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, December 3, 1957, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Bryan
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak (first part of meeting)
Mr. Vardaman
Mr. Williams

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

Messrs. Johns and Deming, Presidents of the Federal Reserve Banks of St. Louis and Minneapolis, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Atkinson, Bopp, Marget, Mitchell, Roelse, Tow, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, 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

Messrs. Daane and Wheeler, Vice Presidents of the Federal Reserve Banks of Richmond and San Francisco, respectively; Mr. Balles, Assistant Vice President, Federal Reserve Bank of Cleveland; Messrs. Parsons and

Coldwell, Directors of Research at the Federal Reserve Banks of Minneapolis and Dallas, respectively; and Mr. Meigs, Economist, Federal Reserve Bank of St. Louis.

Chairman Martin presented for the approval of the Committee the revised draft of the minutes of the meeting held on November 12, 1957. Copies of the minutes had been circulated before this meeting, together with a memorandum showing changes that had been made in the preliminary draft of those minutes.

Mr. Robertson referred to the wording of the directive appearing on page 46 of the mimeographed copy of the draft of minutes, and specifically to clause (b) in the first paragraph calling for open market operations with a view, among other things, "to fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves." He did not recall voting to approve that part of the clause following the comma which called for "moderating the pressures on bank reserves."

Mr. Riefler stated that the wording of clause (b) as recorded in the minutes was the wording arrived at in the discussion at the meeting on November 12 and that the wording had been read a number of times during the discussion. There had been no indication of dissent from that wording when the Chairman had called for comments regarding the change.

Mr. Robertson stated that he had not understood that the directive adopted at the November 12 meeting was to have inserted in (1)(b) the clause "by moderating the pressures on bank reserves." If he had so understood, he would have voted against it. Consequently, he wished to have the minutes of that meeting show his adverse vote and the reason therefor.

There was a discussion of the procedure followed in arriving at the change in wording of the directive at the November 12 meeting, in the course of which Chairman Martin said that, while this was an "after the fact" discussion, the minutes of the November 12 meeting had not been approved and he could see no objection to having anybody who wished to do so clarify the statement of his views both for the minutes and for the record of policy actions that would be published in the Board's Annual Report for the year 1957.

Mr. Shepardson said that he would like to have included in the minutes of the November 12 meeting a comment that he had made and which the Secretary had informed him was included in notes of the meeting but which had not been set out in the minutes. This was a detail that he had not noted when the preliminary draft of the November 12 minutes was sent to him because he did not read the minutes in full at that time.

Chairman Martin stated that he saw no objection to including such a comment in the minutes. He suggested that, under the circumstances, approval of the November 12 minutes be held over until the next meeting of the Committee and that another revision be distributed so that the members of the Committee would have the exact wording of the changes before acting to improve the minutes. Chairman Martin went on to say that it was incumbent on all members of the Committee to read the drafts of minutes as they came around and to get their suggestions in before the meeting at which the minutes were to be presented for approval, or, if that was not possible, to ask that they be held up until they had had an opportunity to suggest revisions. Otherwise, the Chairman felt there was danger that the Committee would not have an accurate record of its meetings.

It was understood that the procedure suggested by Chairman Martin would be followed.

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 November 9 through November 26, 1957, and a supplementary report covering commitments executed November 27 through December 2, 1957. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Commenting on operations since the November 12 meeting, Mr. Rouse pointed out that the directive and instructions adopted by the Committee at that meeting contemplated a different set of circumstances than those that actually developed following the change in discount rates. Acting within the new circumstances emerging from the discount rate action, the Account Management carried out the instructions of the Committee, although at times there had been differences between the actual reserve statistics and those discu[illegible] t the last meeting. Mr. Rouse reported that he had not been too much concerned about the higher-than-anticipated net borrowed reserve figures this past week since to have attempted to reduce them in the prevailing bullish atmosphere would have made the System look silly in the market. The change in the discount rate had a definite easing effect on market psychology. Also, active rumors that reserve requirements would be changed had been an easing influence during the past week, as had been the relatively easy reserve position of the New York banks. In supplying reserves to the market, Mr. Rouse reported that as much as possible had been done through repurchase agreements in order to make it easier to withdraw these reserves if that should be advisable later.

Mr. Rouse went on to say that the projections suggest the need for a rather sizable release of reserves through open market operations during the next few weeks. To the extent possible, these funds also would be supplied through repurchase agreements, so that the withdrawal of reserves after the end of the year would be simplified.

With respect to the Treasury financing, Mr. Rouse reported that the refunding was definitely successful, but the attrition, while relatively small, was still surprisingly large. There must have been a good many small blocks of the December 1 certificates on which the profit to be made by selling "rights" at a 6/32nd premium was not sufficient to justify the effort of selling them.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period November 9 through December 2, 1957, were approved, ratified, and confirmed.

Prior to this meeting there had been distributed copies of (a) a letter from Congressman Abraham J. Multer, dated November 22, 1957, addressed to Chairman Martin, requesting copies of the daily reports of dealers' operations in U. S. Government securities for each of the 17 bank and nonbank dealers who trade in Government securities with the System Open Market Account covering the days November 11-15, 1957, and (b) a letter from Congressman Wright Patman, dated November 26, 1957, referring to the photostatic copies of records of transactions of the System Open Market Account transmitted with Chairman Martin's letter of November 12, 1957, and requesting additional information and explanations concerning not only transactions for the System Open Market Account but also concerning bids submitted by Government securities dealers in the Monday Treasury bill auctions.

Chairman Martin said that he would like to have an expression of views concerning the handling of these letters. He felt that the Federal Reserve should be reasonable in supplying information, but he thought some of the requests being made by Mr. Patman and others might go beyond what the System reasonably could be expected to supply.

Mr. Hayes said that he and members of the staff at the New York Bank had studied the requests of Messrs. Multer and Patman carefully.

With respect to Mr. Multer's request, Mr. Hayes said that he felt it could be turned down quickly and positively because it was a request to reveal information which the System account received on a strictly confidential basis. There seemed to be no question but that there was reasonable grounds for refusing to disclose the requested information.

With respect to Mr. Patman's letter, Mr. Hayes said that some of the data might represent a reasonable request and might be helpful in understanding more about the System's operations. He felt that in general it would be desirable to take a little time in studying this request and in preparing whatever response seemed appropriate. It was Mr. Hayes' thought that the Secretary of the Committee, in consultation with the Chairman, the Vice Chairman, and the Manager, might work up a draft of letter for consideration at a later meeting.

At Mr. Hayes' request, Mr. Rouse then commented in some detail on Mr. Patman's letter, after which there was a general discussion of the requested material. In connection with discussion of the request for dealers' bids in the Monday Treasury bill auctions, it was suggested and agreed that this was not Open Market Committee record material and that any request for such information would properly have to be directed to the Treasury Department. Regarding Mr. Patman's request for information on System account transactions up to June 30, 1957 rather than to the end of 1956, one view was that there might be no objection to providing information to that date in view of subsequent developments in System credit policy, while another view was that no information should be given regarding transactions until the open market policy record required by section 10 of the Federal Reserve Act to be included in the Annual Report of the Board of Governors to the Congress had been submitted and made public.

After discussion, Chairman Martin stated that the suggestion Mr. Hayes had made for denying Congressman Multer's request for information regarding dealers' operations on the grounds that the information was strictly confidential seemed an appropriate way to dispose of that matter. With respect to Mr. Patman's request, he suggested that in line with Mr. Hayes' proposal, Messrs. Riefler and Rouse be requested to prepare a draft of reply in the light of the discussion at this meeting for consideration at a later meeting of the Committee.

There was agreement with these suggestions, and it was understood that appropriate drafts of letters would be prepared.

During this discussion, Mr. Szymczak withdrew from the meeting.

In this connection, Mr. Riefler noted that drafts of replies to the list of questions submitted by Congressman Patman to Chairman Martin on August 6, 1957 when he appeared before the House Banking and Currency Committee in connection with the Financial Institutions Act of 1957 were largely completed and that they would be circulated to the members of the Committee within the near future.

Chairman Martin next referred to a telegram that had been sent by the Secretary on November 25, 1957, to the available Committee members and to the Presidents who are not currently members suggesting that because the Treasury expected that it would be necessary to borrow temporarily from the System at times during December it would be appropriate to reconsider the rate of interest at which special certificates of indebtedness are purchased from the Treasury under the authority contained in the second paragraph of the Committee's directive to the Federal Reserve Bank of New York. The telegram noted that the rate charged for this facility--currently 1/4 per cent--was last approved by the Federal Open Market Committee at its meeting on June 28, 1949, and that the facility was last used in March 1954. The Manager of the System Open Market Account had recommended that, considering the existing market rates of interest, the rate on special certificates of indebtedness purchased direct from the Treasury be increased to a level 1/4 per cent under the discount rate of the Federal Reserve Bank of New York, and the Secretary concurred in this recommendation. The telegram also stated that the Treasury was agreeable to this rate.

Chairman Martin said that at the time the telegram was sent, it appeared that the Treasury would wish to use the facility in December and that in order to have a changed rate effective, a Committee decision would have been needed that week. However, it had developed that the Treasury would not use the facility immediately and the matter had therefore been held over for consideration at this meeting. Chairman Martin went on to say that the Treasury had been trying to put all Government transactions on a realistic interest bearing basis and that the suggestion to have these special certificates carry a rate 1/4 per cent below the discount rate would seem to be in line with the general Treasury position. There had also been some discussion of whether the rate for the Treasury's borrowings from the Federal Reserve might preferably be 1/2 per cent below the discount rate. On the other hand, the Chairman said that some individuals had spoken to him, indicating that they were inclined to keep the existing rate of 1/4 of 1 per cent on the grounds that such Treasury borrowings were strictly an emergency operation. Chairman Martin said that he had no strong feeling about the question, although he was inclined to feel that if this type of borrowing were to be put on a business basis a rate either 1/4 or 1/2 per cent below the discount rate would be appropriate.

Mr. Rouse commented on the origin of the 1/4 of 1 per cent rate, stating that when it was established in the 1940s it was with the thought that the principle of having the Treasury pay a rate of interest should be maintained. Several months ago, the question had come up in a discussion with Mr. William Heffelfinger of the Treasury and out of that discussion arose the suggestion that the rate charged on these special certificates be placed on a more realistic basis. There was no immediate need to use the facility, Mr. Rouse said, but a short time ago when it appeared that the Treasury would need to borrow direct from the Federal Reserve Banks during December the question was brought up again. Mr. Rouse said he thought the suggestion of a rate 1/4 per cent below the discount rate was one he would recommend, which he did, and Mr. Riefler had joined him in the recommendation. He noted that these were transactions between two Governmental bodies and stated that for such transactions it seemed appropriate to have a rate slightly different from that charged private borrowers.

Mr. Hayes added that the Treasury certificates of indebtedness were comparable to very short-term Treasury bills, which usually sold at a rate less than the discount rate.

Mr. Vardaman said that in suggesting a rate below the discount rate, he had in mind the fact that borrowings by the Treasury from the Federal Reserve were properly considered temporary emergency borrowings. He suggested that there might be an unwarranted attack on the System if it charged the Treasury a rate for emergency borrowings that was charged private borrowers. At the same time, he believed that it would not be realistic to charge only 1/4 of 1 per cent on such borrowings, considering the general structure of rates now prevailing.

Chairman Martin said that on a strictly business basis, the borrowings of the Treasury on the temporary certificates should be at a lower rate than the discount rate. He felt, therefore, that the setting of a rate 1/4 or 1/2 per cent below the discount rate could be justified.

Mr. Mills inquired whether there would be any merit to a formula that would set the discount rate as a maximum on these borrowings by the Treasury, with a minimum rate being that which applied on the latest issue of Treasury bills, presuming, of course, that that rate was below the discount rate.

Mr. Riefler said that this had been considered. The only problem was that before the Treasury reached the point of using this facility it usually had made other adjustments such as use of the Stabilization Fund which forced down the bill rate. Thus, if the rate on the latest bill issue were to be used in the formula, it might get us into problems.

Mr. Allen said that he did not think it made too much difference what rate was charged on these borrowings. He would go along with the comments of Mr. Vardaman that the rate should be below that charged private borrowers, and he said that an offhand reaction on his part would have been that the rate charged the Treasury might be set at, say, 2 per cent.

Mr. Robertson said he thought this was a lot to do about nothing. The only importance was from the public relations standpoint. Regardless of the rate charged, 90 per cent of any earnings that the System got from such borrowings went to the Treasury and the actual cost to the Treasury could not be of much importance. He understood there had been a time in the 1920s when the rate charged on these special borrowings by the Treasury was related to the discount rate and that it got as high as 4 per cent or perhaps higher. The System had not had authority to purchase securities direct from the Treasury for several years from the 1930s up until 1942. The rate of 1/4 per cent was fixed after limited authority for direct purchases was provided in Section 14 (b) of the Federal Reserve Act in 1942, and it had remained unchanged since. Since these direct borrowings by the Treasury could be termed emergency in nature, Mr. Robertson thought there was much to be said for considering that the use of the facility was for the benefit of the whole country. Philosophically, he could not see any reason for any interest charge on such emergency-nature transactions, although he would not argue against the present 1/4 per cent rate. He did feel, however, that the direct borrowings should be kept on an emergency use basis, and he thought the present charge of 1/4 per cent would help do that. It represented some charge to the Treasury, but it was not a market rate and did not put the charge on a business incentive basis. Therefore, his judgment would be to let the present rate stand since he could not see that it did any harm or that a change would do any particular good.

Mr. Thomas commented that when the 1/4 per cent rate on direct Treasury borrowings was set in the 1940s it was related to the discount rate in the sense that the discount rate was then 1/2 of 1 per cent and the System stood ready to purchase Treasury bills at 3/8th of 1 per cent on option.

Chairman Martin said he thought Mr. Robertson had made the case for the status quo as well as it could be made. He did not agree with the logic of that case because he believed that the rate should be related to the whole business process. As Mr. Thomas had pointed out, the history of the rate had been related to the discount rate. It seemed to him that some relationship between the rate charged the

Treasury on direct borrowings and the discount rate was preferable to the existing procedure. On the other hand, Mr. Robertson had eloquently presented the reasons for the status quo. It should also be noted that the Treasury was agreeable to a rate that would be 1/4 of 1 per cent below the discount rate. Commenting further on this point, in response to a question from Mr. Leach as to whether the Treasury had actually suggested this arrangement, Chairman Martin said that he would not go that far but would say that the Treasury was perfectly agreeable to the proposed change.

Mr. Hayes said that he felt the question was not of great importance but he rather preferred the procedure of fixing a differential that would move with the discount rate. If the practice of charging practically nothing for the use of this facility were extended along the lines of Mr. Robertson's comments, the question could be raised as to whether anything done through the Open Market Account should have a market rate. On balance, Mr. Hayes thought it preferable to relate this rate to the discount rate, and a differential of 1/4 per cent below the discount rate seemed as good as any other.

Mr. Shepardson said that it seemed to him there was sound logic for putting this rate on a business basis in line with what the Treasury was doing generally. There would be justification for putting it at the discount rate, but in view of the lower rate usually available on very short-term Treasury bills he thought the differential 1/4 per cent below the discount rate was logical.

Mr. Deming felt the status quo position was preferable. The quarter per cent rate had applied for ten years and he could see little reason for changing it now and possibly stirring up unnecessary discussion.

During further discussion, Chairman Martin indicated that, while he did not consider the matter of great importance, he was willing to take the risk of having to explain the basis for a change in the rate before a Committee of Congress, if called upon to do so. He thought it could be explained as a reasonable move.

Chairman Martin then noted that the Committee had before it a recommendation from the Manager of the System Open Market Account and from the Secretary of the Committee that the rate charged on special short-term certificates of indebtedness purchased direct from the Treasury pursuant to paragraph (2) of the Committee's directive to the Federal Reserve Bank of New York be fixed at 1/4 of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases.

