A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, December 16, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman 1/
Mr. Hayes, Vice Chairman 2/
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mangels
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

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. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Marget, 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, Jones, Tow, and Rice, Vice Presidents of the Federal Reserve Banks of Boston, St. Louis, Kansas City, and Dallas, respectively

1/ Entered meeting at point indicated in minutes.
2/ Presided during first part of meeting.

Messrs. Coombs, Baughman, and Einzig, Assistant Vice Presidents of the Federal Reserve Banks of New York, Chicago, and San Francisco, respectively
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

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 December 2 through December 10, 1958, and a supplemental report covering the period December 11 through December 15, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that the usual seasonal liquidation by corporations had resulted in some pressure on Treasury bills, with the result that bill rates in the auction on Monday, December 15, were up 10 basis points from the previous week on the three-month bills and one basis point on the six-month bills. He added that the new six-month bills appeared to have been well accepted on the basis of the first two auctions. The first auction required a fair amount of underwriting by dealers, but the preliminary statistics for the second auction suggested that this underwriting had been reduced.

In the money market, the period since the last meeting had been characterized by corporate preparations for dividend and tax payments.

The flow of money into New York prior to the December 10 dividend rate created easy money market conditions for a few days, but since December 10 the money market had been quite tight. The principal difficulty with the reserve projections in the past two weeks had been in the management of the Treasury's balance, which had tended to run lower than expected. Large calls had been made on the "C" depositary banks; however, it had sometimes not been feasible to call enough money from these banks to bring the balance up to customary levels. Mr. Rouse concluded, with respect to the money market, that there probably had been somewhat less pressure this year than during most previous years at this season.

Mr. Rouse said that additional reserves would have to be provided during the balance of 1958 to offset seasonal currency withdrawals and other influences on reserves, but that in his judgment it should be possible to do most of this job through repurchase agreements. However, he planned to intersperse one outright operation in Treasury bills and to use this occasion to purchase some of the new six-month bills. The market generally understood that the System Account would buy and sell these bills, but an actual operation in them would help to confirm this understanding.

With respect to Treasury financing, Mr. Rouse reported that the Treasury was planning to announce the terms of its cash offering on January 8, with subscription books opened on January 12. He added that he had no further details on what the Treasury planned to offer but that he had mentioned the timing since this might be a matter that would influence discussion during this meeting.

At the conclusion of Mr. Rouse's report, Mr. Shepardson said that although he had no criticism of the conduct of open market operations, he had thought that reserve positions would be tighter than they actually turned out to be. He asked whether the projections had gone astray.

Mr. Rouse replied that there had been sizable errors in the projections. In fact, however, he had given principal attention to market atmosphere rather than reserve figures, and the atmosphere in the money market on most days had been about as tight as the Committee would have wished. The principal reason for the easier than expected reserve figures was the tendency for the Treasury balance to fall below estimates; the Treasury hesitated to call enough money from the "C" depositary banks to pull its balance up.

Mr. Thomas noted that the Treasury's balance on the previous day had risen to above $400 million, considerably higher than expected, so that the reserve figures for the current statement week would be lower than shown in the New York projections. Also, required reserves had been revised upward, and that would have an influence on the reserve figures.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period December 2 through December 15, 1958, were approved, ratified, and confirmed.

In supplementation of the staff memorandum distributed under date of December 12, 1958, Mr. Young made the following statement on the economic situation:

If one takes a cyclical frame of reference for evaluating the economy's performance since the low of last April, the conclusion reached is that the performance has been remarkably good. Gross national product, personal income, retail trade, residential construction activity, manufacturers' new orders, industrial production, freight carloadings, and various other economic indicators have increased about as much in the past seven months as in corresponding seven-month periods of cyclical recoveries following earlier postwar contractions.

Recent recession was somewhat deeper than in the preceding two declines. On the other hand, for brevity and the speed of turn-around to recovery, performance this time has been front rank both as compared with postwar and with prewar cycles. While peak levels of activity have not been reattained, they are now so close at hand that one can view the approaching period as likely to be characterized by resumed economic expansion.

To highlight the current cyclical position:

1. In the present quarter, gross national product in current dollars is estimated to reach a new record annual rate of $452 billion. The physical volume of goods and services output is probably within less than one per cent of the earlier high.

The increase in GNP from the spring low of about $27 billion, or about 6 per cent, reflects widespread strength. Consumer spending has moved up on a broad front; combined Government outlays for all purposes have increased to a new postwar high; and the sharpest inventory liquidation of the postwar period has about reached an end.

2. By midyear, business fixed investment had stabilized, following a pronounced cyclical decline, and has risen modestly since. Past cyclical experience suggests that renewal of business investment expansion will tend to gather momentum

slowly. Such outlays typically lag behind recovery elsewhere, but after a period they join the upswing. Already output in business equipment lines is a tenth above its low and last month private industrial construction rose for the first time in 15 months.

Other fixed investment, as reflected in new construction, is now up over an eighth from the recession low reached in May. This is a little better than in preceding postwar cycles, for the decline in this cycle was greater. Incidentally, private housing starts for November, at 1.3 million units annual rate, were up two-fifths from the spring low, with the pattern of upswing closely paralleling the 1949-50 and 1954-55 recoveries.

3. Early resumption of advance in consumer spending, after only a slight hesitation, has been associated with prompt recovery in personal income. Near stability of personal income during recession has been a notable feature of the three postwar cycles--a feature contrasting strikingly with the pattern of consumer income fluctuation in prewar cycles. This year, income payments under Government unemployment and other special security programs were considerably increased, contributing to upturn in personal income in March ahead of other major economic indicators. In response to the maintenance of consumer income, retail buying has risen in this cycle about 7 per cent, after declining 5 per cent. This is about par performance for postwar cycles.

4. Large-scale production of 1959 model autos is finally under way, and recovery in industrial production in November and December is showing nearly the speed of the first few months after the April low. The industrial production index in November was put at 141 and the December figure is expected to be one or two index points higher. The rise since April in industrial production is close to the experience of earlier postwar cycles, despite a larger decline in this cyclical recession than in both of the earlier ones. Nondurable goods have made an especially good showing in this recovery period. On the other hand, output and the rate of capacity utilization for metals are lower now than at the corresponding points in earlier postwar cycles. New orders for metal products and other durable goods, however, have shown as strong a rise through October as in the 1954-55 and 1949-50 recovery periods.

5. About as many major industries have contributed to the rise in nonagricultural employment in this recovery period as in the earlier postwar cycles, but the over-all gain in employment has been somewhat smaller. Manufacturing employment has lagged more this time relative to output, because of an

indicated sharper rise in output per manhour. Moreover, nonmanufacturing employment has shown somewhat slower recovery. In past cycles, the increase in employment and the decline in unemployment has gained momentum as the period of output recovery shaded into the later, expansionary phase of the cycle.

6. In the 1948-49 recession, industrial commodity prices declined fairly sharply, but in the two following recessions were modest. Increases in average industrial prices for seven months following the troughs have been roughly equivalent, with most of the rise being accounted for by recovery in material prices. In all three recoveries, reports of markups on fabricated goods prices were appearing with increasing frequency after seven months.

7. Cyclical developments are usually anticipated by the stock market, and this time the rise is about par compared with the two preceding cycles. Of course, the percentage rise is a wholly mechanical basis of analysis. This time the beginning level for the rise was high relatively, for yields on stocks were only slightly lower than yields on bonds of the same companies. Now, stock yields are well below bond yields, a condition not reached in the first postwar cycle and only reached late in the second cycle.

8. Economic recovery has been aided by a pronounced growth in the money supply this year, at a somewhat faster rate than in the last cycle. Comparison here with the 1949-50 recovery period is inappropriate since flexible monetary policy was not operative in this cycle. Since January of this year, the amount of expansion sums up to a 4 per cent annual rate. The money supply is now about 3 per cent above last year at this time.

9. In preceding postwar recessions and recoveries, United States exports showed only modest downturn and revival, while imports were about maintained. In this cycle, United States exports, which had been receding prior to recession, declined more sharply, though imports were again maintained. Recently, exports continue to lag, but scattered indications in leading countries abroad suggest that strengthening markets may be ahead. Meanwhile, United States imports have risen significantly.

As a concluding point of diagnosis, one may ask what might be expected on the basis of normal cyclical developments over the year ahead. In other words, what kind of performance might the economy experience if conformity with the broad contours of past cyclical patterns continues to work out?

Without endeavoring a forecast or a projection, at least this specific an answer can be offered on historical cycle grounds. By midyear, industrial production might reach an index level of 150, and by year-end it might attain 155. By year-end, GNP in constant dollars might reach $485 billion, up 7 per cent from present levels.

These figures abstract from inflationary potentials, which have been much stressed in recent staff reports to the Committee. From a purely cyclical standpoint, if the economy has overshot the mark in inventory liquidation, in business investment contraction, and in export sales, a condition of cyclical inflationary pressures can quickly be generated. Domestic and foreign purchasing agents coming to market in a catching-up mood can afford to bid actively against one another while suppliers can afford to become more and more reluctant in offerings. Inflationary psychology, already generated in financial markets, can spread to commodity and service markets at wholesale and thence to retail markets. It cannot be said that this will happen, but it is enough of a potential to constitute a problem for the Committee in its moulding of a financial climate for the period of economic expansion in prospect. If it does happen, there could well result a decided lag in expansion of real output and employment and a higher rate of unemployment than would otherwise be expected to occur.

Mr. Thomas made the following statement with respect to the credit situation:

Money and credit markets have operated with surprising smoothness in the past month in the face of the vigorous progress of economic recovery, the rather heavy financing operations of the Treasury, the liquidity demands customary at this season of the year, and a moderate tightening of bank reserve positions. Interest rates have fluctuated moderately, close to or below the high levels reached earlier. In the past two or three weeks rates have firmed somewhat, but so far increases have not been as great as customarily occur in December.

Additional offers of Treasury bills have so far been taken by the market without severe pressures. City banks have actually reduced their holdings of bills in the past two weeks. It appears that businesses continue to have adequate liquidity to meet their needs with only moderate borrowing at banks and have even been able to acquire Treasury bills.

In the first two weeks of December, preliminary and partial figures for city banks indicate that loans increased somewhat less than in the corresponding weeks of the two previous years and that holdings of Government securities were considerably reduced. As a result total loans and investments declined somewhat in contrast to increases in December 1957 and 1956.

In capital markets, the volume of new issues has been somewhat smaller in the fourth quarter than in previous quarters. Offerings of corporate issues have been larger in December than in November, but less than a year ago. Flotations of State and local governments remain at a relatively low level. The slackening of these demands may have accounted for the absence of more severe pressures in the market. Home mortgage markets, however, continue to tighten. The stock market has continued strong with active trading.

Does the absence of severe pressures on the money market mean that cyclical and seasonal adjustments are being met with unusual smoothness through the processes of the market without undue expansion or contraction? Or is it that demand and supply factors have not yet caught up with the sharp rise in rates that developed earlier in part on the basis of anticipations? That is, in the jargon of the market, had the current developments already been discounted? Or has the current posture of monetary policy been so easy as to permit these adjustments to be made without strain?

It has often been noted recently that market interest rates are unusually high in relation to the existing level of free reserves and the discount rate. Long-term rates are close to or above the highest levels of the 1957 period of strong capital demands. With member bank borrowing generally less than $500 million, short-term rates are as high as when borrowings were close to $1 billion. In fact they are higher relative to the discount rate.

Banks would find it profitable to expand credit even if they had to borrow. Has bank credit not expanded or has there been an expansion based on reserves supplied by System open market operations, so that banks did not need to increase borrowings?

In the first half of the year, when reserves were freely available, total loans and investments of member banks expanded sharply. The bulk of the increase was at city banks. Country banks, partly for seasonal reasons, showed only a moderate increase, as did nonmember banks. Since midyear, when the availability of reserves has been more restricted, until the end of November, New York City banks showed a substantial decline in their total loans and investments, and those of reserve city banks increased only slightly. In contrast, country banks expanded by much larger amounts than in the same period of the two previous years.

As a result total bank credit has shown a further expansion of a greater than seasonal amount. Most of the increase occurred in holdings of U. S. Government securities at country banks. Total loans showed little change compared with a small decrease in the same period last year and a substantial increase in 1956. Country bank loans have increased this year while those at city banks decreased, due principally to a decline in security loans from the high June level. The 1956 increase in loans was mostly at city banks.

Figures that have just become available for November again show that country banks account for a substantial portion of the increase in bank loans and investments in that month, although city banks also showed some increase.

The net result of all these changes on bank deposits is of significance from the standpoint of monetary policy. Since June, the money supply seasonally adjusted has increased by over $3 billion, which is at an annual rate of over 5 per cent. Two-thirds of this increase occurred in July, followed by partially offsetting decreases in August and September and renewed expansion in October and November. On almost any basis of comparison the rate of growth has exceeded 3 per cent a year. The time deposit growth, which was so rapid in the first half of the year, has slackened in recent months and there were declines in November at all classes of banks.

In the first two weeks of December demand deposits adjusted at city banks increased by about $1-1/4 billion. A sharp increase is usual in that period, as deposits are built up for payments of taxes and dividends and for other purposes, and this year's increase is not any larger than usual.

By classes of banks, it would appear that privately-owned demand deposits have increased substantially at reserve city banks and at country banks since midyear, with little growth at central reserve city banks. U. S. Government deposits, which were exceptionally large at city banks at the end of June, have accounted for the decline in total deposits at city banks. This analysis would seem to indicate that the increased stock of money built up in the first half of the year, largely through expansion of Government security holdings at city banks, has become more widely distributed around the country, partly through Government spending of the proceeds of its borrowings. Further expansion has occurred in the second half-year on the basis of greater than seasonal credit growth at country banks.

Reserves to provide the basis for this credit have been largely supplied through System open market operations since August, as free reserves have shown little change since that time. Free reserves declined sharply in August, stayed close to $100 million from early September to mid-November, and have declined a little since then. Since the bulk of the expansion has been at country banks, reserve needs have not been as great as they would have been had the growth been at city banks. It also means that, for operating purposes, current estimates of required reserves have tended to understate the growth.

Current estimates of bank reserve positions are now being revised again on the basis of country bank figures for the last half of November that have just been received. Required reserves are about $40 million larger than had been previously estimated. This means that member banks have had a net borrowed reserve position during most of the past four weeks. They are likely to show moderate net borrowed reserves this week and next. A sharp increase in borrowings will occur in the last week of the month, unless System operations supply about $500 million of reserves. These needs may be met largely, if not entirely, through repurchase contracts. After the turn of the year, reserves will need to be absorbed at a rapid rate--perhaps as much as $1 billion in January.

These estimates allow for a large return flow of currency in January to offset the greater than seasonal expansion that has occurred in recent weeks. They also allow for usual seasonal changes in deposits and required reserves, and likewise in float. A continued gold outflow at an average of $25 million a week is assumed. No special allowance is made for Treasury financing through the increase in the weekly bill offering, as it is assumed that these funds will be promptly expended by the Treasury and enter into the general flow of funds. This would require no build-up of deposits greater than would otherwise be needed. On a seasonal basis, deposits and required reserves should decline considerably in January and February.

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

It seems to me that this is an appropriate time for us to take very careful stock of what the System's general approach--or "posture", if you will--should be at this stage of the business cycle. I think we are all agreed on our general objective, which might be described as facilitating orderly progress toward fuller utilization of our productive capacity and manpower and the renewed growth of the economy at a sustainable rate. During the past several months, I think that our policies have helped the economy to move towards that objective. But I left the last meeting of the Committee somewhat disturbed by references to the need for a policy of further restraint. In my opinion, such a move would be premature at this stage of recovery. I am particularly disturbed by the possibility that a downward drift of free reserves substantially into the negative range, or a discount rate increase, might suggest to the public a policy of progressive tightening and set off an exaggerated market reaction.

I would like to direct my remarks to two aspects of the situation: (1) whether a policy of further credit restraint would be consistent with our current directive; and (2) whether such a policy would be well attuned to the actualities of present business and credit conditions.

First, as to the directive: We describe our goal in the directive as "balanced economic recovery." The "balanced" of course implies among other things that recovery should be free from price distortions, although that is not stated explicitly. But the explicit word "recovery" seems to me to indicate to any reader that our first concern is with the achievement of fuller use of the nation's resources. If we feel that we should be at least equally concerned, or possibly even more concerned, with a developing threat of inflation and should make a major effort to prevent it by credit restraint, we should, I think, make the record clear on this point.

Second, we have the question whether a restrictive credit policy would be well attuned to current economic conditions. I think we can agree that, when it became evident that recovery was well under way, a shift away from a policy of active ease was appropriate. The main question then concerned the timing and rapidity of the shift, in view of the highly disturbed market conditions that prevailed in the summer. But traditionally a <u>restrictive</u> monetary policy has been applied only when there were developments in the credit situation that called for restraint.

If we believe that there is a long-term inflationary bias in the economy regardless of whether business is prospering or ailing, I submit that we should not conclude either that monetary policy alone can solve this problem or that it should be focused so strongly on this problem as to run serious risks of <u>itself preventing</u> adequate use of resources.

In our Bank, we have used the past two-week period to review very carefully our thinking as to current forces and trends in the economy. It is, of course, entirely possible that the recovery may gain such momentum as to encourage speculative inventory policies and excessive credit expansion or other distortions. We can, however, see nothing at present to suggest such an acceleration of activity and a renewal of inflationary demand pressures. Consumer demand is good but not ebullient, prospects of a strong upsurge are remote, and businessmen are conservative in their ordering and inventory policies, as well as in their spending for fixed capital. Business investment in fixed plant and equipment was lower than expected in the third quarter, and only a very modest rise is in prospect after the turn of the year. The meaning of recent data indicating a considerable drop in unemployment is somewhat obscured by the apparent departure of a sizeable number of workers from the labor force and seasonal adjustment problems. The biggest question mark in the business outlook relates to the automobile industry, and it will be six weeks or more before we can really appraise reception of the new models. The current high production rate, designed partly to replenish inventories, and the rise in sales that accompanied the buildup in dealer stocks, still give no clear indication of the sales outlook.

As for prices, the evidence of some continued balance during this phase of the recovery is reflected in free market prices during the last two weeks. The very sensitive index of waste and scrap prices has turned down, and raw materials in the daily sensitive commodity price index have now followed the downturn for farm products. While finished goods prices continue to reflect upward pressures, the latter are less pronounced than in recent months, and approximate over-all price stability still appears to be in prospect for some months ahead.

Conditions in the credit and capital markets likewise yield no argument for restraint. The capital markets continue to operate without any undue pressure and the stock market seems to have lost some of its ebullience temporarily at least. The backlog of new bond issues is somewhat smaller than it has been in recent months, whereas equity financing has increased somewhat. In the credit area, the most valid cause for apprehension would seem to be the possibility that too much liquidity may have been injected into the economy in 1958. Yet I am impressed by the fact that the liquidity of the banks is well below the summer's peak and even further below the 1954 level-- and that the increase in money supply for the year as a whole does not appear excessive. While we must be watchful to prevent the banks from feeling too free to add to their investments, we must also be careful to see that they remain well able to take care of all legitimate business requirements.

The very real effort now being made to achieve something approaching a balanced Federal budget for the next fiscal year is ground for hope of much reduced pressure from this quarter for excessive credit expansion.

As we consider immediate policy questions, we should bear in mind that the year-end period is normally one of rising pressures in the short-term money markets. Thus short-term interest rates may be expected to rise for a time even with no change in System policy. The markets will most likely take such rate increases in stride, as a matter of seasonal routine, unless there should appear to be some change in System policy during this normal period of stress. Wholly inavertent factors prevented our reporting net borrowed reserves last week, on average, although the Desk had been aiming in this direction in accordance with the consensus of our last meeting. (This was written before I had seen the latest figures.) I think this turn of events may prove to have been fortunate for the System, in view of the possible effects of general recognition, at this time, of a change of policy. The System is in an unusually good position this year to indicate the temporary nature of the reserves supplied to meet year-end pressures, remaining needs being of a magnitude which can be provided in large part through repurchase agreements.

Aside from general economic considerations, another reason for continuing present credit policy unchanged is the Treasury's need to borrow about $2 billion sometime during January and to borrow additional cash through the new cycle of six-month bills. The January Treasury offering appears to be the best opportunity, for some time to come, for including a long-term issue, in view of recent market stability and the traditional availability of investment funds after the turn of the year. I believe successful issuance of a long-term Treasury obligation at this time in a moderate amount could have useful effects in the way of dampening the inflation psychology which still lingers in some areas. It would seem unwise to jeopardize this chance with disturbing policy changes on the part of the System in the next few weeks.

To me, all of these factors argue conclusively for maintaining the status quo in open market policy (year-end reserve needs being provided without change in the present degree of pressure). For the same reasons I think there should be no change in the discount rate nor in the directive--subject, of course, to the policy decided upon by the Committee and to my earlier comments on the latter point.

Mr. Erickson stated that First District conditions were good but did not seem to have the vigor indicated nationally by the staff memorandum. In November, the New England index of manufacturing production failed to rise above the October level due to a slower rate of recovery in durable goods industries, while the most recent poll of purchasing agents showed, for the first time since June, a smaller percentage of respondents expecting an increase in production beyond the previous month. Construction contracts were at high levels in August and September, but in October they were only one per cent ahead of last year, with no large contract awards. Residential construction was up in October, but by a much smaller percentage than nationally. Nonagricultural employment was down .2 per cent in October from September, due primarily to seasonal trends in some of the nonmanufacturing industries. Electric power output, which each week since the middle of the year had exceeded the corresponding week of the preceding year, again exceeded the year-ago figure in the first week of December, which meant that in this respect the district was doing better than the nation as a whole. In the first week of December, department store sales were lower than in the corresponding week last year, the second time since the middle of the year that this had happened. Last year's good Christmas business was attributable to sales volume in the last week before Christmas; this year the district would have to do even better to exceed the previous year because to date the figures were lower than for 1957. In October, new car registrations in most of the States of the district were still running 25 per cent less than last year. A survey of 168 lending institutions, covering all types of lenders, indicated that extensions of credit in October were 9.6 per cent less than a year earlier.

Turning to policy for the next three weeks, Mr. Erickson said that in view of the pressures of the year end and the indication of a Treasury financing announcement shortly after the beginning of next year, he would favor no change in the discount rate or in the policy directive. He would like to see the same degree of restraint maintained as in the past few days, with modest negative free reserves. He hoped that any necessary reserves could be put into the market through the use of repurchase agreements.

Mr. Irons said that his appraisal of the economic situation pointed toward continuing strength, and development of further strength, both in the nation and in the Eleventh District. As he saw it, the strength was broadly based, being reflected in a large number of areas including production, sales, retail trade, and the inventory situation. Perhaps the point was here, or at least near at hand, where one could cease to use the word "recovery."

Eleventh District conditions were strong, Mr. Irons said. Although department store sales had been affected somewhat by low temperatures, he felt that they would pick up by Christmas, and the tone generally was one of optimism. Construction activity continued to be good.

On the financial side, Mr. Irons observed that there had been an increase in bank credit and a further increase in the money supply, together with what appeared to him to be comparatively comfortable reserve availability conditions. A strong credit growth was noted outside the major cities. Both bank credit and bank deposits had shown increases in the Eleventh District, and for reasons not entirely clear to him there had been a substantial and steady increase in currency in circulation for the past couple of months, with the totals moving up to record highs. The Dallas Bank, Mr. Irons noted, was the only Reserve Bank whose Federal Reserve note circulation was less than its member bank reserve deposits. The reserve position of Eleventh District banks, as reflected by borrowing at the Reserve Bank, appeared to be fairly comfortable, with no appreciable discounting by either city or country banks.

As to policy, Mr. Irons saw a number of problems in the picture, including the Treasury financing early in January and the refunding scheduled for early February. He would like to see reserve availability move to the negative side and stay there, for in his opinion negative free reserves would be appropriate under the circumstances in which the Federal Reserve was now operating. He was not thinking of a substantial amount of negative free reserves, but more in terms of zero to minus $100 million during the ensuing period. Fluctuations within that negative range seemed to him more appropriate than on the positive side.

Also, he thought the Manager of the Account during the next period should rely more on the feel of the market than on reserve projections; that is, to be sensitive to the feel of the market. If that should cause the reserve figures to go awry for a day or so, this could be offset by operations on a cash basis. In substance, he would hold a more continuous and firm restraint on the side of negative free reserves, with short-term rates permitted to remain at about current levels. It would not disturb him if the bill rate were to rise. He doubted whether the discount rate was actually as much out of line as the figures would seem to indicate. Other things being equal, consideration might be given to the discount rate level at some time in the quite near future. As to the directive, he felt this might be the point, or nearly so, when a change in wording would be in order so as to move a little away from the concept of recovery and recognize the existence of other problems.

Mr. Mangels reported that there had not been major changes in the Twelfth District in the past two weeks. Contrary to the situation reported in the First District, retail stores were quite enthusiastic about the volume of Christmas trade, which was running six per cent ahead of 1957. Employment in defense-related industries showed a small increase in November, reflecting a continuing trend, while unemployment was showing less than the usual seasonal rise for this time of the year. Steel production had improved somewhat, with mills operating at 75 to 80 per cent of capacity, the highest rates for the year. Production of copper and aluminum also was up, while lumber was down a little. Freight carloadings for the first quarter of 1959 were expected to increase around 12 per cent over the first quarter of 1958. Member bank borrowings from the Reserve Bank were nominal, but purchases in the Federal funds market had been greatly in excess of sales.

Mr. Mangels said it seemed evident that recovery was progressing at a moderate pace, with indications that it would continue to progress moderately without too much immediate inflationary pressure, at least until such time as productive capacity and the labor force were utilized more fully. Prices had been reasonably steady and any increase was likely to result from sources other than changes in the money supply. While the System should not furnish fuel for the fire, he would not want to exert such a degree of restraint as to discourage the progress of recovery. In the ensuing period, free reserves around the zero level might be appropriate--perhaps a little more or a little less--with the Manager of the Account authorized to use his discretion on the basis of the feel of the market. Mr. Mangels said that he would not favor changing the discount rate at present, at least during the next three-week period, and he saw no occasion to change the directive.

Mr. Deming said that the Ninth District was presently going through a sharp seasonal contraction in activity but that the general recovery trend seemed to be continuing at a moderate rate. The employment authorities were estimating the seasonal decline in employment to mid-January to be smaller than usual, reflecting a pickup in durable goods manufacturing. At the same time, initial unemployment claims in late November and early December were running about one per cent ahead of last year.

The Minneapolis Reserve Bank, Mr. Deming said, had just completed a study based on bank debits which showed that on a seasonally adjusted basis total debits this year had run about 5 per cent ahead of last year, with the gain slightly larger in the later months than in the earlier months of the year. Debits for 1958 had averaged just about the same as the mid-year peak level (seasonally adjusted) for 1957. The picture was much stronger in the farming centers, where second half debits were running well ahead of the first half of 1958, and those in turn were above the 1957 peak levels.

As to policy, Mr. Deming said he thought the System should lean a little more heavily on reserve availability. He was not sure what he would like to see done about the discount rate, but he supposed the question was academic, at least for the immediate future. He thought, however, that a rate change probably should be in the cards for the rather near future. He had not thought out what timing could be arranged to fit in with the Treasury financing, especially since he had not anticipated a Treasury announcement as early as Mr. Rouse had indicated, and in any event he would not favor a rate change in the next three weeks. Perhaps wording of the directive should be changed to speak in terms of sustainable growth rather than balanced economic recovery. Mr. Deming concluded by saying that he would be a little tighter during the next three weeks but would not favor a dramatic move on the discount rate.

Mr. Allen stated that information that had become available since the preceding Committee meeting indicated that the uptrend in business activity remained vigorous. Preliminary reports for retail sales in November showed that a new record, nationally, was achieved, and the fact that sales of household appliances were finally picking up was encouraging. There had been reports to such effect from Sears Roebuck, from Norge, and from department stores in the Seventh District. In further regard to department store sales, those in Detroit showed a three per cent gain over a year ago in the week ended December 6, and Detroit was not particularly depressed at this time last year. A second indication that the business uptrend remained vigorous was the improvement in November in employment. Nationally, 18 centers were reclassified upward on the basis of that improvement, and seven of those were in the Seventh District. A third factor was that plant and equipment expenditures hit a low in the third quarter; the fourth quarter of this year and the first quarter of 1959 should, on the basis of reports from businessmen, show appreciable gains. In the Chicago area, residential construction was booming, with building permits issued in November for 55 per cent more units than in the same 1957 month.

Mr. Allen went on to say that earning assets and deposits of Seventh District banks declined somewhat in the past two weeks as sales of securities exceeded loan growth, while credit demands on the whole had been moderate for this time of the year. Manufacturers of metals and metal products--an important element in the district--had steadily repaid borrowings during the past two months. Some district bankers apparently felt that the moderateness in the amount of borrowing could be attributed in large part to the continued decline in inventories. Since that decline may have stopped and an increase started, they suspected that the drop in loans which usually comes in the early months of a new year might be less this time than heretofore.

Mr. Allen recalled that at the last meeting of the Committee he had suggested doing about what had been done in the last two weeks, but that the Committee should be poised to take action on the restrictive side. He had come to this meeting with the idea of suggesting for the next three weeks a little more restrictiveness than the reserve figures would suggest, but doing nothing about the discount rate because he had anticipated a Treasury financing announcement later in January. Thus, he had anticipated that the Committee meeting on January 6 would present an opportunity for discussion of the subject. In view of Mr. Rouse's statement, however, it would appear that action on the discount rate, if any were to be taken, must be taken prior to the January 6 meeting. Personally, he felt that the recovery had proceeded so far, and the inflationary bias was such, that something should be done on the rate. However, he considered unity of action in the System desirable always, and particularly so at this time, and he would be persuaded by the thinking of the majority. Thus far, the comments indicated that everyone thought there should be no action until after the period of Treasury financing. This might mean a long wait, and he was concerned about that. He would favor changing the directive along the lines Mr. Deming had suggested.

Mr. Leedy said that from the staff review of the economic situation and from personal observations, there could be no doubt but that the recovery was progressing, and in many respects in a surprising way. He considered that moving down to a negative free reserve position was called for; if the figure moved down a little more, it would seem to him to be in line with what the Committee should be doing. In view of the prospective budget deficit, the very substantial increase in the money supply, and the other indicators referred to at this meeting, he felt that it was going to be necessary for the System to be more vigorous in its actions than it had been in the recent past. If possible, he would like to see action at this time both on the discount rate and on the directive, but he did not feel that discount rate action would be possible because of the seasonal factors between now and the end of the year and the forthcoming Treasury financing. The directive, he thought, should be changed for he saw no reason to refer further to promoting of recovery. In the past the Committee generally had undertaken to change the directive on the occasion of a change in policy and he did not think that some further slight tightening of reserve availability would actually represent a change in policy. Therefore, in the interim between now and the next Committee meeting it was his feeling that the extent to which the System should go would be to allow negative free reserves to edge down a little more. Also, he would subscribe to the suggestion that the Manager of the System Account be guided more by the feel of the market than by reserve projections.

Mr. Leach reported very little change during the past two weeks in general economic conditions in the Fifth District. Wage increases had been discussed in the textile industry--one large knitting concern had in fact announced an increase for January--and a $2 per day wage rise had been contracted for in the bituminous coal industry, where workers were now being paid $22.25 per eight-hour day. This seemed to him of particular significance for it came in the face of a recent shrinkage in production and a poor outlook for the future. Bituminous coal had for some years been losing in importance relative to competing fuels, and this past year saw a further sharp drop, due in no small measure to the decline in residual fuel oil prices as coal prices held firm. Overseas shipments fell by a third in 1958, and European restrictions on coal imports pointed to a further drop this year. While improved steel operations and higher levels of industrial activity called for more coal, the market was scarcely favorable for the price increases that some producers now expected to make. West Virginia, which produces about one-third of the country's total bituminous coal output, had had severe unemployment problems over the past year, and he thought that one could look for little help for this situation from the higher wages now to be paid.

Continuing, Mr. Leach recalled that prior to 1955 average borrowings of member banks generally rose steadily toward the end of the year to a peak in early December several hundred million dollars higher than September-October levels. This was true regardless of whether the System was following a policy of active ease, ease, or neutrality, and the temporary rise in borrowings was not considered to be inconsistent with System policy. As the Open Market Committee's emphasis in policy guidance became more and more centered on free reserve or net borrowed reserve figures, however, this pattern no longer appeared. There now seemed to be a reluctance to permit an increase in borrowings to occur despite the seasonal pressures in this direction. This seemed unfortunate to him, for he saw merit in meeting some of the seasonal needs through borrowings, which are automatically repaid.

Mr. Leach commented that during the first ten days of December member bank borrowings averaged only $376 million, which was $200 million less than during the corresponding period last December and about $100 million less than the average for November of this year. He still thought that seasonal needs should be allowed to run borrowings up a little. To him, this would not mean a significant change in policy even though it would presumably produce a small amount of net borrowed reserves. The appearance of net borrowed reserve figures for more than one week might have some adverse effect on the Government securities market, but he believed this was a risk that should be taken.

As to reserve availability, Mr. Leach noted that he had wanted to see the System get over the "hurdle of zero" and the importance it seemed to have to the market. With regard to the degree of tightness, he felt that the Manager of the Account should be guided by the feel of the market, and he would like to see modest net borrowed reserve figures. This would represent no real change in policy, just being slightly tighter than before. He would not favor a change in the discount rate but he would remove the word "recovery" from the directive, with appropriate changes in wording.

During Mr. Leach's comments, Chairman Martin joined the meeting.

Mr. Mills expressed the view that the trend of economic developments and the multiplying evidence of optimistic expectations in both the financial and business communities justified a System policy of firm restraint over the volume of bank credit. Put in technical terms, such a policy would contemplate negative free reserves in modest amounts. In that connection, he felt that he should comment on the subject of the money supply. Although an increase in the money supply over the past year of approximately 3 per cent might be considered to be consistent with the concept of cyclical long-term and fundamental economic growth, it was questionable whether additions to the money supply that had derived so largely from previous System actions did not reflect in some degree a failure to force the kind of redistribution of U. S. Government securities out of commercial bank portfolios that would have been desirable in order to limit the expansion of commercial bank credit to the basis of the reserves that the System had supplied in recent months to support Treasury financing operations. As brought out in discussion at earlier Committee meetings, a case can be made for compelling the use of reserves supplied by the System under such conditions to do the double duty of first supporting the Treasury in its financing and then subsequently financing the legitimate seasonal expansion of commercial bank credit, all through the process of exerting System pressure to force the commercial banks to reduce their investments in U. S. Government securities and to use the reserves thus freed to sustain the loan demands of their customers. He doubted that the System had accomplished that purpose and to the extent that it had failed to do so, a System policy of firm restraint should be continued if the undesirable consequences of financing the Treasury's requirements through the commercial banking system were to be avoided. By a policy of restraint, he did not contemplate that the Manager of the Account would be foreclosed from supplying new reserves if, in his discretion, that action would be necessary to avoid kinks in the market during the remainder of the year. Working on the side of System policy would be the fact that the liquidity requirements of corporations and banks until the year-end should add to the supply of Treasury bills and other short-term U. S. Government securities that should come on the market and thereby develop a firmness in short-term interest rates that would of itself exert a restraining influence over the expansion of bank credit. This kind of development could occur even though the actual volume of reserves supplied to relieve undue market tightness seemingly might be contrary to any upward movement in Treasury bill rates that might appear. Inasmuch as that kind of situation would reverse itself automatically after the year-end, its appearance would not have implied any change in System policy, except for the possibility that some market participants might have been confused by a level of reserves that seemed to be technically out of line with the interest rate on short-term U. S. Government securities.

Under present conditions, Mr. Mills felt that it was not appropriate to consider an increase in the discount rate. After the end of the year when the supply and demand status for U. S. Government securities had settled down, a clearer and more logical view could be obtained as to what level of interest rates had become pertinent to the new year situation in the securities markets.

Mr. Robertson said it would seem from the economic report given by Mr. Young, the comments of Mr. Thomas, and most of the remarks around the table this morning that the country was moving out of a period of recovery. He felt that it was time to change the directive so as to get away from reference to economic recovery and refer instead to conditions conducive to sustainable economic growth and stability. Under present conditions, it appeared to him that maintenance of a policy of firm restraint would be appropriate, and he did not feel that policy was firm enough at the moment. The upward movement on the part of business throughout the country was not spotty but broadly based, he said, and a policy of less than firm restraint might serve as an encouragement to labor to seek higher wages. Prices, he believed, were already moving higher along the line, although this development was covered up by lower prices in the agricultural field which made it easy to fail to see a price movement that the System ought to be doing its part to stop. For the moment, he said, the Committee should be moving toward an increased negative availability of reserves. Also, he agreed with Mr. Leach that seasonal needs for the rest of the year should be supplied to the extent possible through member bank borrowing, even in preference to the use of repurchase agreements. He would have no objection to rate increases coming about, because he did not believe that the System should be operating on the basis of maintaining any particular rate structure. It seemed extremely important to him to take advantage of the period between now and the Treasury announcement in January to put the System in a position where it could live during the next month or two. The System should not hold steady during the intervening period, let the financing take place, and then find itself in a position of having to come in and destroy the market. It should let rates increase, if necessary, avoid taking up any more of the slack than absolutely necessary, and maintain a tighter position than it had to date. In other words, he was arguing for a movement of reserve availability downward to a tighter position than maintained up to the present time, and he regarded this as very important in view of the fact that the Treasury would be announcing its new cash offering early in January. Serious consideration should be given to an increase in the discount rate before the January 6 Committee meeting, for it probably would not be possible to take action after that date and before the Treasury announcement. If the rate were not increased before the announcement, it might not be possible to move on it until well into the spring, which he felt would be very unfortunate.

Mr. Shepardson said that his views were similar to those expressed by Mr. Robertson. The report from the staff, other available reports, and his own contacts in the field all supported the view that recovery had been largely achieved, that there was a high degree of confidence regarding the period ahead, and that the System should achieve a much firmer policy position than had prevailed. He thoroughly agreed with working toward lower reserve availability, possibly toward the level of $100 million of negative free reserves that Mr. Irons had mentioned. He also agreed that there should be a change in the directive and that it would be desirable to have a discount rate change while it was possible to move, rather than to have the System find itself boxed in, as it had on occasions in the past, and thereby fall behind the parade.

Mr. Fulton indicated that on the basis of developments in the Fourth District he was not optimistic about the situation to the extent of favoring "drastic" action such as Mr. Robertson had suggested. Steel operations in the district were still at rates below the national average and there was no high degree of anticipation that those operations would turn up precipitately, although in the latter part of the first quarter and in the second quarter there would probably be some inventory building against the prospect of a steel strike. Thus far, the users of steel had been buying only what they could use in production. Also, while unemployment had declined, the decline had been slow and this was expected to be the continuing trend. There had been some upturn in orders placed with manufacturers but not in the machine tool industry, which was still in the doldrums. Construction activity had been rather high, both residential and heavy engineering, and this had given a fillip to the figures in the district. For the year to date, however, department store sales were still three per cent behind last year, while auto sales were still about 30 per cent below last year despite some pickup recently. All in all, the recovery in the district was heartening, but it was not rapid by any means.

Mr. Fulton expressed the view that no precipitate move toward tightness should be made. He noted that the increase in bank loans had been largely in loans on securities and in real estate loans rather than in loans to business; the figures did not show any great demand for credit from the businessman. As to reserves, he believed that a range from zero to $50 million of net borrowed reserves might be appropriate, which would be similar to what had prevailed this week and last week. He did not feel that the discount rate should be changed at the present time. On the directive, it would perhaps be appropriate to make a change in wording to recognize the recovery that had taken place, but the revision should not be an indication of any substantial change in the System's position.

Mr. Bopp said that the most important development in the Third District in the past two weeks had been the continued strength in consumer buying. Department store sales had continued to improve, sales for the latest week having been 19 per cent above a year ago--when there was a snow storm--and 9 per cent above a year ago for the past four weeks. The volume of Christmas buying was reported to be good and most store executives thought that more "shoppers" were buying this year than last. However, the demand for major appliances, which improved considerably in the fall, had waned since October, consumers were reported to be price conscious, and competition was keen. Sales of new automobiles were still at a low level, new car registrations in Philadelphia in November having been about one-fourth below last year and registrations in eastern Pennsylvania in October about one-third below October 1957. Final data showed a small decline in district factory employment in October, primarily because of a decrease in fabricated metals, and average hours worked and average weekly earnings also had decreased. Total factory employment in October was six per cent below last year, with employment in durables off 10 per cent and in nondurables off two per cent. There had been little change in steel production in the Philadelphia area in recent weeks; in the latest week, operations were scheduled at 70.5 per cent of capacity as compared with nearly 75 per cent nationally. Total loans of district weekly reporting banks declined in each of the past two weeks following small to moderate increases in each of the preceding four weeks. Business loans, which rose sharply in early November, had also been declining, and the decrease in the past two weeks was somewhat more than in the corresponding period last year. Weekly reporting banks seemed to have made good progress in redistributing the new tax bills. Their holdings of Government securities rose $37 million in the week ending November 26, presumably reflecting allotments of the new bill, and then dropped $48 million in the following week. The large Philadelphia banks had had substantial basic reserve deficiencies in recent weeks. These deficiencies had been met mainly by purchasing Federal funds but in the last week of November the banks borrowed substantial amounts from the Reserve Bank. Only one of them, however, borrowed in the latest reserve week, and its daily average was only $3 million. Total member bank borrowing from the Reserve Bank in the latest two statement weeks averaged $27 million and $16 million, respectively.

Turning to policy, Mr. Bopp expressed the view that in line with national and regional developments, any move toward restraint at this time should be moderate. He would not favor a change in the discount rate or, at this point, in the directive, which he would like to see changed when there was a change in the discount rate.

Mr. Bryan stated that the Sixth District continued to move ahead at a very satisfactory, not to say rapid, pace. Among other things, nonfarm employment, department store sales, demand deposits, construction contracts, and manufacturing payrolls were up, insured unemployment was down, and many of the indices were going beyond the national average figures. As far as the district was concerned, the recovery was vigorous.

As to policy, Mr. Bryan said that in his view more than an even-keel policy was indicated at the present time. He felt that there should be increasing restraint, and he agreed with those who had suggested that unless a move were made on the discount rate fairly soon the System was likely to find itself boxed in for a far longer period than would be indicated by prospective economic and financial developments.

Mr. Johns said that nothing pertaining to the economy of the Eighth District required comment, while his thoughts regarding the behavior of the national economy would be indicated by the views he would express about the use of policy instruments and about the directive. He went on to say that he wished to align himself with those, beginning with Mr. Irons, who had taken the position that the System should be moving toward greater restraint. He would favor moving in that direction somewhat more vigorously and aggressively than in recent weeks. As to timing, he agreed with the view stated first by Mr. Robertson. With respect to the directive, he felt that it was time to eliminate the emphasis on recovery to the exclusion of everything else and begin to say that the primary objective was restraint upon expansion at an unsustainable rate. He would be glad to adopt wording such as suggested by Mr. Robertson.

Mr. Johns continued by saying that he would favor increasing the pressure on bank reserves, that he would not care to suggest any net borrowed reserve target, but that he would simply increase the pressure more rapidly than had been the case so far. With respect to the discount rate, he had come to this meeting under the misapprehension that the Treasury would not be in the market until the third week of January. Having now learned that the Treasury planned to come in as early as the eighth of January, it was his view that the rate should be adjusted promptly, and in advance of the Treasury financing. He was aware of the quirks of the year-end period and the stresses and strains generally prevalent at that time of the year, but he balanced against those considerations the view, to which reference had already been made, that if the even-keel policy meant what it had often been said to mean at Committee meetings the arguments in favor of increasing the rate before the Treasury came to the market were strong, especially if it were true, as many seemed to believe, that the Treasury might offer a long-term instrument. Accordingly, he would prefer to cast his lot on the side of moving before the Treasury financing rather than afterward. Although he would be reluctant to call a special meeting of the St. Louis directors at this season, he would prefer that to being boxed in for a longer period than he would like to contemplate. With respect to the magnitude of a discount rate change, at the moment he would contemplate an increase of 1/4 per cent, although that might be debatable.

Mr. Johns said that he would like to protest mildly against characterization of Mr. Robertson's position as drastic, for he did not think that it was. Short-term rates being as they were, an adjustment of the discount rate would not be, in his opinion, a drastic policy move. As a matter of fact, it might be long overdue. To summarize, he would favor changing the discount rate promptly and he would favor revising the directive at this meeting.

Mr. Szymczak said that he would favor maintaining a negative free reserve position to the extent possible during the current period of seasonal demand. He did not think that it mattered too much one way or the other whether the directive was changed, and it seemed questionable whether the discount rate could be increased at this time without undue effect on the rate structure generally, which might hamper some areas of the economy.

Chairman Martin said that after making his own comments, he would ask Mr. Hayes to summarize the meeting.

The Chairman then commented that in his own thinking he saw some hazards in the situation that perhaps were not real. He would favor more pressure on the market, and he agreed with Mr. Szymczak in feeling that it did not make too much difference whether the directive was changed at this time. After mentioning that the index of industrial production stood at 141 in November against last year's high of 145, he said there was a question about the point at which the trend of the economy constituted more than a recovery movement. However, he would have no objection to changing the directive at this time on the basis of forecasting--about which one should be careful--and on the basis of "where we are, relative to where we were."

Chairman Martin remarked that this had been a difficult year in the money market, and he then expressed the view that at present it was more important to get the level of reserves down than to increase the discount rate. Referring to current seasonal pressures in the market, he said that the System should be endeavoring not to supply all of the needs and the banks should be encouraged to come to the discount window if they needed reserves. At the same time, the System should try to prevent knots from developing in the money market. It did not seem to him necessary to rush up on the Treasury just because it had set a financing date, and a discount rate change would attract quite a bit of attention.

The Chairman went on to say that his thinking was colored somewhat by the efforts being made currently to balance the budget. Beyond that, however, he did not think that a discount rate change would be terribly effective. If he were doing it on his own, he would not change the rate at this juncture regardless of the fact that the System might be frozen in for a while. Furthermore, he did not think the System would necessarily be frozen in if more pressure were put on the money market. Following the Treasury financing, the rate would probably have to be changed, but at that time the change would come as confirmation. If the discount rate were changed, it would be his view that the increase should be to 3 per cent.

In essence, Chairman Martin said, he felt that the System was in another difficult period. This was the end of a trying year and, although conditions admittedly had been difficult, he did not feel that the System had handled things too well. There was a question in his mind about the desirability of going into the Christmas maelstrom just to beat the Treasury to the punch on the financing. To change the rate might create a more difficult situation for the Desk, and it was going to be difficult for the Desk anyhow.

In conclusion, the Chairman said that he would favor putting pressure on the market, consistent with supplying some but not all of the seasonal needs, in the direction of a larger volume of negative free reserves.

Summarizing the meeting, Mr. Hayes said it appeared that in the area of open market operations there was quite a clear consensus favoring a move toward somewhat tighter restraint, but a very moderate move. The figures mentioned were mostly in the zero to minus $100 million range, although some mentioned a range of zero to $50 million. Several persons had indicated that they would favor less emphasis on figures and more on the feel of the market, and he judged those persons would like to see a somewhat tighter feel than had prevailed. There appeared to be no inhibitions about being in the negative free reserve area; in fact, it seemed to be regarded as desirable to be in that area. There were a few who would favor going a little further than others in that regard.

On the discount rate, Mr. Hayes said, his count indicated that a slight majority favored leaving the rate unchanged, although quite a number spoke in favor of changing the rate before the Treasury financing.[1/] The only comments with regard to the magnitude of a rate change were those made by Mr. Johns and Chairman Martin. There were some who saw a need to prepare the way for the Treasury, while others felt that the System should wait until the Treasury financing was completed.

Continuing his summary, Mr. Hayes said it appeared that the majority would like to see some change made in the wording of the policy directive, with the word "recovery" either deleted completely or modified and emphasis put on the objective of preventing expansion at an unsustainable rate.

Chairman Martin inquired how many felt that a change in the directive was important, and several so indicated. He then inquired how many would favor language in clause (b) referring to sustainable economic growth and stability in place of balanced economic recovery, and a large majority gave affirmative indications.

The discussion turned at this point toward interpretation of the apparent consensus favoring a trend toward further negative free reserves, and Mr. Hayes noted that no one had mentioned a figure

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1/ Somewhat later, Mr. Leach suggested that the majority favoring no change in the discount rate at this time may have been more than "slight," and Mr. Hayes agreed.

greater than $100 million. Chairman Martin said that he thought the situation would have to be measured by the Desk in terms of knots in the market and the feel of the market, and Mr. Szymczak indicated that he agreed with the Chairman's statement.

Mr. Hayes commented that certainly the consensus was for a moderate change, and Chairman Martin put the matter in terms that "moderate further negative free reserves were desirable."

Mr. Shepardson said he thought that was right, that the consensus was for a moderate move. However, he had in mind that over the period of the last four or five weeks, including this one, the average would be close to $40 million of net borrowed reserves. A further move would mean trending somewhat below that figure.

Chairman Martin then inquired of Mr. Rouse whether the consensus was clear to him, and the latter replied that he understood the consensus to be "tighter but not too tight."

With respect to the discount rate, Chairman Martin noted that the comments of individuals around the table would be included in the minutes.

The Chairman asked whether any member of the Committee felt strongly enough to want to be recorded against a change in the directive such as had been suggested, and Mr. Hayes replied that he would like to be recorded against such a change. Mr. Leedy noted that he was not a member of the Committee and therefore had no vote. However, as he had said earlier, it was his view that the directive ought not to be changed except at the time of a real change in policy.

Mr. Szymczak said that although actions were more important than the wording of the directive, he was somewhat concerned about deleting the word "recovery" when it appeared from the reports today that some sections of the country still had a way to go before achieving full recovery.

Mr. Shepardson commented that he would not want to argue too strongly the point made by Mr. Szymczak. Even conceding that point, however, the momentum was such as to direct attention to what the System was planning from this point. While the goal of recovery might not yet have been reached completely, it was so close as to permit attention to be focused on another spot.

Chairman Martin stated that that was why he would have no objection to changing the directive, and Mr. Fulton said that he would go along with the comment made by Mr. Shepardson. Mr. Irons noted that the next Committee meeting would be held on January 6 and that the Treasury's financing announcement apparently would follow shortly thereafter. It was his impression that the Committee had been reluctant to change the directive just prior to a Treasury financing. Chairman Martin said that this point had been very much in his mind. He did not believe that the Committee should change the policy directive on the eve of a Treasury financing, and this would argue for a change now rather than at the January 6 meeting.

With reference to the comment about no real change in policy, Mr. Rouse suggested that the Committee was sliding gradually into a definite change. He said he thought the Committee should know that this was not yet realized by the market, where people were still thinking in terms of moderate free reserves.

Thereupon, upon motion duly made and seconded and with Mr. Hayes voting "no", it was voted to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to fostering conditions in the money market conducive to sustainable economic growth and stability, 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. Riefler stated that in connection with the emergency planning program, System personnel were to be assigned to High Point on a rotating basis beginning in the near future. Prior authorization was needed for disclosure of Federal Open Market Committee emergency resolutions to the persons so assigned, and it was his suggestion that the Committee give a general authorization to make available to such persons the emergency resolutions, last approved at the meeting on March 4, 1958.

This suggestion was approved unanimously.

Mr. Rouse reported that the second meeting of the Technical Committee of the New York Money Market was held on December 10, 1958, and that the Committee was continuing its work on plans designed to avoid speculation in the Government securities market and ensuing disturbances of the kind that developed earlier this year. Among the suggestions that the Committee was considering were the following:

1. That a program of education be undertaken to show lenders, both bank and nonbank, the dangers of lending on little or no margin to ultimate borrowers who may or may not be known to them.
2. That there be instituted a new statistical reporting system under which important lenders would report data on the amount, rate, term, collateral, and purposes of their loans or repurchase agreement

transactions against Government securities, and also that discussions be held with the National Association of Securities Dealers looking toward the provision by member firms of data similar to the data now reported to the New York Stock Exchange by its member firms.

3. That further exploration concerning the possibility of a dealer organization be pursued.

4. That the feasibility of developing a system of regulation of the terms (especially margins) of loans against Government securities be explored. (The group felt that regulation would be necessary but hoped that this could be worked out within the framework of existing legislation. The Technical Committee also believed that recognition of dealers as a separate group was indispensable to an effective regulatory system.)

5. That the Federal Reserve consider using its influence to achieve wider and more regular participation of the banking community in financing dealers.

Mr. Rouse said that the job immediately ahead was to explore ways of implementing the Committee's suggestions. He added that he was planning to send a summary of the minutes of the December 10 meeting to each member of the Open Market Committee or that, if any member desired, a complete set of the minutes would be provided.

On Chairman Martin's suggestion, it was decided that complete minutes should be sent to each member of the Committee and to each Reserve Bank President not currently serving on the Committee.

Mr. Rouse commented that the suggestion for a dealer organization should be kept confidential because it would be damaging from the standpoint of getting anything done if word got out of the Technical Committee.

Chairman Martin commented that Under Secretary of the Treasury Baird had been very active in working on the problem of speculation in Government securities and in due course would have reports from savings and loan and savings bank groups.

Mr. Robertson recalled that at the last meeting of the Committee he had requested that Mr. Rouse give consideration to the problem of window-dressing of year-end bank condition statements from the standpoint of the use of repurchase agreements.

Mr. Rouse said that the officers of the Securities Department of the New York Bank had been discussing the matter, that they thought it was necessary to deal with the market as it exists, and that an attempt to shut down on repurchase agreements beyond the general policy adopted by the Open Market Committee might have an effect on the market that Committee policy did not contemplate. It appeared that the place to deal with the problem was where the window-dressing took place rather than to attempt to deal with it through the market.

Mr. Robertson agreed that the problem was a difficult one. He noted, however, that in past years the volume of repurchase agreements had jumped up on the last day of the year and borrowings went down. It appeared that the banks paid off debt and that the dealers then went to the Federal Reserve Bank for repurchase agreements. While he was not prepared to offer any solution, he felt that the problem should be borne in mind.

Mr. Rouse indicated that further consideration would be given to the matter.

It was agreed that the next meeting of the Committee would be held on January 6, 1959, at 10:00 a.m.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary