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 25, 1955, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
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, and Powell, Alternate Members of the Federal Open Market Committee

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

Mr. Thurston, Assistant Secretary
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. Carpenter, Secretary, Board of Governors
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 meeting of the Federal Open Market Committee held on October 4, 1955, were approved.

Before this meeting there had been sent to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period October 4-19, 1955, inclusive, and at this meeting there was distributed a supplementary report covering commitments executed October 20-24, 1955. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse stated in response to a question from Chairman Martin that the only comment he had to make in connection with the report was that the average yield at the auction of Treasury bills yesterday was 2.23 per cent compared with the level of 2.333 per cent established at the previous auction. This morning, he said, bills were quoted at 2.18 per cent.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period October 4-24, 1955, inclusive, were approved, ratified, and confirmed.

A report of an audit of the System open market account made by the Division of Examinations of the Board of Governors as at the close of business March 18, 1955, was submitted to the Secretary of the Committee under date of April 8, 1955, in accordance with the action of the Federal Open Market Committee at its meeting on June 21, 1939. Copies of the audit report were sent to each member of the Committee under date of April 12, 1955, and the report was presented for consideration by the Committee at this meeting.

Without objection, the audit report referred to was noted and accepted.

Chairman Martin called upon Mr. Ralph Young for a statement on the economic situation. A staff memorandum relating to economic and financial developments had been sent to the members of the Committee under date of October 21, 1955, and at this time Mr. Young summarized conditions substantially as follows:

> The economic situation is still one of advance but with the pace of advance in terms of physical output slowing down with the approach of capacity operations.
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> GNP for the third quarter is put at 392 billion dollars, up 7 billion from the preceding quarter, and a further sizable gain is in prospect for this quarter. Industrial production is edging up further and the October index may reach 142. Durable goods output, especially in producer equipment lines, has recently been and still is, the main influence in this rise. Steel production last week was at a new high, 98.9 per cent of capacity. Nondurables output, after slackening over the summer, has been rising again in late weeks. With final sales large and continuing to rise, inventory accumulation has remained moderate; in August, it was mainly at manufacturers.
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> New car sales have continued at high levels, thus enabling a considerable cutback in dealer stocks during the model changeover period, a process which will extend through this month. New model output in November and December is scheduled to reach earlier peak rates. Used car sales hold up at about a third above a year ago, with stocks and prices changing little.
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> Household durable sales have regained and are holding their high early summer level, and output has expanded further from mid-year.
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> With consumer durable sales at peak or close to peak levels, instalment credit outstandings have continued to rise at a 6 billion dollar annual rate. Some slim evidence suggests a halting of terms liberalization, but it is too early to judge these indications. How far terms liberalization has already carried is indicated by data for one large finance company showing that about 20 per cent of July and August new car contracts carried an unpaid balance in excess of the dealers cost.

With recent wage increases now working into the income stream, personal income in September showed a further substantial rise. Income is now 7 per cent larger than a year ago. The rise in income has, of course, supported rising retail sales and in September these were 11 per cent over a year earlier. Department store sales in the first half of October apparently increased further from the high August-September level.

With consumer markets strong, manufacturers' sales have also been rising and in August were 22 per cent above their low of last year. Manufacturers' new orders in August exceeded sales by 5 per cent, putting unfilled orders a tenth higher than last year and equal to two months sales.

Construction continues to maintain its high spring level, with business construction rising and residential building sliding off. New mortgage credit for the purchase of new and old houses in August was well above any previous monthly total and September held close to this volume.

Confidential information on the residential mortgage and construction markets, collected by Federal housing finance agencies, and just available to us, indicates that mortgage credit in most urban markets is quite tight and tending tighter. Reduced availability of FHA and VA funds is emphasized in field reports, and likewise weakness in the secondary market. The new house market is reported to be firm, but sales of existing homes are said to have slowed down. A combination of market conditions, financing troubles, and a cost-price squeeze on new house construction is causing a cutback in builder plans, which some market reporters believe will develop into a slowdown of new home building activity next spring. This pessimistic digest of many local real estate market reports needs to be viewed in the perspective of the very high levels of home completions and starts of the past several months.

The labor market continues to exhibit strength. Civilian employment is running about 2.6 million over a year ago, with unemployment down to 3.2 per cent. The unemployed are showing a fairly high turnover. Also, a comparatively high proportion of the unemployed are women. The manufacturing work week has now reached 41 hours.

Hourly earnings of factory workers in September were up 5 per cent above a year ago and weekly earnings were up 8 per cent.

The agricultural picture continues to be dominated by excess supply and sagging prices. Price declines in recent weeks have reflected mainly larger marketings of meat animals and consequent lower prices to clear markets. Although hog prices are a fourth lower than a year ago, the present relationship with feed prices is not too discouraging to fall hog production. The price-feed relationship for dairy products and eggs has recently been quite favorable to output expansion. The large cotton crop this year foreshadows both another acreage cut-back and a lower price support level for 1956. Yesterday's rather sharp break and partial recovery in cotton futures prices, reflecting among other things increased crop prospects abroad as well as here, emphasizes the cumulative supply-demand disequilibrium affecting this crop.

Industrial prices have risen since mid-year about 3 per cent. The first rise was in industrial materials and, then, accompanying or following this summer's wage increases, it has spread to many intermediate and finished products. Markets for industrial materials have been hesitant in recent weeks, but at the intermediate product stage a new advance in steel prices seems to be in the testing phase. Consumer prices rose slightly in September, reflecting increases in meats, dairy products, fuels and apparel.

In Europe, the boom is continuing. World trade has again picked up, according to July and August figures. The London market continues tight and tomorrow Chancellor Butler will bring forward his new series of economic and fiscal measures to meet Britain's balance of payments and internal inflation plight. Other items on the world financial front include increases in the discount rates of Canada and South Africa.

Reference is frequently made these days to an alleged down-turn showing by the National Bureau's eight leading business cycle series. Without arguing the merits or demerits of this mechanical forecasting approach, it may be of interest to note the latest indications. A simple count of the most recent changes reported--some from July to August, some from August to September, and some from September to October--shows five series registering advances, two registering declines, and one registering no change.

On the basis of a broader look at these series over several months, about all that one can say is that most of them are showing moderate fluctuations at advanced levels, rather than definite trend lines in one direction or the other. Two series do show a trend--new orders for consumer durables show an advance, and residential building contracts a decline. Stability in basic commodity prices, another leading index series, has reflected advances in industrial materials offset by declines in prices of foodstuffs. Altogether, it would seem to be forcing a conclusion to infer that any indication of a turn in the business situation is brought to light by this composite of data.

In response to an inquiry from Mr. Balderston, Mr. Young stated that information available regarding the construction industry showed that nonresidential construction has been rising for some months and that this rise has tended to offset the decline that has been showing up in residential construction contracts since late last spring.

Mr. Thomas said that one of the interesting and significant developments in the credit situation was that the Treasury's balance has been holding up better than expected. Outlays have been less and revenues have been larger than were estimated. On the basis of this development, Mr. Thomas said that Treasury borrowing needs would probably be less than had been anticipated, but it probably would have to obtain around a billion dollars in December either through a new Treasury issue or through some issue by the Federal National Mortgage Association or the Commodity Credit Corporation. Another striking development has been the large volume of new securities issues. Notwithstanding the tightness in the money market, prices of bonds have gone up and long-term yields down. Corporate securities issues have been running higher than last year and the total for 1955 is likely to exceed that for 1954, and, although State and local government issues have been less than last year, they have increased recently and there is a large list of prospective issues. Mr. Thomas indicated the possibility that the recent rise in the prime lending rate at commercial banks might bring out more issues of securities, noting that utilities have been borrowing heavily from banks and the increased prime rate might induce them to refund into capital issues. Already both finance companies and utilities have been moving in this direction.

Mr. Thomas also commented briefly on developments in the stock market and in figures of bank credit. The money market, he said, recently has been characterized by generally firm short-term rates; the bill rate had risen above the discount rate although it had been a little easier during the last few days. The decline in longer-term rates may reflect some shifting from stocks to bonds, suggesting that some investors might feel that the rise in interest rates had reached its peak. At any rate, the bond market has been firm. Increases in nearly all major categories of loans have taken place. The increase in business loans slowed down during October after rising considerably during September. The money supply showed more than a seasonal increase in September and currency in circulation has continued to increase at more than the usual seasonal rate. Reserve needs, which have been somewhat greater than projections presented at the meeting on October 4, have been supplied by System open market operations. Net borrowed reserves since that meeting have been exceptionally stable, Mr. Thomas noted, around the $300-400 million level.

Projections indicate that, in the absence of System operations, net borrowed reserves would rise to more than $500 million by the week of November 9 and increase further in the last week of November and during December. Mr. Thomas indicated that the situation could be handled through a small increase in member bank borrowings and some use of repurchase agreements, with a minimum of outright purchases for the System account. Even toward the end of the year the sharp seasonal rise in need for reserves might be handled with little outright purchases. Mr. Thomas expressed the view that there was no evidence that present policy has been too restrictive. Expansion continues in the business area and slackening in the rate of expansion appears to reflect more an approach to capacity than any decline in demand. There may be a question whether credit policy has been sufficiently restrictive in view of the underlying elements in the picture and the firmness in the bond market.

In response to a question from Chairman Martin, Mr. Thomas stated that estimates indicated approximately three-quarters of a billion of additional Reserve Bank credit would need to be provided between now and the end of the year. This amount could be supplied by increasing member bank borrowings and repurchase agreements to a total outstanding amount of between $1 and $1.5 billion in November and December.

Mr. Sproul then made substantially the following statement:

> 1. We still haven't too much to go on, in the way of facts and figures, in order to come to a judgment as to the economic effects of what may be the altered outlook of businessmen and consumers as a result of the President's illness, the immediate reaction of the stock market, and the possible longer term politico-economic consequences of these events, nationally and internationally. So far as the present and the near-term future are concerned, however, we think we can see the general shape of the domestic economic situation. The growth of economic activity is continuing although at a slower physical rate than earlier in the year. Some signs of inflationary pressures are present, but they do not seem to be carrying through to speculative excesses in such things as the accumulation of inventories or in spiraling prices. Particularly encouraging in this respect, perhaps, has been the responsiveness of raw material prices to increased supplies, and the indication in preliminary estimates

of Gross National Product that inventory accumulation in the third quarter of the year was at a slower annual rate than in the second quarter ($3 billion as against $4 billion). The banking figures for the third quarter appear to have repeated much of the pattern of the first half of the year, taking account of seasonal influences. There was a substantial rise in bank loans, an almost equally substantial decline in investments, total loans and investments were little changed, and liquidity was further reduced. Both investments and loans were up during the first half of October, partly due to Treasury sale of securities during that period. The money supply declined during the first three quarters of the year, and it is now anticipated that the growth during the fourth quarter will bring about a total increase of about 2-1/2 per cent for the year as a whole which, in the light of the growth of the economy, does not indicate too great pressure from the money side, even allowing for increased velocity.

2. The Treasury's position is coming modestly into line with the economic situation. It now appears that a surplus in the cash budget of $1.5 to $2 billion can be expected in this fiscal year, and it may be larger if expenditures hold steady and receipts continue to increase. The Treasury's direct cash borrowing needs during the remainder of the present half year are not large--perhaps in the order of $1 billion. And this borrowing is still at least a month or so away as is the next refunding of $12.2 billion of notes and certificiates which mature December 15. The problems of debt management are not an immediate handicap to the exercise of freedom of judgment with respect to credit policy.

3. There has been considerable speculation as to the effect that recent events might have on credit policy. One body of opinion has been that policy will now be relaxed because of the shock which business confidence has recently received. Another body of opinion has held that inflation is still the enemy, that we haven't done much to combat it, and that it is late but maybe not too late to do more. Then there is the middle view between these two extremes. My own view is that, so far as general credit controls are concerned, we shall do well to maintain the pressure we have been exerting, but that we should not be driven to harsher measures, either in an attempt to convince the market we haven't relaxed, or in an attempt to make up for what some consider to have been our past shortcomings in the way of vigorous and timely action. I think the banking figures which, week after week, show that the System has not relaxed its restrictive policy, will take care of the first group. I don't know quite what the second group wants

since our economy in so many respects has been performing so well. If we could have gotten rid of the imperfections which have been apparent in the mortgage credit and consumer credit fields by way of a general credit policy, which did not strangle other business, we should have tried it, but I doubt if it could have been done given other national policies. And if there were some way general credit policy could redress the imbalance between industrial prices and farm prices, which is threatening economic and political distortions, I would be for it; but there isn't.

4. The short-term market or credit market has been showing a natural response to pressure, in terms of rising rates of interest, as seasonal demands for credit press against a supply which is increasing, with our aid and consent, but not increasing to the extent of meeting all demands at a fixed price. The capital market, which had begun to show signs of responding to pressure a few weeks back, has been less tractable, in the sense that it has rebounded and become, if anything, too buoyant. But this may have been temporary. The mortgage market is under pressure but not so great, I think, as the advocates of an ever ascending housing boom would have us believe.

5. I should say that, in order to maintain but neither to relax nor increase pressure, we should continue to feel our way meeting some of the need for reserves, which now stretches ahead for several weeks

(a) with a more or less continuous volume of repurchase agreements, thus having a current check on our reserve projections while at the same time helping the bill market to function;

(b) making some outright purchases of bills which we would expect to run off after the turn of the year; and

(c) keeping the banks substantially and perhaps increasingly in our debt at the discount window.

6. As of today, I wouldn't want to assume the hazard of the possible reactions to an increase in the discount rate which might create greater concern about present economic conditions than would be warranted. It may be that this situation can be felt out during the next month, however, without any commitment on the discount rate by an increase in our repurchase rate, particularly if the Treasury bill rate goes substantially above the present discount rate and stays there.

In response to a question of Chairman Martin's, Mr. Sproul said that his view would be that figures of net borrowed reserves might range around $300-400 million between now and the next meeting of the Committee.

Mr. Szymczak said that he felt much as Mr. Sproul had expressed himself. Figures were not available to indicate whether a change in business plans for plant and equipment expenditures had resulted since the President's illness. Mr. Szymczak did not think the Committee should relax its policy at all, but he doubted the advisability of pursuing a tighter policy especially at this season of the year. He would concur with the thought of keeping negative free reserves in the $300-400 million area. He would not increase the discount rate. He would use repurchase agreements freely to meet temporary needs in the market, and he would do whatever was required in the way of direct purchases for the open market account in order to have negative free reserves in this general area.

Mr. Erickson said that he could not add much to the views already expressed. He would have in mind negative free reserves between $300 and $400 million, but would resolve doubts on the side of larger negative free reserves. He would not raise the discount rate at this time.

Mr. Irons said he was in agreement with the general views expressed with respect to the uncertainty in the economic picture and with respect to the effects of the System policy of restraint. He would maintain about the degree of tightness maintained in recent weeks and would resolve doubts on the side of pressure rather than ease.

Mr. Earhart said he was in substantial agreement with what had been said thus far. He was inclined to feel that enough demand was likely to be forthcoming during the remainder of this year to maintain pressure on output capacity, but he believed that a measure of caution had been induced by the President's illness that worked in the same direction as the Committee's restrictive policy. Mr. Earhart also thought we might be close to a decline in rate of growth in demand. Under these conditions he expressed the view that it would be better to maintain about the degree of restraint the Committee had been maintaining rather than to increase pressure at present. Mr. Earhart said that he had been unable to reconcile the easing of interest rates in the capital market as indicated by long-term securities' prices, with the action of rates on short-term securities and evidence, which he cited, that mortgage money had been quite tight. He thought the tight mortgage situation was caused partly because of overcommitments by savings and loan associations and others.

Mr. C. S. Young said the picture in the Seventh District was about the same as that given by others. He noted particularly tightness in the real estate credit picture and commented on letters being sent out by builders' associations raising a question as to what the Open Market Committee would do about the tightness in the mortgage market. While much of this could be discounted, Mr. Young thought that the comments had some basis. He also noted that increased interest rates on savings were being offered by banks for the purpose of attracting deposits and that some banks had eliminated service charges as another means of attracting deposits. The agricultural situation in the Midwest was a disturbing element in the picture.

Mr. Young felt that the Committee's restrictive policy had had an effect, and he hoped that no change would be made in the discount rate at this time.

Chairman Martin next called upon Mr. Leach, who made a statement substantially as follows:

> Current developments indicate to me that our policy of restraint is working quite well. Economic activity continues to move upward, but the rate of expansion has apparently slowed down and there are few, if any, signs of speculation, gray markets, bottlenecks, or excessive inventory accumulation. Business leaders and the public are still optimistic but their optimism has been tempered considerably.
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> In the credit area we have not yet seen the full effect of the tightening actions that have been taken, particularly in the area of mortgage credit. A survey made last week of bankers and businessmen in various sections in the Fifth District fully substantiates the report that commitments for mortgage money are becoming more difficult to obtain. There has been strength in the long-term Government securities market in recent weeks, but I suspect that it is largely based on wrong expectations and will prove temporary.
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> I realize, of course, that prices of manufactured products have been subject to upward pressures and that these pressures may intensify as we get closer to productive capacity. Such a development could call for more restrictive measures, but for the time being I favor maintaining about the same degree of pressure as during the past three weeks. To me, this means discounts close to $1 billion, net borrowed reserves in the neighborhood of $400 million, and a long bill rate fluctuating around the discount rate. I would not advocate an early increase in the discount rate, for such an increase would have its principal effect in the capital market and that effect might be much stronger than we would like.

Mr. Leedy said that he did not differ with the views expressed as to policy for the next two or three weeks although he arrived at his conclusions perhaps by a different process. He thought that changes in prices of raw materials might not be as useful as a guide as the increases that have been occurring in prices of industrial goods. What could be done through monetary policy to deal with this situation in the light of its reflection of wage increases was a question. As to the next few weeks, he would aim at the upper side of the suggested range of $300-400 for net borrowed reserves. He would give no encouragement to the press and others who were speculating on the possibility of a change in the direction of easing monetary policy and, as a matter of fact, Mr. Leedy said that by aiming for negative free reserves on the higher side of the suggested range, the Committee might give notice that an easing was not in the picture. He would meet temporary needs in this period as largely as possible through repurchase agreements rather than outright purchases and he would not make a further change in the discount rate at this time.

Mr. Mills said that he would second what Mr. Leedy had said. He believed there was an abnormal sensitiveness in the market at present to whatever System policy is, or whatever new direction it might take. That being the case, we certainly should not act to ease our policy, if for no other reason because a shift in that direction could be misconstrued as an official foreshadowing of a decline in economic activity that is not believed to be in early prospect. That would leave a decision on forward policy as to the degree of tightness that might reasonably be exerted. The discussion this morning had generally moved toward continuation of the present pressure, Mr. Mills said, as reflected in negative free reserves up to a range of around $400 million. There is increasing comment in the financial press on the direction of policy and an assumption that the System is moving along a narrow rut and continuing to let the pressure of negative free reserves of $300-400 million make policy for us. Sooner or later, if that is the Committee's policy, the market would make its own price determinations and the Committee would risk losing the advantages of flexibility in handling its policy through the actions of the Manager of the Open Market Account. Perhaps for the next three weeks, until the next meeting, the Committee might wish to consider as its guide the pressure of demand on the commercial banking system for seasonally new credits, as reflected in the weekly reports of reporting member banks. If there is a consistent rise in the total volume of bank credit in all of its various classifications, the financial community would understandably assume that the pressure of that credit against the supplies of reserves would bring about an increasing tightness. Mr. Mills felt the Committee could test the future more aggressively than had been suggested. If the natural forces for demand for credit express themselves vigorously, the Committee might allow negative free reserves to rise to $500 million, feeling its way cautiously and observing the effects on interest rates and sensing what the business community felt as to the availability of credit. To attempt a policy of that sort would mean eschewing any rigid directive to the Manager of the Open Market Account as to limits within which action could be taken. It would contemplate "feel" of the market as against developments. Three weeks ago, Mr. Mills said, he would have favored an increase in the discount rate but subsequent developments would scout that as now being desirable.

Mr. Robertson made a statement in substantially the following form:

I think all will agree that the business and credit outlook presented to us this morning remains exceedingly strong. Practically all of the economic indicators continue to point sharply upward. There are few chinks in the wall of business prosperity.

The situation appears to me to call for somewhat additional credit and monetary restraint. Despite the drop in free reserves to around a level of minus 400 million dollars over the last week or two, money market conditions have actually eased somewhat rather than tightened. There appears to be increasing complacency developing, both among member banks as to being in debt to the Federal Reserve and in the financial community in general, as to the degree of restraint that can be imposed by the Federal Reserve in a situation like the present. Recent developments in short- as well as long-term credit and capital markets seem to indicate that the financial community senses that somehow the Federal Reserve has been hamstrung, that it is powerless to exert further restraint.

I think that this situation should be remedied, and promptly. As I see the picture, in order to avoid an actual increase in ease in credit and money markets, one of two things must be done over the next few weeks. Either we shall have to increase the discount rate or, alternatively, allow free reserves to drop to a substantially larger negative figure. I strongly prefer action on the discount rate, mainly because I am not sure that even a substantially larger volume of negative free reserves at this time of year would bring about the desired amount of restraint. The complacency that has accompanied the recent change in free reserves from minus 300 to minus 400 million dollars confirms my judgment. It seems to me such complacency might not be dissipated by a further change in free reserves to minus 500 or even minus 600 million.

Consequently, I hope this Committee will adopt a policy designed to achieve further restraint, and direct the Manager of its Account to permit the volume of negative free reserves to drop to between 500 and 600 million, in the event the discount rates are not raised within the next two weeks. I feel confident such action will not be too restrictive. I hope it will be adequate to moderate the upward movement of the economy and stem the inflationary pressures.

Mr. Shepardson referred to Mr. Sproul's comment on the disparity between the agricultural situation and the general industrial picture. He stated that he had just returned from a week's visit through the Midwest. He had been impressed in his discussions with persons in that area that, notwithstanding the decline in some farm prices and a good deal of talk about the present decline in hog prices, the general reaction was that the outlook is good. The cattle industry feels quite confident. Conditions in most of the range territories are good, and feed prices are favorable for the coming season for all classes of livestock producers. Even in the case of hog producers, Mr. Shepardson said, the general attitude was not too unfavorable. This general situation along with other factors caused him to feel that continued pressure on credit extensions was necessary. He was not sure that he would wish to go as far as Mr. Robertson had suggested, but he felt that policy during the next few weeks should be one of keeping net borrowed reserves on the upper side of the $400 million figure mentioned rather than on the down side. He was not sure that an increase in the discount rate would be in order at this time and for the present would think the procedure should be to tighten a little further through increasing the amount of net borrowed reserves as indicated.

Mr. Fulton said that in the Cleveland District activity had continued at a very high rate. There seemed to be more uncertainty in the minds of those observing developments than in the minds of the businessmen who were putting out tremendous sums to increase production facilities. New orders had increased and were firm. The only hampering factor, Mr. Fulton said, was the shortage of skilled labor to operate the factories.

Real estate operators were in somewhat of a "squeeze" but were still claiming they could sell houses before the foundations were dug. Persons who had the down payments could get mortgage money even though financing was being referred to as a problem. Bankers and financial institutions had become accustomed to operating with negative free reserves around $350 million. Mr. Fulton said he agreed with Mr. Mills that from now until the end of the year natural forces should be permitted to tighten the situation. He would favor higher negative free reserves, and the discount rate might well be looked into. However, he would favor waiting on the latter point until after the next meeting of the Committee. By then the Committee could see whether the recent increase in the prime rate had helped its restrictive policy. On the whole, Mr. Fulton felt that additional restriction was called for and he was certain that the Committee should not "float along on a level plane" when the market was demanding more funds.

Mr. Williams said that there was a feeling of confidence and optimism in the Philadelphia District. He noted that capital expenditures in 1955 will total around $308 million or 28 per cent above the forecast for such expenditures at the close of 1954. The estimate of capital expenditures for 1956 was now $286 million, about 7 per cent below the probable actual total for 1955. With respect to these figures, Mr. Williams noted what seemed to be a persistent tendency of manufacturers to overstate probable declines and to understate prospective increases in capital expenditures for a future period. His feeling was that the Committee should maintain the existing degree of pressure and "put a little more power into the foot on the brake." He would not go as far as Mr. Robertson, but if any move in direction were to be made during the next few weeks it should be toward a slight increase in pressure and the Committee should be prepared to move promptly in either direction if that seemed advisable.

Mr. Powell said that if negative free reserves were kept in the neighborhood of $300-400 million at this time of year the Committee's action would be misunderstood. It was expected that banks would increase their borrowings at this season, and he could see no reason why the Committee should not let borrowings proceed to the normal limits without indulging in open market operations as a means of reducing the effect of such borrowings. If negative free reserves rose above $500 million during the next three weeks he could see no reason for concern. He would hesitate to do anything as drastic as increasing the discount rate again at this time of year, feeling that that might be misconstrued as indicating that the System was trying to eliminate the normal seasonal expansion of credit. He did not think the Committee desired to keep business from having the normal seasonal credit increase which would be followed by a seasonal decline. Mr. Powell said that he would leave open market operations almost completely dormant during the next three weeks, letting banks obtain needed reserves by borrowing. He thought there would be no unusual borrowing which would force the Committee to change that policy before the next meeting.

Mr. Balderston said he continued to be concerned about the rise in industrial prices stemming from wage adjustments on the one hand and on the other from the fact that production is pressing on capacity in numerous industries. Therefore, he would move in the direction of greater restraint than we have had in the past three weeks. He would not now favor a change in the discount rate until there had been opportunity to see more clearly what, if any, importance the change in prime rate has had. Concretely, Mr. Balderston said, he would hope the Committee would aim at these targets: (a) a bill rate somewhat in excess of the present discount rate, (b) negative free reserves of approximately $500 million but certainly in excess of $400 million. He felt it extremely important that actions of this sort serve as a signal that the Committee was not being "taken in" by any of the views appearing in the press as to imagined changes in the business mind since the illness of the President. Some of these press comments, he felt, were designed to bring about changes in policy which would be politically beneficial next year; we were in the midst of talk which was difficult to interpret except in the light of an election year coming up. He suspected that businessmen may have changed their minds in some respects because of the President's illness, but he could not find clear evidence of that having happened.

Chairman Martin said that he had had the benefit of having heard the comments of the others this morning. He wanted to start by indicating his reaction to the President's illness in September. He was in Rome at the time and felt it was as dramatic a shock in Europe as any event that had occurred in his lifetime. While this was a broad statement he was judging by discussions he had had with correspondents and others. Word of the President's illness came at a time when nothing of that sort was expected and at a time when inflation was uppermost in the minds of many, and when the President had assumed a leadership as a result of the Summit Conference, which had resulted in a bulge in confidence out of all proportion to any other recent events. Without being disrespectful in any way, Chairman Martin said that he thought the announcement of the President's illness had a very helpful influence because it deflated the "confidence bulge" that had been blown up out of all proportion to what was justified.

Chairman Martin went on to say that he was among those who believed the Committee had been dilatory in approaching the build-up in the spring and summer of the year. If the System had acted more dramatically earlier it would have been in a better position at this time. However, he agreed completely with Mr. Sproul that, even if this were true, that was not a reason at this later juncture to put more burden on monetary policy than that policy could bear. If he were correct that the System would have been better off to have increased pressure faster earlier this year, that was no reason to try to press things at this juncture. The Christmas trade is upon us, Chairman Martin said, and he thought it would be colossal. He was convinced that much of the bulge that was exploded by the President's illness would be rebuilt. In other words, he thought business has a confidence which, if put in terms of the stock market may well see prices rise to the old highs even though there would be some drag.

Chairman Martin said that his own thinking ran completely with what he sensed to be the majority view expressed this morning except that he leaned very strongly on the side of not relaxing, and he would not be the slightest bit worried about a substantial rise in net borrowed reserves for a limited period above the $400-500 million range. In other words, he would make whatever errors were made on the side of dispelling the idea that the System was going to ease its policy. He thought it would be unfortunate to let market commentators interpret policy for the System.

It was a problem how to sum up this policy, Chairman Martin said. He thought no change in the basic directive of the Committee to the New York Bank was called for and, specifically, clause (b) of paragraph 1 of the directive which called for open market transactions with a view "to restraining inflationary developments in the interest of sustainable economic growth" seemed to meet the views expressed. Chairman Martin inquired whether there was any other view as to the wording of the general directive, and none of those present indicated a different view. The Chairman then went on to say that the discussion had revolved around Mr. Sproul's suggestion that, as a rough guide, a range of $300-400 million for net borrowed reserves be used as a target for the next three weeks. He said that he assumed, however, Mr. Sproul did not intend that this be an exact target.

Mr. Sproul said that he thought too much emphasis had been placed in the discussion this morning on some particular figure or figures of negative free reserves. He did not know whether it should be $300 or $400 or $500 million. He thought it more important to consider the effects as conditions developed in the money market. If $300 million of net borrowed reserves were accompanied by a further run-up in short-term interest rates which seemed to be creating greater tightness than the Committee intended, that would call for one action; if a $500 million level was not bringing about that sort of response, then it might not require any action. Mr. Sproul thought the Committee should be paying more attention to the market effect on interest rates and credit extension than to any particular figure of negative free reserves. Also, if the Treasury bill rate should go above the discount rate and stay there, the rate on repurchase agreements might be raised, thus giving an indication of the Committee's willingness to see rates move up somewhat without actually raising the discount rate. Mr. Sproul reiterated that he thought too much attention had been paid to "free" reserves and that more attention should be paid to (a) member bank borrowings, (b) the level of reserves, (c) the reaction in the market to these developments, and (d) changes in interest rates. He also said, in response to a question from Mr. Thomas, that he would include developments in the bond market as well as in the short-term market as another factor to be observed, in terms of the effectiveness of the Committee's policy and whether it was carrying through. As he had indicated before, the present buoyancy might be based partly on market expectations which the Committee would not wish to make come true by its policy. There had been a temporary dearth of new offerings which was now being remedied and which would continue to be remedied in the next few weeks.

Mr. Rouse referred to the suggestion that the repurchase rate might be permitted to rise above the discount rate, and he expressed the view that such an increase need not depend on whether the average issuing rate for new issues of Treasury bills rose above the discount rate.

Mr. Robertson inquired what Mr. Sproul might have in mind as an average issuing rate on bills, and Mr. Sproul responded that he had no specific figure in mind although he would think the average issuing rate would move higher if the Committee policy were carried out in line with the discussion at this meeting. This did not mean that the repurchase rate would need to be administered in accordance with changes in the bill rate if that rate should go down for one week. However, if changes in Treasury bill rates and other short-term rates and the attitude of banks toward making loans contributed to a feeling of ease greater than had been maintained recently, then it would be appropriate to allow negative free reserves to rise. Mr. Sproul went on to say, in response to a further question from Mr. Robertson as to what degree of restraint the Committee wanted to maintain, that in terms of the bill rate he would think it would be a rate fluctuating around the discount rate.

Mr. Leach said that he thought there had been a tendency in discussions to attach too much importance to small changes in net borrowed reserves. He had mentioned $400 million of borrowed reserves as a desirable target, but he would not be concerned if the results showed borrowed reserves of $500 million. After all, he said, there would not be a tremendous increase in pressure if we should supply an additional $100 million of needed reserves through the discount window.

Chairman Martin said that this pointed up the problem that the Committee had been wrestling with for the last several years. He did not know how it could be resolved. None of the members of the Committee thought of these figures as exact goals; they were target figures only. It seemed to him that, whatever was used as a guide, the majority opinion expressed today leaned on the side of restraint but not dramatically. He thought this might be as good a summing-up as the Committee was likely to get at the moment. One or two of the comments this morning were on the side of more negative reserves; some would maintain the status quo and not get any tighter; but none had indicated they wanted to ease the situation.

The Committee was dealing with a series of imponderables. It seemed to the Chairman that the consensus of the meeting was that the Committee should maintain a restraining influence on the market but that it did not wish to increase that pressure drastically. He inquired whether any one could suggest a clearer statement of what the Committee had in mind for the next three weeks.

Mr. Shepardson said that it seemed to him that the discussion might indicate some firming of pressure so that there would be no doubt as to which way the Committee was inclined.

Chairman Martin said that this was another shade of emphasis on the same consensus he had tried to state. He again inquired whether there were any other suggestions for phrasing the consensus of the Committee more accurately.

Mr. Sproul stated that he thought Chairman Martin's preceding phrasing--"to maintain a restraining influence on the market but not to increase pressure drastically"--expressed the majority sense of the Committee.

Mr. Rouse said, in response to a question from Chairman Martin, that he thought the intent of the Committee was reasonably clear from the discussion. There had been an even keel during the last three weeks and the Committee would like to keep up the pressure during the next three weeks and have a little more.

> It was understood that the policy to be pursued by the Committee would be in terms of Chairman Martin's suggestion that, until the next meeting, operations be with

a view to maintaining a restraining influence on the market without increasing pressure drastically.

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 also understood that 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. Thomas said that some of the discussion of the mortgage situation implied that there had been an actual cutback in the amount of mortgage funds available. He noted that more mortgage loans were now being made than at any previous time in history and inquired whether the situation was not one in which demand for funds was simply exceeding the supply, particularly now that there had been some restraint on additions to available funds.

Mr. Earhart said that in the Twelfth District the tightness in the mortgage situation was the result of the increased demand for such funds.

Mr. Rouse noted that in the case of the Federal savings and loan associations, some of the reaction was related to the decision by the Federal Home Loan Bank Board to cut off additional supplies of funds.

Mr. Erickson said that in the Boston area savings banks, which formerly had from 40 to 45 per cent of their deposits placed in mortgages, more recently had found that they were getting closer to the 60 per cent legal limit for such investments and that this was adding to the feeling of tightness for such funds.

Mr. Leedy commented that a well-informed person in the residential building field had expressed the opinion in the presence of Governor Shepardson and himself that the manner in which action was taken by the Home Loan Bank Board in curtailing credit to savings and loan associations would have a definite effect on building starts, and also that recent public statements regarding warehousing of mortgages would have the effect of cutting back mortgage extensions.

Mr. Roelse commented on a conversation he had had last week with an official of a New York savings bank who gave the impression that some of the savings and loan and other mortgage lenders had gotten into an overextended position earlier this year and were now in process of cutting back on their commitments in order to get their institutions back into line. This would have an effect on builders over the next few months but the situation, according to this official, might get pretty well in balance by the end of

1955 and, by the spring of 1956, there would be a freer flow of mortgage money. By then, a good volume of mortgage money could be expected to be available.

Mr. Shepardson referred to Mr. Leedy's comment and to a statement he had heard in the Midwest last week that there would be a very material school-building program within the next year or so which would tend to offset any shrinkage in residential construction.

Mr. Sproul said that there seemed to be a growing attitude in the residential building industry that any amount of funds should be forthcoming to support a growing volume of building that had been stimulated by the easy terms. This was resulting in diverting more and more of the mortgage credit to banks rather than having it go to institutions which mainly accumulated savings, such as savings and loan associations, savings banks, and insurance companies.

Chairman Martin asked that Mr. Robertson comment on a memorandum, prepared under date of September 29, 1955, on defense planning for the Federal Open Market Committee.

Mr. Robertson stated that copies of the memorandum were distributed in accordance with the understanding at the meeting of October 4 and that the only suggestion received thus far was one from Mr. Irons, who raised the question whether all Federal Reserve Banks might be designated as alternate agents for the Committee. Mr. Robertson indicated why, on the basis of the test at the relocation center in June of this year, it would seem preferable not to designate all Federal Reserve Banks as agents. Mr. Robertson also said in response to a question from Mr. Earhart that the suggestion for training individuals contained in his memorandum would apply to individuals at Federal Reserve Bank branches as well as at head offices.

Mr. Sproul made a statement substantially as follows:

The following comments are suggested to me by Governor Robertson's helpful memorandum on emergency planning.

1. All Federal Reserve Bank planning is now going forward on the basis of no Federal Reserve Bank or branch being able to carry on its functions in its usual location. This means setting up of relocation centers and I see no reason why we should plan for the conduct of open market operations on a different basis in case of an emergency.
2. Federal Reserve Open Market Committee planning must relate to
   (a) operations having to do with monetary and credit policy,
   (b) operations having to do with our responsibility for the Government securities market, and
   (c) operations having to do with the immediate needs of the United States Treasury.
3. So far as monetary and credit policy is concerned, outright purchases may have to be made to supplement member bank borrowing.
   (a) All Federal Reserve Banks might be authorized to make direct purchases from holders of Government securities.
   (b) Some Federal Reserve Banks might be authorized to make purchases for System Open Market Account either direct from commercial banks or through the Government securities market, if functioning.
4. The Government securities market might be disorganized or temporarily non-existent and we might wish to provide a market or prevent disorderly conditions in the market.
5. Immediate Treasury needs might have to be met by direct purchases from the Treasury.
6. (a) Advance authorities will be needed to make it possible for these operations to be carried out.
   (b) There will have to be personnel at the selected relocation centers to handle whatever open market operations are undertaken by individual Federal Reserve Banks.

(c) Location of the System Open Market Account.
The probable location of a Government securities market, if functioning, the fact that a large part of the Government securities that ordinarily pass through the market are held by banks in New York City, and the possible availability of experienced personnel suggests the primary location of the System Open Market Account at the relocation center of the Federal Reserve Bank of New York. Supplementary facilities might be located at one or two other relocation centers of Federal Reserve Banks and if New York's relocation center is not able to function, available members of its staff might be moved to one of the other relocation centers.

7. In order to develop specific arrangements drawing on Governor Robertson's memorandum and these comments I think it would be desirable to appoint a subcommittee to be assisted by informed staff members.

Chairman Martin noted that under a previous action by the Committee he was authorized to appoint a committee for the purpose of studying defense planning for the Federal Open Market Committee and said that, in the absence of objection, he would proceed to appoint such a committee. No objection to this procedure was indicated.

Chairman Martin stated that another letter had been received from Congressman Wright Patman under date of October 17, 1955, in which Mr. Patman inquired as to the Board's views regarding provisions of the Internal Revenue Code which permit banks to treat capital losses on securities as fully deductible from ordinary income. Mr. Patman had inquired whether this provision of the Internal Revenue Code conflicted with Board policy, for example in a period when policy sought to restrain excessive expansion of bank credit. At Chairman Martin's request, copies of the letter were distributed, and he stated that he would be glad to receive any suggestions regarding the answer to be made to Mr. Patman.

There was agreement that the next meeting of the Committee would be set for 10:45 a.m. on Wednesday, November 16, 1955.

Thereupon the meeting adjourned.

Winfield W. Riefler [signature]

Assistant Secretary