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, October 21, 1958, at 10:00 a.m.

PRESENT: Mr. Balderston, Chairman pro tem.
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mangels
Mr. Mills
Mr. Shepardson
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Hayes

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

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Marget, Roelse, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Molony, Special Assistant to the 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

Messrs. Ellis, Mitchell, Jones, Tow, and Rice, Vice Presidents of the Federal Reserve Banks of Boston, Chicago, St. Louis, Kansas City, and Dallas, respectively

Mr. Einzig, Assistant Vice President,
Federal Reserve Bank of San Francisco
Mr. Gaines, Manager, Securities Department,
Federal Reserve Bank of New York
Messrs. Anderson and Atkinson, Economic
Advisers, Federal Reserve Banks of
Philadelphia and Atlanta, respectively
Mr. Parsons, Director of Research, Federal
Reserve Bank of Minneapolis

The Secretary stated that since neither the Chairman nor the Vice Chairman of the Committee was able to be present at this meeting, it would be necessary to elect a Chairman pro tem.

Upon motion duly made and seconded, and by unanimous vote, Mr. Balderston was elected to act as Chairman at this meeting in the absence of the Chairman and Vice Chairman of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 30, 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 September 30 through October 15, 1958, and a supplemental report covering the period October 16 through October 20, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that in terms of reserve averages, short-term market rates of interest, and the general money market atmosphere, the Desk had been able to carry out the Committee's instructions during the

past three weeks. Because of an unexpectedly large volume of float, the period closed with free reserves on average above intended levels, but this was temporary and had not had an adverse effect.

The most important development in the United States Government securities market had been the market acceptance of the new Treasury issues, Mr. Rouse said, both of which were now trading at substantial premiums after opening at a discount. Commercial bank underwriters had had the opportunity to get out of their allotments with a profit, and many had done so. Some banks had sold other short-term securities to adjust reserves and kept the high-yielding new issues in portfolio. Mr. Rouse added that the intermediate- and long-term markets were sick. Trading volume was small, but press comments on the likelihood of increased Federal Reserve restraint and of a new offering of Treasury bonds had helped to depress the market. Recent speeches by Treasury officials implying the use of moral suasion in selling Government debt had not been well received in the market; many people failed to understand an important point in these speeches, namely, that the Treasury planned to rely upon liberal pricing to sell its securities. The real root of the problem in the Government securities market was the current Treasury deficit and the prospect of large deficits in subsequent years as well.

Mr. Rouse reported that the new issue of January 22 Treasury bills was auctioned at an average rate of 2.80 per cent, and the new bills were trading this morning at 2.65 per cent. Most references to

"the bill rate" referred to the rate on three-month Treasury bills, Mr. Rouse noted, but at present there were actually three Treasury bill markets: bills within one month of maturity were in general trading at 1 1/2-1 3/4 per cent; two-month bills around 2 per cent; and January bills at 2 1/2 to 2 5/8 per cent. The four issues of shorter-term Treasury bills actually had been trading at yields well below the Federal funds rate.

In concluding his remarks, Mr. Rouse commented that projections indicated a steady loss of reserves for the next several weeks, suggesting that the System Account would be a net purchaser of Treasury bills during the three weeks before the next Committee meeting.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period September 30 through October 20, 1958, were approved, ratified, and confirmed.

The Chairman referred to a memorandum from Messrs. Hackley and Solomon distributed under date of October 16, 1958, regarding Reserve Bank participation in Treasury refundings and asked that Mr. Riefler comment on the subject.

Mr. Riefler stated that for some time the Treasury had been discussing the possibility of a change in the procedure for refunding securities so as to avoid attrition on the maturing securities and to keep the maturing issue from acquiring a "rights" value in the market. As stated in the memorandum from Messrs. Hackley and Solomon, Under

Secretary of the Treasury Baird transmitted with a letter to Chairman Martin, dated October 1, 1958, a memorandum containing a proposal for consideration in connection with the Treasury's December 1958 refunding concerning which he asked "whether there are any legal or other reasons which would preclude the System's participation." The proposal, which was further set forth in draft circulars transmitted by the Fiscal Assistant Secretary of the Treasury under date of October 9, referred to the $9.8 billion issue of 3-3/4 per cent certificates of indebtedness dated December 1, 1957, maturing December 1, 1958, of which the Federal Reserve held approximately $7.8 billion and the public about $2 billion. Proposal "A" was that these be refunded by offering $2 billion of new securities to the general public for which either cash or the maturing securities would be accepted in payment but with no allotment privilege being extended. There would be an additional offering of the same securities to the Reserve Banks for exchange and that exchange subscription would be allotted in full. An alternative referred to as "B" would differ from "A" to the extent that the $2 billion offering to the public would be with the condition that subscriptions accompanied by tenders of maturing certificates in payment would be allotted in full, thus placing the terms for the public and the Reserve Banks on the same basis.

The memorandum from Messrs. Hackley and Solomon took the position that under either alternative the Reserve Banks could acquire the refunding securities without their being subject to the $5 billion

limitation in section 14(b) of the Federal Reserve Act on purchases of securities by Reserve Banks directly from the Treasury. Specifically, the memorandum stated:

> While it probably would be somewhat easier to justify acquisitions under Alternative "B" as being exempt from the $5 billion limit, it is believed that, all things considered, acquisitions under Alternative "A" might also reasonably be considered to be exempt from the $5 billion limit. This would be on the ground that the security is not only acquired as an exchange or refunding but also (1) the security acquired by the Reserve Banks is clearly a security which meets the test of the open market, and (2) any differences between the treatment given the general public and that given the Reserve Banks is in favor of, rather than adverse to, the Reserve Banks. In other words, the acquisition is not only an exchange or refunding, but, in addition, there do not seem to be any aspects of any effort to have the Reserve Banks acquire securities from the Treasury on terms or conditions more favorable to the Treasury than those available in the open market.

With the memorandum there was presented for the consideration of the Committee a draft of letter to Under Secretary Baird which would state that acquisitions by the Reserve Banks of securities under either of the alternatives would not be subject to the $5 billion limitation and that, subject to usual considerations relating to monetary and credit policy and the terms eventually set for the refunding securities, the Reserve Banks would be prepared to refund some or all of their maturing certificates under either of the proposed alternatives. In response to Acting Chairman Balderston's call for comments, Mr. Bryan inquired whether other alternatives which might avoid attrition and rights values on the maturing securities had been explored. To this,

Mr. Riefler responded that these were the two alternatives on which the Treasury had now requested the comments of the Committee.

Mr. Allen noted that the memorandum from Messrs. Hackley and Solomon had not been accompanied by copies of the letters, memoranda, and circulars from the Treasury. While he did not argue the legal point, he felt that the Federal Reserve Act intended to make a clear distinction between open market purchases and transactions directly with the Treasury. He thought it important from the standpoint of the future that any securities purchases outside the $5 billion limitation provided in section 14(b) of the Act should be clearly open market securities in all respects. The Federal Reserve Banks should be treated and should seek to be treated exactly like any other purchaser.

Mr. Treiber said that he concurred in the conclusion of Messrs. Hackley and Solomon that acquisition by the Reserve Banks of new Government securities pursuant to alternative A or alternative B would not be subject to the $5 billion limit stated in section 14(b) of the Federal Reserve Act. He felt, however, that there was a question of policy as to whether the Federal Reserve should concur in a proposal calling for special treatment for the Reserve Banks as compared with other holders of the same maturing securities. Additional comments by Mr. Treiber on this point were substantially as follows:

> As a people we are very fortunate in the United States that our Treasury submits itself to the discipline of the market in the management of the public debt. Only in special circumstances for short periods of time to ease the money

> market problems that arise at tax payment dates are special arrangements made between the Treasury and the Federal Reserve.
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> We think it has been important to be able to say that, in connection with Treasury financing, the Reserve Banks have the same status as any other person--as any other security holder. Once there is special treatment for the Federal Reserve, it might be more easily argued that the Treasury should pay the Reserve Banks a lower interest rate or that the Treasury should receive more favorable treatment in some other way in dealing with the Federal Reserve.
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> Because we believe that it is important to continue to be able to say, without further qualification or explanation, that the Reserve Banks have the same status as any other person in the market, we think that it would be unwise for Alternative A to be used.
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> Accordingly we would suggest that a period be inserted after the words "Federal Reserve Act" in the last paragraph of the proposed letter to Mr. Baird, and that in lieu of the remainder of that paragraph there be inserted a new sentence expressing the view that it would be unwise for the Reserve Banks to receive special treatment in connection with Treasury financing, and suggesting that Alternative A not be adopted.

In the discussion that followed, Mr. Bryan again mentioned that other alternatives might accomplish the results the Treasury sought. He felt that any step toward the Treasury's objectives would be important and that various alternatives should be considered.

Mr. Mills suggested that the issues were first, whether the proposal was legal, to which Counsel had answered in the affirmative, and second, whether the procedure was one that the Federal Open Market Committee wished to adopt. On the latter, he said that it had always seemed to him that the portfolio of the System Account should be looked upon essentially as the base reserve supply of the commercial banking

system over a period of years. If this were the case, the composition of the portfolio beyond holdings of Treasury bills became a matter of indifference. It would not do violence to his conscience to accede to the Treasury's request. In fact, to do otherwise would clothe the System with a degree of chastity that he did not think pertained.

Mr. Leach said there was a real danger in offerings of securities which would have the effect of giving the Federal Reserve special treatment.

Mr. Szymczak added the comment that this was the course by which some other central banks had found that they gradually slipped into the position of being the means for financing the public debt rather than having their Government go to the market for its funds. While he thought the System might be willing to take securities such as the Treasury's proposal contemplated, he doubted that it was wise for the Committee to include a statement in its reply to Under Secretary Baird which would amount to a commitment as to what it might do policy-wise in the future. He also questioned whether the Treasury would wish to use the suggested procedure at this time in view of the market situation.

Chairman Balderston said that it was obvious that there was a difference of opinion regarding the Treasury's proposal, even though there seemed to be acceptance of the view of Counsel that the Reserve Banks legally could acquire securities issued under such a proposal. A response to the Treasury was required, he said, but he questioned

whether it was sufficient to give the Treasury the results of a vote on the issue without also giving it the benefit of the different views expressed at the meeting.

The type of reply that might be given to the Treasury was discussed at some length and a number of suggestions for change in the last paragraph of the draft letter were considered. In the course of the discussion, Mr. Mills stated that he would be willing to move that a letter be sent to the Treasury in the form of the draft submitted, adding that he would be agreeable to placing a period after the word "Act" in the last paragraph and deleting the rest of the sentence.

Mr. Treiber said that he would be willing to second a motion such as that proposed by Mr. Mills.

There then developed a discussion of how such a letter would be interpreted by the Treasury, especially in view of its question as to whether there were legal or other reasons which would preclude the System's participation in a refunding of the type proposed. In clarification, Mr. Mills stated that while a letter such as he proposed would only comment on the legality of the proposal, his motion would contemplate that a deputation would call on the Treasury at the time the letter was delivered and would state that in essence the Committee acceded to the Treasury's proposal. Such a deputation also would give the Treasury the substance of the discussion at this meeting.

The Chairman suggested that the only way to get a clear expression of views to send to the Treasury was to vote on the two issues,

that is, whether its proposal was legal and, if so, whether as a matter of policy the Committee felt that the System would wish to participate in a refunding pursuant thereto.

Mr. Mills said that the Committee had an obligation to give the Treasury a clear reply and that if the vote was unfavorable on either issue the Treasury would be at liberty to renew its plea to the Committee.

Thereupon, Mr. Mills moved that the Committee approve the letter to Under Secretary of the Treasury Baird in the form of the draft submitted with the memorandum by Messrs. Hackley and Solomon dated October 16, 1958.

In the absence of a second, the Chairman declared Mr. Mills' motion lost.

Mr. Szymczak then moved that the last paragraph of the draft of letter be amended by placing a period after the word "Act" and deleting the rest of the sentence, and that the letter as changed in this manner be sent to Under Secretary Baird with the understanding that the Chairman, or whoever might be designated by the Chairman, would present to representatives of the Treasury the substance of the views expressed at this meeting.

Mr. Szymczak's motion was seconded by Mr. Leach.

The motion was put by the Chair and carried, Messrs. Balderston, Fulton, Irons, Leach, Mangels, Shepardson, Szymczak, and Treiber voting for the motion, and Mr. Mills voting "no."

The Chairman then called for an expression of views by the alternate members

of the Committee and the Reserve Bank Presidents who had not voted on Mr. Szymczak's motion, and the following views were expressed: Favorable to the motion, Messrs. Erickson, Allen, Johns, Deming, Bopp, and Bryan.

Mr. Shepardson next moved that as a matter of policy the Committee record the view that action by the Treasury to use Alternative "A" as set forth in the letter to Under Secretary Baird in refunding securities would be unwise.

This motion was duly seconded and carried, Messrs. Fulton, Irons, Leach, Mangels, Shepardson, Szymczak, and Treiber voting to approve, while Messrs. Balderston and Mills voted "no."

In response to the Chairman's request for an expression of views by the alternate members of the Committee and the Reserve Bank Presidents who had not voted on Mr. Shepardson's motion, Messrs. Erickson, Allen, Bopp, and Bryan indicated that they would favor the motion, while Messrs. Deming and Johns indicated that they would not favor such motion.

Secretary's note: The letter to Under Secretary of the Treasury Baird was transmitted under date of October 21, 1958 in the following form:

This refers to your letter of October 1, 1958 and Mr. Heffelfinger's letter of October 9, 1958 regarding certain securities which the Treasury might issue in refunding about $9.8 billion of certificates that mature December 1, 1958. You refer to the possibility of the Reserve Banks acquiring the proposed refunding securities in replacement of the maturing certificates held by them, and you ask, in effect, whether these refunding securities so acquired would be subject to the $5 billion limit stated in section 14(b) of the Federal Reserve Act on purchases of securities by the Reserve Banks directly from the Treasury.

> Mr. Heffelfinger's letter enclosed tentative drafts of two circulars which might be used, alternatively, to carry out the refunding. Under Alternative "A" about $2 billion of the new securities would be offered to the general public, with either cash or the maturing certificates being accepted in payment for the new securities, but with no allotment privilege being extended to the maturing certificates. There would be an additional offering of the same new security to the Reserve Banks in an additional amount in exchange for their holdings of the maturing certificates, with that exchange subscription being allotted in full. Alternative "B" would be substantially the same as Alternative "A", except that with respect to the $2 billion offering to the general public, subscriptions accompanied by a tender of maturing certificates in payment would be allotted in full.
>
> Upon careful consideration of both the alternatives, the Federal Open Market Committee has concluded that acquisitions by the Reserve Banks pursuant to either such type of refunding would not be subject to the $5 billion limit stated in section 14(b) of the Federal Reserve Act.

During the foregoing discussion, Mr. Keir withdrew from the meeting.

In supplementation of the staff memorandum distributed under date of October 17, 1958, Mr. Young presented the following statement on the economic situation:

> Two words--continuing recovery--well sum up the composite of most recent news about domestic economic activity.
>
> Third quarter GNP is now estimated at $440 billion, up $11 billion from the second quarter. Main factors in the rise were reduced inventory liquidation and increased Government and consumer expenditures.
>
> Industrial production this month is rising further and broadly, with extra stimulus emanating from labor settlement and new-model output in the automobile industry.
>
> Over the summer months, pickup in sales and new orders in manufacturing industries generally ran about even, but in September new orders moved ahead. For durable goods industries only, new orders have been a bit ahead of sales since June. Since June also, each successive month has shown a slow-down in liquidation of manufacturers' inventories.

New construction activity in September at $50 plus billion, annual rate, was close to record levels. Housing starts at a rate of 1.3 million units were at a three-year high and for the year as a whole through September were 10 per cent ahead of the first nine months of 1957. August construction contracts exceeded those of a year ago by nearly one-fourth.

With industrial and construction activity rising further, labor markets are strengthening. Unemployment in September declined about twice the seasonal amount, and unemployment claims for October are indicating further unemployment declines. Recent unemployment declines have favored especially male workers and long-term unemployed. September gains in employment were most marked in durable goods manufacture, in finance, and in Government activities.

With more employment, hours worked per week up slightly, and hourly earnings a bit higher, rising wage payments are helping to raise personal income. In September, personal income at $358 billion was 3 per cent higher than the February low. Though 1.5 per cent higher in current dollars than the August peak of last year, income was off about 1 per cent in constant purchasing power.

While personal income rose further in September, retail sales slipped off 2 per cent from high July-August levels. Declines were most marked in durable goods lines which in preceding months had shown the greatest advance.

With forward-look model introductions in process, the automobile market is being closely watched. While work stoppages have slowed manufacturers' shipments and '58-model sales have continued to lag, dealer deliveries have been enough to cut significantly further into dealer stocks, bringing them to a fourth below last year at this time. Used car prices remain firm and used car stocks have also now been reduced to about a fourth under last year's October level.

The farm harvest prospect is for record crops, especially price-supported crops. With improved range conditions and bulging feed supplies, buildup of herds and maintenance of feeder stocks is limiting cattle slaughter. Hog slaughter recently has been about at seasonal levels, but output of poultry meat has been up significantly.

For the past several months, wholesale prices have been stable, with easing of farm prices offsetting strengthening tendencies in industrial material prices and price markups for some fabricated items. Strength in industrial material prices has been most pronounced in metals; prices of a few

materials such as petroleum products, lumber, and wool have eased or declined. Among fabricated products, the number of price advances, while growing slowly, is growing. The necessity of covering higher costs in prices is again a featured subject of discussion in trade periodicals.

The consumer price index, which showed a slight decline in August because of lower food prices, may show a further decline for September. But a phase is now starting when recent price advances of autos and some other durables will begin to register an influence on the index. These increases and further rises in prices of services may change the index drift before the year end.

Abroad, in major industrial countries the news is mixed. In Canada, recovery has slowed, with labor strife and auto model changeover contributing factors. In Britain, mild recession appears to have been extended. In France, some recession evidence is reported. In Germany, activity over-all continues high, but with steel, coal, and textiles still showing weakness.

The level of U. S. exports has not changed significantly since April. With many important nonindustrial countries still suffering serious internal inflation difficulties, and with prices of various materials which they supply at lower levels than last year, pickup in their purchases from industrial countries, including the U. S., is hardly to be expected yet.

There had been distributed copies of staff memoranda dated October 17, 1958, concerning the outlook for member bank reserve positions and the outlook for Treasury cash requirements. With further reference to financial developments, Mr. Thomas made the following statement:

Bank credit developments during the past two months or more have conformed closely to a pattern that might be considered as satisfactory under existing circumstances. Developments in capital markets, in contrast, have not been satisfactory in that the shift from fixed return assets to equities seems to be continuing. Although bond markets showed some improvement in the first half of October, they have weakened again during the past week.

Since July, banks have met moderate seasonal loan demands and have underwritten Treasury cash offerings of

securities, but have been able to sell large amounts of securities to nonbank investors. As a result demand deposits have increased less than seasonally and time deposits have recently declined. The Treasury deficit has been financed through offerings of short-term securities without causing an inflationary expansion in the money supply. Bank loan expansion has in recent weeks been larger than in the corresponding period of 1957, but less than in some other years. Bank acquisitions of the Treasury bills and note issued this month were remarkably small.

This result has been obtained with, at the most, only moderately restrictive monetary policies. Net free reserves of member banks, which were reduced in August, have remained close to $100 million since the beginning of September and the discount rate has continued well below short-term open market rates.

To some extent, the slackened monetary expansion along with Treasudy deficit financing and general economic recovery has been possible because of previously accumulated liquidity. Demand deposits, after adjustment for seasonal variations, increased by over 2 per cent in July, following an increase of two per cent in the first half of the year. Time deposits increased at a rate of over 1 per cent a month from December until July. Further monetary expansion, other than seasonal, has not been needed to finance economic recovery. The higher level of interest rates has helped to attract some of these available funds into other uses, such as short-term Government securities. Turnover of demand deposits, seasonally adjusted, has increased slightly in recent months but continued less than a year ago.

Yields on Government securities rose in the latter part of September after announcement of the Treasury financing, but declined somewhat after the beginning of October. The market was given reassurance by the favorable reception of the new Treasury issues and the large share absorbed by nonbank investors. Yields on short-term securities have continued higher than they were prior to mid-September, reflecting in part the influence of the increased supply of bills and short notes resulting from recent Treasury financing, as well as anticipation of further growth in credit demands. The three-month Treasury bill yield at around 2-5/8 per cent is well below rates prevailing in late 1956 and throughout 1957. Rates on open-market commercial paper have been raised to 3-1/4 per cent, compared with a low of 1-1/2 per cent in July and a high of 4-1/8 per cent a year ago, and rates on finance company paper and bankers' acceptances have also been raised.

Yields on long-term Government securities, after rising in September to above the peak levels of 1957, also declined somewhat after the beginning of October to around the levels prevailing before the financing announcement. They have risen again, however, during the past week to only slightly below their earlier highs.

Although bond markets generally strengthened somewhat in the first half of October, they are still influenced by the tendency of investors to shift into equities. Notwithstanding occasional setbacks, stock prices have risen to new high levels. Yields on high-grade stocks have declined further below those on high-grade bonds.

New issues of corporate securities, which were in relatively large volume during September, have been much lighter in October. Issues by State and local governments in October are expected to remain close to the average for the year to date, if a large New York State Power Authority issue is offered this month.

The trend of economic events and the prospective borrowing needs of the Federal Government indicate the likelihood of growing credit demands in the near future. To what extent these may be supplied from accumulated and current savings and to what extent growing demands for bank credit develop remain to be seen. Seasonal monetary needs call for a further growth of over $4 billion in total bank credit by the end of the year. The Treasury will need to borrow additional cash of about $4 billion in the period and nearly as much more in January. For the remainder of the fiscal year after January, occasional Treasury borrowing needs will be more than offset by retirements of debt.

In addition to seasonal needs for currency and required reserves, the outflow of gold seems likely to persist. This country's current payments and receipts for trade and services with other countries are approximately in balance, while our foreign investments and aid supply funds to foreigners who continue to add to their dollar claims. Some of these claims are kept in dollar balances--deposits or short-term securities--holdings of which have been increasing recently, and some are taken in gold.

The drain on bank reserves resulting from foreign gold acquisitions and changes in foreign balances at the Reserve Banks has amounted to about half a billion dollars in the past three months. Some drain is likely to continue, although the magnitude is difficult to predict. This is largely the result of fundamental forces in our international economic position, that can be changed only through the operation of market forces and competitive factors. While the effects of

the drain on bank reserves may be offset by System open market operations, this situation is one that calls for a generally restrictive credit policy in this country. More effective correctives, however, would be moves to reduce the budgetary deficit and the checking of price rises due to wage and other cost increases. The situation would also seem to call for removal of some of the obstacles to foreign trade and capital movements in many other countries.

Customary seasonal currency and deposit growth, together with an allowance for a further gold drain at the rate of about $100 million a month, indicate a need for about $1.3 billion of additional reserves between mid-October and the end of December. Except for about $300 million of temporary needs in the next two weeks, most of these will develop after the middle of November.

The task of supplying reserve needs through open market operations is relatively clear and simple. The more difficult problem facing the System as a whole is the question of the discount rate. That rate is out of line with market rates. Yet there is no indication that member banks have been increasing their borrowing to obtain reserves for undue credit expansion. As long as this situation continues there is no strong need for a higher rate. An increase at this time might be disturbing to an already shaky bond market.

There are, however, strong reasons for raising the rate at this time. With economic activity fast moving to higher levels and with a large Government deficit to be financed, credit demands are likely to increase. Undue expansion might easily develop in some sectors. A growing economy requires a high rate of investment and saving and a level and structure of interest rates which will keep these elements in balance. The fear of inflation and the tendency to shift from fixed-return assets to equities also exert pressure for rising rates. The discount rate will eventually need to be increased in order to prevent bank credit based on borrowed reserves from being drawn into financing dangerous developments of this nature.

As long as an adequate flow of money is available or is supplied through open market operations to finance a sound recovery and seasonal needs, banks should not need to increase their borrowings. Under such circumstances a higher discount rate would not be a particularly restrictive influence. Except for the psychological effect of an increase, it would become restrictive only as credit expanded beyond the desired limits. It would probably be less disturbing and more effective to make the change before rather than after such a situation developed. The schedule of Treasury financing operations is also a consideration in determining the timing of discount rate action.

Mr. Treiber next made a statement substantially as follows:

Over-all business activity continues to expand, but the expansion now appears to be proceeding less rapidly than in earlier months. There are still a number of uncertainties--for example, the reception of the new model automobiles and the effects of the sharp rise in interest rates, especially in the construction field.

Recent data suggest that the economy may encounter more difficulty in pushing to new high ground than had appeared earlier, when most observers were impressed with the shortness of the recession and the vigor of the recovery. It may prove difficult to make much headway in reducing the present undesirable high level of unemployment.

Bank credit is not expanding rapidly. This is true as regards holdings of Government securities as well as business loans. The commercial banks bought substantial amounts of the recent Treasury issues but they have also sold a substantial amount of Government securities. The underwriting job appears to have been effective.

In general, prices have continued to be stable. The stock market, of course, has been an exception. We were glad to see the Board's action increasing margin requirements, thereby minimizing the extent to which further extensions of credit might contribute to the upward pressures in the stock market.

For the remainder of the year we do not see any major inflationary pressures that are monetary in nature.

The problems of Treasury financing are difficult but not unmanageable. It looks as if the Treasury may be announcing the terms of a $3 billion cash offering in the first week of November. After that it will have the problem of refunding $12 billion of securities maturing on December 1 and December 15. Early in the new year the Treasury will again have to come to the market with a cash offering.

We have been concerned over the rapid rise this summer in interest rates. Expectations, of course, had much to do with the speed and height of that rise. In our opinion, the state of the economy and the prospective demands for bank credit do not call for any steps on our part to encourage further increases in interest rates at this time. The System has sought, over the last several weeks, to promote stability in the money market and in the Government securities market. The effort has been reasonably successful.

In our opinion, in the period until the next meeting of the Committee, the System should continue to seek to promote

stability in the money market and the U. S. Government securities market. We should seek to avoid any action that might cause a deterioration in market atmosphere. Such a policy would include:

(a) no change in the directive; and
(b) probably the maintenance of free reserves at about the level of recent weeks.

The discount rate poses a difficult problem. The present rate is substantially out of line with short-term money market rates and there are good arguments for raising the discount rate for technical reasons. But to bring the discount rate fully into its historical relationship with short-term market rates would require an increase to something like 2-3/4 per cent, and an increase of that size would almost certainly be regarded as a vigorous move toward further credit restraint. It would be likely to set off a new round of interest rate advances. On the other hand, another increase of 1/4 per cent would obviously fall short of restoring a more usual relationship of the discount rate to market rates. An increase of 1/2 per cent would come closer to establishing a more normal relationship, but might be construed as a further step toward a more restrictive credit policy, even if it were announced as merely a technical adjustment.

Every Thursday in recent weeks at the Federal Reserve Bank of New York we have had an extensive discussion of the discount rate, including the possibility of increasing the rate at some appropriate time following the completion of the Treasury's recent financing efforts. Our directors feel strongly that the rise in interest rates generally has been much too rapid and has gone too far for the present state of business recovery. They are impressed by the continued high level of unemployment and the continued uncertainties in the outlook for further recovery--some, in fact, stemming from the sharp rise in interest rates. Consequently, they would strongly oppose action that could be construed as validating the rise in market rates which they regard as excessive. They fear that such action might cause further advances in interest rates and renewed unsettlement in the capital markets, and put a new road block in the way of further recovery. Indeed some of our directors would prefer that through open market operations, the existing degree of restraint be reduced, thus encouraging a reduction in money market rates and in this way narrowing the gap between the discount rate and money market rates.

The officers of the Bank are impressed by the case for a technical correction in the level of the discount rate, and

have so informed the directors. But we, in turn, have been impressed by the directors' conclusion that any step toward more restraint would be unwise and by their conviction that a rise in the discount rate now would be interpreted as such a step. We believe that this is a situation calling for the best collective judgment and appraisals of the System as a whole and hope that it may be furthered by today's discussion.

We are impressed with the important part now played by market expectations. Last fall there was a rapid and substantial reduction in interest rates even though the easing action of the Federal Reserve at that time was relatively modest in extent. This summer, as evidence of an upturn in business became clear, the market turned around in anticipation of a shift in Federal Reserve policy and the turn was accentuated by the collapse of speculation in Government securities and by spreading discussion of the outlook for a persistent inflationary bias in the economy, which encouraged investment in equities rather than fixed-interest securities. In these circumstances, the financial community was unusually sensitive to Federal Reserve policy actions. Each step taken in the direction of reducing credit ease was interpreted as the prelude to other moves. The combined result of all these influences was a rise in market rates of extraordinary rapidity, and a correspondingly sharp fall in bond prices.

The prices of Government securities have fluctuated so greatly in the last twelve months that public confidence in Government securities has been severely shaken. We think that the period of greater market stability in recent weeks has been highly desirable and that the System should use its best efforts to promote a further period of stability, not only in the interest of successful Treasury financing but even more in the interest of further business recovery.

Mr. Johns said that evidence of the strength and rapidity of economic expansion was mounting and was significantly more observable now than a few weeks ago. The time was approaching when the full impact of the Federal deficit would be felt, it seemed reasonable to expect that consumer expenditures would rise as disposable income increased, and businessmen appeared more confident about the future than they had been in the

recent past. Private domestic investment appeared likely to be higher in the fourth quarter than in the third, primarily because of expected larger outlays for inventories, and it seemed reasonable to anticipate further growth in outlays by State and local governments.

All things considered, Mr. Johns said, it was his view that the current degree of monetary restraint was inadequate. Federal and private borrowing should be financed in a noninflationary way and the Federal Reserve System should create conditions conducive to that end. At its present level the discount rate had remained significantly below short-term money market rates for about two months, which could reasonably be taken by observers to mean that the System considered present money market rates too high and intended to cause or permit those rates to decline. In Mr. Johns' opinion, the Reserve Banks should not now administer the discount window in a fashion conducive to borrowing by member banks. Therefore, he had concluded that the discount rate should be increased at least to 2-1/2 per cent and possibly to 2-3/4 per cent. In view of the Treasury's needs and taking into account the even-keel policy discussed at the September 30 meeting, there should be a reasonable period of stability before and after Treasury financing operations. Accordingly, it seemed to him that a discount rate increase should take place not later than the first of November. If so, a special meeting of the directors of the

St. Louis Bank would be necessary. He was prepared to request the Chairman to convene such a meeting, with a view to considering a discount rate increase, at whatever time seemed most appropriate in the light of plans of the other Reserve Banks--if in fact there were such plans--to take action between now and the first of November.

As to open market operations, Mr. Johns said that he would favor working toward a somewhat tighter situation than had prevailed during the past few weeks. He would not seek to impede an adjustment in interest rates--in this case an upward adjustment--which would tend to make Government securities more attractive to nonbank investors. Mr. Johns pointed out that the period was approaching in which it would be necessary to supply some reserves because market factors would tend to tighten. He suggested that these be supplied according to a time schedule determined by the Open Market Committee so as to minimize System intervention in the market, thereby enabling the market to discern the System's intentions and not be confused by frequent operations for the purpose of ironing out short-run fluctuations in reserves. Mr. Johns said he was pleased to read in a market advisory letter yesterday a warning that readers should not be surprised if the Federal Reserve were to permit the reserve position to fluctuate somewhat, even within a short period, from free to net borrowed reserves, nor to be surprised if the Federal Reserve did not attempt to offset factors such as float. Therefore, he suggested that the

Committee schedule injections of reserves, at least for the next three weeks, in some regular time sequence. He felt that the reserves injected in the next three weeks should be in the range of $50-100 million per week, and that float and Treasury balances should be allowed to fluctuate without being offset.

Mr. Bryan said that recovery in the Sixth District was apparently broad and general, and this also seemed true nationally. There had been an astonishing revival of borrowings from the Atlanta Bank, quite general throughout the district. With 5 per cent of the nation's reserves, Sixth District borrowings from the Reserve Bank were now running about 14 per cent of the nation's total. Deposits had gone up rapidly and loans of commercial banks were showing a good trend.

With regard to policy, Mr. Bryan's inclination was to make an adjustment in the discount rate. The System now seemed to be telling the investing public two different things: the open market instrument was saying one thing and the discount instrument another. It was his view that the two instruments should tell the same story. If this was true, the System's choice at this point was either by open market operations to bring down the level of short-term rates to a level more consonant with the discount rate, or to bring up the discount rate. Present economic circumstances indicated the latter. While this was his view, Mr. Bryan said that he was not sure whether the directors of the Atlanta Bank would take the same view.

Mr. Bopp reported that a recently completed survey by the Philadelphia Bank of capital expenditure plans of firms accounting for 60 per cent of manufacturing employment in metropolitan Philadelphia indicated 1959 capital expenditures 14 per cent less than in 1958, employment in March 1959 about the same as in September 1958, and operations in the second quarter of 1959 at 78 per cent of capacity compared with 73 per cent in the third quarter of this year. Little change was expected in inventories. Smaller capital outlays in 1959 than this year were planned by both durable and nondurable goods manufacturers. The decrease for durables was a little over 2 per cent and for nondurables 23 per cent, the latter mostly in the chemical and petroleum industries. Manufacturers in Lehigh, Trenton, and Wilmington had plans to spend about the same for capital improvements next year, an increase in nondurables offsetting a decrease in durables.

Turning to monetary policy, Mr. Bopp noted two principal problems. The first and most important was whether recent objectives with respect to the degree of ease or restraint appeared appropriate for the next few weeks. There was evidence that national recovery was continuing, though at a somewhat slower pace. September data, seasonally adjusted, showed a small decrease in retail sales while industrial production and personal income rose less than in any of the preceding four months. Manufacturers' new orders were down in

August following three successive increases. Inventory liquidation continued, even though at a reduced rate. Business firms planned to spend less for plant and equipment in 1959 than in 1958, and public acceptance of the 1959 automobiles was still uncertain. Furthermore, it appeared that actions taken had been successful in instilling widespread confidence that the Federal Reserve was resolved to deal firmly with the threat of inflation. For these reasons, Mr. Bopp believed that the System should try to maintain about the same availability of credit as in recent weeks.

The second problem, Mr. Bopp said, was a technical one; namely, that the discount rate was far out of line with short-term market rates. The present spread was creating some confusion and uncertainty as to System intentions but, on the other hand, it would be unfortunate if an increase in the discount rate should be interpreted as a decisive move toward a more restrictive policy under present circumstances. In view of the forthcoming Treasury financing, including the probable new borrowing in November and refunding of certificates maturing December 1 and of the bond issue maturing December 15, the alternatives were to raise the discount rate in the next few weeks or to wait until around the first of the year. Particularly after reading the minutes of the last Committee meeting, Mr. Bopp said he believed that an increase of 1/2 per cent in the next two or three weeks was the preferable course. He felt it would be fortunate if some Reserve Banks could raise

the rate this week, in view of the expected rise in free reserves to about $250 million. At the Philadelphia Bank, an executive committee meeting was scheduled for this Thursday, but Mr. Bopp said that he would be happy to call a meeting of the full board of directors and recommend an increase in the discount rate of 1/2 per cent if some of the other Reserve Banks deemed it feasible to move this week. Mr. Bopp added that in view of the considerably slower pace of recovery in the Third District than nationally, he thought it was understandable that the Federal Reserve Bank of Philadelphia would not want to be the first or the only Reserve Bank to recommend an increase in the discount rate. Even though the market probably had largely discounted a rate increase, he thought it desirable to explain the increase as primarily a technical adjustment to bring the discount rate into better alignment with the short-term market rates.

Mr. Fulton said that the steel industry was undergoing a rapid increase, and operations were better in everything but oil casing pipe and structural steel. The increase had not shown up yet in automobile steel because of strikes, but expansion there was expected. Despite this upturn, unemployment throughout the district was still high and no areas had been removed from the substantial labor surplus category. Construction activity was running about 9 per cent above last year because of a rise in heavy construction. Banks had been borrowing but there were no continuous borrowers at the Reserve Banks.

Mr. Fulton stated that he would like to propose an increase in the discount rate to his directors, but at their joint meeting earlier this month there had been a consensus that the rate should not be increased at that time. He did not know what the board would do if it met next week. On open market operations, Mr. Fulton thought the Committee could be tending toward a zero reserve position. The posture of the System should be to announce and maintain a degree of restraint.

Mr. Shepardson commented that the country was experiencing a healthy, stable recovery, and he thought it desirable for the System to lend support to that type of recovery rather than to try to push things too fast. The level of unemployment was a matter of concern, but it seemed to be a natural corollary of the increase in productivity and this situation could not be expected to improve rapidly. In his opinion it was important that the System keep "ahead of the game," as long as there was in prospect the inflationary pressure of the Federal deficit, the effects of which would become more pronounced in the months ahead. The situation would certainly not seem to call for any lessening of restraint; in fact, he preferred open market policy a little more restrictive than it had been. In terms of reserves this might mean "thinking on the down side rather than on the up side."

Turning to the discount rate, Mr. Shepardson noted that it posed two problems. First, there was the disparity between that rate

and short-term open market rates. He felt that the discount rate should be brought into better alignment with market rates as promptly as possible, particularly in view of Treasury activities in the next few months. This appeared to involve increasing the rate fairly promptly or being boxed in for perhaps three months. Thus, he favored action at this time to increase the rate by 1/2 per cent and, as he had said, he also would favor a little more restriction on reserves if the System could clear the atmosphere as to the discount rate promptly. This course seemed preferable to the uncertainty that would exist as long as the disparity between the discount rate and short-term market rates continued. He would not favor as an alternative freeing of reserves to bring the bill rate down more in line with the discount rate. In summary, he would like to maintain the relative stability that had prevailed recently and yet leave no doubt as to the posture of the System in meeting the longer-range problem of Federal deficit financing.

Mr. Mills said that the policy views that he had expressed in recent meetings had focused largely on the financial factors rather than the economic factors bearing on System policy and had brought out his belief that the System should avoid pressure that would be damaging to an already unhealthy United States Government securities market. Of recent days, however, his reasoning had shifted to a belief that the System should be following a more restrictive policy than he had thought necessary earlier. This was for the reason that

as he viewed developments through the summer and fall, the Federal Reserve had fallen captive to problems that had arisen out of its earlier policy actions so that it now was faced with the unenviable choice of directing its efforts to succor within limits the Government securities market or else to accept as an objective the more immediate necessity of contending with an inflationary psychology, especially as it had expressed itself in stock market speculation. Mr. Mills said he sensed a slightly more temperate view on inflation than in recent weeks, but notwithstanding that fact the System had an obligation to direct policy on the side of restraint on the expansion of bank credit as being a possibly contributory influence to inflation and the closely related problem of speculation. This policy would comprehend that the System would wait to provide new reserves until they were clearly needed by the commercial banking system in order to meet the legitimate demands for credit that were imposed upon it. That is, instead of leading with the provision of reserves, the System would only follow a clearly expressed demand.

Relating that problem to a change in discount rate, Mr. Mills said that there should be no precipitate increase in the rate. An increase should be delayed long enough to permit the commercial banking system and the market to adjust to a moderately more restrictive credit policy. As the effects of a more restrictive policy penetrated through the banking system it might be reasonable to anticipate additional demands for discounts, and Mr. Mills felt that those demands

might be freely met, as a means of providing a marginal supply of reserves at the initiative of the banks, until the adjustments in the market had been completed. He hoped these adjustments could be completed in advance of the Treasury's next approach to the market. If by that time the movement of rates in the market indicated a discount rate considerably out of line with the structure of market rates, then the discount rates should be raised.

In response to a question from the Chairman, Mr. Mills said this adjustment conceivably might work itself out before the next meeting of the Committee.

Mr. Leach reported continued economic gains in the Fifth District. Employment had shown steady growth and unemployment had steadily declined.

After commenting on several specific fields of district activity, Mr. Leach said that he thought the shift in System credit policy to less ease prior to the recent Treasury financing was appropriate to the expansion of business that had occurred. However, the continuing growth in activity did not call for reducing reserve availability to the extent of bringing about net borrowed reserves.

With respect to discount rate action, Mr. Leach had some misgivings as to the possible effect of an increase on the market but thought it would be better to take the risk now as there might not be a more favorable time in the near future. Also, he assumed that

a rate increase had been fairly well discounted. Accordingly, he favored a 1/2 per cent increase sometime between now and the first of November, primarily to bring the rate more in line with the changed economic situation and with short-term interest rates. He would seek public understanding that such rate increase was not for the purpose of increasing restraint materially. While it was true that member banks had not abused the low rate, it appeared that the System would be frozen in for the next three or four months and it was not possible to know what would happen during that period. Taking all things into account and realizing the discount rate must go up sometime, it seemed to him that there might not be a better time to act than between October 23 and October 30. Whatever restraint would result from an increase in the discount rate plus maintaining free reserves close to the zero mark would be as much as he considered necessary now. The Committee's current policy directive still seemed to Mr. Leach to be appropriate, even though there had been substantial economic recovery since it was adopted.

At Chairman Balderston's request, Mr. Tow commented to the effect that economic conditions in the Tenth District were continuing on the favorable side. Developments in agriculture showed a striking improvement in the Tenth District position compared with the country as a whole. Construction contracts were showing sharp improvement in recent weeks. Nonfarm employment had changed little recently, but

this picture might accelerate as automobile employment picked up.

With respect to commercial banking, Mr. Tow reported a marked increase in agricultural loans. Banks had taken steps to improve their liquidity by reducing holdings of Treasury notes and bonds. Time deposits at reporting member banks had shown evidence of shifting to other investments with more attractive rates of return. At country banks, however, time deposits were still going up although at a less rapid rate than earlier.

Mr. Allen stated that although the rapid rise in some measures of recovery may have slowed in September, most people in the Seventh District who follow economic trends were expecting a continuance of the general rise in activity for some time to come. Improvement in district employment was evidenced by the fact that in September the Labor Department had raised the classification of Peoria, Kenosha, and Cedar Rapids. At present no localities in the nation were classified in the "A" category while the only two classified in the "B" category--1.5 to 3 per cent unemployment--were Cedar Rapids and Washington, D.C. Record crops of wheat, soybeans, barley, and grain sorghums had been expected for some time, and corn was now added to the list. The corn crop was especially good in Iowa and "soft" corn would not be the problem it was last year for the early frost did little damage.

As yet, little evidence was seen of a pickup in loan demand, Mr. Allen said. A drop in commercial and industrial loans following

the September tax borrowing offset 40 per cent of the early September gains, approximately the national experience. Continuing inventory liquidation by industry was undoubtedly a factor. In the first half of September, 14 per cent of the new business credit reported by Seventh District banks was for maturities in excess of one year, compared with 10 per cent last year. Reserve pressures on the large district banks increased sharply in the past two weeks as they acquired Treasury securities. Borrowing at the Chicago Bank remained relatively small but some larger banks had been net buyers of Federal funds. Mr. Allen suggested that more of those banks should take advantage of the current market to dispose of recently acquired Government securities and thus put themselves in a better position to serve the Treasury again in the near future as underwriters.

Mr. Allen continued by saying that although he was rather impressed by the discount rate views presented by Mr. Treiber, he leaned more to the view expressed first by Mr. Thomas and then by others that in the near future the rate should be increased by 1/2 per cent as a means of coordinating the instruments of monetary policy. The next meeting of the Chicago directors was scheduled for October 30. As to reserves, he agreed that the Committee should lean on the side of restraint but not too much. He would like to see reserves kept at approximately the recent levels for the next three weeks, with emphasis on the lower side.

Mr. Deming reported no striking changes in the Ninth District economy, and recovery was proceeding about as elsewhere. Consumer buying had been slower than seemed natural but had picked up in the past week or two. Financial markets suggested a widespread inflationary psychology but there was no run to get into goods. In fact, there was widespread feeling that in the short run the forces of inflation were under reasonable control, and such fear as existed related mainly to the long run.

Mr. Deming thought the System must recognize the signals in the financial markets. The present posture of mild restraint was appropriate. The point about mildness was important, he said, and reflected the facts of continued high unemployment, the quite natural slowing down in the rate of recovery highlighted by the pause in consumer buying, and the capacity-productivity factors. He would not wish to foster higher interest rates at this time. Unless private credit demand showed a greater than moderate seasonal increase he would hope that the general rate pattern would hold for the immediate future. This implied that the present level of restraint was about right for the immediate future.

With respect to the discount rate, Mr. Deming said a rise was called for primarily as a technical matter. He hoped this could take place within the next two weeks. Because such an increase would be primarily technical, it seemed to him important that the System move

together and extremely important that the New York Bank move among the leading Banks because of its location in the financial center.

Mr. Mangels reported continued improvement in the West Coast economy but at a somewhat slower pace than in recent months. Employment had increased in several categories and a truckers' strike, which affected over-all employment in September, had now been settled. However, for the district as a whole unemployment was higher in September than in August, a rise in California more than offsetting a decrease in the Pacific Northwest. Heavy construction awards, which in August were 11 per cent below a year earlier, bounced back in September. Steel production increased 12 per cent over August and aluminum production also increased. Prices for copper, lead, and zinc were up. Although fir lumber prices had dropped again, plywood prices were firm at $80, a peak figure for 1958, and lumber producers were still optimistic about the remainder of 1958. Vacancies in multiple unit dwellings were continuing to appear in Oregon and other parts of the district, particularly southern California, where rates as high as 10 to 25 per cent were reported in some areas. Interest rates on construction loans to contractors were going up and banks were beginning to shy away from long-term commitments to purchase mortgages. The wheat and cotton crops were about 8 per cent higher than in 1957, but production of citrus fruits was down. Cash receipts of farmers in August were about 7-1/2 per cent below August 1957. Department store sales were off about 1 per cent in the four-week period ended October 11.

After commenting in some detail on business and banking figures for the Twelfth District, Mr. Mangels said that while activity still continued to increase at a reduced rate, demand for bank credit was not heavy--no more than seasonal--and auto sales thus far did not indicate that they would spark a business upsurge in the near future. Plant and equipment expenditures were not booming. The only real exuberance was in the stock market, but this did not signify a rapid and sustained upsurge in business. Long-term interest rates were as high as during the boom and the Treasury would be coming into the market again in December for new money. Nonbank investors seemed hesitant to buy Treasury issues on even a short-term basis.

All things considered, Mr. Mangels felt that the System should not tighten any further. He favored maintaining free reserves around $100 million, and the policy directive seemed satisfactory.

With reference to the discount rate, Mr. Mangels pointed to the difficulty of explaining to the public that a rate increase had been made for technical reasons. His inclination would be to withhold action at this time. He did not think this would mean having to wait as long as four months. He made it clear that he was speaking for himself and that he did not know how his directors felt about the matter.

Eleventh District conditions continued highly favorable, Mr. Irons said. While there had not been an upsurge recently, on the

other hand that district had not had a very sharp decline in activity earlier. Some improvement had appeared in the petroleum industry, and most other nonagricultural measures on which he commented indicated favorable developments. Nothing in the district differed materially from national developments so far as he could see.

On policy, Mr. Irons agreed that the discount rate should be changed. A 2-1/2 per cent rate seemed consistent with the level of market rates. No steps should be taken through open market operations to bring about a lower level of market rates. Therefore, it was appropriate to move on the discount rate. By moving, the System might dispel some of the uncertainty that Mr. Treiber had mentioned. Timing was important in view of prospective Treasury activities. The next meeting of the Dallas Bank Board of Directors was scheduled for November 13, Mr. Irons said, but a meeting of the executive committee would be held on Thursday of this week and he would be willing to try to convert that executive committee meeting into a meeting of directors at which he would recommend an increase in the discount rate to 2-1/2 per cent. An increase in the rate this week he thought would quiet speculation on the discount rate for some little time. He felt open market operations had been mildly restrictive and he would not urge a much more restrictive level in this area, but he would not be disturbed if free reserves ranged around the zero level or $50-75 million.

Mr. Erickson reported continuing recovery in the First District. Over 15 successive weeks ending October 11, electrical output had been higher than in the comparable period last year. In each week of a 14-week period ending October 11, department store sales exceeded last year; in the last few weeks the increases exceeded the national average. Shoe production had been running 2 per cent behind last year but the present outlook was favorable, with forward buying at the shoe show the largest in five years. Insured unemployment declined for 11 weeks through September 27 but remained substantially higher than a year ago. Use of the discount window since the first of this month had been much smaller than in recent months. Last week participants in the Regional Outlook Conference gave forecasts of gross national product during the second quarter of 1959 ranging from $440 to $475 billion, with a median of $456. Forecasts for the industrial production index ranged from 138 to 151 with a median of 145. Participants seemed much more optimistic than at the preceding Conference but there was quite a bit of apprehension about financing--from the standpoint of both the Government and the markets--as well as about the prospect of inflationary difficulties over the next six months.

Mr. Erickson saw no reason to change the Committee's policy directive. He favored continuing the degree of restraint of the last three weeks, with free reserves around $100 million.

After considering all aspects of a discount rate change, Mr. Erickson said he felt the rate should be increased to 2-1/2 per cent. He did not know whether the Boston Bank directors would reach the same conclusion, noting that Boston was the last Reserve Bank to move to the present 2 per cent level. Nevertheless, Mr. Erickson said he intended to recommend a 2-1/2 per cent rate at the next meeting of the directors.

Mr. Szymczak said he was impressed with the fact that the Government had a deficit and would continue for some time to have a deficit. This was the heart of the problem before the Committee because the market interpreted this fact to mean that the System would have to provide more reserves. There was a trend toward inflation which seemed irresistible and this being the case the policy the Committee had been pursuing and would have to pursue was bound to be unpopular. Mr. Szymczak felt that the Committee should continue its present policy despite some unemployment. Similarly, the discount rate must be changed. The fact was, he said, that a rate increase had already been discounted. An increase should be as much on a uniform basis through the System as possible and should be made as soon as possible. While a statement that the change represented a technical adjustment might be desirable, Mr. Szymczak commented that we could not be sure how the market would interpret the change. He agreed with Mr. Mills that the System would have to provide

additional reserves during coming weeks, including consideration for the needs of the Treasury. He would lean in the direction of some free reserves during this period. Mr. Szymczak said he thought no change in the Committee's directive was needed at this time, that the policy it had been pursuing was correct, and that, while additional restraint on inflationary forces would be desirable, he did not think it feasible to increase the general level of credit restraint at this time.

Acting Chairman Balderston said that the consensus seemed to call for no change in the Committee's directive and for a free reserve target about the same as during the past few weeks, but perhaps with some inclination toward more restraint.

Mr. Treiber said that if an adjustment in the discount rate were to be made merely for technical reasons, not accompanied by another turn in the program of restraint through open market operations, the possibility of adverse effects would be small. Nevertheless, the New York Bank's directors had been fearful of another turn in restraint that might lead to adverse market developments. He did not know what the directors might do with respect to the discount rate at their meeting this week, but he agreed with Mr. Deming that when a technical adjustment in the discount rate was made there was great merit in having the New York Bank among the first group of Reserve Banks making such an increase, and he also thought it desirable that several Banks participate in the initial action.

In a discussion of meetings of directors of Reserve Banks, it appeared that five or six of the Banks might have meetings this week at which a change in the discount rate would be considered. The Chairman stated that it would be desirable to have the System move as a unit, but if a group of the Banks acted to increase the rate on Thursday of this week, that action would indicate to the market the nature of System policy and changes by other Reserve Banks could follow along a few days later.

Mr. Deming reiterated his view that an adjustment at this time would be for technical reasons and that, because of this, he considered it especially important that the Reserve Bank in the country's principal money center be among the first group of Banks to move. If this could not be the case, his personal preference would be to delay action a few days.

Mr. Bryan commented that if action were taken by several Reserve Banks and particularly if New York was included in the group--which he agreed would be highly desirable--the System's posture would be clearly indicated and it would not matter much when the other Banks followed along.

The Chairman then reverted to the Committee's directive and open market policy, calling for additional comments as to policy.

Mr. Szymczak stated that, as Mr. Mills had indicated, the System would be having to put reserves into the market for seasonal and other factors.

Mr. Leach said that he was not sure there was a consensus for greater tightness through open market operations, in fact, he would have thought the comments indicated little change in the degree of tightness to be sought through open market operations.

Mr. Treiber said that he thought it highly desirable that there be about the same target for open market operations, that he believed that in present circumstances it would be undesirable to aim toward greater restraint at the same time that an increase in discount rates was being made.

Acting Chairman Balderston said that he personally agreed with this view and that unless there were objections it would be understood that the Committee was agreed on a range of free reserves between now and the next meeting about the same as during the past three weeks. No disagreement with this suggestion was indicated.

The Chairman then inquired whether any change in the directive or in its limits was considered desirable, and no suggestion for change was made.

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:

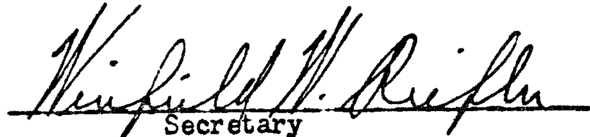
(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury,

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.

It was agreed that the next meeting of the Committee would be held at 10:00 a.m. on Monday, November 10, 1958.

Thereupon the meeting adjourned.



Secretary