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, June 18, 1957, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Bryan
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman
Mr. Williams

Messrs. Fulton, Irons, Leach, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Erickson and Johns, Presidents of the Federal Reserve Banks of Boston and St. Louis, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Atkinson, Bopp, Marget, Mitchell, Roelse, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Williams, Assistant Director, Division of Research and Statistics, Board of Governors

Mr. Daane, Vice President, Federal Reserve Bank of Richmond; Mr. Einzig, Assistant Vice President, Federal Reserve Bank of San Francisco; Mr. Balles, Assistant Vice President, Federal Reserve Bank of Cleveland; Mr. Walker, Economic Adviser, Federal Reserve Bank of Dallas; and Mr. Hastings, Economist, Federal Reserve Bank of St. Louis.

Chairman Martin stated that while Mr. Ralph Young, Associate Economist for the Committee, was in Europe it was contemplated that the economic review which Mr. Young usually presented at meetings of the Committee would be given by Messrs. Williams, Noyes, or Koch of the Division of Research and Statistics of the Board of Governors. He suggested that they be invited to attend the meetings and there was no indication of disagreement with this suggestion.

At this point Mr. Williams, Assistant Director of the Division of Research and Statistics of the Board of Governors, entered the room.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 28, 1957, were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period March 5 through June 11, 1957, as well as a supplementary report covering commitments executed June 12 through June 17, 1957. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that reserve positions had worked out just about as projected at the last meeting of the Committee. Net borrowed reserves averaged $572 million in the week ended May 29, slipped to $446 million in the June 5 week as the Treasury's balance dipped briefly, and were $570 million in the week of June 12. The composition of the reserve statistics changed significantly during these three weeks.

Member bank borrowing increased to a range of $1-1/4 billion in contrast with $900 million or so a few weeks ago. At the same time, some of the reserve tightness shifted to the New York banks, affecting the money market and the market for short-term Government securities.

The additional three weeks of tight money market conditions had tended to have a cumulative effect on the securities markets, Mr. Rouse said. He described the Government securities market as being in a very tender condition. Price declines had been orderly, but the market background was one of real nervousness. Meanwhile, the increase in new issue rates in the capital market had gone on apace; yesterday an A-rated utility issue was brought to market at a reoffering yield to investors of 6 per cent. Market rates of interest on U. S. Government securities had not adjusted fully to the rising new issue rates, but they touched new lows yesterday, with the 2 -1/2's of 1961 and 1963 quoted to yield above 3.80 per cent and the 1-1/2's of 1962 at a yield of 3-7/8 per cent. Dealers reported that there really had been no market during the rapid price markdown; it was only necessary for potential sellers to indicate an intention to sell in order to move prices 1/8 of a point or so lower. Mr. Rouse also noted that in recent days there had been increased attempts to liquidate Government securities, these coming from smaller insurance companies, savings banks, and, increasingly, from commercial banks. The new issue of Treasury bills auctioned yesterday was awarded at an average rate of 3.404 per cent, another new high but nonetheless a lower rate than many dealers had expected; dealers were awarded only slightly more than $300 million of the new bills. With respect to the rapid interest rate adjustment that had occurred in recent weeks, Mr. Rouse remarked that a report had reached him from a private source that some underwriting houses were approaching bankruptcy because of the losses they had taken in recent unsuccessful issues; however, he said that his check of this report showed that while some losses had been sizable the report that there was danger of bankruptcies just was not so.

Mr. Rouse added that discussion in market circles on the course of interest rates had been influenced recently by discussion of the possibility of an increase in the prime rate and/or the discount rate. Apparently, the leading New York banks had decided, at least for the time being, to wait for the Reserve Banks to increase discount rates before they moved on their prime rates.

Turning to the Treasury's financing problem, Mr. Rouse pointed out that the Treasury faced both a new money and a refunding operation. Mr. Burgess, Under Secretary of the Treasury, had called him on two or three occasions to discuss the program, but the last time they spoke he (Mr. Burgess) was still not clear on the course he should follow. It was probable, however, that the cash offering would consist of between $2 and $4 billion of a March 1958 tax anticipation issue. The Treasury had not invited the Investment Bankers Association and American Bankers Association committees to sit in on the discussions of the cash financing, but they had been invited for preliminary discussions on the refunding. Mr. Rouse mentioned that one dealer had recommended that the refunding be a cash operation, with 100 per cent allotment to holders of the "rights." The Treasury would attempt to avoid attrition in this way. However, a possible legal problem for the Federal Reserve System which he would discuss with Mr. Hackley might arise under this suggestion, i.e., whether a subscription by the System on the proposed terms would constitute an exchange or a cash subscription. The proposed plan would call for payment through Tax and Loan Account for that portion of the new issue subscribed in cash, and the funds to redeem securities not presented in payment for the new issues would have to come from calls upon existing balances. Therefore, under this plan the borrowing in early July would have to be large enough to cover the cash redemptions on the maturing issues. Mr. Rouse noted that the proposed plan also had certain tax advantages claimed for it that might make it more attractive to investors.

At the conclusion of his remarks, Mr. Rouse told the Committee that the report on fiscal agency relations between the Federal Reserve Bank of New York and the Treasury, requested at the May 7 meeting, would be ready for mailing to the members of the Committee in about ten days.

Chairman Martin supplemented Mr. Rouse's comment with the statement that Under Secretary Burgess had called him on the telephone late yesterday afternoon to say that he was contemplating a $3 billion March tax anticipation issue, to be sold at auction, the announcement to be made on Thursday or Friday of this week.

The Chairman went on to comment that he felt the Account Management had kept the market in good shape during this period and that it looked as though we would go into this Treasury financing without having had the market ease perceptibly immediately before the offering.

Mr. Rouse said that he was afraid that the situation would become slightly easier next week, but he did not think there was much that the Account could do about such a development.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period March 5 through June 17, 1957, were approved, ratified, and confirmed.

Chairman Martin called upon Mr. Williams of the Board's staff, who made a statement on the economic situation substantially as follows:

> Over-all economic activity is continuing its slow but persistent rise from the record levels reached last winter. Broad dollar value measures, such as the gross national product, are reflecting both higher average prices and small further gains in real output. Total activity has been expanded by further extension of the capital goods boom, steady increases in service activities, a very high level of exports, and further growth in Federal, State and local government outlays.
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> Meanwhile, business has been following a cautious inventory policy. In physical volume, a shift from substantial accumulation of inventories to small liquidation was registered in the first quarter. Inventory liquidation is apparently continuing in the current quarter. Reflecting the change in inventory policy and other developments,

selective downward adjustments have been going on in industries producing such products as household durable goods and automobiles. These, in turn, have contributed to lower output of steel and some other materials. These various adjustments have been reflected in a decline in the index of industrial production from 146 in February to 143 in May. At the May level, however, the index was still 2 points higher than in May and June last year.

Very recently--in late May and early June--there were signs of some firming up of production in key industries. Steel production rates have risen slightly, auto assemblies have increased contra-seasonally, and output of some household durable goods seems to have been picking up. These developments indicate a probability that the index of industrial production for June will hold at the May level.

The general level of wholesale prices advanced slightly from mid-May to mid-June to a new high, as prices of farm products and foods increased further. Prices of industrial commodities continued to show little change from the level which has prevailed since February. Price changes for basic industrial materials have been mixed. In recent weeks, zinc and lead prices have decreased while prices of steel scrap have advanced sharply again. Consumer prices have been continuing their steady rise and in May were estimated to be nearly 4 per cent higher than a year earlier.

Taking account of changes in the physical measures of activity and in prices, it is now anticipated that the balance of forces will result in a further rise in the gross national product in the current quarter. The gain is likely to be moderate, amounting perhaps to a seasonally adjusted annual rate of about $3 billion. If realized, this would bring gross national product to $430 billion, or higher. This level would represent a rise of about $22 billion, or 5 per cent, from a year earlier.

Higher prices and living costs are contributing directly, through escalator clauses, and otherwise, to higher wage rates. At factories, wage rates have risen further this year but hours of work are lower and overtime pay is less. Average hourly earnings at $2.06 in May were only 1 cent higher than at the end of last year and weekly earnings have declined. At the same time, output per manhour has been rising rapidly as further growth and modernization of industrial capacity have facilitated more efficient operations.

Throughout the recent period of rolling adjustments at very high levels, businessmen have been consistently optimistic in their plans for the future. An optimistic attitude has been reflected recently in further increases in stock market prices to new highs for the year.

Underlying business confidence also has been shown by the latest Commerce-SEC survey of plans for plant and equipment outlays. This survey indicates a rise in fixed capital spending through the third quarter. At $37.9 billion, the seasonally adjusted rate of such outlays would be $2 billion, or 6 per cent, higher than in the third quarter of last year. Construction activity in May rose further to a new record level, with increases reported in most types of nonresidential construction. Outlays for residential building were off further but, more importantly, new housing starts in May rose to an annual rate of 990,000 units, the highest in several months.

Consumers continue generally confident as personal incomes have risen further to a level 5 per cent above a year ago. Total retail sales rose slightly in May with sales of automotive dealers showing the first rise since last December. New car sales were especially strong in the latter part of May and in early June apparently were holding up well. Used car sales and prices have been continuing strong. Instalment credit outstanding increased $200 million further in April, on a seasonally adjusted basis, and a rise of somewhat similar magnitude is likely for May.

Unemployment is relatively low and has shown mainly seasonal changes this year. In May, at 2.7 million, it was about the same as a year earlier. Nonfarm employment also has shown mainly seasonal changes this year and in May was 770,000 larger than in May 1956. The stability in the nonfarm total reflected growth in nonmanufacturing activities offset by declines in manufacturing employment.

Abroad, economic activity has continued at very high levels in recent months, with further expansion taking place in major European countries. Upward pressures on prices have generally persisted although indexes of both wholesale and retail prices in several industrial countries were relatively stable through the first four months of the year. In recent weeks, new measures have been taken in a number of countries to restrain inflationary pressures, and credit restraints have been generally maintained or tightened further.

Chairman Martin next called upon Mr. Thomas for a review of recent credit and financial developments, and Mr. Thomas presented the following statement:

Recent developments in financial markets present a test of the effectiveness of monetary policy to curb inflation in the face of strong credit demands and large and widespread public debt holdings. We are still experiencing the consequences of the liquidity built up in the war and early postwar periods. Slowing down of the expansion in bank credit, particularly in bank loans, compared with the two previous years, may be taken as an indication of the restraining effect of credit policies. Demand deposits and currency have shown only a moderate rate of growth for the past two years. On the other hand, the liquidity imparted to the economy by prior increases in deposits and by the large holdings of marketable and redeemable Government securities has permitted a continued growth in the turnover of money. Demands for goods and services, as well as for money, have continued to press upon available resources, and retail prices and wages still show rising tendencies.

Attempts to raise cash by liquidating Government securities, represented by shifts in ownership and by cash redemptions of maturing and redeemable issues, which necessitate frequent Treasury borrowing, have put a great strain on the Government securities market. In a situation of large investment demand in excess of the supply of savings, together with restraint on bank credit expansion, the Government securities market bears the ultimate brunt of the demand pressures. For the Federal Reserve to offset the effect of these pressures by coming to the support of that market would have the effect of supplying indirectly to the money market in general the funds that it has been the intent of policy to deny.

Expansion of bank loans has unmistakably slowed down this year, compared with the high record of the two preceding years, and has been somewhat below the average for the corresponding period of other years. At the same time the offsetting decline in bank holdings of Government securities has been much less than in the two previous years. Total loans and investments of banks have probably shown a slightly smaller decline than the half-year average for previous periods, although precise seasonal measures are difficult to compute.

Demand deposits and currency have increased at an annual rate of a little over 1 per cent in each of the past two twelve-month periods. Time deposits have shown a much larger increase this year than in other recent years, reflecting some shift from demand deposits. The turnover of demand deposits has continued to increase, showing an expansion of nearly 5 per cent in the past twelve months on top of an increase of 7 per cent in the preceding year. Performance of the economy indicates that, while monetary growth has been moderate, it has been fully adequate, and perhaps more than adequate, for the economic activity that we can have on the basis of existing resources.

Business corporations continue to raise large amounts of funds through public offering of securities and private placement of long-term loans with nonbank lenders. It appears that new capital issues in June will equal a record figure of $1.4 billion, bringing the half-year total also to a new record of over $6.5 billion. These offerings are being made at higher and higher yields. In many cases, underwriters have been unable to move issues at the prices at which they were offered. As a result of pressures on capital markets interest rates and bond yields on existing issues have risen to or above the high levels reached last December and January.

In the face of the weakening market, some planned issues by States and local governments have been curtailed or deferred, and the total volume of such issues reduced somewhat. Borrowing on home mortgages has declined from the high records of previous years. The large backlog of loans from banks on warehoused mortgages has been reduced somewhat. In the aggregate, total expansion of private credit, including that of State and local governments, has probably been somewhat less than in 1956 and much less than in 1955, but the United States Government has released fewer funds through debt retirement than it did last year.

Recently prices of common stocks and stock market activity have increased again. This rise has ominous implications. Yields on stocks at current prices and dividend rates--averaging about 3.8 per cent for high-grade issues--are low relative to long-term interest rates. Prospects for higher profits and dividends, in the face of the wage-price squeeze, are not bright, even with rising prices for products. Further rises in stock prices in the face of this situation may be interpreted as an indication of an inflationary climate of opinion--of widening acceptance of the idea that inflationary trends will continue. Increases in farm land values may have a similar implication.

It is in this sort of climate that Treasury debt-management and Federal Reserve credit policies for the near future have to be determined. During the half year about to end, the Treasury has had a cash surplus of about $9 billion, which is $2.5 billion less than in the same period of last year. The Treasury has had to meet redemptions of securities, including tax anticipation issues, savings bonds, and attrition in maturing issues, aggregating more than $13 billion--$4 billion more than a year ago. Thus, the Treasury has borrowed new money in the market amounting to nearly $6 billion this year, compared with no new borrowing last year, and has shown a smaller increase in its cash balance. In the next half year, the Treasury deficit may be slightly larger than in the same period of 1956, and cash redemptions of securities are likely to continue greater and could be very much greater if there should be a wave of redemption of savings bonds. New money borrowing may well equal $10 billion or more, compared with gross borrowing of $7.5 billion in the same period last year. These amounts include offerings to replace maturing tax bills, as well as attrition in other maturing issues, redemptions of savings bonds, and the deficit. Maturing issues to be refunded, including tax bills now outstanding, exceed $25 billion for the July-December period, of which $14.4 billion are held by the Federal Reserve.

The Treasury's task is to offer securities with yields and terms that will attract funds from other uses. Clearly rates will need to be higher than those previously offered. The task of Federal Reserve policy is, while making possible bank underwriting of occasional Treasury issues, to avoid supplying the over-all economy with additional reserves in amounts that will encourage inflationary expansion. To the extent that bank holdings of Government securities increase, the seasonal growth in other types of bank credit should be smaller. Over-all monetary expansion must be kept within moderate bounds if further inflation is to be avoided.

This can probably best be accomplished by making it necessary for banks to borrow substantial amounts in the aggregate--perhaps as much as $1 billion at the Federal Reserve, unless this should prove unduly restrictive. Reserves might be supplied in sufficient amount to keep borrowings down to this level as long as credit expansion continues moderate. Should expansion accelerate on the basis of increased bank borrowing from the Federal Reserve, then a discount rate increase to as much as 3-1/2 per cent would be in order.

The record of the past three months indicates that the tighter policy followed, while restraining in its effect, has not been too restrictive. Monetary expansion has continued and it is evident that rising interest rates have reflected the pressure of strong credit demands. Under the existing conditions and attitudes, it is clear that a firm policy of restraint should be continued.

Mr. Hayes then made a statement on the business and credit situation and on credit policy, and his comments are set forth below.

The business situation has changed very little since our last meeting. While it continues basically strong, especially in the area of demand for final products, most measures of physical activity suggest either a sideways or a slight downward movement. I have in mind such items as the Federal Reserve index of industrial production, total manufacturing employment, and average hours worked per week. There has been no significant progress in the country's real output now for more than six months; and most statistical data foreshadowing future levels of business activity are less favorable than those reflecting current activity. Hence the trend of physical activity seems more likely to be downward than upward for at least the next two or three months.

I am impressed especially by the rather convincing evidence that the investment boom is cresting out. S.E.C. figures on estimated total plant and equipment expenditures, seasonally adjusted, show only a slight gain from the second to the third quarter, and this may be more than accounted for by the price element. At the same time, plant and equipment expenditures of manufacturing concerns are expected to decline. Data on new orders and unfilled orders for durable goods, industrial construction awards and machinery orders all point in the same direction.

Somewhat paradoxically these developments coincide with continued business optimism marked by some signs of speculative attitudes, particularly in the stock market, which appear to suggest considerable acceptance of the thesis that further inflation is inevitable despite our best efforts.

In the area of prices, the last three weeks have witnessed some pronounced cross-currents, with strength in meat and steel scrap prices for example, and continued weakness in non-ferrous metals. While wholesale prices have stabilized for the moment, this stability, such as it is, is clearly jeopardized by the prospective increases in steel prices and freight rates. Consumer prices have been steadily edging upwards. Thus on balance the price situation still seems to contain serious inflationary possibilities.

Credit demands remain strong both for business capital outlays and short-term business needs--as well as for housing and other consumer purchases--but present pressures are more pronounced in the capital markets than in the shorter term lending field. There has certainly been no reflection to date in the capital markets of the apparent "cresting out" of plant and equipment expenditures, but it would be natural to expect a considerable lag in any such effect. Bank loan expansion continues to run well below a year ago.

As the Chairman pointed out at the last meeting, the Treasury's financing problems over the next few months are grave enough to call for very careful attention by the Federal Reserve System. Not only is the Treasury faced with the need to borrow $10 to $11 billion cash between now and the end of the year, including perhaps $4 billion in the very near future, but they also must handle large refunding operations in August and October--and in the background is the fear that the rising level of interest rates will bring accelerated savings bond redemptions.

Coming to the question of credit policy, it seems to me that a sideways or slightly declining business trend, with some prospect of further weakening, clearly suggests that credit restraint should not be intensified. But at the same time, the continuing threat of upward price pressures and the speculative attitudes to which I have referred indicate that it would be unwise to reduce the degree of restraint we have been maintaining. I do think it worth while pointing out that in time we may be confronted with a serious dilemma if prices continue to rise while utilization of material and labor resources remains level or moves downward. With the projections pointing to net borrowed reserves of nearly $900 million in the week of July 3rd and more in the following week, with no allowance in either case for reserves required to support bank purchases of the new Treasury offering, it seems clear that sizable purchases of bills will be necessary in the near future. It would be my judgment that in view of the acute unsettlement in the bond market and the tightness in the money market, and in view of the general business situation already discussed, it would be quite unwise to increase pressures by forcing the banks to borrow a major part of the reserves needed for this Treasury underwriting. The success or failure of the August Treasury refunding will be greatly influenced by the policies we follow with respect to this cash operation. Thus it is my opinion that we should be ready to provide, through open market purchases, most of the reserves needed for the midyear period and the bank underwriting operation.

As for the amount of our purchases, there may be more than usual danger in adhering too closely to a specific target for net borrowed reserves, such as $500 million, in the period under discussion. The imminence of the very large Treasury transactions, together with seasonal influences, might call for even larger purchases than the projections suggest in order to prevent increased tightness. On the other hand, it is possible that the day to day open market purchases of bills during the period of strain may have sufficient market effect so that a somewhat higher figure for net borrowed reserves would bring no real increase in tightness. It seems to me that the Manager should be accorded considerable leeway to guide his operations by the "feel of the market." As for timing, the open market purchase program should probably commence about a week from now, when the bank reserve position is expected to tighten rapidly, and should proceed with some consistency and regularity.

In the New York Bank we have given careful consideration to the questions raised at the last meeting concerning the discount rate and to the reasons advanced at that time for the possible desirability of considering an increase. It seems to me inevitable that an increase in the discount rate would be looked upon as a signal that we believe a more severe policy of restraint than the one we have been following is now in order. There is nothing in the business and credit situation, in my view, to warrant such a signal, nor is there evidence that member banks generally are attempting to profit by the present differential. The other argument which has been advanced for consideration of a rate increase is that it might accelerate the current rate adjustment in the capital markets and thus encourage an equilibrium interest rate structure on which the Treasury could base its financing. I think it would be preferable to keep the discount rate as a drag or anchor upon the short-term end of the rate structure while natural forces of supply and demand are bringing an adjustment in longer term rates. An increase in the discount rate would tend to move short-term market rates higher, thus narrowing the gap between long and short-term rates, whereas there are real advantages in maintaining a broad gap in order to improve the Treasury's chances of accomplishing a funding operation, which it is to be hoped will include an appropriately priced medium term issue. Furthermore, there is always the chance that a higher discount rate might have the effect, on balance, of prolonging the upward adjustment of capital market rates. All this leads me to conclude that a discount rate change at this time would be definitely disruptive.

I think that the wording of the directive might appropriately be retained in its present form.

Mr. Johns' statement of his views, next presented, was substantially as follows:

At the meeting of the Federal Open Market Committee on May 28 the question arose whether the time had arrived for a change in the discount rate in an attempt to control more effectively a recalcitrant inflation as well as to facilitate the forthcoming Treasury financing.

Present indications are that business activity will continue close to current levels in coming months, with majority opinion expecting an upturn in the fourth quarter but with no strong influences for either upward or downward movement in view. Capital market demands are likely to remain heavy though possibly easing somewhat from the first half year. Assuming no lessening of Federal Reserve pressure on bank reserves, interest rates have probably not completed their adjustment to increased demands for funds. While prices are not completely stabilized, their upward movement has been slowed and wholesale prices have shown little change in the past two or three months. Barring a strong resurgence of demand from some quarter of the economy, a possibility not supported by present evidence in my opinion, upward price movements in coming months seem likely to be small. By maintaining present reserve pressures and permitting interest rates to work toward an equilibrium level, the System continues to exert strong and perhaps even increasing anti-inflationary influence. As I view this situation, it is one which calls for continuing restraint but which does not indicate clearly a need for further tightening at this time. This conclusion is not a denial of possible need for such a move later in the year.

It is likewise difficult to make a clear case for a higher discount rate as a ministration to the Treasury. In support of an upward move it is argued that, insofar as a higher discount rate would tend to raise market rates, it would discourage other borrowers and thus facilitate Treasury security placement. Moreover, with a higher discount rate the System could presumably with less reluctance inject reserves and permit borrowing for security purchases. An alternative point of view, however, would hold that the Treasury's financing problem, while serious, is one of selecting an appropriate price which would be consistent with temporary underwriting by the System.

It seems almost certain that the System must assist the Treasury in its coming financing. I think this should be done without pique and that such action can be defended, not as a bailing out of the Treasury, but as a move in the public interest. System action should, however, be conceived and executed as temporary underwriting, assisting the market to effect permanent lodgment of the new securities as expeditiously as the circumstances permit, but providing reserves only for such period as may be reasonably necessary. With continued restraint on reserves through open market operations and discounting, this underwriting service can surely be executed as readily at the present discount rate as at a higher one.

The Federal Reserve System now enjoys, as some are wont to say, "independence within government." I hold this independence valuable because I believe it serves the public interest better than any probable alternative status. But this independence will be preserved only if it is used responsibly. In the presence of a clear case for a higher discount rate, the responsible act is to raise the rate. But if no clear case can be made, as I believe it can not at present, raising the rate might appear as flaunting our independence. Such a step would lay us open to more blame than we can properly be held responsible for. In view of Congressional hearings, the forthcoming Treasury financing and the change in top Treasury management, the timing for such action could hardly be worse. Moreover, I fail to perceive any necessity for acting, regardless of relevance to real affairs, in order to preserve the right to act. Indeed, the ultimate result in that event may be opposite to that intended.

In conclusion, I see no clear case at present for a rise in discount rate on economic grounds, or on the grounds of assistance to the Treasury. In opposition are the ramifications of tightening at an inauspicious time. Hence my recommendation that no change be made in the discount rate at this time. However, since inflationary pressures have not diminished and may strengthen later in the year, I believe the present degree of pressure on reserves should be maintained.

Mr. Bryan said that the situation in the Sixth District was very clearly one of great economic strength. There had been a reversal of the situation in manufacturing employment which for four months had been going down but which had now headed upward. There had been a reversal in manufacturing payrolls also, which, after three months of decline, were now moving upward. Steel mills were operating closer to capacity than for the nation as a whole. Construction contract awards for 1957 through April were substantially ahead of last year and much more sharply up than in the nation. Sixth District automobile sales were up more than nationally and more than seasonally. Bank loans in the district had increased and the increase had come at country banks rather than at the larger city banks. Member bank borrowings were at a very high level. All in all, Mr. Bryan described the situation as one of apparent great economic strength.

On the national picture, Mr. Bryan said that he understood that Mr. Hayes and to some extent Mr. Johns, particularly Mr. Hayes, had urged that we might be cresting out. While this might be happening, Mr. Bryan felt that if we were to rely on what we see rather than what we think we may see, the national situation was one of great strength and at the same time one of great danger. Putting the problem in terms of what we now see, Mr. Bryan said that he felt we were seeing the frittering away of a very priceless heritage of the Government of the United States, namely the confidence of the American people in the integrity of the American dollar. That frittering away of a priceless heritage was going on rapidly and to an alarming degree. Mr. Bryan reported that at the meeting of the directors of the Atlanta Bank last Friday Chairman Mitchell polled the eight members of the board and the four members of the branch boards who were present on the question of how many of them believed that the American dollar would be worth substantially less in five years' time. All 13 men who spoke to this point said that they regarded it as a certainty that the American dollar would depreciate. Mr. Bryan felt that this was a measure of the extent to which confidence in the integrity of the dollar had declined.

Mr. Bryan said that he felt that there was an objective test of the degree of the decline in the confidence of the American dollar if we measured the level of stock prices as Mr. Thomas had reported on the basis of net earnings as against present interest rates. Many people, he said, were evidently moving to stocks purely and simply because they felt they could protect their dollar in so far as such protection was possible. He reported that in Atlanta purchase of buildings was being urged on investors, regardless of current yield, on the basis that funds put into buildings, because of increasing building costs, would yield a substantial capital gain in a very few years. He felt that this widespread and mounting distrust of the stability of the dollar was going to make the Treasury problem extremely difficult as time went on. If we were dealing with policy in the private economy only and if, as a central bank, we were faced with an economic situation as he had described it, and if we were not confronted with the fact that the Government was a continuous and necessitous borrower, then the case for further restriction would be, in his opinion, conclusive. Faced with the Treasury's problem, however, Mr. Bryan said that he did not know what was the part of wisdom.

Mr. Williams said the high level economy of the Third District showed few signs of further ebullience although there was no basis for concern. Department store sales in three of the four weeks ending

June 8 were somewhat below the same period last year. For the four week period they were 1 per cent below a year ago but for the year to date were 2 per cent above. Appliance sales in the Philadelphia area for the first four months of this year were sharply below last year, with sales of refrigerators and vacuum cleaners off about one-half; home freezers, ranges, and water heaters one-fourth; and air conditioners, clothes dryers, and washers only slightly below last year.

Automobile sales continued to lag behind last year with registrations in Philadelphia County during May 2 per cent below April and 22 per cent below May a year ago. Factory employment in the district in both durables and nondurables industries was down slightly in April. Most of the April decrease was in textiles, transportation equipment, and electrical machinery. Average hours worked per week were unchanged. The consumer price index for Philadelphia turned down in April, Mr. Williams said, following four successive months of small increases. The local index for April was 3 per cent above a year ago, compared with a four per cent increase nationally.

Mr. Williams reported that a decline in housing starts and a shift to the construction of higher priced homes along with tight money characterized the housing market in the Third District. Slackening sales caused many builders to cut back starts as early as last fall. Demand for new houses was slow, and prospective buyers were shopping around before making a decision. Housing starts in the price ranges below $15,000 had dropped most, reflecting extreme difficulty in obtaining VA financing and an increase in the price of land. Construction of medium- and higher-priced homes had been fairly well maintained. The home builders association of Philadelphia recently signed a three-year contract providing for a total wage increase of 30 cents an hour by 1959. Sales of old houses had slackened, Mr. Williams reported, largely because asking prices had been too high. Rental property demand was strong and many real estate agents reported a shortage of listings for both houses and apartments in desirable locations.

Mr. Williams went on to say that mortgage money was reported slightly easier since the turn of the year, mostly for FHA loans. Funds for conventional mortgages with a third down payment and an interest rate of 5-1/2 to 5-3/4 per cent were readily available. Conventional mortgages on new homes with a somewhat larger down payment and prime risks were available at a slightly lower rate. FHA mortgages were reported to be gaining in favor with lenders.

There had been little change in the earning assets of district reporting banks in the past three weeks, Mr. Williams said. Decreases in business loans in the last half of May were more than offset by an increase in the first week of June. Holdings of Government securities had fluctuated from week to week but had changed little for the three weeks as a whole. District banks lost deposits, the decline for the three weeks amounting to $24 million or nearly 1 per cent. Large Philadelphia banks stepped up their purchases of Federal funds during the past three weeks. Member bank borrowing at the Reserve Bank was also at a considerably higher level. With reference to policy, Mr. Williams said that viewing the situation on the basis of the indicators that he had cited, he did not feel that any change in either the discount rate or in the degree of pressure was indicated.

Mr. Fulton described activity in the Fourth District as showing mixed trends. Layoffs in three cities had caused them to be classed as moderate labor surplus areas. Unemployment for the district as a whole was quite low but there were indications that a shortening of the work week was occurring, and that, of course, did not get in to the unemployment figure. Foundaries particularly were having a short work week, with orders down in the automotive field and for air conditioning. The steel industry had a little pickup during the past week but this was looked upon as transitory and it was expected that operations would be down during July materially. The industry felt that this recent pickup was because of a substantial reduction in inventories of manufacturers who had been cutting up more steel than they had been ordering for some time, particularly in the automotive field. The automobile industry was now manufacturing ahead of sales and later in the year would have to cut back very materially, Mr. Fulton felt, unless inventories were to be extraordinarily high. Retail sales of automobiles had not been holding up well and were running somewhat less than a year ago.

Demand for business loans was still very active, Mr. Fulton reported, but this was not for inventory purchases or for speculation in inventories. There had been an increase in member bank borrowing. Mr. Fulton noted Mr. Hayes' report that banks were not arbitraging the discount rate against the short-term rate, but he stated that on checking with certain banks in the Fourth District they had admitted that this practice was being followed.

Mr. Fulton said that he was not certain about the advisability of an increase in the discount rate at this time. The statistics would indicate that this would be an appropriate move but there were other factors in the business picture that made him question the advisability of immediate action. He made it clear, however, that he did not feel there was any widespread weakness in the industrial picture at this time and that any letdown at present might be an adjustment for the summer doldrums. In the fall, he expected that there would be a very strong economy. For that reason he would not want any relaxation of present credit policy. This policy had been appropriate, and a fine degree of restraint now existed. He would not relax nor would he increase the restraint.

Turning to Treasury financing, Mr. Fulton said he hoped that the Treasury could be forthright enough to get its new money through an issue of long-term bonds and pay the price necessary. Whether this would be politically feasible was a matter of judgment, but if the Treasury were to do that he felt that the System could give assurance that the discount rate would be held where it is at present. He felt that an extension of the term of the debt would relieve pressures on the Treasury in the money market.

Mr. Shepardson said that Mr. Bryan had expressed views on the point that was giving him greatest concern. Granting that some uncertainty was indicated by the information available on various activities and that there were some weak spots in the economy, Mr. Shepardson felt that the country had a very serious problem in the apparently growing acceptance of the idea that further inflation was inevitable. This was a matter of primary concern to the Committee. For this reason, it had seemed to him that the Committee should be endeavoring to exercise further restraint. The present time and the next three months presented a period of normal lessening of activity at this season. If, however, the Federal Reserve were to take this as an indication of a trend and if it in any way were to relax on pressure, it might put itself in a difficult position for what was widely expected in the fall. Mr. Shepardson felt that the Committee should continue to keep itself in a strong position for dealing with that later problem. He said that he had come into this meeting feeling, as he had indicated at the previous meeting, that this might be the time for closing the gap between the discount rate and the short-term rate. He was well aware of the argument Mr. Hayes had presented, and he was concerned about the possibility that Mr. Fulton had mentioned of banks taking advantage of the gap between the discount rate and the short-term rate. It seemed to Mr. Shepardson that if the System did not move on the discount rate at this time there would be an increasing burden on the Federal Reserve Banks to police the discount windows carefully and in a way to minimize what had been described as "complacent borrowing." He was not certain what the System should do on the discount rate at this time, but if it did not move the rate upward he felt that the Reserve Banks must face the problem of policing borrowing. Generally speaking, he said that he would favor maintaining present restraint fully and not letting the pressure drop below the existing degree.

Mr. Robertson said that it seemed to him that there was considerable unanimity in the views that had been expressed this morning. If there was a difference, he would align himself with the views expressed by Messrs. Bryan, Fulton, and Shepardson. It seemed to him that the economy was extremely strong, and the inflationary potential was the thing that needed to be watched. The Committee should avoid, as he felt the desk had marvelously avoided, getting into the area of nervousness in the market. We should not be panicked and we should maintain the existing tightness. He would dislike very much to see any reduction in the degree of tightness during the next week. He differed from Mr. Bryan to the extent that he was firm in his view that the Committee should maintain fully the degree of tightness that had existed recently. His only qualification of this statement was that conditions must be tempered in the light of the Treasury's needs, but this should be done to the minimum extent and the Committee should avoid coming to the Treasury's assistance any more than was essential.

At the moment, Mr. Robertson said that his feeling on the discount rate differed from that expressed at the preceding meeting. He felt that the System should not increase the discount rate at this time but it should be in position to police the discount window vigorously in the event the tendency indicated by Mr. Fulton became greater. In summary, Mr. Robertson said he would maintain as fully as possible the degree of tightness that had existed in the recent past, and he felt the account should avoid letting the reserve position be eased during the next week.

Mr. Mills said that every statement that had been made this morning had brought out very clearly that the Federal Reserve System's monetary and credit policies could not be disassociated from the Treasury's debt management problems, and particularly at this time. The statements also had brought out that it was incumbent on the Federal Reserve to develop means that would harmonize monetary and credit policy with the Treasury's debt management operations. The Treasury problems were emphasized very clearly in the staff memorandum on the outlook for Treasury cash requirements and bank reserves dated June 17, 1957. This memorandum showed that commencing in July, on estimate, the Treasury would come to the market in each month of 1957 and on into January and February 1958. The same report, on estimate, also reached the conclusion that on the Treasury's August refunding attrition on its publicly held obligations might reach 20 per cent. Such attrition, Mr. Mills said, in effect returns to the market for investment in higher yielding public and private long-term obligations funds that had previously been invested in long-term Treasury obligations. This is undesirable, for under present conditions it throws the Treasury back on the short-term market to make good the attrition and in doing so is placing an almost intolerable burden on that market. Mr. Mills said that the discussion this morning had disclosed contrary views regarding System policy which he felt should be discussed. His own views to a degree followed those voiced by Mr. Fulton and in a sense were expressive not of what ought to be done but of what might be done. In explanation, Mr. Mills then read a paper as follows:

> The principal national financial issue that presently involves Federal Reserve System policy is a growing conflict between public and private demands on the supply of investment funds. The public interest requires that the issue be resolved on the side of the public need for investment funds. To do so necessitates that supremacy be given the Federal Treasury's needs for funds, and in the process of doing so a quieting influence can be thrown over inflationary forces in the economy.
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> To achieve this purpose means that, first and foremost, the inviolate credit standing of the Treasury's obligations should be maintained and exalted as being the keystone in the arch of all public and private obligations. The approach to this objective obviously requires the Treasury to fulfill the obligations imposed upon it by the will of Congress. To do so, therefore, recognizes that the Treasury has and must assert a first claim on the supply of available investment funds. Inasmuch as frequently recurring demands on the money market by the Treasury are disconcerting and have been conducive to an undesirable piling-up of short-term Treasury obligations, it is necessary for the Treasury to go to the market with a moderately sized issue of long-term Treasury bonds. In doing so, the claims of public and private bodies for the supply of available investment funds will have to give way to the first claim of the Treasury on the market.

The assertion of the Treasury's claim on the supply of long-term investment funds can be expected to strike some degree of consternation among all other claimants on the supply of investment funds, but once whatever market unsettlement that first occurred has passed, normal rationalization of the propriety of the Treasury's policy and analysis of the breadth of the remaining supply of investment funds will cause some claimants for such funds to defer their claims, in the process of which the pressure of the expenditure of private funds throughout the economy will be alleviated. Inasmuch as Treasury expenditures cover programs already largely in effect, they are not believed to have the same economic impact as the expenditure of other types of public funds and of private funds destined to create entirely new projects.

The policies of the Federal Reserve System are, of course, closely allied and should be integrated with the type of Treasury financing program recited above. A first step toward that end would be an increase in the discount rate at the Federal Reserve Banks to 3-1/4 per cent in recognition of a trend in interest rates that has already been established. An increase in the discount rate could be expected to clear the atmosphere of the markets and to assist in bringing about a general stabilization in the interest rate structure. It is to be regretted that an increase in the discount rate at the Federal Reserve Banks was not made at least two weeks ago, inasmuch as such action now taken will have been robbed of some of its surprise effects and also will have occurred at a time of extreme price softness in the list of U. S. Government securities and will be embroiled in the atmosphere attendant upon the hearings now commencing under the guidance of the Senate Finance Committee. These difficulties, however, should not be allowed to stand in the way of discount rate action.

Inasmuch as an increase in the discount rate at the present time can be expected to be interpreted not only as an action toward interest rate alignment but also as an indication of a severely restrictive Federal Reserve System monetary and credit policy, it is essential that the System concurrently indicate that although credit restraint will be continued, there is no intention to make it so severe as to restrict unduly the credit-granting activities of the commercial banking system. To that end, System action during the transition period, during which the markets will adjust to a change in the discount rate, should be to moderate rather than to increase pressure on bank reserves. It would, therefore, be desirable to allow net borrowed reserves to remain in the lower range of $500 million over the coming reserve week and for the System open market account to show no change in its holdings of directly owned Treasury bills.

> This type of action would give some indication to the financial community that the Federal Reserve System was not setting out on a still more restrictive credit policy and that reserves would be forthcoming in reasonable volume to meet the seasonal needs of the commercial banks for extending bank credit. It is particularly important that some indication of such System intentions be given promptly now that the pressure on reserves is reaching increasingly into the activities of reserve city banks and country banks who have not been accustomed to operating under reserve discipline of this character and who, unless forearmed with the knowledge that they will be supplied with reserves in reasonable volume for seasonal purposes, might take alarm and especially because of the fact that they are locked by depreciation into their holdings of longer term U. S. Government securities and are consequently fully aware of their impaired liquidity.
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> In a nutshell, the kind of fiscal and monetary policy that has been outlined envisages that the proper aims of the Treasury to lengthen the maturities of its obligations and to maintain the inviolate quality of such obligations will be made to serve the ends of Federal Reserve System monetary and credit policy in a way that will relieve the System of any need of pressing its policy of credit restraint to a point that would undesirably limit an equitable distribution of the available supply of credit. The kind of Federal Reserve System policy outlined has in mind that specific objectives will be set and sought after and that the System will consequently avoid any form of makeshift policy that is guided only by vague generalizations.

Mr. Vardaman said that Messrs. Hayes and Johns had expressed substantially the views he held regarding the situation. He agreed with Mr. Johns that the System must let it be known without any question that reserves to meet the normal seasonal requirements would be available. As to the discount rate, Mr. Vardaman said that he could not approve an increase at this time in view of the information available to him and his interpretations of that information and his impressions of what was going on throughout the country. He could not now see a justification for an increase in the discount rate in the foreseeable future. However, there should be disciplining at the discount windows of the Federal Reserve Banks. Mr. Vardaman went on to say that he would not attempt to discuss Mr. Mills' deeply thought out paper without studying it carefully, but in principle he was inclined to think that he would disagree with the conclusions suggested in the paper. He did not quite agree with the report that Mr. Bryan had given as to economic conditions in the Atlanta District. It seemed to him that the public was in a very doubtful frame of mind. He did not think there was any question, however, but that there was a flight from the dollar. He could not see how at this time an increase in the discount rate would do anything other than to add to a potentially panicky feeling. In sum, Mr. Vardaman said that he would continue the existing policy.

Mr. Leach said that the Fifth District provided no signs to justify an expectation of an immediate change in over-all activity. There was some evidence of improvement in the textile industry, but reports continued that the furniture industry was somewhat over-inventoried at all levels. A survey of district automobile dealers indicated that, contrary to the national picture, less than one-third had better sales in May than in April.

As to open market policy, Mr. Leach said that he thought we had recently been as tight as we could have been without running too much risk. This had had his approval because he had been increasingly concerned about creeping inflation. He believed that we should continue to follow a policy of maintaining as much restraint as we reasonably could, and for the immediate future he was thinking in terms of a level of net borrowed reserves of around $500 million. At this time, however, the feel of the market was more important than at other times, he said. The Committee should not let the Treasury financing cause an increase in borrowing. If predictions worked out, we would be called upon to put in reserves, but at the same time Mr. Leach felt that the System should be as tight as it could in these circumstances.

In spite of the strong demand for credit, which had led to an increase in market rates, Mr. Leach said that he thought it would be inappropriate to increase the discount rate at this time. He had seen no evidence in recent loan figures or in conversations with Fifth District bankers that the use of bank credit to satisfy long-term capital needs was increasing. Moreover, he would be fearful of possible adverse effects on the unsettled securities market of an increase in the discount rate, particularly in view of the forthcoming Treasury financing.

Mr. Leach added that, as far as the Fifth District was concerned, the existence of an undesired spread between the bill rate and the discount rate had not resulted in an increase in member bank borrowing. In the week just before the longest bill rate last rose above the discount rate (the week ended May 22), borrowings at the

Richmond Bank averaged $44 million. In the most recent week (June 12), they averaged $38 million. The evidence of these figures was corroborated by his knowledge of the individual banks accounting for the bulk of the borrowing. There was no evidence that there was any tendency for the banks in the Fifth District to take advantage of the spread between the discount rate and the short-term rate.

Mr. Leedy said that there had been continued improvement in the moisture situation in the Tenth District since the preceding meeting. It was now clear that the prolonged drought had been pretty well wiped out except in a few limited areas. Moisture had caused some delay in planting of crops and had caused some replanting and in early harvests had had adverse effects, but the net had certainly been on the plus side. This was of great significance because of the importance of agriculture in the Tenth District.

As to open market policy, Mr. Leedy said that in the next three weeks he felt the Committee should be particularly concerned about the Treasury's problem, that is its financing for $3 billion of new money which was to be done against the background of the lowest level in the Government securities market since the early 1930s. He had understood Mr. Mills to say that he believed the Committee should operate in the market in the light of the Treasury's requirements as the overriding factor at this time. Mr. Leedy said that he would not subscribe to this view. It seemed to him that the

Committee's obligation was primarily to the economy and secondarily to the Treasury. To the extent that it could do so, it should adjust the needs of both, and in this period ahead it might have to temper its primary, overriding responsibility to the Treasury's situation. He would subscribe to what Mr. Hayes had said as to market operations, attempting to keep the same degree of tightness toward which operations had been directed in recent weeks, but without either easing or tightening the situation. This would require considerable latitude for the Management of the System Account in the light of the needs of the Treasury in this financing period.

Mr. Leedy said that he would not in this period adjust the discount rate. Mr. Mills' suggestion that such a course might have a settling effect on the Government securities market would, in Mr. Leedy's opinion, run too great a risk. His inclination would be that such action might be taken as the signal of an intent to increase the pressures on reserves. He would not now suggest what might be done later with respect to an increase in the discount rate. He had the feeling, however, that whether the System liked it or not, it might be approaching a time when some increase might be necessary.

Mr. Mills said that he wished to correct any impression that his remarks may have left that he believed that the Federal Reserve System should underwrite the success of a Treasury offering by intervening in the market. In his opinion, the System had established and followed appropriate operating policies during periods of Treasury financings. At such times, however, he also felt that the Treasury was entitled to finance under a proper market climate and that supplying the minimum background reserve assistance necessary to creating such a climate should be a purpose of System policy. As the creation of a market climate does not involve direct market intervention by the System, Mr. Mills felt that it would be considered only remotely as a form of underwriting and then only in the sense that decision making by market operators as to the extent and in what manner they participated in the Treasury offerings had been made easier.

Mr. Leedy said that he had not had the impression earlier that Mr. Mills held the view he had first thought he had stated, and he was glad to have this clarification.

Mr. Allen said that optimism among Seventh District businessmen had not diminished in the past three weeks. If anything, it was more widespread. Most statistical measures continued to indicate a high level of activity. Worthy of notice was the fact that on June 3 voters in Chicago and in Cook County approved plans for all twenty-three bond proposals on the ballot totaling $208 million. This was in addition to authority which the City of Chicago already had for borrowing $250 million for various projects, such as airports, water works, and parking facilities. Plans for offerings of bonds were not yet definite but tentatively it was planned to sell around $130 million in the current calendar year, and $85 million in 1958 or 1959, with most of the proceeds earmarked for construction.

Automobile production apparently would hold up better in July and August than had been expected, Mr. Allen said. Since March, assemblies had been fewer each month than in the preceding month. In June they would be about 500,000 compared with 531,000 in May and 640,000 last January at the high point. Industry sources indicated privately that assemblies in July and August would be at the June rate of 500,000 per month and that September would drop to 300,000. That would give 1,300,000 for the third quarter, compared with a million assembled in the third quarter of 1956, and it would mean assemblies for the nine months of 1957 of 4,700,000 compared with 4,200,000 in the first nine months of 1956. New models would be introduced in October and November or earlier, if possible, which explained the low output anticipated for September. The industry did not intend to pare inventories as sharply as last year, Mr. Allen said, and it contemplated that an inventory of 600,000 to 650,000 of 1957 and 1958 models would be on hand October 1 of this year, compared with 400,000 a year earlier. Dealer inventories on June 1 were close to the figure of a year ago (796,000 this year against 820,000 on June 1, 1956). Mr. Allen said that his friends in the industry felt that 1957 calendar year production would be swelled by an inventory rise of 200,000 cars, depending on acceptance of General Motors' 1958 models.

In 1956, about 200,000 cars were sold out of inventory. Thus, if 1957 sales only equal 1956, production could run 6,200,000 cars compared with 5,800,000 last year.

Business loans at Seventh District banks rose $48 million in the first five months of 1957, Mr. Allen reported, compared with a decline for the nation of roughly $200 million. The difference was largely due to two kinds of borrowers: first, commodity dealers whose seasonal repayments resulted in an important minus in the five-month national total are less important in the Seventh District, and second, metals firms which had been a strong borrower group so far this year are important in the Seventh District total. Nevertheless, borrowing by member banks at the Chicago Bank discount window had in recent weeks, for a change, represented less rather than more of the district's normal percentage of total discounts. This appeared to result from somewhat less borrowing by Seventh District banks and more borrowing by banks in other districts.

Mr. Allen then referred to the discount rate, stating that he had come to the same conclusion that had been indicated by most of the others this morning but perhaps on a different basis. All of us have sympathy with the Treasury's problem, he said, but if he felt that the System's responsibility in combating inflation through monetary policy indicated an increase in the discount rate, he would be for it. However, he did not believe such action was required at this time in order to carry out the System's responsibility. He reported that one of the largest Chicago banks had informed him a few days ago that there had been discussions emanating from New York of an increase in the prime rate but that that particular Chicago bank indicated that it would have nothing to do with such a move at this time. Mr. Allen's personal feeling was that if the prime rate were increased, the System would have no option but to increase the discount rate. However, at this time he felt there was no need to take that action.

Mr. Mangels reported a recent meeting of the branch managers of one of the large San Francisco branch banks at which the consensus was that the general situation was quite spotty, with business falling off in the country areas outside San Francisco in northern California, and with merchants complaining about the decline in trade. On the other hand, the usual sources of information indicated little change in the general economic picture on the West Coast in the past three weeks. There had been little change in employment or in trade, and farm prices in May were about the same as in April. Automobile sales were down 16 per cent in April from March, but during the first four months of 1957 they were 2 per cent above 1956. Lumber production showed a slight upward movement in May. Steel mills were operating at about capacity.

Twelfth District banks were losing deposits, Mr. Mangels said, although loans during the past three weeks ending June 5 were up about $5 million, compared with the $300 million decline for all reporting banks in the country. One of the member banks reported an unusual loan demand from national concerns. There were also reports of corporations selling bills to meet dividend requirements, and he added that the California State Treasurer had sold a large volume of bills in order to obtain road building funds and that city treasurers were also selling bills to obtain cash. Contrary to other reports that he had been giving for some time past, Twelfth District banks in recent days had been net buyers of Federal funds rather than sellers. Member bank borrowing at the Federal Reserve Bank had been at quite high levels and last week reached a four-year peak since early in 1953, except for a brief period late in 1955. There had been no indication that banks were taking advantage of the differential between the discount rate and the bill rate. Borrowing had been distributed between city banks and country banks although city banks predominated.

Mr. Mangels reported disturbing comments from banks that they were letting their Government securities run off and that they would not be interested in subscribing to a new offering. He also reported an unfortunate development in which the Superintendent of Banks of the State of California had recently suggested to banks under his supervision that they might consider setting up a depreciation account on Government securities, and while this had now been straightened out, it had caused concern to the banks to which such letters had been written and to other State banks.

On the over-all, Mr. Mangels said that there appeared to have been some easing of the pressures recently and that the economy was showing more stability than in the past, with over-all demand and supply in somewhat better balance. He thought that pressure on prices would be less this year than last. Mr. Mangels said that he agreed with Messrs. Hayes and Leedy as to the discount rate. Any change now in the rate might be indicative of a more restrictive policy in the future than the Committee might wish to indicate. It was Mr. Mangel's view that the Committee should maintain restraint but with flexibility for the Manager of the System Account to avoid an increase in the degree of restraint at this time. If anything, he would modify restraint slightly taking into consideration the needs of the credit situation.

Mr. Irons said that over-all conditions in the Dallas District had not changed much in the past three weeks. The economy was still in a sidewise movement of genuine strength. There had been recent improvement in retail and department store sales, which had lagged in May. Nonagricultural employment was up each month to new records. The outlook for agriculture was much better than in past years. Automobile and durable goods sales were down somewhat in the last month, although so far as automobile sales were concerned for the year to date they were 9 per cent ahead of a year ago despite the slight decline the past month. Petroleum allowables and production had been reduced reflecting a supply-demand relationship, but total output was still very large.

Mr. Irons reported that bank loans during the past three weeks declined more than a year ago, the decline occurring in all categories except for a small increase in real estate loans. Bank deposits and investments were up. Pressure on bank reserve positions had not increased, and Mr. Irons said that it was not intense. There was not a great deal of borrowing and discounts at the Dallas Reserve Bank had not increased. He felt sure that there were no cases of banks borrowing from the Dallas Bank to arbitrage the rate differential. Borrowing was mostly by the smaller banks and in small amounts. On the whole, the Dallas District reflected a high-level, fairly stable economy as far as figures went.

When we moved out of the figures and into impressions, Mr. Irons said that the feeling of confidence seemed strong. Businessmen seemed quite sure that the last quarter of the year would be a good one. As Mr. Bryan had indicated, Mr. Irons said that he found a strong tendency in the Dallas District to accept and to be reconciled to more inflation. The feeling was that if the rise in prices were kept to an increase of two or three per cent a year, that would be pretty good, but businessmen were anticipating a continuing inflationary movement. When businessmen got into that frame of mind, it was a factor of danger, Mr. Irons said. He personally was perplexed. He had the feeling that the System had not been tight enough in its policy, and if he had only to consider the economic situation, Mr. Irons said that he would still take that position. However, he was becoming increasingly disturbed by the present situation in the Government securities market.

Mr. Irons went on to say that perhaps there was a remote chance that what was regarded as a secondary responsibility of the System might, through force of events, become a primary responsibility. For that reason, considering what was ahead for the Treasury and in view of the present situation in the Government securities market, he would be reluctant to intensify restraint at this time. The System should modify its position somewhat on the basis of day to day developments in the Government securities market. It had a real responsibility with respect to the Treasury's situation, he said, and we were at the point where that would be a factor limiting the extent to which the System could push the policy of restrictiveness. It was one thing to say that the Treasury should go to the market and price its securities at what was necessary to get the money, Mr. Irons said, but that would have a whole series of effects and he doubted whether the System could be so orthodox in a realistic view of the market. He stated that whereas earlier in the year he had favored causing banks to borrow to obtain reserves to facilitate Treasury financing, in the current situation he believed the System should provide reserves through open market operations to be sure that banks were in a position to do what was necessary.

Summing up the situation, Mr. Irons said he would not favor changing the discount rate at this time, although technically and theoretically it ought to be raised. Perhaps later on the System would be justified in increasing the rate. At present, he would try to maintain as much restraint on bank reserve positions as was practicable but consistent with an alertness and an awareness to the situation in the Government securities market. It might be wise to go a step further than the System would go strictly on the basis of monetary policy in order to avoid letting the market become disorderly, rather than waiting for it to develop into disorder and then having to correct the situation at a greater cost than if disorder were prevented. Mr. Irons felt that the Manager of the System Account must be very alert to the behavior of the market, to the attitude of the market, and to the feel of the market. Since additional reserves would be required, it might be appropriate to put funds into the market if the Management of the Account felt that conditions warranted such action on the basis of the attitude in the market.

Mr. Erickson said that conditions in New England did not differ materially from those nationally or from those reported for other districts. Nonagricultural employment in April was up, and average hourly earnings were still tending up. Automobile sales continued well below last year. Shoe production was up from last year, when it had been excellent. Department store sales were not good during the first week of June.

Mr. Erickson recalled that last year country banks used the discount window at the Boston Bank actively in May and June. This had been repeated this year, with very active discounting by country banks.

In each recent period several banks had borrowed for the first time in a considerable period. So far as he could see, Mr. Erickson found no evidence of any bank taking advantage of the differential between the discount rate and the bill rate.

As to policy for the next three weeks, Mr. Erickson aligned himself with Mr. Hayes. He would not increase restraint and he would not recommend an increase in the discount rate, nor would he suggest a change in the Committee's directive. He agreed with Mr. Hayes that we were entering in the next three weeks a very difficult period. It would be necessary to rely more than recently on the feel of the market. If it became necessary to supply reserves during these weeks, Mr. Erickson said he hoped they would be supplied through direct purchases rather than through repurchase agreements or through the discount window.

Mr. Szymczak indicated that he concurred in general with the comments of Messrs. Johns, Hayes, and Vardaman. The practical situation was indicated by the projections of negative free reserves for July and August, he suggested, which indicated that there would be a continuous, fairly high level of borrowed reserves during that period. At the same time, the Treasury's needs would be affecting the situation. Mr. Szymczak felt that the success of the Treasury's refunding of August maturities would be indicated to a considerable extent by the degree of success in its offering of $3 billion of securities for new cash in the next few days. The figures showed that the economy was strong, Mr. Szymczak said, and that it would continue to be strong even though there were some weaknesses. Perhaps on the whole this indicated stability. Mr. Szymczak felt that the Committee would find it necessary to provide some reserves during the next few weeks by purchasing bills direct. This would depend on the situation that developed in connection with the Treasury's financing. The problem was not merely one of attrition, he noted, but it was the question of the effect of the offering on the whole Government securities market. Summing up, he said that he would not change the wording of the Committee's directive at this time and he would not change the discount rate at present. He agreed that Mr. Mills had a point in the statement he had made, but he doubted whether it would be possible to take that action at this time, his feeling being that if the rate were increased the result might well be a negative reaction. Mr. Szymczak emphasized that he would take no action that would make monetary policy more restrictive at this time.

Chairman Martin said that he sat down last night and "talked to the mirror." He came to the conclusion that monetary policy was working at the moment. The most dramatic evidence of this was that the markets were actually demonstrating that effective adjustments were taking place. The differential between stocks and bonds was changing every day. Aside from the broad questions of psychology, the Chairman said that he believed in the price mechanism enough to believe that this process was achieving something on a day-to-day basis and that it would ultimately prove effective for the economy as a whole. A few weeks ago we were not having these adjustments in the market. The Committee had been following a restrictive policy but the market was not actually reflecting that policy in the adjustments which are now taking place and which were then being postponed or vitiated. That atmosphere had now been dissipated, the Chairman said, and while he did not know what the adjustment should be, so far we had had what he considered to be an orderly market. He could see no real panic in it.

The Chairman felt it unfortunate that some of the so-called panic in the present market had been created by politicians, some of whom were trying to drum up an issue for the 1958 campaign on "tight money." The whole world today was more or less agreeing with the inevitableness of inflation, the Chairman said, and this was a factor that he had not known how to deal with.

Chairman Martin went on to say that he had great sympathy with the views that Mr. Mills had expressed but that he had come to the conclusion that we could not simultaneously increase the flow of reserves and raise the discount rate effectively under present conditions. He noted that the Treasury was making an announcement at the end of this week, offering securities which would be open for bids next week and for which payment would be made when we are going into a seasonal demand for reserves. Chairman Martin said that he felt the Committee should give the Manager of the Account as much latitude in the execution of policy as consistently could be given, adding the comment that we were in a period of prosperity as well as of inflation.

The consensus seemed to be fairly clear, Chairman Martin said, that there should be no change in the directive for the next three weeks and that we should not deviate from the present general policy but that we should give the Manager of the System Account whatever latitude was needed to try to adjust around the feel of the market, recognizing that in a period such as this net borrowed reserve figures were very difficult to determine. He inquired whether there was disagreement with this statement of the consensus, and there being no indication of disagreement, he called upon Mr. Rouse for comment.

Mr. Rouse stated that he felt the Chairman had covered the views correctly.

Chairman Martin then said that this would stand as the consensus of the meeting, and on that basis the existing directive would be approved without change.

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

while recognizing uncertainties in the business outlook, the financial markets, and the international situation, 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 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 referred to a telegram addressed to him under date of May 31, 1957, by Congressman Wright Patman, reading as follows:

"I am taking this particular opportunity, presented by the resignation of Secretary of the Treasury Humphrey and the nomination of Mr. Robert Anderson to be his successor, to ask you and the entire Open Market Committee of the Federal Reserve System to carefully study the critical financing situation that confronts the incoming Secretary. I am asking you as Chairman of the Open Market Committee and Chairman of the Board of Governors of the Federal Reserve to carefully weigh the consequences--both for the Treasury and the Federal Reserve of the continued refusal of the Open Market Committee to facilitate Treasury borrowings. The Treasury is faced with a "formidable refinancing task in the immediate period ahead. It is confronted by one of the tightest money markets in recent times. A repetition of the attrition experienced by the Treasury on its last refinancing will surely have critical repercussions throughout the entire bond market.

"The Federal Reserve stands at an historical crossroads. Its actions will be closely watched by the people of the country and above all by the Congress of the United States, whose agent it is. The time has come for the Open Market Committee to make a decision. Will the Federal Reserve be restored to its intended function of providing the economy with the money and credit necessary to carry on commerce and trade, and of aiding the Treasury in its borrowings at such times as may be necessary, or shall the System insist on standing aloof, ignoring its responsibilities to the people and the Government, and let the money market become the master instead of the servant?

"I fervently hope that you will use your great influence, Mr. Chairman, with the members of the powerful Open Market Committee and bring home to them the gravity of the situation with which the Treasury is now confronted, and the opportunity for the System to make a wonderful contribution to the country. I urge you, Mr. Chairman, to recommend that the Open Market Committee commence purchases of Government bonds until they are restored to par. If it is deemed necessary to offset inflationary credit expansion, there are several alternatives, including raising reserve requirements and other methods of immobilizing bank reserves.

"Russia repudiates her bond 100%. The Federal Reserve Board representing a majority on the Open Market Committee is permitting and causing our people who are holding marketable United States Government bonds to be required to accept 12% discount on their bonds if sold today, which is 12% repudiation.

"This is certainly a national disgrace, and I hope the Board takes firm, positive action at once to remove this blight on our economy and the reflection on our great system of government."

The Chairman stated that this telegram had been placed on the agenda in order to make certain that it would not be overlooked, although copies had been furnished to all members of the Committee and to all other Reserve Bank Presidents immediately upon receipt. His suggestion was that no action need be taken at this time. In response to a question from Mr. Mangels, he stated that the telegram had been acknowledged by Mr. Balderston as Vice Chairman of the Board while he (Chairman Martin) was in Europe.

Mr. Hayes stated that he had wondered whether the Chairman himself might wish to respond further, and Chairman Martin stated that in his judgment no further action was needed at this time.

Chairman Martin then referred to the Guides for Emergency Operations for the Federal Open Market Committee, copies of which had been distributed to all members of the Committee and to all Reserve Bank Presidents under date of May 27, 1957. The guides had been prepared pursuant to the program contemplated in the report of the Subcommittee on Defense Planning, approved at the meeting of the Open Market Committee on January 10, 1956. As one of the steps necessary to implement that program, the Committee at its meeting on January 24, 1956, requested members of the staff to prepare guides for open market operations with the understanding that they would be brought before the Committee for whatever discussion or action the Committee desired. Chairman Martin stated that he felt that a splendid job had been done in preparing these guides and unless there were additional comments he felt that they should be accepted. There was no disagreement with Chairman Martin's suggestion, and it was understood that copies would be furnished to all relocation or records centers, in addition to the copies that had been sent to the Federal Reserve Banks.

Chairman Martin inquired of Mr. Robertson whether he had any comments to make on the program for Operation Alert 1957, and Mr. Robertson stated that he felt no comment was necessary at this time since the matter would be discussed at the joint meeting of the Presidents and the Board this afternoon.

Mr. Vardaman withdrew from the meeting at this point.

Chairman Martin stated that yesterday he had lunch with Mr. Anderson, Secretary of the Treasury-designate, and that he anticipated that the System would be very fortunate in its relations with the new Secretary.

It was agreed that the next meeting of the Committee would be held at 10:00 a.m. on Tuesday, July 9, 1957.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary