A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, September 25, 1956, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Erickson
Mr. Johns
Mr. Mills
Mr. Powell
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman
Mr. Fulton, Alternate

Messrs. Bryan, Leedy, Treiber, and Williams, Alternate Members, Federal Open Market Committee

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

Mr. Harris, First Vice President, Federal Reserve Bank of Chicago

Mr. Riefler, Secretary
Mr. Vest, General Counsel
Mr. Thomas, Economist
Messrs. Abbott, Parsons, Roelse, Willis, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York

Before this meeting there had been distributed to the members of the Committee a report covering open market operations during the period September 11, 1956 through September 19, 1956, and at this meeting a supplementary report covering commitments executed September 20 through September 24, 1956, was distributed. Copies of both reports have been placed in the files of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period September 11, 1956 through September 24, 1956, were approved, ratified, and confirmed.

Mr. Young presented a review of the current business picture in substantially the following form:

Today's report is essentially a repeat of what was reported at the last meeting--general strength of expansive forces throughout the economy, with demands pressing against supplies in many sectors, and some further rise in wholesale prices.

Suez Canal developments are by now exerting tightening strains on world shipping and resulting in some supply curtailments in international commodity markets. The longer the situation remains critical, the greater the effects on supply conditions for petroleum and other products, on the supply of ocean shipping and ocean freight rates, and on international markets generally.

Indications of realignment of activities toward better domestic-international balance and indications of moderation of inflationary pressures continue to be registered in most current data available for United Kingdom and Germany. In contrast, inflationary pressures continue to be dominant in France.

For the United States, the most recent readings from the data record show the following:

Total national product in the third quarter is now estimated at an annual rate in current prices of $414 billion, up $6 billion or 1-1/2 per cent from the preceding quarter, and $17 billion or 4-1/2 per cent from a year ago. All of the major categories of final product purchases are up, with consumption expenditures showing the greatest rise over the year. From the second to the third quarter, business fixed investment and Federal Government purchases of product accounted for two-fifths of the output rise.

Industrial output in September seems likely to reach 142 or 143. Activity in metal producing and consuming lines is up. Nondurable lines, however, are showing diverse movement, with the result that change in nondurables output will be small up or down.

New auto sales have been off further this month but ahead of output, reduced for model changeover, so that stocks have been cut back further, though somewhat less than the industry had hoped for. Sales and stocks of used cars also have declined further this month. Used car prices, after allowance for depreciation, have continued upward, however, suggesting underlying strength of demand in the used car market.

Household durable goods output and sales have continued at the advanced rate of the summer months. Department store sales this month are remaining a little under last month but the month's record should still hold close to August high of 128, perhaps at 126-27 of the 1947-49 average. Retail sales generally in August ran 4 per cent ahead of last year, so that preliminary indications for September suggest that this gain will about be maintained.

The rate of consumer credit expansion as reported last time has slowed considerably, particularly reflecting smaller extensions and higher repayments on automobile paper. Recent terms data show some further rise in the proportion of new car contracts written at the long end of the maturity range.

Revision of the Board's consumer credit statistics, being made for its requested study of this subject, show an upward adjustment in level of $2.4 billion, divided about half and half instalment credit and noninstalment credit. Automobile instalment credit outstanding will be the only downward revision, amounting to $850 million.

Construction activity is apparently maintaining record levels, with construction costs still rising. Housing starts for August were up slightly, and mortgage lending on residential properties continues to maintain a monthly rate not far under the high monthly rate of the first three quarters of last year. Discounts in secondary markets of FHA mortgages appear to be averaging 3 per cent or about the same as in the late spring of 1953 when discounts were unusually large. Last week the Housing Administrator took several actions to ease credit conditions for the construction and purchase of homes. The actions will have both supply and demand effects for mortgage markets, but for credit markets generally their net effect is on the demand side.

Labor market trends are in the pattern of other recent months, with strength and weakness correlating with those in productive activities. Average hours of work have continued about stable.

Total farm output is now expected to about equal that of last year. Output of livestock and their products will be at a new high; crop output will be somewhat under last year. Unfavorable weather conditions in some regions will again make for unevenness in farm prosperity.

Wholesale commodity prices have continued to rise and in mid-September were 4-1/2 per cent higher than in mid-1955. Industrial prices are on average about 6-1/2 per cent higher.

After rising about 2 per cent from early spring levels, consumer prices decreased slightly from July to August. Further advances are expected, however, over autumn months.

A General Comment: Business Week one week ago raised the question as to whether the economic picture is really a picture of inflation, suggesting that, because this year's money supply increase has been small, we have the anomaly of too little money chasing too many goods. It is true that the money supply increase has been modest this year--at just under a 1 per cent annual rate thus far. With the fall expansion now expected, the rate for the year should be just under 2 per cent. Such an increase would be about a percentage point under this year's real increase in national product, i.e., the increase in GNP at constant prices.

Over the past five years the percentage increase in real national product has averaged 3.3 per cent per year. This average annual rate of increase was about the same as that for the money supply over this five-year period.

The rise in prices of commodities and services this year has been sufficiently general to indicate that aggregate demand in markets has been pressing against aggregate supply. Thus far the higher prices have been paid so that money has been available to support the prices asked. In other words, money has not been too scarce or in the wrong hands; the accumulated stock from past monetary growth has been enough, despite the slower growth this year, to finance transactions at a somewhat higher level of prices. Activation of balances in excess of transactions and precautionary needs has partly made this possible, but activation of money balances is to be expected when interest yield and other incentives to use money are rising and confidence in the future is high.

The slower growth in the money supply this year is to be attributed in part to Federal Reserve policy. That policy since 1951 has been geared to counter-cyclical objectives in the short-run and orderly growth at sustained high levels of activity without inflation over the longer-run. Counter-cyclical monetary policy calls for braking pressure on monetary growth and tightening pressure on the liquidity positions of individuals, businesses, and financial institutions when aggregate demand is pressing against aggregate supply. Such pressure is essential to combat inflationary dangers and to curb financial overcommitment. When aggregate demand is falling short of the economy's resource capacity to supply goods and services, counter-cyclical monetary policy calls for liberal expansion in monetary resources and financial liquidity generally.

If the System were pursuing in this period a monetary policy geared to some mechanistic or constant rate of increase in the money supply, it would be operating in an unstabilizing way under present conditions. It would be adding to the money holdings and liquidity of the public without regard to attitudes toward and actions in spending money and making forward commitments and without regard to price trends in markets. It would be feeding inflationary pressures at a time when they were tending to accelerate and thus would be abdicating responsibility for a stable value for the dollar.

Mr. Thomas summarized the principal recent financial developments as follows:

1. Heavy demands have continued in capital markets, but there has been better absorption by the market of new issues at the higher rate level reached in the latter part of August.

2. Yields on corporate securities have tended to rise slightly further and yields on municipals have been more stable, as have yields on long-term Treasury bonds.

3. Treasury bill yields, following a spurt at the time of the discount rate increase, declined somewhat and then rose again to a new high level of slightly less than 3 per cent. (The average yield on the latest issue of Treasury bills was 2.985 per cent.)

4. Stock prices have declined over 5 per cent on the average from the peak reached early in August, with trading at a relatively low level. There has been a marked decrease in bank loans on stocks and bonds, reflecting some decline in debit balances of margin customers and perhaps some decrease in financing of dealers' inventories, as well as some shifting of loans from banks in leading cities to other banks.

5. For the fiscal year to date, Treasury cash income has been about $1 billion larger and cash outgo a little smaller than a year ago. Net borrowing has, therefore, been less than last year. The Treasury balance declined somewhat more in the first half of September than had been expected, owing largely to a lag in tax receipts, but in the last few days cash has

been flowing in more rapidly. The balance now is in excess of $4-3/4 billion, excluding gold. This should be adequate to meet needs until after the middle of October. Total borrowings of about $3 billion may be needed between mid-October and mid-December.

6. Total loans and investments of member banks in leading cities have declined by about $200 million during the past month, compared with an increase of $300 million in the corresponding period of 1955. Business loans increased by about the same amount during the latest period as a year ago, but other types of loans and investments increased less or declined more than last year. Since mid-year, total loans have increased less than half a billion, compared with a rise of more than $1-1/2 billion in the similar period of 1955. However, holdings of Government securities have declined by about $1 billion less this year than last, and changes thus far during the third quarter of 1956 have been in total loans and investments closely similar to those of the third quarter of 1955. It would seem that difficulty in selling Governments or unwillingness to sell them may be having the effect of restraining bank lending.

7. The principal differences between changes in business loans since mid-year and those in the same period last year have included increased loans this year to the petroleum and chemical groups (reflecting largely the Trinidad oil purchase) and to commodity dealers, while there have been large decreases this year in loans to metal and metal products manufacturers and to sales finance companies, compared with little change last year. Construction loans by banks have shown little change since the middle of 1956 whereas last year they increased by about $60 million during the third quarter. It would be helpful to know whether the complaints of severe restrictions on credit reflect actual curtailment in credit extensions or only limitations on further expansion, and whether regular lines of credit are being unduly squeezed. The actual loan expansion has been above average.

8. Demand deposits increased moderately in the first three weeks of September following a greater than usual decline in August.

9. The annual rate of turnover of demand deposits has been about 8 per cent above that of a year ago.

10. Availability of bank reserves has increased in the last two weeks, reflecting a greater than usual mid-month increase in float and post-Labor Day return flow of currency partly offset by System sales of securities. This purely temporary increase in reserves has had little effect on the

money market or on the attitude of banks toward extending credit.

11. Following a moderate drain on reserves this week, there will be a further sharp reduction next week and net borrowed reserves may be expected to average around $500 million unless offset by System operations. While additional drains on reserves during October will be moderate, total reserve needs will increase by over $1-1/2 billion by mid-December, including allowance for growth of 3 per cent a year and for customary seasonal factors.

Mr. Thomas concluded his statement by noting that the total expansion in credit of all types had been somewhat less this year than last, reflecting principally decreases in the Federal debt and a much slower rate of increase in consumer debt. Demand for credit continues strong, however, particularly from business, and the expansion would be greater if the funds were available. Banks are supplying almost as much credit as last year and the principal savings institutions are providing a little more. Corporations seem to be borrowing more, but they are lending less through purchases of Government securities. Although the money supply is increasing only moderately, the increased turnover of existing money and the rising tendencies of commodity prices indicate that further additions to the money supply would be inflationary. In the fourth quarter of this year, the already heavy demands for credit will be reinforced by the usual seasonal factors and by cyclical recovery in the automobile and metal industries.

Recent credit policies and other influences seem to have resulted in considerable restraint by lenders in the face of strong demand, Mr. Thomas said. It seems doubtful whether excessive credit expansion has taken place, but at the same time the restraint on credit does not appear to have been unduly severe. While continued restraint is clearly needed, it appears that the recent degree of credit restraint may be about adequate. This would suggest net borrowed reserves averaging around $300 million, with fluctuations up to $500 million. Mr. Thomas noted that the immediate problem was how to facilitate the Treasury's forthcoming financing in a difficult period, without supplying reserves that might be diverted in undue amounts to other uses. While most of the needed reserves might be immediately supplied through variations in float, it was Mr. Thomas' belief that current policy would have to be sensitive to the reaction of the market and to broader developments and attitudes throughout the economy.

Chairman Martin said that he would introduce the discussion this morning by reporting that at a meeting with Secretary of the Treasury Humphrey and Under Secretary of the Treasury Burgess last Wednesday, he and Mr. Balderston explored with them the apprehensions they have with respect to the forthcoming Treasury financing. Chairman Martin said that he believed their apprehensions were very real and that he had assured Messrs. Humphrey and Burgess that the Federal Open Market Committee would consider the problem the Treasury was facing at its meeting today. The Chairman expressed the hope that all of those present at the meeting would bear this situation in mind in their comments.

Chairman Martin then called upon Mr. Hayes who made a statement substantially as follows:

1. The rebound in economic activity since the end of the steel strike has been even more rapid than was expected earlier. To a large extent, the great strength of the business picture reflects a record level of capital formation, but consumer spending has also been very well maintained.

2. The latest data on residential construction including a slight reported rise in private housing starts in August, do not lend support to widely publicized statements that a substantial decline is likely to be precipitated by lack of adequate mortgage credit. It is interesting to note that officials of major insurance companies feel that sufficient mortgage money is available to permit maintenance of the current rate of housing starts without real difficulty. The steps taken last week by the Federal Government to ease mortgage credit seemed ill-advised.

3. With wholesale prices rising almost without interruption since the end of June, the vigor of the current economic expansion points to some danger of renewed speculative building of inventories, although there is as yet little evidence that this has commenced.

4. For the immediate future, continued expansion in employment and production and further upward pressure on prices seem likely. The coming season of heavy retail demand will provide some test of the degree to which consumer resistance may limit the present tendency toward higher consumer prices.

5. Total bank loans have risen considerably in the last six weeks, and business loans have more than accounted for all of the increase. The capital markets have recently shown some indications of stabilizing. Successful marketing of a sizable volume of new issues perhaps suggests that the shortage of capital funds may be less acute than many observers had thought. Credit restraints, while tending to dampen incentives for overly rapid capital expenditures as well as for speculative inventory accumulations, have not resulted in undue curtailment of either business or consumer spending.

6. We are still expecting that the Treasury will have to borrow at least $3 billion between now and mid-January. It is our view that it would be preferable to defer part of this cash borrowing until December, when the results of the exchange of certificates maturing on December 1 will be known, and when it will also be clearer to what extent funds will be needed to meet unusually large redemptions of F and G savings bonds. It will be advantageous to carry out the first part of the program,

in the amount of about $1.5 billion, as soon as possible, both for technical reasons and in order to give the Federal Reserve System greater freedom of action. We hope that announcement of the terms of the new financing will be made around the end of September or in early October.

7. The underlying tone of the money market has been consistently tight in the last week or two despite the sharp reduction in net borrowed reserves resulting from unexpectedly large float figures and from large swings in Treasury receipts and payments. Heavy excess reserves have been concentrated at the country banks whereas banks in New York and other large cities have continued in a fundamentally tight position. The steady upward trend of bill rates has reflected this condition, as has the persistent difficulty of Government securities dealers in financing their positions.

8. In the absence of System account action, net borrowed reserves may average around $500 million during most of October, according to our latest projections.

9. This is a difficult time for the Treasury to be coming to the market and we cannot overlook our responsibilities for providing the necessary stable market atmosphere and whatever reserves may be needed to permit the banks to do their part in a successful program. We therefore feel that the Manager of the Account should try to keep the degree of restraint, as indicated by the feel of the market, about where it has been in the last weeks, until the Treasury financing has been completed. Open market operations should be timed so as to be of maximum assistance to the Treasury.

10. Following the completion of the Treasury financing, we should probe cautiously toward greater restraint by limiting open market purchases and forcing the banks to have recourse to the discount window for some part of their seasonal reserve requirements. This view is based on our belief that the System can go further in its efforts to resist inflation without creating a serious credit shortage that might prove disruptive to the general economy. A course of action which would bring about a sustained increase in member bank borrowing would, of course, affect the administration of Regulation A. What is a reasonable use of the discount window depends upon all the facts of the case, including the extent to which, pursuant to conscious Federal Reserve policy, open market purchases are retarded with the expectation that more of the reserves needed by member banks will be obtained by borrowing. At the meeting of the Presidents' Conference tomorrow the Presidents are planning to discuss the subject of continuous borrowing; I trust that we will have a

full discussion of the administration of Regulation A in the light of Federal Reserve credit policy. We do not have in mind any radical change of discount policy or any notification to member banks that the window will be open wider or for longer periods. It does seem appropriate, however, to contemplate larger borrowings by individual banks in relation to their required reserves, more frequent borrowing, and borrowing for somewhat longer periods.

11. In our view it is too early to consider whether further discount rate changes are desirable, but we feel equally that it would be a mistake to reduce reserve requirements against time and savings deposits at this time. A reduction in requirements would give the wrong kind of signal to the market and would tend to undercut the continued useful efforts of bankers to subject loan applications to a most careful screening process. Publicized reactions to last week's White House announcement of measures to ease mortgage credit are illustrative of the confusion which may be caused by such signals. Furthermore, a disproportionate part of reserves released would go to country banks, which have not been subject to the same degree of reserve pressures as the city banks.

12. The widespread statements to the effect that tight money is harming small business suggests the desirability of our trying to find out as much as can of the factual background on this subject. We would recommend that the Board consult with the Council of Economic Advisers as to whether the latter might conduct a survey of experience of the Small Business Administration with claims of unsatisfied needs for credit and of the possible help, if any, which the System might properly give in dealing with such needs. We also believe that the System could do more in the way of assembling pertinent statistics on small business loans extended by member banks, as well as general information on the types of needs indicated in loan applications, reasons for inability to obtain loans, etc. We would do well to be forearmed in view of the criticism which has already been directed at the System in this connection and which may be directed at us in the future.

Mr. Erickson said that conditions in the New England area were still very strong in every sector excepting textiles. It was evident that reserves for country banks were adequate, he noted, and he also stated that discounts at the Boston Bank had been much smaller in amount recently. Mr. Erickson referred to the meeting of stockholders of the Boston Bank to be held this fall. One of the member banks that had total loans in excess of 70 per cent of its deposits and which was feeling the competition for deposits from savings and loan associations had submitted a resolution for consideration at the stockholders meeting which urged an increase in the present limitation of 2-1/2 per cent in the maximum permissible rate of interest that might be paid on time and savings deposits under Regulation Q.

Mr. Erickson said that he would not change the directive of the Open Market Committee at this time nor would he change the discount rate. He agreed with Mr. Hayes' comments as to the Treasury financing and the degree of restraint that should be continued until that financing was out of the way, adding that as soon as the financing was completed the System should probe to see whether further tightening steps were necessary.

Mr. Irons said that conditions in the Dallas District continued strong with no sign of any lessening of activity in any area. Nonagricultural employment was reaching a new high every month. Construction contract awards had improved within the last few weeks largely because of a pickup in residential contracts. While he had heard complaints of a lack of mortgage funds it was difficult to run down such complaints, and he cited a circular letter recently distributed by a mortgage lender in Houston indicating that the firm had mortgage funds to place and was seeking outlets. Agricultural conditions are still dependent on more water. It was probable the district would have a fairly good cotton crop, although production would be 7 or 8 per cent down from a year ago. Demand for bank credit continued very strong with most of the increase in loans over the past year being in the commercial and industrial categories. Some banks were tightening up a little on construction loans.

As to credit policy, Mr. Irons felt that under present conditions the degree of restraint observed during the past three weeks was entirely appropriate and should be continued consistent with creating a stable condition for the Treasury's financing. After that was out of the way the System might want a little further restraint, depending upon developments. He would not favor any overt action at this time such as an increase in the discount rate and certainly no reduction in reserve requirements.

Mr. Irons said he was not sure that he understood Mr. Hayes' proposals for a possible easing of discount policy, but he (Mr. Irons) would rather see essential and necessary open market operations carried out with a maintenance of discount policy consistent with the terms of Regulation A, because he believed that changes in the general rules for administering discount policy would cause difficulty if they were made because of variations in needs for credit.

Mr. Mangels said that, except for the lumber industry in the Pacific Northwest, Twelfth District activities continued to show the expansion that had been evident for some time. Employment had continued to improve, with gains reported in Oregon and Washington despite the dampening effects to the lumber industry. Oregon particularly was showing gains in productive activity. For the district as a whole, unemployment was very low and probably near the lowest point since the end of World War II. Mr. Mangels noted that one of the important elements in sustaining activity in the Twelfth District was the fact that 84 per cent of prime military aircraft contracts during the six months ending in March 1956 were awarded to firms located in California and Washington.

Bank loans continued to increase during the most recent period and all indications were for a continued heavy demand for credit. Borrowings at the Reserve Bank have been quite nominal recently, with only three banks discounting for a total of less than $2 million. Mr. Mangels said that some of the directors of the San Francisco Bank recently suggested that there be brought up for discussion the question whether the Bank should issue a statement that there would be no objection to member banks' coming to the discount window. Another suggestion was that a voluntary credit restraint program on the part of bankers themselves might discourage the use of bank funds for long-term credit purposes.

Mr. Mangels said that his recommendation as to credit policy to be followed during the next two weeks would be to continue the existing program and degree of restraint. He would not reduce reserve requirements and thought there was no occasion to change the discount rate at this time.

Mr. Powell said that there had been a decline in total loans of banks in the Ninth District although city banks were experiencing a seasonal rise in loans for carrying crops. Total loans were somewhat lower than a year ago. Banks were in a comfortable position and balances maintained by banks in other areas had been rising. Seasonal increases in retail trade were being accompanied by a rise in borrowings by retailers. Employment was high. Mr. Powell said that the Ninth District was not in a condition that would require more restrictive activities on the part of the monetary authorities than now exist.

Mr. Harris commented on the new automobile outlook to the effect that dealer inventories of 1956 model cars were low, that the industry was extremely optimistic about the outlook for sales of the 1957 models which were about to be introduced, and that it hoped there would be enough credit available to finance the anticipated increase in sales of automobiles during the coming model year.

On the general business picture, Mr. Harris said that there was solid strength throughout the Midwest with a reported pick up in farm income adding to the optimism resulting from new automobile model production. Credit demands were pressing hard on available supplies of funds. However, weekly reporting member banks in the Chicago District had not shown a net expansion in business loans such as had characterized New York and the nation as a whole during the past three months, partly because the Chicago banks had not participated substantially in the sharp increases in loans to the petroleum industry or to commodity dealers. Credit was being extended to seasonal borrowers and increases in loans were going largely to food, liquor, and tobacco processors, to commodity dealers, and to trade and textile firms. Mr. Harris said that loans to trade and commodity dealers by Chicago banks since mid-year had been greater than in the corresponding period of 1955 while loans to food processors and textile manufacturers had been somewhat slower than they were last year. As to credit policy, Mr. Harris said he still felt that the economy was showing strength and that the present restrictive credit policy should be continued. However, it was his view that some consideration should be given through open market operations to accommodating the new Treasury financing and that this should be done very soon so that the effects on the market could have been observed before the Treasury's announcement was made early in October.

Mr. Leedy said there had been further deterioration in certain areas of the Tenth District because of the continued drought, conditions in some parts of the District being the worst since 1934. He also called attention to increasing evidence of attempts on the part of banks located in other districts, notably in New York, to place loans with banks in the Tenth District, particularly where the borrowers were customers of both the out-of-district and Tenth District banks.

Mr. Leedy went on to say that the economic background presented at this meeting called for continued pressure on reserves. Until the Treasury financing was out of the way, however, the Committee could do nothing in the way of additional restraint. A program that would maintain stability through the Treasury financing was called for, and Mr. Leedy said he hoped the Treasury would give serious consideration to dividing its new financing into two offerings, rather than doing it all in October. If this were done and the balance of the financing were delayed until December, Mr. Leedy suggested the possibility of providing some reserves through a reduction in reserve requirements of central reserve city banks. He emphasized, however, that this thought was contrary to his feeling as to the need for continued pressure, and he would be opposed to any action which would run the risk of confusing the situation such as might result from a reduction in reserve requirements. He also was opposed to a change in discount rate or to making any attempt to encourage use of the discount window. There might be some probing in the direction of having increased use made of the discount window, as suggested by Mr. Hayes, but this would be as a result of a lack of a supply of reserves and a compelling need for more reserves, rather than any change in the policy of administering the discount window.

Mr. Leach said there had been little change in the economy of the Fifth District since the preceding meeting of the Committee, adding that the textile industry had not yet received the hoped for orders for the fourth quarter but that the rest of the economy continued quite strong.

Mr. Leach suggested that policy for the immediate future should be considered in terms of the exigencies of Treasury financing and in terms of current economic developments. An even keel in open market operations obviously was called for, and current and prospective economic conditions called for maintenance of the same degree of restraint that the Committee had been aiming at for several weeks. Any effort to achieve an increased volume of discounts through increased pressure on the money market would result in more restraint than was needed in these circumstances, Mr. Leach said. He did not mean that it was inappropriate for banks to seek funds through the discount window to meet seasonal needs, but the Committee should bear in mind the fact that member banks entered this season with average borrowings close to $1 billion, and in talking about putting reserves into the market through the discount window the Committee should realize that the result would be quite different from what it would be if borrowings at the discount window were not now around a billion dollars. Mr. Leach thought the System would have to furnish most of the reserves needed this fall through open market operations unless it were to permit the situation to tighten up, which he did not think should be done. He also noted that a majority of the member banks in the Fifth District had not borrowed from the Reserve Bank in more than a quarter of a century, and that many others had borrowed only a few times over the past twenty-five years. Thus, if borrowing increased it would come from a small hard core of borrowing banks, some of which would be of the "continuous borrowers" group.

Mr. Leach also reported an inquiry from a large construction firm regarding the possibility of borrowing $25 million from the Federal Reserve Bank of Richmond under section 13b for the purpose of financing defense housing construction. The Richmond Bank explained to the firm that apart from technical reasons as to why such a loan probably would not be eligible, it would be inconsistent for the Reserve Bank to make a loan of the type which commercial banks would ordinarily make but which they were unable to make at this time because of the restrictive credit policy.

Mr. Vardaman said that he could see no occasion for changing the general policy the Committee had been following, that he would not change the discount rate at this time, and that he would not change reserve requirements in the foreseeable future. Banks should be assured that the discount window was available for legitimate normal seasonal borrowing. Mr. Vardaman felt there was a panicky fear, particularly among small businessmen, that money was not available. He believed money was available but at higher interest rates, and that banks were being super-selective. Such a condition would always exist in the private enterprise system and he would dislike any effort on the part of banks to organize a voluntary credit restraint program at this time. The psychological effect of such a program would be dangerous, and the political effects might be fatal in view of the feelings of small business.

Mr. Vardaman said he thought the Committee's program could be carried out through the open market. He would like to see the Treasury proceed with a $3 billion financing in October, feeling that this would be preferable to carrying some of it over to December. He would, of course, leave this to the judgment of the Treasury experts. The less the Federal Reserve said and the more it did in the way of assuring people that money was available and that the discount window was available for legitimate use, the more likely the situation was to work itself out satisfactorily.

Mr. Mills said that it seemed to him that the System continued to face the problem of how to carry on a policy of credit restraint that would stop short of making credit truly unavailable and would also eschew adding momentum to trends that could come to an unfortunate climax. He expressed the opinion that some of the points raised in the discussion as matters of grave concern might, in fact, contain built-in elements of credit restraint that aid and abet System policy at this time. For example, with respect to the commercial banks, where the objective of System policy is to put pressure on financial liquidity, that end is in part achieved because the present high level of their loans, as compared to their deposits, is of itself a restraining factor in that bank managements hesitate to permit their further expansion.

Similarly, the reduction in business liquidity that has been responsible for the increase in deposit turnover cannot but instill caution in managements and work against overexpansionist thinking. All told, considering the results obtained from the liquidity approach of System policy, Mr. Mills doubted that either the status of bank loans or deposit turnover deserved as much concern at this time as has been voiced.

As to trends, unless checked, the steady decline in the prices of stocks and the contributing factor of a continuous withdrawal of bank credit on stocks may give momentum to influences that can have unhappy consequences. Taking into account these various factors in the credit situation, it was his view that for the short run the System should aim its actions at the lower side of the negative $300 millions of free reserves mentioned by Mr. Thomas, and preferably at around a negative $200 millions. With the new Treasury financing less than three weeks off, the time left for the System to act to steady bank reserve positions and in that way to contribute to stability in the U. S. Government securities market and to assist the Treasury is very short. He felt that during this period the System could best signal its intentions of providing adequate reserves and of stabilizing the U. S. Government securities market by supplying new reserves slightly in advance of a crying need for their injection. Such actions should serve to attract a proper volume of commercial bank subscriptions to the Treasury's offering and give confidence that having subscribed, the System would not immediately tighten reserve positions. It would be important to create a reserve climate under which the commercial banks could redistribute the securities they acquired over a reasonable length of time and without loss.

As recent experience has demonstrated that commercial banks and market operators are well aware of the temporary reserve influences of changes in the volume of float and the size of Treasury balances, it was Mr. Mills' belief that the process of making reserves available in support of the Treasury financing should be largely positive in character and without undue reliance on float to "float" the Treasury's new securities and the consequent risk of giving the market an erroneous impression of the System's intentions.

Mr. Robertson said that if it were not for the Treasury financing, he would be urging a more restrictive policy than the

Committee had been following. We were nowhere near the point of a too restrictive policy, and the Committee would be making a very serious mistake if it eased the situation too quickly and too much in the face of the Treasury financing. It was essential for the moment to retain the degree of restraint that had been maintained for the last few weeks so that no one would be misled as to the System's real intentions, which were to fight inflation and to maintain stability. However, the System should do everything it could to make the Treasury financing a success. It must not only put reserves directly into the market but perhaps it should use repurchase agreements to a greater extent than before. It might be necessary to make some kind of commitment to dealers on the repurchases.

Mr. Robertson said that he was troubled by the suggestion for encouraging use of the discount window. This should be a facility available at all times, but its use should not be encouraged. Mr. Robertson agreed with the idea of probing toward greater restraint through forcing banks to the discount window after the Treasury financing was out of the way, but his belief was that the discount window would be used automatically if the amount of reserves in the market was not adequate. The System would get into deep water if it encouraged the use of the discount window.

Turning to the Treasury financing, Mr. Robertson said that the Open Market Committee had no business urging any view on the Treasury as to the type of financing it should do. It was proper to give the Treasury views but not to urge views since Treasury financing was a matter for the Treasury to decide. He would go overboard in providing the reserves necessary to make it possible for the Treasury to do its financing in a way that would not upset the restrictive credit policy.

Mr. Shepardson said he agreed largely with the views expressed by Mr. Robertson. It seemed to him that expansive tendencies were still in the ascendency and that while the System had accomplished something it had not achieved what it might through the proper use of credit policy. For that reason, he thought the Committee should look ahead to the possibility at a later period after the Treasury financing was out of the way of taking further action on the restrictive side. He was very much concerned about the need for maintaining stability of the dollar. Although he recognized the immediate problem of the Treasury financing which called for maintaining a condition that would favor a successful financing to the extent that was consistent with the Committee's policy, he would dislike any action that indicated undue loosening of reserve positions of banks for the purpose of taking care of the Treasury's financing problem. Such a course might necessitate the System's coming back a little later with further restrictive measures.

Mr. Shepardson referred to the use of the discount window, stating that he thought Mr. Leach had made a point on continuous borrowers that deserved consideration; that is, that the continuous and excessive borrowing appeared to be concentrated in a few banks. The time to correct that situation was not when the banks were in a situation where they needed assistance, but it would be very unfortunate to do anything that would further aggravate the problem of continuous borrowing on the part of a few banks. For that reason, even during the period of the Treasury financing, banks should not be invited to use the discount window because that might make it doubly difficult to get back to a better basis later on.

Mr. Fulton said that in the steel and allied lines, which were of major importance in the Cleveland District, activity was at the highest rate on record with steel output in the Cleveland-Loraine area running at 107 per cent capacity. Many products were in tight supply and there was an insistent and great demand for them. Some users of steel who had been carrying up to a forty-day supply before the strike had now reduced inventories to about a twenty-day supply because they felt able to operate on almost a hand-to-mouth basis under the terms of the new wage agreement. Mr. Fulton noted that the price of steel scrap had been very high and he also stated that additional wage adjustments were expected, which would be followed by further price increases for steel and steel products. Demand for bank loans in the Cleveland District had continued very active. Some banks had reported that insurance companies were not seeking mortgage loans at present but mortgage money seemed to be forthcoming at a price. Agriculture was affected by a killing frost last week, but farm income for the

Fourth District would be quite satisfactory for this year as a whole.

Mr. Fulton said that he felt we had been laggard in the degree of restraint on industry. No major plans for plant expansion had been set aside, and the consensus was that higher interest rates had not deterred the majority of industrial borrowers. For the immediate future, Mr. Fulton felt that the existing degree of restraint should be maintained with no signal that the System would relax during the rest of this year. In fact, a little later in the year it might be desirable to add further restraint. The discount window at the Cleveland Bank had been following a course indicated by the directors of the Bank, Mr. Fulton said, which was to keep the window open and to make money available at a price with the thought that if the price was not sufficient it should be increased as a deterrent to excessive use of the discount facility.

Mr. Williams said that the economy of the Third District was active at a high level and that it was difficult to draw a sharp picture of changes over the past two weeks. If consumer and seasonal demands were added to plant expansion activities, it was evident that the area was in for sharp pressure on facilities during the near future. Demand for bank credit in the Third District had shown an interesting shift, Mr. Williams said, because of the pressure put on banks through administration of the discount window. He recalled his earlier remarks that there was a hard core of borrowing city banks in the Philadelphia District. There had been discussions with these banks as a result of which they had shifted from the discount window to the Federal funds market. There was some evidence, however, that total borrowings of the banks were reaching a plateau. The Philadelphia Bank had asked for daily information from these city banks, which had supplied it without reluctance, and he thought this information might prove useful. As to country banks, Mr. Williams reported a discussion with what he termed a flagrant borrower who had been using the discount facility at a fairly high level during much of the past three years. This banker had expressed his philosophy of banking and discussed his individual problems, after which he inquired of the Reserve Bank officers what they thought he should do. Mr. Williams cited this as an indication of the type of situation that might develop with individual administration of the discount window among borrowing banks of the district.

Mr. Williams said that he detected a psychological change in the public's attitude in the Third District in that everybody was now conscious of tightness. Within the past week several questions had arisen as to whether small business was being hurt by current credit policy. Mr. Williams said he had been assured by banks that small business was getting a ratable share of whatever credit was available; banks had taken the position that it would not be good business for them not to take care of the small business concerns needing credit and entitled to it. However, there was a vocal group that could be expected to keep this question alive.

Mr. Williams also reported that Vice President Bopp of his Bank had met a few days ago with a group of fifty-five business executives who held policy making positions with their firms. One-fourth of these were from oil companies, one-fourth from heavy industry, one-fourth from light industry, and one-fourth were from service, finance, and other activities. Mr. Bopp posed the question whether their forward planning contemplated any recession in economic activity during the next three years and not a single one of the fifty-five executives felt there would be a recession of greater severity than that of 1954, and none of them were taking into account the possibility of a greater recession. Mr. Williams said he thought this was typical of the Third District.

With respect to current policy, Mr. Williams said the Committee should hold the restraint line at the existing degree but it should be especially sensitive to the problems facing the Treasury, and it would be desirable for System representatives in conversations with bankers to take a position that would influence them in favor of the Treasury's financing.

Mr. Bryan said that no significant changes in the Sixth District economy had taken place during the past two weeks. He said that he shared the general feeling that the System must maintain at the present time a posture of restraint. However, he was very much concerned about the whole question of maintaining that restraint when the Government of the United States must be in the market, and when it might face a very difficult situation. He was also somewhat afraid the open market instrument might not work the way the Committee contemplated as a means of aiding the Treasury. The banking system had in effect acquired a condition reflex, Mr. Bryan said, and he was beginning to suspect that the reflex was starting to wear off and that simply supplying some reserves through float or through the open market to aid the Treasury financing might not prove sufficient. Mr. Bryan said he noted that the idea he had expressed at the meeting two weeks ago of doing something in the way of reducing reserve requirements had not met with unanimous support at this meeting, but he still thought the idea had some merit particularly in the light of what he thought would be the reactions to open market operations at the present time. He noted that in order to get a 2 per cent growth in reserves by the end of this year it would be necessary to supply approximately a billion dollars of additional funds, and he could not quite see how supplying half of this sum through a reduction in reserve requirements would be objectionable. In fact, it might have some substantial advantages at the present time as a means of assuring the banks that they were not going to come into the market and aid the Treasury financing and then be confronted with heavy losses immediately afterwards on the secondary distribution of the securities. However, Mr. Bryan said that he did not know that he could argue too strongly for the reduction in reserve requirements. He shared many of the views that Mr. Mills had expressed and felt that the points Mr. Mills had emphasized should not be forgotten by the Committee.

Mr. Johns said that activity at the discount window in the St. Louis District had declined substantially in recent weeks and virtually all the borrowing was occurring at present at cotton banks in the southern part of the district. This was to be expected at this time of year and would continue for some weeks. He noted that one St. Louis bank that had been approaching the status of a continuous borrower was now out of debt to the Reserve Bank and that in fact it recently had been a net seller of Federal funds. Mr. Johns said he shared the skepticism expressed by others about attempting to follow one set of plans with respect to the administration of the discount window at one time and another set of plans at another time, although he would not deny that administrative decisions might be tempered from time to time.

Mr. Johns noted a press report regarding loans for small business and the apparent suggestion that business concerns might turn to the Federal Reserve for funds which they were unable to obtain from their usual banking sources. He doubted that such a procedure would be appropriate at this time, feeling that it would be wholly inconsistent for the Federal Reserve Banks to make such loans direct to business while pursuing the present restrictive monetary policy. He did, however, share the views expressed by Mr. Hayes as to the need for accommodating small business with credit and felt that the System should learn as much about this problem as possible.

Mr. Johns said he was also in agreement with much that Mr. Mills had said today which brought out the thoughts he attempted to express at the meeting two weeks ago as to using something other than net borrowed reserve figures as an indication of the degree of tightness in the market. In suggesting that the System attempt to gauge restraint by observing the behavior of loans and loan trends, Mr. Johns said he realized the difficulties of such a procedure and the lag in available statistics. He still found nothing to indicate that the System's pressure was too little and, in fact, there might be some slight indication that pressure might be a little too heavy in the present situation, with the Treasury financing undoubtedly requiring the supplying of some reserves to the market. Mr. Johns said he felt the reserves should be supplied without too much reluctance and he thoroughly agreed with the view that the Treasury would not be able to carry through its financing satisfactorily on the basis of reserves that would be supplied through float.

Mr. Szymczak said that he agreed with everything that had been said on the side of restraint. Whatever could be done with monetary and credit measures to restrain the situation should be done. However, in order to carry through this program it was necessary to be flexible, and the System could not afford to be adamant in its restrictive policy. There was nothing that the System could point to to show clearly that the existing degree of restraint was "right", now, in the past, or in the future, whatever policy might be followed. The System must supply reserves in the present situation and one of the factors would be the need of the Treasury in its expected $3 billion financing. This particular financing was one in which the System must carry through with the Treasury, letting it be known that it would assist in making the financing a success. It would have to provide less reserves if it assumed that attitude, Mr. Szymczak said, than if it assumed an attitude of too much reluctance. He also felt that it would be appropriate for the System to suggest to the Treasury the desirability of issuing more tax bills, partly because the System would find it helpful in administering monetary and credit policy to have more bills in the market. This could include the use of the tax and loan accounts. Also, the System could in effect go with the Treasury to Government securities dealers and assure them beforehand that it was going to make repurchase agreements freely available as needed during the financing. If necessary, the System should purchase bills in the course of the financing. If some $2 billion of tax anticipation bills could be issued, then the other billion of the anticipated $3 billion could be in the form of an increase in the weekly offerings of bills. By following the course he had suggested, Mr. Szymczak felt that the System would find it necessary to provide less reserves than otherwise and would be in a better position to continue its policy of credit restraint. The classical central bank could not take the position that it had nothing to do with the needs of the Treasury in its financing; in fact, in order to be a classical central bank it was necessary to consider and assist in the Treasury's financing problems.

Mr. Balderston said he was as perplexed as others had indicated they were by the conflict between the System's obligation to help the Treasury in its October financing and by its responsibility for minimizing the price-wage increases that are ahead. As to the Treasury financing, he would like to see the Treasury use the occasion to dispose of some $2 billion of bills that would come due in the latter part of January when the situation might be more relaxed. Mr. Balderston said he made this suggestion because an eight- or nine-month security would have to be put out at such an attractive yield as to disrupt the bond market.

As to the System's obligation to help the Treasury between now and the completion of the October financing, Mr. Balderston said it was very clear that the System would have to supply the reserves for the financing but this should be done with full awareness of the fact that we are having a price spiral that will constitute what Chairman Martin in the past has described as a bubble on the boom. Mr. Balderston then referred to features of the steel wage agreement and to the possible effect of those provisions on prices as well as to the possibility of reopening other wage agreements that were not yet due for renewal. He also referred to the request of the eastern railways for a 15 per cent increase in rates on top of the increase granted last year. A second freight rate increase within the same year would be clear evidence of the tendency for a cost-price squeeze to bring about an accumulating spiraling in prices. In view of these factors, Mr. Balderston said that he would have sympathy with the suggestion that Mr. Hayes had made that as soon as the Treasury was out of the way the System should do whatever could be done to discourage price increases because of the impact on the economy that such increases would have in the months to come.

Chairman Martin then made a statement substantially as follows:

> There is very little that I can add to the discussion. I certainly don't want to belabor any points. I do want to make an observation that I think we ought to keep in front of us all the time. We talk a lot about how much monetary and credit policy can do and how much it can not do. Ex officio, I probably get subjected to more calls from the Hill and from others than most of you and I certainly take a beating from time to time. It is very easy to get blase' about criticism and to decide that it is a lot of nonsense. It is also very easy to be influenced by it. It is a problem of always keeping balance.
>
> I have been totally unimpressed with the great number of comments that are being made that the System is heading for disaster (some of them are perhaps politically motivated), and the statements that small business is not getting the credit it needs and that, whatever the cause, the Government will not be able to permit the Federal Reserve to live in an ivory tower and continue monetary and credit policy unless it is more closely connected with the people. I don't have the slightest concern about that. If we do what is right and reasonable, it makes no difference what party is in power or who the individuals are, we will come out all right. We may be changed from time to time in our structure, but I am not worried about that.
>
> I emphasized at the last meeting that there were certain periods when certain things become crucial. I think the crucial thing at the present time is the Treasury financing. I don't think it is the degree of restraint: degree is a very tenuous thing. I don't believe that the degree of restraint at a given time is the measure of our effectiveness.

That deals in bigger things. When it comes to evaluating the money market I am sure all of us have different judgments at different times. That is because of differences of the market and because of differences in individuals. All of us have to make our judgments.

I used the word crucial the last time. Again, I say in my judgment, this is going to be a difficult money market from now to the end of the year, and it may develop into a panicky situation--not because people are reasonable, but because they are unreasonable. That is what we have to deal with.

Governor Szymczak touched on my point here at some length a few minutes ago. I think we ought to engage in whatever devices are needed. I agree completely with Governor Robertson that we should not tell the Treasury the things that ought to be done, but we should give them our judgments on the market. If we have a panic in the Government securities market, we will be saddled with the responsibility just as much as the Treasury, and we will at that point probably have to supply a larger amount of reserves than if we effectuate this financing in a reasonable way.

This is not a plea for any given level of reserves but I am making a plea that we are dealing with fluctuations and flexibility. If we are to make errors--we make errors continually, and this is not in any way a criticism of the desk because the very nature of the problem means that we will make errors--the errors we make during this period ought to be on the side of ease rather than on the side of restraint. To me, that is a matter of common sense. It has nothing to do with anything other than an approach to the market, where we are already under the shadow of two Treasury issues that have not been wholly successful. I have heard a lot of talk from people in the market and from businessmen, many of them informed people, as to the incompetence of the Treasury and how, if things had been done differently, they would have come out all right. I don't think that is of any concern at the present time. We can not run the Treasury. We have to accept the end result and pick up the pieces there.

At this juncture, I think we ought to bend our efforts toward resolving the reserve situation on the side of a clear indication that we are not going to have $600 or $700 million of net borrowed reserves suddenly develop on the up side, and have it explained by some untoward incident. If we are going to make a mistake, we ought to have it on the side of ease. Also, I think we ought to be extremely careful about any projections or about any talk of what we will do in the future. The market will hear ideas of what we are doing, and if the market gets the idea we are trying to help the Treasury only to raise the discount rate later on or to tighten up later on, that becomes an element in the market. I think we have to go from week to week or from period to period without trying to project too far into the future. Another thing I want to emphasize is that in my opinion the Treasury is not being unreasonable at the moment in being apprehensive about this market. Whether they have always been wise or unwise is a matter of judgment but they now have a very real problem.

In considering the policy directive, it seems to me that no one around the table wants to change the directive at this time. I don't know how best to word the instructions in terms of the degree of restraint that ought to be followed. All of us are for following a policy of restraint. The degree in my own thinking would be as I have expressed it; we do not want to create a sloppy money market but nevertheless we have to be alert to the day to day operations of the money market and we have to do what we can in supplying reserves and avoiding an impression that the Federal Reserve is going to sit by and be glad to see further restraint develop to bother the Treasury. Some people will make comments to that effect and part of that will be politically motivated. I would like to have some observations as to how to develop this very delicate point of what directive to give to the account, and I would also like to give Mr. Rouse a chance to comment.

Mr. Rouse said that, as Mr. Thomas had indicated, the Treasury bill market was a shrinking market at present. The appetite of business corporations for bills had been steadily going down for the last few weeks if not for a little longer. Mr. Rouse said he agreed with Chairman Martin that this was a most difficult situation. Steady additions of reserves through open market operations and maintenance of the reserve picture about as we have had recently seemed to be the only procedures that would be in line with the policy indicated by the Committee. At the same time, Mr. Rouse said, he was not sure this would be enough. He felt that a Treasury financing of more than $1-1/2 billion could be done but that the securities might sell at a discount almost immediately in the light of continued restraint and the unavailability of reserves. The amount of reserves that he could see reason for putting into the market in line with the Committee's policy would not be sufficient to relieve the situation in New York or Chicago, Mr. Rouse said, assuming a normal distribution of the reserves in different parts of the country. He noted that the market in New York this morning was quite tight. A reduction in reserve requirements would cause confusion as to System policy, Mr. Rouse said, but it was the type of thing that would give a clear-cut indication to the market in unequivocal terms that the System was providing reserves to support the Treasury financing. On the other hand, if reserves were put in through open market operations in the same atmosphere, he felt the market would continue to be very sensitive. He thought that it would be preferable if the Treasury offered $2 billion of securities rather than $3 billion at this time, even though it left open another substantial piece of financing to be done at the end of the year in a difficult period.

Mr. Thomas said that the Treasury financing in October might not have as great a repercussion on the market as some of the comments had indicated since the Treasury would be paying out some $2 billion in funds in that month because of redemptions of securities. Thus, if it received $2 billion of cash in the financing, there would still be no change in the amount of required reserves as a result of the Treasury financing.

Chairman Martin inquired of Mr. Leedy whether his comments indicated he would favor a reduction in reserve requirements in New York and Chicago as central reserve cities only, and Mr. Leedy responded that this was his suggestion. However, he did not intend to suggest that such a reduction should be made at this time but only on the theory that the Treasury's financing would be divided into two offerings of $1-1/2 billion each, one to be made in October and the other in December.

Chairman Martin inquired whether there were any persons present who favored a reduction in reserve requirements at this time to assist in the Treasury's financing, and Mr. Bryan indicated that he would favor such a move.

Mr. Mills said that he would give qualified support to such a reduction on the basis that the System had three weeks in which to experiment as to what could be done to give stability and confidence to the market. Before the end of three weeks, it was conceivable that the central reserve cities would need the major support of a reduction in reserve requirements and he felt that in some manner the door should be left open to consider that as a possibility at a later date. He would not be in favor of a reduction in reserve requirements at this time.

Mr. Hayes stated that notwithstanding the comments Mr. Rouse had made, he would not support a reduction in reserve requirements at this time, and Mr. Rouse pointed out that his comment as to the way the market would interpret a reduction in reserve requirements was not to be taken as an indication that he favored a reduction in reserve requirements at this time. Mr. Hayes continued by saying that while a reduction in reserve requirements would be very neat from the standpoint of the Treasury financing, he felt open market operations were designed to meet any situation where we needed a temporary easing. If there was some feeling that a net borrowed reserve figure around $300 million still left the central reserve cities dangerously tight for the Treasury's financing period, he would favor going further in open market purchases to the extent that might seem necessary. This would have to be played by ear, he said, and it would not bother him if the Committee had to go in in a little more emphatic way.

Mr. Johns said that he would favor an immediate reduction in reserve requirements for substantially the reasons stated by Mr. Bryan.

Mr. Harris said that comments made to him in connection with the Treasury financing pointed out that while the System seemed willing to make temporary adjustments in the amount of reserves for a Treasury financing, the experience was that before the securities could be given their secondary distribution the System would come along and tighten up the market in a way that would put the prices of the securities down and thus hurt the banks or dealers or whoever acquired them. He felt that the System must consider the problem further and that, if it did not reduce reserve requirements, it would have to do something else to reassure the market in connection with the forthcoming financing.

Mr. Bryan said this was the point he had had in mind. He felt that the System might receive a bad shock if the banks were not informed in a way that they could understand that the System was going to see the Treasury financing through.

Chairman Martin said that he thought the Committee should have in mind the points that Messrs. Harris and Bryan had mentioned. There had been a good deal of pressure on the System to reduce reserve requirements at this time, but he doubted that it would be possible to explain such a move in a way that would avoid confusing the market and the public. He felt that all of the suggestions should be explored but did not think the Committee could work out every detail at this meeting. He referred to the suggestion made by Mr. Hayes that the account management should have some leeway in its operations, and Chairman Martin again indicated that he would prefer to have the Account Manager make his errors on the side of ease rather than restraint during the period ahead. He was not asking that Mr. Rouse intentionally make errors on the side of ease but he was emphasizing that errors which went in the wrong direction, if accompanied by development of a panicky feeling in the market, might lead to the

System's having to supply more reserves than it would have to put in if it handled the situation by leaning toward the easy side in its operations at this stage.

Mr. Rouse said that, to carry out the views indicated, his program would contemplate a substantial amount of buying, more or less steady buying ($200 to $300 million might be adequate). He thought that this procedure, along with use of repurchase agreements, might go a considerable distance toward promoting a feeling of understanding that the System would see the financing through. The attitude Mr. Harris had mentioned was the problem, Mr. Rouse said, and he spoke of one bank that had started selling securities that it acquired in a Treasury financing before the books on the issue were closed. He also noted that the Treasury would be faced with a refunding of $9 billion of maturing certificates on December 1, 1956.

In response to a question from Mr. Mangels as to whether there would be merit in setting the next meeting of the Committee two rather than three weeks hence, Chairman Martin said that he did not believe this would help in the current problem since the Treasury financing probably would have been announced before October 9. The Chairman was inclined to think that the best way the Committee could sum up the views expressed at this meeting would be to say that in general the account management should be given latitude, consistent with the Committee's directive, to carry on operations in the light of the discussion at this meeting. He added that he personally would like the instruction to include a request that any errors made in carrying out that program be on the side of ease rather than of restraint but that the whole operation should, of course, be consistent with an over-all policy of restraint. Recognizing that this was a very difficult program to pursue, he felt that it was the best the Committee could agree upon in the light of the discussion at this meeting.

Mr. Szymczak said that it was clear that the Committee was not in a position now to say exactly how much assistance would have to be given to the market in connection with the Treasury's financing, and for that reason it would be necessary for the management of the account and the Committee to "play by ear".

Chairman Martin agreed, adding that he thought there was full agreement that the Committee should do whatever was consistent with its responsibility to help the Treasury in its current financing problem.

Mr. Robertson said that he would like to make the additional suggestion that perhaps this was the kind of situation in which repurchase agreements should be made available at a rate below the discount rate in order to aid dealers in helping to make a market for the issues that would be offered in the Treasury financing, and he suggested that in the event the Manager of the Account believed such authority was needed, he take it upon himself through the Secretary of the Committee to bring to the attention of the Committee a request for additional authority.

In response to a question from Mr. Hayes as to whether this would be of substantial help, Mr. Rouse said that this would depend on the rate situation, in view of the provision in the existing authority for repurchase agreements that they be at a rate no lower than the lower of (1) the discount rate of the Federal Reserve Bank or (2) the average issuing rate on the latest issue of Treasury bills.

Chairman Martin said that he thought it was clear that the Committee wished to do whatever would be most effective in the way of helping with the forthcoming issue of Treasury securities, and Mr. Hayes commented that he knew of no disagreement with that statement.

Mr. Rouse having indicated that he had no recommendation for change in the Committee's directive, Chairman Martin suggested that the Committee approve the directive without change in either the language or the dollar limitations in it, and with the understanding that it would be carried out in the light of the discussion at this meeting.

> 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.

Chairman Martin then referred to the proposal that had been made by the New York Bank for authority to engage in swaps of Treasury bills and asked Mr. Rouse whether he had any additional comments to make regarding the proposal in view of the suggestion that Mr. Robertson had made at the preceding meeting as to limitations on the authority.

Mr. Rouse stated that he had expressed his feelings at some length both orally and in memorandum form and that he did not now have anything to add to his earlier comments.

Mr. Robertson said that he would like to withdraw his suggested resolution as presented at the meeting on September 11 because he did not think the Committee should force the management of the account to accept a resolution of that type. Since the resolution would not serve the purpose that he had had in mind in proposing it, he would prefer to withdraw it and to suggest that the Committee take no action on the New York Bank's request for authority to engage in swaps in Treasury bills.

Mr. Hayes said that discussions he had had with his staff regarding Mr. Robertson's proposed resolution had brought out the difficulties that would be created by making it necessary to have a complete go-around of all dealers every time the System contemplated engaging in a swap transaction. On the other hand, he thought that it would be quite feasible and desirable if the System needed some swaps to remind the market on a given day that it was interested in swaps and thus to "needle" the market to come to the Bank with whatever offerings it might have. He raised the question whether such procedure would go far enough to meet Mr. Robertson's suggestion.

Mr. Robertson said that this would not go far enough to suit him; it would be a device for the purpose of enabling a dealer to meet the demands of one of his customers, and he did not think the account would be accomplishing what was contemplated by the original suggestion for changing the maturity pattern of the System's portfolio at its initiative.

Mr. Hayes said that his suggestion did not contemplate that such an announcement would be made every day but only if the System had a particular need for changing the maturity pattern of its holdings. Even then the System would only make such swaps if it felt the need. He did not have in mind that the System account would formally notify everyone in the market of each need for swaps.

In response to a question from Mr. Robertson as to why the latter procedure should not be followed, Messrs. Hayes and Rouse responded that such a procedure would not be desirable for the reasons stated in the memorandum distributed by Mr. Rouse under date of September 21, 1956, particularly because it would tend to distort the market.

Mr. Erickson inquired whether swaps along the lines proposed by the New York Bank would be of assistance in the period we are now entering.

Mr. Rouse said he thought such authority probably would be of assistance although he could not say that it was crucial. He would like to have the authority and thought it would be of assistance to the Manager of the Account in carrying out System policy.

Mr. Vardaman said that he had studied this proposal thoroughly but that he could not support any form of swaps at the present time, much as he would like to do anything that would facilitate the operation of the System account at the present. He added the comment that this view did not indicate a lack of confidence in the trading desk but was a matter of principle and that he felt to engage in swaps injected a feature into open market operations which should not be there.

Chairman Martin said that in view of the differences of opinion it would seem best to pass the question for the present time. He would make the general observation, he said, that he felt more strongly than ever the inadequacies of the Government market at the present time, both as to dealers and as to bankers, and that in his opinion the Committee should go further into a study of every aspect of the market. He cited a comment by the chairman and president of a large bank recently who stated that he had no feeling of responsibility to the Government securities market whatsoever, a statement which he (Chairman Martin) felt indicated a lack of proper attitude on the part of a person in that position at a time when we were facing one of the most crucial Government securities offering in recent years.

The fact that such an attitude existed, however, pointed up the necessity for the System's pursuing a review of the problems that it had been wrestling with and for recognizing that the techniques and the problems of the Treasury and of the money managers had not found a solution that was adequate.

Mr. Rouse added a comment as to the attitude he understood had been shown at a recent meeting of a Committee of the New York Clearing House, which was described as lacking in appreciation of the problems facing the Treasury and the System.

Mr. Hayes said that this matter was very important and one he had in mind. The comments that Chairman Martin and Mr. Rouse had cited were not uniform, he said, and there were bankers who did have a sense of responsibility.

Mr. Balderston inquired whether any additional authority with respect to repurchase agreements along the lines suggested by Mr. Robertson should be given at this meeting, and it was understood that in the event Mr. Rouse felt additional authority was needed he would bring the matter to the attention of the Committee.

It was agreed unanimously that the next meeting of the Committee would be held at 10:00 o'clock on Tuesday, October 16, 1956.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary