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, February 11, 1958, 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
Mr. Williams

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

Messrs. Erickson, Johns, and Deming, Presidents of the Federal Reserve Banks of Boston, 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, Tow, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Koch, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Messrs. Gaines and Stone, Managers, Securities Department, Federal Reserve Bank of New York

Messrs. Roosa, Daane, Abbott, Strothman, and Wheeler, Vice Presidents of the Federal Reserve Banks of New York, Richmond, St. Louis, Minneapolis, and San Francisco, respectively; Mr. Balles, Assistant Vice President, Federal Reserve Bank of Cleveland; Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas; and Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston

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 January 28 through February 5, 1958, and a supplementary report covering commitments executed February 6 through February 10, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Reporting on the management of the System Open Market Account since the last meeting, Mr. Rouse said that it had been possible to maintain an even keel in the market during the period of the Treasury financing with minimum open market activity. The New York banks have been in a relatively tight reserve position for the past few days, principally as a result of loans to dealers to carry maturing securities that have been exchanged for the new issues. The new issues will be delivered on February 14, and the New York situation should unwind itself at that time.

On the whole, the Treasury refunding was successful, Mr. Rouse said. Attrition on the 3-3/8 per cent certificates, the most important issue in the exchange was only 5 per cent. Special circumstances with respect to interest adjustments and other factors led to somewhat larger attrition in the case of other "rights." Both the market and the Treasury were well pleased at the outcome of the operation. Mr. Rouse said he was surprised that subscriptions for the long-term 3-1/2 per cent bonds had not been larger; he had expected an amount above $2 billion rather than the $1.7 billion subscribed for. There was some speculation in this issue at first, but that soon quieted down. Trading since the books closed reflects good investor interest.

The problems confronting open market operations in the near future are related to Treasury operations. Mr. Rouse reported that the Treasury had just sold $100 million of gold and had transferred the proceeds into its balances to avoid reducing these balances below a minimum working level, and another $100 million might be transferred into the balance from the sale of gold today in order to meet expenditures. Another problem, related to the Treasury financing, will be the distribution to investor of the $500-$700 million of new issues taken by the dealers. However, the dealers had been successful in reducing their positions in preparation for the refunding, so that their total positions are not dangerously large even with the addition of the new issues. Finally, Mr. Rouse reported that the Treasury will soon have to be in the market again to raise new money. It now appears that the Treasury will need another $1 billion to see it through the middle of March. Since the earliest action by the Senate that can be expected on the increase in the debt ceiling is February 19, it might be assumed that the Treasury will not be in the market to raise this additional cash before late February or early March.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period January 28 through February 10, 1958, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Young made a statement on the economic situation supplementary to the staff memorandum that had been distributed under date of February 7, 1958. Mr. Young's comments were substantially as follows:

> Up to this point, recession in general activity has continued:
>
> (1) The index of industrial production for January is given a preliminary estimate of 133, down 3 index points from December. January declines were again general, but greatest in durable goods and durable goods related industries.
>
> (2) Manufacturers new orders for December showed a 2 per cent drop from November and were down 7-1/2 per cent for the year. The drop in new orders for durables was especially sharp. Such orders ran a fifth below a year ago.
>
> (3) Except for retail lines where stocks rose somewhat, business inventory liquidation continued in December. Some liquidation took place at wholesale levels, but liquidation was mainly concentrated in durable goods manufacturing. In these lines, liquidation again failed to keep pace with the decline in sales so that the stock-sales ratio rose further to the highest level in a decade.
>
> (4) Construction activity in January continued at close to record levels with declines in private activity, except public utilities, offset by increases in public construction, especially highways.

(5) The length of the workweek in January declined to 38.7 hours, the lowest level of the postwar period, and unemployment from mid-December to mid-January rose by 1.1 million to 4.5 million, or close to the postwar peak of 4.7 million in February 1950. Further declines in employment were general, but especially marked in durable goods lines. The rise in unemployment among younger men has been very sharp, and for women only moderate. Initial unemployment claims, by the latest reports, are still at very high levels. Insured unemployment is at a record level.

(6) In January, deliveries of new cars were over a fifth under both December and a year ago. Dealer stocks rose 40,000 further to 822,000. Used car sales were up from December, but ran about 4 per cent under last January. Used car stocks were little changed at an eighth higher than last year. At the beginning of the year, used car prices, after adjustment for depreciation, were about 12 per cent under midsummer levels and 9 per cent under a year ago. Used car prices firmed moderately in January.

(7) Total retail sales over-all for December are now estimated 2 per cent higher than in November, or double the increase estimated earlier. In January, department store sales declined about 4 per cent from December. Despite information showing lower department store sales for January and also very low January sales for new automobiles, the preliminary Bureau of the Census estimate of total retail sales for January arrives at a 1 per cent gain in retail sales over December.

(8) Commodity price levels have not yet shown downturn. At wholesale, industrial prices continue about a half per cent higher than in the first half of 1957. Prices of industrial materials have been relatively stable since the autumn declines, with changes in individual prices offsetting. Prices of processed and fabricated items, which were still rising in the autumn, have since been fairly stable. A few cutbacks in selected prices of fabricated goods have occurred recently and reports of off-list concessions on other goods are becoming more numerous in the trade press. Prices of foods and foodstuffs have risen again this winter and are 3 per cent above a year ago. Livestock prices are close to the high of last summer and about a fifth higher than last year at this time. The consumer price index for January is expected to show little change from December.

(9) Preliminary estimates of first quarter GNP performance are now being made, and these suggest a further

decline of 4 to 5 billion dollars, annual rate, putting total output back to the $429 billion level of the first quarter of last year.

(10) December exports were down sharply after two months of stability to a level 15 per cent under last year's first quarter peak average, but imports apparently held close to levels of preceding months. While economic developments in Latin America and Asia are on the weak side, those in Europe continue to manifest steadiness. In addition to steadiness of economic activity, there are other encouraging developments for Europe--definite signs of monetary stabilization for France and reconstitution of monetary reserves of countries under serious strain in the summer and early autumn, including Britain.

* * * * *

At the outset, we said that up to this point recession has continued. In conclusion, on the basis of the latest economic data and also on the basis of past experience with contraction periods, we can say that recession is continuing. Downward adjustment has gained in momentum and signs of leveling out, or saucering out, are not yet at hand. That point may not be far off, however. Past recessions of moderate severity have involved declines in production averaging about 10 per cent; the decline from August to date has been 8 per cent. In the past, the phase of decline has typically been less than a year, and the pattern of decline has been at first rapid and then gradual. After five months of rapid decline, the economy should be nearing the phase of gradualness. Past cyclical patterns suggest that the upturn phase when it sets in will not be decisively identifiable as of a particular month, but will be a phase lasting, at least, several months and possibly longer. We may, of course, be surprised at the suddenness, speed, and other characteristics of revival in economic tendency once a bottom has been established.

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

1. Business loans at city banks were liquidated in a record-breaking amount during January. A decrease of $1.7 billion since Christmas was nearly $1 billion larger than the December increase. Last year the post-Christmas

decline of $1.1 billion was about $200 million larger than the pre-Christmas increase. Nearly all groups of borrowers showed decreases, with the sales finance companies showing the largest decline relative both to other groups and to previous years.

2. Bank loans on securities fluctuated widely. After increasing about $600 million in December, they declined by almost as much in January, but then increased again last week by over $500 million. These movements reflected principally loans to dealers in connection with Treasury financing operations.

3. Banks have also increased their own holdings of securities on balance since the end of November--both Governments and others. Following a substantial increase in December of about $1.5 billion, city banks reduced their holdings of Governments by about $500 million in the first three weeks of January, but in the past two weeks have again added to their holdings. The net gain for the past ten weeks amounts to about $1.5 billion, for total investments, compared with a small decrease last year.

4. Total loans and investments increased more in December and have decreased less since the turn of the year than they did last year or the year before. The net result for the 10 weeks has been an increase of about $1 billion this year compared with a decrease of over $1 billion last year. On balance this year's increase is largely accounted for by holdings of securities and loans on securities at New York City banks.

5. Demand deposits at banks increased seasonally in December and declined seasonally in January. Including the first week in February, which showed a sharp drop last year, the net change in 10 weeks appears to have differed little from that for the same period last year. United States Government deposits have declined less this year than they did last year.

6. Time deposits at city banks, which increased by $700 million in December and January last year, when higher interest rates were announced, advanced even more sharply this year, showing a growth of over $1 billion. Much of this growth was in deposits of foreigners at New York City banks.

7. Financing operations by the Treasury have included some new money obtained smoothly by an increase of $100 million in each weekly bill issue--now at an end--and the large scale refunding operation now in process. The latter, as

pointed out, has involved a large amount of switching of issues, with dealers and banks increasing their positions and with bank credit brought in to finance dealers. Attrition in the maturing issues was normal for the February maturity, but fairly large for April maturities, particularly the special bill. This indicated the difficulty of obtaining maximum exchanges on issues considerably prior to maturity at reduced interest rates. Savings bond redemptions were smaller in January than they have been. Treasury cash balances, however, have been kept at lower levels than in many years. The refunding operation will result in removing over $5 billion of short-term issues and increasing the medium and long-term issues outstanding by a similar amount. About $4.5 billion more of short-term issues will be retired in the next two months, but the Treasury will also have to obtain about $4 billion of additional cash through borrowing in the same period.

8. New security issues by State and local governments are proceeding at record-breaking volume. Some issues deferred last year are now being brought out. Corporate issues have been about 25 per cent less than in the same period last year. Total capital issues in January and February are about a tenth less than last year's record figures. Interest in home mortgages is reviving rapidly and interest rates on mortgages are declining.

9. Short-term interest rates have declined to the lowest levels since early 1955, while long-term rates have been somewhat firmer in the past two or three weeks. The rate structure has been affected by the shift in maturities of outstanding debt resulting from the Treasury refunding offering. Some recent purchases of the new securities are being carried by dealers and will need to be paid for by the buyers next week. Consequently an appreciable volume of adjustments remain to be made in the market before the interest rate structure can be viewed as reasonably settled. It is possible that bill rates may not remain at their present low levels, or other rates will decline further.

10. Reserves to cover credit demands have been abundantly supplied either through market factors or System operations. Since the last week of November member bank required reserves have increased by about $100 million, whereas some decline might have been expected on seasonal grounds. At the same time there has been a larger drop in float than was expected. Reserves have been supplied, on the other hand, by a larger than seasonal post-Christmas currency return and recently by

a temporary reduction in Treasury balances at the Reserve Banks. Additions to System holdings of Government securities were much larger in December than usual, while the January decline was smaller than usual with a small net increase for the 10 weeks, whereas last year there was a net decrease of nearly $800 million. Some of last year's reduction was to offset reserve additions resulting from the $300 million sale of gold to the Treasury by the I.M.F. Member banks' net reserve positions have shifted from net borrowed reserves of over $300 million in the last week of November to free reserves of over $200 million in the past two weeks, whereas last year net borrowed reserves increased.

11. Projections for the next few weeks, assuming a normal seasonal pattern for deposits and currency but a further reduction in Treasury balances and the use of some of its free gold, indicate that free reserves may fluctuate around $300 million during February and increase sharply, though temporarily, to about $700 million in the first half of March, unless offset by System operations. A Treasury financing operation to raise new cash and build up its balances at any time during this period would lower these estimates of free reserve averages.

Mr. Hayes then made the following statement of his views with respect to the business outlook and credit policy:

Nothing has happened in the last two weeks to change our estimate of the business outlook. There is, as yet, no sign that the recession is nearing an end, and as I stated at the last meeting, we should probably give major attention in determining policy to the unfavorable realities of the present situation, granted that we may be again confronted, in the not too distant future, with a resumption of the inflationary problems faced in the last two or three years.

There are no indications that the process of inventory liquidation has run its course or that capital expenditures are about to stabilize at the present level. On the encouraging side, consumer spending has been sufficiently well maintained to suggest that we may be able to avoid the spiraling effect of a cumulative recession.

As is often the case, the price situation appears to be decidedly confused. The generally sideways movement of wholesale and consumer price indexes may fail to give adequate recognition to all of the discounts and markdowns actually available to consumers as well as to purchasers of producers' goods. On the other hand, if the price indices are taken at face value, we find disturbing evidence of price rigidity at a time when decreasing business activity should tend to produce some price declines.

In the area of bank credit, the last few weeks have witnessed a very rapid drop in business loans, while holdings of investments showed little change, in contrast with the sizeable growth in investment holdings during preceding weeks. The Treasury's successful financing program, involving some curtailment of the available supply of short-term investments, contributed to the very sharp reduction in short-term market interest rates, while at the same time subscriptions for about $1.7 billion of the new long-term 3 1/2s will mean a significant reduction in the supply of long-term funds available in the capital markets. It is still uncertain whether, and to what extent, the Treasury will attempt to raise new cash during the next few weeks. Until this prospect is clarified, possibly through action next week by the Senate on the debt ceiling, we will not know how long it will be necessary to maintain the "even keel" policy adopted at the last meeting.

Turning to policy, with reference first to the discount rate, I do not think we need be concerned over the wide disparity which now exists between the discount rate and the rates on Treasury bills and other market instruments. With borrowing by member banks at a low figure, in keeping with our current policies, the discount rate is of limited effect. Even though in general it is desirable to have the rate maintain reasonably close touch with the realities of the market, there is no need for any close correlation from week to week, especially when the banks are not making active use of the discount window. Quite apart from the possibility of our having to keep our "even keel" policy, I would be inclined to leave the discount rate where it is for the time being.

As for open market operations, I believe that economic conditions call for continuation of at least the same degree of ease existing during the past two weeks, during which period net free reserves have been around the $200 million level. It seems well to bear in mind that we should avoid over-emphasis of free reserves as a measure of ease or tightness, since the reliability of this kind of measure may be even less in a period like the present than during severe credit restraint. During the past two weeks, at least until the last few days, there have been ample funds available in the money market, and Federal funds have held below the discount rate much of the time. Furthermore, commercial banks in New York and other parts of the country have added to their holdings of short-term Government securities since credit policy eased, indicating that they have had more than enough funds to take care of customer loan demand--and any additional funds we might supply might result mainly in further buying of short-term Governments by the commercial banks, rather than in a materially higher level of free reserves. Parenthetically, I might point out that improvements in bank liquidity through the accumulation of short-term Government holdings are part of the preconditioning which the banks need, if they are to be actively seeking new business credits--but we should not wish to push this "liquefaction" too far too fast. The lessons that banks and others have learned in the past few years with respect to keeping their funds very fully employed may have created a situation in which smaller free reserve figures can achieve a given degree of real credit ease than would have been possible in earlier years. On the other hand, we should also not overlook the possibility that a steady figure for net free reserves might well conceal a steady shrinkage of bank credit under certain conditions.

All of this points to the desirability of our giving more attention, as I suggested at the last meeting, to the trends of total reserves and the money supply as important criteria for monetary policy. While recognizing the pitfalls in using these criteria in any mechanical way, it does seem to me encouraging to note that total member bank reserves, which were at or below last year's level during most of January, have shown small gains over last year during much of the past two-week period. I would hope that this trend would continue, with a gradually widening excess over last year's figures.

The current projections suggest that it may be unnecessary to do much in the way of open market operations over the next few weeks. We may have to offset to some extent the bulge in reserves expected in the week ending February 19th, as a result of very low Treasury balances with Reserve Banks and an increase in float. However, it is probably just as well that market factors will be working in the direction of ease. The sale of bills in sufficient volume to retain the present $200 million level of free reserves might, at least temporarily, affect the distribution of reserves and create unwanted pressures in the central money market. My recommendation would be, therefore, that we view $200 million of free reserves as a rough minimum figure during the next few weeks, but that the Manager be given leeway to offset only as much of the expected reserve bulge as is necessary to avoid significantly easier money market conditions, while stopping short of a volume of selling that might tighten the market. Movements in New York reserve positions and in short-term market rates of interest would also be used by the Manager as important guides in maintaining a steadily easy tone in the money market.

For the time being, I think the directive may be left unchanged, although at some point I would hope that we might give official recognition to a wish to encourage growth in the money supply as an offset to economic recession.

Mr. Johns said that Eighth District banks seemed to be well supplied with reserves. Except at the Memphis Branch, where an unusual cotton situation had thrown upon the banks demands for loans which are not customary at this time of year, there was almost no discounting at the St. Louis Bank. For the first time in a considerable period banks are in a mood to welcome applications for loans and soon may aggressively be seeking loans. If it were not for the even keel policy which the Committee adopted two weeks ago and which he believed should be continued, Mr. Johns said that perhaps he would be somewhat more generous in supplying reserves, and he might think that the Bank should begin to consider another reduction in discount rate. However, he assumed the even keel policy would make such action inappropriate at the present time, and he thus favored continuing about the present position.

Mr. Bryan said that he had not receded from the view that, while recent Committee policy had been in the right direction, it had been inadequate. From mid-November to February 5 the net change in total reserves in the banking system amounted to only $34 million on a daily average basis. In Mr. Bryan's opinion, this had been seriously inadequate in a period of recession.

Mr. Williams reported that recession continued in the Philadelphia District. Manufacturing employment continued to decline and there was a substantial labor surplus. Department store sales were holding up well, but automobile registrations were off in January following an increase in December as compared with a year earlier. Construction awards in December were about 12 per cent below a year ago. Business loans were down 4 per cent from last year, when they were relatively low. Member bank borrowings presently were only a fifth of the year-ago level.

Mr. Williams said that recession at the national level, both in magnitude and pervasiveness, suggested consideration of a further change in the discount rate in the near future if this movement should continue. At present, his view was that free reserves should be continued at about the existing level.

Mr. Fulton said that a Fourth District businessman had characterized the present situation with the comment that it seemed to be stabilizing on a low plateau. Unemployment appeared to be leveling off. Claims for benefits continued to rise but at a lesser rate than for some time. Liquidation of inventories continued. Steel operations in the Pittsburgh area were up slightly during the past week but in the Cleveland section had declined to 34 per cent of capacity reflecting lowered operations at pipe mills which had suffered severe cancellations for steel for gas pipe lines. Heavy construction was holding up fairly well, but residential construction had declined largely for seasonal reasons. Although department store sales were down from the strong December level, sales during the past four weeks had approximated last year's performance. Business loans at banks had been reduced 50 per cent more this year than last. Banks were in an easier reserve position and were looking for term loans again. Mr. Fulton said that in view of the leveling off of the decline, he felt the discount rate should stay where it is and that the reserve position of banks should be maintained about where it has been during the past two weeks. The Manager of the System Account should be given latitude to meet any situation that might arise.

Mr. Shepardson said that Mr. Young's report indicated clearly that the economy had not reached the bottom of the recession yet. He was concerned as to what part the System should play in bringing about an upturn. Recalling the comments at the preceding meeting regarding the lack of growth in the money supply and Mr. Irons' suggestion that in 1957 the shift from demand to time deposits affected the statistics, Mr. Shepardson said that the change in velocity of money over the past year also was of significance. At his request, the staff had prepared some figures which indicated that, while demand deposits adjusted had risen by only .5 per cent in 1957, the product of deposits times turnover had risen consistently over the past several years. In 1957, this increase amounted to 7 per cent compared to a range of 6.4 per cent to 8.6 per cent in the previous five years. Mr. Shepardson said that it did not seem to him in light of these figures that the slowdown in growth of demand deposits had necessarily resulted in an inadequate growth in the effective money supply essential to supporting normal growth in the economy. He wondered what would be accomplished by a further relaxation of credit at this time, adding that in his view there was considerable doubt that such a move would be desirable in terms of the long-run objectives of growth and stability. In elaborating on this comment, Mr. Shepardson made a statememt substantially as follows:

First, there is little evidence of inability to obtain credit to meet legitimate needs of business. On the contrary, there is increasing evidence that banks and other lending institutions are in a position to meet such needs and are anxious to do so.

Second, it is difficult to identify desirable types of expenditure which might be stimulated by increased credit availability or lower credit cost at this juncture. Encouragement by easier credit for further business plant and equipment expenditure at this time, even if it were possible, would be highly questionable in the light of the current relationship between capacity and final takings. Furthermore, this is one of the areas where costs have increased at a comparatively rapid rate and are still at high levels. For example, wholesale prices of machinery and motive products, as measured by the B.L.S. index are still at about 150 per cent of the 1947-49 average--an all time high.

While there may be isolated instances of needed State or local expenditure programs that are still being postponed in the hope of more favorable financing, I am doubtful that further credit ease at this juncture would bring forth any substantial increase in this type of expenditure.

I see no reason to suppose that further easing of credit conditions generally would bring about a constructive increase in the availability of credit to consumers for durable goods purchases and thus stimulate consumer expenditures in this area. Current evidence indicates that such credit is readily available on as liberal terms as prudent lending policy would permit.

The one area where further credit ease might provide an important stimulus is in construction--especially in the residential sector. Activity here is already being stimulated by an increased availability of funds from savings banks and insurance companies. Further easing of the general credit situation would undoubtedly increase the interest of these institutions, and of commercial banks and savings and loan associations, in both completed mortgages and commitments to take mortgages generated in the coming building season. While building activity arising from increased credit availability and lowered credit cost might provide an added cushion in the months ahead, I am impressed by the possibility that over-building, at this juncture, might result in an excess supply of houses priced beyond the means of the bulk of potential buyers.

Building costs are still near their all time highs and, as the Chairman has pointed out from time to time before Congressional committees, they have risen more rapidly in the postwar period than most other costs. In the same period builders have geared their operations and expectations to the very high rate of family formation and a large backlog of demand. In this climate, the ready availability of mortgage funds at low rates--perhaps even low enough to activate a last spurt in the VA program--could encourage builders to start more houses than could be sold at the high prices present costs dictate.

All this seems to me to argue strongly in favor of a cautious and moderate policy so far as the Federal Reserve is concerned. This is certainly not a time when the banking system should be squeezed for liquidity and I want it to be perfectly clear that I am not urging any reversal of the present policy, which has permitted a considerable increase in liquidity, both at banks and other financial institutions. I also recognize that to some extent the current ease in credit markets may be due to seasonal influences and that some action on the part of the Management of the Account may be necessary to maintain the present degree of ease in the weeks ahead. I have no objection to such action, but I do not feel that additional ease--beyond that which has prevailed in the last two weeks--is necessary or desirable at this time.

Mr. Shepardson said that he would not favor a change in the discount rate at the present time and that, with the usual leeway being given to the Manager of the System Account, he would suggest that we should aim at holding about the present level of reserves during the next three weeks.