The Chair put this question, and the recommendation was approved, Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Shepardson, and Vardaman voting to approve, and Messrs. Robertson and Williams voting "no."

Mr. Deming stated that had he been a member of the Committee he also would have voted against adoption of the proposal.

A staff memorandum on Recent Economic and Financial Developments in the United States and Abroad had been distributed under date of November 29, 1957. At Chairman Martin's request, Mr. Young now commented on the economic situation as follows:

> The economic report at this meeting may be capsulized, for the picture generally is consistent with that reported at the last meeting--a moderate downsettling of the economy.
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> Industrial production continues to sag, especially in the areas of steel and other metals, equipment and ordnance, household durables, apparel and textiles, and mining, but higher automobile output may have kept the Board's index of industrial production close to the 142 level of October, or at the worst at 141.
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> On the other hand, new construction seems to be maintained, with residential and public utility construction up, industrial construction down, and commercial and public construction about even. Construction contract awards are holding relatively high for this season of the year, reflecting especially strength for residential awards. For six months, relative strength in housing construction has been reflected in a stabilized volume of housing starts at an annual rate of about a million units. A point of interest in this connection is that costs in residential construction declined in October for the second successive month. Financing and selling conditions for newly built houses continue to show little change.
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> Further sag in equipment production and industrial construction is closely related to cutbacks in spending decisions for business plant and equipment. Information just available on third quarter capital appropriations of large manufacturing companies, but not yet made public, shows a decline in appropriations of almost one-third from a year ago. This is the second successive quarter showing a substantial decline; second quarter appropriations were down over a fourth from the second quarter of 1956. While amounts actually spent for fixed capital by large manufacturing corporations have been holding at advanced levels, the backlog of appropriations for spending has been declining this year; at the end of the third quarter, it was an eighth less than a year ago.
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> Data have just become available on new orders for durable goods in October. They show no change from

September. Unfilled orders, however, continued to decline and were 15 per cent under a year ago.

Labor market data show a further rise in unemployment claims, with the increases fairly widespread geographically. The mid-November unemployment survey, not yet released, shows a rise in unemployed substantially more than seasonally, to about 5.2 per cent, seasonally adjusted, of the labor force. Although unemployment has been rising the number of markets reporting a condition of substantial labor surplus has not yet increased, but there has been a significant shift towards areas classified as having a moderate surplus situation.

GNP for the final quarter, according to preliminary estimates, will show little change or a moderate decline from the third quarter. Personal income in October declined for the second successive month, due to reduced wage and salary disbursements. The November estimate of personal income may show a further moderate decline for the same reason.

Preliminary indications, mainly for department stores, point to some recovery in retail sales after the reductions of September and October. Department store sales, however, are still well below a year ago. In automobile markets, the indications, especially at mid-month, are not encouraging to producers. New car sales through the first 20 days of November, which cover carry-over '57 models as well as '58 models, although up from October, ran slightly under a year ago, and dealer stocks rose appreciably. Used car sales were a bit above a year ago with used car prices, after allowance for depreciation, about steady.

The general average of wholesale prices has shown little change in November, and this has been broadly true of group components--basic material, fabricated industrial materials and finished products, and farm products. While the consumer price index was unchanged in October, because of offsetting movements of components, the index is currently expected to show rise in November, reflecting higher new car prices and additional advance in rent and service costs but stability for other categories.

Data on international trade suggest that the changes occurring in recent months have been in the direction of moderating payments imbalances, especially for industrial countries. Although U. S. exports have fallen sharply from spring to early fall, total world trade has evidently contracted only moderately in this period. Evidence just available confirms that economic activity in most major industrial countries abroad declined some during the third quarter. Evidence on the subsequent movement is as yet unclear.

Mr. Thomas then made the following statement on recent financial developments:

Cross currents in economic forces during recent weeks have precipitated spectacular and often paradoxical developments in financial markets. Public recognition by the System--through the discount rate reduction--of the evident economic adjustments, that have lessened and perhaps removed the threat of inflation for the time being, was followed by sharp increases in prices of securities. Stocks, as well as bonds, shared in the rise until announcement of the President's illness gave pause to the rise in stock prices.

Analytically, a decrease in the Reserve Banks' discount rate would not by itself be a cause for such sharp changes in securities markets, particularly when it was not accompanied by vigorous measures to add to the supply of reserves. It needs to be kept in mind, however, that to a degree these trends were already beginning to be evident in the market for Government securities and in credit demands. The discount rate reduction was in a sense a recognition of, and adjustment to, forces already in operation. It served as a catalyst in bringing quiescent forces into action. Investment funds held awaiting more favorable terms or a clarification of trends were brought promptly into use. Investor resistance in corporate and municipal bond markets, which had resulted in pressure on prices and accumulations of inventories in the face of large offerings of new issues, dissipated rapidly after the discount rate reduction. Prices of bonds advanced and underwriters were able to dispose of new issues. The decline in yields on Government securities already in process was accelerated.

Yields on seasoned high-grade corporate and municipal bonds have declined to the levels of last July and those on long-term Treasury bonds are now lower than at any time since April. Yields on medium- and shorter-term Treasury issues, which had risen to above 4 per cent last summer and were generally above long-term yields for over a year, are now close to the long-term level. Yields on Treasury bills, which had been around 3-5/8 per cent during the latter part of October but had declined to below 3-1/2 per cent before the discount rate reduction, fell to about 3-1/8 per cent. Bills have continued available at around this level despite substantial System purchases. Seasonal cash needs, and perhaps some shifting from liquid assets into longer-term holdings, have been influences moderating the decline in bill yields.

The volume of new security issues in December is expected to continue close to the high average level of the past year. With the announcement of plans for a record-breaking issue of A.T. & T. convertible debentures in the early months of next year and in view of prospective State and local government programs, new issues may continue in large volume for some time ahead. As yet there is no indication of a decrease in corporate issues that might be expected to result from the anticipated decline in capital expenditures.

The Treasury's cash and debt positions are necessarily confined within the narrow limits fixed by the statutory ceiling on debt and the minimum needs for a working cash balance. As a result of new issues put on the books in the last few days, the outstanding debt today is very close to the ceiling, although some slight leeway may be provided by savings bond redemptions. The cash balance of about $3.6 billion, excluding $200 million transferred from the Stabilization Fund, may be adequate, with the aid of the Stabilization Fund borrowing, to cover needs for the remainder of this month. It is possible, however, that some temporary borrowing from the Federal Reserve may be resorted to at least once during the next week or two.

Some additional cash borrowing by FNMA may be obtained around the middle of January and somewhat more than $1 billion will be needed by early February. The situation will not be comfortable until mid-March. The Treasury faces a large refunding operation early in February. A most important question is when and how to take advantage of the strong bond market and extend the debt maturities by offering a long-term issue.

Bank credit has continued to decline, contrary to the usual seasonal tendency at this time of the year. During the four weeks since October 31, banks in leading cities showed declines in loans, in holdings of Government securities, and in other securities, amounting to around $200 million in each case. The total decline of $600 million compared with increases of approximately the same amount in November of the two previous years.

Demand deposits adjusted at city banks have been increasing during the past three weeks at a somewhat slower pace than in the same period of the two previous years and, owing to an unusually sharp drop in the first week of November, showed a net decline for the month as a whole. U. S. Government deposits increased only moderately. Time deposits have declined as is usual in November. Demand deposits adjusted are apparently smaller now than they were a year ago, as are Treasury deposits, but time deposits are much larger. Deposit turnover declined, on a seasonally adjusted basis in October, and showed a somewhat smaller increase over a year ago than has been the case in other months of this year.

As a result of slackened growth in bank credit and deposits, required reserves of member banks failed to show the customary seasonal increase in November, thus reducing the projected need for bank reserves. In addition, reserves were supplied by a reduction in Treasury balances at the Reserve Banks (including that of the Stabilization Fund) and by substantial System purchases of bills last week. Currency in circulation, however, after lagging somewhat in September and October, increased a little more than the normal amount in November. Float failed to show the usual seasonal increase in mid-November and declined much more sharply in the last two weeks than was expected, thus exerting a drain on reserves.

As a consequence of these offsetting influences, net borrowed reserves remained above $300 million in the last week of November. In other words, member bank reserve positions continued fairly tight, notwithstanding the continued slackening in credit expansion and the System's efforts to follow a less restrictive policy. Conditions became easier, however, in the New York money market. The principal shift was a decline in excess reserves and increase in borrowings at country banks toward the end of the semimonthly reserve period.

The cumulative results of the easing measures are, however, being reflected in member bank reserve positions this week, when net borrowed reserves are expected to average less than $200 million. If the Treasury continues to keep its balances in the Reserve Banks (including that of the Stabilization Fund) at a low level, net borrowed reserves will continue relatively small during most of December. Projected increases to nearly $400 million next week and to around $600 million in the last week of the month could be kept down through repurchase contracts or moderate outright purchases in those weeks. To provide the liquidity usually desired at this season, an abundant supply of reserves will be appropriate.

These needs, however, will be short-lived. In January the seasonal return flow of currency and decrease in required

> reserves may be expected to release a substantial volume of reserve funds. While some part of these will be absorbed by a decrease in float and eventually by restoration of Treasury balances to normal amounts, a reduction of several hundred million dollars in the System's portfolio will be needed to avoid creating excessive temporary sloppiness in the money market.
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> While the present situation calls for a lessening of previous restraints, it would hardly be desirable to let a normal seasonal decrease in credit and monetary demands result in building up a large volume of temporarily redundant reserves. Only if credit contraction exceeds usual seasonal amounts should further ease be permitted to develop. After this month positive measures to supply additional reserves should not be needed until March.

Chairman Martin said that Mr. Balderston had suggested that in the statements to be made by the individual Reserve Bank Presidents, each include a comment as to whether loan volume had declined in his district and, if so, whether the decrease reflected lessened loan demand from borrowers or whether it reflected decisions by banks to curb their lending or to force the repayment of loans.

The Chairman then called upon Mr. Hayes.

Mr. Hayes said, in response to the question suggested by Mr. Balderston, that the experience in the New York District pointed to both of the factors mentioned as playing a part in the reduction in loan volume. The banks certainly had felt a substantially lessened demand for loans in the last two or three months, but before that they had exercised a very considerable control on loan expansion because of their liquidity position. Mr. Hayes thought that the banks had continued to exercise that control. Most of the banks talked in terms of restoring their liquidity position as funds became available to them. He did not think that in the New York District it would be correct to say that either one or the other of the factors mentioned in Mr. Balderston's question was mainly responsible for the decrease in loans.

Mr. Hayes went on to present his views on the economic situation and credit policy as follows:

> Since our last meeting the System has surprised the country and the rest of the world with a sudden overt signal that our posture with respect to monetary policy has undergone a substantial change. Time will tell whether the timing and form of this action were the best we could have chosen. It had seemed to most of us at the last meeting that some preparation in the form of diminished restraint through open market operations would be advisable before any change was made in discount rates. However, the move has been made, and it may well turn out to have been useful on purely monetary grounds--at least it is now even clearer than it was three weeks ago that the economy is experiencing a rather broad and general decline, so far very moderate in degree, but carrying with it some risk of a cumulative recession.
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> Confirmation of the business decline is to be found in a wide variety of statistical measures of current trends, including figures on employment, average hours worked, personal income, retail sales, and industrial production. Other statistical data foreshadowing future levels of activity, such as reports of new orders, point to a continuation of the decline. Besides the expected drop in private plant and equipment expenditures, which may of course be accentuated by future adverse psychological factors, I have in mind also the likelihood that business expectations, the ready availability of goods and the current level of inventories may lead to some inventory liquidation in the next few months. Uncertainties and depleted monetary reserves in a number of countries point to a decline in exports. Among the few remaining strong spots in the economy are non-Federal Government expenditures and construction in general.
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> The greatest uncertainties with respect to the future level of activity concern consumer spending and Federal Government spending. As for the first, the Christmas season will provide a significant test. Over the next few months the crucial factor,

apart from the course of personal income, may be the degree of willingness of consumers to defend their level of living by means of reduced savings or increased borrowing. By and large, consumers are in a strong financial position and may be ready to reduce their liquid assets and/or to incur further debts, if their confidence is not shaken. As for Federal spending, the short-run outlook is for only a mild expansion, but it is quite possible that over the longer term heavier defense outlays may involve substantial Government deficits and may give new impetus to inflationary influences in the economy.

It is evident that intangible elements such as the Russian satellite development, political uncertainties abroad, and now the grave question as to the President'shealth, will play a major and unpredictable role in shaping the future course of business activity.

Meanwhile, wholesale and consumer prices seem to have achieved a considerable degree of stability for the time being. And the latest figures on bank credit offer further evidence of the pronounced slackening in credit growth as compared with last year. According to our rough estimates the money supply at the end of 1957 may be nearly 1 per cent lower than it was at the end of 1956.

Fortunately our decisions with respect to credit policy over the coming weeks can be taken with a minimum of consideration of the Treasury's problems, since no major cash or refunding operation is now in prospect until around February.

It seems to me that the basic uncertainties in the present situation are so great that any policy based on definite anticipations of future developments may well prove dangerously wrong. Accordingly, the most appropriate criterion of policy may be that of minimum risk, whatever may be the course of economic developments. On the one hand, I think we should avoid forceful action, such as that taken in 1953-54, to flood the economy with liquidity, for this might easily prove to be a most unfortunate prelude to a program of heavy defense expenditures and possibly renewed inflationary pressures. On the other hand, if we were to confine our easing of credit policy to the discount rate cut already made, we would run considerable risk of seeing the development of an undesirable degree of tightness in the credit markets at a time when credit demands are slackening appreciably but when liquidity needs are likely to increase seasonally. Also there is already some confusion in the market as to the meaning of the sudden rate cut without a definite easing of reserve pressures, and for the sake of clarity and consistency open market policy should be brought into alignment with discount rate policy.

> I believe there should be enough slackening of restraint to confirm the System's change of policy, but the slackening should not be carried to such an extreme that it would be difficult or disturbing to tighten the reins again if future conditions should call for such action. The current target of about $250 million of net borrowed reserves should now, I think, become a maximum, and we should work slowly and gradually over the next few weeks toward the zero mark--with of course the usual proviso for leeway for the exercise of judgment by the Manager.
>
> Until the market has had time to observe our open market activities and to recognize this gradual confirmation of our discount rate move, it might be well to avoid any further overt signal, such as a cut in reserve requirements or in margin requirements, however desirable such reductions may be at some time in the next few months.

Mr. Johns said that the reaction to the discount rate change had proved that some of the fears that he expressed at the meeting three weeks ago about the possibility of adverse reaction to what he then thought was too large a decrease in the rate were unfounded. Those fears were wrong and the psychological reaction had been good. Taking into account the fact that there was some justifiable delay in executing the policy directive and carrying out the consensus arrived at at the meeting three weeks ago that there should be a moderating in the pressures on bank reserves, Mr. Johns said he was gratified to see that that policy would become evident within the next few weeks. He would like to see the moderating of pressures on bank reserves continued through a slow and easy and gradual change.

With respect to the question Mr. Balderston had asked, Mr. Johns said he would prefer to supply the answer when he had more complete information on the Eighth District. Business loan figures in the Eighth District seemed a little though not significantly stronger than the figures for the nation. His impression was that the behavior of loans in that area was due largely to slackening of loan demand. Banks had been rather careful about screening loans for some time and at the moment, Mr. Johns said, he was not certain whether they had changed their policies since the discount rate action in mid-November. He had an indirect report that in the eastern part of the district the change in discount rate had produced a considerable bulge in demands for loans, but he was somewhat skeptical of the accuracy of that report. Experience in St. Louis and other parts of the district did not indicate that there had been a change in lending policy because of the discount rate change reduction, and Mr. Johns said that he was inclined to believe that the report to which he referred was a fishing expedition seeking to find out what the policies of the Federal Reserve System would be in the future.

Mr. Bryan said that the Sixth District was showing rather extraordinary differences in tendencies in different figures. Unemployment was up pretty sharply. Steel production was down rather radically, and one of the most dramatic figures--that for new plants--was down 75 per cent compared with a year ago. On the other hand, contract awards and some other indicators showed equally large changes in the other direction. The over-all picture was difficult to analyze but, Mr. Bryan said, his impression was that in the national picture pressures were easing and perhaps in total the situation was moving downward.

In answer to Mr. Balderston's question, Mr. Bryan said that the larger banks were still under pressure from loan demand. This showed in the loan figures and in borrowings from the Reserve Bank.

As for policy, Mr. Bryan said that there obviously had been a sudden and dramatic change in the public posture of the System. He was inclined to believe that that change was associated with a shift in the economic climate and was justified. However, he was content for the moment not to go forward with any further dramatic moves and he would associate himself with the views expressed by Messrs. Hayes and Johns in that respect. He thought we faced very grave dangers. On the economic side there was the danger that we may have misinterpreted a minor adjustment as a major one and that the policy change might create further dislocations in an economic system that in his opinion already was pretty badly distorted. The other danger was the one Mr. Hayes had mentioned, that developments largely in the Governmental field might put the country under savage inflationary pressures in the not too distant future. There were other dangers also. One was that the System might imagine it had done more by the discount rate change than it had done. So far, it had only aided the securities markets. This aided large borrowers who had access to these markets, but so far as Mr. Bryan could see the general public depending on bank credit had not benefited, although he made it clear he was not complaining about the action taken. Mr. Bryan also thought we faced a very grave problem in the use of our instruments, if the economic situation should slide and slide rapidly. This was a preliminary to saying that, if the economic system should slide, Mr. Bryan did not believe that the open market instrument was the ideal way to handle the situation.

Mr. Williams reported that Third District business trends were mixed. This meant weakness was developing instead of strength. Department store sales in October were below September as well as last year. For the ten months, however, department store sales in the Philadelphia District were 1 per cent ahead of last year. Inventories at the end of October were 7 per cent above September but the increase was less than usual. A 3 per cent gain in value of inventories from a year earlier reflected price increases. New automobile registrations were 13 per cent ahead of October 1956 but in the first ten months of this year were 7 per cent below a year ago. Registrations in Philadelphia in the first three weeks of November were up 20 per cent from the previous month and 45 per cent from a year ago. Construction activity was relatively strong with total awards 6 per cent above the first ten months of last year. Preliminary data for October showed a small decrease in both employment and earnings in manufacturing. Business loans were up recently by about the same amount as a year ago. Compared with last year, the total showed little change, since a decline in business loans over the year-period had been offset by an increase in loans on securities.

With respect to Mr. Balderston's question, Mr. Williams said he had the feeling that there had not been restraint on loans in recent weeks. One banker had reported that he was taking advantage of this opportunity to improve the quality mix of his portfolio.

For the next few weeks, Mr. Williams felt that open market operations should be directed toward preventing any real tightness and yet should retain moderate restraint. He cited a net borrowed reserve figure somewhere between $150-$200 million, with a bill rate range of 3 to 3.15 per cent.

Mr. Fulton said that the steel industry in the Cleveland District had shown a very substantial drop from the rather high rate of operations that had existed and that it was very unhappy. There had been a working off of backlogs and new orders had diminished. Unemployment was up but large layoffs in some industries to some extent were being counteracted by developments in automotive suppliers and in the automotive industry itself, which had been putting quite a number of men previously laid off back to work. Retail sales were about the same as last year and Mr. Fulton thought there would be a pretty good Christmas season. It appeared that inventories were being worked down to a minimum level and production in many industries was at the minimum needed to supply current sales. Consumers of steel appeared to be using more steel than they were ordering. Mr. Fulton thought it possible that a scarcity of goods could develop at some point that would result in fast ordering. Automobile credit terms seemed to be deteriorating, with a larger percentage of sales having 36 months maturity than was the case earlier.

In response to Mr. Balderston's question as to loan demand, Mr. Fulton said that business loans had declined in seven out of nine preceding weeks. It was reported that this was largely due to lack of demand and again it might relate to the inventory situation he had referred to. The reduction in the discount rate had given a psychological fillip to the general public, but Mr. Fulton did not think it had had an effect on the businessman who was not ordering and who was trimming his sails. Plants that were under way would be completed but others would be laid on the shelf to be looked at later.

In speaking of policy, Mr. Fulton expressed the view that nothing dramatic should be done, believing that through open market operations and repurchase agreements the situation could be kept in fairly good shape. The present amount of net borrowed reserves seemed appropriate. In response to a question from Mr. Vardaman, Mr. Fulton said that it was expected that the steel industry would run around 70 per cent of capacity during the current quarter and that the current month would show about the lowest point in operations. Beginning next quarter, there should be a pick up.

Mr. Shepardson said it seemed to him that, while there were indications of some further turn down in some areas, we still had the factors that had been mentioned which might lead to upward forces in the next few months. He thought it difficult to tell at this stage which would tip the balance. Recalling the comment that Mr. Young had made that costs in residential construction declined in October for the second successive month, Mr. Shepardson noted a report in the newspapers this morning of a proposal by a leader of the AFL-CIO Building and Construction Trades Department for a moratorium on demands for wage increases during 1958 as a step toward stabilizing wage gains and sustaining full employment through increasing production. While this leader might not be speaking for labor generally, Mr. Shepardson hoped there would not be any easing of the situation that would cause a cessation of this kind of thinking on the part of labor organizations. It seemed to him that the Committee would be well advised in the next two weeks to continue to hold about the present situation.

Mr. Robertson said that he agreed with Mr. Shepardson. It seemed to him that the System had exaggerated the situation we were in, believing as he did that the action taken in lowering the discount rate was wrong. He felt that the Committee should now hold the situation where it is, but if a recession started in, we should definitely consider using open market operations. For the time being he would not be in favor of any further moderation of pressures. In fact, he would be in favor of less moderation than had already occurred.

Mr. Mills said that from now to the end of the year there were valid reasons for following a cautious policy in providing reserves, particularly so that they would not become so freely available as to create a sloppy market and force prices of United States Government and other securities up so strongly as to cause other reaction that from the standpoint of the Committee's policy should be avoided. A plausible conception for a reserve policy to the end of the year might be to tie it to the movement of loans in the "leading cities." If the loan trend continued down, it could be regarded as representing an easing in the availability of credit, and overt action in aggressively providing reserves would not have the urgency that was true of recent years when bank loans rose progressively around the end of the year. However, in following the movement of loans in leading cities, the Committee should make allowances for tax borrowings and other corporate financing activities that necessitate resort to bank lines of credit. By making a comparison with last year in the movement of borrowings for tax purposes and the movement of finance company loans into the banks, and assuming that the weight of that movement would not be as strongly upward as a year ago, a picture of the underlying movement of bank loans might be obtained. Mr. Mills said it was hard to believe that credit in any area of the country was not comfortably available now, although varying in degree of availability from section to section, and for that reason the injection of reserves in amounts that would not find an immediate and justifiable loan use could possibly result in undesirable securities market distortions. Central reserve city bank areas were feeling the greatest impact of the liquidation of commercial and industrial loans.

Mr. Mills' belief was that a target for negative free reserves of around $200 million would not be far off and no concern need be felt if the level should rise even to $250 million. However, if last year's experience was repeated, tightness might occur that would be entirely unrelated to the statistical position of negative free reserves and it might become necessary to supply reserves more liberally than is presently indicated.

Going beyond the immediate, Mr. Mills thought that the most important financial problem faced was a tendency for required reserves to shrink. That tendency was presumably a reflection of the abatement in the demand for loans in major centers and the actual liquidation of loans in those areas. In the long run this meant that at some point the System might be faced with a decision as to how it should meet a potential shrinkage in the money supply, particularly whether a moderate shrinkage in the money supply was desirable or whether it would be inconsistent with conditions that favor a stable economy and foster growth. If after the turn of the year it was found that there was a contraction of loans of more than seasonal magnitude, a case could be made for providing reserves more liberally on the grounds that the commercial banks would be recasting their ideas as to the employment of their resources, and if reserves then were freely available they might find their way into increased investments in both public and corporate securities. Such actions could have a beneficial effect in moving the prospective supplies of new securities on to the market, at a time when the System might wish to encourage that kind of financing as a stimulant to slackening activity in the areas affected by capital financing programs.

For the time being, Mr. Vardaman said, he certainly did not feel the Committee wished any more overt action. At the same time, he felt strongly that it should point open market operations toward less restraint and toward convincing the public of the Committee's recognition of the trend. He would go along with Mr. Hayes' goal and he urged that the Desk play by ear. He agreed with Messrs. Fulton and Bryan that up to now the System's action had been simply a gesture, in that he did not think the discount rate reduction had affected the ideas of the public or businessmen, either large or small. Mr. Vardaman said that he would go along with changing the directive to insert the word "continued" ahead of the word "moderating" in clause (b) of paragraph 1. He would favor not over $100 million of net free reserves and preferably would move closer to zero.

Mr. Leach said that the past three weeks had served to confirm earlier evidences of a small but widespread downturn in Fifth District economic activity. Mining employment in West Virginia dropped slightly from September to October and in October was 4.2 per cent below the corresponding month last year. Industry forecasts indicated that bituminous coal production in the first quarter of 1958 would be down slightly from 1956 and 1957. Cotton cloth prices had moved up slightly in the past two weeks, almost entirely because of the recent rise in cotton prices. However, there was no evidence of any change in the fundamental problems of the industry. Contrary to the usual seasonal rise in October, nonagricultural employment in the two Virginias and the two Carolinas dropped from September to October with the major portion of the losses occurring in manufacturing industries.

Mr. Leach said that Fifth District agriculture had been hard hit this year in contrast with the good showing of other parts of the country. Harvesting of most district crops was nearing completion, and despite somewhat improved yields it was obvious that cash receipts from crops would be far below last year. Flue-cured tobacco, cotton, and grains were all substantially down. Tobacco cash receipts would drop $170 million, and a cotton crop two-thirds of the size of that of 1956 would likely bring $40 million less than last year's crop.

One brighter--but not very bright--spot in the Fifth District economy to which Mr. Leach referred was the furniture industry, where production apparently turned up somewhat in October as employment increased slightly and sales showed some improvement.

Seasonal expansion in business loans in the Fifth District has been below last year's experience, Mr. Leach said, but not as much below as has been true of the country as a whole. As to Mr. Balderston's question, one reason for the smaller expansion of loans in the Fifth District this year had been the smaller needs for credit for moving crops, particularly tobacco. The reserve position of member banks continued rather tight and borrowings from the Richmond Reserve Bank were slightly larger now than in recent weeks and larger than at this period a year ago. Member banks still say they are experiencing demands from customers for loans. Mr. Leach also commented that when the discount rate went up, the banks told their customers that was why their interest rates were increased. Now that the discount rate had been reduced, the banks were hooked.

In general, Mr. Leach thought the Committee's policy should not be so easy as to impede salutary adjustments that were taking place in the economy or to provide redundant reserves that could lead to sloppy markets and lay the basis for expansion of inflationary forces when they recur, something that he was sure would come about at some time. Consistent with this view, he did not think the System should make bank reserves substantially easier at the moment. He believed, however, that some further easing in reserve pressures would be appropriate because of the widespread change that has taken place in the economy and the relatively light seasonal demand for bank loans. He noted that member bank borrowings in November averaged $800 million, slightly higher than a year ago when the Committee's objective was one of restraining inflationary developments. If the present directive were to be continued--and he thought it should be--it seemed clear that there should be a further moderation of reserve pressures. The moderation should be gradual, and at the end of the next two weeks he would like to see conditions consistent with a benchmark of $100 million net borrowed reserves.

Mr. Leedy commented first on Mr. Balderston's question, stating that, as he had reported previously, loans in the Tenth District since mid-year had moved opposite to those nationally. There actually had been a growth in loans in the district since the end of June, and total reporting member bank loans had shown about double the volume of growth since mid-1957 that they had shown in the corresponding period of 1956. Commercial and industrial loans had increased about a third more this year than in the same period last year. By and large, this growth represented the seasonal pattern. The increased loans largely were to food manufacturers, trade firms, and commodity dealers. In one category--loans to farmers, particularly loans on cattle--the growth had been the largest since 1953. This year's excellent pasture conditions had resulted in considerable demand for feeding cattle. At $109 million, these loans were the highest since the spring of 1953. Borrowings by member banks last week reached a postwar peak of $131 million, Mr. Leedy said, and as he had commented at the preceding meeting, a considerable part of this represented loans to banks in Oklahoma because of the loss of deposits from that State in connection with the assessment of intangibles as of the end of November. Even after washing that out, however, there had been an increase in loans because of other large demands.

Regarding policy, Mr. Leedy said that since Mr. Johns had confessed that he was mistaken as to what the effect might be of a discount rate reduction as large as the one that had been made in November, he also wished to confess that he was badly mistaken as to what he suspected the effect of such a reduction might be. Mr. Leedy recalled that he had thought such a reduction would involve the risk of contributing further to deterioration in business sentiment, but he could not have been more wrong. The result indicated that the factor of sentiment still had a great deal of strength and he had misjudged the fragile nature he thought it might have. It seemed to Mr. Leedy that, having taken this step, the Committee should now give notice through the weekly report of net borrowed reserves that the pressure on reserves was being relaxed. He noted that the report distributed this morning showed an estimate of a net borrowed reserve position of $165 million for the current week. He thought that for subsequent weeks borrowed reserves should not exceed that figure. He would establish very definitely that the Committee was trending downward in net borrowed reserves. Beyond that, and pending a meeting two weeks from now, he would suggest no further change in policy.

Mr. Allen said that the decline nationally in business activity was evident in virtually all Seventh District centers except Michigan, which was an outstanding exception. Automobile production was projected at 620,000 units in November compared with 580,000 in the same month last year, an increase of 7 per cent, but The Wall Street Journal this morning indicated that because of a work stoppage actual production has been about the same. The State employment services in the Seventh District reported almost universally that the number of manufacturing jobs this fall was less than had been anticipated. The easier job market, however, was confined for the most part to the unskilled manual worker. Department store sales and scattered reports on other retail trade have compared unfavorably with last year in recent weeks, Mr. Allen said. In the four largest cities of the Seventh District, sales during the first three weeks of November on a seasonally-adjusted basis were off 8 to 11 per cent from August levels. Some stores had reported that the final week of November had been encouraging.

Available data do not yet suggest an appreciable upturn in liquid savings, Mr. Allen said, but he felt that such an upturn was taking place because consumer income was now running well above last year whereas retail purchases were lower. Mid-west farm income prospects had been dimmed somewhat as a result of wet weather which hampered the harvesting of corn and soy beans. Those crops had been under snow in a considerable part of Iowa and elsewhere, and moisture content had been too high for storage. One result of this might well be the feeding of cattle and hogs to heavy weights so that corn could be used before spoiling. This could defer current marketings but could cause substantial pressure when these animals are marketed after the turn of the year.

Since midyear, the reduction in business loan outstandings has been greater in the Seventh District than in the nation generally, Mr. Allen said. For the entire country, business loans dropped 2.3 per cent between June 27 and November 20, in Chicago they dropped 4.4 per cent, and in Milwaukee 3.4 per cent. As to Mr. Balderston's question, Mr. Allen was sure that the decline in business loans was generally a voluntary reduction on the part of borrowers. One of the very large banks indicated a little more than a month ago that it had changed its lending policy as a result of the economic picture. (This bank had been an extremely aggressive lender for many years.) The result was that its loans had stopped going up, but it had not shared in the actual reduction experienced in the Seventh District and the nation. In Chicago, where deposits are virtually unchanged, banks have offset the decline in business loans by increases in their security holdings. Mr. Allen also reported that interviews with commercial finance companies in the Chicago area revealed that most of those firms were in a position to increase their business loans substantially but that demand for funds had been reduced. In fact, they were speaking of a shortage of customers.

Reverting to the automobile situation, Mr. Allen reported finished car inventories on November 20 totaled 660,000, of which 175,000 were 1957 models. The industry does not seem to be disturbed by the size of the 1957 model inventory, but it is disturbed by the fact that the daily sales rate in the second 10 days of November was 16,840 compared with 17,993 in the first 10 days of the month. A decline in sales rate at this time of year is unusual, Mr. Allen noted, besides which current production is geared to a daily sales rate of

18,000 plus. Sales in the second 10 days of November also were of interest because of the distribution among the various manufacturers. General Motors' sales were 50 per cent of the total, Ford 30 per cent, and Chrysler 14-1/2 per cent. Ford and Chrysler officials were disappointed and General Motors enthusiastic. The General Motors' showing was due chiefly to the good reception accorded the Chevrolet.

Mr. Allen stated that he had been on the telephone hookup with the Desk during the past week, when net borrowed reserves had been higher than the Committee had suggested, but he did not know how the Desk could have come any closer than it had under the conditions that existed. He thought that the goal for net borrowed reserves in the next two weeks might well be around $250 million.

Mr. Deming said that yesterday he sat with a group of Twin City businessmen in an economic conference and that almost without exception these men felt that the slide-off in the economy would continue through the first half of 1958. They noted that the downward drift in the Northwest had been less than for the nation as a whole, and they believed that the outlook for that area was better than for the nation. This reflected basically the strong agricultural year the Ninth District had had and the belief that the outlook for lumbering and mining at present was brighter than it had been for some time. Recent statistics pointed to some increase in weaknesses in certain lines. Retail sales were off from last year's level, and there had been some layoffs in both larger and smaller industrial plants. Bank loans were down and deposits showed less than the usual seasonal gain.

With respect to Mr. Balderston's question, Mr. Deming said that the figures showed that the city banks experienced a decline this past few weeks of $25 million in their loans, compared with a decline of $15 million last year. Country banks showed an increase of $5 million this year, whereas last year they increased $15 million. These figures reflected primarily a decline in demand for loans, but this was not anything that the banks were resisting very strongly and they had not been going out to replace the loans. Mr. Deming also reported that real estate loans had gone up and that banks seemed willing to make more real estate loans because basically demand for other credit had fallen off.

Housing seemed to be showing real strength, Mr. Deming said, with figures for the Ninth District showing a 34 per cent gain in October in the number of housing permits. Builders were expecting a pretty good year in 1958.

On credit policy, Mr. Deming said that he agreed that a target of around $150-$200 million of net borrowed reserves would be appropriate.

Mr. Mangels said that the Twelfth District continued to have a somewhat mixed picture. Over-all activity continued on the down side, but there were a couple of bright spots. The important lumbering industry in the Pacific Northwest was showing increases in production and in employment, although the increases had not been very large and operations were still well below year-ago levels. Construction had shown strength with residential awards in October up 10 per cent and nonresidential awards up 25 per cent from September. There was an indication that builders were going into the new year with a feeling that the strength in construction would continue. Mr. Mangels said he had not yet noted any decrease in costs of construction although it was hoped that such decreases would show up. Automobile sales in September were 21 per cent ahead of a year ago, and in California October registrations were 4 per cent above September. Department store sales were down in both October and November, and the total for the year to date showed practically no change. Over-all employment showed little change. In manufacturing, employment was down, reflecting conditions in the aircraft industry. However, development of the Thor missile program should improve employment in that industry in Southern California.

Bank loan figures, about which Mr. Balderston had asked, showed an increase of $69 million during the three weeks ending November 20, Mr. Mangels said. This was less than half the increase shown in the preceding year in this period. From June 1 to November 20 of this year, loans had increased only a third as much as a year earlier. Demand for loans was continuing but not as intensively as it had been. Banks were still willing to make loans where credit risks were good. Demand deposits had increased in the past three weeks, but time deposits had declined reflecting withdrawals of Christmas savings funds. Most of those funds were going into the spending stream, Mr. Mangels said, but various industries were not too optimistic about the outlook, feeling that by the middle of next year there would be a lower level of activity than at present. However, the consensus was that by the end of the third quarter of 1958 there would be an upturn. It was expected that there would be a continuation of high level Government expenditures and high consumer expenditures.

Mr. Mangels said that it seemed to him that in the present situation we might be facing not much more than an extension of the decline in the rate of growth. No projects that he knew of, which were economically justified, had been deferred because of a lack of funds or because of cost. If additional funds were supplied too freely, they might be put to speculative uses. His thought would be that for the next two weeks net borrowed reserves in the $200-$250 million range would be just about right, with the maximum leeway to be given to the Manager of the System Account in carrying out Committee operations.

Mr. Irons said that changes in the Eleventh District had been small during the past few weeks and rather mixed. On the whole, the district was continuing to show a high level of activity. Department store trade seemed to be running below last year in the first half of November, but in the last few days it had shown signs of spurting up. It was difficult to point to the significance of some of the changes that had taken place in the past three or four weeks, but Mr. Irons thought that on balance there had been no real net change. The attitude of confidence certainly had not been shattered. He did not find people pessimistic although they were reasonably cautious.

Mr. Irons referred to Mr. Balderston's question stating that, unlike the picture in the nation, demand for bank credit in the Eleventh District had continued strong. Virtually all bankers with whom he talked referred to this factor. Figures of reporting member banks had been consistently running ahead of the pattern of a year ago. Commercial and industrial loans in the last two weeks of November had shown a rise of $30 million compared with a rise of $15 million in the corresponding period a year ago, while since last June the increase had been $62 million this year compared with $37 million in 1956. Total loans showed the same pattern: one of continuing strength. Bankers state that the demand for loans is there. Mr. Irons said he did not know whether bankers were being more selective--they say they are always selective--but his opinion was that the degree of selectivity now did not differ much from what it was three months ago or six months ago. Banks are meeting demands if they can. There had been fairly steady and at times strong discounting at the Reserve Bank, with discounts having run to $53 million, a figure higher than that usual for Dallas. Mr. Irons reported that one of the large banks with a 65 per cent loan ratio, which had not borrowed for over a year, had come in periodically in the past three or four weeks because its loans were going up. This banker had indicated that he felt these were loans that should be made. He also had indicated a willingness for certain types of loans to increase, and in the case of automobile credit he indicated that if he could get the money, he would make the loans to move the cars. Mr. Irons expressed the opinion that if the banks were put in a position where they had the liquid funds, they would find a way to use them, and he thought the economic situation in the Eleventh District was strong enough to offer the opportunity.

On matters of general policy, Mr. Irons said that now that the System had decided to move to a three per cent rate structure, he hoped it would retain as much restraint as was consistent with that level of rates as contrasted with the 3-1/2 per cent level that existed previously. He was more interested in the short-term rates than in any given amount of net borrowed reserves. He hoped that the Federal funds rate would not drop below the discount rate and that the bill rate would be kept in the 3 - 3.15 per cent area. Because of the discount rate action, he felt that the System had to indicate that, as it saw the situation, some such rate structure was more appropriate, and his feeling was that operations should point toward that end. The System should avoid putting funds into the market too freely, should be cautious in supplying funds, and should be more concerned with the movement of rates. Mr. Irons said he did not believe that the Committee should give any weight whatsoever to influencing net borrowed reserves so that they would come out at a figure that would indicate that the System had eased. He did not believe the net borrowed reserve figure was much good anyway, but because the System had eased credit it should have a bill rate around the 3 - 3.15 per cent level. This should be the guide rather than some predetermined figure of net borrowed reserves.

Mr. Balderston said that the change in the discount rate last month seemed to him now to have been fortunately timed. Since that change had given a signal to the business community in the only way the System could appropriately speak out, it would seem that the Committee ought to select as a target for open market operations a figure slightly lower than the $200 million of net borrowed reserves that was achieved a year ago. He favored a target of $100-$200 million, with a bill rate kept near the discount rate.

