

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 30, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Fulton
Mr. Irons
Mr. Mangels
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Erickson, Alternate for Mr. Leach
Mr. Treiber, Alternate for Mr. Hayes

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

Mr. Bopp, President of the Federal Reserve Bank
of Philadelphia

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

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Mr. Wayne, First Vice President, Federal Reserve Bank of Richmond; Messrs. Ellis, Roosa, Mitchell, Jones, Tow, and Rice, Vice Presidents of the Federal Reserve Banks of Boston, New York, Chicago, St. Louis, Kansas City, and Dallas, respectively; Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia; and Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis

Chairman Martin stated that in the absence of objection Mr. Molony, Special Assistant to the Board of Governors, would attend the meeting. There being no objection, Mr. Molony entered the room.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 9, 1958, were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period September 9 through September 24, 1958, and a supplemental report covering the period September 25 through September 29, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Reporting on open market operations since the last meeting, Mr. Rouse stated that an even situation had been maintained in the money market. The System's holdings of bills declined by somewhat over \$250 million, while the money market was generally firm. A tendency for some over-borrowing to occur early in the statement week has led to

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temporary easing of the market in the middle of the week; on the whole this has been helpful.

Mr. Rouse said that two weeks ago he was quite concerned about the state of the market on the eve of the Treasury's financing operation. For a time he began to think he was wrong, because some stability seemed to be developing a better atmosphere in the market. However, he then attended the meetings of the Treasury's advisory committees in connection with the financing. The ABA Committee had recommended to the Treasury that the 3-1/2 per cent notes of 1960 be reopened for \$1 billion and that a special bill to mature next May be auctioned to raise \$2.5 billion. Shortly thereafter the IBA Committee, consisting of dealers and the portfolio managers of large banks, met with the Treasury and the picture they painted was grim. They gave the Secretary of the Treasury no encouragement unless he placed very generous rates on the offering. The first recommendation of the IBA Committee was for a June tax bill in the amount of \$3.5 billion at a 3-1/4 per cent rate. The Secretary asked for the Committee's views concerning the possibility of reopening the 3-1/2's of 1960, but the group did not think that this issue would be at all well received. When asked what they thought subscriptions would be for a 3-1/2 per cent 1-year obligation, they replied about \$1 billion. The majority of the Committee felt that the Treasury would have to

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place a rate of up to 3.25 per cent even on a June tax bill in order to have a successful sale, and a substantial number thought 3-3/8 - 3-1/2 per cent would be necessary. Mr. Rouse pointed out that there is wide representation of the underwriting community on the Committee of the IBA. In general, he said, the Committee reflected the attitude that underwriters are in no temper to take losses voluntarily. It was indicated that the Treasury would have to buy back their underwriting good will by placing very generous terms on the new issues if it was to look forward to successfully financing its needs later in the year.

Mr. Rouse went on to say that the market's reaction to the new issues on Friday was satisfactory but that it deteriorated on Monday. Some transactions in the special bill by commercial banks had been reported while the books were open, despite the required certification, at rates up to 3-1/2 per cent, and the bill was quoted this morning at 3.45 to 3.40 per cent; the new 3-1/2 per cent note also was quoted at a discount this morning. In the regular Treasury bill auction yesterday, the average rate was 2.92 per cent and the stopout price was slightly over 3 per cent.

Mr. Mills noted a difference in estimates of required reserves between the Board and the New York Bank and inquired whether this difference reflected different assumptions as to the amount of the new issues that will be taken up by commercial banks. If so,

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he suggested that some effort should be made to reconcile the difference, for a knot might develop in the market on payment date for the new issues if the requirements of the banks are seriously underestimated. Mr. Thomas replied that the difference in estimates of required reserves mostly reflected differences in estimates of changes in other deposits, and not differences in estimates of the amount of the new issues to be purchased by commercial banks. Mr. Rouse commented that there would soon be good data from the Treasury concerning commercial bank subscriptions. A complicating factor, however, is the rate at which the new issues will be distributed into private hands. Mr. Mills observed that because of these uncertainties the Manager of the Account must be given adequate latitude in operating the Account. Mr. Rouse pointed out that nonbank subscriptions might well be reduced because of reports that banks have arranged to sell the special bill to nonbank investors at a discount, despite the banks' certification that customers have no beneficial interest in their subscriptions. He observed that there appeared to have been some breakdown of ethics in this connection.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period September 9 through September 29, 1958, were approved, ratified, and confirmed.

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The staff economic and financial review at this meeting was in the form of a visual-auditory presentation devoted to the consideration of questions regarding the nature of the current recovery. Participants included Messrs. Thomas, Young, Marget, and Koch along with Messrs. Garfield, Williams, and Brill of the Board's research staff.

The introductory portion of the script of the economic presentation was as follows:

Monetary authorities are faced with policy questions at all times, not just at peaks or lows. But the most important questions relate to how soon and how much to influence credit and monetary conditions when there are basic changes in the course of business, as in the autumn of 1957 and the spring of 1958.

In one view, easing of restraints on bank credit and monetary expansion should be started immediately when it is determined that the crest of a boom has passed, while action looking toward restraints on expansion may be needed only after some time has elapsed for recovery to gather momentum. In another view, giving greater weight to the risk that inflationary forces may accentuate instability, the authorities in booms should retain restraints until inflationary pressures have clearly receded and in recoveries should begin early to reimpose restraints in order to avert emergence of an inflationary spiral that might intensify ensuing boom and subsequent recession.

In the postwar years, contrary to expectations based on the experience of the 1930's, the central continuing problems of monetary policy have stemmed from excessive demands which have tended to push prices up and to increase activity to levels not sustainable. At first, high levels of demand could be attributed to backlogs of needs and funds accumulated during the long, world-wide war. Later, developments of the cold war, and in particular the Korean episode, stimulated demands. A tenth of gross product is now being absorbed in the defense program, in contrast to

less than 1 per cent after the First World War. Meanwhile, in contrast with the late 'twenties and 'thirties, population has been increasing right along at a rapid rate. Technological advance has proceeded apace, making possible introduction of many new products, application of new processes that increase manhour productivity, and stimulation of demand for both consumption and capital goods.

Abroad since the war, economic advance has been substantial and fairly steady. In the past year, however, output in Western Europe has levelled off rather than rising as in 1953-54. In the United States, postwar recessions in activity have been moderate as compared with the 1920-21 recession after World War I or the devastating depression after 1929, but it can not be said that growth in activity has been steady. In all industrial countries of the free world, postwar price levels have moved irregularly higher.

The most recent domestic decline in industrial production, amounting to 13 per cent, was greater than declines reported in 1949 and 1954. Since April industrial production has risen sharply and in September, according to a preliminary estimate, it was only 4 per cent below the level of August 1957.

Unemployment remains at a level close to the maximum reached during the recession, lagging as it often does in recovery. The rise in output has been achieved in part through increased employment but much more through increased hours of work and increased productivity.

Wholesale prices of commodities and consumer prices of goods and services have risen somewhat further during recent recession and recovery. But price developments have been more selective than the broad indexes suggest.

Last autumn and early this year, prices of industrial commodities eased, with a sharp decline in sensitive industrial materials, and the rise in the total index of wholesale prices then mainly reflected advances in prices of farm products. More recently, industrial material prices have been strengthening while farm product prices have been declining.

Farm land values have continued to advance through recent recession and recovery, accompanying a sharp rise in farm income resulting from higher livestock prices and the combination of unprecedented crop yields and price supports. Through earlier postwar cycles, farm land values had generally advanced, while incomes drifted downward, reflecting in part growing confidence that the sharp income increases of the war period would be held much more than after the First World War, when both incomes and land values declined markedly.

In some financial markets, adjustment to revival in economic conditions has been anticipatory. Stock prices began to decline before the downturn in industrial production and, from mid-July to year-end, dropped one-fifth. In January, they began to turn up and are now close to their all-time peak, while production and profits are still well below earlier highs. Stock market trading activity lately has been unusually heavy.

Adjustments in bond markets have been later than stock prices in coming about, but have come sooner than in earlier cycles and have been very sharp. Bond yields remained at high levels through mid-November 1957, then dropped one-seventh in two months. Long-term yields stabilized at this reduced level until early summer. Since then, reflecting in part a spreading acceptance in financial circles of the inevitability of creeping inflation and investors' need for an inflation premium in long-term interest rates, they have risen rapidly to levels close to the highs of 1957. Thus, with re-emergence of inflationary expectations, stock yields and bond yields have completed a swing of marked amplitude since the crest of 1955-57 boom. While recovery in most fields is by no means complete, the relationship of bond and stock yields is now similar to that of mid-1957 when creeping inflation psychology was also dominant in financial markets.

With bank reserve positions eased last winter, banks were able to provide additional funds to the market on terms relatively favorable to borrowers. Until very recently, business borrowing at banks has lagged as inventories declined, but other bank lending increased moderately and bank investments rose rapidly. As a result, the money supply--seasonally adjusted--has risen sharply this year. It is now about 2 per cent above a year ago.

Moreover, time deposits at commercial banks until recently have risen sharply, partly swollen by a recession shift of precautionary and speculative balances from a demand to a time deposit category. Time deposits are currently 15 per cent above a year ago. Turnover of demand deposits outside New York is about 2 per cent below highs reached last year but turnover in New York is up considerably.

In the light of these key facts, how is the currently developing economic situation to be interpreted? Are we really not emerging from recession, as unemployment figures might suggest? Or is this about the middle of a period of rapid recovery, as the industrial production figures might indicate? Is this a normal type of recovery? Or is this some unusual

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combination of recovery-boom developments with half recovery in output accompanied in financial markets by so much discounting of possible inflationary developments as to impair chances of a flowering of recovery into vigorous economic advance? And what should be the posture of monetary policy in the face of an uncertain recovery outlook?

Following analyses of business and financial developments during the recent recession and subsequent recovery which included references to business cycle theory and comparisons between recent developments and the pattern of earlier business cycles, the staff presentation concluded with the following statement:

Recovery from the April lows has been something of a surprise, challenging economic analysts to fresh study. Is this the middle of a normal recovery, with the usual problems of overexpansion in demand and rising prices in the period ahead? Will legacies of excess capacity from the preceding investment boom and of unused labor resources perhaps check price advances? Or, on the other hand, will faster than usual recovery perhaps lead to greater than usual inflationary pressures? In what ways can monetary policy assist in shaping a sustainable recovery? Specifically, at what rate should the economy's holdings of cash balances--the money supply--be permitted to increase?

After eight months of decline in industrial production, just at the time when business expectations were being influenced by the idea of a levelling-out period such as occurred in 1948-49 and 1953-54, rapid recovery in the economy was in fact beginning. Thus, once again it appears that the normal course of every cycle is a unique course.

Going back before the war, it is evident that after the 1937-38 decline recovery also started promptly but the preceding decline had been much greater and the background circumstances were different in major respects.

Considering this cycle then as another unique cycle, why did the rise come so quickly and why was it so sharp? Clearly there was no single event, domestic or international, to explain the early, general rise.

One factor was an overshooting of the mark on the downside, creating a situation favorable to quick reversal. Thus, inventory liquidation was at a rate in some sense too fast, especially considering the maintenance of most types of consumer expenditures and the revival of defense procurement. The rate of decline in capital outlays was also very fast.

One element counteracting the rapid decline in domestic private investment and helping to sustain consumption was the large shift in Federal finance from surplus to deficit position--reflecting a substantial rise in defense and other payments to the public.

Furthermore, aggressive monetary actions were easing credit conditions and by early 1958 the money supply was increasing at a rapid rate. The active money supply rose at an annual rate of 7 per cent from January through July and, adding time deposits, the rate of increase was 10 per cent. In the past two months, however, changes in deposits have conformed to the usual seasonal pattern.

One of the recurrent news items of the recession months last winter and spring was the announcement that, contrary to earlier expectations, consumer prices had again reached a new high. This certainly encouraged the view that values were not being undermined by the recession and that prices were bound to go up further over the longer term.

The various developments just noted encouraged the irregular rise in stock prices before the advance in economic activity and this rise in turn was a factor in changing business attitudes.

Now, what do the observations already made concerning the nature of this recovery since April suggest with respect to the direction of business and credit developments and of appropriate monetary and debt management policy? It seems evident that the behavior of prices during the recession, the speed and generality of the recovery, the pace of monetary expansion since spring, and the size of the Federal deficit in prospect have brought new support to the proponents of the theory of the inevitability of creeping inflation. Once again, as in most of the postwar period, the central problems of the years ahead may well be those of unsustainable demands and widespread price advances. Prices are already being raised for some industrial products, including steel, whose output has yet to reach 70 per cent of capacity.

While the price experience of the recession and of the recent recovery have encouraged the view that price levels

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were bound to trend upward, it need not even now be taken as decisive. Prices did show some selectivity in movement during the recession, with sensitive industrial materials down sharply. Also the rise in consumer prices, in so far as it depended on the vagaries of the weather and the biology of the cattle cycle, was in part fortuitous.

Furthermore, question may still be raised as to the possible effect of excess capacity in helping to check any broad price advance. The latest survey of plant and equipment plans does suggest that present capacity is not so large as to prevent some recovery in capital equipment outlays later this year. Also, current sharp increases in profits may stimulate expansion in such outlays and provide some of the needed funds. But present capacity and other resource availability may, nevertheless, be large enough to cushion the effects of increasing demands on prices and facilitate effective operation of such credit restraints as may be needed.

The totally different behavior of U. S. exports in the last two cycles raises the question of what effect changing foreign demands may have on domestic activity and prices. As noted earlier, the moderate export expansion this spring was mainly confined to agricultural products. Exports of machinery to nonindustrial countries were falling.

While there has already been a considerable recovery in Canada, prospects for resumption of general expansion abroad depend partly on maintenance of world trade, and partly also on resumption of growth in investment expenditures. In Canada, a bottoming out of the decline in investment outlays is now expected. But in Britain some decline in capital expenditures is expected this year, after a rise that extended right into the first quarter of 1958. In Canada and also in Germany, growth of residential construction activity, stimulated by ample availability of mortgage funds, has been a strong force for general expansion. But indications of cyclical upturn in steel and textiles in Europe are still scanty and tentative.

Following a period of sharp drains on the gold and foreign exchange reserves of some countries, there have been renewed gains in reserves for most industrial countries and these have led to easing of the credit policies of central banks in Europe and Japan, although this easing has been done with caution. The International Monetary Fund has helped relieve foreign exchange strains for many nonindustrial countries, and has exerted an important influence for tighter internal

policies in countries still suffering inflation. A continuing large outflow of private U. S. capital has helped to sustain foreign reserves and U. S. exports.

Altogether, assuming that international political developments do not have major economic repercussions, it would appear that demand on the U. S. economy from abroad in the near future may continue near recent levels.

In the domestic financial area, developments have been so rapid and so much influenced by actions to provide protection against inflation that financial markets, in some sense, may be out of touch with underlying forces. The current relationship between bond yields and stock yields, for example, may not be indefinitely sustainable. While total demands for financing are increasing and restraints have been placed on further bank credit expansion, the total supply of loanable funds in the economy is still very large. Further expansion in economic activity to earlier peaks is not likely to be seriously hampered by lack of funds, although it might be retarded by the recent sharp rise in interest rates, which appear to have been excessive in view of basic demand and supply factors in credit markets.

Under these circumstances, considering the importance of curbing inflationary and speculative developments before they gain headway, the central policy issue would seem to be how much monetary restraint should be exercised at this time. Clearly, this issue should be resolved with reference to the System's responsibility for maintaining in a growing economy reasonable stability of the value of the dollar, as well as in employment. Taking into account the monetary expansion already experienced this year, the currently accentuated problem of Federal deficit financing, and the inflationary psychology pervading financial markets, the appropriate course would seem to be along the following lines: To permit further expansion of credit and the money supply only on terms which would indicate the System's continuing awareness of potential inflationary risks in the present situation and its determination to prevent them from stimulating speculative excesses in the use of credit.

In view of the current disturbed conditions in bond markets, the effect of declining securities prices upon bank liquidity when they are facing seasonal credit demands and large scale Treasury financing needs, and the slackening of credit expansion in the past two months, continuation of the recent degree of restraint may be appropriate. Yet the prevalent speculative fever and inflationary psychosis, together with the underlying liquidity of the economy and the genuine

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stimulants to expansion call for the imposition of severe restraint on any tendencies toward undue expansion.

Copies of the text of the economic presentation and reproductions of the accompanying charts have been placed in the files of the Federal Open Market Committee. Copies likewise were sent following the meeting to the members of the Committee and to the Reserve Bank Presidents not currently serving on the Committee.

Mr. Rouse reported having learned that total subscriptions received in New York for the new Treasury issues, including those received yesterday, now amounted to \$1.6 billion for the bills and \$846 million for the notes. The market seemed to be reasonably stable after an unsteady opening, and the System Account had purchased \$44 million of Treasury bills this morning. The reported subscription figures, Mr. Rouse said, indicated that the Treasury financing would at least be covered.

Mr. Treiber then made a statement substantially as follows:

The economic recovery has been proceeding nicely. Further improvement may be expected during the fourth quarter, but probably not at the rapid rate of recent months. The most important item pressing upward is the prospect of increased Government spending.

Consumer spending is high but is conservative in relation to consumer income.

While residential construction has reached the highest level in three years, recent gains have been modest, and anticipatory figures such as FHA appraisals and VA applications do not suggest further increases. The less favorable position of mortgages in relation to other alternative investments is raising questions as to the prospect for residential building beyond the current

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year. The decline in plant and equipment expenditures seems to be over, but there is no basis for expecting a strong upturn soon. While in June all the major component series in the index of industrial production were rising from the preceding month, the rise was not so general in August. Unemployment is still high; in fact it rose slightly in August to 7.6 per cent. Unemployment of long duration also rose.

Certainly, near-term profit expectations don't justify the recent rise in the prices of stocks to record levels. No doubt the desire to own equities rather than debt obligations has been an important factor in the behavior of the stock market.

As for prices other than of stocks, spot and future prices of basic commodities continue to decline. The whole-sale price index declined in August after showing little change for several months. The consumers' price index appears to have entered a period of stability.

To summarize our views on the economy: Recovery is likely to continue at a reduced pace, without generating bottlenecks and unusual demand pressures. Rising productivity is likely to reduce labor requirements generated by a growing physical output, so that unemployment may continue to be large.

The rapid expansion of bank credit of earlier months has been checked. Holdings of Government securities by the reporting member banks have declined to the lowest levels since early June, suggesting that Treasury deficit financing does not necessarily involve rapid expansion of credit.

The yields on long-term securities--U. S. Government, corporate and municipal--have risen with extraordinary rapidity in recent months. The yield on Treasury bonds due or callable in 10 years or more is now higher than the October 1957 peak. Aaa corporate bonds are very close to their 1957 high, while Aaa municipal bonds are back to November 1957 levels. Thus in an early stage of recovery we find long-term interest rates at about the same level they were at the peak of the boom. This is disturbing, especially in view of the current amount of unemployment.

Short-term interest rates also have risen very rapidly in the last two months. Indeed the rates on bankers acceptances and commercial paper have risen another 1/4 per cent this morning. It seems to us that a pause in the rise would be beneficial at this stage of the business recovery.

The Treasury has just offered for cash subscription two short-term issues totaling \$3-1/2 billion. Attractive interest rates were fixed by the Treasury--3-1/4 per cent on

a seven-month fixed-price bill and 3-1/2 per cent on a thirteen-month note, but the market has adjusted quite fully to these rates so that at present no premiums on the new issues are indicated. Since the subscription books closed only last night, it is too early to know the amount of subscriptions.

We are not quite six months from the bottom of the recession and the Treasury can borrow only with great difficulty at high rates. In the last quarter of 1958 not only will the Treasury have to refund \$12 billion of securities but it will have to borrow about \$2-1/2 to \$3 billion for cash in addition to the \$700 million it expects to raise through increasing the weekly Treasury bill issues to \$1.8 billion. The Treasury will have to raise further substantial sums in cash during the first half of 1959, beginning in January; this will be quite different from previous years when the first six months of the calendar year were marked by surpluses.

The difficult financial operations confronting the Treasury raise again the question of the responsibilities of the Federal Reserve in connection with Treasury financing. The policies of the Federal Government with respect to income and spending are determined by the Congress. The Treasury is bound by these policies. The Government must be financed.

There is, of course, some latitude in the details of Government financing, and the Treasury has the primary responsibility for determining those details. It seems to me that our administration of credit policy must pay appropriate regard to the Government securities market and to the financing requirements of the Treasury, within the limits set by essential monetary policy.

There must be a maximum of coordination between the System and the Treasury consistent with the primary responsibilities of each. The Treasury should price its securities adequately in relation to market rates, and it has done so in its current financing. The Treasury having done so--having submitted itself to the discipline of the market--the System has a responsibility to avoid action that may jeopardize the current financing or future financing.

As underwriters of the new issues the commercial banks will be large buyers. Reserves should be supplied to enable

the banks to acquire the securities in the first instance, and the reserves should be there for a reasonable period to facilitate the completion of the underwriting. As the securities are sold to nonbank investors the reserves released thereby will be available to meet seasonal business needs. Experience in the current underwriting will be an important factor in the willingness of the banks to perform the underwriting function in connection with future Treasury issues.

The extent of the recovery to date and the prospective rate of continuing recovery do not call, in our opinion, for further restrictive action at this time. The Treasury's financial operations call for market stability not only through the dates for payment of the new issues but for a reasonable period thereafter, say to November first.

In our opinion the System should seek to maintain an even keel at least through the period until the next meeting of the Committee. Such a policy would involve avoiding, by act or word, anything that might cause a deterioration of market atmosphere. Such a public policy would include:

- (a) no change in discount rates;
- (b) no change in the directive; and
- (c) probably the maintenance of free reserves at something like the present level.

Perhaps we should consider offering resistance to further rises in short-term rates, particularly if expectations by the market of further tightness on our part continue and seem to be the major force in the deterioration of the market.

We should not at this time undertake to decide or predict what action should be taken at the end of the "even keel" period, but should make that decision when the time comes in the light of economic and credit conditions at that time.

Mr. Erickson reported that there continued to be evidence of recovery in the First Federal Reserve District. In some respects the current pace in the district seemed to be faster than for the nation as a whole while in other respects the district seemed to be lagging. The manufacturing index for New England in July did not move up from June but in August it moved up 4 points, due primarily to metals. In States for

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which reports were available, the employment trend from July to August was stronger than in 1957, although weakness was still seen in durables. The States of Connecticut and Rhode Island had their first gains in manufacturing employment for many months. Construction contract awards in August were 33 per cent ahead of August 1957, due primarily to public utilities. On the other hand, there was still weakness in residential construction which was running far below the national average. Electric energy output, department store sales, and savings bank deposits were still moving up.

Turning to policy, Mr. Erickson said he thought there was a great deal in what Mr. Treiber had said. He felt that the System should maintain as even a keel as possible; that it should continue the degree of restraint which had been maintained during the last three weeks. In his opinion the present situation called for no change in the directive or in the discount rate, and to the extent possible free reserves should be held between \$100 and \$200 million.

Mr. Irons said that there was nothing new to discuss in regard to developments in the Eleventh District. Conditions were good and the situation was generally favorable. With regard to credit policy, it seemed to him that during the past three weeks the Account had been reasonably successful in maintaining an even keel, that is, in maintaining a sort of static position in regard to reserve availability. At this time, he felt that there probably

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should be no significant change in monetary policy. There should not be a lessening of restraint; rather the System should attempt to maintain about the degree of restraint already achieved. Under the prevailing circumstances, this would mean giving considerable leeway to the Management of the Account to take care of day-to-day situations that might come up and had not been anticipated. As to the discount rate, he had nothing particular in mind but he felt sure that a change in the rate should not be long deferred. The Treasury in its offering and its rate, and the market in its reaction to the rates, have pretty well taken the action for the System if the rates on bills and other short-term securities are any indication. With the bill rate in the neighborhood of 2.80 or 2.90, with the discount rate at 2 per cent, and with the market having responded to the Treasury issues, some thought might well be given to the matter of a discount rate change. However, Mr. Irons said, he was not pressing for a change at any particular time. Furthermore, he doubted whether it would be desirable for a rate change to be made by any one Bank in isolation.

Mr. Irons said he fully recognized that it was necessary to give support to the Treasury as far as the present issues were concerned. This meant that the System should be reasonable about the availability of reserves and that it should not tighten appreciably, perhaps not at all right now. However, one of the reasons for the Treasury's situation was to be found in what appeared to be a very

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strong inflationary fear or psychosis. Until that fear had been dispelled by one means or another he did not believe that the market would be ready to go into Treasury securities, at least until the market believed that the threat of inflation was going to be combated. If there could be no real confidence in the continuity and soundness in policy, Mr. Irons said, there were not many people who were likely to become heavy buyers of Government securities. If the fear of inflation was an important factor in the market, this meant that sooner or later the market had to be convinced that it was not a factor, and until such time it was hard to blame people for going into equities. The problem was certainly a difficult one but sooner or later--whether now or a month from now or two months from now--the decision would have to be faced up to by the System.

Mr. Mangels reported that from preliminary figures the West Coast continued to show an expansionary trend in early September. However, it was noticed that two areas--agriculture and construction--which earlier were principal factors in the expansion were now beginning to level off. While farm returns continued to exceed those of 1957, the margin was narrowing. Thus, while Twelfth District gains were greater than the national average in the first part of 1958, in the past two months farm returns in the district were only 7 per cent above a year ago as compared with an increase of 11 per cent nationally. In the construction field, heavy engineering contract awards for the first

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eight months of the year were six per cent above the similar 1957 period but August figures showed a rather sharp drop. Similarly, awards for public construction, particularly public buildings, were lower in August than in any month since January and February of this year. In addition, there were indications that some large institutional investors who put funds into West Coast mortgages had now withdrawn from the market. However, most residential builders felt that they were well equipped with commitments for mortgage funds to carry through programs to the end of the year.

Continuing his resume, Mr. Mangels said that lumber orders for the first half of September were better than for August and for a year ago. Lumber production was below the volume of orders received and the volume of shipments made, with producers working down inventories. The lumber producers had avoided a strike by signing new contracts with the labor unions calling for an increase of 7-1/2 cents per hour. At the same time they had reduced lumber prices, reflecting partly a seasonal adjustment but primarily the feeling of the industry that prices had gone up too rapidly for current market conditions.

Steel mills in the district were operating at about 80 per cent of capacity and producers were looking forward to good business during the remainder of 1958. Nonfarm employment continued to move up and was now only 1 per cent below the April 1957 peak. There had been further increases in aircraft, machinery, and ordnance employment but

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word had been received that the aircraft firms anticipated some decline in employment between now and the end of the year. Unemployment declined less than seasonally in August.

Mr. Mangels said that bank loans in the district were up slightly in the three weeks which ended September 17 due to a \$34 million increase in real estate loans. On the other hand, business loans were down \$17 million for the period as compared with a \$98 million increase during the similar period a year ago. This drop might be noteworthy because business loans usually expand at this time of the year. Two or three San Francisco banks indicated a slight pickup in loan demand but it was not pronounced as yet, and some banks reported that deposits had not increased to the extent anticipated. While demand deposits were up \$178 million, time deposits declined for a second straight period, this time by \$40 million. There had been some increase in member bank borrowing from the Reserve Bank, with banks in each of the reserve cities of the district except Portland having been in and out during the past three weeks. The banks of the district were substantial buyers of Federal funds whereas usually they are net suppliers, and it was anticipated that they would continue to be in the market for Federal funds.

Mr. Mangels said that, while the recovery did appear to be proceeding with considerable vigor, there might be some question as

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to how long the rapid pace of that recovery would continue. There had been some rumblings about a slowing down in residential construction activity, attributed partly to a tightening of monetary policy. Plant and equipment expenditures did not indicate immediate pickup and the future of automobile sales was not particularly certain. Demand for bank credit was not heavy but in some instances banks had already become a little more restrictive in making credit available. Also, the Treasury would have some major problems in connection with its future financing.

Mr. Mangels noted that average free reserves for September had been about \$150 million, ranging up to \$221 million and down to \$120 million. He agreed with those who had suggested that a range of free reserves between \$100 and \$200 million would be a proper objective; he would not favor going down to a zero level. He regarded the policy directive as satisfactory and he would not favor a change in the discount rate just at this time.

Mr. Deming said that there was little new to report from the Ninth District. In general, the district economy continued to recover from its rather mild recession low. The farm picture remained favorable, the mining situation continued to be weak, and total nonfarm employment was still running below last year's levels. Perhaps the most noteworthy development was in business loans at city banks. The gain in such loans in September through the 24th of the month was

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broadly based and was substantially larger than in any comparable period during 1957 or 1958. In the first quarter of this year business loans at city banks dropped slightly in contrast to a small gain in the like period of 1957, while in the second quarter they gained about the same amount as in the second quarter of 1957. However, in the third quarter the gains had been stronger than a year earlier. Whether those gains would continue was problematical, since bankers seemed to feel that no more than a normal seasonal increase was in prospect for the rest of the year.

Mr. Deming said that on the national scene he was impressed by three things. The first was the continued high level of unemployment and the probability that it would continue for some time, the second was the apparently strong prospect of higher productivity and perhaps even of increasing gains in that area, and the third was the very sharp increase in debt security yields and the contrasting decline in equity yields. The first two of these developments would seem to point to the probability of further expansion without very much price pressure; the third seemed to indicate in part a rather substantial increase in money tightness, in part a strong belief in future economic expansion, and in part some fear of future inflation. At the last Committee meeting, Mr. Deming recalled, Mr. Thomas spoke of the possibility of following a policy which would aim at putting sufficient reserves into the market to take care of seasonal needs and letting

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the market tighten or ease in reflection of more or less than normal seasonal demands. Leaving aside the question of just what represents normal seasonal needs, he found this broad approach most appealing. It would mean a very careful appraisal of seasonal needs, reasonably close timing of reserve injections, and almost complete abandonment of free reserves or net borrowed reserves as a guide. Assuming a reasonably accurate appraisal of needs and good timing, and assuming a normal seasonal increase in needs, it would also mean that the present state of conditions in the money market should be preserved--no greater ease and no greater tightness--with interest rates becoming the chief measure of such conditions.

Mr. Deming said he believed that the discount rate should be advanced as quickly as possible by one-half per cent, primarily as a technical move rather than a restrictive move. It might well be that a further advance would be desirable in the latter part of the year, but that would depend on developments. If demand did not increase as anticipated, there would be no need to move further; if it grew more than expected, further rate increases might be in order. Mr. Deming concluded by saying that he saw no reason to change the directive at this time.

Reporting on the Seventh District, Mr. Allen said that perhaps the most significant economic development was the evidence that in this district, too, the downward trend in capital expenditures had been halted and might soon be reversed. In fact, an important factory

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locating service in Chicago indicated that their current work-load was the greatest in their history. To mention scattered reports, two new steel expansion programs had been announced for the Chicago area and a well-known food processor was understood to be reactivating a program for replacement of all old facilities. Virtually all Seventh District centers which furnish employment information were reporting either the beginning of a rise, after adjustment for seasonal trends, or an ending of the deterioration. There had been no change in the prospects for crops, which continued very favorable. Loans of district reporting banks had increased substantially since the month of August, with most of the expansion in business loans, while investments had declined. Although the rise in business loan figures at district banks in the past six weeks exceeded that of the nation, the decline in the district from October 1957 through July 1958 was considerably greater than that of the nation. The large Chicago banks, after being net sellers of Federal funds for an extended period, last week were net purchasers, but they still were not borrowing at the discount window. On the other hand, Detroit banks had not only been net buyers of Federal funds but had been borrowing in substantial amounts at the Detroit Branch, largely because this is the time of year when their largest depositors--the automobile companies--are making substantial outlays with relatively little income.

Speaking of the automobile business, Mr. Allen said it was difficult to interpret current sales data because this year the model

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clean-up period was earlier by the calendar than last year. The daily rate of sales for the period September 11-20 was only half of the rate a year ago but last year the sales dip did not come until October. Dealers' stocks of new cars on September 20 were 417,000--around 332,000 1958 models and 85,000 1959 models--so it appeared certain that the goal of 400,000 new cars on the first of October would be attained. In fact, current labor difficulties might result in a lower figure. Meanwhile, used car inventories were at the lowest absolute levels since 1952. An acute shortage of one- and two-year old cars was attributed to the low new car sales in the last year and the resulting drop in used car trade-ins. Used car prices firmed several months ago and were still rising, and with the shortage of later model used cars more upward pressure on prices could probably be expected. This could be a stimulus to new car sales. In Detroit there was widespread but cautious optimism about the reception of the 1959 models. Most forecasts for 1959 sales were around 5 to 5-1/2 million for domestically produced cars and around 400,000 for imports, which would be close to 25 per cent above the level estimated for 1958. Automobile production in September had been low because of the changeover shutdowns and because of numerous walkouts incidental to labor negotiations. On the Ford contract, the first-year cost of the package was estimated at between 12 and 16 cents per hour on an annual basis. However, even with the contract

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signed many thousands of Ford hourly workers had not yet returned to work because of dissatisfaction with the provisions, and conditions at General Motors and Chrysler were even worse.

With regard to policy, Mr. Allen said that despite all of the crosscurrents and difficulties encountered in determining direction, the course for at least the next three-week period seemed quite clear. The pause to which Mr. Treiber had referred actually appeared to have begun three weeks ago and he (Mr. Allen) felt that it should continue. If the Committee were to aim at maintaining the current level of free reserves, that would mean that it was providing what the banks would require to take on the new Government securities. Of course, the Committee did not yet know how many of those securities the banks would take or how long it would require for the banks to market them. In the circumstances, for the next three weeks he would aim at maintaining the current level of free reserves, which would in effect mean maintaining an even keel. However, before the end of that three-week period the Open Market Committee might want to hold a telephone meeting if developments seemed to warrant. Mr. Allen concluded by saying that he would not favor changing the discount rate at present.

Mr. Wayne stated that the Fifth District continued to follow about the same course that it had been following for the past several weeks. The upturn was real and not illusory in the district but the

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pace was not as rapid as indicated by the national figures. There were one or two spots in the district that were causing a bit of concern. The textile industry, which is the largest manufacturing employer in the district, continued to operate on a fairly full basis but inventories at mill level were rising slightly. Orders had not been keeping pace for the last couple of weeks and efforts were being made in the cotton sector of textiles to extend the usual Thanksgiving and Christmas holiday periods in order to work off some inventory at mill level. There was, however, no expectation of any shutdown and the real problem of the industry related to profits; in output and employment the industry was running at a fairly even rate not far off bottom, which was where it had been for the last year or so. Another somewhat disturbing note was that contacts in the southern bituminous coal areas expressed the conviction that a wage agreement had already been reached between the United Mine Workers and the northern bituminous coal industry, the natural consequence of which would be a demand upon the southern producers. This would result in increases in coal prices of from 40 to 60 cents per ton and the ultimate effect might be to destroy the important utilities market. The concern was with the long-range effect on the district, particularly in the depressed areas of West Virginia which were running at their customary low level. However, the rest of the district's economy seemed to be holding up well. The outlook for agriculture over the rest of the

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year was encouraging and on the whole economic activity in the district was definitely moving up.

Mr. Wayne reported a consensus at the Richmond Bank that the degree of restraint the System had been applying in the last three weeks was appropriate to the circumstances. The district's reserve city banks were apparently feeling some effects of this restraint on their reserve positions and some erratic upsurge in borrowing at the reserve city level had been observed. This, no doubt, would continue since financing needs would affect the reserve positions. There was an unwillingness to take security losses if they could be avoided and the lack of availability of Federal funds was likely to send the banks to the discount window.

Mr. Wayne expressed the view that the present degree of restraint should be maintained, certainly for the next three weeks. He would not be inclined to change the discount rate at this time but felt that an upward movement in the rate might be appropriate in the not too distant future.

Mr. Mills said that he had found the staff economic presentation illuminating, particularly from the standpoint of its historical perspective and the questions it raised regarding economic movements as they might develop in the near future. His own remarks, he said, would be confined to the financial factors that the System must grapple with in the near future. Mr. Mills then made the following statement:

A monetary and credit policy dedicated to maintaining an appropriate availability of credit must be followed. Credit availability in this sense means the provision of an adequate supply of reserves in support of legitimate demands for commercial bank credit. Even though some overflow of expenditures may occur as the result of rising Federal disbursements, concern over this possibility should not be permitted to cause Federal Reserve policy-making to overallow for such expenditures by an offset in the way of an unnecessarily severe restriction on the expansion of commercial bank credit.

The diversified effects from the use of commercial bank credit are essential to economic recovery and stability and cannot properly be curtailed on the premise that the more limited economic coverage of Federal expenditures can be a substitute.

Consequently, Federal Reserve System policy should lean on the side of supplying reserves in a quantity that will support all visible demands for the legitimate use of commercial bank credit. A by-product of this policy contention is reiterated--namely, that a parsimonious policy of supplying reserves, by damaging the market for U. S. Government securities may subsequently compel the Federal Reserve System to supply a greater quantity of reserves in support of Treasury financing programs than would otherwise be the case. An approach toward bringing about a continuous condition of negative free reserves should be very cautious and exploratory as to effects. In that connection, I am relieved to see that there seems to be no disposition to press the supply of reserves too strongly in that direction. Along the same line, attention should be paid to the fact that the demonstrable thinness of the U. S. Government securities market has produced an element of artificiality in the interest rate structure that gives the appearance of a supply-demand inspired increase in longer term interest rates that did not occur in reality. On the contrary, the lack of two-way trading in U. S. Government securities by putting upward pressure on interest yields has compelled other public and private borrowers of long-term funds to hurry to the market to provide themselves with funds at constantly higher interest rates in order to compete with increasing interest yields forced upon U. S. Government bonds. Therefore, in the absence of orderly market developments for U. S. Government securities it may well be that economic historians of this period will discover an abrupt upward distortion in interest rates that had not been the consequence

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of movements in an appropriately free securities market, but had been caused in part by the restricted market activity of the commercial banks, the depreciation in whose bond accounts prevented their trading except as necessitous sellers, which transactions acted as an additional market depressant.

Mr. Mills said that according to his concept of Federal Reserve System policy the System should stand ready under present conditions to supply reserves to serve as an equilibrating factor between the demand for long-term capital funds and the demand that is even now in evidence for term loans from the commercial banks. The latter could produce an unwanted expansion of bank credit. An appropriate well-gauged provision of reserves might conceivably bring these two kinds of demands for funds into reasonable balance and, by fostering some measure of stability in the capital markets, prevent an unnecessary demand for term loans from being pressed upon the commercial banks.

Mr. Mills said that he would not care to propose any change in the policy directive. As to the discount rate, he would hope that it would not have to be changed. However, developments--in some part of the System's own making--might force an increase in the discount rate to align it more closely with market rates. He hoped the rate would not be changed unless there was a disposition to allow the member banks to borrow more liberally at the Federal Reserve Banks as a means of permitting them to obtain the differential in earning power between the discount rate and the rate available to them on bills and in other areas of investment. The only conceivable

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advantage of such a development would, of course, be to provide reserves at the initiative of the member banks as an element for working toward stability in the Government securities market and the capital markets. On the other hand, a movement of that sort would involve policing problems from the standpoint of the appropriate use of Federal Reserve Bank credit and that could prove extremely difficult.

Mr. Robertson stated that the big problem today was to continue to combat--and to dispel if possible--the widespread expectation of inflation. In his opinion, monetary policy could do that best in present circumstances by exerting a continued pressure. By this, he did not mean additional pressure but the continuation of pressure such as had been maintained during the past few weeks. This would mean a difficult job for the Manager of the Account because of the additional tightness that would be created when banks paid for the Treasury securities that they purchased. It would also mean a difficult job in the following weeks when more of the money obtained by the Treasury went back into the economy. Nevertheless, he would hope that the Account Management could maintain approximately the same degree of pressure as had been maintained during the past few weeks. Although it was appropriate to consider within the System the raising of the discount rate, he could not see any possibility of making that move in the next few weeks. On the other hand, it was his opinion

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that the rate should be changed at the earliest possible time. He would not favor a change in the policy directive at present.

Mr. Shepardson said that he found no need to comment further on the general economic picture that had been presented. His thinking on policy, he said, was much in line with the thinking of Mr. Robertson and also that of Mr. Irons. The problem of the Treasury in the months ahead would be affected materially by the psychological atmosphere and some way must be found as expeditiously as possible to minimize the fear of inflation. Like Mr. Treiber, he felt that in order to obtain the participation of the commercial banks in underwriting the Treasury flotations there should be a period of reasonable stability until the present offering was digested. This would contemplate that the Account Management should try to maintain the present degree of restraint--not increase it in any way--in order to take care of the digestive period. However, the nature of the job to be faced at the end of that period should be kept in mind. It should also be remembered that it would be a relatively short time before the Treasury would be in the market again. Plans, therefore, should be laid in the direction of a greater degree of restraint and adjustment of the discount rate in order that the System might make its full contribution to allaying the fear of pending inflation. He would not be inclined to make any change in the directive at this moment.

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Reporting from the Fourth District, Mr. Fulton said that there was an aura of optimism in the business community. The manufacturers had felt for some time that the liquidation of inventories was overdone, and the buying now taking place was sound and necessary rather than speculative. In steel, the rate of production had increased in the district more than in the nation as a whole and orders were up about 10 to 15 per cent in the last month. They were not particularly heavy from the automotive industry; instead they came from a broad segment of users, including the appliance industry. Steel operations were now at about 64 per cent of capacity in the district against April production of around 40 per cent. A disturbing note, however, was the belief in the industry that steel prices were going to go up again in early 1959. The steel contract is scheduled to expire next June and it is feared that a large package is being prepared by the union. As evidence of the apprehension, steel fabricators were now taking orders for delivery in 1959 at increased prices ranging from \$3 to \$5 per ton.

The machine tool industry, Mr. Fulton said, showed a modest increase in orders but backlogs were diminishing. Unemployment had been reduced slightly but the picture was affected by the strikes and the model changeover in the automobile industry. In general, unemployment was still substantial and there was no upward movement in employment commensurate with the upturn that had taken place in

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production. Department store sales were up somewhat but for the year to date were down 4 per cent from last year, while auto sales were very low--30 per cent below a year ago. Agricultural income in the district had been hurt rather badly by incessant rains; the hay crop spoiled to a large extent and it appeared likely that in many cases the grain crop would be left in the fields. From an agricultural standpoint, therefore, the Fourth District would not do very well this year.

Mr. Fulton said that bank loans rose in September, this being the first gain since June. Banks reported an increasing number of inquiries about term-loan credit, with borrowers apparently trying to work the capital markets against the bank loan rates. Banks had been borrowing at the discount window without hesitation and discounts this month were 13 to 17 per cent of the national total. The discount window was in frequent use and the discounts were of good size.

Turning from district developments to policy considerations, Mr. Fulton said that the System had to face up to the threat of inflation and the problem of increasing prices all along the line. He would not like to see any backing up from the pressure that the System had been exerting in the market. Although the System might have a difficult time trying to prove itself, he felt that it should stand fast and keep a pressure on the market such as to give an adequate signal that the System was firmly of the belief that inflation should not prevail. He also believed that the discount rate should be raised

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by 1/2 per cent as soon as feasible so as to bring it into better alignment with money market rates. He saw no reason for changing the directive at this time.

Mr. Bopp said that the Third District was showing some modest improvement. Continued claims for unemployment compensation were down somewhat in recent weeks, although they continued to be significantly above year-ago levels. Loans of weekly reporting banks were up during the past few weeks but, on the other hand, were down from corresponding periods last year. In this connection, he noted that year-to-year comparisons from now on would be likely to become more favorable because of the trends that began to develop about this time last year.

With regard to System policy, Mr. Bopp said that in his opinion the problems confronting the Treasury were such as to dictate maintaining an even keel during the next three-week period. He would not favor any change in the directive at this time, or in the discount rate.

Mr. Johns reported that the cotton crop was going to the gins late this year. During a trip last week through the southern parts of the Eighth District he heard a good deal of apprehension expressed by informed parties concerning the weather from here on out. There had been excessive moisture thus far, and if weather conditions caused further delays the cotton crop might be down substantially. Mr. Johns also reported that business loans at banks in the district were up less

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than seasonally in the last four or five weeks, principally attributable to the volume of loans to commodity dealers. In most recent weeks there had actually been a contra-seasonal decline in loans because of less borrowing by finance companies.

Mr. Johns said he was rather impressed by the results of a survey made recently among real estate mortgage bankers in the St. Louis area. From this survey it would appear that there had been a rapid and substantial turnaround in the availability and cost of mortgage funds; respondents had spoken with astonishment about the suddenness and rapidity of this change. A number of smaller insurance companies and other purchasers of real estate mortgages are reported to have disappeared or withdrawn from the market. Although the larger ones customarily do not withdraw completely but continue some activity, though at lower levels, in order to maintain mortgage banker correspondent relationships, the amounts they are making available to such correspondents have been reduced and a further reduction of as much as 50 per cent is expected next year. There was some opinion that for a time, and to some extent, savings and loan money might pick up some of the slack, but it did not appear that this could continue to offset the insurance company decrease for a very long period of time. To what extent and when these developments would be reflected in reduced housing starts remained to be seen.

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In further comments Mr. Johns said that conversations with representatives of the larger banks in the district indicated that they did not feel that their banks were in a very liquid or easy position. They had no bills to speak of, they have substantial losses in their Government bond portfolios, and there is a sharpened reluctance to dispose of bonds at current prices, especially in a number of banks which took capital gains in the early part of the year. The banks, he said, foresaw no very strong loan demand this fall.

Mr. Johns stated that he agreed with the view expressed several times at this meeting that there should be no increase in the existing policy of restraint, at least for the time being. However, he said, there was considerable opinion within the group with whom he consults in the St. Louis Reserve Bank that at the first appropriate time--whenever that might be--the discount rate should be adjusted to bring it into better alignment with present short-term market rates; also, that an increase of 1/2 per cent was the least that should be considered under circumstances now existing. The next directors' meeting at the St. Louis Bank, Mr. Johns said, would come in the midst of Treasury payment dates and he was not inclined to think that adjustment of the rate at that time would be appropriate.

Mr. Szymczak expressed the view that one of the strongest fears in the market at the present time reflected the large

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Government deficit and the resultant need of the Treasury to go to the market to borrow new money. What happened in the Government securities market in July and early August, he said, was not due to a policy of restraint on the part of the System; in fact, any criticism leveled at monetary policy during that period would have to be on the grounds that it was too easy. Instead, it was an expectation on the part of purchasers that security prices would rise that caused the speculation. Now the Treasury had a large Government deficit to finance, and in view of the large number of unemployed the market appeared to feel that money must continue to be supplied, whether that was inflationary or not. It seemed to be the general conclusion that inflation was in the offing, as reflected by the trend of stock market prices. The frozen portfolios of the commercial banks made the situation difficult for them, particularly because they were liquid for a long period of time and suddenly became illiquid.

Mr. Szymczak went on to say that much of the uncertainty regarding the future appeared to be due to lack of clarity of Federal Reserve policy. Therefore, it seemed to him essential that System policy be clear, continuous, and steady. He felt that seasonal demands for credit, whatever they might be, should be met through open market operations. Like Mr. Mills, he felt that the System could not allow the Government securities market just to

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keep on faltering because sooner or later the System would have to come to its support and perhaps provide more reserves than would otherwise need to be provided. In his opinion, free reserves should not go down to the zero level. While he did not like to mention any specific figure, he noted that operations in the market in recent days had been substantially along the lines of keeping free reserves above zero and maintaining an even keel. That, he felt, was about where things should stand.

Mr. Balderston, after commending the Desk for achieving the degree of stability that had been maintained in the past three weeks, said he was concerned about the misunderstanding on the part of some people as to why rates had moved up. As he saw it, the change in margin requirements and the discount rate had little or nothing to do with it. Instead, the basic considerations mentioned by Mr. Szymczak had caused quite naturally a stiffening of rates, short as well as long. It appeared that one must look forward to a long period when the Federal Government would be competing with the private sector of the economy for capital funds, and the competition would make it difficult for corporations, State and local governments, and the Federal Government itself to acquire the funds they desired at prices they would like to pay. The System's immediate task was to see that monetary policy helped to make the current bank underwriting of the Treasury issues a success in order to overcome the bankers'

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disenchantment with the underwriting role. The Treasury, he noted, had priced these issues in accordance with what those responsible for monetary policy would wish. In fact, the pricing was so much on the liberal side that any lack of success of the issues would be an indication of a greatly disturbed market. These particular issues, he said, had to make the bankers feel that the next time they would be willing to do the necessary underwriting. Therefore, an even keel in monetary policy seemed called for during the period until the next meeting of the Open Market Committee. In other words, he would like to see open market operations conducted during the next three weeks in a manner as similar as possible to the past three weeks.

It was important, Mr. Balderston suggested, to avoid rumors during the ensuing period and there should be no discussion of a discount rate change at the Federal Reserve Banks. If such discussions and rumors were to reach the market, confusion would certainly be the result. When the System did move, however, circumstances would seem to dictate moving more decisively than had been customary at times in the past, particularly because the intervals available for action would be short. Unless the System made its move as a System, neither the public, the market, nor the Congress would understand the situation and they would be properly critical. In summary, when the time came to move he would hope that, to avoid confusion in the market, the move would not be strung out, and instead the System would move as a System.

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In an introductory comment, Chairman Martin said that it was encouraging to note the degree of unanimity around the table this morning. He expressed wholehearted agreement with Mr. Irons' analysis of the overriding problem with which the System was confronted and of the Treasury's longer-range problem. At the last meeting, he said, he was rather discouraged about the role of the Federal Reserve System. Personally, he had not anticipated that recovery would be as rapid or as full as had turned out to be the case. While the Treasury had not been perfect in its analysis of the situation, within the System family emphasis should be placed on the System's own faults first, rather than on what other people do. In his opinion, the System had not acted definitely, clearly, or sharply enough during the past two months to make possible the type of Government securities market that he regarded as necessary and essential.

At the last meeting, Chairman Martin recalled, he had expressed himself to the effect that if he had been doing it on his own he would have moved the discount rate to 2-1/4 per cent. No one, of course, can do it on his own. However, it must be recalled that after the difficult July period the System had about two months when it was free to act so far as Treasury financing was concerned. The problem, of course, was complicated by the irregular scheduling of directors' meetings, especially during the vacation period. In any event, there were now

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two problems--the economic problem and the financial problem--and a sympathetic critic of the System had said to him several times in recent weeks that the System appeared to be much more proficient in economics than finance.

Chairman Martin expressed the view that action today should be directed toward the three-week period ahead. Nevertheless, he agreed that at the first feasible time a move should be made toward better alignment of the discount rate and the bill rate. In talking about an even keel, he said, one must remember that there is a flowing reserve picture, which means that in order to maintain a given degree of restraint, substantial reserves may have to be supplied due to seasonal factors. Another way to think about it would be to say that in maintaining an even keel one must try to maintain about the level that there is in the stream. Also, it must be recognized that it is necessary to give the Treasury some period of stability both before and after it goes to the market. It would be most unfortunate at the present time for the System to pull the rug from under the Treasury immediately following the current financing. Most press commentators, he noted, would be anticipating an increase in the discount rate and a further tightening of credit because that was the logic of the situation.

Continuing, Chairman Martin commented that differences within the System and within every organization are all to the good, but when

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an organization can not resolve them effectively it is not functioning properly. The System, in his opinion, did not have too good a record in the last discount rate experience. In saying this he was not blaming anyone, just trying to put the matter in terms of the future and the situation that he could see developing. Within the System there had been real differences of opinion, based mostly on economics rather than finance. At the same time, the market was very much upset because it thought at one point that the System was going to ease further, and later because delays by various Reserve Banks in coming into line on the discount rate caused people to think that the move was going to be to 2-1/4 per cent. In going through the journals he did not find any expectation that the New York Bank would not move its rate. Rather--and he was just citing the New York Bank as an example--the theory was that the debate concerned whether to go to 2 per cent or to 2-1/4 per cent. That was unsettling to the market and confusing to the logicians looking at the market.

As the System approached the forthcoming period, Chairman Martin said, it should not foreshadow what it would or would not do. While it did not seem likely, there was always the possibility of a downturn between now and the time of the next meeting of the Committee. However, even if the current upward trend continued, he would hope that no Reserve Bank would move on the discount rate prior to the next Committee meeting, at which time there would be another opportunity to review the

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situation. If it appeared at that time as though some action should be taken, he would hope that it might be possible for at least three or four Banks to act so that the action would be sharp and decisive. Furthermore, it was his opinion that if conditions appeared to call for an upward adjustment, that adjustment should be 1/2 per cent so that there would be no misunderstanding of System policy. To stick a knife in the wound, he observed, is only to prolong the misery.

In short, Chairman Martin said, there had been some uncertainty in the market and the System had participated in the creation of that uncertainty. He was not saying necessarily that one point of view was right and the other wrong, but as an institution the Federal Reserve must resolve its differences and move. From here on, the System would have only limited time periods in which to make its moves because of the Treasury situation.

Chairman Martin repeated the observation he had made at other meetings of the Committee that the System was very fortunate from the standpoint of the cooperation exhibited by the Treasury during this period. He had found both Secretary Anderson and Under Secretary Baird to have a rare degree of understanding of the System's problems. While they did not always agree with the System, they were fully as anxious to defeat inflation as those in the Federal Reserve.

The Chairman went on to say that in approaching its responsibilities the System should bear in mind the needs of the Treasury

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without, of course, making them overriding. In other words, the System should realize that this was a joint endeavor. There was a sick Government securities market, and while he had not tried to analyze all of the causes, the Federal Reserve System could not be held entirely blameless for the sickness of the market.

Summarizing the views expressed at this meeting, Chairman Martin said that it seemed very clearly the desire of the Committee to try to maintain an even keel in the market, and that no change in the policy directive appeared to be contemplated. It also seemed clearly to be the desire of the Committee to give the Desk latitude to take into account the color, feel, and tone of the market. No one appeared to favor a further increase in the degree of restraint that had been exerted; nor, on the other hand, was there a desire to ease the market. The prevailing view would be to endeavor to keep the general level of free reserves within about the same range as had prevailed during the past three weeks.

Chairman Martin went on to say that if some situation should develop before the date of the next regular Committee meeting which indicated a need for a telephone meeting it would, of course, be proper to have one. However, it was his view that telephone meetings should be avoided if possible. Barring unforeseen developments, it did not seem to him that from now to October 21 would be too long a period in which to pursue an even-keel policy. At the October 21

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meeting there could be another full discussion, and then it would not be possible for the System to continue indecisively; it must decide one way or the other, and any action should be clear and decisive. Thereafter, there should be again a period of stability before and after the Treasury went into the market.

Chairman Martin then asked whether there was any question about the directive or about his summation of the meeting, and no questions were raised.

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

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

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

It was noted that if meetings of the Federal Open Market Committee were maintained on a three-week schedule a meeting would fall on Tuesday, November 11, which is a legal holiday in Washington and other parts of the country. After discussion of alternatives, a general preference was expressed for Monday, November 10, and it was understood that a meeting on that date would be contemplated.

Some of the Reserve Bank Presidents then reported figures that had reached them during the meeting from their respective Banks concerning subscriptions to the issues involved in the current Treasury financing. It appeared from these reports that the subscriptions were running rather favorably.

Pursuant to the understanding at the Committee meeting on September 9, Mr. Rouse had distributed to members of the Open Market Committee and the Presidents not currently serving on the Committee under date of September 11, 1958, a memorandum on speculation in the Government securities market prepared at the New York Bank for the use of the Technical Committee of the New York Money Market. Under

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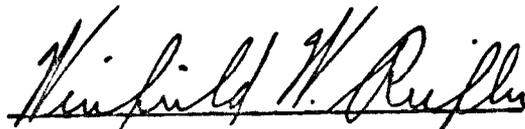
date of September 22, Mr. Rouse also had distributed a summary of the first meeting of the Technical Committee, which was held at the New York Reserve Bank on September 15, 1958.

Mr. Rouse commented that his secretary had received from Under Secretary Baird's office a request for additional copies of the two memoranda, since the supply sent originally by the New York Reserve Bank to the Treasury had been exhausted; a copy of the memorandum had gone to the President, and Secretary Anderson had asked that a copy of the summary be sent to the Secretary of Commerce.

Chairman Martin stated that Mr. Mills had been designated by the Board of Governors to head up the Board's study of speculation in the Government securities market. He said that arrangements had been made with the New York Stock Exchange for a representative of the Exchange to confer with Mr. Mills and members of the Board's staff.

It was agreed that the next regular meeting of the Federal Open Market Committee would be held on Tuesday, October 21, 1958, at 10:00 a.m.

Thereupon the meeting adjourned.


Secretary