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, October 4, 1955, at 10:00 a.m.

PRESENT: Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Earhart
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Erickson, C. S. Young, Johns, and Powell, Alternate Members of the Federal Open Market Committee

Messrs. Williams, Bryan, and Leedy, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Rice, Roelse, Wheeler, and R. A. Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on September 14 and 26, 1955, were approved.

Before this meeting there had been sent to the members of the Committee copies of a report prepared at the Federal Reserve Bank of New York covering open market operations during the period June 22-September 28, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed September 29-October 3, 1955. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period since September 13, 1955 were approved, ratified, and confirmed.

Members of the Board's staff from the Divisions of Research and Statistics and International Finance then entered the room for the purpose of presenting an economic review illustrated by chart slides. Following the meeting, a copy of the text of the review was sent to each member of the Committee.

The review stated that by late September the economic situation had advanced to a point where financial developments had become a more critical factor in the shaping of business trends. Consumer credit had been rising rapidly to new heights and so also had mortgage credit, supporting very active markets for autos and housing. The buoyancy in stock prices during late September had been especially striking, a buoyancy that in recent months appears to have been mainly fostered by ebullient confidence rather than speculation on the basis of credit expansion, for the growth in stock market credit tapered off following the second increase in margin requirements in April and by summer had virtually ceased. It was at this stage of economic development that announcement of President Eisenhower's illness came as a shock to confidence. While it is too early to assess the economic significance of that announcement, the immediate response was a sharp set back in stock prices accompanied by a sharp rise in trading. Events in the stock market often foreshadow changes in business activity and suggest at least the possibility of more widespread hesitation and also of some postponements in business and consumer spending.

After commenting in some detail on various elements of the economy, the review concluded with a statement regarding projected reserve needs for the balance of 1955. This projection assumed that seasonal and normal long-run growth in demand deposits during the remainder of this year would be about $4-1/4 billion and that currency in circulation would show the usual seasonal increase of about three-quarters of a billion. The projection indicated a need for a little over $1 billion of Federal Reserve credit for the rest of this year--about $500 million in October and most of the remainder in late November and December when large pre-holiday needs for credit and money were expected. The review suggested that the Federal Reserve could supply the reserves needed by outright Treasury bill purchases or repurchase agreements, or it could refrain from open market action in which case member banks would need to increase their borrowing. A combination of these means could, of course, be used. Despite uncertainties in the economic outlook, it was suggested that the situation still appeared to be one in which demands were expanding rapidly while supplies of industrial products were coming under capacity restraints. In this situation, a strong case could be made for limiting the volume of reserves made available through open market operations but such a policy would need to be pursued with caution in order to avoid the sudden emergence of undue restrictive tension in credit markets. Under such a program, the discount rate level might need to be raised further at a relatively early date. Critical qualitative scrutiny of consumer and mortgage credits should be continued if not strengthened. Finally, the System would need to be alert--perhaps more than in most other periods--to possible shifts in the general economic situation which might call for modification of current monetary and credit policy.

Mr. Sproul inquired of Mr. Young as to what elements in the economic situation, aside from mortgage credit and consumer credit, might be considered to be unsatisfactory.

Mr. Young said that he would add the agricultural situation to the list of elements which were not satisfactory. However, taking the economic situation as a whole, it was very strong and the outlook was very good. The existing situation was just what would be desirable if it did not present a danger of spiraling prices based on levels of demand running ahead of supply.

Mr. Thomas felt it important that, as brought out in the economic review, there had been great expansion in the economy thus far and industry was now approaching capacity levels. Further expansion in demand could not continue without putting upward pressures on prices.

In response to a question from Mr. Johns as to whether the retardation in the rate of expansion reported prior to the President's illness was attributable solely to limitations of capacity of industry, Mr. Young said that while there were other elements, he felt that the approach of output to relatively full capacity was the most important factor.

The members of the staff who had entered the room for the economic review then withdrew from the meeting.

Mr. Sproul called for comments regarding open market operations to be pursued in the light of the review of economic and credit conditions.

Mr. Balderston stated that until after the payment date for the current Treasury financing (October 11) he would attempt to maintain the degree of restraint that existed in the market last week. After October 11, however, he would favor still greater restraint such as would be reflected by a bill rate of 2.30 to 2.40 and negative free reserves of perhaps $500 million, more or less. Despite the psychological shock to the business community caused by the illness of our Chief Executive, Mr. Balderston felt that the current and prospective momentum of recovery must be appraised carefully by the Committee. Quality of credits being granted must be appraised; the approach of production to capacity in the steel, construction, and other industries must be observed; and the resultant danger of price and inventory increases must be watched carefully. Mr. Balderston's concern was that the existing business momentum was being accompanied by such changes in wages and labor costs and in raw materials costs as would bring about price rises detrimental to consumers generally and especially to farmers. He felt that the price increases now evident and in prospect would be conducive to inventory growth that would ultimately cause trouble to the economy. Therefore, Mr. Balderston felt that in addition to greater restraint exercised through open market operations after October 11, an increase in the discount rate to 2-1/2 per cent prior to mid-November would be called for. This date was mentioned, he said, so that a condition of relative stability might be established prior to the Treasury financing to take place in December.

Mr. Szymczak thought that the present situation was one which called for continuing the present policy of tightness without allowing the tightness to become so severe as to be a cause, or to be cited as a cause, of a down turn in the economy, if such a down turn developed. He did not think that negative free reserves of as much as $500 million would be desirable and was inclined more to a level of around $300 to

$350 million. He would also allow member banks to come to the Reserve Banks with discounts for additional funds that might be needed, but at this time he could not say whether he would favor a discount rate change later on since the need for such an increase at a later date could not be appraised at the present time. Mr. Szymczak also noted that the Treasury now had its books open. Developing trends should be observed over the next two or three weeks, he said, and in the meantime he would favor continuing the general policy of tightness discussed at meetings of the Open Market Committee during the past month although he would not have quite as much tightness as before the illness of the President.

Mr. Erickson thought that open market policy had been handled very well recently. He would not go as far as Mr. Balderston in restraint during the present period. The President's illness had caused some weakening of confidence in the general economic picture and, while he would keep pressure on and would let it increase slightly over the next few weeks, he would not move to tighten the situation sharply. He hoped that the discount window would be used more and he would not raise the discount rate at the present time. Mr. Erickson said that he would favor taking another look at the situation toward the end of this month to see what the effect of developments had been during the month of October. He also noted that a very distinct tightening of mortgage money had become apparent in New England recently.

Mr. Irons said that he generally agreed with the position taken by the staff in its review. The economic situation is very strong. It seemed to him that this reflected the consequences of a full production, full employment situation. The economy was moving nearer capacity in many respects, and as this point approached less efficient means of production would be utilized and prices would tend to rise. While it could not be known what uncertainties might arise as a result of the President's illness, it seemed to Mr. Irons that the Committee should continue to exert pressure on bank reserves, the bill rate should be in better relation to the discount rate, and if he were to use a figure of negative free reserves he would say something in the range of $300 to $350 million rather than any substantially higher amount. He would not be prepared at present to recommend an increase in the discount rate and would wait for two or three weeks to consider such a change. In carrying out this program, he would resolve doubts on the side of restrictiveness rather than ease. He also felt that during the next two to four weeks the day-to-day situation might be such as to make it desirable to allow the management of the account considerable leeway so as to permit it to meet, within the limits of the Committee's general policy of restrictiveness, whatever conditions developed.

Mr. Earhart stated that his views were very close to what he understood to be the views expressed by Messrs. Szymczak, Erickson, and Irons, rather than to the more vigorous policy suggested by Mr. Balderston.

Mr. Powell said that he would favor waiting a little longer than Mr. Balderston had suggested before making any further restrictive moves. The larger banks in the Ninth District were beginning to borrow quite heavily again, he said, indicating that the 2-1/4 per cent discount rate was not offensive to them. If this tendency to borrow were to develop much further he would feel inclined to recommend to his board of directors a further increase in the discount rate promptly. After commenting on economic conditions in the Ninth District as well as in the United States generally, Mr. Powell said that he was inclined to favor a "go slow" attitude for a period of two or three weeks with the thought that consideration could be given to what further moves might be necessary when the next meeting of the Committee was held.

Mr. Leedy recalled that for some time he had taken the position that the Committee should have applied more pressure than it had exerted. At this particular juncture, however, he felt the situation was sensitive and that the Committee should not attempt to increase the pressure it has been applying recently. Developments over the next two or three weeks would enable the Committee to appraise the situation much better than was possible today. At that time it might seem necessary to increase the discount rate or the amount of negative free reserves. For the present, however, Mr. Leedy felt that the Committee should continue just about the same program it has been applying recently although if, from day to day it appeared that some little increase in pressure could be made, he would favor that course. In other words, he would resolve doubts on the side of additional mild restraint.

Mr. C. S. Young expressed the hope that no increase would be made in the discount rate for several weeks. There was much uneasiness under the surface, he felt, and he would hope that negative free reserves might run around the $300 million level during the immediate future, rather than closer to the $500 to $600 million level.

Mr. Leach said there had been no fundamental change in the economy since the meeting on September 14. It looked as strong as before but the Committee could not be certain as to the effect the President's illness and the down turn in the stock market would have on business planning. Once the Treasury financing was behind, Mr. Leach felt that Committee policy for the next three weeks might be the same as before the telephone conference meeting on September 26. This would mean restoration of the understanding that doubts in carrying out open market operations be resolved on the side of tightness rather than ease. Estimates of free reserves indicated a substantial negative position during the next several weeks, Mr. Leach said, and in addition to use of repurchase agreements to take care of temporary situations, outright purchases of securities probably would be necessary. While he would not tie exclusively to any one or even two indicators in measuring tightness, he was thinking in terms of a level of around $1 billion of member bank borrowings and short-term interest rates about where they are. This presumably would mean negative free reserves around $400 million.

Mr. Leach went on to say that there seemed to be some difference of opinion as to how the Committee's restrictive policy had affected banks. He was convinced, he said, that in the Fifth District the larger banks approved the policy and that they had become more selective and restrictive in making loans. While loans were increasing, this was to be expected at this season. Mr. Leach did not think the restrictive policy had directly affected the smaller banks a great deal except that most of them now have some depreciation in their security accounts. While he advocated resumption of the degree of restraint that existed before the President's illness, he would not wish to intensify pressure at this time by increasing the discount rate.

Mr. Mills said he gathered that all of the comments were moving toward the same goal. He referred to the economic review which presented a picture of an active economy which might be approaching a leveling off period and which might be unusually exposed to psychological influences. At the same time, he felt the economy needed the influence of credit restraint. In applying credit restraint, however, Mr. Mills felt that the Committee should not be too severe. For example, negative free reserves should not go much beyond the $300 to $350 million level that had existed recently. The economy may not yet have felt the full effects of the operations of the commercial banking system against a level of free reserves of this scope. Mr. Mills said that he would favor experimenting for a period with the program the Committee had already pursued so that it could be sure it was not shutting down on the availability of credit in a way that would be harmful to the economy rather than helpful. Until after October 11 when the Treasury financing payment date would have passed, the Committee would not wish to move more aggressively by altering the pattern now being followed. The next positive step to be taken by the System, he felt, would probably be an increase in the discount rate to 2-1/2 per cent. For the immediate period, however, and considering the reserve requirements for the remainder of this year which would call for additional reserves of a magnitude around $1 billion, he felt that a combination of repurchase agreements, additional discounting at the Reserve Banks, and direct purchases of securities for the open market account was called for.

Mr. Robertson then made a statement substantially as follows:

1. The degree of restrictiveness of monetary policy has been inadequate during the past six months. We have been too slow to act in the light of the upsurge of economic forces with inflationary tendencies. Today it is wholly inadequate. A given volume of negative free reserves today lacks the restrictive weight of a much smaller volume a few weeks ago.
2. In the week before the President's illness our action was wholly inadequate. At the time of the last meeting of this Committee on September 14th, the New York Bank's estimate of the average level of free reserves for the week ending September 21st was -60 million dollars. Yet despite that estimate, no action was taken to tighten reserves. The actual figure for the week turned out to be -116 million dollars. Some market participants misinterpreted this development as a swing toward ease, particularly in view of the fact that we had been so prompt and precise

to keep negative free reserves around a level of -250 million for several weeks preceding. It would seem probable that if the projection had shown negative free reserves as much above the target as -60 million was below, credit easing action would have been taken by the account promptly.

3. The action of the Committee on September 26th to take the "strings" off the Manager (i.e., relieve him of the obligation to resolve doubts on the restrictive side) in order to enable him to move to offset unexpected and indeterminable public psychological reactions to the President's illness was a sound and correct action. It did not intend, I feel sure, to seek a back-up in the absence of unexpected tightening beyond levels contemplated at the last meeting, although the activity on September 27th and 28th and 29th would indicate that perhaps that was the understanding of the Manager of the Account.
4. The purchases during the first few days of last week can be justified both on the basis of the sharp decline in stock prices that occurred a week ago yesterday and the substantial decline in reserve positions. However, I can find no justification for the repurchase agreements entered into last Thursday, particularly of the magnitude involved--almost a hundred million dollars. They came a day after the account itself had predicted that average free reserves would decline from a level of about -350 million dollars to -330 million and despite the fact that the degree of tightness has been consistently overestimated in these projections from week to week in the past.
5. This behavior of the account's operations over the past three weeks strikes me as crystal clear evidence that we must find ways and means of more clearly delineating our judgments and more specifically fixing targets if our directives are to be properly implemented.
6. The rebound in the stock market on September 27th and its behavior since then is evidence that the break of Monday, September 26th, may have been simply a short-lived jittery reaction to a calamity, based in large part on sentiment, and was not indicative of any over-all weakness in the economy. Certainly this morning's presentation of the economic outlook evidences the continued upward trend of important economic indicators.
7. Today many people take it for granted that the Federal Reserve cannot move, and as a result it is disregarded as a potent force to stop the upward trend. It is being disregarded on the theory that it is now too late to act and that we are frozen into position--as we are to some extent,

at least. Only a shock could restore the restraint called for by the economy in order to prevent damage in the way of unwarranted expansion, and during the next ten days we can hardly administer a shock and still maintain an "even keel" during the government financing period. This is so even though this particular financing is not one that can be affected adversely by restrictive monetary policy to the same degree as ordinarily would apply, because of the volume of available funds in the market and the character of the offering.

8. Bank loans are continuously moving up, and despite cries of tightness, the banks seem able both to meet advance commitments and expand loans generally without reserve difficulties. It is possible that between operations in the Federal funds market and borrowing from the Federal Reserve Banks, some banks are continuous borrowers and some even could be characterized as complacent rather than "reluctant" borrowers. Certainly there has been small liquidation recently of government securities in order to meet needs for reserves on which to base credit expansion.
9. Hence, it seems to me that now (during the last two of the next three-week period) is the time to be putting on the brakes a little harder.
    a. Therefore, I suggest aiming toward between 450 and 500 million dollars negative free reserves during that portion of the three-week period, provided that aiming at such a target will lead to a short-term government rate of near 2-1/4 per cent, a volume of borrowing between one billion and one and one-half billion dollars, and a reasonable curtailment of member bank lending.
    b. We should refrain from moving too fast in adding reserves through either outright purchases or repurchase agreements--movements should be made in the light of the results achieved through aiming at the suggested target.
    c. In addition, grave thought should be given to an increase in discount rates as soon after October 15th as possible. The Treasury financing will be out of the way by then. A fairly even keel will have been maintained through the government financing period. Such an increase will not be wholly unexpected but will evidence a concern with the maintenance of stability and can be followed by a more restrictive open market policy at the next meeting if conditions then warrant.

Mr. Sproul asked that Mr. Rouse comment on two questions that Mr. Robertson had raised about the operation of the System account: (a) whether a decline in negative free reserves during the week ending September 21 might not have been offset by operations for the System account so that the average level of negative free reserves might have been considerably higher; and (b) whether it was appropriate to enter into repurchase agreements on Thursday, September 29.

Mr. Rouse noted that projections of average negative free reserves during the week of September 21 differed, the projection prepared at the Board indicating a substantially larger volume than the one prepared at the New York Bank. While the projections indicated a reduction in negative free reserves on Thursday and Friday of that week, there was also an indication that there would be a very high deficiency the following Monday-Wednesday. The System account management did something about the situation, Mr. Rouse said, through arranging with the Treasury for a special call which would bring its balance up and thus reduce the volume of reserves. It was because of this action that an average free reserve position of minus $120 million for the week ending September 21 was attained. Mr. Rouse said that he also had in mind that if an attempt had been made to sell securities from the account to reduce the volume of free reserves on the Thursday and Friday in question, it would have become necessary to reverse that operation on the following Monday because of the expected very tight situation. Such in-and-out operations, he had understood, were generally not desired by the Committee. Mr. Rouse also stated that during the week in question when free reserves averaged negative $120 million, there was no dimunition in the feeling of tightness that existed in the market.

Mr. Rouse then referred to the repurchase agreements executed on September 29. He was not at the New York Bank that day but there was a question whether the System account should facilitate the dealers' operations by picking up some of their bills. Dealer positions were large as a result of their allotments of new bills on that day and the selling by corporations and by banks preparing for their September 30 statements. Also, since the quarterly statement date fell on a Friday, bank borrowing was large on Thursday to average out against repayment the following day. As a result of these conditions, there seemed to be a degree of tightness developing which resulted in the decision to make the repurchase agreements. As it turned out, the judgment appeared to have been right, Mr. Rouse said, in that average negative free reserves that day turned out to be minus $335 million which was about $36 million higher than on the preceding day. Approximately that volume of negative free reserves has continued up to the present time.

Mr. Robertson said that he thought Mr. Rouse was overestimating the criticism to be put on in-and-out transactions; he (Mr. Robertson) did not understand the Committee to be clearly opposed to "in-and-out" transactions for the System account if they were not confusing to the market.

Nothing in his statement was designed as criticism of the management of the account, he said, but rather of the Committee for failing to be more specific in its directives.

Mr. Shepardson said that there still seemed to be a strong movement upward in the economy with considerable indication of further wage and price pressures. The situation in agriculture did not give promise of immediate improvement, he said, and with other segments of the economy moving in the direction in which they appeared to be moving, a further disparity was developing between agriculture and the rest of the economy. He felt the System was fully justified in continuing a strong and increasing pressure on the credit structure. During the past week an unusual situation was presented because of the element of uncertainty and the Committee should continue to watch this closely. On the other hand, Mr. Shepardson felt that the first shock of the President's illness was pretty well behind us and that the Committee should continue to exert the pressure contemplated prior to the meeting on September 26. He would favor going back to a continuing degree of tightness with some increase in negative free reserves and with the understanding that, in carrying out operations for the System account, doubts should be resolved on the side of tightness. Mr. Shepardson also expressed the view that for a considerable period of time operations had been carried on with doubts having been resolved on the side of ease. While he did not wish to suggest a precise limit, he felt that negative free reserves should increase somewhat.

He would not suggest an increase in the discount rate at this time. The System should be looking toward the probability that such an increase would be advisable when the Treasury's current financing was completed, but he felt it unwise to make any commitment on this point at present.

Mr. Shepardson went on to say that he gathered from discussions of this subject that reluctance to engage in "in-and-out" operations in the past had arisen partly because of the tendency of some elements in the market to look at changes in the open market account rather than at the resulting free reserve situation. He suggested that if the amount of free reserves was a significant index of the degree of tightness, it might be desirable to try to get the financial community generally to look at the level of free reserves as such an index and thus to interpret buying and selling for the System account in those terms. This, he felt, would give the System more freedom in using the open market instrument.

Mr. Sproul said that he personally did not think the Committee should take negative free reserves as the index of whether it should be tightening or easing the market, and he did not think the market should be brought around to believing that the Committee assumed that negative free reserves represented the index or that the Committee was relying solely on that index. In the first place, a good deal depended on the distribution of reserves, whether they were concentrated in reserve cities or central reserve cities or spread out over the country; also, on whether the existing volume of negative free reserves was having effects on the market which were in accordance with or contrary to the policy the Committee was trying to pursue. The condition of the money market is not always a direct resultant of any fixed level of free reserves, Mr. Sproul said, and different levels of reserves could show up in different movements of interest rates, in the condition of the dealers in the market, or in the operations and attitudes of member banks including their willingness to borrow from the Federal Reserve System. Mr. Sproul did not feel that it would be fruitful to use negative free reserves as a single indicator of the direction either of System credit policy or of conditions in the money market.

Mr. Fulton thought that the uncertainty the country was supposed to be in was more a matter of conversation than actuality. Businessmen in the Cleveland District indicate that they have not changed plans for expansion one iota, he said, and the man in the street is satisfied with his welfare under the present administration and feels that if a change in administration comes along there might be some inflation which would result in his receiving more dollars. With this background, Mr. Fulton did not feel that actions of individuals in making commitments had been affected by the incident of the President's illness. One problem, he said, was the difficulty industry was experiencing in obtaining fairly skilled workers to operate the machines already available and this was an element causing production to seem to "top-off." There were still free reserves in the Cleveland District as a whole. Mr. Fulton felt that the System should be on the tighter side, that it should resolve doubts in its operations on the side of tightness, and that the discount rate should not be moved until the Committee could see more clearly whether the economy would level off in the next couple of weeks. Also, he felt the discount rate should not be advanced again until market rates had been brought up consonant with it.

Mr. Bryan said that he was less certain as to which way the economy was going than was indicated by some of the other comments. Bank loans were still going up but marginal borrowers in the Atlanta District were having difficulty in finding credit. He felt the System's restrictive policy had been having an effect during the last 60 days and there was unmistakable evidence that the mortgage market in the Sixth District had tightened rapidly during the past 30 days. Mr. Bryan was inclined to attach more significance to the behavior of the equity market than others had indicated. The situation in the equity market, he thought, was not fundamentally produced by the President's illness but by a level of prices, particularly for high quality equities, which was high and had been predicated on a continuing advance in the economy and in profits. Such a level of equity prices could not be justified even on the assumption that the economy would continue stable. Mr. Bryan felt that monetary policy may have had a basic cause and effect relationship to developments in the equity market and, in turn, there might be effects from the stock market decline (and the possibility of further rapid declines) which might well induce a more cautious approach to expenditures and capital commitments. Nevertheless, information showed a booming economy and one that could increase price levels sharply with the result that serious capital distortions in the economy might develop--something that the System would not desire. Mr. Bryan's inclination was to go along with the general theory that the System should not relax pressure and he noted the suggestion for using a combination of methods to pursue an appropriate degree of tightness: some reserves to be supplied through open market operations but not the entire seasonal requirement; some reserves to be supplied through repurchase agreements, and part of the seasonal requirement to be met during the fall months at the discount window. He would agree with this general approach although he thought that the System might find there would be a sufficient additional tightening if member banks were brought further into debt at the Federal Reserve Banks. Such a development would be desirable as a means of offering an opportunity to talk directly with the member banks on a lender-borrower basis. Mr. Bryan also said that he was inclined to agree with Mr. Balderston regarding the level of the short-term rate. Mr. Balderston had suggested a level of 2.30 to 2.40, which he (Mr. Bryan) would agree with as an experimental approach to further restraint. As to negative free reserves, Mr. Bryan felt that the Committee would do better if it would watch the short-term rate rather than the volume of negative free reserves. He also felt that Governor Robertson was correct in thinking that it would be necessary for the

Committee to state more precisely than it has in the past just what it wishes to have the Manager of the System Account do to carry out the Committee's policy.

Mr. Williams said that his judgment was that the Committee should exercise restraint but he would not do it in the clear cut and forceful manner that Mr. Robertson had indicated. Such a program would be too heavy-handed during the next two to four weeks. Mr. Williams felt that the reaction stemming from the President's illness was largely emotional but it could become more important and could extend throughout not only the domestic economy but into the international picture. His view was that in this country there was already a tendency to discount the effects of this emotional reaction. Banks in the Philadelphia District were becoming more selective in credit extensions and on the whole he felt that the full effects of the adjustments that would result from this emotional reaction were yet to be seen.