This morning's report by Mr. Young of a heavy increase in unemployment to a level of 5.2 per cent brought before the Committee afresh a problem that had been quiescent for a time, Mr. Balderston said, but a problem which might be before it continually in future months. It was his belief that the problem of unemployment would be discussed in and out of Congress and would be something that would concern the System greatly. It would not be easily solved. He felt that excess capacity, which had appeared in a number of industries, would not disappear quickly. As an example, it would take time to find use for the aluminum that would carry the rapidly increasing capacity for aluminum production. He reported a conversation with an industrialist last evening who was happy that his firm was nearing the end of an $80 million expansion program. He was happy because the consulting service that advised him as to prospective automobile sales indicated a figure of 5.3 million cars for 1958. In short, this industrialist felt that he had all the capacity he could use for the predictable future. Mr. Balderston said he suspected that the strong feeling expressed by this industrialist might be held by many other manufacturers.

On the other hand, Mr. Balderston noted that there was in prospect a sharp increase in Government spending at the Federal level and also indication of increased spending at local and State levels. There also were in prospect wage advances next year, some of them automatic and some to be freely negotiated. Whether automatic or not, these threatened price stability. Consequently, he favored such continuing restraint as would avoid pushing out reserves that would be either not used or used improperly.

Chairman Martin said that he found himself almost completely in agreement with Mr. Hayes' summary this morning. He thought the System had done the right thing. He believed it was essential to change the posture of the System. He was not afraid of using the word: he thought we were in a recession. But that did not mean that he thought it was an alarming situation. Chairman Martin said he had based all of his thinking during the past year on the view that when inflation gets ahead of us, as this inflation did, it would be most unnatural if some adjustments were not required in the economy. He thought those adjustments were taking place and in a different form than in 1953 and 1954. In his view, there was no comparison now with what we had then in the congestion of inventories. Plant and capacity also were on an entirely different basis at that time than today. He believed very firmly in the growth factor that Mr. Mangels had mentioned. The overcapacity he was talking about was temporary, he said, and growth comes very quickly in this country. However, he did not think that eliminated the fact that we have a great deal of indigestion in plant and capacity because of the degree to which inflation got ahead of us. He was inclined to think we will not get the same response to monetary ease at this time that we got in 1954, even assuming that we were to throw reserves in with the reckless abandon that we did then. He thought the foreign situation also was entirely different today, and this was a factor that the Committee should bear in mind.

Having given a clear signal, the Chairman said that he thought the System ought not be supplying reserves <u>ad infinitum</u>. He did not think there was any need for additional reserves at the moment, although there were some places where the banks could put them out. But he had found a great many places where he was convinced the bankers were more bearish than some of the economists and were very anxious to clean house in some of their loans. They wanted to blame the Federal Reserve for that action, just as at times they blamed the Federal Reserve for restraint when they felt it would be desirable for them to be more generous in their lending. The Chairman said that he thought sentiment in business circles was bad now and was likely to grow worse, although he believed there would be good business during the Christmas period. He agreed with Mr. Irons' comment on the net borrowed reserves figures and expressed the wish that the Committee had never used them. However, they had come to be used as a benchmark. Chairman Martin said that his view was that we should be moving to a lower level of net borrowed reserves. How much lower would depend on feel and color in the market. He did not wish any overt move that would make it appear that the System was trying to flood the market with reserves, but he did want it clear that the System was moving to prevent any knot. He could see no need for changing the Committee's directive at this time. He thought that Mr. Hayes had made a clear statement of the majority view. There were differences of view around the table, he said, noting that Mr. Robertson would rather have no moderation of pressures, and that at the present time it appeared that Mr. Shepardson leaned in that direction. His own view was that the management of the System Account ought to continue moderately to moderate the pressures on reserves.

Mr. Allen noted that the projections of the New York Bank indicated net borrowed reserves of $164 million for the week ending December 4. Assuming the directive was to be renewed in its present form, he inquired whether that action would mean that net borrowed reserves should be moved below that figure.

Chairman Martin said he was assuming that that figure was a rather rough estimate. During the past three weeks, net borrowed reserves had not gotten down to the level discussed at the meeting on November 12. As Mr. Allen had pointed out, he agreed that the Desk had performed beautifully during the past three weeks. It would be faced with a tightening problem during the next few weeks. What we were dealing with was a general prospectus within which the Desk would have to operate.

Mr. Leach said that if the present directive were renewed, he felt there had to be some further easing in the reserve position.

Chairman Martin said that this was his view and he thought it was the consensus or the majority opinion that we should move in that direction.

Mr. Leach emphasized that he did not wish to change the wording of the directive at all. He simply wished to point out that if the directive was adopted in its present form, it meant that there should be some moderation from the position we were in today.

Mr. Mills said that presumably we were thinking about the distribution of reserves. The run-off of loans was in the money market banks that are located in the financial centers that get the first benefit of open market operations. Therefore, if reserves were supplied to moderate the situation, those reserves might concentrate in the areas that need them least and they might not move tc the country bank areas which, judging from statistics, are not as comfortably supplied. If that should be the case, undue ease might be felt in the money markets, with repercussions on the prices of Government securities and other market instruments.

Chairman Martin said that he knew of no real way of meeting that situation. He thought it necessary to give the maximum latitude to the Manager of the System Open Market Account who then had to do the best he could with feel and color of the market.

Mr. Irons said he was not sure that the directive would require any further moderation in the reserve position if renewed in its present form. The directive called for a change in the light of the discussion at the November 12 meeting, when the Committee was moving from a restrictive to a less restrictive policy. During the past three weeks there had been some moderation in restraint. The fact that the directive would read "by moderating the pressures on bank reserves" if renewed in its present form would not, in his opinion, mean that we would have to move further during each period.

Mr. Hayes expressed the view that the Committee established its statement of policy at each meeting. If this was correct, he would interpret the renewal of the present directive as calling for some moderation from where we are at the time of the renewal.

Mr. Irons responded that if this were done over and over, at some point we would reach a point where we had "moderated" to a very excessive degree.

Mr. Johns said that in the past the Committee had not attempted to state the degrees of restraint in its directive, but whether we were on the side of restraint. He thought the discussion was making a very literal definition of the word "moderating."

Mr. Vardaman said that in order that there might be no misunderstanding, it might be desirable for Messrs. Robertson and Shepardson to state exactly what they would like to see done.

Mr. Robertson said that the Chairman's summary had covered his dissenting view.

Mr. Shepardson said that he had made the statement that he thought the Committee should continue about the present degree of restraint,which in line with the comments by Mr. Rouse he would take to be a somewhat moderated position from that contemplated at the last meeting.

Chairman Martin said that we could play with these words too much. He thought we were talking about trends and he had put Mr.

Shepardson in the category of leaning some in the direction of having no moderation in pressures. He inquired whether the Committee would be reasonably happy with the summary conclusion as he had stated it.

In response to a question from Mr. Robertson as to whether it was necessary to readopt a directive at this meeting, Chairman Martin said that he thought this was necessary. In further response to Mr. Robertson's question as to how the phrase "by moderating the pressures on bank reserves" appearing in clause (b) of paragraph (1) of the directive was to be interpreted, Chairman Martin said that he thought the correct interpretation should be that this called for a continued moderating of pressures on bank reserves.

Mr. Hayes said that he thought it would mean that we were to move to a somewhat lower level of pressure than in the period since the preceding meeting of the Committee.

Mr. Robertson said that this was his interpretation also and that on that basis he would find it necessary to dissent from the action renewing the present wording of the directive.

> Thereupon, upon motion duly made and seconded, the Committee voted 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 fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves, 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.

Votes for this action: Mr. Martin, Chairman; Mr. Hayes, Vice Chairman; Messrs. Allen, Balderston, Bryan, Leedy, Mills, Shepardson, Vardaman, and Williams. Vote against this action: Mr. Robertson.

Mr. Robertson stated that his reasons for dissenting were the same as those stated previously for dissenting from the wording of the directive adopted at the meeting on November 12.

It was understood that the next meeting of the Committee would be held at 10:00 a.m. on Tuesday, December 17, 1957, and that tentatively the following meeting would be held at 10:00 a.m. on Tuesday, January 7, 1958.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary