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, January 6, 1959, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mills
Mr. Robertson
Mr. Szymczak
Mr. Deming, Alternate for Mr. Mangels

Messrs. Erickson, Allen, and Johns, 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. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Marget, Roelse, Walker, Wheeler, 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, and Tow, Vice Presidents of the Federal Reserve Banks of Boston, Chicago, St. Louis, and Kansas City, respectively

Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia
Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis
Mr. Brandt, Economist, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on December 2 and December 16, 1968, were approved.

Under date of December 29, 1958, there had been sent to each member and alternate member of the Federal Open Market Committee, and to each President not currently a member of the Committee, a copy of the report of audit of the System Open Market Account made by the Division of Examinations of the Board of Governors as at the close of business November 7, 1958. The report, which has been placed in the Committee's files, was submitted to the Secretary of the Committee under date of December 16, 1958, in accordance with the action of the Federal Open Market Committee at its meeting on June 21, 1939.

Chairman Martin inquired whether any of the members of the Committee wished to comment on the report, and there was no indication to such effect.

Accordingly, the audit report was noted and accepted without objection.

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 16 through December 30, 1958, and a supplemental report covering the period December 31, 1958, through January 5, 1959. Copies of both reports have been placed in the files of the Federal Open Market Committee.

In his comments on recent open market developments, Mr. Rouse stated that the money market had functioned more smoothly this December than in other year-end periods. The market had been somewhat tighter than in recent weeks, but there had been little impact on short-term rates of interest. Treasury bill rates reached a peak on December 16 but since then had moved downward. The tightness in the money market toward the end of the year was relieved by a substantial flow of funds from country banks to the money centers, a movement that had since been reversed.

Mr. Rouse went on to say that the prices of intermediate and long-term bonds had declined by as much as four points since late November, reflecting primarily continuing discussion of the possibility of an offering of long bonds by the Treasury this month. The announcement of the terms of the Treasury's offering was expected toward the end of this week. Prices of corporate and municipal bonds had drifted lower in seasonally quiet trading. Projections of bank reserve positions indicated that seasonal factors would supply reserves over the next few weeks, but the System Account had ample amounts of Treasury bills that could be redeemed or sold to offset those reserve effects. The Account bid in yesterday's auction to run off about half of its $259 million holdings of bills maturing January 8.

Mr. Rouse pointed out that the supplementary report on open market operations distributed to the members of the Committee this morning contained reserve projections only for the current statement week and the three succeeding weeks, whereas in the past, projections for a period of sixteen weeks ahead had been shown. From the standpoint of operations, he said, only the shorter-range projections were useful. The Research Department of the New York Bank was preparing to make a study of the basis of the longer-range projections, and if as a result of this study it became possible to improve them, the practice of including the longer-term projections in the supplementary report would be resumed. Until that time, however, it was planned to show only the shorter-range estimates in the report.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period December 16, 1958 through January 5, 1959, were approved, ratified, and confirmed.

The staff economic and financial review at this meeting was in the form of a visual-auditory presentation, participants including Messrs. Thomas, Young, Marget, and Koch, along with Mr. Brill of the Board's staff. By permission of the Committee, Miss Burr of the

Board's staff and Mr. Storrs of the Richmond Reserve Bank joined the meeting for this presentation.

A copy of the text of the presentation has been placed in the Committee files. Following the meeting, copies also were sent to the Committee members and alternate members and to the Presidents not currently on the Committee. A summary of portions of the presentation follows:

> The current picture of the economy is one of maturing recovery. Output is back, or nearly back, to prerecession levels. This means that problems of sustainable growth have now replaced problems of recession. Among these new problems the threat of resumed inflationary tendencies is clearly forecast from a financial point of view.
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> The behavior of commodity prices during the recession, the speed and generality of the economic recovery, the persistent rise in common stock prices, the pace of monetary expansion early last year, and the size of the current Federal deficit have encouraged expectations of further creeping inflation and strengthened views that continuing inflation is inevitable.
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> A key question for Federal Reserve policy now is what rate of monetary expansion would contribute best to the sustainability, without inflation, of prospective economic expansion. While the present ratio of money supply to GNP is significantly lower than after the recovery period 1954-55, it is still higher than the average ratio of the 1920's--by some 10 per cent. Hence, there may remain some margin for further increase in the rate of money-use, but it is probably smaller than at the beginning of the last expansion period. Perhaps the rate of growth in the money supply for the years ahead could be somewhat greater than in the comparable period of the 1954-57 recover-expansion, without inflationary consequences, but growth in the money supply always needs to be determined in the light of tendencies in velocity of money and of developments affecting the quality of credit.

With resumption of business borrowing, prospective large demands for mortgage loans, and the financing needs of governments--particularly State and local--total demands on the capital markets will increase along with further expansion in economic activity. While the total supply of loanable funds in the economy is still very large and economic expansion to a new high level is not likely to be seriously hampered by lack of funds, saving will need to be encouraged so as to cover the bulk of financing demands and to keep the demand pressures on bank credit creation within tolerable limits. In a situation of this type, economic pressures may be expected to sustain a relatively high level of interest rates.

As to current System policy, the vigor of the upsurge in activity generally, the strengthening of private credit demands, and the persistence of inflationary psychology--particularly in financial markets--suggest that monetary expansion should be temporarily held to a moderate rate. Banks should be under pressure to borrow reserves needed to cover credit extensions in excess of seasonal needs, and, to maintain the discipline of the discount window, System discount rates should be kept closely in line with market rates. Such a policy points to an early lifting of these rates.

Pursuit of a policy of limiting monetary expansion to a noninflationary volume is facilitated, at this time, by the fact that bank reserve positions were allowed to contract somewhat during last December and early January. On the other hand, it is handicapped to some extent by the imminence of more cash financing by the Treasury. Even to keep bank reserve positions relatively steady, the System will need to absorb a half billion dollars or more of reserves that will be made available to member banks in the immediate future as a result of a return flow of holiday currency and seasonal decline in deposits and required reserves. Under the circumstances, it is important that these reserves be absorbed promptly--perhaps a little in advance of their availability to member banks--in order to prevent their commitment to speculative and other undesirable uses.

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

The most striking economic news since our last meeting has been the announcement of external convertibility for sterling and other major European currencies, the French devaluation, and related financial developments in Europe.

While it is very hard to estimate the ultimate detailed effects on domestic business conditions, the chances are that there will be little near-term effect one way or the other. In general, the changes are distinctly constructive, indicating important progress toward a more viable world economy, which should bring significant benefits to the United States in the long run.

The outlook for continued recovery has firmed up since our last meeting. It is encouraging to note that almost all branches of activity shared in the recent advance and that consumer buying in the Christmas season was apparently somewhat better than expected.

Price developments have shown contradictory tendencies, with continued declines in spot and future prices of raw materials, as well as food products (and in sensitive wholesale prices), whereas the consumer price index and industrial wholesale prices have exhibited some slight upward pressure. At the same time prices of equities have soared to new peaks.

Looking ahead, we find that the view is very widely held among informed economists that the prospect is for a continued moderate recovery during 1959. Unfortunately there is also a predominant view that reasonably full employment will continue to elude us for many months ahead and that prices will show some upward tilt, although probably very moderate in degree. One key question is whether the current and prospective strength of consumer buying will cause an upward revision in business spending for plant and equipment, besides a significant inventory accumulation. There are also major uncertainties in the automobile outlook and in the future course of the stock market, with related psychological influences on business expectations and plans.

It is never easy to draw a clean-cut line, either conceptually or statistically, between recovery and long-term expansion. In a sense recovery will certainly remain incomplete as long as the rise in output and income is not sufficient to absorb workers who became unemployed during the recession. Yet growth of the economy can take place under conditions when workers who enter the labor force or become unemployed because of automation or other improvements in efficiency fail to find employment. We can, I think, agree that as long as unemployment remains a problem, economic policy must aim at expansion, provided additional employment does not produce an inflationary situation by pressing against limited capacity of facilities and inelastic supplies of materials.

We must concern ourselves at this time with two aspects of the Treasury's activities--first, the timing of the cash financing scheduled for announcement this week, and of the large refunding due two or three weeks later; second, the serious question whether the Administration's highly laudable goal of a balanced budget will actually be attained in fiscal 1960.

Recent credit statistics have shown greater expansion than we realized a month or two ago. I am thinking especially of the larger-than-expected growth in loans and investments in country banks, bringing the increase in loans and investments of all commercial banks to around $13 billion for the first eleven months of 1958. We now look for a full year increase in the money supply of around 3 per cent, higher than earlier forecasts but still not disturbing in view of the fact that the money supply was virtually unchanged from the end of 1955 to the end of 1957.

As for credit policy, we should certainly recognize that recovery is proceeding on a broad base and is likely to continue. We must not overlook either the persistence of large unemployment or the continued evidence of speculative fever in the stock market. It seems to me worth noting that recovery, or the existence of prosperous business conditions, does not per se require a policy of restraint, and that we should move toward restraint only as and when we see real evidence of price pressures or financial excesses.

For the present it is, I believe, appropriate to continue a moderately firm rein to prevent the accumulation of excessive liquidity. The modest tightening which has recently occurred in reserve positions should not be intensified, but neither should it be relaxed. To this end we should act promptly to absorb the return flow of currency and to prevent the expansion of the reserve base that would otherwise occur. While the desirable degree of restraint may be symbolized by net borrowed reserves of about $100 million, I think the Manager should seek to maintain the present degree of tightness as indicated by the feel of the market. This flexibility is especially appropriate now inasmuch as seasonal factors in January could lead to a greater feeling of ease than the figures alone might suggest. On the other hand, with the possibility of a long-term Treasury offering in January, we may find our monetary policy assisted by debt management policies in providing a degree of pressure in the money and capital markets.

With respect to the discount rate, there are serious drawbacks to a change from the standpoint of Treasury and

> international considerations, and fortunately economic conditions do not require an immediate change. The even keel policy clearly points to the desirability of an unchanged rate for several weeks. Furthermore, I have some fear that a discount rate rise at this particular time might be construed abroad as an uncooperative and unnecessary defensive response to the European move to convertibility, which after all is much more indicative of European economic strength than of dollar weakness.

Mr. Johns said that as he interpreted the discussion at the last Committee meeting, there was a rather strong consensus, almost approaching unanimity, to the effect that the System's posture should be one of growing monetary restraint. This was a somewhat stronger position than previously, he thought, but it was not dissimilar as to direction from the consensuses at the last couple of meetings or even before that. As he viewed the situation, it was extremely doubtful whether there had actually been restraint, either during the past three weeks or somewhat further back into the last quarter of 1958. As a matter of fact, he felt that the System had not been restrictive, or at least not restrictive enough. From preliminary estimates, it appeared that the active money supply, seasonally adjusted, rose at an annual rate of about 6 per cent in the fourth quarter of last year, while the use of the money supply had been relatively high and rising. Interest rates generally were still at about the early October levels despite rising levels of business activity and greater than seasonal demands for credit, and loans at weekly reporting banks rose more than seasonally during the four weeks ended December 24, the increase having been 2.3 per cent compared with the seasonal growth of about 1.7 per cent. Also, total member bank reserves rose about $1.3 billion in the fourth quarter through December 26, whereas in the like periods of 1955, 1956, and 1957 the average increase was about $.7 billion. In only one statistic that he desired to mention did it appear that there had been any compliance, or gesture of compliance, with the decisions of the Open Market Committee in the direction of greater restraint. In the last three weeks free reserves of member banks had drifted lower, but they were prevented from falling further by net System Account purchases of about $1.5 billion of Treasury bills during the fourth quarter through December 26. This compared with net purchases during the corresponding period in 1957 of about $1 billion and purchases averaging $1.1 billion in the like periods of 1955 and 1956. Accordingly, it was his view that the Committee's expressed decisions had not been fulfilled. In making this statement, he did not intend nor did he wish to imply any criticism of the Management of the Open Market Account, for in his view the fault lay with the Committee itself due to the kind and manner of instructions that had been given to the Manager of the Account. He did not wish to go into that further today but at some future time he proposed to discuss the matter to a greater extent.

Turning to policy for the next few weeks, Mr. Johns said he agreed with the suggestion made by Mr. Thomas during the chart show to the effect that absorption of currency returning from circulation and of reserves resulting from other factors should proceed somewhat in anticipation of the economic impact of those developments. In short, he would seek to be tighter by open market operations, for in his opinion the time had come to make restraint a reality. He would hope that during the next three weeks there might be no purchases of securities by the Account and no attempt to offset short-term wiggles in the reserve position. He had expressed the opinion at the last Committee meeting that an adjustment of the discount rate should be made promptly, and he continued to feel that a rate adjustment was overdue. However, he did not know what that feeling implied in terms of timing in view of the Treasury's forthcoming trips to the market for new cash and then for refunding. If this meant that the Reserve Banks were prevented from making a discount rate change until the middle of February or thereafter, he felt that it would be regrettable and unfortunate. As to timing, however, he would want to have the benefit of the discussion at this meeting.

Mr. Bryan said that the statistics for the Sixth District seemed to conform in general to the national figures and that the recovery appeared to be solidly-based and continuing. With regard to national policy, he said that he was alarmed by certain factors that were not, strictly speaking, on the economic side. By this comment, he referred to what he considered the very real possibility that in the forthcoming extraordinarily crucial session of Congress, policies might be decided upon that would make inflation a certainty for many years to come. Mr. Bryan went on to say that his own thinking as to System policy was rather negative in the sense that he felt that policy at this immediate juncture should not become easier. In fact, he tended to agree with Mr. Johns that, if anything, it should become more restraining. He had some apprehension that, in view of the seasonal factors now involved, the System could very easily get itself into a situation where its absorption of reserves would not be on a sufficiently massive scale and a position of ease would inadvertently develop. This, he felt, would be a very grave blunder. Therefore, he had been thinking in terms of an open market operation that would take as its principal guide to policy in this immediate period not the figures of free reserves or net borrowed reserves but the actual behavior of short-term rates in the market, his idea being that it would be a very real mistake in the face of rising corporate liquidity, and apparently a considerable corporate demand for short-term instruments, to permit short-term rates to back away from the recent levels and perhaps go below the discount rate. Like Mr. Johns, he believed that a change in the discount rate was overdue, but he did not see how a change could be accomplished at the moment.

Mr. Bopp said that, going into the New Year, business sentiment in the Third District was cautiously optimistic. The general expectation was that business activity would continue to improve but that absorption of the unemployed would be slow. There was as yet no boom psychology. In view of the forthcoming Treasury financing, he felt that the principal problem for monetary policy was to try to maintain an even keel despite the seasonal return flow of currency and other factors tending to supply reserves to the market. Fortunately, the System's holdings of bills maturing in January appeared ample to absorb reserves created by the return flow of currency and other factors. Therefore, he favored maintaining about the same degree of pressure on reserves as during the past three weeks, and he would emphasize the importance of the feel of the market rather than the statistics as a guide to day-to-day operations. He would not favor a change in the directive or in the discount rate at this time.

Mr. Fulton reported that the Fourth District was participating with the rest of the country in the recovery movement, and in this connection he noted that the low point of the recession in that district may have been about the lowest in the country. The steel industry had recently been receiving considerably more orders than in the past few months, possibly in expectation of a strike later this year. The automotive industry had informed some mills that it would buy eight months' supply of steel within the next six months, and orders were coming in for steel inventory from various other users. Accordingly, the steel manufacturers felt that they would have an operating rate of perhaps about 78 per cent in the first quarter of this year and 86 per cent in the second quarter. No matter what happened after that, however, they felt that the rate would go down to 45 or 50 per cent for a period of weeks during the third quarter. If there should be a strike, the rate would be down and if there should be no strike, inventories would take care of the needs of users. For the year as a whole, it appeared that steel operations would probably average a rate of around 75 per cent. In the automotive industry, there had for some time been projections of possibly 5.2 to 5.5 million cars this year, but the thinking now was between 5.5 and 6 million, the upward revision reflecting the fact that the new-model automobiles seemed to be experiencing better acceptance by the public than was the case earlier. Certain types of steel were now rather tight and the mills producing them were scheduling a high rate of operations for the first quarter.

Mr. Fulton continued by saying that department store sales in the district had been surprisingly good during the Christmas season but that sales for the year as a whole ran 2 or 3 per cent behind 1957. Unemployment was not being alleviated to an extent comparable to the rise in industrial production, and there continued to be a number of spots of substantial unemploument. All in all, it might be said that the Fourth District was experiencing a gradual rise in activity.

As to policy, Mr. Fulton expressed the view that absorption of redundant reserves should be undertaken promptly, and in a volume that would permit no ease whatsoever to get into the banking system. Like Mr. Bryan, he felt that the present structure of short-term rates should be maintained and not allowed to drift downward. Because of increased business and economies effected during the recession, corporations had become considerably more liquid, and he believed there was a considerable amount of funds available from that source. In his opinion, the Desk should keep a weather eye on the structure of rates rather than any particular amount of net borrowed reserves, and member banks should be required to come to the discount window to obtain any needed reserves. He would not favor a change in the discount rate at this time. In a concluding comment, he suggested that there was more ebullience in the stock market than anywhere else at this time, and that whatever could be done to dampen the ardor in that sector would be of substantial benefit.

Mr. Robertson said he concurred with Messrs. Johns and Bryan that economic conditions were such, and had been such for quite a little time, as to call for an increase in the discount rate. He considered it regrettable that an adjustment of the rate had not been made. He also concurred in the view of Mr. Johns that open market operations in the past three weeks had not achieved the degree of restraint that he personally had thought desirable or even the lesser degree of restraint which appeared to be contemplated at the last meeting of the Open Market Committee. He regretted the "feather touch" that had been followed. However, it seemed obvious, in view of the Treasury financing announcement later this week, that the Committee had no alternative except to maintain an even keel throughout the financing period and perhaps even into the refunding period. This, he said, connoted action to offset easing factors that were bound to appear during this period. He saw no need for any change in the directive or for any change in policy, since it seemed necessary to maintain the same degree of restraint as existed at the moment. He concurred in the view that the guide to open market operations should not be the amount of net borrowed reserves but the rate structure in the short-term area.

Mr. Mills said he was confident there would be general agreement that the broad direction of System policy should be on the side of credit restraint. To the extent that there were differences, those obviously reflected judgments as to what degree of restraint was attainable without disrupting securities markets or without interfering with a legitimate movement of economic recovery by choking off the availability of credit. Personally, he believed the degree of restraint exerted since the last meeting of the Open Market Committee had been appropriate and had accomplished the purposes that were intended by the majority of the Committee. It was inevitable, he said, that the discussion today should focus on the discount rate and the propriety of an increase in that rate. In his view, the System should by all means avoid a dramatic rate change which in essence would be an action taken in a vacuum. In other words, at a time such as this there were more than normal reasons for changing the discount rate only in order to bring it into alignment with the movement of the market rates in a free market. In that connection, he brought out, it was necessary to decide in what sector of the market the System wished to produce an alignment. The long-term sector essentially has to do with the movement of investment and capital funds, and in his reasoning the short-term sector, particularly as symbolized by the yield on Treasury bills, was the sector of alignment toward which the System should point its policy. The yield on Treasury bills, he observed, had not at this time moved far out of alignment with the discount rate. In fact, if one looked at the "ask" side--the yield on bills obtainable by purchasers--there was no lack of alignment. For that reason, he suggested that when consideration was given to an increase in the discount rate, the thinking be realistic and the action taken in accord with whatever alignment might be necessary at the time.

As to the movement and direction of interest rates, Mr. Mills said that a period when there was a seasonal withdrawal of reserves accompanying a return flow of currency from circulation could, of course, be capitalized on by the System to bring pressure on interest rates and perhaps to bring short-term rates to a level that within a reasonable time, and consistent with Treasury problems, would justify an increase in the discount rate. As that time approached, and if advantage were taken of it, the thought occurred to him that System considerations would be concentrated very largely on its domestic responsibilities. As Mr. Hayes had brought out, however, the Federal Reserve likewise has international financial responsibilities. An increase in the discount rate following a rise in the yield on Treasury bills might be regarded by the domestic and international financial communities as an action on the part of the System to recognize the outflow of gold during the past year or eighteen months, and through such recognition to state tacitly that the System proposed to subject the domestic economy to the discipline that is implicit in a gold outflow by terminating a policy of acquiring U. S. Government securities to offset gold withdrawals. Mr. Hayes, he noted, was concerned about the possibility of actions in the United States market being interpreted abroad as contrary to supporting the steps taken by foreign countries to firm their currencies and bring them toward convertibility. On the other hand, it was possible that where question had been raised about the stability of the dollar, an action taken on the disciplinary side of System monetary policy would bring credit rather than discredit on System intentions. If nothing else, it was quite likely that an upward movement of Treasury bill yields in the United States to equality with, or above, the yield on Treasury bills in the United Kingdom would tend to stem the outflow of gold from the United States. Moreover, it might draw gold back to this country because of the more attractive investment opportunities offered in the U. S. Government securities market.

Mr. Leach said that in the Fifth District the year 1958 closed with continuing evidence of gradual economic expansion. The textile industry continued to enjoy a better market but had not yet returned to industrywide six-day operations. Cigarette manufacturers closed out a year of operations well above the 1957 level, and 1958 was a banner crop year for Fifth District farmers. After a rapid rise in November, business loans of weekly reporting member banks rose slowly in December to produce an over-all increase of about seasonal proportions.

Mr. Leach expressed the opinion that in view of the imminent Treasury financing an even keel policy was clearly appropriate for the period immediately ahead. This suggested a moderate amount of net borrowed reserves as the desired bench mark, and the latest projections indicated that only moderate action by the System would be required to maintain such a level. That action presumably should take the form of a runoff of Treasury bills. After expressing the view that prompt absorption of any redundant reserves was very important, Mr. Leach said that, as he saw it, the Desk had maintained just about the degree of tightness that he sensed the Committee as a whole intended at the last meeting. He felt that this degree of tightness should continue, with the Manager of the Account guided by the general feel of the market and not solely by free reserve or net borrowed reserve figures. Obviously, no change should be made in the discount rate while following an even keel policy, and he saw no reason to change the directive at this time.

Mr. Leedy said he was one of those who felt that it would have been well to have had more restraint in the periods between the last two Committee meetings, particularly the more recent period. He said this without any criticism of the Desk, for the Desk had had a very difficult problem, but in his own thinking he would have preferred more restraint than had actually been accomplished. If a change could be made in the discount rate, he would favor that course, for he did not share the apprehension of Mr. Hayes about possible misunderstanding of the purposes involved in such a move. With the Treasury cash financing immediately ahead, however, he did not see an opportunity to adjust the discount rate. For the present, he felt the System could do little more than what it had been doing in the recent past, but he hoped that the System could move somewhat further in the direction of restraint.

Mr. Allen referred to the annual meetings of economic and statistical associations held in Chicago last week and said there was a remarkable degree of unanimity on the business outlook, to the effect that the uptrend in activity would continue for the next several months at least. The very high level of Christmas retail trade seemed to him to be the biggest business news in recent months, with the statistical increase over a year ago particularly noteworthy because Christmas trade was considered strong last year. He was pleased to note that department store sales in the Seventh District were as good as those in the nation as a whole during the Christmas period, following a poorer performance earlier in the year. He went on to say that employment had risen in all Seventh District States in recent months and, while employment was below last year and unemployment higher, new claims for unemployment compensation during November and early December were below the previous year in all States of the district. Despite easier job markets, wages and salaries had continued to rise during 1958. For example, a survey of 42 large Chicago employers indicated a rise in the average pay of white-collar workers of 2-1/2 per cent in the six months from May to November. No evidence was seen as yet that higher interest rates were hampering the rise in construction activity in the Seventh District. Total contract awards in November were 10 per cent higher than last year, compared with 9 per cent higher for the nation as a whole.

Mr. Allen reported that the atmosphere in Detroit was one of optimism, a characteristic of this time of year. Sales in the first part of December averaged 18,100 cars daily and it was understood that sales in the final 10 days of December were a little better. Because Chrysler was in effect out of the picture due to lack of stock, the showing for the last 10 days was more optimistically regarded than would otherwise be the case. Production schedules for January were projected for 580,000 to 590,000 cars, and for the entire first quarter 1,500,000 or even a little more, while January inventory totals of 600,000 were almost 200,000 below the figure of a year ago. That inventory, incidentally, did not include approximately 80,000 imported cars. As a reflection of the current optimistic atmosphere, the professional forecasters in Detroit were talking of 1959 sales in terms of not less than 5.5 million domestic cars and 500,000 imported cars. Unemployment was expected to continue large in Michigan, however, because automobile manufacturers were using overtime in order to avoid sharp reductions in force later on.

Turning to the financial picture, Mr. Allen said that year-end pressures on Seventh District banks resulting from corporate tax payments and seasonal credit needs appeared to have been somewhat lighter than usual. In the four weeks ended December 24, loans to business by district weekly reporting banks rose $67 million, compared with $94 million last year, while loans on securities increased $72 million to a level of $500 million--the highest volume since the midyear

Treasury financing. This doubtless was related to unusually large dealer positions in Government securities. The year-end pressure on reserves had been strongest at the large banks of the district; in recent weeks, Chicago central reserve city banks had shown a deficit position after being in a surplus position for the better part of several months. In the statement week ended December 31, borrowing at the Reserve Bank's discount window and purchases of Federal funds exceeded excess reserves by $70 million, a somewhat smaller deficit than for the same period a year ago but considerably larger than at any time since last April. Two of the largest banks had indicated that they expected their positions to ease by reason of substantial loan liquidation in the month of January.

In a concluding comment on the economic situation in the district, Mr. Allen said that some users of steel had indicated that they expected within the next month or so to place orders for the third as well as the second quarter.

Turning to policy, Mr. Allen said that economic considerations would suggest, if they did not actually require, more restraint and an increase in the discount rate to maintain what Mr. Thomas had referred to as discipline of the discount window. However, any discussion of a rate change at this time seemed academic. He agreed with those who had pointed out that the System must give consideration to the Treasury financing and that it should try to maintain in the next few weeks the degree of restraint that now existed. He was not inclined to be critical of the Desk, for in the periods between the last two Committee meetings he felt that it had done what the Committee requested. For the ensuing period, he would try to stay about as at present, and he considered it important to mop up excess reserves as fast as possible. He would not favor action on the discount rate until after the next meeting of the Committee at least.

Mr. Deming said that at the end of 1958 most business indicators in the Ninth District, as in the nation, pointed to further recovery in economic activity. In the Ninth District, however, the trend had been obscured by the sharp contraction normal for this time of year. For example, both manufacturing and nonmanufacturing employment in the Twin Cities was lower today than it was two months ago. On the other hand, the drop in manufacturing employment was only one-third as large as last year and in nonmanufacturing--virtually untouched by the recession--the drop was about equal to last year. These developments were normal for good years and the iron ranges of Michigan and Minnesota remained about the only real soft spots in the district.

Mr. Deming went on to say that Ninth District banking presented a somewhat different picture from that of the nation. As of mid-December, member bank loans were approximately $145 million higher than a year earlier, with about two-thirds of the increase coming at country banks. Both Government and other security holdings were substantially higher, this being in keeping with national performance. Despite the loan growth, both city and country bank loan-deposit ratios on December 10, 1958, were almost exactly the same as a year earlier, with city bank ratios fractionally higher and country bank ratios fractionally lower.

As to policy, Mr. Deming said that an even keel seemed to be indicated during the next three weeks. To him, that meant prompt absorption of redundant reserves but continuation of about the same level of restraint as had been maintained recently. He agreed with Messrs. Leach and Allen that the Desk had maintained about the degree of restraint appropriate in the light of Committee instructions, and in his view this was about the degree of restraint appropriate at this time.

Mr. Irons said it seemed to him that economic conditions were clearly strong and strengthening, both nationally and in the Eleventh District. Further growth had been experienced in the district in virtually all areas. In the period since Thanksgiving the volume of retail business had averaged very strong, and the petroleum industry was now in a somewhat better situation than earlier. Cutbacks on missile and related contracts had caused a large aircraft manufacturer to release employees just before the holidays, but in relation to total employment this was not damaging, and it may have been that the consequences were more emotional than real. District construction activity was holding up well. As to the banking picture, the demand for loans was up, according to latest statistics, and the year-end call report showed substantial increases in virtually all items over a year ago, not only for banks in the large cities but for banks in all cities. It would not appear that banks were pressed for reserves, for there had been virtually no borrowing at the discount window. In his judgment, the recovery was now a thing of the past and the System should be looking toward fostering sustainable growth rather than promoting recovery.

As to policy, Mr. Irons said he felt that the System should certainly avoid anything that would give the appearance of, or permit, any introduction of ease into the reserve position. At the same time, he was rather satisfied with open market operations over the past three weeks. All of those around the table were of course interested in maintaining restraint and the differences were only in judgment as to degree. After allowance for year-end developments and the problem of meeting end-of-year strains, the Desk had introduced some degree of greater restraint and in his judgment the operations could be regarded as successful. While the bill rate had moved down to some extent, this was due to a more liquid position on the part of corporations and the situation might reverse itself rather quickly. At this time of year, natural forces tending toward ease would come into the market, and he suggested that the System be alert to offset them in every way possible. Fortunately, the System held a substantial amount of bills which could be run off to absorb reserves as they came into the market, and he felt that the Desk should certainly follow that course. Any errors, he said, should be made on the side of restraint and clearly so. On the other hand, he would not want to be strongly or dramatically tighter than during the past three or four weeks.

Continuing, Mr. Irons said that the discount rate did not bother him from the standpoint of its being out of line, even though it was currently under the Treasury bill rate. He hoped, however, that some further restraint, as it became possible, would produce a rate situation in the market such that adjustment of the discount rate would be more or less automatic. In any event, discussion of a discount rate change at this time seemed academic. With the Treasury financing announcement scheduled for this Thursday, it seemed important for the next couple of days to allow no evidence to appear that any ease was creeping into the picture; in other words, the System should try to maintain as firm a position as possible pending the Treasury announcement.

In summary, Mr. Irons said he was happy about open market operations during the past few weeks. They had achieved some additional restraint, and he hoped that this could continue without being dramatic or sensational. He would leave it to the Manager of the Account, through his contacts with the market, operational estimates, and similar guides to try to press gradually toward more restraint without any upsetting factors.

Mr. Erickson said that in the First District recovery was continuing in some areas at a slower pace than nationally and in other areas at a pace ahead of the national figures. In November, nonagricultural employment was down slightly although manufacturing employment was up due to improvement in durable goods industries. The New England industrial production index was up from 108 to 110 in November, while electric power output during the last six months of 1958 was 6 per cent ahead of 1957. For the first eleven months of the year, construction contracts were 8 per cent ahead of the previous year due to public works and utilities. Over the same period, residential construction was down 4 per cent from 1957, and nonresidential construction was down 9 per cent. Department store sales were excellent for the Christmas season, sales in the last four weeks of the season having been 8 per cent higher than in the similar period of the previous year. On the other hand, automobile registrations were still running a good deal behind year-ago levels. A survey of savings banks at the end of November showed for the first time during 1958 a rate of deposit increase less than for the previous month, and the same situation held true in a survey of Federal savings and loan associations. Whether that development was of significance, he did not know.

As to policy, Mr. Erickson said that Mr. Irons had covered his own position. He expressed satisfaction with the operations of the Desk during the past three weeks and, in view of the Treasury financing date, said that he would make no change in the directive or in the discount rate at this time. He would favor continuing to maintain the existing degree of restraint and would make sure that no ease appeared.

Mr. Szymczak said that for the next three weeks System policy quite obviously would have to stay put. While excess reserves coming into the market should be absorbed through open market operations, the System was stymied for the time being on the discount rate. He would like to study at greater length the question of when it would be possible to raise the discount rate with the Treasury due to come to the market first for new money and then for refunding. This raised the question whether a rate change would be feasible for a month or even a month and a half. In this connection, he noted the System's responsibility as an arm of the Government to work in harmony with the Treasury in obtaining the amount of money that the Treasury would have to raise. Also, Mr. Szymczak said, he would like to study the cause of the present volume of unemployment, for his readings indicated the possibility of relatively large unemployment for some length of time. This seemed to him to be important because continuation of unemployment to the extent of around 4 million people over a long period of time meant that the Congress might take actions for which the System must be prepared. The System, he suggested, should know what could be done about unemployment other than to spend large sums of Government money. Analysis of the causes of unemployment should be on an area basis and should determine to the extent possible how long substantial unemployment might be expected to continue.

Monetary policy should now become tighter, Mr. Szymczak said, from the standpoint that all economic indicators were on the upward side. As he had indicated, the System was stymied frequently by Treasury financing operations, and it might be stymied by Congressional action in the light of the unemployment statistics. He suggested, for the next three weeks, absorbing redundant reserves coming into the market, and in a concluding comment he expressed the view that the Desk had done a good job over the last three weeks.

Mr. Balderston said that although he recognized that history may be looked upon as a pageant and that one cannot count on history repeating itself, he had been thinking a great deal about comparisons between the current recovery and recovery from the preceding recession. Accordingly, with the help of Messrs. Young, Eckert, and Trueblood of the Board's staff, he had endeavored to answer three questions: (1) how does the current recovery compare with its predecessor; (2) how have the Federal Reserve responses to the two situations compared; and (3) what lessons, if any, may be derived with respect to current policy.

As to the first question, Mr. Balderston said that he need not comment because the subject had been dealt with admirably in the visual-auditory presentation. Therefore, he would merely remark that, aside from the lag in automobile and steel output, he saw no significant difference between the two rates of recovery. On the second question, it must be noted that the stimulation by monetary policy this time was matched by that of a record-breaking peacetime Government deficit. Last year, short-term rates declined more sharply and from a higher level to approximately the same low points reached in 1954, while long-term rates continued higher than at any time prior to the fall of 1956. Interest rates had risen more rapidly and to higher levels, both in absolute amounts and relative to free reserves and the discount rate. In both recoveries, the shift of reserves away from active ease occurred in the fourth month after the upturn. In the subsequent five weeks last year, free reserves dropped from $530 million to $86 million by early September, a tightening equivalent to that which took four months in the preceding recovery. Moreover, the current reserve position tightening started from a lower level, say $500 million, as compared with $725 million in August 1954. Prior to the April 1958 turnaround, free reserves had been permitted for only three months, whereas prior to the August 1954 turnaround they had prevailed for eleven consecutive months. In this recovery, discount rates were increased from 1-3/4 per cent to 2-1/2 per cent in two rounds, the first beginning in the fourth month and the second beginning in the sixth month, while in the preceding recovery the rate was raised once from 1-1/2 to 1-3/4 per cent, principally in the eighth month after the turnaround.

Mr. Balderston went on to point out that commercial banks entered the current recovery in a more fully loaned position and with less secondary reserves than they entered the previous recovery. They might be expected, therefore, to be more responsive to central bank restraint this time. During the first seven months of this recovery, the loan-deposit ratio had changed but little, whereas it had risen nearly three points in the 1954-55 recovery. Expansion of total loans at commercial banks had been less than 3 per cent this time, compared with 8 per cent in the previous recovery.

As to lessons for current policy, Mr. Balderston said that he was far from sure as to the answers. However, he started with the belief that in the 1954-55 recovery Federal Reserve restraint could be described as having been "too little and too late." He attributed that to two things, first, the fact that there was more water in the brakes last time, which caused the commercial banks to be unresponsive for a considerable period, perhaps six months, and second, a solicitude on the part of some members of the Open Market Committee with respect to the young and budding recovery; that is, disinclination to move vigorously because of a fear that the infant recovery might be starved. Here he was drawing solely on his memory. However, if he was correct in his criticism of open market policy in 1954-55, it seemed to him that there were cogent reasons for making the restraint this time more stiff than before. In the first place, price increases for nonagricultural production had been pyramided on top of an already high price level, and as a collateral point many industries had lost some of their ability to compete, both at home and abroad. Second, policy this time suffered from the fact of deficit spending; monetary policy had lost an ally on the fiscal side. Furthermore, expectations as to unwillingness to raise the revenues that the Congress seemed inclined to spend contrived to make the outflow of gold and the rise of stock prices danger signals of real moment. Thus, the current situation was different from the previous situation in these several respects.

Mr. Balderston said he had come to the conclusion, as to policy, that nothing could be done in the next three weeks in the nature of overt action. However, the System could make plans so that, when the opportunity did come, it could get the short-term rate above 3 per cent and take appropriate discount rate action. In this respect, it should move as a system and not present to the world at home and abroad the spectacle of indecisive, ill-timed action. He hoped that by the middle of February the System would be prepared to act in concert as a system.

Chairman Martin said that he had nothing to add to the discussion of policy this morning and that the course of System policy was clear for the moment. However, he would like to make a general comment on the problem facing the Treasury, which in a sense was the problem with which the System also was faced. In his thinking, he said, inflation was a process going on over a period of years, and the current problem was a heritage of the war. Whether inflation could be contained, he did not know, and there were differences of opinion on that. He suggested that diligent study of money and credit tends to make one humble, for knowledge of how money and credit acts in the economy is really fairly limited and there is a great deal to learn. Of course, the total problem was bigger than money and credit, but he felt that 1959 would perhaps be a crucial year in the battle against inflation because the Government was now forced to come to grips with the saving-investment process, and the Treasury was faced with a very serious problem in attracting bona fide savings into Government securities. After noting that the Treasury was limited by law to a 4-1/4 per cent rate of interest on its issues, he said that he could state unequivocally that within such limit the present management of the Treasury, at least so far as his contacts indicated, was willing to pay whatever rate might be required to obtain money. The management of the Treasury was doing its best in approaching this problem and he only wished that he had been able to give them more help by way of ideas as to how the problem could be handled. All those around the table, he said, should be concentrating on the problem of saving and investment. In this connection, he suggested looking at what had happened to the man who bought United States Savings Bonds as compared with the person who bought common stock. One source had indicated to him recently that in the case of a large trust company handling nothing but investment funds, the amount of money put into fixed investments had declined something like 25 per cent in the last six months. While this was not important in itself, it afforded an indication of a trend.

Continuing, the Chairman pointed out that this problem was one that could not be corrected by a single change in the discount rate or by any one move, for it involved a continuous process, but he suggested that in 1959 all should be seriously concerned with the problem. Referring to the chart show presented earlier during this meeting, he called attention to the disparity illustrated by the charts between the rates of return on equities and fixed investments. That situation would not last forever, but in the meantime the Treasury had to live with the market and devise means of attracting bona fide savings into Government securities. He did not pretend to know the answer, but no one could afford to be complacent about the problem the Treasury was facing. He did not think there was anything the Federal Reserve could do directly, although this was partially the System's problem. However, as mentioned by Governor Balderston, whatever actions the System decided upon must be decisive actions, for it complicated the Treasury's problem when the System was split within itself on what it was going to do. The System should endeavor to have a clear position which would make things easier.

Summarizing the meeting, Chairman Martin said that with the Treasury financing imminent, it seemed clear that all who had spoken wanted to maintain an even keel. He agreed with Mr. Irons, however, in feeling that any mistakes should be on the side of restraint rather than on the side of ease under present conditions, recognizing the burden that this placed upon the Management of the Open Market Account. He then went on to say that an even keel policy, as debated from time to time at Committee meetings, seemed to mean many different things to different people. However, he was talking about the feel of the market generally, and he felt there was a reasonable meeting of the minds on what the Committee intended to do. There was no sentiment for a change in the discount rate at this time, while there would be a continuation of about the same degree of restraint that had been maintained recently in order to give the Treasury as free an operation as possible.

Chairman Martin said he was hopeful that the Treasury would come out with a long-term security which would be complementary to monetary policy.

In concluding comments, Chairman Martin repeated that he felt the year 1959 was going to be a crucial one in the battle against inflation. He hoped that inflation would not get out of hand to such an extent that a very serious price would have to be paid for its correction, that instead it could be contained at least within reasonable limits.

Mr. Szymczak again referred to his concern about the possibility of Congressional actions in the light of the unemployment problem and the extent to which the Government in such circumstances would permit the Federal Reserve System to follow the monetary policy it should be pursuing from the standpoint of the inflationary problem and long-range needs of the economy.

Chairman Martin inquired whether there was any disagreement with his summary of the meeting, and there were no indications to such effect. He then asked Mr. Rouse whether he had any comments, and the latter replied in the negative.

> 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 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.

It was agreed that the next meeting of the Committee would be held on Tuesday, January 27, 1959, at 10:00 a.m.

Thereupon the meeting adjourned.

Winfield Thurston

Assistant Secretary