands for credit stemming from the demand influences I just mentioned, it also anticipates that the System will not abdicate its responsibilities and freely provide the funds to meet all these demands. It is expected that restraints over the creation of credit will continue.

These fundamental influences of demand and supply for credit have led to a general conviction that interest rates, which are already at the highest point in a quarter of a century, will rise still further. This conviction was heightened in the past three weeks by more immediate influences which played an important role in the extreme pessimism that emerged in the market early last week. First, the large

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demands for liquidity around the mid-September tax and dividend dates caused an excessive supply of Treasury bills to appear in the market as corporate demand virtually dried up and as repurchase agreements which corporations had made with dealers matured; corporations also engaged in some outright liquidation of bills. Furthermore, bank reserve positions came under increased strain as banks accommodated the heavy mid-September demand for loans, and hence some banks also sought to liquidate Treasury bills. The second of the more immediate influences on the market was the focusing of attention on the large prospective demand for credit in the immediate future. The announcement of the Treasury's October cash financing is only ten days away. Furthermore, a heavy calendar of Government agency financing will be superimposed on the Treasury's operation. This agency financing is highlighted by the developing plans of the Federal Home Loan Banks to borrow a total of \$300 million new money between now and early November and the difficulties facing the Federal Land Bank in the refinancing of its October 20 maturity in view of the latter's legal limitation of a 5 per cent rate exclusive of commission. Another influence on the market during the past three weeks was the appearance of a press article in a national publication which called attention to the dangers inherent in the current fiscal situation and which went so far as to suggest that a "money panic" might develop. Furthermore, the publication in the New York Bank's Monthly Review of an article dealing with the discount window led some to believe that access to the window might be sharply curtailed although locally it was recognized as a description of the way the window has operated over a number of years. The publication of the first of these articles, and the interpretation placed on the second, are symptomatic of the state of mind of the market as it approaches the Treasury cash financing. That state of mind is one of underlying pessimism that, given the strong current and prospective demand for credit, and its limited availability, interest rates--including the discount rate--will increase. It is in such an underlying atmosphere that the Treasury must set terms on its financing next week. It looks as though the Treasury will need help from the underwriters in this financing, i.e., from the large banks from coast to coast.

At a recent meeting of the Committee there was discussion of the prospective investment by the International Monetary Fund of an additional \$300 million of Treasury bills. We have been working, in conjunction with Mr. Thomas and Mr. Riefler, with the IMF on an investment program for this \$300 million.

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A part of that amount, \$100 million, became available last week, and we have thus far bought \$22 million bills, and have tendered for \$8 million, in working toward the program adopted by the Fund. We have discretion as to the timing of these purchases and as to the issues purchased under the program.

This statement may appear pessimistic since the market has been somewhat better in the last few days, but the bidding in yesterday's auction showed a considerable lack of interest, even though the average rate at which bills were allocated had fallen from the previous week.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period September 1 through September 21, 1959, were approved, ratified, and confirmed.

Members of the staff of the Board of Governors entered the room at this point for the purpose of presenting a review of the economic and credit situation in the form of a chart show. Copies of the script, Economic Situation After the Steel Strike, and of the accompanying charts were sent to the members of the Committee following the meeting, and copies also have been placed in the Committee files.

Mr. Young introduced the economic review with the following statement:

From the spring of 1958 through June this year recovery in economic activity was rapid and uninterrupted. In 14 months, industrial production rose 23 per cent to a point about 7 per cent above the prerecession level of mid-1957. After June, production in industries not directly affected by the steel and copper strikes rose somewhat, but the total index declined from 155 in June to 149 in August.

For all goods and services the rise in output was \$53 billion or 12 per cent, almost all in physical

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volume. This increase reflected chiefly a major advance in consumer spending, which had declined little during the recession; an upsurge in residential building; a dramatic shift from rapid inventory liquidation to rapid accumulation; and an increase in Government expenditures. Business capital outlays, which declined until the third quarter of 1958, have risen since then. In the current quarter, despite the strike, GNP may be above the second quarter annual rate of about \$485 billion.

With production rising, profit margins have widened and profits--which had dropped sharply--have risen well above prerecession levels. Reflecting market views as to prospects for earnings and capital values, prices of common stocks by this summer had advanced two-fifths and were one-fourth higher than in mid-1957. In recent weeks they have declined and at yesterday's close were 8 per cent below their high of early August.

Stock prices rose much more than dividends and stock yields declined sharply. Meanwhile, yields on bonds rose to levels far above those on stocks and the spread for some time now has been unusual.

Expansion in business, consumer, and Government demands for goods and services has been facilitated by a rapid rise in credit outstanding. Federal requirements for funds have been high this year partly as a result of the delayed impact of the recession in reducing revenues. In capital markets, corporate flotations have been at a more moderate pace this year.

Abroad, activity this year has expanded considerably and in some countries such as Germany and the Netherlands demand for labor is beginning to press on the available supply. In Japan industrial output is up even more than in the United States. Gold and foreign exchange reserves of many countries have been greatly strengthened. Foreign demands for U. S. goods were declining until last spring but are now on the increase, while shipments to the United States are no longer rapidly rising.

As is usual in a recovery period, the initial effects of increased demands have been largely to increase production rather than to raise prices. Sensitive materials have advanced about 10 per cent, as they did from early 1954 to mid-1955. Industrial commodities have shown an increase somewhat larger than that before mid-1955, but perhaps not as large as might have been expected in view of the greater increase in industrial production this time.

As in the period from early 1954 to mid-1955, farm prices have declined considerably during the recovery period

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and, as a result of offsetting changes, the index of all wholesale prices has shown little change.

Whether market pressures, domestic and international, will bring about a marked rise in industrial prices such as developed after mid-1955, is a central current question. Closely related questions are whether, after activity is resumed at steel mills, total output will be appreciably higher than before the strike, and if so, how closely it will approach the limits of our expanded capacity.

Events of the past year and a half suggest that activity may rise considerably in the period ahead but do not provide assurance that substantially higher levels can be reached without strong upward pressures on prices. One encouraging feature of the current situation is evidence of some free productive capacity at a time of record final demand and of rapid inventory rebuilding.

Another encouraging feature is the prospect for balancing of the Federal budget in fiscal 1960, after a deficit of \$13 billion in fiscal 1959, a fact not to be lost sight of because of present Treasury financing difficulties--although it may be regretted that a surplus is not being achieved.

Money rates now are higher than at any time in 1953 or 1957 and considerably higher than in mid-1955. Net borrowed reserves are at the level reached at the end of 1955. Corporations and banks are in less liquid positions than at this stage in some earlier cycles--although corporations have substantial holdings of Government securities.

One prospect after steel production is resumed is a generation of demands from many sources in a short period, carrying activity to a very high level in relation to capacity and putting industrial prices under strong upward pressure. However, some features of the current situation suggest that anti-inflationary monetary policy is beginning to temper business and investor exuberance in forward expectation and planning. In this more realistic environment, strike settlement might be followed by more orderly expansion of economic activity from present high levels without inflationary price advances.

The presentation was concluded by Mr. Thomas with substantially the following remarks:

Uneasiness about the state of money markets, plus the hard facts of heavy Treasury financing in the period immediately ahead and peak demands for private credit, are

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among the important elements that need to be considered in appraising the general business and financial situation.

The postwar years, like the 1920's, have been years of strong upward push in demand and production. Real gross product has grown at a substantial rate, with only three important interruptions--in 1949, 1954, and 1958--and these turned out to be mostly inventory adjustments. Demand in fact has been so strong that the basic problem of monetary policy has been to hold credit within bounds in order to discourage speculative spurts in demand and prices and thereby promote sustainable growth in output. It is to be hoped that through such restraints the speculative excesses of the late 1920's and the credit collapse of the 1930's may be avoided.

A continuing problem in promoting orderly growth and maintaining stable prices has been the development of cumulative forces during various phases of the business cycle. In fact, in contrast to the 1920's, price increases during boom periods--immediately after the war, during the Korean period, and even in the period of high activity from 1955 to 1957--have been great enough, along with failure of prices to decline during recession, to lend support to the view that creeping inflation is inevitable--and perhaps even essential for continued growth. Acceptance of this view by many people in business, academic circles, and Government, lies at the heart of many of the difficult problems that face the System at this time.

A basic issue at this stage of the cycle is whether further substantial expansion can be achieved in the near future without distortions in prices, production, and incomes that would prevent sustained growth over a considerable period and also place new difficulties in the way of international balance-of-payments adjustment. Increasing demands after mid-1955 resulted in relatively small increases in output but marked advances in prices; the rise in gross product in current dollars was much greater than in real terms. Distortions such as undue inventory accumulation, too hasty capital expansion in some areas, too rapid a rise in debt burden, and consumer resistance to price increases undermined the prevailing high activity and led to the recession of 1957-58. During these years the United States also failed to strengthen its international competitive position. Can that type of development be avoided this time?

As has already been indicated, the existence of somewhat larger industrial capacity in relation to current production and the agricultural supply situation provide reason to think

that price advances as rapid as those that occurred after mid-1955 can be avoided. Moreover, the strengthened competitive position of other industrial countries and their restraints on inflationary developments may also help to hold down price rises in this country. But if actions are taken to stimulate demand and to raise costs and prices, and if expectations of inflationary developments continue, efforts to prevent rising prices and to achieve this goal of sustained growth may be thwarted.

Expansion in economic activity and price increases in recent years have been accompanied by persistently heavy demands for credit and by growth in total debt, in the bank credit component, in the money supply, and in other liquid assets. When private credit demands have slackened in some areas, governmental borrowing has generally increased. Demands for mortgage credit have been persistently strong with variations in the amounts extended determined by other competing demands. Savings have increased along with the growth of income, with significant variations among the various sectors--consumers, business, and Government.

A significant feature of credit developments has been the proportion of savings that has gone into consumer indebtedness, including mortgages, and into governmental debt, relative to investment for expansion of productive capacity. An essential for the promotion of sustainable growth with stable prices is the maintenance of an appropriate balance of consumption, savings, and investment of the type that contributes to expansion in output. This is a combined problem of fiscal, debt management, and monetary policies and of private actions with respect to costs, prices, and long-term commitments.

Money supply, which is the responsibility of the Federal Reserve, has expanded during recent years. The growth has generally not been as great as that in GNP at constant prices, and GNP in current prices has risen at an even faster pace. Turnover of money, therefore, has increased, reflecting in part the utilization of money substitutes, some of which were accumulated in the past and some currently.

Debt management and Government actions to insure or guarantee values of various forms of indebtedness and to enhance their liquidity have contributed to the growth of over-all liquidity other than cash balances. The sharp increase in short-term Treasury obligations outstanding and the virtual impossibility of decreasing them, particularly in view of existing interest rate ceilings, is a factor that must be considered in determining the appropriate level of the money supply and the availability of bank credit. It is likewise

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a factor that may be expected to produce money market pressures whenever heavy cash needs emerge--as illustrated by last week's developments.

The idea that in such a situation the Federal Reserve System should do something--beyond meeting seasonal needs--to ease the financial strain or to prevent further tightening, may be supported by arguing that the situation in financial markets is becoming disorderly--an argument which at some point might have some validity--or on the ground that public and private demands for credit should not be restricted because its restriction will limit growth and economic activity. However, in view of the present levels of activity and the prospect for higher levels when output of steel is resumed, and in view of upward pressures on costs and prices, the need for maintaining restraints seems persuasive.

Another question of great importance to the System at the present time is how much positive value there is in large increases in interest rates as a restraining factor in themselves, apart from the basic weapon for limiting growth of credit availability in the face of increasing demands for funds. Clearly, high interest rates help towards balance-of-payments equilibrium, and clearly the healthy functioning of the whole interest rate structure is essential for the market's allocation of supply to meet competing demands. Under the circumstances likely to prevail in the months ahead, increasing the availability of credit for the purpose of keeping interest rates from rising can provide no assurance of either stable money markets or the allocation of resources in a manner that will maintain sustainable growth.

Supplementing this broad review of economic forces, comments may be added about certain specific aspects of the immediate situation: (1) Partial figures for city banks for September 16 indicate that in the past three weeks bank credit supplied may not have been quite as large as usual during the September tax period; (2) demand deposit expansion at city banks also appears to have been somewhat smaller than usual, following a seasonally-adjusted decline in August, and correspondingly required reserves have increased less than projected three weeks ago; and (3) projections of reserve needs for the future indicate that to maintain about the recent degree of restraint and cover seasonal demands, about \$100 million of additional reserves should be supplied in each of the next three weeks. Additional amounts will be needed in November and December.

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There being no questions regarding the economic and financial review, Chairman Martin next called upon Mr. Hayes, who commented as follows:

The lull in business activity reflecting mainly the slowly spreading effects of the steel strike has developed about as expected. For August we have seen a fairly sharp drop in industrial production, a small increase in seasonally adjusted unemployment, and a slight decline in retail sales. The Second District has been affected somewhat less than the nation as a whole.

One of the strongest factors in the outlook is the upward trend of private expenditures on plant and equipment. Earlier estimates have been raised, with a 9 per cent gain now expected for the full year 1959 over 1958, and a considerably higher annual rate in the last quarter. Residential housing volume, while perhaps limited somewhat by the cost and availability of mortgage money, has held up better than had been expected.

As is so often the case, the price situation is not clear cut. The index of wholesale prices was down in August, especially in the area of farm products and processed foods, whereas the consumer price index showed a disturbing upward tendency through July, the latest month for which it has been reported. Recent wage settlements and price developments in several industries justify some uneasiness. Stock prices have dropped about 7 or 8 per cent in the past six weeks--the decline being attributed to the steel strike, rising interest rates, and some drying up of interest on the part of large investors at current advanced prices.

It seems well to recognize that a real showdown is in process in the current struggle in the steel industry. There is therefore a possibility at least that a rather lengthy period of strike-induced stagnation is in sight. On the other hand, I think the probabilities are strongly in favor of a rapid recovery as soon as the strike ends, perhaps developing boom characteristics.

In the area of bank credit the most striking development since the preceding meeting is the sharp drop in the seasonally adjusted money supply reported for August. We estimate a money supply increase for the past four months at an annual rate of 1 per cent, as against about 2-1/2 per cent in the past twelve months. The comparable 12-month

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period in 1954-55 showed a 3.8 per cent rise, suggesting that the record of early action to combat inflation has been more impressive this time than in the previous business expansion. The rise in bank loans in August was at a record level; and while the banks have continued to be able and willing to dispose of Government securities at a record rate, the net effect has been to make them increasingly illiquid.

We are of course again confronted with a difficult Treasury financing operation--a cash offering of perhaps \$3.5 billion--with the market apprehensive in view of the very sharp run-up in interest rates on Treasury securities and other market paper in recent weeks, some of which reflected a sharp reversal in corporate demand for Governments as well as the growing illiquidity of the banks. This, combined with the spreading public view that credit may be becoming unavailable, suggests a situation in which I believe we should adopt a cautious attitude. Last week our directors expressed the fear that we might be pressing the economy a little too hard.

I would certainly not advocate any change in our basic policy of credit restraint. However, having confirmed that policy publicly with our latest discount rate increase, I think we can well afford to recognize the Treasury's problem and the pressure of seasonal demands for credit and to try to take some of the sharp edge off the present policy of restraint with a view to helping the market achieve at least some temporary rate stability. We should make clear our readiness to provide for seasonal needs. It would be better to put out some reserves now in a modest amount rather than run the risk of subsequent knots in the market that would require a large injection of reserves. I think the Manager should be given considerable leeway, with the understanding that any shading in the degree of restraint should be handled in such a way as to avoid any erroneous impression of a change in basic policy. It seems to me that the directive should be continued as it is.

Mr. Erickson said that the economy in the Boston District continued to be healthy. Whatever softness there was in the statistics seemed due to seasonal factors rather than to the steel strike or to basic weaknesses in the economy. The industrial production index went down 1 per cent in July and was expected to decrease further in August, he said, and department store sales in three of the four most

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recent weeks were off 8 per cent compared with last year, probably reflecting weather conditions. The drop in nonagricultural employment in July of this year was less than in either 1957 or 1958, and insured unemployment had been down in five of the last six weeks. At savings banks, deposits showed a 6 per cent increase and mortgages a 10 per cent increase compared with a year ago. All information indicated that the steel strike had had only small effect on the First District, Mr. Erickson said, noting that carloadings in the seven weeks of the strike decreased less than 4 per cent in that area compared with an 11 per cent decrease for the nation.

Speaking of monetary policy for the next three weeks, Mr. Erickson said he would be inclined to leave open market operations to the Desk and to keep the same degree of restraint without increasing it in any way. He would make no change in the directive at this time.

Mr. Irons said there had been no important basic changes in economic activity in the Eleventh District recently. The oil industry continued on a nine-day allowable and he doubted whether there would be much change in the district oil situation over the next two or three months. Agricultural conditions were favorable and this should be a good year in that field. Department store sales were excellent during August. Employment had improved and unemployment as a percentage of labor force was running substantially lower than nationally. Construction had declined during the past month. The

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effects of the steel strike had not been significant in the Eleventh District thus far. Demand for bank loans continued strong, but the rise had been tempered over the past three weeks. Member bank borrowing at the Reserve Bank averaged lower in August than in July. Pressure on banks continued heavy, Mr. Irons said, and their liquidity positions continued relatively low with ratios of loans to deposits high.

Mr. Irons said that he felt operations for the System Account had been quite satisfactory during the past three weeks, with continued pressure in the money market that had not been entirely reflected in the statistics. During the next few weeks reserves should be provided as needed, neither anticipatory nor reluctantly but as the situation evolved. Mr. Irons felt it particularly important for the System Account to be free to operate as needed according to the tone and feel of the market during this period. He would like to continue the present degree of restriction, but recalling that over the past several months he had expressed a view that deviations be on the side of restraint, he now was inclined to feel that in this period it would be more appropriate that any deviations be on the side of less restraint. This was because he believed less damage would be done in the period of rising seasonal demands for credit just ahead, when the market would tend to tighten itself anyway, by resolving doubts in that way than if they deviated on the side of restraint. He would not change the discount rate or the directive at this time.

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Mr. Mangels reported figures for California showing mid-August employment at an all-time record high level. Unemployment had dropped to 3.4 per cent of the labor force, the lowest percentage in two years. In the Pacific Northwest the present high rate of employment reflected a later than usual expansion in agricultural employment rather than in general activity. Seasonal cutbacks in that area during October were expected with increasing unemployment during the winter in various industries. Consumer spending continued high, department store sales increasing 11 per cent over 1958 for the year to date and 12 per cent in the four weeks ending September 15. Consumer borrowings also had been increasing.

Mr. Mangels referred to the effects of the strike in copper mining in Utah, noting that banks reported some requests for extensions on loans because of this factor, although it had not yet become a serious problem. He also commented that tax receipts for the State of Utah would be affected adversely because of the copper strike. Residential construction was still a little higher than last year but was declining from month to month.

After reporting that a proposed \$100 million issue of school bonds in the State of California had been reduced to \$50 million and that it had been sold at a yield of 4.01 per cent, Mr. Mangels said that bankers were emphasizing the feeling of tightness in the money market even though loans were showing increases during the past several weeks. This increase in loans, however, was offset by sales

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of Government securities. However, Twelfth District banks were net sellers of Federal funds in this period and borrowings from the Federal Reserve Bank had been quite low.

Mr. Mangels said that consideration of the factors reviewed led him to the conclusion that, while Committee policy should not be modified, there should be no increase in the degree of restraint and the Federal Reserve should be willing to supply freely legitimate credit needs between now and the end of the year as seasonal demands increased. He would make no change in the Committee's directive.

Mr. Deming said that the long steel strike and the short small-grain crop were likely to have a double effect on the Ninth District economy. The steel strike effects had been masked partly by an excellent tourist season, but after Labor Day when the tourist season ended the effects of the strike had begun to show up in the district, particularly in the areas directly affected. Considerable seasonal unemployment in the mining areas was anticipated this winter and, for reasons that he outlined, income in the mining areas would be severely affected even if the steel strike is settled soon. The closely balanced budget of the State of Minnesota would also be affected adversely by the steel strike. Cash farm income was likely to be reduced by 13 to 15 per cent during current crop year, Mr. Deming said, and the combination of the effects of the steel and copper strikes and the reduced farm income would undoubtedly have a dragging effect on the district's economy during the next twelve

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months. The district would probably tag behind the rest of the country.

Mr. Deming said he saw no reason to change the Committee's directive or the discount rates of the Federal Reserve Banks at this time. He agreed that there should be no increase in the degree of restraint through open market operations or otherwise in the light of all of the factors that had been mentioned at this meeting. He would resolve doubts in carrying out policy on the side of ease rather than of restraint during the coming weeks.

Mr. Allen commented that the steel supply situation was the subject of greatest current interest and concern in the Seventh District. Although deteriorating at an accelerated pace, the transition from adequate to inadequate steel supplies had not been as abrupt as suggested by press reports. About ten million tons of the steel on hand at the beginning of the strike were believed to have been used up by mid-September, leaving about twelve to thirteen million tons on hand at present, or about the amount held at the beginning of 1959. This sizable tonnage did not adequately measure the current steel supply, however, because some firms held relatively large supplies, because of the problem of mix of inventory, because some steel was in speculative channels and would stay there, and because some users would be slow to deplete stocks below their basic LIFO stock on December 31.

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Newspaper reports notwithstanding, Mr. Allen said that reports in the automobile industry indicated that steel inventories would permit it to operate at scheduled rates of production at least until October 15 and possibly until October 31. If as reported the steel industry could reach 60 per cent of capacity by the end of the first week of production after the end of the strike and 90 per cent by the end of the second week, and if the mills went back into operation soon after October 1, there might be little, if any, hesitation in automobile production.

Loan expansion at reporting member banks had slackened over the past three weeks, Mr. Allen said, security loans having been paid down and real estate loans having been virtually unchanged. Consumer loans continued strong. The most striking feature was the decline in growth of loans to business, he said. Factors contributing to this included the high degree of corporate liquidity and accumulation of tax funds as manufacturers of metal products liquidated inventories. Despite the slow-down in loan growth, bank reserve positions had become tighter, particularly in the larger centers where deposits were down rather sharply, although the tightness of Chicago banks had become no greater than in late spring or early summer. Increased reserve pressures had appeared in Detroit and Milwaukee as well as Chicago. On the other hand, country banks had reduced their borrowings somewhat from the unusually high levels of recent months.

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Mr. Allen said he felt the Committee should maintain approximately the current degree of restraint. He hoped and he believed that the high cost of money was beginning to bite. He thought there would be an increased bite resulting from the policy that the Committee had been following, but he could see no reason now to change what the Committee was doing. As Mr. Thomas had noted, additional reserves would be needed to meet seasonal demands between now and the end of the year. Mr. Allen said that he would make no change in the directive at this time, although he hoped the time would come soon when the reference to expanding employment opportunities might be removed from clause (b) of the first paragraph.

Mr. Leedy said that Tenth District conditions continued strong even though output of agriculture, particularly of wheat, was smaller this year than last. There was some concern as to the prices of livestock and banks lending on livestock were said to have attempted to cut back such loans and to require additional security. Insured unemployment continued at a lower level than in the nation as a whole. Department store sales since the first of this year continued to show gains which have been exceeded only in the Twelfth District. Member banks reported a slight increase in loans in the past three weeks, but there had been some reduction in demands on the Kansas City Reserve Bank discount window.

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Mr. Leedy said he subscribed to what had been said thus far regarding policy for the coming weeks. He would continue what the Committee has been doing, making every effort not to tighten any further. He would not anticipate the seasonal needs that were coming up but he would readily respond as the needs actually appeared. With the recent increase in the discount rate, with no change in credit policy, and with the Treasury financing needs this fall, it would be inappropriate to change the directive at this time or otherwise to change any policy indicators.

Mr. Leach said that the Fifth District economy had been largely unaffected by the steel strike except in specific areas such as Baltimore and the West Virginia mining centers. This was because the district's economic structure predominantly was not directly and immediately tied in with activity in the steel industry. The textile industry remained in strong position with virtually no possibility of scheduling new orders for 1959 delivery in many lines. Furniture orders picked up strongly in midsummer, putting unfilled orders at the highest level in the current expansion. Bituminous coal production was at a reduced level because of the continuing steel strike. Cigarette sales for 1959 through August established a new record well above that of 1958. The rise in cigarette sales was said to reflect an increase in the number of smokers among teenagers and women. The continuing popularity of filter tips and the growing boom in menthols was primarily responsible for this year's rise.

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Loan demand kept district banks under pressure through the first week in September, Mr. Leach said, this being evidenced by continued reduction in investments, by a high level of borrowings from the Federal Reserve, and by net Federal funds purchases. A temporary inflow of funds during the past week enabled banks to reduce borrowings at the Federal Reserve sharply and to sell Federal funds.

Mr. Leach said that he felt it would be inappropriate to tighten credit any further at this time in view of the current weakness in the Government securities market, the impending Treasury financing, and the continuance of the steel strike with its secondary effects becoming more and more pronounced. At the moment, he would resolve doubts on the side of ease while maintaining approximately the present degree of restraint and recognizing that the need for further restraint may well reappear in the near future. He would not advocate a change in the directive.

Mr. Mills said that he was in general agreement with Mr. Hayes' appraisal of the economic and financial situation and with the recommendations that he had suggested as to current policy. He had grave fears, however, that the Federal Reserve System was drifting into a position of clinging dogmatically to policies and theories that in the light of current developments deserved a thoroughgoing rethinking. He pointed particularly to the psychological factors that clouded the market and which should be a

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matter of first concern in the Committee's policy developments, adding that he did not believe the Committee could ignore the effects on general thinking of the decline in the stock market or the fears that had been expressed about a Federal Reserve policy that would so restrict the availability of credit as to handicap the normal growth of the business community and the regional economy. Mr. Mills said that it might be superstition, but he recalled clearly many years ago the Hatray failure in London that unlocked the doors to a financial collapse, and he read only yesterday of the Jasper situation that had developed there and which conceivably could foretell a similar development in that market. We in the United States, he said, must continue to be the element of strength in the international picture and should bend our greatest efforts toward maintaining the sort of strength and the sort of posture that would give the greatest assurance internationally. He doubted whether that confidence would be strengthened if we continually expressed a lack of confidence in our own ability to maintain a viable economy. If at some point it should be the desire of the Committee to ease the situation of the commercial banking system moderately (he believed in restraint), and when the Committee arrived at the point of wishing to supply reserves, a moderate shift should be engaged in very cautiously. This was because the abnormally high level of member bank discounts at the Federal Reserve Banks has had the effect of feeding reserves into the Federal funds market which would

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not be extinguished simultaneously with an expected reduction in the volume of discounting, and as a result when new reserves were additionally supplied a superfluity of reserves could occur that might erroneously give rise to an impression of a reversal rather than a moderation of System policy.

After referring to the information presented by the staff regarding economic conditions, Mr. Robertson stated that it was clear from that presentation that the economy was on the edge of a boom. He could see some evidence that during the past three weeks the policy the Committee had been following had, as Mr. Allen had commented, begun to bite. In Mr. Robertson's view this was wholesome. He could see no indication that the Federal Reserve was pressing too hard on restraint, and he would recommend that the Committee maintain the same degree of tightness that now prevailed throughout the forthcoming Treasury financing period. He differed perhaps from some others who had spoken this morning only in that he would not resolve doubts on the side of ease. He would hope there would be no doubts to resolve and that Account operations would maintain an even position throughout this period.

Mr. Shepardson said that there seemed to be general agreement thus far on the approach to be taken in System operations during the next few weeks, with fine shadings of views as to just exactly what the position should be. He was inclined to feel as Mr. Irons had expressed himself, that is, that with seasonal demands adding

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pressure during the next few weeks there would be less danger if the Committee's operations were to err on the side of ease than if doubts were resolved on the side of increased tightness. He would prefer to hold as nearly as possible to the present position, with a recommendation that if a drop in the degree of pressure became evident the seasonal demand for credit would be permitted to restore the present position.

Mr. King said that he agreed generally with the comments made at this meeting, more specifically with those of Messrs. Hayes, Irons, and Shepardson. The need for additional reserves to meet the seasonal rise had been well pointed up and there was no question in his mind but that the System should do everything appropriate to supply the reserves necessary for this purpose. With reference to comments that there might be a resumption of boom conditions when the steel strike ended, Mr. King commented that he doubted industry would run out of steel before the strike was settled. The fact that the strike thus far had had little effect on other parts of the economy made him think that its settlement might not spur activity generally. His discussions with businessmen led him to believe that the economy was not on the verge of a new boom. Repeating that he agreed with the policy suggestion of Mr. Hayes, Mr. King said that he would make no change in the directive at this time but would hope that the financing needs during the fall months would be met through System operations.

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Mr. Fulton described conditions in the steel industry as he observed them in the Fourth District, commenting that in so far as the strike was concerned both management and labor appeared to be standing adamantly on the original premises they had expressed. He doubted that a noninflationary contract would result in the end. There had been rather few complaints as to shortages of steel, but inventories were becoming unbalanced. A rapid rise in unemployment might result from this factor within the next week or two. Mr. Fulton said he was not quite as sanguine as Mr. Allen regarding a rapid rise in output in steel within the first two weeks after the strike was settled. In fact, his information was that 90 per cent capacity operations would not be attained for some little time after production had been resumed.

Mr. Fulton reported that department store sales in the Fourth District were holding up well during the current month although unemployment claims had been rising. Construction had declined and there was concern regarding the level of housing activity the latter part of this year. Loan demands were substantial but banks had not been coming to the Reserve Bank's discount window in inordinate amounts.

Monetary policy, Mr. Fulton said, should aim toward continuing the degree of restraint that now existed. Normal fall demands would tighten credit and he would favor erring a little on the side of ease, believing that this could be done without doing violence to the Federal Reserve's position.

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Mr. Fulton went on to say that he would like to see an effort made to get part of member banks' vault cash counted as reserves as would be permitted under the new reserve requirements law. He hoped that this could be done during the fall of 1959, thus reducing the need for putting so much in the way of reserves into the market through Account operations. He would make no change in the Committee's directive or in the discount rate at the present time.

Mr. Bopp commented on the discussions that directors of the Federal Reserve Bank of Philadelphia had regarding a change in the discount rate subsequent to the meeting of the Federal Open Market Committee on September 1, his remarks being for the purpose of indicating that the fact the Philadelphia Bank was the last of the Reserve Banks to raise its discount rate from 3-1/2 to 4 per cent in no way indicated that the directors of the Bank were reluctant to take such action.

With respect to economic developments, Mr. Bopp said that secondary unemployment in the Third District resulting from the steel strike had increased only moderately during the past three weeks. Few steel fabricators in the Philadelphia region had been compelled to shut down because of a shortage of steel, but some were reported to be running out of key items and the consensus was that the shortage of steel would become serious by the end of this month. Unless the strike was settled by that time many fabricators

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would face reduced operations or shutdowns. Mr. Bopp also commented on the industrial centers classified as chronic labor surplus areas, noting that five of the seventeen major areas so classified were in the Third District. This classification meant that such areas had an unemployment rate at least 50 per cent above the national average during four of the past five years. New claims in Philadelphia for unemployment insurance averaged somewhat less in the last three weeks and continued considerably below the corresponding period of 1958, he said, adding that the Pennsylvania Secretary of Labor and Industry had reported a few days ago that 78 plants in the State had shut down completely because of the steel strike. Philadelphia member banks increased their borrowings from the Reserve Bank in the latest week and also had been net purchasers of Federal funds recently.

Mr. Bopp said that he agreed in general with the statements that had been made regarding Committee policy during the next three weeks, that is, it should aim to maintain the present degree of restraint and should resolve any doubts on the side of ease. There should be no change now in the directive or in the discount rate.

Mr. Bryan commented that almost no new figures on economic activity in the Sixth District had become available since the meeting three weeks ago. At that meeting, he reported that construction contracts had declined sharply, but more recent information indicates that this measure has shown a reversal. August loan figures of banks showed an almost complete cessation of growth, but this probably was temporary.

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On the matter of national policy, Mr. Bryan said he subscribed to the policy implied by Mr. Hayes and by others who felt that the Committee should freely supply seasonal reserve needs and make its errors on the side of ease rather than restraint in the next few weeks. He added that he had been studying data regarding the long-run growth rates in reserves of the banking system and that, on any basis he had been able to arrive at, it appeared that by the end of this year there would have been no growth rate in reserves unless the Federal Reserve met seasonal needs and a little bit more. The System could easily get itself into the position of bringing about greater tightness this fall than it desired unless it freely supplied the amounts estimated for these seasonal needs, plus a little bit more.

Mr. Johns said that economic activity in the Eighth District gave no noticeable evidence of differing from the nation as a whole. Louisville had been affected by the scarcity of steel which already had resulted in curtailed operations at the General Electric appliance plant, and this had an especial impact on activities in that area because of the relatively large local importance of that industry. Mr. Johns said that his views as to policy accorded with those presented by Mr. Hayes.

Mr. Szymczak said that he did not believe the Committee could afford to change policy at this time. He felt that the Federal Reserve

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should have an operational attitude at the discount window and in the open market that would not create further tension or further tightness in the market.

Mr. Balderston recalled that three weeks ago he was one of those who felt the brakes should be applied more vigorously. Evidence that had come forward during the past three weeks had changed his view, however, at least for the moment. In this period the cumulative effects of System policy to which Mr. Mills had referred had become evident. A report this morning indicated that new orders had declined. The steel strike was showing no signs of termination. This was a strike, he noted, that involved working rules that affect the job security of union members, and he thought it might be an unusually difficult strike to settle. A resulting concern outside the steel industry might be inhibiting exuberance and delaying plant construction. For these and other reasons, Mr. Balderston said he would sense that some of the speculative fever that had disturbed him so greatly during the summer months and which was reflected in the stock market might for the moment have been reduced. Consequently, he would continue the policy of recent weeks but with a great deal of caution in order to avoid a psychological knot occurring.

Chairman Martin said that for his part he believed that System policy had been about right recently and that it was achieving the purpose that the members of the Committee had been seeking. One

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of the problems at the moment was to keep from having a psychological situation carry us away and into a position on one side or the other which would be inconsistent with the long-term objectives sought by the Committee. This was always true, he thought, when the expectation that the Committee must meet large seasonal requirements and the growth factor in the economy impinged on what the actual situation in the economy would be.

The imponderable at the moment was the steel industry. The Chairman said he did not think any of us could be certain what the result of the strike would be when it was settled. He was less optimistic about the result than he was several weeks ago and perhaps a little more optimistic about having the economy fall into a more stable state than then appeared likely. This was because psychology was now working toward having a stabilizing influence. The stock market had dropped somewhat and some of the fever seemed to have gone out of it. People were still worried about the availability of credit. We could not know whether the new model automobiles were going to click, and there was doubt as to whether the new small cars would sweep the country.

Until the picture was clearer, the Chairman's view was that the Committee should be cautious in its approach. He agreed with Mr. Szymczak because he believed the psychological problem that had been created by the failure of the Treasury to get relief from the Congress with respect to the interest rate ceiling and the

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unquestionable problem that faced the Treasury in its current financing, along with all the difficulties in the Government securities market, were matters of major concern to the Federal Reserve. He supported Mr. Robertson's view that it would be desirable to have perfection in the Committee's policy and operations, but he did not believe that the Committee could get perfection and he did not believe that it should ask the Desk to get perfection in its operations. Tone, color, and feel in the market were too difficult to measure. For this reason, he favored resolving whatever errors there were on the side of ease during the next three weeks. This was because he felt that the odds were on this side. Several weeks ago he felt that the odds were on the other side.

The Chairman went on to say that his observation of the comments at this meeting made him feel there was so little difference in the views expressed that it was unnecessary to elaborate on the understanding as to operations for the System Account during the next three weeks. It was clear that the majority favored no change in the directive and no change in the discount rate. It desired the same degree of restraint to be maintained, allowing for tone, color, and feel in the market, with a clear majority resolving whatever deviations there were from that policy on the side of ease and in favor of giving the Manager of the System Account the latitude that Mr. Hayes had requested for him. The Chairman inquired whether any of the members of the Committee differed with these comments and whether any wished to be recorded in

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the minutes of the meeting as holding views other than those that would be recorded in their comments during the go-around.

Mr. Mills said that the question of the record of policy actions of the Committee had come up before and that perhaps the Committee would like at some time to consider whether the policy record truly recorded the actions of the Committee. These actions were recorded as votes, he noted, but in his view, the actions were not based on votes. The Committee reached a general consensus through discussion, and the Chairman then asked whether there was a difference of opinion. In Mr. Mills' view, that did not constitute a vote, and personally, he did not think it possible to take a vote on problems of the sort that come up in Open Market meetings. He contrasted the procedure at Open Market meetings with that in meetings of the Board of Governors or in Boards of Directors of the Reserve Banks, where the procedure and nature of problems made possible specific votes on matters concerning which there was no difficulty in reaching formal decisions by the members. He suggested that the opposite was true in the Open Market meetings, where the members came to draw on the thinking of others and to have the benefit of the regional reports of those present. When all of that thinking was distilled, there was a general area of agreement that could not, in Mr. Mills' opinion, be recorded in a vote. The difficult task of drafting the Open Market policy record called for indicating a consensus by drawing shades of opinion so that the impression would not be gathered by the reading public

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that there was unanimity in a group as diverse as this.

Chairman Martin said that he was glad Mr. Mills had raised this question. There had been a number of discussions of this matter in the past and there were differences of opinion as to how the record might be made most satisfactory. He thought it probable that the Chair had been in error at times in that it should have given individuals greater opportunity to vote against a policy decision on the record. As to Mr. Mills' question whether the policy record really gave the differences of opinion that were brought out in the meetings, Chairman Martin suggested that it would be desirable for all of the members of the Committee to review the minutes carefully and to give consideration to the matter in terms of the comments that Mr. Mills had made. This was not something that the Committee could come to a conclusion on in an offhand discussion, and he suggested that at a subsequent meeting a period be set aside during which there could be a full discussion of the subject and whether the Committee was developing the kind of policy record that it should have to meet its obligation to the Congress under the provisions of the Act. Chairman Martin said that shades of policy differences were difficult to record, but on the other hand, he intended to make it clear that whenever any individual member of the Committee wished to record a vote against a policy decision, he should have full opportunity for doing so and for recording that vote with whatever amplifying comments he wished to have in the record.

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Mr. Hayes said that he had sympathy with the position indicated by Mr. Mills. He had wondered whether, without recording a vote, the record of policy actions might state in a general way that there were differences of opinion in arriving at a policy decision.

Chairman Martin reiterated his suggestion that the Committee schedule a meeting before the end of this year at which it would discuss the character and nature of the policy record.

Mr. Hayes then mentioned the desirability of getting drafts of policy record entries currently, so that the shades of opinion expressed by the participants would not be lost with the passage of time. Chairman Martin responded that the secretariat was working on this and planned to get the entries to the members of the Committee earlier than in the past.

Governor Shepardson reverted to the discussion of policy at this meeting, stating that in this case the consensus was near universal. Although Mr. Robertson would have favored resolving doubts on the side of tightness, there seemed to be no other difference in the policy decision. Mr. Shepardson suggested that in a case such as this the writing of a record of the policy decision could include a sentence that would cover this one shade of difference.

Chairman Martin said he understood this to be the thing Mr. Mills was suggesting, but he felt that it would be desirable for the whole Committee to review the matter and think it through in terms of the entire record. He also agreed with a suggestion by Mr. Szymczak that it would be desirable for anyone wishing to do so to send the

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Secretary comments on the form of the policy record. This should be taken, he suggested, as an opportunity for anyone who had any disagreement with the present form of the policy record to express his views and give his constructive suggestions, either in writing or at the meeting at which the subject would be discussed.

Following a question as to when drafts of 1959 policy record entries might be available, Mr. Shepardson recalled that some time ago it had been the consensus that these entries should be prepared and distributed from meeting to meeting. For various reasons this work had not gotten on to a current basis, he said, but it was expected that the draft entries for meetings held during 1959 would be distributed before the end of the year.

Mr. Johns commented that without minimizing the importance of having a policy record that would be an enlightening rather than a confusing one to the public that read it, a critical consideration was whether the written record so confirmed the understanding that the Manager of the System Account took away from the meetings that his actions seemed to be consistent with the decisions at the meetings. He thought this should not be overlooked as a part of the problem of preparing the record of policy actions.

Chairman Martin then turned to the understanding as to the policy to be followed during the next three weeks, stating that he gathered there was unanimous agreement that the directive to the Federal Reserve Bank of New York should be renewed without change.

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Hearing no indication that any member of the Committee wished to be recorded as voting otherwise, the Chairman stated that the directive would be so renewed.

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

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than \$1 billion;

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

Mr. Rouse referred to the request of the Joint Economic Committee through Senator Douglas, reported at the meeting on September 1,

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1959, that that Committee be furnished with aggregate figures over a period of years on Government security dealers' positions, volume of purchases and sales, and borrowing. In a letter to Senator Douglas on September 11, 1959, he (Mr. Rouse) had explained that all but two of the dealers had given permission to supply the requested information. Since these two had declined on the grounds that the burden and expense of preparing the data would be unreasonable, he had informed the Senator that the Federal Reserve would not be able to furnish the totals desired. This was because the position of at least one of the two nonreporting dealers might be revealed, since both of the nonreporting dealers (one large and one very small) had furnished 1957-1958 material that had been published in the Treasury-Federal Reserve study of the Government securities market. Thus, if their figures were to be omitted from a series covering a period of years, their positions might be revealed by a process of subtraction. Mr. Rouse said that, accordingly, his letter had suggested to Senator Douglas that the Joint Economic Committee obtain the information directly from the dealers if the Committee concluded that such procedure would be desirable.

Mr. Rouse went on to say that both he and Mr. Riefler had now received telephone calls from Mr. Knowles, Economist, Joint Economic Committee, requesting that a series of figures for the period since 1950 be furnished by adjusting the total for the firms that had agreed to supply the data so as to raise it by the proportion reported by the two nonreporting firms during the 1957-58 period covered by the

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Treasury-Federal Reserve study. Mr. Rouse said that he had pointed out to Mr. Knowles that such method of adjustment might produce misleading figures. While such a series could be prepared, Mr. Rouse said that he would not wish to furnish it to the Committee unless it were accompanied by a statement that clearly pointed out the statistical defects in the procedure.

Mr. Riefler said that although he felt the suggestion made by Mr. Knowles was statistically unsound, there had been a commitment to furnish data on dealers' positions, if in so doing the Federal Reserve did not reveal directly or indirectly the positions of individual dealers. Therefore, Mr. Riefler felt that if the Joint Economic Committee desired to make a written request for the figures, including a statement as to how it wanted the estimated totals prepared, there would not be a good basis for declining to comply with the Committee's request.

After some discussion and at Chairman Martin's suggestion, it was agreed that if a written request were received from the Joint Economic Committee for the preparation of figures on the basis outlined there would be no objection to complying with the request with the understanding that when the figures were transmitted they would be accompanied by a statement commenting on the unreliability of a series prepared in the manner suggested.

Mr. Balderston then referred to the discussion near the conclusion of the meeting on May 26, 1959, regarding the problem of

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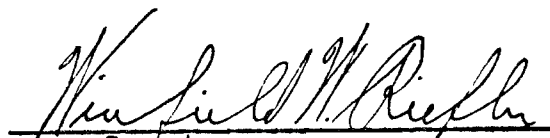
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estimating the money supply. He recalled the understanding that the System Research Advisory Committee be asked to prepare a memorandum setting forth the problem and perhaps making some suggestions, and he inquired of Mr. Thomas as to the progress toward developing such a memorandum.

Mr. Thomas reported that a preliminary memorandum was now being prepared by a subcommittee and that it would be considered by the System Research Advisory Committee at a forthcoming meeting.

Chairman Martin noted that the next meeting of the Committee would be scheduled for Tuesday, October 13, 1959, unless there were objection. In view of the fact that Tuesday, November 3, which normally would be the date for the following meeting, was an election holiday in some States, he suggested that it might be desirable to schedule that meeting for Wednesday, November 4. After brief discussion, it was agreed that the next two meetings of the Committee would be held on Tuesday, October 13, and Wednesday, November 4, 1959.

Thereupon the meeting adjourned.


Secretary