A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, September 9, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mangels
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman

Messrs. Erickson, Allen, Johns, and Deming, Alternate Members of the Federal Open Market Committee

Messrs. Bopp, Bryan, and Leedy, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively

Mr. Riefler, Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Marget, Walker, Wheeler, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Koch, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Acting Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York

Messrs. Ellis, Roosa, Mitchell, and Tow, Vice Presidents of the Federal Reserve Banks of Boston, New York, Chicago, and Kansas City, respectively; Mr. Balles, Assistant Vice

President, Federal Reserve Bank of Cleveland; Messrs. Anderson and Atkinson, Economic Advisers, Federal Reserve Banks of Philadelphia and Atlanta, respectively; Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis; and Mr. Meigs, Economist, Federal Reserve Bank of St. Louis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on July 29 (two meetings) and August 19, 1958, were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period June 17 through September 3, 1958, with emphasis on the August 19-September 3 period, and a supplemental report covering commitments executed September 4 through September 8, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Reporting on operations since the last meeting, Mr. Rouse stated that reserve availability has been about what the Committee hoped it would be. Free reserve levels have been worked down steadily with a minimum of market disturbances. During the last few days the market has been more calm than at any time since last June, despite the reduction in reserve availability and the developing tensions in the Far East. A better tone has also developed in the markets for corporate and municipal bonds. The Standard Oil of California issue sold well at a reoffering yield of 4.40 per cent--which compares with the 3.75 or 3.80 rate at which the issue could have been brought out in June, as originally planned. The Sears Roebuck $350 million issue is being offered at par to yield 4.75 per cent and is expected to be an initial success.

Mr. Rouse stated that looking ahead, the Treasury is planning to begin consultations on its next cash offering on September 22 and the announcement of the terms of the offering is expected to be made on September 25. Between now and then a major problem confronting the Account Management is how to deal with float, which is expected to raise free reserve levels sharply over the next two or three weeks. Current projections indicate average free reserves of $182 million for the week ending September 10, $492 million for the September 17 week, and $561 for the September 24 week. Mr. Rouse added that the figure for the week ending September 10 had been expected to be lower than the $182 million (shown on the attachment to the supplementary report), but that a substantial "miss" had occurred in the projections on Friday and it turned out that there were considerably more reserves available over the week end than had been anticipated. Mr. Rouse stated that as regards the float-induced bulge that lies ahead, his plan, based on existing policy, is to offset this rise in reserves almost entirely, if possible, unless the Committee feels that he should do otherwise.

Mr. Mills observed that since the initial benefit of float appears largely in country banks, and since corrective action would involve taking money out of the central money market, he wondered whether the attempt to offset float might cause a severe tightening of the money market just before the Treasury is ready to come in for cash. Mr. Rouse replied that the market will be looking closely at the statistics on free reserves, and unless float is offset, the feeling might develop that the money market was being adjusted to help the forthcoming Treasury offering.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period August 19 through September 8, 1958, were approved, ratified, and confirmed.

In supplementation of the staff memorandum distributed under date of September 5, 1958, Mr. Young presented the following statement on the economic situation:

> Sparked by a marked rise in financial liquidity of businesses and consumers, a liberal dosage of Government spending and subsidy, and an inflationary psychology in equity markets, domestic recovery in output, income, and consumption has been vigorous indeed. At this point, recovery certainly holds promise of continuing vigorous over the period ahead. Current information indicates that the August index of industrial production will be marked up two more index points to 135 relative to the 1947-49 average, and further that the rise in third quarter GNP will amount to at least $10 billion, bringing the total to $439 annual rate. These figures mean that half of the decline in industrial production and over half of the decline in the dollar value of GNP from the third quarter of last year has now been recovered.

Gains in industrial production have continued to be widespread and to extend through durable goods and non-durable goods lines, to be sure with some uneveness. Fuel and minerals output has also risen further, as have rail freight loadings and electric power output, the latter to new high ground.

New orders at durable manufacturers rose again in July. Though small, the rise was the third in a row and unfilled orders edged up slightly for the second consecutive month. At all manufacturers, the July sales rise, amounting to 2 per cent, was the third significant monthly increase in succession.

Manufacturers in July continued to liquidate inventories, but at the lowest rate of liquidation since December. Reduction of finished goods inventories was again a feature of the liquidation, but as in the past two months liquidation also included materials supplies and goods in process.

In the area of industrial production, the big uncertainty for the near-term future relates to automobiles. Here retail sales are lagging, but with model changeovers in process dealer stocks are being worked off and market forces point towards a fairly tight new and used car supply situation by this month's end. Meanwhile, though the threat of labor work stoppage continues to be an industry hazard, output of parts for new model cars is proceeding apace.

Construction activity in August rose again and reached a total value, annual rate, of $49.5 billion, up 5 per cent from May and about 2 per cent under the peak in December. Contract awards have continued very high, with residential awards once more particularly strong. Prices of building materials and construction costs have resumed an upward drift.

Pertinent to the rise in activity in durable goods production and construction is the latest information on plant and equipment expenditure plans. Whereas earlier reported capital investment plans of business indicated decline extending through the fourth quarter, though at a rate sharply reduced from the preceding three quarters, the most recent Commerce-SEC survey just released shows a leveling off in this quarter and a modest rise in such investment in the fourth quarter.

With activity in industry, transportation, power, and construction all showing marked upward tilt, some further strengthening in labor markets might well be expected. Such improvement as has occurred, however, has been moderate. Over the past month, changes in employment, unemployment, and workweek have been largely seasonal, though some contra-seasonal rise seems identifiable in manufacturing, trade, and Government employment.

At the consumer level, retail sales, which had held the March-April gain of 2-1/2 per cent through May and June, rose again by 1 per cent in July. August department store sales, which climbed 5 per cent ahead of July and 3 per cent over August of last year, suggest another strong month at retail outlets. Retail inventories, which had shown modest accumulation in June, showed modest liquidation in July.

Since early August, average prices at wholesale have declined slightly, reflecting declines of about 3 per cent in average wholesale prices of farm and food products with average prices of industrial commodities--materials and finished goods--about stable.

Consumer prices, which rose slightly further in July, have probably declined slightly in August, reflecting the influence of lower prices for meats and vegetables.

In industrial countries abroad, the indications are of either revival, as in Canada, or of stability at moderately reduced levels, as in most European countries and in Japan. Contractive tendencies in steel and textiles in Europe seem to have largely run their course. In raw material countries of South America and Asia, balance of payments problems, stemming in part from lower export prices, remain acute with various country situations critically inflationary. Taken as a whole, however, markets for U. S. exports seem stronger and our export volume appears to have been showing gradual recovery from its low reached last February. By latest indications, which relate to June, U. S. imports appear to hold at the high level of preceding months.

Mr. Thomas made the following statement with regard to financial developments:

The most striking financial developments of recent weeks have been those associated with the adjustment of interest rates. Long-term and medium-term rates continued during August the rise that began in June; short-term rates joined the procession and rose most sharply in August. Yields on long-term securities are now close to the highs of 1957, with U. S. Government bonds near 3-3/4 per cent, high-grade corporate seasoned bonds at 4 per cent, and new issues 3/8 of a point higher. Yields on medium-term U. S. issues are almost up to the level of long-term rates but lower than they were at last year's peaks. Rates on various types of short-term paper have risen from the neighborhood of 1 to 1-1/2 per cent to near the range of 2 to 2-1/2 per cent, but are still well below the range of 3-1/2 to 4 per cent that existed approximately a year ago.

It is as yet difficult to judge to what extent these changes in interest rate levels reflect a basic shift in credit demands relative to the supply of savings; to what extent they reflect speculative forces that may have moved too far first in one direction and then in the other; or to what extent they reflect the shift in System policy as to availability of reserves. Each of these elements has exerted an influence. The steadier tone of the market during the past week may indicate that the rise has halted until fundamental trends can be reappraised.

Somewhat higher interest rates than those which prevailed in the early summer are clearly justified by basic factors in the credit markets. The clear indications of economic recovery presage growing credit needs from the private economy. The prospective Treasury deficit--designed to offset declining private expenditures--will probably coincide with an increase in such expenditures and probably in private borrowing. The aggregate amount of credit that has been supplied this year has been very large. Expansion of total loans and investments of commercial banks has already been larger than that for any other recent year taken as a whole and the season of greatest increase is still ahead. New security issues have continued at a high level. Mortgage lending activity has increased.

It is likely that the speculative and professional forces that operated so dramatically to depress bond prices have abated. Many of the weak holders have been sold out. Investors, such as banks, that might be inclined to sell in anticipation of declines have been restrained by the rapidity of the decline and the unwillingness to take losses. Dealers in securities, who build up positions to very high levels in June, have reduced their commitments to manageable and in many cases negligible amounts. Dealers in Government securities, for example, who had positions of about $2.5 billion in June, approximately double normal holdings, now hold negligible net amounts with short positions in many issues. They are more likely to be buyers than sellers in the future.

The volume of credit demands during the remainder of this year is difficult to predict. It is clear that the Treasury will be a heavy borrower. Something like $7.5 billion may need to be borrowed before the end of the year. A similar amount of new borrowing may be needed in the first half of 1959, but that will be offset by redemption of maturing debt.

A major uncertainty is whether the Treasury deficit, by providing funds to the economy, will reduce private borrowing demands, or whether economic recovery, stimulated in part by the Government deficit, will induce increased private borrowing. Coincident increases in both, following the bank credit expansion that has already occurred, could result in much greater credit and monetary growth than is needed or desirable for sustained economic recovery.

Most of the bank credit growth that has occurred this year has been in holdings of Government securities, and other borrowing at banks has been moderate. The funds supplied by the banks through buying Government securities, however, have gone indirectly into other uses. This trend might continue. There should be no objection to financing Treasury needs through the banks, if other types of bank credit are limited and total credit expansion is kept within moderate limits. To achieve this result, however, in a period of business recovery may require some restraint on credit growth with resulting increases in interest rates.

The policy question to be decided is how much monetary expansion should there be in the next few months. There are no specific quantitative guides, because of variations in the use of existing money and of money substitutes. The active money supply, as measured by demand deposits and currency, declined somewhat more than seasonally in August from the record high, on a seasonally adjusted basis, reached after a very rapid growth in July. The total--seasonally adjusted--at $136.8 billion, is $2 billion or 1-1/2 per cent larger than a year ago. In addition, time deposits have increased by $10 billion and U. S. Government deposits by $1.5 billion, making a total growth of over $13 billion, or nearly 6 per cent, in all deposits and currency over the past year. The gross national product, after dropping over 4 per cent, is by now probably about 2 per cent below the peak quarter of last year. The existing money supply plus normal seasonal expansion should be more than adequate to support a rise of GNP to above its previous peak by the end of the year.

The usual seasonal growth in demand deposits from the end of August to the end of December would be about $6 billion at all commercial banks, with $5 billion at member banks, requiring additional reserves of nearly $800 million allowing for certain changes in the Treasury tax and loan accounts. The usual currency growth would be nearly $1 billion. After allowance for float and other factors, to meet these needs would call for open market purchases or additional member bank borrowing of nearly $1.5 billion by the end of the year. The bulk of these operations would come in November and December and would need to be reversed in January to provide for the seasonal increase in money and then to offset the post-holiday decline.

Timing of operations would need to take into consideration temporary variations, the impact of Treasury financing, and the degree of restraint to be exercised. The projections presented allow for supplying reserves at the time of Treasury cash financing, but their subsequent absorption as Treasury tax and loan balances are reduced. In view of the possibility that banks may be willing to increase their borrowings to meet credit demands rather than liquidate Government securities at prevailing prices, if the pressure of total credit demands should exceed the seasonal pattern, then net borrowed reserves should be allowed to increase accordingly. To absorb existing free reserves, other than a moderate amount during the mid-September tax week, there probably should be further open market sales of $200 million or more in the next two weeks depending on how much float is absorbed. Purchases to meet seasonal needs would not need to begin until late October.

If purchases conform in amounts and timing to the pattern projected, then any greater than seasonal credit growth would bring about higher borrowings by member banks. If, on the other hand, credit growth should fall below the projected seasonal pattern, then free reserves would increase. In either case, these results should be permitted to occur; no particular level of free or net borrowed reserves should be rigidly maintained. The policy guide should be to provide a certain addition to the reserve supply.

Stricter administration of the discount window and further discount rate increases may be appropriate if bank credit tends to expand more rapidly than seems desirable and borrowings increase accordingly.

Mr. Hayes presented the following statement of his views on the business outlook and credit policy:

On returning from a month's absence, during which I had some uneasy feelings as to national monetary developments, I was struck especially by the dramatic upsurge in interest rates, both short-term and long-term, which had occurred during August. I was afraid this upsurge might be a sympton of a state of intensifying tightness in the money and credit markets--tightness that might not, in my judgment at any rate, be appropriate in the present early stage of the recession-recovery cycle. My concern mounted when I found not only a bill rate almost 1-1/2 per cent higher than at the end of July and long-term yields within striking distance of the 1957 boom peaks, but also that a number of bond issues had been postponed and that the availability of mortgage funds was being adversely affected.

I feel apprehensive especially over the fact that the Federal Reserve System, far from acting to damp down this extreme movement, has abetted it by effecting a substantial tightening of monetary policy. The rise in margin requirements early in August could be properly attributed to an overexuberant speculative surge in the stock market. But the subsequent speed with which free reserves have been reduced from the $500 million level to around $100 million, coupled with discount rate increases which may partly have been induced by these open market pressures, has pointed clearly to a sharper change in reserve policy than I believe has been warranted by actual business developments.

Expectations of better business and fears of resumption of strongly inflationary trends are doubtless at the root of the rise in interest rates. (Involved here is a public assumption, I believe an erroneous one, that the prospective Federal deficit for fiscal 1959 makes near-term inflation inevitable.) But these basic causes have been reinforced and exaggerated by a widespread belief that Federal Reserve policy has been getting tighter and is likely to get a good deal more so from now on.

Undoubtedly business recovery is proceeding more rapidly and on a broader front than most of us had expected a few months ago. This is cause for rejoicing. The major uncertainty in the business outlook lies in the future course of consumer buying. So far, in spite of a sharp pickup in personal income, retail sales seem to have done little better than hold even. It remains to be seen whether the 1959 automobile models will have sufficient appeal to spark a strong revival in buying. While there is some evidence of upward revisions of plans for business plant and equipment expenditures, these are not yet very substantial. I am impressed by the fact that unemployment in July was still at about the same level as in the April trough of the recession, despite the recovery in industrial production. As has been true for many months, the situation is still characterized by surplus capacity, surplus labor, and surplus inventory. In the absence of unforeseen diplomatic and military developments abroad, it is hard to discern any near-term danger of excessive pressures on available real resources.

The same general conclusion appears to be supported by a review of recent price trends. Both wholesale and retail indexes have been leveling off, and the prospect of lower food prices over the coming months is a distinctly favorable element in the over-all price outlook. Raw material prices are not behaving as if traders expected a strong upsurge in demand. General price stability seems to be a reasonable expectation for some months to come.

If neither the state of business activity nor price conditions seem to convey a threat of imminent inflation, it still behooves us to examine carefully the potential inflationary influence inherent in any excessive increase in the money supply or in liquidity in general. Our studies of this situation do not support the conclusion that liquidity is dangerously high, either in or outside of the banks. Gains in the money supply to date (and in prospect for the rest of 1958), when viewed in reasonable perspective over the last few years, appear consistent with the economy's long-term growth. It has been pointed out that the seasonally adjusted money supply rose at the rate of 8 per cent per annum from the end of January to the end of July--but this came on top of a very sharp decline from July 1957 to January 1958, so that the gain for the whole year ending July is around 1.2 per cent. For the calendar year 1958 the gain is unlikely to exceed 2.5 per cent to 3 per cent (and I believe will probably be less than 2.5 per cent) and the average for the eight years 1951-1958 is likely to be about 2.5 per cent. There is danger, I believe, in overemphasizing possible errors in our policies in 1954-1955 and drawing a close parallel between that period and the present one, when virtually all measures show substantially less liquidity now than at that time.

Essential as it is for the System to stand guard against the dangers of inflation, I think we would be doing the public a disservice if we put too much stress on this danger, at a time when the danger does not seem imminent. For our excessive concentration on the subject could lead the public to believe that the data at our disposal suggest an explosive threat of inflation. I would be the last to deny that inflation is a serious long-term problem, primarily because of the tendency of wage increases in key industries, in good times and bad, to exceed a reasonable share of national productivity gains. But I cannot see any justification for combating this long-term threat by means of a rapid shift in monetary policy, at a time when inflationary forces are not dominant and when, in my view, a gradual shift away from ease would be appropriate. Because the events of the past summer have already brought many rates to high levels, there is danger that the further steps required, if the present business improvement should become a boom, could lead to interest-rate levels so high as to be harmful to the economy and so high as to place the System in political jeopardy. Just what is the right remedy for this long-term wage-push inflationary threat, I am not sure. It may be some form of concerted Government effort to discourage or prevent wage increases in excess of a reasonable share of national over-all productivity gains. The Federal Reserve System might well devote considerable attention to this question even though responsibility for any ultimate action along these lines would doubtless rest with the Executive Branch of the Government.

We must of course bear in mind that the Treasury faces a difficult cash financing problem early in October. Treasury problems and Federal Reserve credit policy are interrelated. We can never be unmindful of those problems. It seems to me that it is important that there be a period of stability in the money and securities markets. This should help not only the Treasury but the entire economy. I believe that the Federal Reserve should promote that stability; that we should make clear, through open market operations, that the move away from active ease is a mild and gradual one, not a sharp change of policy. I think we should always be guided by the market effects of our actions, and if the market has overreacted, as indicated by the course of interest rates, we might well let free reserves rise above the current $100 million level, perhaps ranging up to $300 million, in the hope that this would encourage the reestablishment of a better feeling of equilibrium in the capital market, perhaps evidenced by some modest decline in interest rates. We should make clear, I believe, that we intend to provide reserves readily both for seasonal needs and to permit the banks to underwrite the coming Treasury offering.

Our Bank has given very careful consideration to the discount rate for the past several weeks, and at last Thursday's meeting of our Directors, I recommended that the rate be reestablished without change. The Directors voted unanimously to do so, and the comment was made that if the recommendation had been otherwise I would have had a very hard fight on my hands. In fact I had no inclination to recommend otherwise. It seemed to our Directors, and to me, that an increase in the rate would be undesirable if it were to be regarded as a signal (as it doubtless would be) tending to confirm a substantial tightening of Federal Reserve policy. As I have outlined above, we felt that the tightening effect had gone too far already, and that the appropriate policy at this juncture is to try to damp down this tendency, not to encourage it. We did not believe that there was any serious danger of abuse of the discount window, for the time being at least, and hence an increase did not seem to be required for such a technical reason.

While the argument has been made that a move to 2 per cent might have "cleared the air," removing fears that our Bank might be contemplating a 1/2 per cent rise, and thus tending to stabilize market conditions well in advance of the Treasury offering, I cannot accept this argument. It seems to me that if we had raised the rate, the market would still be wondering two or three weeks from now whether a second rate increase was in prospect, if not before, then immediately after, the Treasury financing. I respect the views of those Reserve Banks which have seen fit to increase the rate, but this is a very delicate juncture in Federal Reserve policy when it is perhaps especially desirable to give scope to regional differences of opinion. I might add that our Directors, who were unanimous in their views, wished me to convey to the Committee their opinion that monetary policy has been too restrictive in the last few weeks and that some modification of this tightening process is greatly needed if we are to avoid serious economic and political consequences.

It seems to me that the present directive provides a suitable framework within which to operate over the next three weeks.

Mr. Johns stated that due to the fact that the directors of the Federal Reserve Bank of St. Louis would hold their regular September meeting this Thursday, at which time there would, of course, be consideration of the discount rate, the matter uppermost in his mind at this moment was how he would discharge his obligation to make a recommendation to the directors concerning the rate. As the Committee was aware, he had been one of a minority who believed that perhaps the rather rapid and substantial rise in interest rates, and more recently the greater restrictions upon the availability of reserves, had proceeded a little faster than they should have. It might turn out, of course, that this was absolutely right; it could even turn out that it was not enough. Nevertheless, whatever his own views about those developments might be, he had to accept the fact that these changes had occurred--that the Federal Reserve System had either permitted or caused them to occur. He was not inclined to believe that the actions taken and the results achieved could be reversed irrespective of whether they had gone too far or had proceeded too fast. Neither did he wish to magnify out of proportion the importance of the St. Louis discount rate at this time. In all the circumstances, his present inclination was to conform to what very rapidly was coming to be national policy regarding the discount rate--and which perhaps ought to be national policy without too much further delay. Therefore, he expected on Thursday to recommend to his directors that the St. Louis discount rate be increased to 2 per cent. Although he proposed to make such a recommendation, he could not forecast what the directors would do. At the meeting on August 28, at which six of the directors were present, the action to reestablish the existing rate was taken by unanimous vote, and conversations with two other directors who could not be present at that meeting indicated that if they had been present they would have voted the same way. He was not sure that the directors' views had changed or could be changed so as to bring about the action that he expected to recommend.

Mr. Johns said he had a feeling that Federal Reserve action in the next three weeks--and he supposed he did not have to look too much further ahead at this time--should not accelerate the tightening which had already occurred. He said this without regard to the needs of the Treasury which would be quite great. At this juncture he thought that the Committee might pause--that is, keep things as they are for at least another three weeks--and then take another look at the situation.

Mr. Johns recalled that he was one who suggested a few weeks ago that it might be appropriate to look at margin requirements. Although he had no recent figures--in fact did not know whether they were available or not--he still had some question in his mind as to whether margin requirements were as high as might be appropriate. He had no suggestions with respect to the policy directive.

Mr. Bryan stated that the latest figures available for the Sixth District seemed to indicate as a continuing matter a rather broad and vigorous recovery. Nonfarm employment had improved and manufacturing employment was up sharply. Department store sales showed increases which were rather dramatic, about 10 per cent over a year ago, and other indicators were telling about the same story.

There had been a sharp increase in manufacturing payrolls and in average hours worked per week. Weekly reporting bank business loans were increasing and the increase in the past four weeks was larger than that occurring in four of the last five years. The picture in the Sixth District seemed to him eminently to justify the recent increase in the Atlanta Bank's discount rate.

In general, Mr. Bryan said, he did not believe that System policy had proceeded too fast or had gone too far. If the market had over-reacted, that was an indication of the fact that a two-way market was operating at the present time. He believed it was very necessary to get a two-way market operating in the Government securities field where there had not been such a market for a considerable period.

Mr. Bopp said that he found this a very difficult period on which to comment. From the standpoint of the nation as a whole, quite clearly there had been a significant and general recovery, especially in the past three months, so that conditions in the money and capital markets which were appropriate at an earlier date were no longer appropriate. In his opinion, however, conditions had changed more radically in these markets than called for by business conditions. He would not wish to increase pressure at this time and, in fact, would favor some slight moderation in the implementation of policy.

Turning to the Third District, Mr. Bopp said that recovery continued to lag behind the country as a whole, especially in the critical area of employment. In July 1957, when the national level of unemployment was 4.3 per cent, the percentage in the Third District was 5.8. This July, when the national level was 7.5 per cent, the rate in the Third District was 9.4 per cent. Since mid-July new claims for unemployment compensation in the district had been down irregularly but not as much as might have been expected on a seasonal basis. Therefore, it appeared to him that a split discount rate might be appropriate and that the Philadelphia Bank perhaps should be at the tail end of the rate change. Meanwhile, the Bank was watching closely the level of member bank borrowing and the details of such borrowing. For the last three weeks city banks had been coming in to the discount window over the week ends but last night they had all repaid their borrowings. These borrowings have been running at a rate equal to 5 per cent of the national total.

Mr. Bopp repeated that if there was any time when a split discount rate would be appropriate this would appear to be the time. However, if member bank borrowings should go up substantially and administration of the discount window became difficult, it would be quite inappropriate for the Philadelphia Bank to continue operating at a lower rate. Under such circumstances he would recommend to his directors that the Philadelphia Bank move along with the other

Banks on the discount rate, even though it might feel that the national policy was not quite appropriate.

Mr. Bopp concluded by saying that he would favor leaving the policy directive unchanged.

Mr. Fulton said that the rays of dawn had begun to appear in the Fourth District but that they were not as bright as everyone would like to see them. The district steel industry had had a considerable rise in the proportion of capacity being used, the present figure being about 56.5 per cent against the April low of 43 per cent. He pointed out, however, that 56.5 per cent is not very high for the industry. The foundries were working at a very limited percentage of capacity and in the machine tool industry orders had fallen off in July after a spurt in June. Employment did not go down as much in July as might have been indicated on a seasonal basis, so there was a little improvement in that respect. The model change-over in the automobile industry, of course, always sends unemployment up at the time of the year when it occurs, and the change-over was taking place now.

All in all, while there had been some improvement from a rather low level of activity, total activity in the Fourth District was still on the low side. The automobile industry was not ordering to any extent and until very recently--the last couple of days--the steel mills had received no orders from the oil industry for large pipe or similar materials. In some quarters business was being characterized as having improved to a plateau--a somewhat low plateau--and it was reported that no improvement had been shown in the last couple of weeks. Therefore, a little discouragement was being voiced, the question being whether business activity was going to stay at the present level. Nevertheless, it was believed generally that if an agreement was reached with the auto unions, ordering of steel and components would take place and there would be a noticeable improvement in the latter part of the year.

Continuing, Mr. Fulton said that construction activity in the Fourth District was rather strong in terms of heavy engineering projects and residential construction, but the picture as to non-residential construction was not very good. Retail trade continued below the year-ago level, being down about 6 per cent, and although department store sales rose quite substantially last week they were still down 4 per cent for the year to date. In summary, the situation was hopeful but no strong upsurge had appeared as yet. A disturbing factor was the continuous price increases and the anticipation of price increases in a broad segment of industry. Steel, aluminum, and rubber had all increased their prices. The National Cash Register Company had just announced a 5 per cent price increase and many others were anticipating increases as the result of labor contracts being signed which provided for a 3.5 to 4 per cent increase in wages despite unemployment in the fields of activity concerned.

Mr. Fulton reported that member banks had been coming to the discount window very substantially during the recent period but a check did not disclose that they were borrowing at a preferential rate and selling Federal funds to banks in other districts at a profit. Instead, it appeared that the banks needed the money that they were borrowing.

Mr. Fulton expressed agreement with the comments of Mr. Johns about a national policy with respect to the discount rate level. Therefore, he said, he intended to recommend an increase in the discount rate of the Cleveland Bank on the basis of national policy at the directors' meeting this Thursday. However, he was not sure whether the directors would go along with that recommendation. At the meeting of the executive committee two weeks ago, the directors in attendance voiced strongly the feeling that the Fourth District was not in such a condition as to warrant an increase in the rate at that time. Mr. Fulton concluded his comments by saying that he saw no reason to suggest a change in the policy directive.

Mr. Shepardson said it seemed to him that all of the reports, statistics, and other economic information indicated that the national picture continued to be one of strong recovery. Admittedly, there were some areas that had not moved back as fast as others, but for the country as a whole there seemed to be a vigorous movement toward a strong recovery. However one looked at the prospects for the next few weeks, it seemed certain that there would be expansion in the fall, along with a serious Treasury problem beginning with the financing in the next two or three weeks and continuing on through the rest of the year.

Mr. Shepardson then referred to Mr. Rouse's earlier comment to the effect that he thought System operations had about succeeded in meeting the Committee's target as to reserve availability and said that this was not his (Mr. Shepardson's) understanding. At its last meeting, he recalled, the Committee first talked about getting down to approximately a zero level of reserves by Labor Day but later the idea seemed to be more one of getting down to that level by the date of this meeting. Apparently there was still some difference of opinion. His own feeling was that free reserves should have gotten down close to zero by this time so that member banks would have had to come to the discount window under the pressure of further demands for credit this fall. He said that he was somewhat disturbed by the reserve projections presented at this meeting. According to the New York Bank's projections, average free reserves for the current statement week would be $182 million and the average would be substantially in excess of $400 million for the next statement week. There was a very short time remaining if free reserves were going to be gotten down further, and in his opinion they should be gotten down so that there could be some period of stability before the Treasury financing later this month. It would be his hope that the Account Management could get free reserves down below the figures presently projected. In his opinion, the trend should still be toward the zero level that some of the members of the Committee had had in mind.

Mr. Shepardson said that this was no time to be in a position of indicating any vacillation in policy. If free reserves were to turn back up, that would create more uncertainty and leave the System in a more vulnerable position later on. He felt that it would be most desirable if the discount rate situation could be straightened out promptly. There may have been reasons why some Banks did not move at the beginning but that period was now past. Therefore, he believed that the Reserve Banks should reach a uniform basis without delay.

Mr. Robertson, who had been on vacation during August, said that upon reviewing monetary policy following his return he found that he approved wholeheartedly everything that had been done during the time that he was away from his office. He then made the following statement:

> The specific problem which this Committee now faces is how many bank reserve dollars should be provided in the next few months to meet the credit and monetary needs of general economic recovery to a higher level of activity, as well as those customary at this season of the year, and

<u>at the same time not encourage unsustainable expansion based on commitments of a speculative nature.</u> The outstanding money supply, which increased while economic activity was declining, is presumably already adequate to support a level of output and consumption higher than the peak reached last year. Thus no more than the usual seasonal increase should be needed.

The huge Treasury deficit, which seems inevitable for this fiscal year at least, makes the problem an exceptionally formidable one. If private credit demands should increase, along with Treasury borrowing, the total expansion of credit could be excessive. It is not inevitable, nor is it necessary, that this should occur. Treasury borrowing and spending will supply a large portion of the funds needed for recovery; other borrowing could be correspondingly smaller than it would otherwise be. The danger is that the government deficit will be a stimulus to a too rapid acceleration in private borrowing and spending, instead of an offset to a decline in private activities, as it was designed to be.

It is very important that total credit expansion be kept within reasonable bounds, that the Treasury compete in the market for the funds it needs, and that private borrowing be tailored accordingly. If we supply the volume of reserves that we believe to be appropriate for the situation, and private credit demands are moderate, the task of Treasury financing should not be too difficult, although interest rates might stay at present levels or rise a little in order to attract savings, as well as bank credit, into Treasury securities. If private credit demands expand along with Treasury borrowing, there may well be strengthening upward pressures on interest rates. System policies should not be designed to prevent rates from rising. To do so would require pumping more money into the economy than will be needed for sound recovery.

Since the likelihood is that such pressures will develop, some rise in rates should be permitted to occur before the Treasury comes to the market in October. Consequently, I would welcome further advances in discount rates to 2-1/4 or 2-1/2 per cent immediately.

The principles that should govern our operations seem to me to be clear. The mechanics of providing the proper amount of reserves will by no means be easy to determine. That task will have to be handled with skill and judgment by the Management of the Account with such guides as the Committee may decide upon from time to time in the light of developments. But at this juncture, when we are in the midst of a broad and vigorous recovery, we should avoid the appearance of being afraid of our shadow. We should show by our actions that we are firmly resolved to resist inflationary pressures.

In conclusion, Mr. Robertson said that he would not favor changing the policy directive for he did not feel that any change was necessary. In his opinion, existing open market policy should be continued. He agreed with Mr. Shepardson that this was a time to be more restrictive rather than the opposite.

After stating that his appraisal of System policy considerations followed quite closely the views expressed by Mr. Hayes, Mr. Mills made the following statement:

> In reading the minutes of this Committee's last meeting, I was impressed with Mr. Bopp's remarks, which I took to mean that the Federal Reserve System would be ill-advised to be so overwhelmingly concerned with the problem of inflation as to become oblivious to other pressing problems and responsibilities. My own thinking follows his and leads me to the conclusion that too severe a policy attack on anticipated inflation can defeat its own purpose.
>
> This spring's experience again demonstrated the lag between initiating a System policy and getting its effects and that impatience in obtaining results can produce too strong policy actions which, on this occasion, were reflected in excessive credit ease and speculation in the market for U. S. Government securities. A policy of severe credit restraint can now produce undesirable consequences of a reverse order that will show up in a further thinning of an already thin U. S. Government securities market and speculation on the short side of the market that will tend to accentuate the downward trend of securities prices. In turn, the congestion in the new issues market for corporate and public obligations will worsen as prospective borrowers hasten to assert their claims in anticipation of still higher interest rates.
>
> This is the kind of a situation that relates itself to a restrictive monetary policy whose effects cannot be

measured by the available supply of reserves, which technically does not denote severe credit restraint, but by the impact on the commercial banking system of a relative reduction in the supply of reserves from that which the System's policy of earlier this year had accustomed it to. When it is considered that the rapid fall in the prices of U. S. Government securities has produced a major depreciation in the investment accounts of the commercial banks at a time when the level of their loans is high and their holdings of U. S. Government securities very substantial, their ability, under a policy of credit restraint, to shift their assets to make room for seasonal loans and investments in new issues of U. S. Government securities is greatly handicapped. Hence it is that if a System policy or credit restraint is pushed too vigorously, the System may be confronted with the need of supplying reserves in quantity in order to foster commercial bank subscription to new Treasury offerings and, in so doing, an undesirable inflationary impetus will have been created. Moreover, a too aggressive policy of credit restraint by hampering commercial bank financing of new underwritings of securities can retard the kind of investment programs that are conducive to a sound economic recovery.

All of the above preaches the thought that the Federal Reserve System's responsibility to the U. S. Government securities market needs re-study. Policy actions of recent date cannot be said to foster the kind of market breadth, depth and resiliency that has been lauded in the past but, instead, have produced opposite results. Inasmuch as the Federal Reserve System must accept a large share of the responsibility for having promoted an illusory excessive liquidity in past months and a major speculation in U. S. Government securities, thought must be given as to whether the U. S. Government securities market should have been left entirely free to work out its own adjustments or whether the Federal Reserve System had, and has, a responsibility to ease the path of these adjustments in ways that will restore the much vaunted market breadth, depth, and resiliency that has been a policy objective.

Mr. Mills concluded by expressing the view that free reserves, temporarily at least, should be in the range of $200-300 million.

Mr. Vardaman said that when he found himself in disagreement with Mr. Mills and Mr. Hayes it caused him to think very seriously. He agreed with Mr. Hayes in the latter's analysis of the factual situation but he reached somewhat different conclusions as to what the System should do in the circumstances. As to the views expressed by Mr. Mills, he did not think that in times like this, or in fact at any other time, the System could build a monetary policy around the Government securities market.

Mr. Vardaman went on to say that if one should look back a couple of years from now it seemed likely that he would regard the San Francisco Bank discount rate action as one of the most commendable and farsighted moves that the System had made. He did not think that this was a time to retreat from the policy thus initiated. He considered it fortunate that there had been initial disagreement as to the discount rate level and that there had been a split rate. At present, however, he would like very much to see the other Reserve Banks seriously consider going along up to the present level and being poised to go still higher. As he said at the last Committee meeting, he felt reasonably sure that shock treatment would be necessary later this fall, and the shock treatment would be lessened a bit if there could be a uniform discount rate at 2 per cent or even higher. He did not feel that he and Mr. Hayes were in disagreement as to whether there was going to be inflation, the difference of opinion being principally as to the imminence of inflation. Personally, he felt that inflation was inevitable unless restrictive action was taken at the proper time, and that time, in his opinion, was already here. He believed that the public was ahead of the statistics. With the landing of troops in Lebanon the Government established a frame of mind on the part of the buying public which would cause them, and also borrowers, to seek to obtain their requirements at the earliest possible time in anticipation of a price rise that was bound to come with United States military operations being carried on in various parts of the world. The psychological effect of those operations was bound to sting and spur the public. He would like to have money rates at a point where only necessitous borrowing would be indulged in, and prices at a point where only necessitous buying would take place. The Federal Reserve System should not retreat from its present policy and it should maintain reserves at the level of zero to slightly minus. The System should not attempt to rig a market just for the benefit of the Treasury when it was very apparent, at least to his view, what was going to happen. This was that the country was going to have inflation and that there must be serious shock treatment.

Mr. Vardaman felt that it would be impractical to attempt to control wage pressures and that, in fact, there would be greater pressures. Therefore, he felt that the Committee ought to go on as at present, facing the fact that it was confronted with inflationary pressures not only now but increasingly so with the passage of time. In the light of that prospect, the System should act accordingly.

Mr. Leach said that the recession in the Fifth District was marked by a severe decline in the coal mining areas of West Virginia and a lesser but still substantial decline in the heavy industries of Maryland. Declines in Virginia and the Carolinas were much less pronounced. Textile and tobacco manufacturing are important industries in the latter three States, and textiles had declined before the general recession had started while tobacco manufacturing is to a considerable extent depression resistant. In recent months there had been continuing and widespread recovery in the Fifth District but bituminous coal mining had not yet recovered to a satisfactory level. Current production in this industry was running about 20 per cent under its year-ago volume. There had been significant gains reported in a variety of other industries including construction, furniture, lumber, and hosiery and there had also been signs of improvement in some parts of the long-depressed textile industry. All told, there had been a marked improvement in practically all areas of the Fifth District. No evidence was seen, however, that the rate of expansion had been too rapid.

With respect to policy, Mr. Leach said he thought the System was correct in shifting to less ease fairly early in the recovery phase. Indeed, the System's actions may have already had some slight effect in dampening inflationary sentiment. Certainly, the System had made it clear that its policy had shifted toward less ease. It was true that there was now substantial depreciation in the investment portfolios of commercial banks which might limit their liquidation of longer issues. But holdings of bills and certificates by weekly reporting member banks are now $3.7 billion above last November and nearly $1 billion above their level at the end of 1954. This might seem to be a cause for further tightening now but he was impressed by the rapidity with which the System had moved in this direction in the last several weeks. It did not now have much room left to move as far as the availability of reserves was concerned before the reserve data would indicate a posture of restraint. He thought it would be unfortunate to take such a posture at this time when further recovery was desirable. Specifically, while he realized that time was running out on this period of relative freedom of action before the next Treasury financing, he would not be in favor at this time of open market operations that would produce net borrowed reserves. In his opinion, the System had gone far enough and had moved fast enough for the time being.

Logically, Mr. Leach said, the next tightening move should take the form of an increase in the discount rate above 2 per cent, but in view of the substantial tightening that had already occurred he thought that this should wait. Under present conditions it would be extremely difficult for the Government securities market to stabilize if the System should continue to follow one tightening move with another. The forthcoming Treasury operation would be difficult in any event and he did not think that the System should intensify the difficulty without a clear case for further action. At present, he saw no clear case.

Mr. Leach said that he expected to recommend an increase to 2 per cent in the discount rate of the Richmond Bank at the regular monthly meeting of the board of directors to be held the day after tomorrow. A discount rate of 2 per cent would be quite a bit below the bill rate at the moment but thus far a 1-3/4 per cent rate had not led to any administrative problems at the discount window. Two weeks ago the full Richmond Board of Directors was unanimously of the opinion that action on the discount rate at that time would be premature and he could not say what the directors would do this week. The policy directive, he felt, was satisfactory as presently written. In this connection, he suggested that if the System should move over into a policy of restraint, or even to a tighter policy than at present, it might be that the Committee would not be following the directive, which calls for operations with a view to fostering recovery.

Mr. Leedy stated that the trends in the Tenth District continued to be very much the same as he reported at the last meeting and at previous meetings. It seemed to him that the question whether the System had gone too far and too fast as far as reserves were concerned was now a moot question, for the System had arrived at a certain point and it seemed to him that it could not retrace its steps. While he would not advocate at this time going any further, on the other hand he would certainly advocate that the System not attempt in any wise to move in any opposite direction. The next question, it seemed to him, was whether the level of discount rates on which the System had embarked was high enough. If time permitted before the next Treasury financing and if any further policy move was to be made, it seemed to him that perhaps a rise above 2 per cent would be the logical move.

Mr. Leedy went on to say that he could not escape the feeling that what appeared to be a babble of voices within the System was not serving the System's best interest. To him, the movement that had taken place with regard to reserves was not at all consistent with what should have been done by this time with respect to the discount rate. In order to be effective he thought that the System ought to be speaking with more unison than had been the case since the last Committee meeting. The present situation might be creating a condition such as to undermine to some extent the things that the System was attempting to accomplish. At present he did not have in mind suggesting to the Kansas City

Board of Directors that a further move be made on the discount rate but he noted that at the last directors' meeting there was some feeling within the board that perhaps even then the establishment of a 2 per cent rate was not going far enough.

Mr. Leedy went on to say that he subscribed to a great deal of what Mr. Vardaman had said. From all of the available signs, the System should not postpone the matter of looking at the possibility of inflation ahead of it. There were signs of recovery on every hand, and if the System should wait until there was recovery beyond any shadow of a doubt it seemed to him that the System would have lost its opportunity to do the kind of a job that it was supposed to be doing.

Mr. Allen commented that his report on the Seventh District would be largely a repetition of what he had said three weeks ago. Business improvement continued but at a less rapid pace than the national experience. On the one hand, Iowa showed up very well indeed, whereas Michigan at the other extreme would be in the throes of model change-overs through September. Construction awards showed improvement in the district but nothing like the sharp increase reported nationally. Department store sales were very strong in August in many of the Seventh District cities, as nationally, but Detroit and Milwaukee were laggards. Although employment improved in the nation as between June and July, it remained practically the same in Illinois, Indiana, and Iowa and worsened somewhat in Michigan and Wisconsin. After a two-week rise as a result of the Lebanon crisis, prices of agricultural commodities continued a normal seasonal decline, and the record crops expected this year would keep prices under heavy downward pressure. Growing conditions have been excellent throughout the Seventh District except where drought conditions existed in parts of Michigan, central Wisconsin, and northwestern Iowa. It was anticipated that increased marketings, especially crop marketings, would largely offset the price declines during the last half of this year, with the result that on the whole farm income in 1958 would be the best since 1954.

Mr. Allen went on to say that improving business activity and reduced reserve availability were beginning to be reflected in the operations of Seventh District member banks. Those banks appeared to be expanding their lending to business somewhat faster than the national pace. However, reserve pressures in the district had been considerably less than in New York, and Chicago banks continued to be net suppliers of funds to other areas. Nevertheless, these banks had been supporting their positions by liquidating Treasury bills, which had declined by $157 million, or about 40 per cent, since August 6. Since the increase in discount rates by the San Francisco and Dallas Reserve Banks, there had been a noticeable increase in the proportion of Federal funds going to banks in those areas. In the month of July, for example, 14 per cent of sales by Seventh District banks went to banks in the San Francisco and Dallas districts. In the first ten days of the rate differential, the proportion rose to 27 per cent.

Mr. Allen said that there had been two directors' meetings in Chicago since the San Francisco Bank raised its discount rate to 2 per cent. At the first of those meetings, held on August 21, he recommended, and the directors decided, to take no action on the rate in recognition of the business situation in the Seventh District. At the second meeting, held on September 4, he recommended, and the board of directors decided, that the recovery nationally should be recognized, in a token way to be sure, by raising the rate to 2 per cent. In the light of the figures presented by Mr. Young and in the light of other factors, including the serious inflation of the past twenty years, the hugh Government deficit now in the offing, and the requirements of flexible monetary policy, he found it hard to reconcile a 1-3/4 per cent rate at this time--in Chicago or elsewhere. Chairman Martin, he recalled, had said that flexible steel is stronger than iron that breaks--but true flexibility means bending both ways. Certainly, the System went in the direction of ease very fast and very far, and the current situation seemed to him to call very clearly not only for the action which had been taken by this Committee but by a coordinating movement in the discount rate. The increase to 2 per cent was not fully coordinating but at least it went part way. The Chicago directors, he commented, were not unanimous on the discount rate change but the reluctance on the part of those directors who did not wish to raise the rate reflected a feeling that New York is the main money market. Therefore, those directors would have preferred for the discount rate action in Chicago to be coordinated with or to have followed discount rate action in New York. The reluctance was not based on business conditions in the Seventh District.

As far as the next few weeks were concerned, Mr. Allen said that his views were similar to those of Mr. Shepardson. As he saw it, any movement on reserves probably must be accomplished in the next week with the Treasury financing imminent, for an even keel policy ought to begin in about ten days. He would like to see free reserves in the range of zero to $100 million. However, if that range could not be achieved by ten days from now, he felt that the System should try to stay at the level that was achieved by that time through the period of the Treasury financing.

Mr. Deming said that the Ninth District picture continued to be one of above national average strength and general pick-up in activity. Figures in bank debits highlighted this picture. In the first quarter of this year debits in the district were 2.6 per cent ahead of the like period in 1957 and in the second quarter the gain was 4.8 per cent over a year earlier. July 1958 was 5.4 per cent ahead of 1957 and the August-to-August comparison should be even better. Only one or two recent district developments were worthy of particular note. Against the background of an excellent farm picture in general, cool wet weather had retarded corn and soy bean maturity. Without some warm weather or a later than normal fall frost, there was likely to be another soft corn crop. Even so, however, farm income would be high this year, and if corn and soy beans could mature normally a record cash farm income was probable. A soft corn crop probably would contribute to the prospective hold-back of feeder cattle for higher prices. Feed supplies in general were excellent and cattle producers were in a basically strong position for the coming fall and winter.

Continuing, Mr. Deming said that in the first seven months of 1958 total loans of all district member banks increased 3.5 per cent as against a rise of 2.7 per cent in the same period of 1957. Most of the loan increase was at country banks where loans were up 6 per cent relative to year end as against a 1 per cent gain at city banks. Incidentally, no inventory borrowing was seen as yet. In the first seven months of 1958 district member bank investments were up 4.3 per cent as against a decline of 3.2 per cent last year, with the gain mostly in longer-term securities. This kind of investment behavior, he noted, did not indicate a strong liquidity position. Rather, it argued for caution in applying restrictive action.

Referring to the discount rate action taken last week by the Minneapolis Board of Directors, Mr. Deming said that the increase was made without great enthusiasm but without opposition. He also said that for the immediate future he would be content to coast along about as at present with free reserves in the neighborhood of $100 million. He would prefer not to see further restrictive action taken at this point.

Mr. Mangels reported that on the West Coast business conditions continued to follow a trend of moderate recovery with strength in construction, including residential, nonresidential, and public, and Government spending becoming more of a factor. In both July and August factory output increased more than seasonally with a rise in average work-week hours. An increase in employment stemmed particularly from construction, aircraft, ordnance, electronic equipment plants, and State and local government payrolls. Insured unemployment in six of the States of the district dropped in July, but in the State of Washington it increased because the new benefits year started July 6 and a number of old claimants restored themselves on the rolls. Despite the improvement that had taken place, unemployment still amounted to about 5.8 per cent of the labor force in California and in Oregon and Washington the figure was about 9 per cent. This reflects the fact that on the West Coast the labor force is increasing more rapidly than the number of jobs. Department store sales were 3 per cent better in August than in August a year ago but automobile sales were down, while agricultural conditions continued to be quite good in all categories except that out-of-State shipments of California deciduous fruits were down 24 per cent from a year ago. This was particularly noticeable with respect to peaches where Georgia so far this year had shipped more than California, as opposed to last year when its shipments were only about one-fifth of those from the State of California. Out-of-State shipments of Washington apples also showed a decline because of increasing production in eastern areas.

Mr. Mangels said that for the three-week period ending August 27 business loans were up $109 million with borrowers now applying for credit in anticipation of an increase in the prime rate. Real estate loans were up $37 million, which was the largest increase for any three-week period so far this year. Demand deposits were up slightly but time deposits reversed their course and were down $4 million. There was practically no member bank borrowing at the Federal Reserve Bank during this period.

In the over-all picture, Mr. Mangels said, there were several questions which caused some concern. First, he was not too sure that business indicators for August and September would continue to show the rate of gain that was indicated in July. He wondered whether, if there were strikes or if international tensions became greater, such developments might not have an effect on public psychology and shake public confidence so as to result in some adjustment in the rate of business improvement. There was also the question whether interest rates had risen more than justified by the improvement in business. It might be that the rise in the rate structure was an indication of less liquidity in the banking system than some had thought. Also, the bond market was still in not too good shape. The Treasury would need about $7.5 billion before the end of the calendar year and one would have to be rather naive to assume that the banks were not going to have to take a substantial portion of the new offerings. If there was more than a seasonal demand for credit and free reserves were at the zero level, there probably would be considerably more use of the discount window. Mr. Mangels felt quite sure that the member banks on the West Coast would not want to come to the discount window; they would do this only as a last resort and somewhat reluctantly. However, if they were forced to do so, this might be a drag on credit and have the effect of increasing interest rates further. Therefore, it seemed to him that if free reserves stayed pretty much at the present level, that is, in the $100-$200 million range, the System would be easing things for the Treasury in the coming offering and would be going along for the time being on an even keel. That was the way in which he felt the Committee should approach the next three weeks.

Mr. Irons stated that as he saw it the recovery showed continued strength nationally, with evidences very clear on that point. In the Eleventh District a high level of economic activity continued to prevail, with further improvement in the oil industry. The agricultural crops were virtually made at this time and he was told by agriculturists that crops would be better than a year ago in all the major areas, so agricultural income would be up substantially. Construction was strong and retail trade good, while hours in manufacturing were now around 40.8 per week against 39.8 some time ago. The unemployment situation did not show much change. With the exception of one city (Houston) the district had not been plagued by unemployment. In Houston the figure was about 7.0 per cent but in other principal cities it was only running about 4.5 per cent so there was not too much problem in that respect.

Turning to the banking picture, Mr. Irons said that the demand for credit continued to show improvement, with business loans up as compared with the same period a year ago to the extent of about 6 per cent. Loan figures were high and demand strong. Deposits of individuals, partnerships, and corporations continued to rise. Discounts from the Reserve Bank were averaging from a few hundred thousand dollars to around $1 million. Thus, on the whole conditions in the district were very good and people were looking forward to a strong fourth quarter.

Mr. Irons went on to say that at a special meeting of the Board of Directors of the Dallas Bank which was called promptly after the San Francisco Bank had acted on the discount rate, the directors unanimously and enthusiastically voted to change the rate. In fact, there was some minority support for a rate of 2-1/4 per cent, although no actual motion to that effect was presented. These sentiments, Mr. Irons said, were put in the form of comments to him which indicated that, although those directors making the comments agreed with the action that had been taken, they felt that it might have been a mistake not to go to 2-1/4 per cent. The action on the discount rate was not taken solely on the basis of regional indicators but rather on the basis of the over-all situation as the directors saw it.

Mr. Irons said that he was rather satisfied with open market policy in the past two or three weeks. Disregarding the volume of free reserves but watching rate movements, particularly rates in the short-term market, he felt that the results of open market operations were not too much out of line with what the Committee had anticipated. At the last meeting, he recalled, he had spoken against trying to pinpoint agreement on a zero level of reserves. However, open market policy definitely had moved away from ease, although perhaps not far enough. His own feeling was that the System should not relax the movement toward restraint that it had initiated, and that the System had not gone too far. He would like to see the System continue in the direction of the movement that had been initiated. There was not too much time remaining before the Treasury financing when policy would have to get on an even keel, and in his opinion it would be a mistake to permit a condition of ease in the market sometime around, or prior to, the Treasury financing period and then move away from ease as soon as the financing was over. Certain of the Dallas directors, he noted, had spoken very clearly along that line. If the System was going in the direction of restraint it should do so honestly and without rigging the market so as not to have banks come in at a comparatively favorable rate and then find the System exerting restraint. Mr. Irons agreed with Mr. Rouse that if float or some other aberration should cause conditions in the market to ease the Management of the Account should attempt offsetting action so as not to go into the even keel period on a basis of unsustainable ease. He would like to see the reserve position move into net borrowed reserves and he would have no qualms about how rapidly and steadily the System moved. Thus, he would bring banks into a position where they would use the discount window. Mr. Irons concluded by saying that he saw no need for a change in the policy directive at this time.

Mr. Erickson said that economic conditions in the First District were not as buoyant as in the nation as a whole. The New England manufacturing index for July showed no change from June; while textiles and leather were up slightly, primary metals were down. Construction contract awards in July were up 6 per cent over a year ago but this increase was less than the increase nationally and the main strength was in public works. Residential construction was 1 per cent less than a year ago. For July, the seasonal drop in nonagricultural employment was less than a year ago, while the average hourly work week in factories was the same in July as in June. Department store sales for eight consecutive weeks ending August 30 were ahead of similar weeks last year. The index was up 15 points and this was the highest point in a year. Deposits of banks were up slightly but loans in July were off slightly and were still behind a year ago. The Reserve Bank's survey of mutual savings banks in July showed that deposit balances were up more than 6 per cent with deposits up and withdrawals down. Real estate loan balances were up 8 per cent over last year.

Mr. Erickson said that at the directors' meeting which was held yesterday it was recommended that there be an increase in the discount rate but the directors did not see fit to follow that recommendation. There was a feeling that conditions in the First District did not warrant a move at this time. He did not know whether it would have made any difference if he had been at the meeting himself. The matter probably would be brought up again at the meeting on September 22.

Mr. Erickson said he was inclined to agree with Mr. Rouse that the System ought to try to absorb any excess reserves that might be created by float. He assumed that the System would only have a week or ten days before entering an even keel policy on account of the Treasury financing, and he would hope that it might be possible to get free reserves down to a level around $100 million. He saw no reason for a change in the policy directive at this time.

Mr. Szymczak said that this had been one of the most educational meetings he had ever attended for the discussion reflected the way in which the recession had developed according to geographical areas. As all were aware, this had not been a recession of uniform proportions throughout the nation. He recalled that there had been similar discussions during the period when the discount rate was being reduced. The latest figures, he noted, showed improvement in the economy earlier than had been expected. It was satisfying to see these figures but there was still the problem of geographical upturn and the problem of a lagging behind in the durable goods area, steel, automobiles, and plant and equipment expenditures. It is always inevitable during an upturn, he said, that the timing of policy has to coincide with when the upturn starts in order to make that policy effective because of the liquidity that has been provided to the banking system. Thus, the System is always bound to get all kinds of protests.

Mr. Szymczak said he agreed with the policy that had been followed, However, he did not think that it would be possible to get down to a zero level of reserves during the ensuing period. He would keep reserves around $100 million or a little higher but not above $200 million. In other words, he would keep them about as at present to the extent that it was possible to do so. Experience, he said, had shown that the discount rate is a national rate, for a change in the rate has repercussions all over the country. In other words, the effects are visible on a national basis. Originally, it appeared to have been the intent of Congress that there should be different discount rates in the different Federal Reserve districts so that discounts would be more or less available according to local conditions, but over the years that did not happen and any discount rate change reflects itself in the market generally. Therefore, in a sense it seemed academic to discuss whether the discount rate should of should not be changed at the remaining Banks, for the rate is now

2 per cent as far as the market is concerned. Whether to go further on the discount rate would depend on improvement in the economy. In his opinion, that improvement would not develop as fast over the balance of the year as the figures would seem to indicate that it had proceeded since this spring. However, he felt that there would continue to be improvement.

Mr. Szymczak said he would continue the open market policy that had been initiated and followed. He would keep free reserves in the $100-$200 million range until it was known what the Treasury was going to do, for that was one of the things that must be taken into account.

Mr. Balderston said that he had found this meeting a most intriguing session, partly because he had heard so much with which he agreed and partly because the comments of some of his colleagues with which he disagreed were useful nudges to one's complacency. To him the calendar posed a crisis that called for prompt and unified System action. He had always been a strong believer in the structure of the Federal Reserve System and the decentralized nature of its operations, but there are times of crisis when that structure is a weakness. The present time, he felt, was such a crisis. On the one side, there was the basis for an inflationary upsurge. Economic activity as measured by the index of industrial production was half way back to the boom peak. Also, although some figures might indicate that the money supply had increased only 1-1/2 per cent since last year, actually he felt sure that the increase had been greater, for the 1-1/2 per cent figure did not take into account near-money equivalents. Some figure such as the one quoted by Mr. Young at the last Committee meeting seemed more realistic; if time deposits were taken into account, the rate of increase of the money supply since the beginning of the year would be found to have been over 12 per cent. Furthermore, the Congress had authorized spending in excess of income to the extent of $11 or $12 billion for the fiscal year and this has an impact on the economy even before actual Government spending expands substantially. It seemed to him that what the Congress did before it went home increased significantly the problem of monetary control because the very expectation of Government business and subcontracts stimulates planning activity and borrowing in such a way as to aggravate the problem. Then, one must think also of the auto union negotiations referred to previously during this meeting. If wages were to go up, one might expect higher automobile prices as a result and the beginning of a new wage pattern.

Continuing his analysis of the situation, Mr. Balderston commented that the Treasury must by September 25 decide how to seek new funds in a capital market disturbed by uncertainty, an uncertainty to which the System in the discharge of its own functions had contributed. This uncertainty should be reduced by all means available to the System between now and September 25.

All this led to the question, Mr. Balderson said, of how the current crisis should be handled. Although for the last two months he had desired zero free reserves as a target because he felt that the free reserve figure was incompatible with the needs of the situation, he now found himself in the position of desiring a compromise simply because time was of the essence. He believed the use of the free reserve figure is the best language available to the Committee, although he deplored reliance upon that one figure by the market. Therefore, the anticipated rise in free reserves to an average of $182 million for this statement week caused him much concern.

Mr. Balderston suggested that the Desk be asked, if possible, to reduce the $182 million figure by action today and tomorrow to such extent as might be feasible. His suggestion contemplated a level of perhaps around $100-$150 million which would announce to the capital market that the System was going to hold a steady hand for a while, at least through the next Treasury financing. Of course, the Committee could not say that in words, but if the Desk could establish a figure of $100-$150 million and hold that for two or three weeks, it would tell the market what the market needed to know.

In Mr. Balderston's opinion the time had come for the System to have a unified position regarding the discount rate, even though three weeks ago, or thereabouts, there might have been some virtue in a split rate. Now, however, a split rate was something that could not be defended before the court of public opinion. It gave the appearance that the decentralized Federal Reserve System could not get itself together to reach a decision in a time of crisis. If unity were not achieved within the relatively near future, the Treasury would be left with an impossible climate for its financing and the Federal Reserve System would be responsible for that. By failing to achieve a uniform rate policy the System would neither be fighting inflation nor helping to see that the Treasury got the money it must have. This week, Mr. Balderston said, was the time for decision.

Chairman Martin, in expressing his views as to the System's position and problems, said he believed this was a time when what he had said at the last Committee meeting was again pertinent. There would, of course, always be honest differences of opinion and differences in judgments, which is a very proper thing in a system such as the Federal Reserve System. However, it was his conviction that the problem the System was facing today was that of inflation in a bigger way than anything that had been faced during his own lifetime. With respect to the Government securities market, the summer had been a very difficult one and he had great sympathy and understanding for the problems faced by the Secretary of the Treasury and the Under Secretary. As he had stated to the Committee on previous occasions, if the Treasury had not had men of the caliber, understanding, and insight of Messrs. Anderson and Baird, the System would have been in even greater difficulty.

Chairman Martin said that if he were doing it on his own he would fix a 2-1/4 per cent discount rate at the present time. The problem was one of dealing with human nature and people always tend to prefer disagreeable facts whose effects will be felt in the future to a disagreeable remedy in the present. The remedy for the inflation which had gotten ahead of the country over a period of twenty years was bound to be disagreeable but the problem required taking a stand. Certainly, the Federal Reserve System could not handle the fiscal, debt management, or budget policies of the Government, but as to its own posture there should be no misunderstanding. He was glad that the System's posture was fairly clear but wished that it was more clear. Referring to the question of an adjustment of 1/4 per cent in the discount rate, he said no thinking man could really believe that an increase of that size could brake or destroy the recovery process if it was really under way. Nobody could really know what was going to happen with regard to the current negotiations in the automobile industry but if wages should get even further ahead of productivity than they were now he did not know at what point it would be possible to retrace steps. In some respects he saw certain similarities to 1929.

The Chairman emphasized that he had always been a vigorous advocate of flexible monetary policy. He had favored moving down when it became clear that the economy was declining, although he did not think that the Federal Reserve System caused the decline. As to the political front, he said it was constantly being thrown up to him that the System was in jeopardy because its actions might be so unpalatable that the System would be destroyed. Many times this summer he had been told that if the System did not move in certain ways it would lose its independence, to which his stock answer had been: "Then let's get it over with. Make the System an arm of the Treasury and stop worrying about its independence." If those of us who are in the System were to be nonentities, if they were not to play a role involving judgment but were here just to serve to finance the Treasury under whatever conditions might arise, nationally or internationally, certainly the purely operating problems of the System would be much simpler. It would be a situation where the Treasury and the Federal Reserve worked side by side with no clear distinctions as to authority.

In further comments, the Chairman said he was somewhat disturbed about a few Reserve Bank directors taking the position that the open market policy of the System was wrong. Of course, they were entitled to their views but open market policy is determined by the Federal Open Market Committee. If it should ever reach the point where open market policy was being determined by individual directors per se, and this became known, there would eventually be some revamping of the System setup. Prior to enactment of the Banking Acts of 1933 and 1935 there was unlimited discussion of this particular point and that discussion brought out the desire, without impugning anyone's integrity, to remove bankers and businessmen from control of the supply of money. That was the whole intent and purpose of the relevant sections of those two statutes.

It was important, the Chairman said, to face up to the fact that the Federal Reserve System could preserve its independence ad infinitum if those in it chose to be complete nonentities and just did the bidding of others. However, he for one would not care to participate in that type of operation. The System, he felt, had an obligation to adopt a posture which would make it clear that the System was pursuing a firm line and was willing to stand up and be counted. He again expressed the view that it was important that those responsible for System policies should not let their judgment be warped by fear of the System losing its independence.

Continuing, Chairman Martin commented that during the discussions of the easy money policy some people had charged that he was not always consistent. However, he had always taken the position that when business was declining it was appropriate to make easing adjustments, and when business was moving up also to make firming adjustments. Likewise, he had intended to make it clear that he did not believe monetary policy was the controlling factor on either side. He recalled that, toward the end of last year and in January when business was moving down and other things besides monetary policy were needed to create recovery, he made the comment that during all the time he had been in the Federal Reserve System the real problem came when the situation called for moving up. Sometimes it is hard to make a start moving down, but when the start is made it is possible to go down almost to zero. When you are moving up, however, resistance is encountered all along the line. He could go back over his seven years in the System and see how this factor had come into the picture time and again. Periods when System policy had been moving upward were times of struggle against charges that the proposed actions would result in collapse. Naturally, of course, the System had to assume a risk, for it would always be blamed if things went wrong. All he was saying and hoping for the System was that it would stand up and be counted, and would not dilly-dally unduly about the risks and particularly about political jeopardy. If the System should lose its independence in the process of fighting for sound money, that would indeed be a great feather in its cap and ultimately its success would be great. He happened to believe that the American people want sound money and that they would support the System when they saw what was really involved. Certainly, it could not be said that there was sound money when the credit of the United States Government was endangered as it had been in the last few months, but he did not believe that Federal Reserve action had been responsible for that. The Government securities market, he said, ought to be better organized, for it is not properly put together today. It is not properly regulated and it does not have the depth, breadth, and resiliency it should have. Accepting all of those things, the real factor of unsettlement that the Government securities market had been faced with in the last six months went far deeper than Federal Reserve policy. It had been faced with the first intimations of the beginning of a flight from the dollar. If this should continue, it would change the whole structure of the money market. Ultimately the Treasury would not be able to sell securities and would be on a perpetual treadmill. The Federal Reserve System might not be able to stop those developments but it should do everything it could in the battle to try to stop them.

Chairman Martin said that, as he understood the feeling of the majority, open market policy was about right. The trend should be in the direction of a zero level of reserves.

Mr. Shepardson noted that in the discussion around the table the phrase "where we are" had been stated several times. Pointing out that free reserves were close to $200 million, he asked whether that was a temporary aberration.

Mr. Rouse said he would interpret "where we are" as being better signified by the average of free reserves for the last statement week, which was $128 million. Aberrations in the Treasury balance, primarily, had thrown free reserves off somewhat and the figure was liable to fluctuate.

Chairman Martin observed that for the last several meetings it had been agreed that the free reserve figure itself is not too good a benchmark. However, it had been the consensus of the Committee that the Account Management should be trending toward zero. Some had been "higher on the totem pole" than others but the trend was clearly in that direction. Only one or two persons around the table today had suggested going below the zero level. Therefore, it appeared that open market operations could be based on trending toward zero as reflecting the majority position.

Mr. Hayes raised a question, stating that as he understood it the majority position would favor "staying about where we are."

After Chairman Martin commented that he had been endeavoring to express the majority opinion in terms of a trend, he said he assumed there was no disagreement with the thought that the System should maintain an even keel operation through the period of the forthcoming Treasury financing. No disagreement was expressed with that statement.

In the discussion that ensued Mr. Thomas observed that it would be difficult to get to the zero level next week because of the usual mid-month bulge in float and a probable sharp drop in Treasury balances at the Reserve Banks for two or three days, and Mr. Vardaman suggested that the matter might be put in terms of "from where we are trending toward zero." Mr. Riefler suggested putting the matter in terms of "an even keel" which would signify endeavoring to maintain free reserves in the neighborhood of $128 million through the Treasury financing, and Mr. Thomas commented that such a course could be in fact quite restrictive in a tax week, when a high degree of liquidity is desired. Actually, that would be "trending toward zero."

Chairman Martin then commented that the System did not have much time left before the Treasury financing and that thinking in terms of "an even keel" was perhaps the best way to look at it, bearing in mind that the Committee would not like to see an even keel projected into an upsurge of reserves.

Mr. Shepardson said that he would still be in favor of "trending toward zero," as originally suggested, and Mr. Robertson agreed but added the words "if possible."

Mr. Rouse stated that there might be an opportunity to get rid of a good part of the bulge in reserves through sales to foreign accounts and through letting bill maturities run off, as well as by selling bills to dealers. It would be possible to do a good job, he thought, and the Account Management would do the best it could. Nevertheless, operations might result in higher reserve figures. He felt sure that he understood what the majority of the Committee desired, that is, what it was trying to bring about, and he felt that this could be accomplished. However, as Mr. Thomas had pointed out, it was quite doubtful whether it would be possible to get free reserves too much lower in the ensuing period.

Chairman Martin stated to Mr. Rouse that the Committee would have to rely on his judgment from the standpoint of the stability of the market.

Mr. Rouse then stated that he would think of the matter in terms of trending toward zero, with the qualification of avoiding a serious upset in the market.

Mr. Robertson said that, despite the difficulties with respect to terminology, he felt that there was actually general agreement within the Committee. Use of the term "trending toward zero" did not mean necessarily that it would be possible to get there. The Account Management would do the best it could, but developments might work out in the other direction.

Mr. Hayes then commented that he continued to feel that the majority wanted to keep "about where we are" in terms of atmosphere.

In discussion based on Mr. Hayes' comment, Mr. Robertson stated that the trend should be downward but that if this was not possible in the light of market conditions the Account Management, of course, could not do it. The Chairman referred again to the maintenance of an even keel, and Mr. Shepardson inquired whether continuing to exert some pressure would still be contemplated.

Mr. Hayes responded that an even keel meant an even keel to his way of thinking; he did not think one could say "even keel" and keep exerting greater pressure.

Mr. Szymczak commented that an effort to keep free reserves around $125 million would mean, according to the projections, that the Desk would have a problem of absorbing considerable reserves.

Mr. Hayes then commented that if the Management of the Account tried to get the free reserve figure below $128 million it would have to put a considerable and increasing pressure on the market.

Mr. Shepardson said he would accept that statement and that it would be agreeable to him just to continue the degree of pressure now being exerted.

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 fostering conditions in the money market conducive to balanced economic recovery, 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.

Mr. Rouse referred to the speculative situation in the Government securities market during the summer and said that a meeting of the Technical Committee of the New York Money Market, the appointment of which had previously been reported to the Committee, had been called for next Monday. It had been suggested to the Committee that an appropriate subject for study would be the question of the possibility of avoiding a recurrence of the conditions which brought about the speculative fever in the market. Whether anything would come out of it was an open question, but the committee was on notice. The Federal Reserve Bank of New York was preparing a memorandum on the matter of a factual nature for the use of the committee and copies would be furnished to the Federal Open Market Committee.

It was agreed that the next regular meeting of the Federal Open Market Committee would be held on Tuesday, September 30, 1958, at 10:00 a.m.

No objection was interposed to Vice President Tow of the Federal Reserve Bank of Kansas City attending the next two meetings of the Federal Open Market Committee as an observer in the absence of Mr. Leedy, or to First Vice President Wayne of the Federal Reserve Bank of Richmond attending as an observer in the absence of Mr. Leach.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary