

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, August 18, 1959, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Allen
Mr. Balderston
Mr. Deming
Mr. Erickson
Mr. Johns
Mr. King
Mr. Mills
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Hayes

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

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

Mr. Riefler, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Messrs. Marget and Mitchell, Associate Economists
Mr. Rouse, Manager, System Open Market Account

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

Mr. Wayne, First Vice President, Federal Reserve Bank of Richmond

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

Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia

Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas

8/18/59

-2-

Mr. Gaines, Manager, Research Department,
Federal Reserve Bank of New York
Mr. Stone, Manager, Securities Department,
Federal Reserve Bank of New York
Mr. Brandt, Economist, Federal Reserve Bank
of Atlanta

Chairman Martin noted the attendance of Mr. Wayne in the absence of Mr. Leach, Mr. Tow in the absence of Mr. Leedy, and Mr. Noyes in the absence of Mr. Young. No objection being indicated, Messrs. Wayne, Tow, and Noyes were invited to participate in the meeting.

The Chairman then called attention to the fact that Mr. Thurston had relinquished his duties as Assistant to the Board of Governors on July 31, 1959, and that his service as Assistant Secretary of the Federal Open Market Committee therefore automatically terminated.

The Chairman also reported that Mr. Solomon had submitted his resignation as Assistant General Counsel of the Federal Open Market Committee effective September 1, 1959, in view of his transfer from the Board's legal staff to the Division of Examinations.

Thereupon, Mr. Solomon's resignation was accepted.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 28, 1959, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period July 28 through August 12, 1959, and a supplementary report covering the period August 13 through August 17, 1959. Copies of both reports have been placed in the files of the Committee.

8/18/59

-3-

Mr. Rouse reported that the money market had remained tight during the period since the last meeting. Reserve positions at reserve city banks had continued under pressure while the New York banks experienced an increase in pressure, as evidenced by the fact that their basic reserve deficiency averaged well over \$500 million during the past three weeks. Aggregate borrowings had averaged more than \$1 billion for the past two statement weeks, and might well average more than \$1 billion in the week ending tomorrow. Borrowings had typically increased sharply on Friday of each week and had exceeded \$1 billion on every Friday since the week ending June 3.

Open market operations supplied \$29 million reserves on balance over the three weeks. The Account purchased Treasury bills and made some repurchase agreements early in the period, but in the past few days took advantage of opportunities to sell bills and allowed the last of the repurchase agreements outstanding to run off last Thursday.

The rate on three-month Treasury bills, which had been running at around 3.30 to 3.40 per cent in mid-July, moved down to around the 3 per cent level shortly before the last meeting of the Committee and stayed there until early last week, when it began to rise under the influence of the additional 91-day bills sold by the Treasury in connection with its cash financing program. In yesterday's auction the average rate on the 91-day bill was 3.42 per cent, about where it was in mid-July, but about 42 basis points above where it was at the time of the last meeting. The six-month and one-year bills, on the

8/18/59

-4-

other hand, edged downward through most of the period, and it was only last Thursday that rates on these bills began to increase. At the close yesterday, these bills were at about the same level as at the time of the last Committee meeting, but were considerably lower than in mid-July. As a result of these relative rate changes, the unusually wide spread between the 91-day bills and the six-month and one-year bills had narrowed substantially and the 91-day bill had been brought into a more customary relationship not only with the rate on the other two bills but also with the discount rate. One aspect of the spread between the rates on the three-month and six-month bills was that customer tenders submitted by the major New York banks for six-month bills about doubled between the auctions of July 27 and August 10, while customer tenders for the 91-day bills fell by 40 per cent. As a result, in the August 10 auction customer tenders in New York for the 182-day bills exceeded those for the 91-day bills by \$20 million. Much of the demand which kept the rate on short bills as low as it was until last week represented the storm cellar demand that had been evident for several months. In addition, the liquidation of inventories brought about by the steel strike may have been a source of demand for shorter bills.

Prices of Treasury notes and bonds moved higher over most of the period, but a technical reaction set in last Wednesday and prices moved lower. The new 4-3/4 per cent notes of 1964 resisted this reaction for a time. Last Friday, for example, the issue gained

8/18/59

-5-

nearly $1/4$ point to close at 101-10/32 bid, while the rest of the market was declining. Yesterday, however, the $4-3/4$'s turned around and lost $6/32$ as the rest of the market continued to decline. Over the period as a whole the $4-3/4$'s of 1964 gained $3/4$ point, while prices of other notes and bonds, which until last Wednesday had shown gains in every issue, closed $3/8$ point lower to $3/4$ point higher.

The corporate and municipal bond markets were firm during the early part of the period in reflection of the improved atmosphere of the bond markets generally. In the past few days, however, attention was focused on the growing calendar of forthcoming offerings and this dampened the atmosphere somewhat.

Reserve projections of the New York Bank indicate that natural market factors will absorb reserves over the next few weeks and that in the absence of open market operations average net borrowed reserves will increase to over \$600 million next week and rise to the \$800-\$900 million range in the following two weeks. The New York Bank learned late yesterday afternoon that required reserves of country banks had been revised upward by \$43 million extending back to July 16. This information was received too late to be incorporated in the projections attached to the supplementary report of open market operations. Hence all net borrowed reserve figures shown therein should be revised upward by \$43 million.

Mr. Rouse commented that the Treasury was giving some consideration to raising the \$200 million new cash which it planned to

8/18/59

-6-

raise in next week's bill auction by placing an additional \$100 million in both the 91-day and the 182-day bills, rather than to place the whole \$200 million in the shorter issue, as had been done the past two weeks. However, the Treasury had not yet made a decision on this matter. The Treasury would be out of the market until around October 1, when it would be necessary to raise new money. The Treasury would need this new money by October 9 at the latest.

In response to a question by Mr. Balderston with regard to the prospective Treasury situation around the first of November, Mr. Rouse noted that the Treasury had issues maturing November 15 and that the November calendar was complicated by two holidays. He added that the Treasury would have to come back to the market in December for cash, probably about \$2 billion. The Treasury might also have to come to the market in January and April, in addition to its refunding operations.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period July 28 through August 17, 1959, were approved, ratified, and confirmed.

Supplementing the staff memorandum distributed under date of August 14, 1959, Mr. Noyes presented a statement substantially as follows with respect to economic developments:

Many economic observers anticipated that we might see some slackening in the rate of recovery in the third quarter

of this year. These predictions were based in part on the assumption that the rapid pace in the first half was due in some measure to inventory accumulation in anticipation of the steel strike (or a settlement involving price increases) and in part on the assumption that the major impact of the fiscal 1959 deficit fell in the first half of this calendar year. Some also expected that the very high rate of construction, especially in the residential sector, would not be maintained.

For the time being, there appears to be little support for these expectations. But as the quarter progresses it will become increasingly difficult to tell whether the movements in most of our measures of activity reflect the steel strike, the shifting winds of international politics, or some basic change in the economic situation.

The two-point decline in the index of industrial production in July can easily be accounted for by the steel strike. In fact, we can guess that the index might well have increased by another point or more were it not for the strike and related developments. Actually, the index lost 3-1/2 points due to the decline from prestrike levels of activity in steel, coal, and ore, but we must recognize that to some extent those levels were artificial in that they related to the prospect of the strike.

It now appears that gross national product for the second quarter will be almost \$485 billion--about a billion more than was generally anticipated.

Construction has been well maintained, and the 1,350,000 seasonally adjusted annual rate of housing starts in July came as a surprise to many who had anticipated that the large volume of building earlier in the year and increased tightness in the mortgage market would show up in a reduced level of starts by this time. All the evidence to date indicates that consumer demand, supported by substantial consumer borrowing, is continuing at very high levels. The most recent data on auto sales, for the first ten days of August, are up again from the reduced rate in early July. In the first full week of August, department store sales were 9 per cent above a year ago, which is especially significant because of the extraordinarily high level that prevailed at that time.

If the steel strike continues, and if the personal visits back and forth among the heads of state add further to the expectation of peaceful coexistence, we shall certainly see declines in some of these measures of economic activity. Then it will be difficult to judge whether the underlying situation is still strong, or whether these declines also reflect some slackening in the mounting demand pressures that have characterized the year to date.

8/18/59

-8-

For the moment, it seems clear enough that the drop in production is more than accounted for by the strike and the reaction in the stock market is primarily attributable to a re-evaluation of the international situation. Hence, all indications are that the underlying situation at present is one of strong and broadly based demands. At the same time, abstracting from the possible effect of whatever strike settlement is ultimately agreed upon and the possibility of renewed international tension, the immediate outlook for continued price stability appears to be very good. The fairly tight position maintained in recent months with respect to credit availability, coupled with the fact that the Congress has shown less zest for many types of expenditure than was expected, appears to have so tempered the burgeoning demands in the economy as to hold them generally within the limits of our rapidly expanding output of goods and services.

In fact, the first half of 1959, and perhaps the first three quarters, may well appear in retrospect as a period in which markets, influenced by well-timed and courageous action in the field of both monetary and fiscal policy, performed their traditional function of directing resources to their most efficient uses, within the framework of reasonable over-all price stability.

Mr. Koch made substantially the following statement with respect to financial developments:

Having just returned from four weeks of vacation, I should be listening rather than talking today. But perhaps it will be of some interest to you to relate the main impressions of the current financial situation that strike one who has been away from the scene for a time.

Looking first at our most immediate field of interest, bank credit and money, I am struck most by the heavy and persistent loan demand. Loan growth at city banks since midyear has been larger than in the comparable period of any postwar year except 1950, when loans expanded sharply following the outbreak of hostilities in Korea. This recent growth followed a record \$5-1/4 billion loan increase at all commercial banks in the second quarter, 40 per cent more than the previous high second quarter in 1955. This was due in part, of course, to the build-up in metal and metal product inventories in anticipation of the steel strike. Moreover, we are just entering the usual seasonal build-up in business loans at banks, reflecting harvest and other autumn needs for funds.

As to the recent heavy loan demand on banks, I am impressed by the importance of the consumer in these demands. Strong consumer borrowings are reflected not only in the sharp increase in the instalment loan portfolios of banks but also in their real estate loan growth and in the heavy borrowing of finance companies.

Despite the large increase in bank loans thus far this year, the active money supply has been held to a seasonally adjusted annual rate of growth of 3-1/2 per cent when measured by end-of-month figures, lower when measured by daily average figures. It changed little in May and June and then increased sharply, \$1.4 billion, in July—a month in which banks initially bought practically all of the \$5 billion of new Treasury bills. Deposits at city banks have declined thus far in August, in the main due to special and seasonal factors.

Growth in deposits has been kept moderate in recent months because banks have sold substantial amounts of Government securities at their higher yields to nonbank investors. This development, in turn, has reflected the increased pressure on bank reserve positions, as well as the higher loan to deposit ratios of banks today compared with those of similar periods of other recent economic expansions.

Turnover of bank money is also up sharply, reflecting tighter credit conditions and higher interest rates. The seasonally adjusted annual rate of turnover of demand deposits at leading cities outside financial centers is currently not only 15 per cent above its trough in the recent recession but also 7 per cent above its peak in the previous upswing in the third quarter of 1957.

I am struck, too, by the hesitation in the stock market and the related strength, or at least absence of further weakness, in bond markets. Even before the sharp drop a week ago yesterday, stock prices had been drifting lower. They are still, however, only 2-1/2 per cent below the peak reached on the first trading day in August. Although the recent decline has been generally described as a "technical adjustment", we should probably be expecting some reactions in the stock market with current dividend and earnings to price ratios as low as they are.

The recent improved tone in bond markets has no doubt been associated to some extent with events in the stock market, but it has also undoubtedly reflected the adjustments from the over-reactions in markets for fixed-yield securities to the Treasury's

earlier poor debt and cash position, to fears of further inflation, and to expectations of large prospective private and municipal demands for credit and capital. It has also reflected seasonally low new offerings of securities by corporations and State and local governments, and an assurance that there could be no additional long-term Treasury offerings with the 4-1/4 per cent interest ceiling. Yields on outstanding bonds of all types are currently down 5 to 10 basis points from their recent peaks, and interest rates on most shorter-term obligations are also down from recent highs.

There is a feeling developing in financial markets that pressures on interest rates and bond yields may be beginning to reassert themselves, but this feeling has not yet been reflected in most of the available financial statistics. Three-month Treasury bill yields, however, which had fallen to less than 3 per cent, have increased to a level only slightly below rediscount rates.

A correlated impression of one who has been away is the better cash and debt position in which the Treasury finds itself today as compared with only four weeks ago. That was before the recent highly successful refunding and just after the two large issues of bills had been auctioned at high rates of interest. Last week's \$1 billion issue of March tax anticipation bills went at 3.72 per cent, and the Treasury is expected to be out of the market until October.

Some of these impressions suggest a pause in financial developments in recent weeks. It is extremely difficult, however, to appraise what part of any pause that may have occurred was due to the steel strike, to the usual summer lull, and to what may be transitory international events. To my mind, no signs in recent financial developments contradict the continuation of a vigorous economic upswing.

Finally, as to the immediate problem facing open market operations, the Board's staff reserve table distributed to you this morning shows--and this is broadly confirmed by the New York Bank's figures also furnished to you this morning--that market factors are likely to drain a considerable volume of reserves from the banking system over the next two weeks. This is due mainly to the rise in required reserves resulting from initial bank purchases of the recently auctioned Treasury bills as well as other credit expansion, and to the usual late-month decline in float. Assuming no change in credit policy and a desire to maintain over the next two weeks approximately the level of net borrowed reserves of the recent past, this seasonal drain could be met by repurchase agreements. However, since it is likely to persist, except

8/18/59

-11-

for brief periods, on into the fall as a result of the working of seasonal factors, it might well be met by outright purchases of securities.

Mr. Marget commented as follows with respect to the United States balance of payments:

At the last meeting of the Committee, after having reported the sobering news of a projection for a balance-of-payments deficit this year considerably larger than the already large deficit of last year, I reported the late arrival of an estimate of U. S. exports in June; and I suggested that it was barely possible that these figures might turn out to be the first significant evidence of that turn upward in our exports for which we have been hoping. At that time we did not have any details as to the nature of this increase in exports. Now that we have these details, we can ask whether they are or are not such as to encourage an optimistic view as to a possible turn in our balance-of-payments position. The answer is that, as far as they go, they do support an optimistic view.

To begin with, the June rise was not the kind of export rise we had been having through May. This earlier and slower rise was concentrated in agricultural commodities, and was largely related to U. S. surplus disposal programs; this hardly brought much encouragement to those of us who were concerned particularly about our competitive position in the field of manufactures. But in June there was a significant and widespread increase in nonagricultural exports--the first such increase since the export decline began two and a half years ago.

Secondly, the distribution of the improvement within the range of nonagricultural exports was such as to suggest that we have not yet lost our ability to compete in some fields about which some pessimism has been expressed. The case of coal, for example, the exports of which did drop sharply again in June, is not a proof of our noncompetitive-ness: we know that we can produce and land coal in Europe more cheaply than many European producers can sell it, and that proof of this was provided some months ago when Germany, in particular, put up discriminatory restrictions against U. S. coal which have not yet been removed. What is striking, on the other hand, was the pickup in the exports of such things as motor vehicles, which included

8/18/59

-12-

advances in the exports of trucks, tractors, and automobile parts, together with some increase in passenger cars. As the written report of the staff points out, exports of trucks and tractors were up about one-third as compared with a year earlier, and automobile parts were up by a fifth.

Having reported this much, which I would certainly call good news as far as it goes, I hasten to point out that it still doesn't go very far. In the first place, it is only one month that has shown this degree of improvement. The months to come are those that will tell the story. Secondly, the kind of turning point for which we have been hoping has not yet been evidenced in the post-June figures for the international movement of gold and dollars, which is, after all, the reflection of the magnitude of our over-all balance-of-payment deficit, though it must be said that the more recent increase in the deficit, as so measured, large though it is, is still somewhat less than it was expected to be on the basis of the forecast of a \$4.5 billion deficit for the whole year. Finally, as I suggested at the last meeting of the Committee, even if we have in fact begun to see the turn in our export performance, we still have a very long way to go before we get our foreign accounts into balance. On the most optimistic basis possible, our balance-of-payments problem is likely to continue to be with us for some time to come.

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

The business situation remains strong despite the month-old steel strike, while price trends in most markets have continued steady.

In the Second Federal Reserve District some 31,000 steel workers are on strike; 23,000 of these are in the Buffalo area. Presumably reflecting the steel strike, department store sales in Buffalo during the three weeks through August 8 were up only 1 per cent from the corresponding weeks last year, while sales in the District as a whole were up 6 per cent. The steel strike apparently has had little effect in the District outside the Buffalo area. Four of the District's major labor market areas were reclassified to show lower unemployment in July and there are now no major labor market areas in the District classified as having unemployment of 9 per cent or more. Reports from about the District indicate optimism on the business and employment outlook over the next few months.

8/18/59

-13-

Bank credit has been expanding throughout the country. There has been a strong demand for bank loans widely distributed among different types of borrowers; this has been especially true as to all types of consumers. So far, the steel strike appears to have had little effect on business borrowing. Bank investments rose by only \$250 million in July in connection with the Treasury's \$5 billion cash financing; in early August bank investments were reduced by more than that amount.

Demands in the capital market have been surprisingly light this summer. There are, however, signs of at least a seasonal building up of new capital market issues in the next few months.

Although the money market has continued tight, the yield on Treasury bills tended to move lower until a week ago. The impact of the new Treasury financing has since helped to turn short-term rates around. Yields on three-month bills have risen to a point well above what they were three weeks ago.

When the steel strike is settled, a new burst of expansion is likely. And we may expect an upward pressure on prices. The intensity of the pressure will depend on the length of the strike and the nature of the settlement. At this stage the steel strike is an important uncertainty. Another factor that must be borne in mind is the public spotlight in which we now find Federal Reserve policy as the Congress and the Administration struggle with legislation to remove the limitation on the maximum rate of interest on U. S. Government bonds. Whatever action is taken by the System will be subjected to critical public analysis and will be evaluated particularly in the light of the steel strike.

While a further tightening of credit restraint may well be called for in the near future, immediate overt action does not seem appropriate. We would not recommend a change in the discount rate or in the directive at this time. It does seem to us, however, that it is desirable for the System to move toward greater restraint through open market operations. If current reserve projections are borne out, this aim might be accomplished to a large extent by allowing market factors to absorb reserves. This would primarily be a matter of the Manager feeling his way. If the tightening is too severe, reserves could be supplied "reluctantly" to meet a part of the expanding needs.

Mr. Erickson said that the latest available statistics on production, construction, employment, and trade in the First District

8/18/59

-14-

continued to present a favorable picture and that the steel strike had thus far had little impact. Most steel users reported sufficient inventories to last for a few weeks. Industrial production in the district rose in June, although not as much as nationally, while construction was strong, being 8 per cent ahead of last year and 27 per cent ahead of 1957. The cumulative figure for the first six months of this year was 15 per cent higher than last year, and the picture was strongest in residential construction, 37 per cent ahead of last year. All of these comparisons were more favorable than the national figures. Employment improved in June, as compared with May, mostly in construction, trade, and services, but compared with a year ago the greatest improvement was in manufacturing. This improvement had led to the upward classification of labor areas; six areas formerly classified as having unemployment of 9 per cent or more were reclassified, with the result that in July there were no such areas in the district. Retail trade continued to be good, although not as strong as nationally.

Mr. Erickson reported that the July survey of mutual savings banks showed one bank paying interest of 3-3/4 per cent, 29 paying 3-1/2 per cent, 30 paying 3-1/4 per cent, and 13 paying 3 per cent. The survey also showed that the interest rate on conventional mortgages, generally, in Boston and New Hampshire was 5 per cent, while in the rest of the district it was 5.5 per cent. These levels appeared to be somewhat lower than those prevailing in many other sections of the country.

8/18/59

-15-

Turning to questions of policy, Mr. Erickson said that he would recommend no change in the directive and that he would not favor a change in the discount rate. As to open market operations for the next two weeks, he would leave it to the Manager of the Account to judge the feel of the market and to keep that feel as tight as it had been. He would supply reserves reluctantly and resolve any doubts on the side of restraint.

Mr. Irons reported that the economic picture in the Eleventh District continued to be one of strength, although there had been some leveling off, perhaps attributable to the summer lull. Department store sales in July, while well above a year ago, were slightly under June totals. In the petroleum industry, production and refining both edged a bit lower, pulling the industrial production index down slightly. While the stock position in the petroleum industry had perhaps improved a little, it seemed likely that there would be no increase in allowables in the district in September, or possibly even into October. The steel strike as yet was not an important factor. Employment was strong and rates of unemployment, measured in terms of percentage of the labor force, continued to run appreciably below the national figures. In construction the picture also was one of strength. Mortgage money was reported to be available at a bit higher prices, with the levels still somewhat below national average figures. The agricultural situation was very

8/18/59

-16-

good, the situation in the fields appearing even better than the statistics. To summarize, while there may have been a bit of leveling off, perhaps due to the summer lull or the petroleum situation, most of the indicators were holding at a high level.

With respect to banking, Mr. Irons said that reserve positions were tight and bankers were talking continually of an unusually strong demand for credit. They stated that they were being selective and could easily increase their loans further if they had the wherewithal to do so. Various kinds of consumer lending had advanced sharply and some seasonal demand was now beginning to show up in the loan picture. There had not been much change in the rate of borrowing at the Reserve Bank over the last three or four weeks; with the exception of an occasional day or two, discounts were running close to 5 per cent of the System total.

Turning to policy, Mr. Irons said he found himself in agreement with the statements made by Messrs. Treiber and Erickson.

Mr. Mangels said that the Twelfth District picture was similar to that described by Mr. Treiber as far as over-all production was concerned. No serious effects of the steel strike were seen as yet and general business activity did not appear to have been dampened down. Two major labor market areas had been removed from the severe unemployment classification, leaving only a few smaller areas still classified as critical. Exclusive of the steel strike, some 60,000 persons were on strike at present within the district, but worker

8/18/59

-17-

income nevertheless was at a high point, some 10 per cent higher than in mid-1957. This was reflected in a greater increase in department store sales in the Twelfth District than for the nation as a whole. Auto sales were holding up well. Instalment credit had been increasing quite rapidly, and banks appeared to be stretching out repayment terms, but delinquencies were considerably lower than a year ago. Residential construction was declining, and agricultural income was expected to be somewhat less than last year due to lower prices and higher costs incurred by farmers.

Mr. Mangels went on to say that demand deposits showed a modest increase during the past three weeks. While total time deposits were down, savings deposits increased \$184 million. Bankers were commenting on the tightness of money and indicated that they were being selective, yet loans increased more than \$300 million in the three-week period. The banks had been selling Government securities somewhat more rapidly in the Twelfth District than elsewhere; only 2.3 per cent of the total portfolios of district banks was in bills as compared with 9.3 per cent for the nation as a whole.

Mr. Mangels saw no compelling reason why restraint should be increased at this time. The Treasury financing was still in the picture and the effects of past restraint were beginning to take a strong bite. In a number of cases, banks were declining loan applications from substantial customers. Exclusive of those on strike, approximately 5 per cent of the labor force was unemployed

8/18/59

-18-

and some excess productive facilities were still available. In two weeks, Mr. Mangels suggested, the Committee might be able to evaluate better the seriousness of the effects of the steel strike. He concluded by saying that he would favor no change in the policy directive and that he saw no occasion to change the discount rate at this time.

Mr. Deming reported that some adverse effects of the steel strike were beginning to be seen in the Ninth District, but that so far they had been confined almost exclusively to the iron ranges. The longer the strike lasted, the more severe these effects would be on the ranges. Early settlement of the strike probably was more important to that section than to any other, the mines being highly seasonal in activity. By and large, rainfall continued inadequate in large areas of the district, and the August crop estimates showed an even more unfavorable comparison with a year earlier than did the July 1 estimates. South Dakota, in particular, had been hard hit.

Bank loan demand continued to be very strong, Mr. Deming said. Loan-deposit ratios were high by any recent past standards and had shown more growth so far this year than in the nation generally. City banks, however, seemed to feel that the peak of pressure may have passed. Country bank loans fell slightly in the most recent half-month period, but the prospective need to carry over a larger than normal volume of farm loans due to drought, plus cattle feeding requirements, seemed likely to keep country bank loans higher than usual for the balance of this year.

8/18/59

-19-

As to policy, Mr. Deming expressed agreement with Mr. Mangels. He would prefer to see no increase in the pressure on reserves, and he saw no particular reason to change the discount rate or the directive at this point.

Mr. Allen said that the underlying economic picture remained strong and relatively unchanged in the Seventh District. Some businessmen were thinking in terms of a leveling off of activity late this year, and it seemed reasonable to expect a slowing of the rapid expansion that had been experienced. But assuming settlement of the steel strike in the reasonably near future, no evidence was seen at this time of any basic change in the general business picture.

The automobile manufacturers, Mr. Allen said, felt that production lines could run on present inventories of steel until October 15. By this, they meant that they would be able to run at scheduled rates, which contemplated lower production during the change-over period. In August, production of 260,000 cars was expected as against sales of around 460,000, which would reduce inventories 200,000. Another reduction of at least 150,000 in September was contemplated. Thus the high inventory of 965,000 cars on August 1 should be reduced on October 1 to about 600,000--still a full figure under normal conditions but perhaps not excessive (as a matter of business judgment) considering that the duration of the steel strike was an uncertain quantity.

Reporting banks in the Seventh District had shown a steady loan expansion since mid-July in all categories except loans on

8/18/59

-20-

securities. Moreover, the increases in business, real estate, and finance company loans were considerably greater at Seventh District banks, in the three weeks ended August 5, than at reporting banks for the nation as a whole. However, heavy net sales of Government securities, largely the short-term issues acquired in the Treasury's July cash financings, more than offset the loan growth. Thus, reserve pressures on district banks had not been severe. The basic position of Chicago central reserve city banks was not as good as a month ago, but it was less tight than two months ago. District reserve city banks continued to sell Federal funds on balance and their borrowings at the discount window had been reduced, while country banks showed little change in position.

Mr. Allen saw no reason to change the directive at this time. The Chicago Board of Directors was to meet the day after tomorrow--the only meeting prior to the next meeting of the Open Market Committee--and he expected to recommend no change in the discount rate, largely because a major industry was on strike and the strike might last a long time. Some months hence, he might feel that he had made a mistake in judgment and should have urged a rate increase at this time, but in any event another Chicago directors' meeting was to be held on September 3, by which time the picture might be clearer. With reference to the operations of the Desk, he would not change the direction followed in recent weeks. However, he agreed with

8/18/59

-21-

Mr. Erickson that doubts should be resolved on the side of restraint.

Mr. Wayne said that the situation in the Fifth District was similar to that reported for the nation as a whole. The only effects of the steel strike were those clearly to be expected: the layoff of some 30,000 workers in the Baltimore area, spreading unemployment in the bituminous coal mining regions, and the layoff of some workers by the coal-moving railroads. Otherwise, the strike appeared to have had no appreciable effect on the level of economic activity, and there was no evidence of any change in the optimistic sentiment evident throughout the district. The rate of increase in loan totals had slackened somewhat since the date of the last Committee meeting; loans were no longer rising at a pace as fast as indicated by the national figures or as fast as they had previously in the district. This suggested that some of the demand was being resisted by banks in a tight reserve position or that the situation had moved back into a somewhat more normal pattern for reserve city banks. Earlier in the year, some banks were called upon to make good on outstanding lines of credit that had been in existence for years, but unused, and some of this might now be moving back.

With respect to policy, Mr. Wayne indicated that his views were similar to those expressed by Mr. Erickson.

Mr. Mills said that in following the discussion today and the discussions at previous Committee meetings, he detected a tendency

8/18/59

-22-

to use as the measure and criterion of the effectiveness or ineffectiveness of Federal Reserve System policy the expansion of commercial bank loans. There appeared to be an inclination to doubt the effectiveness of System policy in view of the continued rise in such loans. On the other hand, if one focused his thinking on the total of commercial bank loans and investments, which he believed was the correct measure and criterion on which to fix policy actions, one noted a substantial divestment of Government securities from commercial bank portfolios, a movement which was now tending, to a degree, to spread to other types of securities. This suggested to him that System monetary and credit policy had been more restrictive than might seem to be the case from surface indications; that is, from looking only at the movement of loans. Mr. Mills then read the following statement:

There is nothing in the economic situation as I see it that would justify any change in the views that I have expressed on the System's monetary policy at previous meetings of the Federal Open Market Committee. There are certainly no reasons that I can find to commend intensifying the restrictiveness of the System's present policy. On the contrary, a more moderate monetary policy, in my opinion, is still called for. In any event, there are two redeeming elements in the monetary policy that has been pursued which have prevented the development of as severe restrictiveness over the availability of credit as would otherwise have been the case:

1. The periodic injections of additional reserves that have been made on the occasions of Treasury financing operations have tended to relieve the build-up of reserve pressures.
2. The higher average level in the volume of Federal Reserve Bank discounts that is now in evidence has derived

8/18/59

-23-

from an increasing amount of continuous borrowing, which in effect has added to the supply of reserves on a relatively permanent basis and has thereby offset in part the pressure on commercial bank reserve positions that System policy actions would have otherwise exerted.

It is not improbable that a problem resides in the discount situation at the Federal Reserve Banks, in that under current conditions of leniency towards continuous member bank borrowers, the repayment of outstanding discounts in effect implies a complete reversal of System monetary policy from restriction to ease. Should that course of developments ensue, the change in policy in all probability would have been dictated by the need of alleviating a slackness in economic conditions that had been induced in part by the earlier severity of a Federal Reserve System monetary policy that had restricted the availability of credit. A more moderate monetary and credit policy would conceivably avoid the undesirable economic and monetary effects that reside in pushing System policy actions to extremes of either monetary tightness or ease, in consequence of which abrupt policy reversals are then necessitated.

Mr. King commented that the factors bearing on the question of a change in monetary policy at this time had been so well pointed out that there seemed no need to elaborate upon them. In his view, the situation was under good control at present and the economy was in a healthy state. The policy that had been followed seemed adequate, and he did not feel that greater restraint would be likely to produce desirable results at the present time. Accordingly, he would favor no intensification of the prevailing degree of restraint. The uncertainty as far as the steel strike was concerned represented, in his view, an important factor to be considered, and he felt that the System must await further developments along that line before re-assessing the situation.

8/18/59

-24-

Mr. Fulton's report on the steel strike indicated that little progress was being made in labor-management negotiations, that the strike perhaps would continue for some time, and that the provisions of the Taft-Hartley Act might ultimately be invoked. The unions reportedly were not permitting maintenance workers to go into the plants to reline furnaces in need of repair, which would mean a further delay of perhaps as much as thirty days, after settlement of the strike, in getting the furnaces in shape for full production. It appeared that inventories in the hands of manufacturers using steel were adequate thus far. Steel warehousemen, who had stocked up substantially, indicated that to date there had been no increase in their normal orders for steel and that there was no imbalance of inventories. In fact, it appeared that inventories probably would be quite adequate for some time to come. Steel men believed that the industry was now getting substantial moral support from the public and they were heartened by the recent action of the House of Representatives in passing a strong labor bill. One factor in the picture was the possibility of a dearth of iron ore later in the season; after the mills got into operation, it might be that substantial shortages of ore would necessitate shipping by rail, a more expensive operation than shipping over the Great Lakes.

Mr. Fulton said that other factors in the Fourth District economy were quite favorable. Department store sales had not been

8/18/59

-25-

affected by the steel strike; only in the Wheeling, West Virginia, area did they fail to show an increase during the past week. Department store sales were at an all-time high, thus following the trend noticed during previous steel strikes, when such sales continued to increase in most parts of the district. Machine tool orders in the past month were at the highest level since mid-1957, reflecting an underlying urge to improve the conditions of plants. Total construction figures were down a bit, largely as the result of heavy engineering contracts being considerably under last year.

Mr. Fulton recalled that following the steel strike in 1952, a surge occurred which carried the whole economy abruptly to higher levels. While he did not believe that a change in the discount rate should be made at this time, it seemed advisable to be alert to the possibility of a similar surge occurring and getting out of hand. Therefore, he did not believe that the System should allow any ease to creep into the picture. Instead, he would maintain about the same degree of restraint as had prevailed during the past several weeks. If any ease were allowed to creep in, he saw a considerable danger, with the surge that seemed likely to follow the end of the steel strike, that prices might rise promptly.

Mr. Bopp reported that the steel strike thus far had had only limited secondary effects in the Third District. In Pennsylvania, the strike had idled nearly 170,000 steel workers and as of last week indirect unemployment in the State totaled nearly 40,000, an increase

8/18/59

-26-

of about 20,000 in the past three weeks. Most of the secondary unemployment was in mining, railroads, metals, metal product manufacturing, and construction. On the basis of preliminary data for eight major labor market areas, manufacturing employment declined in July. However, the decline was less than seasonal and percentagewise was somewhat less than for the country as a whole. Four major labor market areas were reclassified in July, reflecting reductions in the percentage of the labor force unemployed, but there were still seven substantial labor surplus areas, with six per cent or more unemployed. New unemployment claims in Pennsylvania had declined seasonally, despite a sizable number of claims filed by workers indirectly idled by the steel strike. There was as yet no evidence of any significant effect of the strike on consumer buying. Department store sales registered good gains in the past two weeks; sales for the past four weeks were four per cent above a year ago and for the year to date were seven per cent higher. Mortgage credit had become tighter since midyear, with the supply decreased because of a smaller net inflow of savings and the high yields on long-term securities. Some lenders were only meeting previous commitments, and the others were more cautious about future commitments. The rates on conventional loans were mostly 5-3/4 and 6 per cent.

Mr. Bopp stated that total credit of district reporting banks declined during the past three weeks. Total loans and business loans

8/18/59

-27-

were virtually unchanged, but holdings of securities decreased. Liquidation of Government securities in the past few weeks had more than offset increases that occurred at the time of the Treasury's two new offerings in the first part of July. The large Philadelphia banks continued to have a substantial basic reserve deficiency, the daily average being \$86 million in two of the past three reserve weeks. Daily average borrowing by those banks from the Reserve Bank ranged from \$24 million to \$36 million and net purchases of Federal funds from \$18 million to \$49 million. Borrowings by country banks declined somewhat. Third District member bank borrowing ranged from 4 to 5 per cent of the System total.

Mr. Bopp said that he would not favor a change in the discount rate or in the policy directive at this time. He felt that the Desk should try to maintain an even keel but resolve doubts on the side of restraint.

Mr. Bryan commented that there did not seem to have been any developments in the Sixth District such as to warrant a conclusion that there had been any considerable change in the general uptrend. Nonfarm employment and manufacturing employment continued to increase, and department store sales were well above a year ago. The only unfavorable comparison against a year ago was in construction contracts. Loans of district commercial banks continued to rise, at a more rapid rate than nationally, and demands at the discount window had increased sharply. Member bank borrowing was now running from

8/18/59

-28-

9 to 12 per cent of the System total, substantially in excess of the Atlanta Bank's usual proportion. The Reserve Bank was getting a good deal of continuous borrowing and there would have been more had it not been for some rather vigorous collection efforts. The steel strike had not as yet had any major impact in the Sixth District, but the strike, if long continued, must inevitably have its effect.

With regard to policy, Mr. Bryan said that he was sympathetic with the views expressed by Mr. Mangels and seconded by Mr. Deming. While he could see no reason for easing, neither could he see any convincing reason for further tightening at this time. The economic situation, though strong, did not at the moment seem to be in a wild boom stage. Also, he felt that the System, unless careful, could tighten reserves in the next few months a little more than they should be tightened from the standpoint of allowing for some reserve growth. A chart on effective reserves over a long period of years indicated that at present effective reserves, seasonally adjusted, were on the trend line, and that therefore they would go under the trend line in the next few months unless the System was careful to allow some reserve growth. Consequently, he would try to maintain about the present degree of restrictiveness, one which he thought was justified, but he would be inclined to resolve any doubts slightly on the side of ease.

Mr. Johns said that as the cotton-picking season approached in the southernmost parts of the Eighth District he had become

8/18/59

-29-

somewhat apprehensive about the ability of most, if not all, of the cotton-financing banks to accommodate the usual loan demand without recourse to the discount window for greater amounts and for longer continuous periods than had generally been felt appropriate. It appeared that a number of these banks, having already accommodated loan demands from other sources, were in a worse position than usual to effect adjustments as the cotton loan demand developed. If the Reserve Bank should be somewhat stingy with reserves at the discount window and the member banks were forced to reject loan applications by regular cotton customers, the blame would undoubtedly be placed on the Reserve Bank. He was not at all sanguine about the ability of the banks to make asset adjustments necessary or obtain all the assistance necessary through correspondent relationships.

As to policy, Mr. Johns said he was inclined to agree generally with Mr. Bryan. He was not willing to give a clear signal of intensification of restraint, but neither would he like to give a signal of relaxation. A period of the year was approaching when it would be necessary to supply some reserves and he would hope they could be supplied in such a way as not to suggest a relaxation that was not intended. If possible, he would hope that this operation could be carried out so perfectly there would be no serious errors, certainly no errors that would permit short-term interest rates again to soften.

Mr. Szymczak commented that on the basis of the optimistic picture reported by Messrs. Noyes and Koch, one could say that the

8/18/59

-30-

System should tighten somewhat at this point. However, there were three uncertainties that argued against tightening at this time. These included the situation with respect to the pending legislation on interest rate ceilings, the optimism expressed for peace by heads of state and the current international negotiations, and the uncertainty as to when the steel strike would be settled. Therefore, he could recommend nothing for the moment but continuation of the present open market policy. He would not favor a change in the discount rate at this time.

Mr. Balderston commented that he continued to be worried about "water in the brakes." Even though bank liquidity had decreased, corporate liquidity appeared very great, and there had been a striking increase in deposit turnover outside of New York City. If the time should come when restraint needed to be applied vigorously, he feared that central bank control would be found to have diminished. At this time, however, he would not change the discount rate because of the facts already mentioned. He would favor continuance of the present degree of restraint, leaning toward the side of restraint in the manner Mr. Treiber had suggested.

Chairman Martin summarized the meeting by saying that the majority clearly favored maintenance of the status quo, with no change in the discount rate or in the policy directive at this time. One or two who had spoken were slightly on the side of ease, but this was offset by others who were somewhat on the side of further restraint, so the situation tended to balance out.

8/18/59

-31-

Chairman Martin noted that the Open Market Committee was to meet again in two weeks, at which time data might be available that would be helpful in clarifying the situation.

The Chairman then suggested that the policy directive be approved in its present form, and no dissenting comments were heard.

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

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

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

8/18/59

-32-

Chairman Martin noted that a bill authorizing the President, for a period of three years, to eliminate the interest rate ceiling on Treasury bonds had been tentatively approved by the House Ways and Means Committee by a 15-10 vote, with a watered down "sense of the Congress" amendment relating to debt management and monetary policy. In commenting on the proposed amendment in its present form, Chairman Martin said that, despite the recent vote within the Committee, it remained a matter of concern to him that little progress appeared to have been made in explaining the role of interest rates. He expressed the view that all of those around the table had a real job confronting them in endeavoring to explain the role of interest rates in the economy and why short-term Treasury financing was not perhaps better than long-term financing.

At the Chairman's request, Messrs. Treiber and Rouse then summarized for the Committee's information the hearings held by the Joint Economic Committee in New York City on August 5, 6, and 7, which were directed principally toward the functioning of the Government securities market. In this connection, Mr. Treiber also commented briefly on a visit made by Congressman Patman, a member of the Joint Committee, to the Federal Reserve Bank of New York during the course of the three-day hearings.

At this point Chairman Martin reverted to the proposed interest rate ceiling legislation and read an announcement that had just come over the ticker which stated that the Ways and Means

8/18/59

-33-

Committee had reversed its earlier action and by a vote of 14 to 11 had tabled the proposed bill and put the legislation off the docket for consideration until the next session of Congress. In this connection, the Chairman again remarked that the real problem seemed to revolve around the need to explain fully the role of interest rates in the economy.

With a transmittal memorandum dated August 7, 1959, the Secretary sent to the members of the Committee and the Presidents not currently serving thereon a memorandum prepared by Vice President Holland of the Federal Reserve Bank of Chicago analyzing, from the point of view of a Reserve Bank officer with responsibility for the discount function, the problem involved in the relationship of member banks to the discount window of the Federal Reserve Banks in connection with the underwriting of new Treasury issues. The memorandum stated that some commercial bankers had observed to the Treasury that their relationship to the discount window inhibited them from underwriting new Treasury issues; the subject therefore was to be included on the agenda for discussion at this meeting in view of its close relationship to open market policy as well as to administration of the discount window. The tenor of Mr. Holland's memorandum was to the effect that bank underwriting operations should ordinarily be planned in such a way as to involve no net loss of reserve funds to the underwriting institutions; that underwriting operations of judicious size entered into on such a basis might be regarded by the Reserve Banks as part of the regular banking business of the commercial banks involved; and that in instances where extraordinary market or Treasury actions tended to upset anticipated schedules of liquidation and payment, underwriting banks might appropriately be accommodated by the Reserve Banks under the same general standards and limitations applied in assisting banks to meet any other kind of unexpected reserve pressure temporarily pending adjustments.

In the course of introductory comments, Chairman Martin said that Under Secretary of the Treasury Baird had become rather disturbed

8/18/59

-34-

by comments on the part of commercial bankers in connection with the July bill issue that went at a rate of 4.72 per cent. Many banks that normally bid for bills passed up the issue entirely and put in no bids. In the temporary absence of Chairman Martin, Mr. Baird had discussed the subject with Mr. Balderston, and the Secretary of the Treasury later participated also. The Chairman suggested that it might be well for the System not only to review the Holland memorandum and be thinking on the broad problem but also, perhaps, to invite Mr. Baird to meet with the Open Market Committee before coming to a final decision. He made it clear that the possibility of inviting Mr. Baird was his own idea and one on which he had not yet reached a conclusion. In further comments, Chairman Martin said the problem was one that went to the Board's Regulation A and therefore was, in a sense, a problem before the System on a continuing basis. In view of Mr. Mills' work in connection with the revision of Regulation A several years ago, the Chairman called upon him for the first comments.

Mr. Mills said he thought the Holland paper was ably prepared and that the conclusions in it were correct. It is not possible, he noted, to separate scrambled eggs. The proceeds of member bank discounting move into the same reserve pool as the proceeds of other transactions. The System, he observed, customarily supplies reserves to support Treasury tax and loan account operations on the occasion of Treasury financings, and in his view this really answers the

8/18/59

-35-

problem, because it is then up to the initiative and discretion of the member banks as to whether or not to turn to the discount window for temporary support of their acquisitions of newly-issued Treasury securities if they have any occasion to do so. Thereafter, it becomes the responsibility of the Federal Reserve Banks to determine whether discounts originating at such a time are such as to become subject to criticism and to require policing.

The Chairman then turned to Mr. Balderston, who said that on the occasions when he talked with the Under Secretary, during one of which the Secretary joined in the discussion, he found himself on the defensive. After he had explained the System's traditional role in relation to Treasury financings--the one that had been followed since the time of the ad hoc subcommittee report at least--the question was asked whether he felt that the Treasury had paid too much for the money borrowed on the occasion of the second of the two large July bill auctions. The price, it was noted, was higher than had been anticipated by financial writers only a few days before. It was pointed out that the rate had risen by 1/4 per cent and then receded again to about the anticipated level.

Mr. Balderston said he felt there was one point, at least, on which the System possibly might be vulnerable; namely, a possible lack of consistency among the twelve Federal Reserve Banks. He simply was not sure whether the administration of the discount window was consistent or not.

8/18/59

-36-

Mr. Balderston explained that the Under Secretary had no criticism of what the Open Market Committee did through the Desk in connection with Treasury financings. However, some bankers on the Government Borrowing Committee had indicated that they felt unable to participate in the second bill auction because of a fear of the discount window. In all honesty, Mr. Balderston said, he did not feel he could say that there was no basis in any district for claiming that the commercial banks could not help the Treasury with the second auction because of fear of the window.

Mr. Balderston went on to say that after these discussions it occurred to him that it would be helpful to have the views of a Reserve Bank lending officer who was on the firing line. Consequently, with Mr. Allen's consent, Mr. Holland had written down his thinking on the subject and also had spent several hours with him (Mr. Balderston) and members of the Board's staff.

His own tentative reaction, Mr. Balderston said, might be colored by the discussions with the Secretary and Under Secretary. However, in trying to examine the System's position, he was inclined to wonder whether the System should not perhaps take a fresh look to see whether the discount window could be used to facilitate Treasury financing in lieu of, or possibly in addition to, what the Desk had been doing. He then read the following comments, indicating that they were subject to revision in the light of what might be said in further discussion of the matter:

It has been the practice of the Open Market Committee to adjust bank reserves before, during, and after a Treasury financing in such manner as to preserve what is called an "even keel." To me this phrase connotes no greater ease or tightness at the end of the financing period than at the beginning, with the supplying of only such additional reserves during the period as will take care of the additional drain on reserves caused by the financing itself. Theoretically the amount of such reserves required would be 18 per cent of the amount of a cash financing taken by the banks.

The additional reserves that we have been supplying in this fashion get used in part to support additional lending. This approach through the open market instrument might be likened therefore to the shotgun approach. In contrast would be the use of the rifle to inject into the C banks, which do the bulk of the Treasury underwriting, additional reserves through the use of the discount window. It could be urged, I suppose, that this approach would require the injection of fewer additional reserves to accommodate a financing than is needed by the present method if it is true that some of those now supplied become diverted to uses other than Treasury financing.

The central question is whether the officers who administer the discount windows can make reasonably sure that the additional reserves supplied to underwriting banks to lubricate a Treasury financing by maintaining an even keel can in fact be recaptured when the financing period is over. This reasoning would seem to narrow the issue to the question as to whether the officers who administer the discounting function can manage the additional reserve supply as effectively as the Desk. The latter commands our admiration for the skill with which it frequently succeeds in preventing undue ease or tightness by observing the feel of the market. Nevertheless, it can scarcely be said that the Open Market Account has control that is precise. To the extent that the additional reserves supplied have gone into additional lending the net borrowed reserve figure will rise and this gauge of open market operations may signify, falsely, that the reserves do not need to be recaptured.

In short, Mr. Balderston said, his conclusion at the moment was that the System ought to reexamine its practices to the end that

8/18/59

-38-

it could either provide a satisfactory explanation of its practices to the Treasury or else modify those procedures.

Mr. Johns inquired whether the Treasury's indication that it could not understand what the System did reflected a lack of understanding generally or was related specifically to administration of the discount window in relationship to Treasury financing operations. When Mr. Balderston replied that the latter appeared to be the case, Mr. Johns inquired whether the remarks attributed to commercial bankers went so far as to allege that any bank desiring to serve as an underwriter had been denied credit or whether the commercial bankers appeared to fear that, having received credit at the discount window, they might be asked to repay before disposing of the securities they had underwritten. Mr. Balderston replied to the effect that the latter situation apparently was closer to the one that the bankers had suggested.

Mr. Johns then expressed the view that this was a case where the Federal Reserve was being made the "whipping boy," and Mr. Bryan and others indicated agreement.

Mr. Treiber said that the New York Bank agreed generally with the conclusions in Mr. Holland's memorandum. The simple fact that a member bank subscribed to a new Treasury issue was not regarded, by itself, as a proper reason for borrowing from the Federal Reserve Bank. However, in combination with other factors,

8/18/59

-39-

it might justify borrowing. Mr. Treiber then read the following statement:

The problem arises when a member bank subscribes for and acquires more securities than it is justified in holding as an investment in the light of its reserve position. When a member bank acquires such securities it may properly be expected to dispose of the securities or other assets as promptly as practicable in the light of all the facts of the case, including current Federal Reserve policy and the condition of the Government securities market.

Although the word "underwriting" is frequently used in reference to such a subscription by a bank to a new issue of Government securities, there is not a true underwriting as that term is customarily used in the securities business. The goal of the so-called underwriting, so far as the U. S. Treasury is concerned, is to assure immediate purchases of the new Government security when it is offered by the Treasury. It is generally immaterial whether the member bank sells the new issue or some other issue already in its portfolio. If the bank sells Government securities in the same total amount as the amount of the new security purchased by it, the underwriting is accomplished. It does not matter whether the bank involved is a large bank or a small bank.

The Federal Reserve has a responsibility to aid the Treasury in the management of the public debt consistent, of course, with basic Federal Reserve credit policy objectives. In accordance with this responsibility the Federal Reserve has customarily supplied the additional reserves temporarily required by the banking system as a result of the increase in deposits resulting from the public sale of a new issue of Government securities for cash. As such needed reserves are supplied through open market operations they do not, necessarily, go directly to the banks which need the reserves; there is a substantial redistribution of reserves through the money market and, in due course, those banks that need reserves tend to get them. Thus, in the case of a particular member bank, it may find that its purchase of a new issue increases its reserve requirements and makes it necessary for the bank to obtain additional reserves immediately by borrowing; such need, however, should probably not be extensive, at least for any period of

8/18/59

-40-

time, because of the creation of the additional needed reserves through open market operations and the distribution of such reserves through the money market.

We concur in Mr. Holland's suggestion that discount administration should view member bank subscriptions to new Treasury cash issues as a normal part of the bank's lending and investment operations for which the bank should attempt to make provision in scheduling its investment operations and its flow of funds. In the application of this general principle there may be circumstances when a bank subscribing for a new issue may be properly accommodated by the Federal Reserve under the same general standards applied in assisting banks to meet temporarily any unexpected reserve pressure. Although a bank may be expected to reduce its holding of Government securities within a reasonable time after it has subscribed for the new issue, what constitutes a reasonable time would be longer if there were continued turbulence in the Government securities market or disturbance and unsettlement in the money market.

In the light of these general principles, decision with respect to the propriety of specific borrowing by a particular member bank must rest on the judgment of the Reserve Bank discount officers in the light of all the facts of the case.

Mr. Erickson said there was no bank in the First District that could claim it was actually an underwriting bank. He added that no member bank during his tenure of approximately 10 years with the Boston Reserve Bank had raised a question about accessibility to the discount window in connection with Treasury financings. Having been a commercial banker himself, he agreed heartily with what Mr. Johns had said. If a member bank did not ask the Reserve Bank about discount facilities, it scarcely had reason to complain. Mr. Erickson thought that the Holland memorandum was excellent, and he expressed agreement with what Mr. Mills had said.

8/18/59

-41-

Mr. Irons also expressed agreement with the Holland memorandum. In the Eleventh District, he said, there were a number of banks that thought of themselves as underwriters. On some of the recent issues, particularly the last tax anticipation issue, district banks were heavy takers, when measured from the standpoint of relative size. Upon receipt of the Holland memorandum, he asked the Reserve Bank staff to go back several months and compare subscriptions for new issues with the borrowings of individual banks prior and subsequent to the financings. From this study, he felt certain no bank in the district could say that it had been discouraged about discounting anywhere near the time of subscription to a Treasury issue, or that it had been pressed to get out of debt to the Reserve Bank within a reasonable period after subscription to an issue. No banker had raised the matter with him, Mr. Irons said, and no bank that regarded itself as an underwriting bank had been a borrowing problem. The few banks that might be called continuous borrowers were in that category for other reasons and had not been large subscribers to Treasury issues. In substance, Mr. Irons saw no important merit to the bankers' complaint, although he felt the problem had to be considered and an answer made to the Treasury. He was inclined to agree with Mr. Johns that there might sometimes be a tendency to throw the burden onto the Federal Reserve System when that was not the reality of the situation.

8/18/59

-12-

Mr. Mangels said he would be surprised and disappointed if any Twelfth District banks were included in those making observations to the Treasury. Only on rare occasions did the San Francisco Bank talk to a member bank about its borrowing program, and then only with regard to the cause of the borrowing, the possible duration, and plans to relieve the need for continuous borrowing. On the other hand, there had been occasions when larger banks were encouraged to subscribe to new Treasury issues that might not otherwise have had a full degree of success, even though some of those banks may have been continuous borrowers. Mr. Mangels expressed concurrence in Mr. Holland's conclusions but said that two points occurred to him. First, as the memorandum implied, a program to provide for reserve needs as a basis for underwriting operations of judicious size was based on projections of what seemed reasonable in the way of required reserves. Because of differences in the method of preparing the Board's projection of reserve needs as compared with that of the New York Bank, this phase of the matter might call for some further discussion. Secondly, the question of opening the discount window specifically to meet underwriting needs would again raise the question of making advances to Government securities dealers, either directly from the New York Bank or indirectly by assuring banks lending to the dealers of their ability to discount. Heretofore, the Open Market Committee had concluded against proceeding in that direction.

8/18/59

-43-

Mr. Deming said that he had no disagreement with Mr. Holland's memorandum, which reflected generally the manner in which the Minneapolis Bank had been operating. With respect to the larger banks in the Ninth District, he said that if they borrowed to buy new issues and liquidated the indebtedness within a reasonable time, the Reserve Bank said nothing. If the member bank continued to borrow and to carry the securities, the Reserve Bank was likely to say something, and in essence this was what Mr. Holland's memorandum contemplated.

Mr. Allen said that his experience, which included rather close contact with larger underwriting banks, bore out what had been said previously at this meeting. The substance of the matter was that banks tended to go into a financing when they felt they were going to make some money. Otherwise, they stayed out. Mr. Allen raised the question whether too much importance was not being attached to this matter, although he realized it was necessary to make an answer to the Treasury. There seemed to be general agreement with Mr. Holland's conclusions, and they appeared to reflect the manner of administration of the discount window throughout the System.

In the course of further discussion, Chairman Martin suggested that it was properly of concern to the System if bankers were making comments to the Treasury. The problem could not be ignored, for eventually it might lead to serious trouble. He also

8/18/59

-44-

noted that in any organization, including the Federal Reserve System, there was likely to be a natural inclination to feel that the organization was right. Therefore, it seemed necessary to go through the kind of review that had been prompted by the Treasury's questions. Whatever the facts might be, this was business with which the System must concern itself in order to be able to supply the proper answers.

Continuing the discussion, Mr. Wayne expressed concurrence in Mr. Holland's memorandum. He thought it would be hazardous if System people began to think in terms of treating Treasury needs as an exception to the principles governing appropriate and inappropriate use of the discount window. In his opinion, the most appropriate way to provide reserves in connection with Treasury financings was to operate through the Desk. By that process, the reserves reached banks that were really underwriting banks. In the Fifth District, there were no banks that were truly underwriting banks.

Mr. Bryan said that the Atlanta Bank refrained from making representations to member banks about borrowing before or after a Treasury financing and that he could not believe any complaint was justified as far as the Sixth District was concerned. He supported the Holland memorandum for reasons that had already been stated, including one that was implicit in what Mr. Treiber said. This involved asking how one could distinguish between assisting the Treasury through providing reserves to permit subscription to a new issue and assisting the Treasury by allowing a bank to hold

8/18/59

-45-

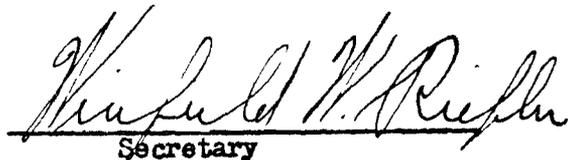
investments already in its portfolio. There were banks that could be helped, and the Treasury thus helped also, merely by letting them keep their current portfolio.

Messrs. Fulton and Bopp both indicated that they agreed with the Holland memorandum.

In conclusion, the Chairman responded to a question by indicating that he would like to consider further, in the light of this discussion, the possibility of speaking to the Under Secretary of the Treasury with regard to his attending a meeting of the Open Market Committee for additional consideration of the matter.

It was agreed that the next meeting of the Federal Open Market Committee would be held at 10:00 a.m. on Tuesday, September 1, 1959.

The meeting then adjourned.


Secretary