

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 Wednesday, May 23, 1956, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Erickson
Mr. Johns
Mr. Mills
Mr. Powell
Mr. Shepardson
Mr. Szymczak
Mr. Fulton, Alternate
Mr. Treiber, Alternate

Messrs. Leedy and Williams, Alternate Members,
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. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Abbott, Parsons, Roelse, Willis, and
Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of
Governors
Mr. Miller, Chief, Government Finance Section,
Division of Research and Statistics, Board
of Governors
Mr. Gaines, 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
May 9, 1956, were approved.

Before this meeting there had been distributed to the members of
the Committee a report covering open market operations during the period

5/23/56

-2-

May 9 through May 18, 1956, and at this meeting a supplementary report covering commitments executed May 21-22, inclusive, was distributed.

Copies of both reports have been placed in the files of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period May 9, 1956 through May 22, 1956, inclusive, were approved, ratified, and confirmed.

Chairman Martin called upon Mr. Young for a statement on recent economic developments. Mr. Young's statement, which supplemented the staff report distributed under date of May 18, 1956, was substantially as follows:

Economic activity has been extending its sidewise movement on a high plateau. Divergent tendencies in production, employment and trade have become more noteworthy than earlier, but credit demands have remained very strong and average wholesale prices have been holding about at their high for this past year's rise of 5 per cent. Abroad, economic conditions continue generally strong.

For several months now, retail markets have reflected a slackened growth of consumer demand. On the other hand, business capital expenditures have shown impressive strength. Recently, expenditures for inventory build-up have decelerated, with accompanying corrective cutbacks in output. Although uncertainty about the strength of the economy for the near term future is now being expressed with greater frequency at decision-making levels, the market and output adjustments and testing currently taking place in individual sectors are essential to the sustainability of growth for the economy as a whole. Mixed business tendencies at this stage would hardly seem to sum up to a conjuncture of weakness such as would foreshadow general economic recession.

Recent data which highlight key business tendencies merit brief summary:

(1) Results of the McGraw-Hill survey of business capital expenditures show remarkable strength of investment programs and also remarkable business confidence in potential for longer-term economic growth. The gross figure for expenditure plans of \$39 billion needs a \$2 billion cutback to put it on a

basis comparable with Department of Commerce business investment estimates, but a \$37 billion total for the whole year 1956 still implies a very large rise in domestic business investment from the second to the third quarter of the year.

(2) There is, of course, question about how firm these investment plan figures are. They are being confirmed, however, by most recent production figures for producers' equipment and by trade reports of output prospects for equipment lines. Construction contract award figures for commercial and industrial building have been showing very large gains over a year ago, and early May data indicate that the high March and April levels are being maintained. Confidential data on nonresidential construction plans (other than for manufacturing) reaching architects' drafting boards during the first quarter of the year were likewise larger by an appreciable amount than a year ago. Architects drafting board activity seems to lead contract awards by 9 to 15 months. On the other hand, new orders for durable goods have been drifting downward in most lines since the end of the year, and in March were about equal to sales. Orders for machinery and transportation equipment showed the least decline. The backlog of durable goods orders at the end of March stood at \$54 billion, equal to about four months' sales.

(3) April retail sales were off some from March, and April and March sales together averaged 1 per cent below the last four months of 1955. Department store sales for the first three weeks of May suggest that the May seasonally adjusted department store figure will hold at the March level of 122, with possibilities that it may reach 123. Hard goods sales seem to be holding up well at department stores in May. Sales of furniture and appliance stores in April reached a new high.

(4) New automobile sales are the big weak spot at the consumer level. Advice from one manufacturer received yesterday states that daily sales thus far in May are averaging 10 per cent under the April rate. This is worse than the first 10 days' indication for the industry. Dealer new car stocks continue close to the 900,000 unit level and output, which had been reduced to 110,000 units per week in early May, is reported to be in process of further cutback. Representatives of two manufacturers have visited the Board's office in the past two weeks to report the concern of their managements over market conditions, including the availability of credit to purchasers.

(5) While the new car market has indeed been sour, sales of used cars are running well ahead of last month and about 6 per cent under a year ago compared with a decline of 29 per cent for new car sales. Stocks have been reduced 14 per cent

under year ago levels and stock-sales ratios are more favorable than a year ago. Prices of late model used cars after allowance for depreciation have risen further and are now above spring levels of the past two years.

(6) Consumer instalment credit slowed further in April with the increase for the month down to about \$100 million on a seasonally adjusted basis, compared with a monthly average of \$275 million for the first quarter. Extensions of automobile credit declined considerably but are only moderately under a year ago levels. About 65 per cent of all new cars were purchased on credit in the first quarter compared with 55 per cent a year ago. Indications, incomplete to be sure, point to an increase in longer-term automobile instalment contracts this year.

(7) Industrial production for May is expected to hold at the April level of 142, though 141 index figure is possible. Output of consumers durables, steel, and crude oil will be off for the month; equipment production and mining will be up; and nondurables output will likely hold its reduced March level.

(8) Total construction expenditures on a seasonally adjusted basis were up somewhat in April, with residential outlays showing a small rise and nonresidential a larger increase. Housing starts rose seasonally in April and on a seasonally adjusted basis totaled 1.1 million units, lower than a year ago but higher than in April of the two preceding years. Residential contract awards thus far in May are holding close to the high levels of March and April and above year ago levels. VA appraisal requests and loan applications were both up in April but FHA applications were off some.

(9) Demand for nonfarm labor has continued active, with manufacturing employment little changed in April and nonmanufacturing employment at a new peak. Unemployment fell to 2.6 million. The manufacturing work week was little changed, as were also weekly earnings. In June, several wage increases go into effect and in steel, present wage agreements expire as of the end of the month.

(10) The most recent comprehensive figures on inventories are for March and show a relatively small over-all increase from February. Retail stocks were down but manufacturers' stocks up. At manufacturers, the increase was again in final product and goods in process. Preliminary information indicates that department store stocks for April will show a rise again from an index level of 135 in March to a level of 137. The 137 index compares with one of 124 for April a year ago.

(11) From last June to April, the rise in prices of industrial commodities averaged .5 per cent a month. Since mid-April, average prices of industrial commodities have about leveled off. There have been declines in copper, metal scrap, and rubber in recent weeks, but over these same weeks there have been further price increases for metal products, building materials, and paper products. With regard to the recent price declines of copper, steel scrap and rubber, these materials had earlier shown very sharp price increases; the recent declines in these material prices would seem mainly to reflect specific market situations.

(12) Prices of farm products have recovered about 5 per cent from the December low, with grains, oil crops and meat animals accounting for the rise. Recently hog prices have risen further and dairy product prices have advanced. Farm land values have risen further, according to the March 1 survey of farm land values, to a level about 4 per cent above a year ago. The latest rise in land values was concentrated in the Eastern cornbelt, the Southeast, California, and Florida.

(13) U. S. foreign trade showed continuing gains up to March, but imports, mainly because of lower coffee purchases, were down in April, and nonagricultural exports were off more than seasonally. Total exports were up 18 per cent over a year ago, the total export gain for the month reflecting a bulge in agricultural shipments which for several months previously had declined.

(14) In industrial countries abroad, economic advance continues, though evidently at a slackened pace. In a few countries, there has been little further production gain this year. Central banking curbs on monetary expansion of varying sternness generally continue in effect.

In conclusion, it should be said that with diversity of tendency in business trends more marked than in other recent reports, the situation will need to be watched closely and carefully in the weeks immediately ahead. A prospect of accumulating weakness with an increasingly pessimistic business and investor psychology cannot be ruled out, of course, but neither can a prospect of relatively rapid correction of present imbalances and a resumption of expansive momentum. If business spending plans actually materialize in orders and construction contracts, there will surely be some lifting or multiplier effect on consumer incomes and a resulting stimulus to consumer spending. The April data on personal income show a record rate of \$317 billion, up nearly \$5 billion from the fourth quarter and \$18 billion from a year ago.

5/23/56

-6-

Mr. Thomas next made a statement with respect to financial developments as follows:

The principal financial developments in the past two or three weeks have resulted in a continuation of a fairly tight reserve position of banks--tighter than expected. There has been some rise in Treasury bill yields in reflection of the reserve situation, but this has been accompanied by unexpected strength in the bond market with declining yields. At first, there was an improved tone in the new issues market, but that has been followed by some softness as a large volume of offerings came to the market. Stock prices have declined sharply to the lowest level since early March, the decline from the peak reached on May 4 having been about 5 per cent or roughly the same as the decline last January. Total loans and investments of city banks have declined somewhat, reflecting a continuing increase in business and other loans, more than offset by a further decrease in holdings of both Government and other securities. Demand deposits at city banks declined \$1.9 billion, in the past three weeks, compared with \$700 million last year. Since the end of February, there has been a net decline in demand deposits of these banks of more than \$1.2 billion, whereas no change was recorded during the corresponding period last year.

Demand deposits adjusted at banks in leading cities on May 16 were more than \$1 billion smaller than a year earlier. Declines of over \$800 million at central reserve city banks in New York and of \$150 million at central reserve city banks at Chicago accounted for most of this decrease, and the banks in New York also showed decreases in U. S. Government and in time deposits. As of May 9, demand deposits were also somewhat below year-ago levels at city banks in the Philadelphia, St. Louis, Kansas City, and Dallas Districts, while increases had occurred in the Boston, Cleveland, Atlanta, and San Francisco Districts. At country banks, demand deposits during the last half of April were larger than a year ago in all Districts except Kansas City, although the increases in the Minneapolis and Dallas Districts were negligible. Time deposits were somewhat larger in all Districts.

The uncustomary decline in demand deposits adjusted during the past two weeks was responsible for some reduction in estimated required reserves of member banks during

5/23/56

-7-

that period. On the other hand, a larger than expected increase in currency and the maintenance of Treasury balances at a higher level than projected, together with a reduction in Federal Reserve holdings of Government securities, served to keep net borrowed reserves close to \$600 million for the last three statement weeks, but they will probably average about \$400 million for this statement week. The recent tightness in reserves has appeared at reserve city and country banks but has been moderated a little at New York and Chicago compared with the preceding month.

Unless there are offsetting System operations, net borrowed reserves may again rise to around \$600 million next week and may continue well above that level during June and July, as indicated on the sheet distributed showing a pattern of projected reserve changes until August 1. These projections allow for a substantial increase in credit demands--reflected in required reserves--around the June tax debt period. The allowance is somewhat smaller than the increase that actually occurred in March but is in excess of the rather substantial increase around mid-June of last year.

In summary, the credit picture, like that of the business situation in general, is by no means clear-cut, and contains many cross currents. Loan demands continue strong and banks feel the reserve pressures. Likewise current and prospective new capital issues remain large. Money pressures are reflected in higher rates for Treasury bills, but the bond market is strong. Likewise price pressures in commodity markets continue strong, notwithstanding the weakness in automobile sales and some concern about top-heavy inventories, which are reflected in the declining stock prices. The situation may be likened to that we believed we might be facing early in the year, when it was thought that the anticipated decline in automobile sales would release resources for capital expenditures. The decline in autos was delayed, but has finally arrived in greater amount than expected, but the planned expansion in capital expenditures is much larger than was anticipated. Credit demands were even larger than had been expected and unquestionably called for restraint. We are now entering a period of heavy seasonal demand for credit and the question for consideration is how much restraint should be maintained while these demands are being met.

Mr. Johns raised the question whether the staff was prepared to discuss the amounts of reserves that would have to be supplied to the market between now and the end of the current year, and Mr. Thomas commented

5/23/56

-8-

briefly on tentative estimates prepared earlier this year which indicated that somewhere in the neighborhood of \$1.6 billion of added reserves would be needed during the second half of 1956. Mr. Thomas also noted that the staff usually prepared projections of these needs for presentation at a meeting of the Committee in June.

At Chairman Martin's suggestion, it was understood that the staff would prepare a statement with respect to reserve funds that would be needed by the market during the remainder of this year for presentation at a meeting of the Committee during June.

In response to a question from Mr. Erickson regarding Treasury plans regarding the use of surplus funds, Chairman Martin stated that there had been general discussions of this subject but he knew of no specific indications as to what the Treasury plans were.

Mr. Rouse stated that Treasury cash requirements during the second half of this year were expected to total around \$5.5 billion and that he understood the Treasury expected to begin coming to the market in mid-August.

Mr. Thomas noted that the main reduction in debt could be expected to take place during the second half of the 1956-57 fiscal year rather than in the autumn of 1956. Mr. Rouse also said that he understood that the Treasury probably would make an exchange offering about mid-July covering Treasury 2 per cent notes maturing August 15, 1956, in an amount somewhat in excess of \$12.5 billion.

Chairman Martin made a statement substantially as follows:

5/23/56

-9-

The first thing I want to note today is that this is our first meeting without the services of Mr. Sproul. I know all of us regret this deeply. I had hoped to prevail upon him to be with us today, but he is so overwhelmed with his various activities at this time that he could not be here. We are very fortunate in having Mr. Treiber with us and I will be glad to call on him within a few moments. This marks a milestone. I did not want to let it go by without saying how much we regret not having Mr. Sproul's stimulating remarks.

Last night, I reviewed the minutes of our meetings from the first of this year. It is difficult in a period such as we are in, when everybody and his brother becomes a monetary expert in the public press, to isolate ourselves and to see ourselves in the correct perspective. I was trying last night to place myself on a desert island to see what would be the proper approach if we were able to look at the current situation from a distance. It seems to me that one of our biggest problems is psychological. We must not be influenced in our judgments because some commentators may interpret the situation one way or the other, and we should not avoid taking action that in our judgment should be taken just because some of them are urging that we act. In my own thinking, I am quite clear that there has been a real change in business sentiment. I think monetary policy is getting more credit for that change in sentiment than it deserves, but it is so real that some of the people who were saying that monetary policy could have no effect whatsoever are now claiming that it has more effect than it really has. We ought to keep that in mind.

Being a stock market operator, I believe in double tops and double bottoms upon occasion. Not as anything conclusive, but just as guides. We have been having that. If you look back, I took the position in January that there were items of change coming into the picture and that we should not keep a firm position indefinitely, but that we should recognize them when they did come. It was at the January 24 meeting that we changed our directive by adding the words "while taking into account any deflationary tendencies in the economy" so that clause (b) would read "to restraining inflationary developments in the interest of sustainable economic growth, while taking into account any deflationary tendencies in the economy." That was followed by a period of watchful waiting, and gradually we worked up to the action that the System took six weeks ago on April 12, effective April 13, increasing the discount rate.

In my opinion, our record is surprisingly good. I say that knowing that one ought never to say that, but it is a

5/23/56

-10-

very intelligent, readable record all through. I think we ought to consider whether we wish to change our directive today so that it would show that we are recognizing a change in emphasis at this time. There have been deflationary implications in the net borrowed reserve figures recently and in their implications for management. There has been a real change in sentiment and we ought to recognize it. We should keep alert when the spotlight is on us, and in taking our vacations we ought to be certain that there is a Committee available to vote on these questions at any time we may need to. I would hope that we would set the next meeting of the Committee for June 12, which would mean that this next period would take us through the Decoration Day holiday. In today's discussion, we can think of developments over the three-week period before we will act again. If need be, we can make the next meeting earlier, but that is my present thinking.

It is obvious from what I am saying--I don't want to take any position until we have all spoken on this--that I am inclined to the view that some change in the directive might be appropriate and that a shift in emphasis might be desirable in our operations. I question very much whether there ought to be any change in discount rates, but that also is a problem. We recognized the problem of momentum in our discussion at the last meeting, and we should consider that again. Flexible monetary policy requires us to keep alive to these changes.

This is not a criticism of anybody, but I have been alarmed by the tendency of net borrowed reserves to creep up on us. That has been offset by things like the President's statement since the last meeting, which unquestionably created a strong bond market. But we ought to remember that the discount window is being watched. Many bankers have become severe in their attitude and they now may be overly severe on credit requests. We should consider whether we want to shift our emphasis to somewhat the same approach that we had in mind at the time of the meeting on January 24, when it seemed to me that we would have been going along pretty blindly if we had just maintained our position without consideration of the variety of factors that were then appearing. We can not tell what way things will go and these forces may move in the opposite direction from what we are inclined to think. What I am talking about at this time is a change in emphasis and general direction and not a major change in policy. Having made those preliminary remarks, I would like to go around the table and get the comments of others and then come back to a consideration of what we should do.

Chairman Martin then called upon Mr. Treiber, who made a statement substantially as follows:

Our analysis of the business and credit situation is similar to that presented by Messrs. Young and Thomas this morning. We are still in an area of uncertainty as far as the forces of expansion and of contraction are concerned. In the aggregate, the economy moves sidewise. But the aggregate conceals divergent trends.

Employment in April was at an all-time record.

Capital expenditures are heavy and each new estimate shows larger expected capital outlays. There is some question as to whether capital goods producers can expand output fast enough to meet the projected demand.

While consumer demand in the aggregate continues high, the demand for durables has slackened. Inventories of automobiles are high and auto production has been cut back greatly, with further reductions in prospect for the third quarter. Demand for steel continues high but unbalanced inventories are building up.

Housing starts, while still high, have declined somewhat and will probably not reach levels expected earlier in the year. Mortgage market conditions have tightened again, and are a deterrent to expansion of building activity. Outlays for nonresidential construction have advanced to record levels, and the prospects are for continued high activity.

While price changes, as evidenced by the aggregates, have been small, the aggregates have concealed individual price movements. Prices of manufactured goods have risen for a year. Price increases are generally expected in the steel industry and in metal-using industries.

The capital markets have adjusted from the low prices and high yields of a few weeks ago and may be finding a trading base at which they can operate.

Will the weaknesses in the auto industry and certain other areas spread their contractive influences to other parts of the economy? Since expectations in the minds of men are so important, what effect will there be on business confidence?

Demands for bank credit, particularly business loans, continue larger than can easily be explained by the current needs of a business situation which, in the aggregate, is moving sidewise. The great bulge in business loans during March has not since been reduced. It looks as if there may be similar high demand for bank loans in June. It is beginning to look as if the demand for bank credit of many

businesses and industries, in considerable part, has grown out of an over-all squeeze on corporate liquidity, accompanying the growth of inventories and receivables, larger capital expenditures, and the temporary use of tax accruals for working capital purposes.

As for the Treasury, it will need to refund an issue of \$12-1/2 billion of notes maturing August 15; \$5 billion of the issue are held outside the Federal Reserve and Treasury. In the second half of the year the Treasury will also need to borrow about \$5-1/2 billion for cash. Half of this might be raised before Labor Day on tax anticipation certificates due in March 1957. Such financing will call for some bank underwriting, and some Federal Reserve credit will be needed in connection with the cash borrowing.

In recent weeks we have heard businessmen expressing fear as to whether credit for needed purposes will be available. So far as we can ascertain, needed credit for business purposes has been available, but at increased cost. All this would seem to indicate that our restrictive credit policy has been working reasonably well. We must be on guard, however, lest the pendulum swing too far. The Chairman, of course, made strong effort at the recent meeting of the Pennsylvania Bankers Association to make it clear that needed credit would be available--that the pendulum would not swing too far.

Net borrowed reserves in the last two weeks were higher than expected. The actual statistics had a way of turning out to be considerably more severe than the projections indicated. Added to this was a \$45 million correction increasing required reserves in the first half of May by that amount.

It would seem desirable to maintain about the present degree of pressure in the money market, avoiding any appearance of increasing pressure and avoiding any reason for the public to infer that essential credit will not be available.

No change in the discount rate at the Federal Reserve Bank of New York is called for. It should be clear that the discount window is always open subject, of course, to appropriate scrutiny to avoid abuse in its use.

Projections of member bank reserves for the remainder of May and for June show a need for some open market purchases. After June, System purchases in much larger amounts will be probably needed.

In the period immediately ahead, recognizing that "net borrowed reserves" are only one of many factors measuring money market tightness, net borrowed reserves might be allowed to decline somewhat, perhaps to the \$400 million range. This could be a minor signal that the wind against which credit policy is leaning is not blowing quite as hard as it appeared to be a short time ago.

5/23/56

-13-

We, too, have reviewed the form of the general directive by the Committee to the New York Bank, considering whether a change in the directive is in order. Since March 27, 1956 the Committee has directed open market transactions with a view "to restraining inflationary developments in the interest of sustainable growth." In the two preceding months the directive had been qualified by the addition of the clause: "while taking into account any deflationary tendencies in the economy." In our deliberations today we should consider the desirability of restoring this additional clause.

Mr. Johns said that the St. Louis Bank had been spending a good deal of time recently in trying to evaluate the situation. He noted that when you have, on the one hand, continuing strength in business expenditures for plant and equipment and, on the other hand, some doubt as to the future of consumer demand, there are those who argue that weakness in the consumer sector is a forerunner of weakness in the business expenditure sector, while others argue that business expenditures at the levels existing and expected generate personal incomes which consumers will spend. In the latter view no weakness in business expenditures is considered predictable. These considerations partly lay aside matters of psychology. Mr. Johns said that he was inclined to the view that strength in the business expenditures sector should be appraised as of greater importance than doubts about the attitudes and expectations of consumers. He doubted that personal incomes would sag much in the presence of the expected business spending, and he was inclined to think that perhaps what we have is a shift in the pattern of consumer spending rather than a fundamental decision by consumers not to spend. He was not too greatly concerned about the slump in

5/23/56

-14-

automobile sales, although he did not mean to imply that it is unimportant. Some weakness might be appearing in business psychology, and he reported comments from bankers yesterday to the effect that there might not be quite so much confidence and bullishness now as earlier. If this change in attitude were to grow, weakness might appear in what is now the strong sector of the economy. Mr. Johns said that he would not favor any dramatic change in policy between now and the next meeting. However, he would be quite pleased if the net borrowed reserve figure could be kept somewhat lower than the recent \$600 million level; and he mentioned \$500 million or a little below that figure. Mr. Johns said he would not propose any change in the discount rate at the St. Louis Bank at the present time.

Mr. Williams said that there was no change either statistically or psychologically to be reported for business activity in the Philadelphia District. There is great strength in the manufacture of plant machinery and equipment, and plans in this field continue to go forward. Evidence of a little softening in some areas is related to the automobile industry--for example, the cutback in steel--but a resumption of activity is expected in the third quarter. Production of steel goods for general and industrial construction continues strong. Some weakness in the apparel industry has appeared, perhaps growing out of the two-year cycle referred to for that industry, which had a very good year last year. There has been a small drop in employment. In the over-all, no great change in the economy is indicated, Mr. Williams

5/23/56

-15-

said. In discussions with bankers, especially those borrowing from the Reserve Bank, reports indicate no diminution in the demand for credit. Businessmen talk about the restraint and their attitudes are mixed, some being critical and others regarding the current restrictive policy with approval. As to the general public, it is aware of the problem and is interested in the controversial aspects of current credit policy. The "informed public" reflects the views expressed at the Business Advisory Council meeting last weekend, Mr. Williams said, where there was an attitude of concern, lest confidence weaken. Mr. Williams referred to the meeting of the Delaware Bankers Association which he attended recently where he found a great deal of support for the System's approach to current problems and some criticism of comments which were looked upon as attempts to generate a psychology which would put pressure on the System. At that meeting, he said, views were expressed indicating that the origin of current problems in the automobile industry was of its own making. Mr. Williams questioned whether the System should move in anticipation of changes or on the basis of rumors, suggesting that it might be preferable to wait until it had some evidence that a move was necessary.

Mr. Fulton said he agreed substantially with Mr. Young's comments on the business situation. In the Cleveland District steel operations continued at a high level, but the outlook depends on whether there is a strike. If there is not a strike, operations are expected to drop to 85 per cent of capacity during the first part of the third

5/23/56

-16-

quarter, although some increase would take place when new model automobile production was being started. If there is a strike, it may be of considerable duration. Mr. Fulton said that while there were excess inventories of steel throughout the country, this was not considered a particularly bad factor and most of it was allied with the automobile industry. Structural steel continues very tight. The machine tool industry is working at capacity. Road building machinery is also very active. Foundries allied with the automobile industry have reduced output sharply, but foundries producing products for other industries are working full time. Mr. Fulton commented on the building situation to the effect that it was very active in the Cleveland District and that some criticism was being made in connection with the failure of insurance companies to take up commitments readily. Capital expenditures for which plans were laid a year or two ago are going ahead regardless of the restrictive monetary policy, but some pause is being given where plans are not yet formulated. Mr. Fulton said he had been disturbed about the size of net borrowed reserves recently, thinking they were higher than the Committee had anticipated they would be, due to mechanical factors. He thought there might be less intensity of pressure, with net borrowed reserves perhaps around the \$500 million level instead of \$600 million. A change in the Committee's directive might be appropriate, but he would not favor any change in the discount rate at this time.

Mr. Shepardson said that it was evident there were conflicting pressures in different segments of the market. He thought this

5/23/56

-17-

indicated that the System had been achieving the aims it had in mind a short time back. He recalled earlier comments that it would be difficult to meet the continued consumer demand and at the same time to take care of the capital expansion to provide increased resources. The allocation of resources then considered necessary had been taking place, and Mr. Shepardson said he thought this had been wholesome. Despite some of the softness now appearing, he did not think conditions had reached a point indicating a retreat from the Committee's present policy. Savings to meet both building and capital investment demand could come from some turn down of consumer expenditures, such as appeared to be taking place in the automobile industry. Mr. Shepardson said that he did not know what the level of net borrowed reserves should be. Perhaps a lower figure than that we had had recently would be proper. But he thought the Committee should be in the position of providing the needed reserves without providing them in sufficient amounts to permit any appreciable reduction in the pressures against unsound credit expansion. Mr. Shepardson referred to the Committee's directive, stating that he had given some thought to suggesting a change in clause (b) of the first paragraph so that it would provide for "maintaining a climate of sustainable economic growth." He thought the Committee would be in sound position if it provided the additional reserves that would be needed, together with some lessening of the volume of net borrowed reserves.

Mr. Mills made a statement substantially as follows:

Considering the tangible factors that are bearing on economic developments and the intangible influences that are coloring the psychological climate of the business community, it would seem that the System should supply additional reserves on a gradual basis that would aim to bring the level of negative free reserves down to around \$400 million. In the process, the Committee would observe events, and if the additional reserves had too great an impact on the market and on the interest rate structure, we should take a second look. It would seem important at this time to supply additional reserves on a lead basis so that the commercial banks, in looking forward to the credit demand that they anticipate over the June 15 tax payment period, can be prepared with reasonable confidence to satisfy those demands. In supplying additional reserves, I would doubt that we would call into being any inflationary risks. When you pause to think that the banks are in a decidedly tight position and that their liquidity is at a low point, you might reasonably expect their first move, as new reserves are acquired, would be to improve their liquidity and not aggressively to expand their loans except for the constructive and necessitous requirements of their customers. Banks will move to improve their liquidity by building up their holdings of Treasury bills, and in their doing so we should look for pressure on Treasury bill yields which, however, should not disturb us at the present time, especially as our primary responsibility hinges on the question of adequate availability of credit. Any doubts about supplying additional reserves and the possibility for their having inflationary consequences can be resolved by the knowledge that the leverage of the System's actions works much more quickly when the banks are in a tight position, as is now the case, than when they are in an easier position. Therefore, as bank reserve positions are eased, we should anticipate prompt results, and by the same token, earlier reserve positions can be promptly restored, if deemed necessary, by subsequently withdrawing reserves.

It would seem that direct Treasury bill purchases are the best means for supplying new reserves. Repurchase agreements might not serve the desired purposes. The commercial banks, in following the policy actions of the Federal Reserve, are going to look for a continuity of direction that is not as perceptible where reserves are provided on a temporary and ephemeral basis as in the case of repurchase agreements. Therefore, if reserves are supplied in correlation with changes in the economic picture, a case

5/23/56

-19-

can be made for providing them through direct Treasury bill purchases. Any resulting change in the interest rate structure should be considered of secondary importance to the need of making credit more available. I also have some doubts about whether making repurchase agreements for only overnight is appropriate. It might be better to make them for longer periods and to allow the dealers to use their own judgment and initiative in picking them up before maturity, as they presumably can and will if there is a marked upward movement of Treasury bill prices.

It would seem appropriate to modify the directive to the Manager of the System Open Market Account. It would not seem that the present situation calls for any change in the discount rate; but as and if additions to the supply of reserves react toward lower yields on the list of U.S. Government securities, and where the pressure on yields on short-term securities presumably will be accentuated over the next six weeks as outside investors come into the market and as Treasury tax anticipation certificates are retired, a softening of interest rates is likely. In that event it would be a logical time to reduce the discount rate in order to be consistent with the over-all change taking place in the interest rate structure.

Mr. Leach said that Fifth District business in recent weeks has shown a slight weakening. Tobacco manufacturing and bituminous coal production are holding at good levels, but furniture manufacturing has slowed down and price concessions have been necessary to get orders, particularly in the cheaper lines. Output of textiles has continued to decline, and hosiery mills are operating at only about 50 per cent of capacity. Department store sales declined in April from the record level of March, but are still high. There is definitely less exuberance now than a month or two ago.

Borrowings at the Richmond Bank were down to \$22 million last Friday, the smallest in the System, but this did not reflect a lack of

5/23/56

-20-

loan demand at member banks. Loan demand continues very strong, especially at larger banks. Aside from increased demand from commercial customers, correspondent banks report heavy demands from their bank customers both for outright loans and for carrying excess lines. It seems apparent that a substantial amount of bank credit is going into plant expansion: small and medium-size concerns have no other place to go.

Mr. Leach said that he thought the policy the Committee has been following recently has been about right and he believed it would be a mistake to ease perceptibly at present. He would continue almost the same degree of tightness, taking pains to assure that needed reserves are provided in sufficient amounts in ample time to avoid a tax squeeze in June. Mr. Leach said he hoped there would be no change in discount rates in the immediate future but that it would seem appropriate to make a slight change in wording of the directive by adding to clause (b) a statement to the effect that any deflationary tendencies in the economy should be taken into account.

Mr. Seedy said that there had been no substantial change in Tenth District activity recently. The District has not been enjoying the same degree of prosperity that exists in most other districts. There is some unemployment due to cutbacks in defense production and in automobile assemblies. Agriculture has been very severely affected this year by the drought, perhaps more so than in other predominantly

5/23/56

-21-

agricultural districts. Mr. Leedy felt that nationally business was moving sidewise, the one exception being the indicated strength in capital expenditures, now bolstered by the latest McGraw-Hill survey. It seemed apparent there had been some deterioration in optimism on the part of businessmen. There had been some marked change in the public psychology, reflected in the stock market. Great inflationary pressures do not seem to be present across the board, Mr. Leedy said, even though some may exist in the case of capital expenditures. In view of some deflationary trends reported, he felt that the Committee's directive should be changed to restore the wording that was used in clause (b) of the first paragraph from January 24 to March 27 of this year. He also thought that additional reserves should be supplied, stating that net borrowed reserves in the \$400 million to \$450 million range would be about the level he had in mind. It would be a mistake to change the discount rate at this time. In summing up, there should be no change in policy, Mr. Leedy said, but a lessening of the tight policy the Committee has been applying.

Mr. Powell said that practically all business indicators in the Ninth District were showing good increases, and unemployment continues very low. Bankers are very optimistic. Borrowings from the Reserve Bank reflect this feeling, and Mr. Powell noted that Minneapolis District reserve city banks recently have been borrowing about 24 per cent of their required reserves, more than in any other district.

5/23/56

-22-

Many banks have increased the rate they pay on time and savings deposits to 2 or 2-1/2 per cent. Mr. Powell referred to a city bank which presented some paper as collateral for borrowing at the Reserve Bank yesterday which included notes of finance companies. Mr. Powell said that he felt there was every reason to retain the 3 per cent discount rate at the Minneapolis Bank at this time, although this did not blind him to the fact that there may be soft spots developing in the economy generally. In fact, he thought the economy was developing more and more weak spots and that at some point it would be necessary for the System to reduce the discount rate in order to maintain the high level of economic activity that was desired nationally. This might be necessary rather soon. Mr. Powell felt that this would call for open market operations and he thought there was not much reason to let the level of net borrowed reserves get any higher than it is at present.

Mr. Mangels said that Twelfth District activity seemed to be continuing at a relatively higher rate than was shown for the national picture. This applied particularly to the employment situation, where there had been a further decrease in unemployment than was indicated nationally. Department store sales in April were better in the Twelfth District than nationally. During the three weeks ending May 9, Twelfth District credit extensions accounted for 30 per cent of the rise for the country as a whole. Except for automobiles and lumber, output of

5/23/56

-23-

most industries continued to expand. Residential building declined in April, and this had had an effect on the lumber industry. There had also been a further weakening in the plywood section of the lumber industry, Mr. Mangels said, since he reported two weeks ago; and plywood is now selling below the lowest point last year. There has been some easing in prices of Douglas fir, although that easing has not been reflected in actual quoted price reductions. The lumber industry is not pessimistic and expects this to be a good year. Mr. Mangels said that there was less tightness at country banks than at city banks in the Twelfth District and that borrowings at the Reserve Bank had continued at a very modest level. One of the Bank's directors recently reported a slackening of business and some development of pessimism in the inter-mountain district, but that was the only area in which there has not been evidence of more optimism. Mr. Mangels expected the discount rate to be discussed at the June meeting of the directors but, in his opinion, it was now preferable to hold the 3 per cent rate. Mr. Mangels said there seemed to be some change in psychology. He would be inclined to make no change in policy until this was more clearly indicated, but he would favor a change in wording of the Committee's directive along the lines suggested by others. Mr. Mangels then commented on the results of a questionnaire distributed recently at the meeting of the California Bankers Association to which responses indicated bankers predominantly expected business activity to continue at

5/23/56

-24-

a high level during the rest of this year and in which they also indicated widespread approval of the discount rate in effect at San Francisco.

Mr. Irons said that the economic trend in the Dallas District was about what it has been for the past three to six weeks--pretty much a sidewise movement. There had been a further decline in unemployment and the labor situation is tight. Department store sales declined slightly in April but have been very strong thus far in May. However, petroleum refining activity is up, and crude oil production is very high although it has declined seasonally lately. Construction is maintaining record levels and gains in residential construction are adding to the strength in nonresidential. Contract awards are running ahead of last year. It is difficult to find areas of weakness. With respect to the confidence factor, Mr. Irons said that businessmen and bankers generally were confident as to the outlook for business in the Dallas District. He described the feeling three months ago as one of "unbridled confidence" to such an extent that some businessmen were concerned as to what might happen, whereas now the concern has disappeared and a more cautious type of confidence exists. There is no pessimism in the Dallas District so far as he has observed, Mr. Irons said. Loans have continued to increase in the past several weeks, and bankers report very strong demand for credit. The greatest pressure exists at a few reserve city banks; for example, the loan-deposit ratio in Dallas is 67 per cent, and in one other city 58 per cent; but in some other cities it is around 27 to 30 per cent. Country banks have excess reserves,

5/23/56

-25-

and their loan-deposit ratios are not high. This situation is reflected in borrowings of member banks, most of the demand at the Reserve Bank coming from a few large city banks. Credit policy is being effective in causing bankers to scrutinize loans and to be more selective in their credit extensions, Mr. Irons said. In the overall, the strength of factors on the side of business expansion, rising personal income, record employment, and low unemployment impressed him more than the healthy readjustment taking place in the automobile industry. He would not wish to see any change in policy at this time and would not be prepared to recommend a change in discount rate. He would like a measure of restrictiveness maintained. Bank reserves may have been a little snugger in the market in recent weeks than was necessary, and he would not wish to see policy any tighter. Perhaps net borrowed reserves should be \$500 million or under, rather than on the over side. There should be a willingness to provide funds to the market when needed. Mr. Irons said he thought the Committee's directive might be changed to restore to the wording of clause (b) of the first paragraph that was adopted at the January 24 meeting or in some other way to take into account the other factors mentioned this morning, but the change should not be strong enough to imply that the Committee had changed its policy.

Mr. Erickson said that there had been no marked change in business in the Boston District except that there was evidence that business sentiment was not quite as optimistic as he had reported at the previous meeting. Our recent Massachusetts survey of plant and equipment expansion shows an increase of 21 per cent over last year. Greater use of

5/23/56

-26-

the discount window has been made in the past few weeks, and Mr. Erickson stated that within the past few days three banks which had never before borrowed from the Boston Bank had come in for funds while five others that had not borrowed since 1953 had come in. Mr. Erickson referred particularly to the third paragraph of the staff's review of economic developments dated May 18, 1956, which described the recent economic situation as one "in which expansion forces have about been balanced by forces of deceleration of advance and of correction of various imbalances which have accumulated," and which he stated expressed his present views. Under these circumstances, Mr. Erickson felt the directive should be changed by inserting the words in clause (b) of paragraph 1 that had been taken out at the meeting on March 27. He would make no change in discount rate at this time and would prefer to see net borrowed reserves a little less tight than they have been; for example, in the range of \$450 to \$550 million, tending on the low side of that range.

Mr. Szymczak said he would prefer to wait until a later meeting for a change in the wording of the directive, although he did not think this was important. He did not think there ought to be any change in discount rate at this time, and net borrowed reserves should be brought down to about the \$500 million level with the idea of watching developments carefully to see what else is needed.

Mr. Balderston made a statement substantially as follows:

Our difficult task is to pick a proper course among the cross currents that are now evident. Like Mr. Erickson, I picked up the third paragraph of the staff review as reflecting the current situation. It seems to me an accurate portrayal of what we face today. My solution would be to break free from the inertia of the status quo and take action which seems to me imperative if we are to act in time. On this I have to struggle with myself because I am addicted to the philosophy of gradualness. But there are turns in the road that you cannot get around by a slight turn of the wheel. I gather we may be at such a point now. Although I am content with existing discount rates that may inhibit some marginal debt or plant expansion, the availability of credit should be increased, and substantially.

My reason for urging this change in posture, which is an extension of my thinking of two weeks ago, is that we seem to have arrived at a cessation of demand for automobiles. The policies of the automobile industry last year have helped to create a dearth now of buyers. The number of suppliers to the automobile industry is very great, perhaps as many as 20,000, and the effects of the reduction in production and employment in the automobile plants are extremely pervasive and will injure a considerable number of plants in many localities.

The number two consideration is the apparent end, even if temporary, in the long forward advance of common stock prices. A 40 point reduction in the Dow Jones industrial price index seems to presage market weakness that, added to the weakness in the automobile industry, may have considerable psychological impact. It may have an effect out of proportion to its real importance, especially when these factors strike the public consciousness at the same time as the summer doldrums.

Third is the sharp drop in bank deposits, especially in May. It has been of great concern to me these last few days. It was quite understandable some time ago that investors should withdraw deposits to invest in Government bonds, but the May 9 reporting member bank report shows a sharp drop of \$379 million of demand deposits, compared with an increase of \$253 million a year ago.

That remedial action is imperative is indicated by the fact that corporate holdings of cash are so inadequate to meet the June tax payments as to cause heavy demands on banks just before and after that time. It would seem imperative to meet that tax demand by putting substantial funds into the market, and I agree with Governor Mills and President Leach that we cannot wait. My preference is to return to the wording of

5/23/56

-28-

the directive adopted last January 24, to maintain present discount rates, but to increase sharply the availability of credit. Unless we take action on those portions of the economy that are slumping, our remedial action may be too late. If there should occur a fresh upsurge of consumer demand, which is quite possible, our philosophy of flexibility means we would take whatever action may be appropriate then. I would suggest net borrowed reserves of around \$250 million. If our staff forecasts of reserve needs are correct, we may have to buy \$400 to \$500 million of bills. We should not temporize with a situation which seems to me to call for real action. I think we should act and act now.

Chairman Martin then made a statement substantially as follows:

As far as the consensus is concerned, there is an overwhelming majority in favor of altering the directive, and unless I hear a dissent we will change the directive by tacking on the last phrase to clause (b) of the first paragraph so that it will read "to restraining inflationary developments in the interest of sustainable economic growth while taking into account any deflationary tendencies in the economy." Perhaps we could have better language but there may be some merit to sticking to the language that we have used in the past.

Now I would like to make my own comments. I have listened very intently to the discussion and I lean even further than Governor Balderston does to the other side. I deliberately avoided using any figure of net borrowed reserves in my own remarks. To me, the capital survey McGraw-Hill has just released is adequate justification for the policy we have pursued. Also, I think perhaps we were late in our tightening moves and that we ought to recognize the fact that we got in here in a difficult period; there has been a backwash that has carried negative free reserves higher, along with the increase in the discount rate, than we expected. That is not intended as a criticism of the account, but supply and demand factors have worked that way. We have gotten accustomed to accepting \$600 or \$700 million as more or less a figure that is normal, whereas earlier we were talking about getting to around \$400 or \$500 million. We are coming into Decoration Day and the tax situation which is upon us. I think I discern straws in the wind. I realize how dangerous that is. Governor Szymczak and Mr. Williams think we ought to wait and see the statistics before we act. Nevertheless, we see banks coming in to borrow who have never borrowed before, as Mr. Erickson said, and we know that is

going on all around the country. There are delayed reactions in all of this and the psychological factors may have gotten ahead of us.

We have had marvelous acceptance of our policies. Bankers are almost 100 per cent behind us. You have to differentiate between the banker and the borrower, however, and there are the other components of the economy. I have had at least twelve directors of substantial corporations not connected with the automobile industry talk to me recently in entirely different terms than they talked to me a few weeks ago. That will not appear in the statistics for another four to six weeks, but it is enough of a consideration in my thinking to say, as I did in January, that we ought to be trending in a direction so as to make it plain that we are following a flexible monetary policy. We cannot do this tomorrow. We could not start tomorrow and go to "X" reserves unless we just completely shocked the market. But I think we ought to be trending towards zero reserves. This could easily be a double bottom, and there may well be another upsurge; we may find later that we want to put the discount rate higher than it is now. But I think we are in grave danger of being put in the position of not recognizing the interpretations that will be put on these developments. In my address before the Pennsylvania Bankers Association, I tried to provide some reassurance.

I think we should be trending towards zero free reserves. Governor Balderston says \$250 million. I would not worry about a charge that we were "selling out" because of pressures that have been put on us. That is one of the things you have to anticipate from the commentators. But if we had been successful in keeping lower net borrowed reserves in this period, we would not have had built up the pressures that we now have. I really feel, and I would like to be recorded on this, that we have made a great mistake in our emphasis on figures. We have debated this again and again. I have been one of the offenders in wanting to get our discussions as close as we could to saying what we wanted and of having an understanding of our policy. But we talk about these figures, and they get put in a framework in which others think of the figures as a measure of what we are doing. There are far too many people around Washington who are looking at the figures of net borrowed reserves. We have helped produce that psychology. When I say we ought to be trending to zero free reserves, it is the trend I am talking about. We cannot afford to let the market think that we are not trending in the direction of supplying the reserves that will be needed under these conditions. How that is done is not particularly important, and I am not saying that the desk could get to \$250 million by the next meeting of the Committee, but if I were running it on my own I would want to be certain that the trend was in that direction. That is what I mean by a shift in emphasis and not a change in policy.

5/23/56

-30-

Mr. Szymczak inquired as to how long it would be, under such a program as that suggested by Chairman Martin, before the discount rate would have to be adjusted also.

Chairman Martin reiterated that he was not talking about getting to zero free reserves tomorrow but about trending in that direction. It was necessary to talk about that trend or we would find that the backwash was working in the other direction.

Mr. Balderston said that originally he had put down a target of zero to \$250 million free reserves, and when he got the supplemental report from New York this morning he noticed that net borrowed reserves had averaged \$253 million during December, January, and February. It seemed to him that the Committee should be aiming at a figure at least as low as \$250 million if it readopted the wording of the January 24 directive.

Mr. Williams suggested that perhaps it had been almost a conscious program of the Committee to get to its present position of restraint as a means of bringing attention to its policy. Only when the public became thoroughly aroused and when the pressure had been put on by the System had real restriction resulted. Mr. Williams also raised the question whether to follow the suggestion the Chairman made before statistical evidence became available would amount to having the general public tell the Committee how to run the shop.

Chairman Martin said that the point he would make on this was that the Committee should not ignore the general public. It is an important factor. That does not mean that the Committee succumbs to

5/23/56

-31-

the pressures of the general public. He felt that a flexible monetary policy required an adaptation to the views of the public. The Committee had been getting more and more into the position where people who ought not to be alarmed about credit were alarmed about credit, and he did not know how to eliminate that feeling so as to avoid knots such as we had in the spring of 1953. He thought that the Committee should make clear the direction in which it was going. On Mr. Szymczak's point as to how long the Committee could go in this direction without the discount rate coming down, this was a matter of watching developments.

Mr. Szymczak said that the rate could not be separated from the supply factors in the credit situation. If there was a demand for credit and if the reserves were not there to supply it, the rate would, of course, go up. If enough reserves were supplied to the market abruptly, it meant that rates would come down.

Mr. Johns said that he had difficulty with the idea of trending toward zero free reserves, and he raised the question whether such a directive to the Manager of the System Account might be setting a policy that would carry beyond the next meeting of the Committee, if we were not to get down to the zero free reserve level by the date of that meeting. Was it necessary to set policy that far ahead at this time?

Chairman Martin said that his thought was that the shift in emphasis he had proposed was necessary but that he did not believe it was necessary to go beyond a shift in emphasis at the present time.

5/23/56

-32-

Mr. Leach said that he agreed net borrowed reserves should be brought down from where they have been. It bothered him somewhat, however, to say that they should be brought to zero and to say that this was not a change in policy.

Chairman Martin said that he may have overstated the situation but that he had been discouraged as he listened to the comments around the table this morning. It had not seemed to him that we were alert enough to the implications in the situation. The Committee is pretty well insulated from the operation, he said. Flexibility of policy is not just a catch phrase that has come into the picture. He thought it was three years ago, but today things have moved beyond that stage. He was not asking for any set figure of net borrowed reserves. He had suggested zero free reserves because he wanted to make clear his own position. He thought it would be a very serious mistake if by accident the Committee permitted the trend to appear other than that. As to the discount rate, Chairman Martin said that his feeling was that the rate and the supply of reserves could not be separated; he had hoped that the increase in the rate could be eased by greater availability of reserves, but the supply and demand factors that had come into the picture had operated against this. The committee should be aware of storm signals and should not ignore them.

Mr. Leedy said that he had felt that net borrowed reserves, having been around the \$550 million mark, in being dropped \$100 or \$150 million would require such substantial additions to reserves,

5/23/56

-33-

According to current projections, that the size of those additions, aside from the level of net borrowed reserves, would indicate the policy being pursued.

Mr. Mills suggested that it might be preferable to set the next meeting for June 5 instead of June 12 with the thought that the Manager of the Account could be given another directive within a short period of time.

Chairman Martin said this was agreeable to him and, after brief discussion, it was agreed that the next meeting of the Committee would be held on Tuesday, June 5, 1956.

Chairman Martin went on to say that on the basis of the discussion there appeared to be a consensus that operations should be continued so as to have a downward trend in the amount of net borrowed reserves without any statement as to the amount of reserves.

Mr. Thomas commented that he did not think the public looked at the volume of net borrowed reserves as much as at the direction of System operations. He noted that during the next two weeks there would have to be substantial operations in order to keep the pressures from increasing. It was not correct to say that at the present time net borrowed reserves were higher than the Committee had intended at its meeting two weeks ago; they had been last week, Mr. Thomas said, but that was not true now. At the present time they were around \$400 million. The figure to look at was the growth of credit and not net borrowed reserves, he said. From now on, in order to take care of seasonal demands for credit the Committee would have to inject

5/23/56

-34-

substantial volumes of reserves. Mr. Thomas said that he had been concerned before this meeting that the injection of these needed reserves to meet seasonal demands might be looked upon as more drastic than the Committee intended, but if as indicated at this meeting the Committee wished to change the emphasis of its policy, perhaps the supplying of the volume of reserves that would be needed to take care of seasonal credit demands would not be misinterpreted.

Mr. Rouse said he appreciated the statement Mr. Thomas had made and that he also wished to call attention to the fact that the System account was purchasing about \$80 million of bills today and that it intended to make an additional purchase tomorrow. Net borrowed reserves for the week might be \$400 million or less, although they would be higher than that on Wednesday. However, when the statement was issued on Friday, it would be in the light of the market's knowledge that the System account had been in the market both today and tomorrow.

Chairman Martin inquired whether there was agreement with his suggestion that the directive of the Committee be modified so as to include in clause (b) of paragraph 1 the additional words he had suggested earlier during the meeting which would provide that the Committee would take into account any deflationary tendencies. He also inquired whether it was agreed that the Committee's operations should be carried on between now and the next meeting with a

5/23/56

-35-

view to bringing about a downward trend in the volume of net borrowed reserves. In response to Mr. Johns' question, Chairman Martin re-read clause (b) of the Committee's directive of January 24, 1956.

There being no indication of disagreement with Chairman Martin's statement of the policy to be followed by the Committee between now and the next meeting, upon motion duly made and seconded and by unanimous vote, the Federal Reserve Bank of New York was directed until otherwise directed by the Committee:

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

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

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate \$500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

Chairman Martin noted that the agenda included as a topic for consideration Mr. Sproul's proposal that the System account be authorized to engage in swapping of Treasury bills, along the lines discussed at the meeting on May 9. He suggested that because of the lateness of the hour this topic be carried over until the next meeting of the Committee, and there was agreement with this suggestion.

Chairman Martin then referred to the Committee action at its May 9 meeting at which it decided to set up a staff committee to study the facts of the experience with present operating procedures along the lines suggested by Mr. Sproul. This would be a "spade work" study. Chairman Martin went on to say that he had consulted with Mr. Sproul with respect to participation from the staff of the Federal Reserve Bank of New York and as a result would suggest that the committee consist of Mr. Harold V. Roelse, Chairman; Mr. Tilford C. Gaines, Secretary; Mr. J. Dewey Daane; Mr. Robert Holland; and Mr. Donald C. Miller. Mr. Riefler, as Secretary of the Federal Open Market Committee, would be expected, ex officio, to keep in touch with the committee's work. Chairman Martin also said that Mr. Sproul had suggested that Mr. Rouse not be asked to serve on the committee as such but that he would be

5/23/56

-37-

available for counsel and information. His suggestion would be that when the committee is organized it present the Federal Open Market Committee with a report indicating the nature and scope of the material it would undertake to gather.

There was no indication of disagreement with Chairman Martin's suggestion for the membership of the staff committee or of the procedure to be followed by the committee in proceeding with the study suggested.

Mr. Mangels withdrew from the meeting at this point.

Chairman Martin said that he was forwarding to the Treasury, as authorized by the Committee at its meeting on May 9, copies of Mr. Riefler's memorandum "Experience Since the Accord with Short-Dated Federal Debt" distributed to members of the Committee under date of April 10, 1956. After the Treasury representatives had had an opportunity to study the memorandum he would plan, in accordance with the understanding at the May 9 meeting, to discuss with them possible approaches to studying the problems of coordination of debt management and credit policy.

Chairman Martin stated that Mr. Sproul had suggested that it might be appropriate to send the Treasury also a copy of the memorandum prepared at the Federal Reserve Bank of New York under date of September 29, 1955, entitled "Notes on Debt Management--Structure of the Debt and Credit Policy." He suggested that between now and the next meeting of the Committee the members review this memorandum to refresh their

5/23/56

-38-

minds with respect to its contents, with a view to deciding at that time whether to send the New York Bank's memorandum also to the Treasury.

There was no disagreement with Chairman Martin's suggestion.

Chairman Martin next referred to the proposal by Mr. Sproul at the meeting on May 9 that there be a study of the Federal Funds market, the first phase of which would be the development of factual information by a subcommittee operating under the Committee on Research and Statistics of the Presidents' Conference. The Chairman said that he understood that Mr. Leedy was taking steps to appoint this subcommittee of the Presidents' Conference.

Mr. Leedy said that he had referred this matter to the System Advisory Committee on Research and Statistics.

Chairman Martin noted that the next meeting of the Committee would be held on Tuesday, June 5, 1956.

Thereupon the meeting adjourned at 1:28 p.m.


Secretary