Mr. Robertson stated that in his view we should retain the status quo in our credit policy for the immediate future at least, and since in his opinion this would be in accord with the majority view, he requested the privilege to insert in the record the following comments prepared to substantiate his conclusion, together with the right to re-enter the discussion in the event the majority view was not in accordance therewith. This privilege having been granted, his statement is set forth below:

Let me say at the outset that my remarks today should not be interpreted as a criticism of past policy or action, even though I have not agreed with all recent aspects of such policy and action as it has developed. Rather, my remarks today assume our current position and are addressed to the most appropriate next steps forward.

To state my conclusion before my arguments, it is for the retention of the status quo in our credit policy, for the immediate future at least, rather than for an intensification of our already rapid easing actions. I reach this conclusion for the following reasons:

In the first place, we have already achieved, or are in the process of achieving, through actions already taken, the lion's share of the contribution that credit easing action can make in a recession. This has been clearly indicated by such developments as the very dramatic declines in market interest rates, the greater availability of all types of capital as well as credit, the re-emergence of many previously postponed security issues of business corporations and State and local governments, and the reduction in mortgage discount rates.

Moreover, it is generally recognized that credit easing actions take time before they achieve their full effectiveness, that is, before they achieve their maximum impact on spending and investing decisions. Why not give our previous actions a little time to take effect before rushing into further rapidly easing actions?

My fears regarding further rapidly easing actions stem from a feeling that such action not only would not add materially further in assisting recovery, but also that it might very well lead to credit maladjustments and overcommitments that would actually delay the development of a healthy and sustainable recovery. Unduly sharp and rapid changes in interest rates and capital values produce speculative developments that disturb rather than settle financial markets and distort rather than promote economic development. In fact, to my mind, overeasing now could so contribute to misguided financial decisions that it would enhance the likelihood of the economy having to go through a protracted period of severe liquidation and structural realignment before it recovers.

My plea for retention of the existing degree of credit and monetary ease is based also on the firm view that our longer-run inflation problem is still very much with us. I am greatly concerned that we are not getting the price adjustments that are so necessary before a healthy recovery can set in. And I feel very strongly that the economic situation this spring should be such as to insure sound and sustainable wage contracts rather than one that encourages business management to accede to wage demands that are in excess of gains in productivity.

It seems to me that we would all do well to examine carefully the economic road that England is taking today. She seems to be facing her all important wage problems and the longer-run adjustment of demands to resources in a much more direct and potentially effective manner than we are.

To conclude, I would strongly urge that we continue to maintain a free reserve position of banks at approximately the recent level and that no further action on discount rates be taken. Although discount rates are for the moment out of line with Treasury bill and other short-term market rates of interest, I regret the very rapid decline in such short-term market rates that has occurred recently and that we have facilitated by our open market operations. If we maintain our present credit posture, however, I feel that rates will re-attain an alignment which to my mind would be more consistent with our aim of contributing to monetary and credit developments in a way that will maximize the possibility of achieving a firm and vigorous recovery once needed readjustments have occurred.

There are no important basic reasons why the discount rate should be moved immediately in line with existing lower market rates. For the time being the 2-3/4 per cent rate will do no great harm. As long as money seems to be relatively easy in the market, as it has been in recent weeks, with free reserves available to the banking system and Federal funds generally quoted at much below 2-3/4 per cent, the 2-3/4 per cent discount rate is not an effective rate in terms of the market and the banking community. In the 1953-54 easy money period, the discount rate generally lagged behind the Treasury bill rate and the spread between these two rates was much wider than during the following tighter money period. The availability of funds during such periods is a more important consideration than the level of this key rate. Furthermore, an additional discount rate drop at the moment might cause unwarranted concern over the economic condition of the nation.

On the other hand, there are reasons why serious consideration should be given to moving the discount rate down in the not too distant future so as to be more in line with market rates. If the economy turns around and begins to boom again later in the present year, there is something to be said for having the discount rate at that time in close proximity with existing market rates so that upward adjustments could be made not only rapidly but, if necessary, in quite large jumps so as to be effective in resisting inflationary pressures.

Mr. Mills said that between now and the next meeting of the Committee, development of System policy would have to be shaped against two almost conflicting factors. On the one hand, there was evidence of accelerating momentum to the deflationary tendencies in evidence, while on the other hand it is known from experience that the first quarter of each year is always a period of low economic vitality and obscure visibility. There is a possibility that as spring opens up economic activity will revive. As of today, however, the acceleration of deflationary tendencies is the overriding problem and it is necessary to shape System policy against that background. To do so requires the Committee to look on public attitude and psychology as an economic factor rather than as a general outside influence and to be alert to the fact that in the public view, the System has lagged in providing reserves and thereby in giving the kind of encouragement that derives from making additional reserves available to the commercial banking system. On that reasoning, Mr. Mills said it would be his thought that the Committee should allow natural factors to assert themselves over the next three weeks and permit the supply of positive free reserves to range around the $300 million level. However, before moving to that position it would be advisable to wait until after February 14 or 15 to see if the windup of the Treasury's financing operation had resulted in a marked easing of the reserve positions of central reserve city banks and an easy tone in the money market. If so, a further increase in the supply of positive free reserves could be deferred.

Mr. Mills said he shared the concern suggested in Mr. Hayes' comments that a too free supply of reserves, although initially desirable to encourage the commercial banks to strengthen their liquidity positions, could ultimately force a reduction in the level of interest rates to a point that would cause the banks to extend the maturities of their security holdings in order to maintain their earnings, and in doing so to impair rather than improve their liquidity. Problems from such a development could arise at such later date as the System found it necessary to reverse its credit policy and the commercial banking system was then caught with a depreciation in the value of its holdings of U. S. Government and other securities at the same time that a deterioration in economic conditions had left a substantial portion of its loans in a relatively frozen position. Notwithstanding those potential difficulties, Mr. Mills said, he felt that the psychological situation should be taken into account in the Committee's policy formulation and that the level of positive free reserves should be permitted to rise above the $200 million figure.

Mr. Leach said there was little additional information on economic conditions in the Fifth District since the preceding meeting, but the most recent data on unemployment, employment, and production indicated no diminution in the downward trend of economic activity.

Mr. Leach went on to say that he felt very strongly--perhaps as strongly as one can feel about such things--that inflation is our long-run problem and that we may be fighting it again in the not too distant future. However, inflation is not our immediate problem. There has been a definite recessionary movement in the economy for some time and the end is not in sight. Under a flexible monetary policy, Mr. Leach said, the Committee's posture should be consistent with the state of the economy. To him, this meant that reserve availability should be increased somewhat further as soon as this could be accomplished without interfering with the Treasury financing. Such ease as we had in 1954 when free reserves ranged from $600 to $800 million and the bill rate fluctuated around 3/4 of 1 per cent would be far more ease than the current situation called for and would create grave risks for the future. At this time, he was thinking in terms of a degree of ease consistent with free reserves in the $300-$350 million range. To advance beyond such a range under existing circumstances might merely drive down short-term interest rates without real benefit to the economy. The Committee now had an even keel policy during Treasury financings, and this policy would prevent the Committee from adding to reserves for the time being. However, he wished that free reserves were a little higher than at present, and in carrying on operations he would be as easy as we could be without upsetting the principle of an even keel during the Treasury financing. Any action should be in the form of an easing of reserve availability rather than use of the discount rate at this time.

Mr. Leedy said that there had been no change of significance in the Tenth District since the preceding meeting. On the assumption that operations during the next three weeks should not differ much from what they had been during the past few weeks, Mr. Leedy said he would favor letting the natural forces that were operating to ease reserve positions have fairly full play with free reserves in the $200-$300 million range. He would watch yields on short-term obligations feeling that largely they should be permitted to find their own adjustment. He would not favor a program of providing much additional ease if it would indicate that the Committee might be contributing to a substantial further lowering of yields on short-term obligations. However, as soon as it could be done in the light of the Treasury's operations, he would permit the natural forces to have free play moving toward the upper end of the $200-

$300 million free reserve range. He would make no change in the discount rate for the present.

Mr. Allen said that business in the Seventh District had declined further in the past few weeks although the pace of decline may have slackened in some sectors. The level of unemployment continued below the U. S. average in all Seventh District States excepting Michigan. District department store sales after showing up relatively well in preceding weeks slumped sharply in the week ended January 25. Although steel production continued at a depressed level, Mr. Allen said that some observers felt that the firming of the price for steel-making scrap might indicate that the bottom had been reached in steel output. However, he did not feel sure that inventory liquidation had reached the point where increased production would soon be required to maintain the current rate of steel consumption.

With respect to automobiles, Mr. Allen reported that sales did not show the usual pick-up during the last ten days of January. Average daily sales rate in the first 10 days of January was 14,657, during the second 10 days 14,653, during the last 10 days 14,672, and for the month as a whole 14,661 or 22 per cent below January of 1957. Production continued well ahead of sales and it looked as though there would have to be a cutback from the schedule of 112,000 cars a week. Inventories of new cars in dealers' hands on January 31 totaled 822,000 compared with 726,000 a month earlier. Dividing the inventories on January 31 by average daily sales during January indicated a 56-day supply of cars in dealers' hands.

Declines in loans at Seventh District banks in recent weeks more than offset deposit declines, Mr. Allen said, even to the point of permitting some increase in security holdings. None of the large district banks had been using the discount window and only one was now a regular buyer of Federal funds. The others were regular sellers. The situation suggested continued ready availability of bank reserves, Mr. Allen said, and this left him where he was two weeks ago when he expressed the view that we should not move further in the direction of ease unless and until we felt that the economy was in a downward spiral which would continue for some time. He did not feel that we were in such a spiral and would prefer that the Committee tread water to judge better the impact of the current degree of ease before making further moves in that direction. He considered that position defensible among other reasons because of the substantial decline in market rates which had occurred over such a short period. Thus, his conclusion was that for the next three weeks we should stay where we now are.

Mr. Deming said that a mild slide in employment and production continued in the Ninth District but that there had not been an acceleration of the downturn. However, crosscurrents in the national economic picture bothered him more than usual. With prices staying where they were and with retail trade holding at a high level, he did not have much concern about a progressive downward spiral. On the other hand, he found it more difficult to be complacent about 4-1/2 million of unemployed.

Mr. Deming went on to say that it seemed to him the banks had been using the funds generously supplied in the market to reach for a degree of liquidity that he had not realized they would reach for. He had underestimated how tight they felt last fall. It appeared that they had been using the reserves coming to them to provide more liquidity and that the reserves had not made them much more responsive to new loans. They seemed comfortable facing the loan decline that had taken place thus far, and there was no disposition on their part to look for more real estate loans or more consumer credit loans. This indicated that while the banks had received additional reserves the amount had not been adequate to loosen loaning. Perhaps in the long run the Committee would not wish to increase ease, but in the short run he was convinced that it should be somewhat easier than it had been. He found himself somewhat closer to the positions of Messrs. Hayes, Bryan, and Mills than to the positions expressed by others, although he recognized the danger of providing greater ease at present. However, he would think that it might be well to let the level of free reserves advance somewhat, perhaps as Mr. Mills suggested by not trying to offset the natural forces. Free reserves of $300 million plus would not bother him at all.

Mr. Mangels said that no important statistics had become available since the preceding meeting to change the picture given at that time. He had then reported that Twelfth District employment appeared to have shown only the seasonal changes in December, but final data becoming available indicated a slight decline during that month with total employment at the end of December 3/10ths of 1 per cent lower than a year earlier. It appeared that most of the worst of the adjustments in the aircraft industry had now been made. This also seemed to be true in the lumber industry and there was some slight indication of an uptrend, particularly if building improved during the spring. Steel production had declined during January and was 7-1/2 per cent lower than a year ago. Aluminum production had been cut back because of a lack of demand. Department store sales in January were down 3 per cent from December. Automobile registrations in December were up from November but were below December 1956. Both demand and time deposits figures had increased recently but loans since the beginning of the year had declined by four times as much as in January 1957. The largest decline came in business loans. Nominal borrowings were reported at the Reserve Bank and local banks were still net sellers of Federal funds. There was some feeling in the investment departments of banks that the bill rate would not go to over 2 per cent in the near future.

On the whole, the economy was still operating at a high level, Mr. Mangels said, with adjustments having taken place and more adjustments to come. These, however, seemed to be of a beneficial character and there had been an increase in productivity with a reduction in waste and inefficiency. Mr. Mangels thought that it might well be that we were not far from an upward surge in the growth pattern, and if too much ease were indicated by the System some of the adjustments taking place might be discouraged with the result that subsequently there might be a decline more precipitous than if the adjustments were now continued. Mr. Mangels said he had been happy with the recent rise in the bill rate and, looking ahead, he would assume that free reserves in the $200 million range would be about right. There should be no change in the Committee's directive and he had no comment to make on the discount rate.

Mr. Irons said there had been little change in the picture that he had reported two weeks ago. With respect to policy, he felt about as he did at that time. He would like to see no further easing. He believed the availability of reserves had been quite adequate and that this was reflected in the rate structure in the market. He would suggest continuation of about the same policy that the Committee had been following in the past two to three weeks, and he would certainly not wish to move in the direction of further easing. It was obvious that there should be no move in the opposite direction. He would have no suggestion of a change from the 2-3/4 per cent discount rates prevailing at most Reserve Banks. Net free reserves in the $200 million range would seem to be all right. He would not favor any aggressive action either by the Open Market Committee or by means of a change in reserve requirements to provide additional reserves to the market. He was pleased with the comments Mr. Mills had made about letting market factors have their influence, but he would not wish to see that carried to the point that would result in additional ease beyond that which now existed. Mr. Irons also commented that while there had been reference to an even keel during the Treasury financing, his position would be the same even if the Treasury were not in the picture. He would still come to the conclusion that he had expressed, namely, that there should be no further easing at this time.

Mr. Erickson said that the recession in business in the First District continued without any particular evidence of either acceleration or lessening. Last week one of the Boston Bank's outside men reported that he had been told that four machine tool manufacturers were re-hiring men, while one was reducing the number of work hours. Mr. Erickson said that the Boston Bank had checked with two of the larger firms. One reported that orders for machinery in December were substantially down from October and November and that January was no better, but that the industry as a whole might show some improvement. The other concern reported that the slowdown of new orders for defense products up until the first of December had been reversed. Department store sales in the first five weeks of 1958 were 3 per cent ahead of last year. In the survey of consumer credit, the data from 177 lenders made up of banks, finance companies, and credit unions, showed a drop in outstandings in December of $1.8 million despite a 7.9 per cent rise in extensions between November and December. This was the first time that outstandings had dropped since the series was started in 1956. Mr. Erickson said that for the next three weeks he felt that there should be no change in discount rates and that free reserves might be continued in the $200-$300 million range.

Mr. Szymczak said that he still felt as he had two weeks ago that the downturn would come to an end during the second quarter of the year and would show a leveling off or a slight upturn in midyear. If the decline should continue, that would add to the problems of the System. We could not disregard four to five million unemployed. On policy, for the present he would continue about what the System has been doing, but he would allow the market to add to free reserves up to the $300 million level or a little bit more. He was sorry that the discount rate could not be reduced at this time. He had been hoping that it could be reduced to 2-1/2 per cent but this seemed impossible at present. Therefore he would continue the policy the Committee had been following, allowing the market to provide reserves.

Mr. Balderston said that it now seemed clear to him that the depression involved more than an inventory adjustment. There was consumer debt that inhibited buying, excess capacity, and a profit squeeze and cost-price maladjustment. One could hope that no new increase in wages and price rises of pervasive type would occur this spring although that might be a vain hope. Whether managements and union officials would exhibit the needful restraint was yet to be seen, he said. One could not yet be certain that the upward creep of prices and wages had been halted. The dilemma of substantial unemployment was already here and its future extent and duration could not now be determined. Mr. Balderston's guess would be that the imprudent decisions of 1955 and 1956 and the resultant waste and inefficiency would take considerable time to overcome and that the depression would last until inventory shrinkage, price adjustments, and sales programs had taken care of some of the excess capacity. If, therefore, we must contemplate a depression of unknown length and severity, the question was what should be done.

Mr. Balderston's preference was for the use of tax reduction to place substantial funds of specific amount in the hands of individuals but on a one-shot basis that he hoped would be controlled as to amount. He was speaking of action to be taken by the Congress in terms of payroll deductions. This he would do not next year but right now. This action would permit monetary policy to be held back for a more propitious time. In the interim, monetary policy would be used only to facilitate the adjustments but not to force so much reserves on the banks as to induce speculation and to bid up bond prices unduly. However, corporate and bank liquidity needed to be rebuilt. Free reserves of about 1/4 to 1/3 of a billion dollars would be conducive to this, Mr. Balderston thought, and would help to soften the harshness of the downward adjustment. The current discount rates seemed to him appropriate for the moment, and he would not change the Committee's directive or the level of reserves at the present time.

Chairman Martin said he was not going to discuss tax policy or make a prediction on the time when the recession would end, but considering the fact that the Ides of March were approaching it seemed to him that the group was surprisingly optimistic. He thought that we might well expect at this time of year a great deal of pessimism. This was being indicated by some of the comments of members of the Congress. It was difficult to distinguish between pure politics and the real situation, but this did not minimize the importance of having 4-1/2 to 5 million of unemployed persons.

As to the views expressed this morning, the Chairman said that there seemed to be a surprising agreement in the comments made.

His own view was that the policy the Committee had been following was about right and that the results had been about as much as could have been anticipated in putting the posture of the System where it should be. The people who had been thinking that the System was wrong on the tight money policy now were spending their time saying that the System had lagged in easing too little or too late. He did not think these commentators were entitled to too much consideration in taking such an approach. It might be necessary at a later time, if there were clear indications that the recession was spiraling, to do something more drastic than had been done to date, but it did not seem to him at the moment that that was the case. He questioned some of the comments on the discount rate, stating that it really did not mean too much at the present time. There had been two downward adjustments recently and borrowings continued to lag. If one wanted to be completely technical, perhaps it would have been desirable to have gone to a 2-1/4 or 2-1/2 per cent discount rate rather than to 2-3/4 per cent, but it was his view that the System should be extremely careful at the present time about making greater difficulties by taking too many actions that were not effective. Quite aside from the Treasury's problem, if the discount rate were to be changed at the moment it might indicate that the situation was worse; it might be construed as a sign of panic and desperation on the part of the System and it probably would not achieve any constructive results. This should be borne in mind in using any of the instruments of System policy. The problem of reserve requirements which would be discussed later today at the joint meeting of the Presidents and the Board was one which must be considered carefully. If the System requested legislation in this field, that would be construed as a move toward reducing reserve requirements.

Chairman Martin said that during the next three weeks he would favor doing just about what the Committee has been doing during the past three weeks. He liked the views Mr. Leach had expressed in indicating that we might follow an "even keel policy tipped on the side of ease." He did not believe we could measure the degree of ease closely and he recognized that the Manager of the System Account would have to use his judgment. He would not wish to have any sizable increase in reserves develop but would think that the $200-$300 million range that had been mentioned and which was close to where we were at the moment would be about right and would be about as close as we could come to a consensus of the comments given in the go-around today. He also gathered that no change was desired in the Committee's directive. In response to Chairman Martin's question as to whether any of the members of the Committee differed with this statement, no comments were made, and he suggested, therefore, that the Committee reaffirm the directive to the New York Bank without change, with the understanding that operations would be carried on along the lines of the foregoing comments.

Mr. Rouse stated in response to the Chairman's question that he understood that policy would be continued with the same objective toward which the System Account had been aiming its operations during the past two weeks.

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 cushioning adjustments and mitigating recessionary tendencies in the economy, 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.

At this point Mr. Leonard, Director of the Board's Division of Bank Operations, entered the room.

Chairman Martin referred to the report submitted by the System Committee for the Study of Float dated December 16, 1957, and to the preliminary comments regarding that report made by Mr. Robertson at the meeting on December 17, and he requested that Mr. Robertson now review the recommendations contained in that report.

Mr. Robertson stated that the reports of the System Committee dated May 31, 1957, and December 16, 1957, and the April 19, 1957, report of its Subcommittee, submitted four basic questions or recommendations. These were:

1. How should float fluctuations affect open market operations?

   This question is before the Open Market Committee today.

2. What should be the role of the Federal Reserve Banks in the check collection process?

This is a major policy question for the Reserve Banks and the Board. The Presidents' Conference should be asked for a recommendation on this.

3. Change in time schedules to provide a maximum of 3-day instead of 2-day deferment.

This is an important question because, for one thing, any such change would absorb approximately $400 million reserves. Here again, the Presidents' Conference should be asked for a recommendation.

4. A review of operating practices, with a view to action leading to reduction of float and greater uniformity of operating practices within the System.

While some of the findings and conclusions in this area might depend upon the decision as to the role of the Federal Reserve in the check collection process, the Subcommittee on Collections might start promptly to formulate some tentative conclusions.

There should be no delay in making this review, which could lead to improved practices, increased efficiency, and a more realistic collection system. The review also might demonstrate, of course, that there is no possibility of improvement in these respects.

Mr. Robertson went on to comment in detail on these basic points. His statement was substantially as follows:

On the question of how should float fluctuations affect open market operations, the Committee's report of December 16, 1957 recommended that the Open Market Committee determine the following policy questions raised in the Committee's report of May 31:

1. Are float fluctuations sufficiently large and frequent to seriously and adversely affect administration of credit policy and open market operations?
2. Could float fluctuations be disregarded except in periods of major seasonal changes, such as December-January?

3. Apart from fluctuations as such, should the Federal Reserve System nevertheless take action to reduce the ever-increasing average level of float? Why? If so, what action should the System take to offset the resulting loss in member bank reserves?
4. To what extent does the trading desk attempt to offset fluctuations in float?
5. To what extent is the desk expected by the Open Market Committee to offset fluctuations in float?

The December 16 report stated that there would seem to be three possible basic approaches:

1. Ignore float as a special factor, base operations on the general reserve position, and treat changes in reserves due to float the same as changes due to other factors.
2. Treat float as a rather special factor, make allowance for the temporary nature of the swings in reserves due to fluctuations in float, and attempt to offset fluctuations in float or not depending on the circumstances.
3. Generally ignore changes due to float (except possibly for such major swings as in December-January) and endeavor to make it understood that fluctuations in free reserves (or any other aspect of the reserve position) due to fluctuations in float have no significance with respect to Federal Reserve policy. To further such understanding, the System might release daily figures as to the amount of float.

Another possibility would be a combination of 2. and 3., that is,

4. Plan to offset only unusual fluctuations in float or those covering longer than usual periods, and endeavor to make it understood that fluctuations in free reserves (or any other aspect of the reserve position) due to fluctuations in float have no significance with respect to Federal Reserve policy. To further such understanding the System might release daily figures as to the amount of float.

The second basic question that was presented was, what should be the role of the Federal Reserve Banks in the check collection process?

What has been the System's role historically? What is it now? What should it be? Should the System, for example, take positive steps to reduce the proportion of total check volume that is collected through the

System's facilities?

A number of the Subcommittee's specific recommendations, if followed, would tend in the latter direction: For example, sponsorship and organization of regional clearing facilities; a program designed to channel items payable in other Federal Reserve cities (interdistrict items) from first-collecting banks directly to correspondent banks in those cities.

The Reserve Banks, of course, should provide rapid and efficient check collection service. However, in certain situations, better or at least equally good service can be provided through other channels. In such circumstances, the Reserve Banks might well welcome the use of such other means.

A clear-cut answer to this question as to the proper role of the Reserve Banks would provide an important guide to those who may be assigned to study the specific recommendations of the Subcommittee on Float and to formulate plans for carrying out those that appear to be desirable. Pending a definite answer to this broad policy question, the Presidents' Conference might well direct its Committee on Collections and Accounting to begin studying this question.

The third basic question was whether there should be a change in time schedules to provide a maximum of 3-day instead of 2-day deferment.

This raises an important policy and bank relations question: After having been on a 2-day maximum deferment schedule for several years, should the System now alter that policy?

It also raises some practical operation problems: Whether intra-district but inter-zone items should continue to have 2-day maximum deferment; and what, if anything, can or should be done about the relatively large volume of intra-zone items that can not be collected in less than 3 days.

Any such change would absorb approximately $400 million reserves (page 10 in the Subcommittee report). The change could have an important effect on the reserve positions of some banks, particularly the larger banks that deposit in big volume. If such a change is to be made, it might be considered along with any other major moves affecting either the amount of reserve balances or the amount of required reserves.

This change is urged by some on the grounds that the present time schedule is "unrealistic." If the change is to be made on that basis, the Reserve Banks might also logically change some of their time schedules and practices which are equally "unrealistic," such as immediate credit for New Orleans items when, because of clearing house rules, they can not be collected until the following day, and the practice at New York, where immediate credit is given for drafts drawn on certain nonbanking corporations although the Bank receives payment for them in clearing house funds which are not collected until the following day.

The fourth basic question or recommendation was that there be a review of operating practices, with a view to action leading to reduction of float and greater uniformity of operating practices within the System.

The Subcommittee's recommendations with respect to matters coming under this heading are summarized principally on pages 5-8 of the System Committee's report of May 31.

The Subcommittee's report shows (Chart VI following page 13) that for the 3-month period covered in the survey 62 per cent of float was due to items forwarded for collection (transit float), whereas 38 per cent of the float was incident to operations at the Reserve Banks. Most of this latter category--about 85 per cent--was due to holdover.

On page 8 of the program suggested by the System Committee in its report of May 31, the Committee endorsed strongly the suggestions of the Subcommittee, summarized in the following paragraph:

> The Subcommittee suggests that the Subcommittee on Collections (or such other group as may be deemed appropriate) be charged with the assignment of studying check collection and other operating policies and procedures in the various Federal Reserve offices with a view to (a) drawing up a reasonably precise statement of principles and objectives which would be accepted on a System-wide basis, and (b) making recommendations as to specific operating policies or procedures in particular offices which lead to the absorption of float.

The following expression of views of the Subcommittee seems pertinent:

> The Subcommittee has the general feeling that there should be more uniformity among Reserve offices as to their basic approach to check collection and other operations leading to float. It has no wish to see

prescribed rigid and uniform operating practices, but it does believe that a statement of principles and objectives could be framed on a System-wide basis. Further, it believes that were this done, some of the variation in operating practices and procedures would disappear. Finally, it believes that a close appraisal of certain of these local practices by a System committee would lead to the elimination of such practices and to a consequent reduction in float. (Page 47.)

In this connection, it might be well to ask someone like John Davis to work with a System committee in the proposed review and to be responsible for the follow-through. The System committees and subcommittees are made up of men with full-time responsibilities. The assistance, therefore, of someone like John Davis, who could devote a substantial part of his time to the work and who could bring to it the viewpoint of one who is thoroughly familiar with the System but is no longer an active part of it, could expedite the review and its translation into action.

The System Committee's report of May 31 contained the following paragraphs:

The System Committee suggests that the designated System authorities, committees, and subcommittees make careful studies of the suggested program and formulate specific steps to carry it out. If, however, studies clearly indicate that it would not be advisable or feasible to carry out some particular part of the program, there is, of course, no need to attempt to formulate steps to do so, but there should be a clear-cut statement of the reasons why that part of the program should not or can not be carried out.

Upon receipt of the studies called for in the attached memorandum, the System Committee will proceed to analyze them and then submit its report. The System Committee trusts that the various reports requested may be received by the end of this coming September.

The System Committee's report of December 16 concluded with the following paragraph:

The Subcommittee on the Study of Float made a thorough study, accumulated much material, and produced a most worth-while report. That report, a copy of which you have received, raises a number of challenging questions. The System Committee

> believes that the benefits of the work already done should not be lost and that the time is ripe for the System to make a thoroughgoing review of its check collection functions and operations. As a basis for such study, the Committee submits this report, its report of May 31, and the report of its Subcommittee.

Returning to the question before the Committee of how float fluctuations should affect open market operations, Mr. Robertson said that his personal feeling was that it would be desirable to combine the second and third possible basic approaches that had been outlined in the December 16 report. This would be along the lines of having the Open Market Committee plan to offset only unusual fluctuations in float or those covering longer than usual periods. There should also be an effort to bring about an understanding that fluctuations in free reserves (or any other aspect of the reserve position) due to fluctuations in float have no significance with respect to Federal Reserve policy. To further such understanding, the System might release daily figures as to the amount of float. Mr. Robertson hoped that, whatever the approach decided upon by the Open Market Committee, it would not throw cold water on the need for further study of float which was an important System problem and should be dealt with. Regardless of whether the decision was to offset fluctuations in float through open market operations, the work already done provided a basis for further studies that would look toward eliminating as much of the float as possible.

Mr. Erickson stated that Mr. Robertson had given an excellent summary of the reports submitted by the System Committee for the Study of Float, and by its Subcommittee. On the question before the Open Market Committee today, he found himself in the same position as that indicated by Mr. Robertson, that is, of the three possible basic approaches that the Committee might take with respect to float, it would seem preferable to combine the second and third alternatives that had been outlined in the December 16 report. This would mean we would try to offset only unusual fluctuations in float, and there would be an attempt to make it understood that fluctuations in free reserves because of float had no significance as far as Federal Reserve policy was concerned. Mr. Erickson suggested that Mr. Rouse might also comment as to whether the procedure agreed upon at the December 17 meeting and made effective at the end of December for reporting by the Reserve Banks of daily figures by telegram to help the New York Bank in preparing estimates of reserves had improved the situation.

Mr. Rouse said that he had addressed a letter on February 7 to the individual Reserve Banks which said, in effect, that the figures currently being obtained were much improved over those previously available. Mr. Rouse also replied to a question by Mr. Leach as to what changes would result if the recommendations made by Mr. Robertson were adopted, stating that a combination of the two alternatives that Messrs. Robertson and Erickson had said they favored might present problems in making decisions and it would seem necessary to allow a fair amount of discretion to the System Account for dealing with these problems. However, he said he would like an opportunity to study the problem before expressing firm judgments on how operations might be affected.

Mr. Robertson said that his suggestion was not meant to bring about immediate changes in procedure but would require experimentation which might take a good many months in order to determine how operations could be improved.

Mr. Johns said that as the third member of the Committee that had studied float, he shared the feeling Mr. Rouse had expressed regarding the difficulty of combining the two alternatives that Messrs. Robertson and Erickson felt could be followed in dealing with float. At the time the float study was started, it appeared that fluctuations in float were interfering substantially with execution of open market policy, Mr. Johns said, and it then seemed to him that the System needed to get some facts after which it would decide what it wished to do. Float was only one of the factors affecting reserve positions and causing short-run fluctuations, he noted, and he had come to the conclusion, which was still tentative, that in the past we had attempted to do too much in the way of evening out short-run changes in reserve positions. He doubted seriously whether the fluctuations, which the commercial banks might not be able to identify as to source but which they recognized as temporary, caused commercial banks to make basic decisions in lending and investment policies. In fact, it now appeared that this was not the case. In questioning the purpose of the System's attempts to iron out the short-run positions in reserves, Mr. Johns said his tentative opinion was that there was not as much to be concerned about as had been assumed at the time the study of float was started.

Turning to the question of the deferred availability schedule, Mr. Johns said that he would like to see this changed back to a three-day maximum deferment schedule because he questioned seriously whether as an incidence to the check collection system the Federal Reserve should be supplying reserves in the manner caused by the two-day maximum deferment schedule. He then reiterated his general view that the System was trying to do too much with the open market tool. Even though the projections of reserves had been improved as a result of the new procedure for submitting daily figures, there were still errors, and attempts to offset fluctuations in reserves resulting from float and other factors by conducting open market operations in New York and Chicago might put in reserves at a time and place when they were not needed or take them out when they were needed. In sum, Mr. Johns had great reservations about trying to offset these aberrations in float through open market operations.

Mr. Hayes said he was in almost complete agreement with Mr. Robertson on studies to be made. He agreed that the suggested studies should be made with a view to the possibility of reducing float fluctuations. He would put greatest stress on changing the deferred availability time schedule which he considered to be the key operating question. He leaned not so much to a rigid three-day time schedule as to abandonment of the rigid two-day schedule. The Presidents' Conference Committee on Collections might well pursue this study. With respect to the role of check collection operations, Mr. Hayes said he would like to see a committee at work on that subject and he would like to see something in the way of specific suggestions to implement the report of the Joint Committee on Check Collection study that had been gathering dust because of the unwillingness of commercial banks to take it up; he thought it might be desirable to consider whether the System should adopt some of the recommendations of that study, even without the endorsement of the commercial banks. Mr. Hayes suggested that if the group present at this meeting felt these studies should be made, it could now be understood that the appropriate committees of the Presidents' Conference were directed to proceed with the studies.

With respect to the effects of float on open market operations, Mr. Hayes said that it was clear to him that these fluctuations were important and that the Committee should try to minimize them. He leaned more toward the second alternative approach by the Committee than the third. While he sympathized in some ways with the views expressed by Mr. Johns, he still believed that the swings resulting from normal float fluctuations could mislead the market. Perhaps the Committee should continue to try to offset the major fluctuations in float.

Mr. Leedy commented that as far as the procedural aspects were concerned, the appropriate committees of the Presidents' Conference could proceed with the proposed studies whenever a decision was reached on whether they should be made.

There ensued a discussion of the alternative approaches that the Open Market Committee might adopt toward float fluctuations and of the suggested studies of operating matters by committees of the Presidents' Conference. In the course of this discussion, Mr. Hayes suggested that a major purpose of the float study would have been accomplished if it was concluded that float fluctuations were important, that it was necessary to give them attention, and that it would be desirable to reduce the amount of float as much as feasible. On the question as to whether or not it should be Committee policy to offset fluctuations in float, Mr. Hayes said he did not think the Committee yet had enough information to reach a conclusion and that further studies should be made.

Chairman Martin agreed that considerable progress had been made in the studies thus far. At one time, he said, the Committee thought that float fluctuations were wrecking open market policy, but it now could tentatively conclude that that was doubtful. At the same time, it could conclude that the volume and fluctuations in float were important and that further study might enable the System to do something about the problem .

Mr. Robertson suggested that an appropriate action at this time would be for the Federal Open Market Committee to ask the Manager of the System Open Market Account to consider ways and means of increasing understanding of fluctuations in float by releasing daily figures and other information that could properly be given out. He also suggested that as a part of the immediate program the System might go on record today as agreeing that studies be continued with a view to developing recommendations on the three basic questions as to operating matters, i.e., the role of the Federal Reserve Banks in the check collection process, the time schedules, and a review of operating practices looking toward reduction in float and a greater uniformity in operating practices in the System.

Chairman Martin inquired whether anyone present disagreed with the suggestions that Mr. Robertson had just made as a program for moving ahead, and none of those present indicated disagreement. Chairman Martin then stated that these suggestions would be considered as adopted as the action of the Open Market Committee at this time on the study of float. It would also be understood that the Presidents' Conference was in agreement with this procedure and that it would arrange to have the appropriate committees proceed with the operating studies suggested.

Mr. Leonard withdrew from the meeting at this point.

Chairman Martin next referred to the report of the New York Clearing House Association distributed with Mr. Hayes' letter of October 22, 1957, and to a memorandum prepared by Messrs. Roelse, Rouse, Thomas, and Riefler and distributed under date of February 6, 1958, on the Clearing House Study of Interrelations of the Money Market and the Government Securities Market. At Chairman Martin's request, Mr. Riefler commented on the report substantially as follows:

> The Clearing House Committee did not come to any constructive suggestions unless we accept the basic proposition that corporate financing of dealers through the negotiation of repurchase agreements by dealers with corporations represents a revision of the banking laws. The Clearing House study attacks this practice as illegal in that it in effect results in the creation of money by nonbanking institutions, that it provides a figure for payment of interest on demand deposits and that it represents a practice that is dangerous to the money system of this country. All of the study's constructive suggestions turn around acceptance of that proposition, a proposition which the Staff Committee was not willing to accept. The staff suggests to the Open Market Committee, however, that the charges are so important and come from such a pre-eminent body that they should not be dismissed offhand. It believes, therefore, that the Open Market Committee may wish to commission the staff to make an exhaustive study of the charges and to report back to the Committee at a later date.
>
> Aside from that suggestion, the Staff Committee makes two general observations on the Clearing House Study. First, it appears that the money market and the dealer mechanism is getting along and that there is no crisis to require overt action. Second, there are two minor suggestions made in the Clearing House report which the staff

> believes might be accepted, namely, (a) the establishment of a standing money market committee composed of representatives from the Federal Reserve Bank of New York and the Clearing House banks to meet two or three times a year to discuss technical problems and market practices against the broad background of public policy, and (b) the release of daily figures covering aggregate reserves, reserve requirements, and borrowings of New York Clearing House banks.

In response to Chairman Martin's request, Mr. Rouse stated that Mr. Riefler had covered the matters in the report as he saw them. He and Mr. Hayes had discussed the question of having a committee such as the Clearing House report suggested and on the suggestion that daily figures be released he felt as did the other members of the Staff Committee that this could be done without any harm.

Mr. Allen commented that he had some sympathy with the view of the Clearing House banks that it was not desirable for business corporations to be making funds available under repurchase agreements although his view was based on reasons other than those given in the Clearing House report.

At the conclusion of a brief discussion of the report, Chairman Martin suggested that the report of the Staff Committee be accepted and tabled for the moment with the thought that further consideration would be given later to what additional study should be made.

In response to Mr. Riefler's question as to whether this included authority for the staff to make a study of the Clearing

House report, Chairman Martin stated after some discussion that he could see no harm in having the staff study the report further.

Chairman Martin noted that the next meeting of the Federal Open Market Committee would be held at 10:00 a.m. on Tuesday, March 4, 1958, with the understanding that the meeting would continue during the afternoon of that day and on Wednesday, March 5.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary