

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, January 12, 1960, at 10:00 a.m.

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

Messrs. Bopp, Bryan, Fulton, and Leedy, 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. Sherman, Assistant Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. Hackley, General Counsel  
Mr. Thomas, Economist  
Messrs. Jones, Marget, Noyes, Parsons, Roosa, and Willis, Associate Economists  
Mr. Rouse, Manager, System Open Market Account

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

Messrs. Hostetler, Daane, Baughman, Tow, and Einzig, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, Chicago, Kansas City, and San Francisco, respectively

1/12/60

-2-

Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia  
Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas  
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York  
Mr. Brandt, Economist, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 15, 1959, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Federal Open Market Committee, taken pursuant to a wire from the Secretary dated December 21, 1959, in authorizing that sample sets of the minutes of the Committee be made available to representatives of the Subcommittee on Foreign Operations and Monetary Affairs of the House Government Operations Committee, was ratified.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period December 15, 1959, through January 6, 1960, and a supplementary report covering the period January 7 through January 11, 1960. Copies of both reports have been placed in the files of the Committee.

In commenting on developments since the preceding meeting, Mr. Rouse made the following statement:

During the past four weeks, the Desk has been faced not only with the customary seasonal pressures that emerge at the year-end but also with several special occurrences that demanded our close attention. All of these factors taken together resulted in a substantial rise in market

1/12/60

-3-

rates of interest. Among the more significant of these special occurrences was the attitude of the New York banks toward the extension of credit to dealers over the year-end. The details as to the reason for the banks' attitude have already been covered in the written reports and need not be repeated now. Suffice it to say that we regarded this attitude as decidedly harmful to the market at a crucial period. We therefore talked with several banks, and perhaps partly as a result of these conversations their attitude apparently softened somewhat. Nevertheless, dealers reduced inventories to abnormally low levels for this time of year, partly out of apprehension over the availability of credit at year-end. I should also mention in connection with the banks' attitude that some progress may have been made toward breaking down the tradition of window dressing, for two major banks showed substantial borrowings from the New York Reserve Bank on December 31, while another was a net borrower in the Federal funds market. I question, however, whether we should take credit for this since it was policy in one case and real need in the other two cases.

In addition to the threatened scarcity of credit at the year-end, additional pressure was put on interest rates by the approaching Treasury financing. Also, expectations of a developing boom in 1960 were further strengthened by the settlement of the steel strike which, in the eyes of many observers, carried inflationary overtones. As a result of these factors, coupled with the increasing demands for credit, and the resulting expectations of higher interest rates ahead, the Government securities market had a generally heavy tone over the period. Prices of some long-term bonds declined nearly four points while most Treasury bill issues traded at new high levels.

As is usual toward the end of each year, open market operations for bankers' acceptances were stepped up to meet seasonal pressures in that market. These pressures, however, were more severe than usual in 1959. The supply of new acceptances increased seasonally but foreign accounts stopped buying acceptances and, in many cases, sold on balance, apparently for window dressing purposes. The accepting banks, faced with a large addition of dollar exchange bills early in January, pressed relatively large blocks of acceptances onto a dealer market which was unable to move them in size, with the result that dealer portfolios were built up to a new peak of \$80 million. Dealers were reluctant to raise rates further because they could not see that a moderately higher rate would clear the market quickly; because they felt rates were already high in relation to other borrowing rates; and because they believed the situation would tend to correct itself early in

1/12/60

-4-

the new year. As a result, the dealers finally curtailed their purchases of acceptances sharply, leaving a large overhanging supply in the hands of the accepting banks.

The action by the System both in increasing its outright holdings of acceptances and making repurchase agreements against acceptances was designed to meet the seasonal pressures and to assist in maintaining general stability in the money and securities markets within the framework of restrictive open market policy. The extent of the action was roughly in line with measures taken under similar but less drastic circumstances prevailing at previous year-ends, and in accord with the guides to action arising out of the Committee discussion a little over a year ago.

After the year-end, dealers' portfolios were reduced to around \$43 million but because of the large backlog of acceptances still overhanging the market, dealers have moved their rates up by  $\frac{3}{8}$  of 1 per cent to 5 per cent bid for 90 days, and even at the new rate have been buyers on balance, portfolios aggregating \$52.4 million last night. Some of the backlog has apparently been taken care of at these higher rates, but it may be some time before the market is cleared up, particularly if the block of Venezuelan dollar exchange bills is pressed on the market as appeared likely yesterday afternoon. Whether borrowers generally will be willing to pay the resulting acceptance cost of  $6\frac{1}{2}$  per cent (5 per cent, plus  $1\frac{1}{2}$  per cent commission) remains to be seen. It is possible that this cost will increase the pressure on the prime loan rate. Dealers are attempting to interest buyers in swaps out of short-term Treasury bills.

I might also mention that the special payment of part of System surplus to the Treasury, amounting to \$266 million in addition to the regular monthly payment which amounted to \$73 million, was handled with a minimum impact on member bank reserves. The payment was made on January 4, but the reserve impact was neutralized as the Treasury permitted its balance at the Federal Reserve to run higher than usual until January 7, when the System ran off \$206.2 million Treasury bills scheduled for maturity on that date.

As far as Treasury financing is concerned, the January program of a \$2 billion issue of June 22 tax anticipation bills, and the rollover of only \$1.5 billion of the \$2 billion special issue maturing January 15 into one-year Treasury bills, was generally well received by the market, which had been anticipating new Treasury borrowing of at least \$2 billion net. There was considerable early apprehension about the auction of the  $\$1\frac{1}{2}$  billion one-year Treasury bills, particularly in view of the fact that there would be no Tax and Loan Account

1/12/60

-5-

privilege on this issue. Market guesses last week indicated a range of 5.30 to 5.40 per cent in the auction, but there was a decided improvement in sentiment towards the close on Friday. Over the weekend, an article in the Sunday Times pointing to these issues as the Treasury's "best bargain" led to an unexpectedly large public interest in the issue, reminiscent of the reception accorded the 5 per cent notes of 1964 last October. This is another example of public responsiveness to attractive interest rates. A 5.10 per cent average issuing rate, for example, would mean a net return to an investor of about 5.47 per cent on an investment yield basis. Guessing as to the rate in today's auction is now down to about 5.05 per cent, according to information from the Desk just a few minutes ago. The System holds \$245 million of the maturing January 15 bills. In view of the reserve projections over the next few weeks, and with the large public interest in today's auction making its success very likely, we plan to submit tenders in today's auction which will run off a portion of these bills on the 15th. Our tenders for this part of our subscription will be designed to be only a shade below the stop-out bid. The Treasury is fortunate in having a rally in its securities develop just prior to the bidding today. Basically the rally developed as a reaction to a bearish position on the part of commercial banks which was considerably overdone, and the recovery was aided by the budget surpluses projected in the President's State of the Union Message on Thursday. The bond rally seemed to lose steam yesterday afternoon, but the Treasury bill market closed with all outstanding bills at or below 5 per cent bid. In the auction yesterday 91-day bills averaged 4.59 per cent and the 182-day bills 4.99 per cent, compared with 4.60 per cent and 5.10 per cent a week ago.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period December 15, 1959, through January 11, 1960, were approved, ratified, and confirmed.

In supplementation of the staff memorandum distributed under date of January 8, 1960, Mr. Noyes made the following statement with respect to economic developments:

1/12/60

-6-

The most noteworthy developments in the period since the last meeting are the settlement of the steel strike and the announcement by the President in his State of the Union Message that he anticipates a small surplus in fiscal 1960, and that in the budget estimates for 1961 receipts exceed expenses by \$4.2 billion.

While we do not yet know all of the details with respect to the steel settlement, the broad outlines are clear. It provides for a rate of increase in labor cost that will probably be slightly in excess of the rate of increase in productivity in the steel industry. The best guesses seem to be that for the industry as a whole, employment costs will go up about 3-1/2 per cent per year over the period of the contract. On the basis of recent trends, output per man hour will probably increase at a little less than 3 per cent per annum. The difference between these two rates is much smaller than in other postwar settlements, as is evidenced by the industry's estimate that employment costs have increased 7-1/2 per cent per year on the average since 1946.

In the longer run, the limitations on the escalator clause that are contained in the settlement may be even more important. If one grants that technical factors are likely to carry the consumer price index up a few points in the next two years, in any case, then the steel workers have everything to lose and nothing to gain from further inflation and this fact should be readily apparent to them. From the point of view of the Federal Reserve, and perhaps the country as a whole, this is probably the most significant fact emerging from the welter of claims and counter claims as to the inflationary or noninflationary nature of the contract.

The estimate in the President's message, that there will be a small surplus for fiscal 1960, appears to be well-founded. Whether the \$4.2 billion surplus for 1961 will survive in an election year is less certain. In any case, the strike settlement and the State of the Union message, taken together, have put the stock market into a position in which it hasn't seemed to know which way to turn, despite the universally bullish prognostications for economic activity in the year ahead. Some observers seem to feel that we may have now reached the long-heralded point where the relative yields are attracting a substantial flow of new institutional investment away from equities into fixed income securities.

The customary measures of current activity are almost all up, and further increases seem as certain for the near-term future as anything can be. On a seasonally adjusted basis, even construction activity, which has been lagging for several months, was up in December. The Board's

1/12/60

-7-

revised index of industrial production, moving at new and unfamiliar levels, rose from 156 in November to about 163 or 164 in December, and should easily pass the pre-strike peak of 166 this month. Gross national product is estimated to have been \$481 billion in the fourth quarter, and is expected to come close to \$500 billion for the current quarter. The record seasonally adjusted rate of 151 per cent of the 1947-49 average which is estimated for department store sales in December represents an impressive volume of cash and credit by any standards. It is almost alarming to estimate what the expansion in instalment credit in 1959 might have been had it not been for the steel strike. The \$5-1/2 billion expansion which did take place was equal to 1955 in dollar volume, although the percentage increase was, of course, smaller.

These data, portraying as they unquestionably do a high and growing rate of economic activity, stand in interesting contrast to wholesale prices and the money supply, both of which are substantially unchanged from year-ago levels.

Perhaps this contrast accounts, at least in part, for the fact that in the forecasts for 1960 one finds much less assurance of the inevitability of inflation than in their counterparts of a year ago.

Mr. Thomas presented the following statement concerning financial developments:

Further increases in interest rates to new high levels in the past month and severe pressures on money markets may be attributed basically to the large volume of credit demands to cover seasonal liquidity needs, though in part to market expectations as to forthcoming developments. Since the termination of the seasonal pressures, the tone of the market has changed and interest rates have steadied or declined somewhat from their highs. Other causes for the varying moods of the market were, first, anticipations as to the effect of forthcoming Treasury financing, and then the changes that occurred when the Treasury announced smaller needs and also when the President mentioned the possibility of a budgetary surplus.

The shifts in actual credit demands, aside from psychology and expectations, are shown by the banking

1/12/60

-8-

figures of the period. At banks in leading cities, business loans, including those to sales finance companies, increased by over \$1.1 billion in the four weeks from December 2 to December 30--a larger increase than in the same period of other recent years. Loans on securities also increased substantially, though not as much as in some other years. There were further increases in real estate and other loans and in holdings of securities other than Governments. Holdings of Governments declined further, reflecting redemption of an outstanding tax bill issue, as well as continued bank liquidation to obtain funds to meet loan demands. As a net result total loans and investments, excluding loans to banks, increased by around \$1.2 billion--a substantial but not unusual expansion for December.

Pressures on the Government securities market resulted from sales by banks and also from a sharp decline in dealers' portfolios. A decline in dealers' positions is unusual for December and it resulted in part from fear of financing difficulties at the year end. At the same time many other holders were probably endeavoring to sell securities to raise needed cash. Treasury bill rates rose to a high level--well over 5 per cent on an investment yield basis for many issues. Long-term rates increased sharply and rose above the highs reached temporarily in September. Within the past few days these trends have been reversed. Bill yields have declined somewhat and reception for the new offerings has been much better than expected. In fact, public interest evidenced in the new one-year bill to be auctioned today is exceptional. Less than a week ago a failure of the offering was viewed as a possibility.

The changed tone of the Government securities market in the last few days may also reflect the course of bank credit. In the first week of the month there was an exceptionally sharp decline in loans at New York City banks and also a moderate decrease in investments. Partial figures for banks in leading cities outside New York also show marked seasonal declines in loans and investments, although perhaps not as great as in the same week of some other recent years.

New capital issues by State and local governments, which were in moderate volume during November and December, are scheduled for rather large offerings in January. Corporate offerings continue moderate.

1/12/60

-9-

Although the number and frequency of Treasury offerings in January has kept the market under some pressure, the amount of cash financing is less than had been expected. Since early December the volume of the public debt outstanding has been in the process of decreasing, and in the months ahead any new borrowing will be more than offset by earlier or subsequent retirement of debt. It is possible that except for a moderate volume of borrowing in April, no substantial cash borrowing will be needed until July.

Bank credit expansion in December apparently resulted in a somewhat greater than seasonal increase in the money supply during that month. At city banks demand deposits increased somewhat more than in other recent years, but there was a larger than usual decline in the first week of January. Time deposit growth was only moderate. Figures are not yet available for country banks, which usually show very large and often unpredictable changes in December. Comparisons with the past, moreover, are somewhat complicated by the change in definition to exclude Federal Reserve remittance drafts from deposits. When allowance is made for changes in the banking structure and in the definition, demand deposits adjusted at member banks in the last half of December may have been a little smaller than a year ago. Much, or perhaps all, of this decrease was offset by an increase at nonmember banks. The decline for member banks was mostly in central reserve city banks; country member banks showed a moderate increase.

Reserves to meet the large and varying seasonal needs of banks in recent weeks have been supplied in part by System purchases of securities, to a small extent through increased vault cash holdings, and to a considerable degree by a large, partly seasonal, increase in float. Banks have kept their borrowings at an average level of between \$900 million and \$1 billion, with a substantial temporary increase in the first few days of this year to correct for year-end deficits. Since some of the available reserves arose from float and also because of the large seasonal liquidity needs, excess reserves were permitted to increase to relatively high levels at times during the period. This may explain in part why money markets were often tighter than the level of net borrowed reserves would indicate.

System operations have been absorbing reserves for nearly four weeks. Including sales yesterday and the redemption of maturing bills next Thursday, the total

1/12/60

-10-

reduction effected so far is close to \$1 billion. An additional \$400 million reduction will be needed in the next two weeks to maintain a level of about \$500 million of net borrowed reserves on the basis of usual seasonal demands. Further sales or redemptions of as much as \$300 million may be appropriate in late February and in March.

The major policy question for the immediate future is how much restriction should be placed on credit growth. Actually the next two months should be a period of seasonal credit contraction. Appraisal of the economic outlook points to the strong likelihood of large and vigorous demands for credit from various sources, which may diminish the size of the seasonal decline. It is possible, however, that the usual seasonal loan liquidation, together with the high level of interest rates already attained, may result in at least a temporary relaxation of pressures toward further increases in rates. The trend in the stock market since the upward spurt at the turn of the year indicates that investors may not be so enamored of stocks as they have been in the past. Savings may move in larger volumes into fixed interest securities and give strength to the bond market.

It appears evident from December developments that rising interest rates and limitations on reserve availability will not prevent banks from meeting the essential credit needs of their customers. They will borrow if necessary. Yet restrictive forces will probably be necessary to induce healthy caution under the circumstances that are in prospect.

If banks show any tendency to increase borrowings and expand credit relative to the seasonal pattern, the discount rate should be raised. Perhaps it should be raised as a precaution against such a development. A higher discount rate, accompanied by open market operations which would assure an adequate though limited money supply, should serve as a desirable deterrent to unsound credit commitments without preventing healthy growth. In view of the current level of market interest rates, there may be a question as to whether a rate of  $4\frac{1}{2}$  per cent would be high enough.

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

The broad picture I have been presenting on developments with respect to our balance of payments

1/12/60

-11-

has been essentially this: a long, sustained deterioration from a peak surplus in 1956-57 to a low point which can be taken as represented by the levels of exports and imports prevailing from February to May of last year; and then, beginning with June of last year, evidence of an underlying improvement which, while it was certainly anything but spectacular, gave reason to hope that, if the right policies were followed, we should expect to attain, in time, the necessary degree of balance in our international accounts. But I have felt it necessary several times to warn against the assumption that this adjustment which seems to have been taking place has been proceeding "so rapidly and certainly that we no longer have a balance-of-payments problem, and that we therefore have no need to frame our policies with reference to what is happening in that area."

The need for this kind of warning is illustrated by the foreign trade figures that have become available since the last meeting of this Committee--the trade figures for November. The figures are not good. On the import side, to be sure, the news is not bad: November imports were at the same average rate that prevailed during the six months May to October, and customs collections in December are such as to suggest another month of little change in the import level. But the export showing in November was poor: instead of a continuation of the fairly steady rise in the rate of exports that we have been witnessing since last spring, the November export rate dropped sharply to a level that was not much higher than it was last spring.

It would be quite wrong to conclude from this that the adjustment which we believed we had been witnessing since last spring was a snare and a delusion. In the first place, past experience has shown that no great reliance should be placed on the trade figures for any single month. Secondly, there is reason to suspect that steel shortages had something to do with the poor November export figures. More than half the drop in exports, for example, was in automobiles and machinery--sectors, that is, in which steel shortages last November were hindering output. Thirdly, our gold and dollar figures for December, while they are still incomplete, are such as to suggest a distinct improvement in our over-all balance of payments for that month.

The thing to say about the disappointing trade figures for November, therefore, is not that they mark the beginning of a reversal of the improvement in our balance of payments

1/12/60

-12-

which began to be evidenced last spring, but that they emphasize again how far this improvement will have to go before we can feel comfortable about our position. The relatively favorable gold and dollar figures for the fourth quarter of last year, if our guesses are correct, would suggest, to be sure, an over-all balance-of-payments deficit at an annual rate considerably below the \$4.5 billion, and even below the \$4 billion, figures that have been used within recent months. But the over-all deficit for 1959 is almost certain to turn out to be still about twice as large as it was in the years before our balance-of-payments position began to be a matter of national concern. From that standpoint, the disappointing trade figures for November had best be taken as a salutary reminder of how long a road we still have ahead of us in the field of balance-of-payments adjustment.

Chairman Martin suggested that during the go-around the Presidents might wish to comment regarding the extent, if any, to which it appeared that borrowing at the discount window was being used to supplement the capital of member banks.

Mr. Hayes then presented the following statement of his views with respect to the business outlook and credit policy:

Settlement of the steel strike has removed the uncertainty as to the availability of steel for the economy, but there remains considerable uncertainty as to the settlement's over-all inflationary effects, including not only the future course of steel prices but also wage and price consequences in other industries. We cannot overlook the importance of public psychology, and there is no doubt that the press and other public comment have interpreted the settlement as inflationary. On the other hand, we can find encouragement in the fact that the increase in the average hourly wage cost will be only about half as large as in the earlier postwar agreements and will therefore be much closer to the average annual rise in productivity in the industry. The staggered effects of the various cost increases may permit the industry to get through most of this year without increasing prices, although I am

1/12/60

-13-

inclined to think this may be overoptimistic. But the country has been alerted to the issues of wages, prices and productivity, and it is possible that the settlement may turn out to be an important first step toward breaking the spiral of wage increases, even though this aim has certainly not been fully achieved as yet.

In any case the path is now clear for further business expansion, sparked by inventory rebuilding. Although the full year's rise in inventories may be only moderately above the \$5 billion increase of 1959, a sizable growth of inventories early this year will contrast sharply with the record of virtually steady inventories in the fourth quarter of 1959. It remains to be seen whether this temporary influence will be supplemented later by a more lasting surge of consumer spending and business investment in plant and equipment. With considerable slack still available in the way of excess plant capacity, it seems doubtful whether sharp upward revisions in business capital spending will develop. To date there are no statistical indications of such a surge. In the consumer area, much may depend on future developments with respect to consumer credit, which will bear watching in the coming months, both as to volume and as to further liberalization of terms.

One moderating influence on aggregate spending will be the substantial retirement of Federal debt in prospect for the last four months of this fiscal year and perhaps for the ensuing fiscal year. All in all, I think it is too early to guess whether a real boom will develop in the coming months. Of course we should welcome a moderate rate of further business expansion in view of the current existence of substantial unused resources in the economy.

Wholesale prices, including sensitive commodity prices, continue to show over-all stability, but on the other hand we can look forward to a less helpful contribution from farm prices as the year progresses--and consumer prices continue to inch ahead.

In the credit area, all statistics point to continued strong loan demand, and bank liquidity is being significantly reduced. Pressure on the New York banks has been especially severe. These banks were forced to reduce investments by 22 per cent between late July and late November in order to meet a 5 per cent increase in loans while at the same time experiencing a 6 per cent loss of deposits. Undoubtedly the severe loss of foreign time deposits was a major factor making it increasingly difficult for the New York banks to play their traditional role as leading business lenders.

1/12/60

-14-

While loan-deposit ratios have risen throughout the country, the increase in New York has been much faster than elsewhere and the ratio now 69 per cent, is far above that of the rest of the country. With substantial legitimate business borrowing needs in view to support the prospective business expansion, it seems clear to me that we ought to allow some moderate growth in the money supply if we wish to avoid the excessive pressure on interest rates that is likely to result from exclusive reliance on increased velocity. Presumably this should be accomplished through open market operations designed to reduce slightly the degree of pressure which we have been maintaining on bank reserves.

The major question facing us at this time is what to do about the discount rate--or perhaps the question really is not whether to raise the rate, but when and by how much. Obviously the spread between the discount rate and market rates is enough to warrant action if only as an "adjustment" to the market. We must of course be mindful of prospective Treasury financing operations, which include today's bidding on \$1.5 billion of one-year bills as well as the announcement late in January of the major February refunding program. A strict interpretation of our "even keel" policy might require us to refrain from a rate change until after the February refunding is out of the way, when there will be a fairly long "free" period. On the other hand, the current range of market rates is already so high, and a discount rate change is so widely expected, that it could be argued that a moderate discount rate rise in the near future would not do any real damage from the Treasury's point of view.

Another factor bearing on our timing is the prospect that the banks' prime rate may well be increased in the very near future. While some bankers favor going slowly in the matter of pressing for higher rates, in view of the fact that rates are already high and profits quite satisfactory, the probabilities seem to favor early action on the prime rate. On several recent occasions discount rate moves have followed shortly after prime rate changes, and I think it would be unfortunate if this sequence should become traditional. Generally speaking, I think it would be preferable for the System to assume the leadership in interest rate changes.

One argument for delay is that we should avoid appearing to react "automatically" to the steel settlement and thereby seeming to stamp the settlement as clearly inflationary. Such an interpretation might have special significance abroad. Incidentally, rate increases are probably being considered in the U.K. and other European countries, who may, in fact, be delaying action until a move is made here. With international

1/12/60

-15-

funds now flowing more freely in response to comparative rates than at any time since the twenties, rate changes here and abroad may now take on an unfortunate "competitive" aspect. However, despite our position now as the leading international money market, I feel that our decision must be based primarily on domestic grounds.

With regard to amount, I don't believe a change of more than 1/2 per cent should be considered at this time. If the move is delayed till late February, a 1 per cent increase might then be warranted if market rates continue to strengthen--but at present it would be too strong a signal.

Our directors discussed this whole problem at length last week. Most of them believe that discount rate action fairly soon is inevitable--but there was no disposition to rush matters. On the other hand there was considerable reluctance to see the prime rate lead the discount rate once more in the next advance. On balance, I think I would favor a 1/2 per cent increase this week or next week, accompanied by a slight easing of open market pressure on bank reserves; but I recognize that valid points may be adduced in favor of delay and I am eager to hear how the others around the table feel on this matter.

I believe the directive should be renewed without change. Once again, I would like to suggest that serious consideration be given to the feasibility of stand-by authority to impose consumer credit control so that we shall not be caught short if real excesses should develop in this sector.

Mr. Johns said that the continuing question in administration of the discount function was whether member banks were using such credit to supplement their capital and deposit structures. Some Eighth District banks, including some of the larger ones, pursued a policy of keeping fully and even over-loaned and invested. As long as they could cover with Federal funds or otherwise in the market, there was only occasional resort to the discount window. When such funds were not obtainable and the banks were called upon to discharge their indebtedness to lenders,

1/12/60

-16-

their only choice was to come to the Reserve Bank. Early this month, the St. Louis Bank's discounts reached an all-time high, occasioned partly because banks had preferred to show no indebtedness in their end-of-year statements. In summary, to answer the question whether funds obtained at the discount window were used to supplement some member banks' capital and deposit structures, his answer would be in the affirmative--as long as the Reserve Bank let them pursue such a course, which generally was not very long.

Turning to monetary and credit policy, Mr. Johns said that the responsibilities of the Federal Reserve seemed to call for permitting an increase in restraint in the near future. This would come automatically from a business boom unless the System undertook to accommodate all of the credit demands that the boom would undoubtedly generate. Consumer and investment demands appeared likely to press on capital limitations in many parts of the economic system and inflationary tendencies were likely to be stronger in the immediate future than in the immediate past. Likewise, the balance-of-payments situation continued to call for restraint.

During the past year the degree of monetary restraint exercised had involved keeping bank reserves and the quantity of money practically constant. Mr. Johns suggested for the near future permitting bank reserves, credit, and deposits to rise, if at all, only slightly. To avoid inflationary developments, investments should be financed out of savings and an increase in the rate of

1/12/60

-17-

turnover of demand deposits. Apparently velocity of money leveled off in 1959 after midyear, but with the resumption of activity after the steel strike it seemed likely that velocity would again increase. In view of the present strength of credit demands, he wondered whether the greater danger was not in too little rather than too much restraint.

Mr. Johns then referred to the chart introduced by Mr. Bryan at the December 15 meeting showing the course of member bank reserves. He agreed that there was a need for developing a means of giving instruction to the Desk in quantitative rather than qualitative terms. The concept of effective reserves seemed to him useful. However, whether the Committee wanted to keep the supply of reserves steady, increase it, or reduce it, he would suggest total reserves as the appropriate objective of monetary policy and that instructions to the Desk be in such terms. This would reduce disproportionate emphasis on net borrowed reserves and the feel of the market as guides to the Desk.

Since the boom seemed strong and in a sense revived by termination of the steel strike, Mr. Johns felt that it would be a mistake to provide a stimulus by an expansion of bank reserves at this time. Therefore, he would suggest that the Desk be instructed to carry on operations during the period until the next Committee meeting with a view to bringing about roughly a seasonal decline in total reserves. He would not change the policy directive.

1/12/60

-18-

Mr. Johns then turned to the question of the discount rate and said he continued to feel that an increase was desirable. As Mr. Hayes had said, the questions of timing and amount were difficult. Hoping that an adjustment of perhaps 1/2 per cent could be made promptly, he found consolation in the memorandum dated January 11, 1960, from the Board's Division of Research and Statistics (showing estimated periods of Treasury financing during 1960) which suggested that the traditional concept of the even-keel policy might appropriately be altered this year. He felt that serious consideration should be given to a prompt change in the discount rate. This might involve action on the part of the St. Louis directors on January 14, effective perhaps January 18, if the Board of Governors should see fit to go along with that timing. In saying this, he was aware that an increase of 1/2 per cent probably was not enough, unless further action was to be expected in the not too distant future. However, he agreed with Mr. Hayes that an increase of more than 1/2 per cent at this time might be a stronger signal than the System ought to give, particularly in view of the relatively short period between the current Treasury financing and the expected date of announcement of the forthcoming refunding. If it were thought prudent to take all discount rate action at one time, he would be willing to wait for a while and then consider a full one per cent increase.

Mr. Bryan said that Sixth District conditions did not differ sufficiently from those for the nation as a whole to warrant detailed

1/12/60

-19-

comment. On use of the discount window, he recalled having reported at the December 15 meeting that there was disproportionate use of the window in the Sixth District. While this had happened on occasion in the past, it seemed more persistent now and had been running on for a number of months. It seemed to be occasioned (1) by a slight run-off of funds from the district, (2) because loan expansion trends at commercial banks had been heavier than elsewhere, and (3) because district banks, generally speaking, had not liquidated investments as rapidly as banks throughout the country as a whole. He suspected that the average maturity of portfolios of Sixth District banks was somewhat longer than at banks of the nation generally. As to whether banks were using Federal Reserve credit as a substitute for capital or depositors' funds, Mr. Bryan felt that the answer was clearly in the affirmative in a number of cases. There were banks that had borrowed heavily and regularly, yet had bills in their portfolios and in some cases could dispose of investments at little loss. After discussion with the Reserve Bank's executive committee, he was asking for repayment of the borrowings of those banks. However, there were other situations where the problem was more difficult. These situations related to banks with a run-off of deposits that were totally illiquid in their investment accounts and were having a hard time making adjustments in their loan accounts. In two cases, if the bank concerned was required to reduce its borrowings by selling investments,

1/12/60

-20-

there would be a substantial diminution of capital because the loss would be so great. With borrowings at the Atlanta Bank running 15 per cent of total member bank borrowings throughout the System, the discount window was proving difficult to administer.

Mr. Bryan said that he would like to see an increase in the discount rate rather promptly and that he would be willing to ask the Atlanta directors to lead off such a move. As on two or three other occasions in the past several years, he was even toying with the idea of progressive discount rates to bring some recalcitrant borrowers under restraint.

With reference to the steel settlement, Mr. Bryan commented that there was a temptation to debate the question whether it was inflationary on the basis of the degree to which the terms of the settlement were allied to the increase of productivity. In his judgment, any wage policy which transferred the entire benefits of increased productivity to the employees was inflationary, at least in the longer run.

Mr. Bryan said that he would like to pursue the matter of giving the Desk instructions in quantitative terms at some later time, but he would not do so today.

Mr. Bopp said that 22½ member banks borrowed from the Philadelphia Reserve Bank in 1959, more than in any year since the early 1930s. However, daily average borrowing of \$42 million was about the same as in 1955 and considerably less than averages of

1/12/60

-21-

\$68 million in 1956 and \$66 million in 1957. The Philadelphia Bank, which in various years was in a position such as reported by Mr. Bryan, had recently been fortunate not to be in such a position. Borrowings were running about 5 per cent of the System total. There were a few problem banks, and on these the Reserve Bank had been working with some insistence. A few other banks had been borrowing for longer periods than usual, but for understandable reasons. For example, in Lancaster County there was a recurring problem related to tobacco and feeder cattle. In another case a bank had held for many years a substantial account that recently was withdrawn; it would not appear that a bank should necessarily be prepared for such a contingency. Two banks perhaps had been using the discount window in lieu of additional capital, and if one took into account borrowings from the Reserve Bank plus Federal funds transactions, additional banks would have to be placed in this category. However, the Reserve Bank was working with those member banks, and as a whole borrowing seemed moderate relative to 1956 and 1957.

Mr. Bopp said that Third District economic developments were not such as to affect his recommendations on monetary and credit policy. He would favor continuing about the present degree of pressure on bank reserves. The slow rate of increase in recent months in the money supply, adjusted for velocity, the tight mortgage market, the reluctance of banks to see their loan-to-deposit ratios go much higher, and the persistence of a relatively high unemployment rate

1/12/60

-22-

indicated caution about moving to a significantly more restrictive policy. On the other hand, the persistent upward trend in prices, other than of farm and food products, the absence of evidence that high interest rates were causing a downward adjustment in plant and equipment expenditure programs, indications that the bulk of unemployment was frictional and structural, and the prospect that the steel strike settlement would initiate an upsurge in business activity and intensify price pressures all suggested that any significant easing of restraint at this time would be inadvisable. In weighing these two sets of factors, Mr. Bopp found no strong evidence that present policy was either too restrictive or too easy. At this stage of the upward phase of the cycle and in view of current optimistic expectations, he believed the risk that any significant easing of credit might contribute to another upward spiral of prices and the development of an unsustainable boom was greater than the risk that continuation of approximately the current degree of restraint would inhibit a sustainable rate of growth of the economy. The System should be alert, however, to detect emerging evidence that credit was becoming so tight that it was retarding a sustainable rate of growth. All things considered, he would favor no change in the directive.

Mr. Bopp then commented that the discount rate presented difficult questions relative to the timing and amount of any increase. The wide disparity that had prevailed for some time between the discount rate and short-term market rates indicated either that the

1/12/60

-23-

discount rate was too low or that market rates were too high. He would not favor supplying funds to bring market rates down close to the discount rate; instead he would favor moving the discount rate up to closer alignment with current market rates. However, on the timing and the amount of increase that would be appropriate, he was less certain. The interval between completion of the current Treasury financing and expected announcement of the terms of the February refunding was less than two weeks. This was hardly enough time for the market fully to adjust to a rate increase before the Treasury must consider the terms of the February refunding. The longer interval from the latter part of February through most of March would be distinctly preferable from the standpoint of Treasury financing. As to the amount of increase, there was no evidence yet as to whether settlement of the steel strike would set off a stable, sustained expansion or a feverish, speculative boom. An increase now of at least 1/2 per cent would be warranted to bring the discount rate into better alignment with market rates; however, an increase of one per cent, which would be justified if evidence of a boom should emerge, would not be appropriate now in the absence of such evidence. Should a speculative boom emerge, he would like to see a one per cent increase as a sort of shock treatment to indicate that the Federal Reserve was determined to use its powers to prevent inflation and an unsustainable boom. Weighing the advantages and disadvantages of these possibilities, he leaned toward no increase now in order that

1/12/60

-24-

the System might be in better position for a one per cent increase should evidence of a boom appear. However, he would not be opposed to an increase of 1/2 per cent if the Manager of the Open Market Account thought there was sufficient time for the market to adjust to the increase before announcement of the terms of the February refunding.

Mr. Fulton said that Fourth District member banks had been borrowing considerably less than a proportionate amount of total member bank borrowings, taking into account the size of the district. The proportionate size of the district was around 10 per cent of the total of the System, whereas borrowing had been only two to three per cent of the System total. The Reserve Bank had initiated conversations with some member banks. There was an inclination, he felt, to use the discount window, if permitted, in order to augment capital and to arbitrage the discount rate against rates on Treasury bills or any short-term securities that would yield more than the discount rate. The Reserve Bank is watching that carefully. Regardless of the size of the member bank concerned, the Reserve Bank followed the practice of finding out why it was borrowing, except when the borrowing was very temporary. The Reserve Bank then initiated discussion with the member bank, and it had been quite successful in keeping the number of continuous borrowers down.

Turning to Fourth District economic developments, Mr. Fulton said there was a general feeling of relief that the steel strikes had

1/12/60

-25-

been settled. After discussing some of the developments that had led to the strike settlement, Mr. Fulton commented that the terms were better than those accepted by the can companies and the aluminum industry. They would involve an increase of about 3.5 per cent of total payroll, but if the terms of the aluminum settlement had been applied the increase would have amounted to about 4.7 per cent. If the Kaiser formula had been applied, the mills, taking into account the older mills, would have had an increase amounting to about 5 per cent. There was no letup in the demand for steel and inventory building was going on apace. Present production was at an annual rate of about 140 million tons, but some industry spokesmen felt that production for the year would be around 125 to 130 million tons, which would indicate a cutback later when the pipelines for steel had been filled. The outlook for profits and prices depended to a considerable extent on the efficiency of the employees. Reports indicated that the mills had good cooperation during November and December and that some production records were broken; if this continued, cost increases to the companies might not be too great, for production would take up the slack. However, other costs entering into the price of steel would tend to reduce profits. For example, one company reported a significant rise in the cost of gas during the coming year. Nevertheless, there was no indication that the mills would cut back on their expansion and improvement programs. After commenting on one such anticipated

1/12/60

-26-

program, Mr. Fulton said it was claimed that foreign competition was still great and that some foreign steel was obtained during the strike on promise of future orders over a period of time. At the same time, it was reported that European users were taking all of the cold-rolled steel available and it was expected that United States mills would be able to ship this particular steel product to Europe in quantity.

Mr. Fulton said the general tenor among businessmen was one of considerable optimism for the first quarter of 1960. Unemployment was going down and employment was increasing, although it was asserted that overtime would be used as an alternative to hiring additional employees as long as it was profitable to follow such a course. Loan demand was strong and persistent, and doubt was expressed that the usual seasonal run-off would prevail. The pressure for mortgage loans was great; brokers were trying to obtain expanded lines and promises of more funds. Inventories were being financed from internal funds to the extent possible, but bankers did not expect that those funds would last too long. Construction, department store sales, and in fact the whole gamut of business in the Fourth District was high and seemingly going higher. All of this would add to inflationary pressures.

In Mr. Fulton's opinion, it was appropriate that the discount rate be raised at this time because of the current relationship between that rate and short-term market rates. He felt that such an increase

1/12/60

-27-

had been discounted by the market to a substantial degree. If action were deferred, that might be a cause of unsettlement in the market while a rate increase would not appear to be a surprise. Accordingly, while he would not change the Committee's directive, he would favor increasing the discount rate by 1/2 per cent now regardless of the impending Treasury financing, feeling that this would have a stabilizing rather than a disruptive effect. He recommended that the pressure on bank reserves be maintained in about the same degree as during the past week, with net borrowed reserves as near the \$500 million level as could be reasonably achieved.

Mr. King recalled that his standard comment at the past several Committee meetings had been to the effect that System monetary and credit policy was putting the economy under substantial and desirable pressure. He felt that this was still a proper statement. He did not believe that a constant increase in restraint should be a major objective of System policy, and the lack of growth of the money supply seemed clearly indicative of the fact that System policy over the past year had produced a substantial amount of restraint on the expansion of bank credit. Tightness in the money market and restraint on expansion of credit had reached a point where unsound credit commitments were not likely to be made; it appeared that applications were being screened carefully. Predictions apparently were unanimous to

1/12/60

-28-

the effect that 1960 was likely to be a year of high activity, and along with this no doubt would come additional inflationary pressures.

Mr. King said he was not surprised to hear Mr. Bryan's comments about the extent of member bank borrowing in the Sixth District. This seemed a natural consequence of a tight situation in credit markets generally, and of the South being an area experiencing more rapid industrial development than the country as a whole.

Mr. King agreed with Mr. Thomas that a 1/2 per cent discount rate increase at this time was not likely to accomplish great results, and he would not recommend a change in the Committee directive at present. He found himself in agreement with Mr. Bopp's thinking on both the directive and the discount rate. Like Mr. Bopp, he would prefer to postpone action on the discount rate rather than to make what amounted to a technical adjustment now and then follow in a few weeks with another technical adjustment. As he had commented before, he believed frequent changes were more disturbing to the public than one good dose of medicine when it should be applied. Accordingly, he would favor postponing discount rate action to around the first of March and, if an increase then seemed in order, to move upward by one per cent. That statement was, of course, subject to developments that might take place.

Mr. Shepardson expressed agreement with Mr. Bryan's comment regarding the inflationary aspect of recent wage settlements. The

1/12/60

-29-

idea that there was no inflationary effect if labor got no more than the productivity increase seemed to him definitely a mistaken concept. There would be continuing inflationary aspects until such time as there was a different allocation of the fruits of increased productivity.

Mr. Shepardson said that the outlook in the country generally appeared to be one of extreme optimism, one that was likely to be stimulative of excessive developments. In many areas, price changes either were occurring or were on the verge of occurring. Already there had been advances in segments of the labor market that were going to have their effect on prices. It seemed that the country was going to be faced with growing inflationary pressures. For that reason, he considered it highly important that the System stay ahead of the game and through reasonable restraint try to curb excessive enthusiasm before it got to a point beyond control.

Mr. Shepardson felt it appropriate to consider more restrictive action at this time. From the standpoint of bank reserves, the System should try to recover the normal seasonal return flow of the reserves that were put out during the fall. What effect that would have on net borrowed reserves would be determined by the way that the economy reacted. If credit demands were not as great as anticipated, it might result in some lowering of the level of net borrowed reserves. If the demand pressures were heavier, it might mean a higher level of net borrowed reserves. In any event, the

1/12/60

-30-

System should try to keep reserves at a level that would maintain restraint during the next few weeks.

As to the discount rate, Mr. Shepardson said he would prefer that the System take the lead rather than follow. There had been much talk recently of an increase in the commercial bank prime rate. There had been situations in the past where it was desirable not to take the lead, and to explain later discount rate action as a technical adjustment. In the present situation, however, it appeared to him that the System rather than making a technical adjustment, should be moving ahead of a change in the prime rate. The amount of a discount rate increase was, of course, open to question. His own inclination would be to move up by 1/2 per cent, and fairly promptly. He would favor continuing the existing directive; the System was still faced with the problem of combating inflation and the present directive seemed appropriate.

Mr. Robertson commented that he agreed with everything Mr. Shepardson had said. At this particular stage of the business cycle, he considered it incumbent upon the System to maintain a restrictive policy. Any easing would inevitably bring about expansion accompanied by inflation, which would be followed in turn by painful readjustments. At the same time, he had the feeling that the monetary and credit policy followed in the recent past was beginning to bite as the liquidity of the banking system was reduced. In his view, the Committee's policy was taking a bigger bite at the moment than he had

1/12/60

-31-

thought would be likely not too long ago. It was not taking too big a bite; he would not advocate any lessening of restrictiveness. However, it appeared that System policy was beginning to be quite effective, and in this he was rather pleased.

Mr. Robertson said that Mr. Bopp had set forth well the pros and cons as to the discount rate. He (Mr. Robertson) leaned toward moving up step by step, that is, 1/2 per cent now, and quickly. Then, if the situation called for an additional step later on, he would take it. There were times when an increase of one per cent should be the action of the System, but as he saw it today an increase of 1/2 per cent might be the right amount to add now to the psychological atmosphere in which business was being carried on. He would not recommend a change in the directive.

Mr. Mills said that in furtherance of the very thin line of sentiment expressed in favor of lessening pressure on the reserve position of member banks, he proposed to enlarge on the statement that he made at the December 15, 1959, meeting of the Open Market Committee, after which he would warn against an increase in the discount rate at this time. Mr. Mills then presented the following statement:

The opening of the year 1960 reveals the national economy badly overextended creditwise and finds the System's Open Market Committee faced with the necessity of conducting a monetary and credit policy that will prevent tautness in the credit markets from reaching the breaking point and will allow enough credit headroom to support stable and sustainable economic growth. The rationale of such a policy argues that

deflation is a more imminent danger than inflation, and that if a severe deflation is to be avoided economic momentum must be maintained through the invigorating impulse of a reasonable flow of newly created commercial bank credit into the economy. The objectives of this program cannot be reached through a monetary and credit policy whose primary purpose is to eradicate the assumed evidences of inflationary pressures through restricting the availability of commercial bank credit solely within the narrow limitations of repayments on outstanding credits and the proceeds of securities sold into the hands of nonbank investors. This kind of policy in all likelihood will induce the very deflation, escape from which should be sought after.

The rejection of a severely restrictive monetary and credit policy demands the adoption of a policy of moderate restraint over the expansion of commercial bank credit that will allow sufficient leeway for the extension of some volume of new credits that, in serving constructive economic purposes, will at the same time foster an appropriate complementary growth in the money supply. In the process of conducting this kind of a policy, the backwash of previous inflationary pressures can be expected to carry over into the opening months of the year and to give the illusion of inflationary dangers that in all probability will never materialize. Based on this expectation, a policy of moderate restraint over the expansion of bank credit is a sufficient safeguard against the possible occurrence of tangible inflationary dangers, especially as such a policy is strongly reinforced by the restriction that is exerted over credit expansion by the heavily loaned-up position of the banks. In fact, the loan-to-deposit ratio of the commercial banks may now be approaching a point that will deter their creation of essential new credits, even though reserves are made available to them for that purpose. Under such circumstances, new reserves supplied by Federal Reserve System policy actions are apt to largely find their way into commercial bank investment in Treasury bills and other short-term U. S. Government securities. In that event, any consequent softening of short-term interest rates must not be taken as an indication of a weakening effect of System monetary and credit policy demanding remedial attention, but rather as a precautionary measure taken at the initiative of the banks to partially relieve the strain to which they are subjected by their heavy loan and investment positions.

1/12/60

-33-

With regard to the discount rate, Mr. Mills said that the recent increase in the call loan rate in New York City, the differential between the discount rate and the yield on Treasury bills, and the increase in rates on commercial paper and bankers' acceptances all argued technically for an increase in the discount rate. A case might be made that such an increase would clear the air and set a more favorable climate for the Treasury's various financing operations. On the other hand, although an increase in the discount rate might produce the impressions mentioned, it was likely that on second thought the financial community, particularly the commercial banks, would logically and properly regard an increase as an official announcement that tighter money could be expected to continue on an accelerated basis and that it would be incumbent upon the System to make the increased rate effective through its open market actions. The financial community might anticipate that the commercial banking system would be subjected to the pressure of a high level of negative free reserves. Interpretations of that kind would come at a season when the commercial banks customarily experience a shrinkage in deposits and contraction in loans. In the face of that experience, of which there was already evidence in available statistics, the banks could properly and reasonably look forward to extreme difficulty in fulfilling their credit obligations to the business community. The business community and the economy would then be deprived of sources of credit which must be in reasonable supply. For these

1/12/60

-34-

reasons Mr. Mills believed it would be a serious error for the Federal Reserve Banks to increase discount rates at the present time.

With regard to the discount window, Mr. Mills said that extreme care should be given not to confuse the purposes for which borrowings were being sought. In his guess, there were few instances where borrowings were undertaken to scalp the differential between the discount rate and higher yields obtainable on other loans and investments. His instinct told him that the greatest cause of the high level of discounts in evidence at the present time was strain on the banks, a strain they sought to alleviate by discounting at the Federal Reserve Banks in order to maintain their normal functioning.

Mr. Mills said that he wished again to propose the rewording of the policy directive that he had submitted for consideration at the two previous Committee meetings. This would change clause (b) so as to provide for "fostering sustainable economic growth and expanding employment opportunities while guarding against inflationary credit expansion."

Mr. Leedy said a few Tenth District banks had been using the discount window in substitution for capital. One of the principal offenders was a bank that had traditionally kept fully invested and loaned up; some of its portfolio was under water, and it was a chronic borrower. Another chronic borrower was a bank that had

1/12/60

-35-

experienced rather phenomenal growth. This bank had from time to time been increasing its capital account, but the increase was not keeping pace with loan demands. A number of banks were borrowing from the Reserve Bank for various reasons that could not be generalized, but not in substitution for their own capital. Some banks in the cattle areas were unwilling to require liquidation of cattle loans, and their borrowings remained high and constant. Some banks having a high rate of fluctuation in deposits from month to month or during each month seemed unable to anticipate the extent of those fluctuations with enough accuracy to avoid borrowing from the Reserve Bank. The Reserve Bank analyzed all such cases; where it appeared that a member bank was not using the facilities of the discount window as it should, the Reserve Bank entered into discussion with the bank concerned.

Mr. Leedy said that with few exceptions, indicators for the Tenth District economy were much the same as the national indicators. He would not favor reducing the degree of pressure that System policy had been applying on bank reserves, nor would he increase it at this time. It seemed to him the results that this policy had been accomplishing were rather salutary. On the discount rate, Mr. Leedy felt that it should be changed, but he was not certain as to the timing. It seemed to him that a technical adjustment should be made due to the levels of short-term market rates, and that increase should be made as early as possible bearing in mind the Treasury's financing program. He did not subscribe to the view that the Reserve

1/12/60

-36-

Banks should be thinking of a rate increase in excess of 1/2 per cent at this time. Sufficient steam might develop in the economy later on to require some shock treatment, but as the situation now existed it seemed to him that that kind of treatment was neither necessary nor desirable. If it developed later on that a larger increase than 1/2 per cent was required, this would indicate that in the System's judgment the country was on an inflationary spree and it might have the repercussions that Mr. Hayes had indicated on rates in other countries. Mr. Leedy concluded by saying that he would make no change in the directive at this time.

Mr. Allen presented the following statement with regard to Seventh District developments:

The steel strike settlement is commonly interpreted in our area as inflationary, and that attitude, whether or not justified, has bullish overtones in itself. Our friends in the steel industry continue to forecast production in the first half of 1960 at near capacity, or around 70 million tons, and second half production at 60 million tons, or 130 million tons for the year compared with the 1955 record of 117 million tons.

A very large producer of construction and earth moving equipment expects that its dealers will be "on allocation" throughout 1960, a prospect based in part on anticipated strong demand from abroad. Surprisingly perhaps, producers of farm machinery expect 1960 sales close to the 1959 figures despite the prospective further decline in farm income.

Stocks of new automobiles, as stated in the staff review, were 575,000 at December 31. The industry talks of a new high for first quarter production of 2,250,000 cars. At the same time they say that they will probably cut back production if and when inventories reach 1,000,000 cars. If they hold to that view about cutting back, and if they produce at the anticipated rate, sales of cars will have to average 23,400 per selling day in the first quarter, which would mean an inventory of

1/12/60

-37-

1,000,000 cars on March 31. The daily rate of 16,463 cars for the last ten-day period in December was regarded as disappointing; our friends in the industry felt that the mix of cars in the hands of dealers warranted a higher sales rate. The middle sales period in January is regarded as important. If sales move up to around 20,000 cars per day, the feeling about the first quarter will be more assured.

Unemployment in Detroit is expected to drop below 100,000 in the first quarter. In March of 1959 it was 200,000, and in March of 1958 it was 250,000.

While complete retail trade estimates for December are not available, it is certain that the rise in the total will be dampened by the low automobile sales. However, Seventh District department store sales were 5 per cent above the previous year, and Sears Roebuck, with the biggest sales month in its history, was 6 per cent above the previous December.

We have nothing to add to what the staff review reports concerning the farm situation except that our people feel that the prospective decline in hog production, mentioned in the staff review, could mean hog prices next fall 20 per cent above the prices of this past fall, which may result in a smaller decline in net farm income than is generally forecasted.

The final three weeks of 1959 were marked by strong demands for bank credit in the Seventh District. Total loans of our weekly reporting banks rose 5 per cent compared with an increase of 3 per cent for all reporting banks in the country. Nevertheless, for Chicago banks the ratio of loans to deposits on December 30 was about the same as at the 1957 peak, 58 per cent, and the ratios in Detroit and Indianapolis were only 50 per cent.

To finance the loan expansion our weekly reporting banks steadily liquidated Governments in December, and on January 6 the six largest Chicago banks held only \$63 million of Treasury bills--the smallest volume in two years. While they doubtless wish to acquire early April maturities in connection with the April 1 tax date, their current positions make it probable that such acquisitions will come more slowly and in smaller amounts than in some other years.

With respect to the discount window, Mr. Allen said he did not feel that there had been any significant abuse in the Seventh District. While there were problem banks, they were few in number. During his

1/12/60

-38-

tenure as President of the Chicago Bank, he had found that the problem banks tended to be the same ones. In 1959, 250 banks borrowed from the Chicago Bank, slightly less than  $1/4$  of the member banks. The volume of borrowing was higher in amount, but he did not feel that there was significant abuse of the discount window.

With regard to the discount rate, Mr. Allen said his personal preference would be to make no change at this time but to be poised to go from  $4$  to  $5$  per cent during the period from February 15 to April 1, if developments meantime should make the desirability of an increase more apparent. Although the present rate of  $4$  per cent was out of line with other rates, an increase to  $4-1/2$  per cent would not eliminate the disparity. He did not feel that the differential had produced significant abuse at the discount window, at least in the Seventh District. Having stated his personal preference, Mr. Allen noted that a majority of those who had spoken thus far appeared to favor a prompt increase to  $4-1/2$  per cent, and he recognized the desirability of System uniformity. He was agreeable to recommending a  $4-1/2$  per cent rate, and he believed the Chicago directors would go along, particularly if other Banks were taking that action at about the same time.

Mr. Allen said he would recommend no change in the policy directive and he would favor continuing about the current degree of restraint through open market operations until the next meeting of the Committee.

In summary of the Ninth District situation at year end, Mr. Deming said that bank deposits were off one per cent, loans were up

1/12/60

-39-

11 per cent, and Government security holdings were down 11 per cent. The banks were under considerable pressure during the greater part of the year, particularly the second half. The summer drought and the steel strike had caused a loss of \$400 million in district personal income. Putting it another way, the district's gain in income in 1959 was about half as large as that recorded for the nation as a whole. He foresaw that this spread between district and national gains might continue for several months in the future.

As for the use of the discount window, Mr. Deming said he agreed with Mr. Mills' analysis. He felt that there was relatively little scalping of the discount rate and that borrowing reflected largely the degree of pressure on the banks. He agreed with Mr. Allen that the problem banks of today were mostly the same ones as two years ago, and probably ten years ago. There had been conversations with some member banks, and it had been necessary to get progressively tougher with a few of them.

Mr. Deming said he came out with the feeling that the discount rate ought to be moved up now by 1/2 per cent. He concurred in Mr. Leedy's view that the System should try to avoid shock treatments if possible. An increase in the rate at this time was expected by the market, and by people in general, and that was what he thought ought to be done rather than to wait and deliberately shock the economy at a later date. At the same time, influenced perhaps by Ninth District developments, he would dislike to see the Committee go further in

1/12/60

-40-

terms of restrictiveness through open market operations. On balance, he would favor easing a little the present level of restrictiveness. He saw no reason to change the policy directive.

Mr. Mangels said that preliminary information as at the end of 1959 indicated plusses in practically all categories of West Coast production, except steel production and nonresidential construction. For the year through November, awards for residential construction increased about 24 per cent and the number of dwelling units increased about 21 per cent, refuting statements that tight money had cut back residential construction. December showed increases in practically all lines of business except construction. Department store sales for the Christmas week were 22 per cent above a year ago and for the year the gain was a little better than for the nation. Copper production resumed during the last week of December but production was not yet back to normal, pending settlement of some issues in labor negotiations. Steel production was about 92 per cent of capacity, with two large producers in excess of 100 per cent and Kaiser running at about 78 per cent due to some technical difficulties. Employment for November was at an all-time high despite further cutbacks in aircraft employment in California and Washington because of cancellation of military orders for jet aircraft. During the four weeks ending December 30, reporting member bank loans increased about \$250 million, with increases in practically all loan categories. The largest increase, in business loans, was \$92 million; of that, the greatest

1/12/60

-41-

portion of the increase came in the week ending December 16 to make corporate tax payments. Demand deposits were up by about the same amount as loans, while time deposits were up a little more. After year end, however, California banks had rather substantial withdrawals from savings and time accounts reflecting shifts to savings and loan associations that had now gone to a dividend rate of 4-1/2 per cent. After three large associations announced such an increase some time ago, others voluntarily or reluctantly followed suit. It appeared that savings and loan associations were somewhat overcommitted and had had to cancel some commitments and increase borrowings at the Home Loan Bank. The San Francisco Home Loan Bank increased its rate from 5 to 5-1/4 per cent on loans up to 2-1/2 years and from 5-1/2 to 5-3/4 per cent on loans in excess of 2-1/2 years. Banks also lost deposits when public treasurers and others put money into Treasury bills. San Francisco and Los Angeles banks reported that they had never seen so many individuals buying bills. The Federal funds market was reported to be tight; district banks were about even on purchases and sales but the amounts were nominal in relation to the usual volume. Borrowings from the Reserve Bank had not increased significantly. The Reserve Bank assured San Francisco and Los Angeles member banks that if the run-off of savings deposits was as extensive as estimated, the discount window was open. There were no particular problem banks as far as the discount window was concerned, although he cited isolated special instances of borrowings.

1/12/60

-42-

Mr. Mangels reported a general feeling throughout the district that business would be booming for the next six months, perhaps on through the year. Such exuberance ordinarily would be alarming, but factors in the picture might have a dampening effect on what normally would generate inflationary pressures. For example, there was still some excess productive capacity and an excess labor supply, and there was rather general and aggressive competition from abroad. There were the indications of a balanced budget, and there also was an increasing public feeling against any policies, public or private, that would result in further inflation. Thus, while there would probably be price changes, those changes might be rather moderate.

Mr. Mangels said he would not be inclined toward deliberate action increasing restraint at this time. Instead, he would let natural credit demands for legitimate needs exert a further tightening effect and perhaps offset part of it. In the Twelfth District, banks had been screening applications for credit thoroughly for some time, and it appeared that only legitimate applicants were getting credit.

Mr. Mangels felt quite sure that the San Francisco Bank's directors would go along with a recommendation for a change in the discount rate at their meeting tomorrow, but he would be inclined not to make such a recommendation now. Action somewhere around February 15 during an open period in the Treasury financing schedule would perhaps be appropriate. He would not recommend a change in the Committee directive.

1/12/60

-43-

Mr. Irons commented that this was a particularly difficult time to form judgments. It was true that everything pointed to expansion, composed perhaps of some substantial inventory build-up, deferred as a consequence of the steel strike, along with some real growth and probably some speculation and possibly inflation. The situation in the money market seemed to point to a thin and possibly a weak Government securities market, in which the rate structure had already moved up substantially. He did not know whether the present rate structure was solid or whether it still reflected some of the adjustments and tightness of the year end.

Turning to the Eleventh District, Mr. Irons said that in the last month there had been modest strengthening, after a fairly flat level for some period of time. He anticipated further moderate growth but believed that district activity would move upward at less than the national average for a time. The petroleum situation apparently was not going to be a strong stimulant, defense contracts in the district were mostly for aircraft, which had been cut back, and agricultural prices were declining.

The situation as to member bank borrowing was not much different from normal, Mr. Irons said. Borrowings were around 5 per cent of the System total, about the usual percentage. Four or five banks would use the discount window continuously under almost any circumstances if the Reserve Bank would permit them to do it, but he did not feel that the general situation was much different from what it had been for several months. As credit restraint and

1/12/60

-44-

reserve pressures increased, some pressure at the discount window was to be expected.

With respect to policy, Mr. Irons said he would be a little cautious. He would lean toward open market operations designed to continue about the degree of restrictiveness that had prevailed. If he understood correctly, Mr. Hayes had suggested operations with a little deviation on the side of ease, and he (Mr. Irons) also favored leaning toward that side, in view of the uncertainties that had been mentioned. Not knowing whether the interest rate structure was solid, and with the Treasury situation and the position of the Government securities market to consider, he would prefer not to move on the discount rate at this time even though a case could be made for a technical adjustment. There might be an increase in the prime rate, but he did not feel that the System should necessarily base a decision on action that might be taken on the prime rate. To summarize, he came out in his thinking on the side of maintaining through open market operations about the present degree of pressure on bank reserves, but he would not feel too badly if there was a shade of easing; he would leave the discount rate at its present level and see what developments actually took place in the next few weeks, and he would make no change in the Open Market policy directive.

Mr. Erickson said that recent First District statistics continued to show progress, but in many classifications not as strongly as the progress nationally. During the first week of

1/12/60

-45-

December, district banks were net buyers of Federal funds, but in the remaining weeks they were net sellers. For the three weeks ending January 6, average member bank borrowings were only \$16 million, and last week average borrowings were only \$11 million; this was much lower than usual. No evidence was seen of any banks scalping the discount rate, and there were no problem banks. Three smaller banks had been borrowing for several reserve computation periods, but this was due to seasonal factors and agricultural obligations. The loan ratios of Boston banks had been averaging better than 60 per cent recently.

Mr. Erickson felt that it would be desirable to continue a restrictive policy and to raise the discount rate at some time. However, after analyzing the pros and cons enumerated by Mr. Bopp, on balance he would prefer to wait on the discount rate until after the next meeting or the February meeting of the Committee before taking action. He would recommend no change in the directive.

Mr. Erickson added that he was a participant in the morning telephone calls during the past four weeks and that, in view of the usual seasonal factors and some new factors which were in the picture, he felt the Desk had handled the Account most skillfully. He would favor continuing the same degree of restraint, leaving latitude to the Manager of the Account to make judgments based on his feel of the market. If that led to net borrowed reserve levels slightly lower than recently, this would not bother him.

1/12/60

-46-

Mr. Szymczak said that on balance, after having listened to all of the information presented at this meeting, he felt sure there should be no change in the policy directive. However, he agreed with those who felt that reserve positions should be eased somewhat, without any change in basic policy. As to the discount rate, he noted that the interest rate structure had changed and that the Treasury was in the market. All things considered, it was his view that the rate situation might be helped by changing the discount rate as soon as possible by 1/2 per cent.

Mr. Balderston said that he would favor continuing the current degree of restraint for the reasons Mr. Bopp had set forth. Until policy was modified, he felt that the directive should remain unchanged. As to the discount rate, he would hold a change in abeyance until after February 20. At that time, if an increase was appropriate, he would make the increase a full one per cent. These conclusions were based on certain impressions which unfortunately he could not substantiate with objective data. Although the steel strike settlement was the focal point of public attention, it was only one of a number of inflationary labor settlements, including those in the rubber, aluminum, and copper industries and the settlement with the can companies. Statistics at the moment seemed to him somewhat deceptive. The statement that steel prices were certain to rise seemed a questionable one as long as the steel companies were operating at capacity and were able to absorb overhead, as apparently

1/12/60

-47-

they could during the next six months. Furthermore, the inventory build-up assumed to be going on was offset to the extent that manufacturers at long last were able to ship out work in process which had been held up because of the shortage of one or two parts. Similarly, work-in-process inventories tended to be inflated over the year end in the case of manufacturing companies selling consumer durables because of the practice of forward billing. They were forced to hold in work-in-process items shipped out for the Christmas trade until dealers disposed of them. He assumed that the apparent ability of corporations to finance inventories and capital expenditures from internal funds would continue for a while, but not indefinitely. He was surprised that it had continued as long as it had. When the time came that the companies must resort more heavily to the banks and to the capital markets, the System should be prepared for a sharp increase in credit demand and to meet such an increase with vigor. In saying this, he was suggesting a situation that might be ahead but which was not here yet. From the charts of estimated Treasury financing periods prepared by the Board's staff, it appeared that there would be four open periods during the year ahead, each of about a month's duration. These would fall in March, June, September, and December, and the last one would not be of much use to the System. The comments of the Presidents seemed to indicate that a change in the discount rate during the next two weeks was not imperative and could wait until February. If the System were to wait until February,

1/12/60

-48-

he supposed that the prime rate might then be 5-1/2 per cent, or that it would be raised shortly after the System acted on the discount rate. The six-month bill rate was already at 5 per cent; this ought not be ignored by confining attention solely to the three-month bills. In the light of those factors, he felt that a change in the discount rate of only 1/2 per cent would give an impression to sophisticated observers that the System did not mean business.

Chairman Martin commented that most of the time the Chairman of the Board of Governors has a relatively simple role in matters such as the discount rate because of the availability of a group of men in the System who, with their associates, study the situation carefully and offer the benefit of their judgment. However, the role of the Chairman was not quite so simple today. It seemed to him that the System was not far from a turning point, and the discussion around the table indicated how difficult a problem becomes when such a point is near. For the past six or nine months, he had not seen answers to the System's problems. Now for the first time, as he said at the December 15 meeting, he was beginning to be hopeful that a solution was in the making. He approached these problems without any dogmatic point of view, but he wanted to take this opportunity to explain what he conceived to be the role of the Chairman of the Board in System operations. He approached such matters with a sense of humility, and he had no desire to be a dictator within

1/12/60

-49-

the System or to assert leadership for leadership's sake alone. However, a particular responsibility is placed on the Chairman for Presidential, Congressional, and Treasury relationships. This did not mean that the other members of the Board and the Open Market Committee might not be superior in judgment or that under certain circumstances they might not differ completely with the Chairman. He solicited their advice even when he was of a different point of view. He had leaned over backward when dealing with the Committee never to assert leadership unless he felt it essential, and then with due regard to the fact that he might be in error. He had initiated the procedure at Committee meetings according to which the Chairman speaks last rather than first. This was not because he did not have convictions, but because he wished to have the best judgments that he could get and avoid taking a firm position until after hearing those judgments.

The Chairman then posed the question of the right thing to do at the present time. The fact that there was some doubt around the table about the course of System policy caused him to lean in a different way than if there had been unanimity of opinion. If, in going around the table, he had found that to a man--or perhaps with only one or two exceptions--the Committee was united, he might have forgotten his own point of view and gone along. However, because there was sufficient doubt about a judgment in an area of System policy, and because he shared some of the doubts expressed, he

1/12/60

-50-

wished to say from the standpoint of Presidential, Congressional, and Treasury relations--and without indicating in any sense that the System should play politics--it seemed to him that it would be wiser not to act on the discount rate at the present time and upset the even-keel approach by jumping the gun on the Treasury financing, payment for which would come due on the 15th of this month. Instead, he would prefer to await developments. The Open Market Committee presumably was to meet on January 26 and again on February 9. It was dangerous, he felt, to talk about what the System might do at some point in the future. In fact, he would feel a little better at the moment if the discount rate were moved immediately to 5 per cent rather than to take action at this juncture which might lead to a general market expectation that there would be a further increase of 1/2 per cent within a short period of time.

The Chairman again said if this group were united on moving to 5 per cent at the present time, he would be disposed to go along despite the factors about which he was now talking. However, he felt that the System would be running a serious risk that the anticipated boom might not develop, in which event it would have moved prematurely. The Chairman then noted from a statement on the news ticker that had just been handed to him that the President had today sent a message to the Congress renewing his plea for elimination of the 4-1/4 per cent interest rate ceiling on Treasury bonds. This was the President's first special message to the Congress at this session,

1/12/60

-51-

and it was something that he felt ought to be borne in mind. He recalled that last summer he had tried to the best of his ability to determine what was politics and what was not in regard to the thinking on money, and he had found that there was a great deal of misunderstanding. Certainly the System ought not swerve from its course when it had come to a meeting of the minds, but he felt that the System would be dissipating some of its resources if at this early juncture it put itself in the position of leading the commercial banks into an increase in the prime rate, much as he would like to see the System move in advance of the banks.

If in time, the Chairman said, forces in the economy made action on the discount rate clearly appropriate, the System would have a responsibility to act promptly, effectively, and efficiently. However, his assessment of the present situation was that the market would not be stabilized by a technical adjustment of the discount rate to  $4\frac{1}{2}$  per cent. He felt that the System would come closer to a permanently stabilizing effect for some period of time if the rate were increased to 5 per cent. Of course, that was a matter of judgment. If the System waited for a limited period of time and reappraised the situation, it might be that it would develop that the best move would be to go to  $4\frac{1}{2}$  per cent. In any event, when action was taken there ought to be no misunderstanding as to what the System was doing, and no doubt that System action was out of the way for the time being.

1/12/60

-52-

In further comments regarding recent discussions that he had had with the Secretary and Under Secretary of the Treasury, during which he emphasized that neither of these individuals had indicated in any way a desire to interfere with System policies or operations, Chairman Martin said he had remarked to the Secretary yesterday that as he understood it the Secretary would be happier, all things considered, if the situation was not complicated at this juncture by a premature move on the part of the System, and the Secretary had responded that that was definitely his feeling. In going over the matter in his own mind last night, the Chairman concurred in that view. As he had said, there had been no pressure of any kind from the Treasury, but later in the year there might be real pressure from other quarters. In his opinion the System should not throw away its ammunition needlessly, or until it knew more about the present picture than was known at the moment. He did not believe in rushing to abandon the even-keel philosophy.

In conclusion, the Chairman said that to the best of his ability he was trying to espouse the view that, with no change in the directive, the System should postpone a decision on the discount rate until some time in the period following the Treasury refunding, at which time the System should not pull any punches necessary for the performance of its role in fighting inflation. The discount rate question, he noted, could have been discussed separately within the ranks of the Board of Governors, but he had chosen to put it before

1/12/60

-53-

this meeting, realizing that there might be differences of opinion. There appeared to be enough differences of opinion at the present time so that he would be loath to see any Reserve Bank move to 4-1/2 per cent in the next week or so, and to have the Board approve such an increase.

Mr. Hayes commented that in advocating an early move on the discount rate he had done so with some doubt in his mind, as indicated by the statement that he was eager to know how others felt on the matter. He was inclined to think that if and when a move was made, it ought to be a move in which the System participated wholeheartedly and more or less as a body. He had respect for the Chairman's appraisal of the intangible elements having to do with System relationships. Therefore, he was inclined to go along with the Chairman's thinking on the matter.

Chairman Martin then suggested further discussion, following which Mr. Robertson inquired whether that comment related to the discount rate only or also to open market policy. Mr. Robertson noted that in the latter respect there was also a division of opinion.

Chairman Martin said that there was a division of opinion as to the degree of restraint to be sought through open market operations but that he thought the consensus probably favored maintaining the status quo.

Mr. Hayes inquired whether the consensus was not more in the direction of going slightly on the side of ease, and the Chairman

1/12/60

-54-

replied that he thought a vote if taken, might result in about an even split.

Mr. Robertson said he would be willing to go along with the procedure suggested by the Chairman on the discount rate, even though personally he would have been inclined toward a different course. On open market operations, the decision appeared to him to be between maintaining the status quo or easing off somewhat.

The Chairman then suggested going around the table for a summary of views with respect to open market operations. He turned first to Mr. Johns and inquired whether the latter would favor going somewhat on the tighter side.

Mr. Johns said that he would, but not very much. What he had meant to suggest, he said, was that the System accommodate itself to the seasonal movement. Whether or not that would result in a tighter situation would depend on the demand side. As to the discount rate, he was not unaffected by the doubts expressed around the table.

Mr. Bryan said, with regard to the discount rate, that he had favored an increase partly because of the help that might be afforded in dealing with member bank borrowing in the Sixth District. If he had spoken on open market operations, he would have expressed an inclination to go a little on the side of ease, but not much.

Mr. Bopp said that he would favor maintaining the status quo, following which Mr. Fulton said that he would like to recapture the

1/12/60

-55-

firmness that seemed to have been lost in the early part of December. Therefore, he would favor being slightly tighter.

Mr. King favored maintaining the status quo but not being any tighter. He would attempt to avoid giving the impression that there had been any change of policy. He would leave the market alone as far as that could be done, and reassess the situation later.

Mr. Shepardson commented that if the System moved only as far as to recapture the ordinary seasonal movement of reserves and if the demand for credit was less than anticipated, this might mean a lowering of negative free reserves and perhaps a lowering of pressure. If demand was greater, however, there might be an increase of net borrowed reserves and an increase in pressure. The view that Mr. Thomas spelled out in his statement set forth what he thought the Committee should try to do. On the matter of the discount rate, he was in favor of effective action. If a large increase at some later time would appear to represent more effective action than piecemeal increases, he would be in favor of such a course.

Mr. Robertson said he would oppose any easing of restraint, while Mr. Mills said he would favor easing.

Mr. Leedy said that his view was toward maintaining the status quo. As to the discount rate, he agreed that the Chairman had a special responsibility in the areas that the Chairman had indicated. With regard to the timing of a rate change, he felt that the Chairman was better able than others to appraise what was presently involved.

1/12/60

-56-

Mr. Allen said he would favor maintaining the status quo in open market operations, while Mr. Deming favored a mild easing. Mr. Deming also commented that the Minneapolis Bank's directors probably would not want to lead on the discount rate.

Mr. Mangels agreed with waiting on the discount rate. He suggested letting natural forces of demand develop any tightening of credit restraint, without deliberate tightening on the part of the System but offsetting part of such tightening; therefore, a slight easing would be acceptable to him.

Messrs. Irons and Erickson expressed the view that the status quo should be maintained through open market operations, the former adding, however, that he felt any deviations should be on the side of ease, while Messrs. Hayes and Szymczak expressed themselves as favoring a slight easing. Mr. Balderston favored maintaining the status quo.

The Chairman then said that the consensus seemed to favor maintaining the status quo. He added that he doubted whether there was any way that the Committee could measure the matter with sufficient preciseness to get away from that consensus.

Mr. Hayes commented that he had thought the Committee's policy as stated in the directive was expressed in terms which were broad enough so that within it there could be a slight change toward ease. He noted that the Committee had approved the directive at times in the past subject to an understanding that deviations should be either on the side of restraint or of ease.

1/12/60

-57-

Chairman Martin agreed that this had been done at times, but said that he questioned whether the Account Manager could resolve questions of degree very well in terms of any policy directive that could be issued by the Committee.

There being no further comments, Chairman Martin said he understood the consensus was to continue the present policy directive, that the Account Manager should do the best he could to maintain the status quo, and that the Manager should endeavor to conduct operations in such manner as to make it apparent that no change in policy had occurred. He then inquired whether there was agreement with these statements as representing the consensus.

There being no comment to the contrary, the Chairman then inquired of Mr. Mills whether the latter would like to be recorded on the broad question of monetary and credit policy in the same way as in the minutes of the past several Committee meetings, with a memorandum of his views included in the record.

Mr. Mills replied in the affirmative, adding that since he had proposed a change in the directive, he would like to be recorded as voting "no" on continuing the present directive.

Thereupon, upon motion duly made and seconded, the Committee voted, with Mr. Mills voting "no," 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

1/12/60

-58-

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.

Chairman Martin said he would propose that the Open Market Committee meet on January 26 and February 9, 1960, with the organization meeting following on March 1, 1960, and no objection was indicated to this proposed schedule of meetings.

Chairman Martin then commented that the Open Market Committee, in connection with the annual organization meeting, would be looking at operating procedures. He felt that the Committee ought to start now, when there was no real pressure, to consider any possible changes in its operating techniques. This seemed an appropriate time to see whether the Committee wanted to make any such changes in

1/12/60

-59-

its operating procedures, which would include consideration of the "bills only" policy. In this connection, he referred to questions likely to arise in the course of time relating to the 2-1/2 per cent bonds of 1961.

The Chairman then suggested asking Messrs. Young, Thomas, and Rouse to review these matters and give the Committee, at the earliest opportunity, material that would afford a basis for discussion.

In the absence of objection, Messrs. Young, Thomas, and Rouse were requested to consider the matters mentioned by the Chairman.

Chairman Martin then turned to a memorandum from Mr. Young on an information program for the Government securities market which had been distributed under date of January 7, 1960. The memorandum noted that at its meeting on October 13, 1959, the Committee requested the staff to bring forward a specific program, under Treasury-Federal Reserve auspices, for the collection and publication of information about the Government securities market, and that in carrying out this assignment it had seemed appropriate to work through the steering group and associated staff of the Government securities market study. The report of that group, dated January 5, 1960, was attached to the memorandum. The proposed program would continue responsibility for surveys of ownership of Government securities in the Treasury and responsibility for statistics relating to market operations in the Federal Reserve. Accordingly, the Treasury

1/12/60

-60-

participants in the report had not shared in the administrative recommendations pertaining to the System's responsibility, except insofar as it impinged on Treasury debt management responsibilities. In putting the statistical program into effect, various unforeseeable problems were considered likely to develop, for example, with regard to schedule content, and it was suggested that the Committee delegate to the staff authority for resolving these technical problems without referring them back for Committee consideration. Those associated in the preparation of the report included Messrs. Young, Koch, and Keir of the Board's staff, Messrs. Larkin and Roosa of the New York Bank, and Messrs. Mayo and Saunders of the Treasury. Submitted with the memorandum and report was a draft of letter, to be signed by the Secretary of the Treasury and the Chairman of the Federal Open Market Committee and to be sent to all potential respondents, outlining the new program and indicating that full collaboration was anticipated.

In commenting on the matter, Chairman Martin noted that the planning group had tried to achieve four basic things in this program. The first was to enlarge the factual base available daily for System open market operations and Treasury debt management. The second was to provide adequate information to meet potential Congressional requests. The third was to provide a flow of current information for public uses, and the fourth was to do these things in such a way as to protect the confidentiality of individual dealer reports and at the same time avoid any market criticism of System operating officers.

1/12/60

-61-

Chairman Martin commented that the report had not come out with all of the answers but that the program, which resulted from negotiation with the Treasury and the Desk, appeared on the whole to be one that should be carried forward. The Chairman then stated that he would like to have the views of Messrs. Hayes and Rouse.

Mr. Hayes said he agreed that Mr. Young had done a splendid job, in cooperation with the Treasury and the staffs of the Board and the New York Bank. On the whole, the proposed program was a constructive and needed one. The only part on which he had serious doubts involved the question whether it was wise to cut off the Desk from information on individual dealer data. He had felt generally that the more the Desk knew, the more effective a job it could do. Recognizing differences of viewpoint on this phase of the matter, he suggested that the program be given a fair trial. He added that he and the Desk and everyone else at the New York Bank would be willing to give it a fair trial.

Mr. Rouse agreed that the report represented an excellent job in most ways. However, he wished to make a statement so that the Committee might have before it his point of view on the matter to which Mr. Hayes had just made reference. Mr. Rouse then read the following statement:

There are just a few comments that I would like to make in connection with this program. It certainly constitutes a major step in the development of information in an area where the public interest is deeply involved. When the program reaches a point where publication of data covering activity in the Government

1/12/60

-62-

securities market becomes a reality, it should make for a more informed public and may even lead to a better public understanding of the relationship between monetary policy and the market. This information program is the most urgent of the suggestions that developed out of the Treasury-Federal Reserve Study.

However, the program contains unnecessary restrictions on the availability of data to the Management of the System Open Market Account. Up to this time, the data on the operations of individual dealer firms has been available to the Management and this information has been helpful to it in making a general appraisal of the market and in discharging its responsibilities to the Committee. I wish to point out that under this new program the Manager is denied access to individual dealer data except under particular conditions, and that only information on the aggregate of dealer operations would be available to him. Ordinarily, these aggregate data would be sufficient to form an over-all appraisal of market conditions. Yet there are, and have been, many occasions when it has been necessary to go beyond the data covering all dealers as a group and to review the operations of individual dealers for the purpose of interpreting and evaluating the significance of the aggregative data. Dealer operations in terms of both the aggregate and of individual dealer firms also have an important bearing on Treasury financing--before, during, and after. To deprive the Committee and the Secretary of the Treasury and their staffs of any of the information collected from dealers on a regular basis is an unnecessary limitation on the use of the data. The people in authority having a public responsibility have an obligation to be as well informed as possible about the market. This means getting to know the whole market and it would embrace an understanding of behavior patterns and individual dealer performance through continuous day-to-day contact with dealers and the data covering their operations. The data on operations of individual dealer firms is particularly important--indeed, it is essential--in administering the repurchase agreement arrangements at the Federal Reserve Bank of New York. While the new information program makes special allowance for the availability of certain data on individual dealers in connection with the use of repurchase agreements, it does not go far enough. In effect, the total information covering individual dealer operations that has been available to the Manager for many years will be sharply reduced under this program, even though that information will continue to be collected from dealers. Whether we like it or not the Government securities market is a personalized

1/12/60

-63-

market. That is, it is a market in which a number of highly individualistic personalities play a crucial part, and it is this characteristic that prompts this comment on my part. I hope the time will arrive when the market will be large enough so that no one or two personalities at any one time can dominate it. When that time comes the use of aggregate figures may be sufficient. If the Committee concludes that individual dealer data should be denied the Desk on a trial basis, we will of course do our best to operate effectively under the proposed limitation.

In my experience the current information available on the financial standing of dealer firms has been adequate. I question the need, as set forth in the proposal, for obtaining formal income statements from dealers and I also have reservations concerning the need for balance sheet information as often as four times a year.

I have one final comment to make. It has to do with the protection of the confidentiality of individual dealer positions and the need for an appropriate time lag between current dealer reports and their date of publication, even in aggregate form. The paper submitted to the Committee covers this point, but I would like to emphasize here for the benefit of the group that will carry out your instructions the importance of having an adequate time lag between current dealer operations and their release for public consumption.

Some of my comments have been covered in greater detail in a paper on this subject prepared in November of last year by the Federal Reserve Bank of New York, primarily as an aide memoire for Mr. Young's group. If any of you would be interested in receiving that paper, I would be glad to forward copies.

I would like to suggest that Mr. Young's group continue its work, looking to recommendations to the Federal Open Market Committee and the Treasury arising out of the additional matters uncovered by their Study and also some of the technical points that were raised. These latter points include, for example, extending maturity of securities eligible for Federal Reserve repurchase agreement, reverse repurchase agreements, lending of System securities to dealers, swaps, and the confidentiality of dealings with the Federal Reserve System. While most of these suggestions are primarily related to the operations at the direction of this Committee, they hold an interest for the Treasury as well in that it is primarily responsible for the market for its own securities.

1/12/60

-64-

Chairman Martin suggested that Mr. Rouse send to all of the Committee members and other Presidents, without specific request, the paper of the New York Bank to which he had referred. The Chairman then proposed that the Committee adopt the program suggested by the planning group and review it some time in the course of the next three months.

No objections to this proposal were heard, and the Chairman then said that the matter would proceed on the basis he had suggested.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, January 26, 1960, at 10:00 a.m.

The meeting then adjourned.

  
Assistant Secretary