Mr. Johns said that his views were similar to those expressed by Mr. Szymczak. This did not mean that he would not sooner or later agree with the views expressed by Mr. Balderston along the lines of greater restraint, but he was not yet ready to agree with that position. He also referred to the comments in the economic review which he interpreted as indicating that slackening in the rate of economic expansion might have resulted from an approach to capacity rather than from actions taken with respect to monetary and credit policy. Mr. Johns expressed doubts about the desirability of supplying at the discount window too large a proportion of the reserves which would be needed during the remainder of this year. In the St. Louis District banks had not made preparation for their fall needs. Some of them were warehousing mortgages and were obtaining funds through the Federal funds market to help in carrying these credits. Also, some banks were extending credit to finance companies heavily. If the System were niggardly about supplying reserves through the open market, banks would be forced into the discount window. These banks would more and more find it impossible to get funds they needed in the Federal funds market and would tend to become continuous borrowers at the discount window. If this developed and if the discount function were to be administered in accordance with what seemed to have been recent decisions, it would mean that the Reserve Banks later this year would be applying much more pressure than the System intended through the discount window. Mr. Johns' preference, therefore, was to rely a little more on open market operations, and a little less on the discount window than some of the others had indicated.

Mr. Sproul then made a statement substantially as follows:

1. The President's illness suggests an analogy with our present economic situation. There has been an unforeseen event, the ultimate consequences of which cannot be foretold. The immediate repercussions were sharp in a sensitive nerve center, but so far we cannot know whether this was wholly an emotional and psychological reaction or whether it also has a deeper significance. We can be pretty sure, however, that the event will leave some scars, and we are now concerned with the question of how an otherwise vigorous

economic organism will function despite the scar tissue.

2. What we can observe at the moment is an economy which seems to be levelling off at a high level of production, but in which increasing upward pressure on prices and the demand for credit may be accumulating. The index of industrial production, which had increased about five points on the average in each of the previous three quarters, rose only two points in the past quarter and some of the more sensitive indicators of economic activity have turned down. On the other side of the shield, there are still strong foreign and domestic demands for raw materials and for our products and services, much of the pressure of increased costs on prices is probably still to be felt, personal savings are at a lower rate than in recent years, and demands on the capital and mortgage markets have been exceeding the accumulation of savings, bringing in increased participation by commercial banks.
3. The situation is clearly not one that calls for the use of the oxygen tent of easy money. It does suggest to me, however, that we should not now step up the pressure of credit restraint as we might previously have contemplated. And I am fortified in this view by the fact that the strongly competitive character of the business situation, with its reflection in buyer's markets at retail for many consumer goods and in the failure of undue inventory accumulation to appear, indicates that we have not pressed to the limits of productive capacity.
4. I continue to believe, therefore, that our best policy for the immediate future is the continuance of the measure of credit restraint which we have been trying to maintain for the past two months. Since the effectiveness of credit restraint is greatly influenced by opinions about the future, and since opinions about the future may be undergoing some revision, I think such a policy of maintained but not affirmatively intensified pressure will be most conducive to our objective of contributing to the highest possible levels of economic activity without inflation, in this period. And for the next three weeks, of course, such a prescription is further suggested by the fact that it is a period which brackets a payment date on a Treasury financing, which will call for additional reserve funds beyond the seasonal needs of business and agriculture.
5. In so far as figures can be our guide, such a policy might mean member bank borrowings of around $1 billion, negative

free reserves around $300 million plus or minus, and money market rates grouped reasonably closely around our present discount rate, with the Treasury bill rate perhaps above the discount rate at times. And we shall have to keep a sharp watch also on the effect of our policy in the capital markets, which are going to have heavy demands made upon them during the coming quarter and whose continued active functioning is necessary to keep our economy going at high levels.

6. On the basis of the present forecasts of reserve positions, a policy of this sort will mean some increase in member bank borrowing, substantial outright purchases for System Open Market Account, as well as timely use of repurchase agreements during coming weeks. We shall have to be guided not only by figures but by feel; by whether or not the seasonal demand for credit seems to be adding significantly to tightness in the money market, and by whether signs appear of gray markets, inventory hoarding, overtime work and other evidences of increased inflationary pressures.

In summing up his view, Mr. Sproul said that he would share the views expressed that the Committee should adopt the same general instruction with respect to open market operations that it adopted at the meeting on September 14, 1955. From the comments made at this meeting it seemed that while there were perhaps differences of opinion and various shades of opinion, the general view expressed by the majority was that the Committee desired at this time to maintain the degree of credit restraint that it had been trying to maintain on the basis of the instruction given on September 14 and that this meant it wished to reestablish the instruction given at that meeting that, in carrying out open market operations, doubts should be resolved on the side of tightness rather than of ease. There was agreement with Mr. Sproul's statement of the majority views expressed at this meeting.

Mr. Sproul then referred to the suggestion made by Mr. Rouse at the meeting on September 14 that the Committee increase the authorization for purchases of bankers acceptances from $25 million to $50 million, and to the memorandum sent to the members of the Committee by Mr. Rouse under date of September 26 commenting on this recommendation.

Mr. Rouse stated that, as indicated in his memorandum, he felt it would be desirable to increase the limitation on purchases of bankers acceptances but that this suggestion did not contemplate any change in the original concept of the Committee in authorizing such purchases. In sum, he felt that it would be desirable to spread some of the System's outright purchases into the acceptance market as a means of further indicating that some real use is intended for this means of providing reserves directly through this channel of business financing.

Mr. Mills stated that he had raised a question regarding Mr. Rouse's recommendation at the meeting on September 14 and that while he did not think it was a matter of vital importance one way or the other, he still questioned the desirability of authorizing an increase in the limitation. He then made a statement substantially as follows:

> The Federal Reserve System's interest in bankers' acceptances is to foster the use of a form of financing that will strengthen and enlarge the United States as an international money market. It is doubtful that an increase from $25 million to $50 million in the amount of bankers' acceptances that can be held in the System Open Market Account will go far to serve that purpose.

Financing accessibility at competitive international interest rates is the first requisite to a greater use of bankers' acceptances in the United States. New York, on a rate basis, is now competitive with London and Continental money markets. As interest rate is not presently a barrier, it is fair to look upon the lack of widespread currency convertibility as a principal hindrance to the development of bankers' acceptance financing on an international scale in the United States. A greater willingness on the part of our domestic commercial banks to encourage bankers' acceptance financing at a cost at least comparable to the cost of the prime interest rate is also necessary to the expanded use of this financing vehicle.

A second requisite to the wider use of bankers' acceptances is the development of a broader investment market for these instruments. The Federal Reserve System's present policy of purchasing bankers' acceptances in modest amounts can be helpful in providing dealers a stopgap market for their offerings pending final distribution to permanent investors. Repurchase agreements are especially useful in this regard. Direct purchases, however, are open to question, particularly if their effect is to push down the market rate on bankers' acceptances to an artificially low level, in which event the investment attractiveness of this instrument is diminished. Obviously, to raise the System Open Market Account's purchase ceiling to $50 million would aggravate this difficulty, and the more so in that dealers would have a less salable security to offer and, therefore, less incentive to press its sale. In other words, excessive System support to the bankers' acceptance market can, in part, defeat the very purpose for which it is intended.

Instead of raising the System Open Market Account's ceiling for purchasing bankers' acceptances, a more appropriate policy would be to retain the present ceiling and in so doing operate more flexibly as to the total amount held. Implementation of such a policy would contemplate a wider use of repurchase agreements to tide dealers over the short periods necessary to distribute their holdings, and a lesser use of direct purchases. Under this program direct purchases would not be made to maintain a relatively constant holding of bankers' acceptances, but the total holding would fluctuate in amount with market conditions and the ease or difficulty with which these instruments found investor homes. By these means the System would continue to exhibit its solicitude for bankers' acceptance financing but without an interest depressive influence or giving the appearance of coddling the market. By the same token, the interest return on bankers' acceptances would better find its level in the structure of interest yields on high quality investments which would tend to broaden their market and thereby add zest to dealer incentives for their handling. Under present conditions a broad and free market for bankers' acceptances offers the most constructive target at which System policy in this field of finance can aim.

Mr. Robertson then made a statement as follows:

I will not take up the time of the Committee to repeat my views on this matter, which I expressed in dissenting from the Committee's March 1955 decision to purchase bank acceptances up to $25 million.

In 1954 I resisted this proposal vigorously because I was concerned about its feasibility and the wisdom of its purpose—to "free demand generally from administered rate constriction . . ." Later, however, this objective apparently was dropped, and when the Committee decided to enter the bank acceptance market in March 1955 the Chairman expressed the view of the majority that the Federal Reserve System should avoid any "finagling" in the market but should participate in a very modest way in order to show the interest of the central banking organization. It seemed to me that this limited objective made the proposal relatively innocuous, although I felt that the acceptance market would receive more convincing assurance of Federal Reserve interest if we resumed the "backstopping" procedure that worked quite well in the 1920's.

In any event, I am unable to see any valid reason for now raising the permissible maximum from $25 million to $50 million. As the Chairman said, it was intended that our participation in the bank acceptance market should be a very modest one. Our present modest holdings clearly display our interest in the development of American bank acceptances. To the extent that the Federal Reserve increases its holdings, the participation of others is necessarily limited, and the acceptance market is thereby deprived of the participation of a certain number of financial and industrial organizations that otherwise would be holding the additional acceptances taken by us. The more we take, the smaller is the number of participants in the market and the more limited are its breadth, depth, and resiliency.

To sum up, I believe we could better strengthen the acceptance market by standing ready to purchase at a rate slightly above the current market, rather than by making modest purchases at the market rate. However, if the Committee wishes to continue the present practice, an increase in our holdings offers negligible benefits and would tend to narrow rather than broaden the self-sufficient market we wish to see developed.

During the discussion that followed, Mr. Szymczak stated that he favored increasing the authorization to $50 million as recommended by Mr. Rouse but that he thought that the increase should be used gradually and that the System account should also make repurchase agreements covering bankers' acceptances. The reason for favoring this procedure was that he felt this would provide the System with an additional instrument to be used in furnishing reserves to the market.

Mr. Earhart then moved that the present authorization for bankers' acceptances be continued with retention of the limitation of $25 million, and Mr. Earhart's motion was seconded by Mr. Mills.

Mr. Earhart's motion was put by the Chair and carried, Messrs. Balderston, Earhart, Fulton, Leach, Mills, and Shepardson voting "aye" and Messrs. Sproul, Irons, and Szymczak voting "no". On this action, Mr. Robertson did not vote, stating that he would not vote to increase the authorization nor would he vote to continue the existing authorization for the reasons indicated in the statement he had made at this meeting.

In response to a question from Mr. Sproul, Mr. Rouse stated that he had no suggestions to make with respect to a change in the authority for repurchase agreements with nonbank dealers in Government securities.

Thereupon, upon motion duly made and seconded and by unanimous vote, the Committee approved a renewal of the authorization for repurchase agreements as follows:

The Federal Reserve Bank of New York is hereby authorized to enter into repurchase agreements with nonbank dealers in United States Government securities subject to the following conditions:

1. Such agreements

    (a) In no event shall be at a rate below whichever is the lower of (1) the discount rate of the Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of three-month Treasury bills;

    (b) Shall be for periods of not to exceed 15 calendar days;

    (c) Shall cover only Government securities maturing within 15 months; and

    (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.

2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.

3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System open market account.

Mr. Rouse stated in response to a question from Mr. Sproul that he had no changes to suggest in the general directive to be issued to the Federal Reserve Bank of New York.

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

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

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

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

It was agreed that the next meeting of the Committee should be scheduled for Tuesday, October 25, 1955. In this connection, Mr. Earhart raised the question whether the hour for the meeting should be at 10:45

a.m. or 10 o'clock, and after brief discussion it was agreed that the meeting to be held on October 25 should be scheduled for 10 a.m.

Mr. Sproul then referred to the discussion at the meeting on September 14 regarding a visit which Senator Douglas proposed to make to the Federal Reserve Bank of New York, probably between October 20 and November 1, 1955, accompanied by a member of his staff, for the purpose of observing the handling of open market operations.

Mr. Szymczak reviewed a conversation he had had with Senator Douglas pursuant to the understanding at the meeting on September 14 during which he stated that Senator Douglas proposed that Mr. Asher Achinstein, a member of the regular staff of the Library of Congress, accompany him on the proposed visit to assist in his discussions of the matters that he observed.

There followed a discussion of the proposed visit at the conclusion of which it was agreed that Mr. Sproul, in his capacity as Vice Chairman of the Committee, would communicate with Senator Douglas, stating that he understood the Senator wished to visit the New York Bank and to bring Mr. Achinstein with him and indicating that he (Mr. Sproul) would be glad to arrange for such a visit on a mutually convenient date. It was understood that while the New York Bank would be glad to assist the Senator and Mr. Achinstein in observing the operations of the securities desk, information concerning the policy of the Open Market Committee or transactions for the Open Market Committee would continue to be made available only through the channels which have been established previously for formal transmission of information to Committees of Congress.

Mr. Balderston stated that in a letter dated September 22, 1955, addressed to him as Vice Chairman of the Board of Governors, Congressman Wright Patman expressed the point of view that the Open Market Committee's operations should be removed from New York and located in Washington. The Board's reply of September 29, signed by Vice Chairman Balderston, indicated that Mr. Patman's point of view would be presented to the membership of the Open Market Committee. By this time, he said, each member of the Committee had doubtless received a copy of Congressman Patman's letter. Mr. Balderston said that he wished to record the fact that the request of Congressman Patman had also been presented to the Committee in formal session. Although he did not share Congressman Patman's view, because of the practical difficulties of conducting the desk at a distance from the New York financial center, he expressed the belief that Congressman Patman's suggestion should have careful consideration.

> Mr. Balderston then moved that Congressman Patman's proposal be referred to the subcommittee that has been studying the housekeeping arrangements for the Open Market Account, pursuant to the action taken by the Committee at its meeting on March 2, 1955.
>
> This motion was put by the Chair and carried unanimously.

In response to a question from Mr. Robertson, Mr. Balderston stated that the intent of his motion was to refer Congressman Patman's letter to the subcommittee for its consideration with the understanding that in the normal course the subcommittee would report back to the full Committee on the matters which it had been requested to consider.

Mr. Robertson recalled that at the meeting of the Committee held on September 14 it was noted that a subcommittee had not been appointed for the purpose of reconsidering defense planning for the Federal Open Market Committee. (This subject had been discussed at the meeting on July 12, 1955, with the result that Chairman Martin was then authorized to appoint a subcommittee for the purpose of making such a review.) Mr. Robertson went on to say that at the meeting on September 14, Mr. Sproul had suggested that he (Mr. Robertson) might do some advance thinking on the problem in order to facilitate the work of the Committee. In accordance with this suggestion, he said, he had prepared a memorandum regarding defense planning for the Federal Open Market Committee, and he suggested that copies be distributed to all members of the Committee and to other Reserve Bank Presidents following this meeting with the thought that any comments which the Committee members or other Presidents might wish to make be transmitted to the Chairman of the Committee prior to the meeting to be held on October 25. It was his further hope that it would be possible to consider the subject matter at the meeting on October 25, in which event it might not be necessary to appoint a subcommittee for further work on this matter.

This suggestion was approved unanimously with the understanding that the Secretary would distribute copies of Mr. Robertson's memorandum following this meeting.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary.