A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, September 1, 1959, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Allen
Mr. Balderston
Mr. Deming
Mr. Erickson
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Hayes
Mr. Bryan, Alternate for Mr. Johns

Messrs. Bopp, Fulton, and Leedy, Alternate Members of the Federal Open Market Committee

Messrs. Leach, Irons, and Mangels, Presidents of the Federal Reserve Banks of Richmond, Dallas, and San Francisco, respectively

Mr. Riefler, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Mitchell, Parsons, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Hostetler, Daane, and Tow, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, and Kansas City, respectively
Mr. Clay, Vice President and General Counsel, Federal Reserve Bank of Kansas City
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia

Mr. Coldwell, Director of Research,
Federal Reserve Bank of Dallas
Mr. Gaines, Manager, Research Department,
Federal Reserve Bank of New York
Mr. Stone, Manager, Securities Department
Federal Reserve Bank of New York
Mr. Brandt, Economist, Federal Reserve Bank
of Atlanta

Chairman Martin noted a request by Mr. Leedy that Mr. Clay participate in this meeting, and no objection was indicated.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period August 18 through August 26, 1959, and a supplementary report covering the period August 27 through August 31, 1959. Copies of both reports have been placed in the files of the Committee.

In supplementation of the information contained in the written reports, Mr. Rouse made the following comments:

> The most noteworthy occurrences during the past two weeks have been the developments in connection with the proposed removal of the Treasury's interest rate ceiling and the not unrelated further steep increase in Treasury bill rates. The rate on three-month bills had been at the 3 per cent level in late July, and by the time of the last meeting it had moved up to around 3.40 per cent. Yesterday the rate closed at 3.88 per cent bid and in yesterday's auction the average rate was 3.89 per cent, with a tail running to nearly 4 per cent. The average rate on the six-month bills in the auction yesterday was 4.47 per cent, almost 75 basis points above the average rate set in the auction of August 17. This level of bill rates has caused increased attention to be focused on the discount rate and the prime rate, and the market regards it only a question of time before one or both of these rates is increased. The atmosphere in the market for Treasury notes and bonds has also been heavy during the past two weeks. Prices have fallen off substantially and at the close yesterday 38 issues of notes and bonds reached new all-time lows. As indicated in the supplementary report, the

highest yielding issue, the 2-1/2's of 1961, was yielding 5 per cent at bid prices last night.

The general deterioration in the Government securities market during the past two weeks reflects mainly the revival of expectations of higher interest rates in the autumn. Such expectations have, of course, been characteristic of the Government securities market for many months, but the outstanding success of the Treasury's refunding of its August 1 maturities in July, together with the onset of the steel strike and the announcement of the Eisenhower-Krushchev exchange of visits, temporarily led to a feeling that interest rates might have reached a plateau for the time being. This feeling has by now completely disappeared, and a major cause of its disappearance has been the evidence of broad strength in the economy despite the steel strike, along with the possibility that the end of the steel strike will witness an even greater rate of economic advance.

The weakness in the Government securities market has been reflected in the markets for corporate and municipal bonds, where yields have risen fairly sharply in the past two weeks. The syndicates for three recent utility offerings were terminated last week, with upward yield adjustments ranging to 20 basis points or up to three dollars per hundred. With the calendar of new issues large and still growing, it is hard to see any reversal of the upward trend of yields in those markets.

The money market has had a somewhat tighter feel during the past two weeks despite the fact that there has been no significant change in reserve figures. Federal funds have remained firmly at 3-1/2 per cent, and New York bank lending to dealers has been at 4-1/4 per cent. The Account supplied $196 million reserves net to the market since the last meeting, which had the effect of offsetting most of the withdrawal of reserves by market factors during the period. Looking at the reserve projections, net borrowed reserves will probably rise to over $600 million next week because of the pre-Labor Day currency outflow, but then will move back down to the level of recent weeks.

The Joint Economic Committee, through Senator Douglas, has requested that we furnish the Committee with aggregate figures on dealer positions, volume of purchases and sales, and borrowing. The Committee wants daily figures for the years 1950 through 1958 and for selected shorter periods running all the way back to 1937. The information requested by the Committee, I believe, can be developed from the data already in our files, except the material for dealers who have not reported their figures to us. We have sent letters to all dealers explaining the Committee's request and have asked, on behalf of the Joint Committee, their permission to furnish the Committee with the figures. We have heard from about half the dealers thus far, and all but one have given their permission to make the data available. The one refusal is from a dealer who has not been reporting figures to us.

Mr. Mills said he noticed in the reports of open market operations that the dealers appeared to have reduced their positions substantially, apparently on the ground that they foresaw uncertainties in the market. He inquired of Mr. Rouse whether the latter had any concern that the dealers might refrain from performing their accepted function of making markets, thereby adding a push to the deterioration of the Government securities market that could threaten disorder.

Mr. Rouse replied that dealers' positions in longer-term securities had not changed materially in recent months. As to short-term securities, their positions had gone up in connection with the recent Treasury refunding operations and then moved down in the areas of refunding. As indicated in the reports of open market operations, the dealers were distrustful of a 3.00 per cent level on three-months bills, and even a 3.40 per cent level, because they believed that rates would be higher later on, but nevertheless they made markets. Prior to the auction yesterday, their position in Treasury bills was in the neighborhood of $500 to $600 million net.

Mr. Mills inquired how that would compare with the aggregate dealers' position six weeks ago, to which Mr. Rouse replied that as far as short-term issues were concerned, he would say that it was larger. Ordinarily, the dealers had been going into the auctions in recent weeks with a position in bills in the order of $250 million. However, there had recently been a substantial inflow of bills from customers and the dealers were not able to sell those bills readily. In yesterday's auction, the dealers took another $350 million, so their positions were at a relatively high point.

In response to a question by Mr. Robertson, Mr. Rouse confirmed that he had no qualms about the dealers making markets.

With reference to Mr. Rouse's comments about the furnishing of daily figures on dealers' positions to the Joint Economic Committee, Chairman Martin called attention to the fact that this represented a change in attitude with respect to the furnishing of such figures. During the hearings in New York City, Mr. Rouse had agreed that he would try to supply these data, while heretofore the Committee had taken the position that it would not want to undertake to supply the figures. In the past, when requests were received from the Congress, the Committee had said that the Congress would have to go direct to the dealers. He emphasized that he was not commenting in a critical vein. Under Committee questioning, it was hard for Mr. Rouse to say that he would not endeavor to supply the figures. From his own personal experience, the position of a witness on the firing line is much different from that of a person receiving a request indirectly.

Mr. Thomas commented that certain aggregate figures published in the recent Treasury-Federal Reserve study of the Government securities market included those of the dealer referred to by Mr. Rouse as not reporting to the New York Reserve Bank. Therefore, compliance with the current request for all but the one dealer would have the effect of revealing his operations for those periods as to which comparisons could be made with the securities market study.

Mr. Treiber said that this had been pointed out to the dealer in question in connection with the current request. In reply to a question by Mr. Robertson, Mr. Rouse indicated that it was the intention of the Reserve Bank to advise the Joint Economic Committee of the refusal of the one dealer to furnish figures. If the Committee wished to do anything further, it would therefore have to contact the dealer itself.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period August 18 through August 31, 1959, were approved, ratified, and confirmed.

Supplementing the staff memorandum distributed under date of August 28, 1959, Mr. Young made a statement substantially as follows with respect to economic developments:

> Since June, industrial activity has shown a divided trend. Activity in metal output and fabricating lines affected by work stoppage or model changeover has declined sharply, while activity in other lines has continued to expand. The weight of curtailed industries in the Board's

production index, however, has been enough to reduce its level since June by an estimated 4 index points--2 points each in July and August. GNP for the third quarter will reflect the impact of reduced output in these metal producing or working industries by a much smaller advance than in the preceding quarter. Over-all inventory accumulation for the third quarter is expected to be considerably reduced and there also will be the income losses suffered by strike-bound industries.

Aside from the work stoppage influence, the total economic picture appears to be one of widespread strength. For instance:

(a) While construction activity has shown moderate decline from its all-time record of April and May, its level is a third higher than a year ago. A continuing large volume of contract awards suggests that the current construction level will be sustained.

(b) July new order and sales figures for durable goods manufacturers reflect marked demand strength for most lines, especially for machinery and transportation equipment other than motor vehicles.

(c) Retail sales in July sustained their high June level, and sales at department stores in August continued vigorous for both durable and nondurable lines. August sales of new cars remained about a third higher than last year, while used car sales also held close to a 15 per cent margin over a year ago.

(d) Consumers continue to seek and incur instalment and mortgage debt at a near record pace.

(e) U. S. exports in July again rose abruptly, reaching a seasonally adjusted annual rate of $18 billion, or a fifth higher than the low months of earlier this year. While the rise in July was attributable in part to agricultural exports, larger shipments of industrial items helped for a second time to raise total exports.

(f) Total business inventories as of July, not yet back to prerecession levels, remained historically low in relation to current sales volume.

(g) The labor market impact of metal strikes appears to have been limited, and aside from industrial areas immediately affected, total employment has been well sustained.

With demands continuing strong and, in the aggregate, expanding, prices of industrial commodities have been showing general strength at a level about 2 per cent higher than a year ago. In recent months, increases in supplies of foodstuffs, chiefly meats and eggs, have resulted in enough price decline for foods to keep the wholesale price average about stable. However, the consumer price average through July has risen four successive months, the July rise reflecting a broad range of price increases.

Industrial expansion in Europe, from the latest figures, is apparently continuing. While European price levels have been generally stable this year, there are spreading indications of official concern about the resumption of inflationary tendencies.

Mr. Thomas made a statement substantially as follows with respect to financial developments:

Financial developments during the past three weeks have been in some contrast to those of preceding weeks. Interest rates, which had declined somewhat in the latter part of July and early August, turned sharply upward. The most pronounced shifts in both periods occurred in short-term rates. Ninety-day Treasury bills are now approaching the 4 per cent level.

This tightening of rates has occurred notwithstanding a slight easing of the pressure on banks' reserve positions and a continued relatively low level of new securities issues. It apparently reflects three sets of influences: (1) continued sales of short-term securities by banks in order to raise funds to meet an exceptionally strong loan demand at this period; (2) lessened demand for bills by nonbank buyers as seasonal increases in cash needs approach; and (3) further additions to the supply of Treasury bills.

Fundamentally, the situation probably reflects pressures growing out of the somewhat unusual liquidity position of the economy. For several months banks have been able to meet heavy loan demands and at the same time the Treasury has been able to finance its large deficit through sale of short-term securities, with only a moderate increase in total bank credit and the money supply. This has been possible because nonbank owners of liquid funds have preferred to hold Treasury bills rather than add to their bank deposits. As cash is needed to make payments, however, pressures mount in the bill market and are further reflected in other securities markets.

Figures now available for all member banks for July indicate that banks supplied a large amount of credit in that month--much more than had been earlier indicated by the data for city banks alone. Most of the expansion was in loans, but holdings of securities also increased moderately. Private demand deposits showed a much greater than seasonal increase, and the turnover of deposits also increased. The availability of bank credit may have eased some of the pressure on the money market, although banks continued to be heavy borrowers of reserves.

In August, preliminary and partial figures for city banks show a continued large expansion in loans. In contrast to July, however, this expansion has been more than offset by a renewed decline in bank holdings of securities. As a result total loans and investments of banks in leading cities declined--the first decline for August since 1955, when banks were also reducing holdings of securities to increase loans. Whether these developments at city banks reflect the situation for all banks any better in August than they did in July remains to be seen. Figures for the first two weeks in August indicate that, although loans increased and investments declined at all classes of banks, country banks showed a small increase in total loans and investments and also in demand deposits, in contrast to declines in the total at city banks.

The city bank loan expansion in August, as indicated by partial figures for August 26, reflected perhaps slightly greater than seasonal increases in business loans, in loans to finance companies, and in consumer loans, together with a continued moderate increase in real estate loans and little change in loans on securities. The city banks reduced substantially their holdings of Treasury bills and also the total of other Government securities maturing in less than a year, despite the increase in bills outstanding. They also showed a decline in other securities.

It would appear from these data that private demand deposits may have shown a greater than seasonal contraction in August, offsetting some of the July increase. Whether all banks will show such a decline cannot yet be known. In any event, the total money supply at the end of July was more than 3 per cent larger than a year ago and 4-1/2 per cent larger than the July 1957 peak. In addition, there have been substantial increases in the public's holdings of short-term Government securities and the turnover of demand deposits has been at a higher level than in mid-1957.

Developments in the past two months may give an indication of the type of banking and monetary situation that may characterize the period ahead. As nonbank holders attempt to convert Treasury bills into cash, there will be recurrent pressures on the short-term money market. If, as now seems likely, the Treasury will not be in a position to reduce the liquidity of the economy by funding some of its short-term debt into long-term securities that will attract more permanent savings, the situation may be a particularly difficult one to manage.

This type of situation calls for a tight rein on monetary expansion, not relaxation. It may result in further increases in short-term interest rates. The six per cent rate in Canada reflects such a situation and the resistance of the central bank to further monetary creation in the face of heavy Treasury financing needs. In view of the prevailing liquidity of the economy in this country, it is likely that considerable economic expansion can be accomplished with little or no further increase in bank deposits. In any event, increases of greater than seasonal amounts might well be based on member bank borrowing at discount rates close to or above Treasury bill rates. Any relaxation is likely to encourage excessive credit and monetary expansion.

In order to minimize further additions to liquidity, Treasury debt management under an unrealistic ceiling on long-term interest rates will present difficult problems. All possible means should be adopted to minimize further additions to liquidity.

Tax anticipation bills amounting to $1.5 billion will be redeemed in September and the Treasury will not need to raise new cash until about mid-October. At that time some $3 billion will be needed, with another $3 billion in December and $2 billion in January. These amounts could be raised through issues of June and September tax bills and a final quarterly series of bills to mature in October 1960. Opportunities for longer-term issues would arise in connection with the November and February refunding operations. Moderate-sized offerings might be made for cash at some time and the proceeds used to reduce Treasury bills or other maturing issues. It is obvious that nothing over 5 years could be offered under present legislation.

If August developments are a reliable indication, the degree of restraint exerted by member bank borrowings at the Reserve Banks of around $1 billion may be adequate. It is probably unnecessary to bring about any reduction in reserve availability. Adequate pressure can probably be exerted at the present level of borrowing by keeping the discount rates above the three-month bill rate. Seasonal reserve needs may be supplied through open-market operations. If greater-than-seasonal credit demands are supplied by banks, then borrowings should be permitted to increase and the discount rate raised further. If demands are less than seasonal, then borrowings should be allowed to decline accordingly.

Projections of customary seasonal needs indicate that some additional reserves should be supplied in the next week or two. These might be met through repurchase contracts. There will be further moderate needs in October and substantial reserve needs in November and December.

Mr. Treiber presented the following statement of his views with respect to the business outlook and credit policy:

> The economic situation shows continuing strength despite the steel strike. If the strike is long, we may expect increasingly disruptive effects with a reduction in economic activity and an increase in unemployment. Yet, when the steel strike is settled, we are likely to see a new burst of expansion and an upward pressure on prices. The intensity of the pressure will depend on the length of the strike and the nature of the settlement.
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> While wholesale prices have been relatively stable, consumer prices rose in July to an all-time high. The consumer price index has risen 1 percentage point over the last three months.
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> While U. S. exports in June and July were a shade higher than a year ago, foreign countries continued to build their official and private dollar holdings at about the same rate as in the second quarter.
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> The demand for bank credit, especially consumer credit, continues to be very strong, and deposit turnover has been increasing.
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> The money market has continued tight. Member bank borrowings have averaged about $1 billion in recent weeks.
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> Prices of U. S. Government securities of practically all maturities have declined since the last meeting of the Committee. In the auction yesterday, three-month Treasury bills were awarded at an average yield of about 3-7/8 per cent; this compares with an average yield two weeks ago of a bit over 3-3/8 per cent. In the last month, yields have risen about 3/4 of 1 per cent.
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> The Treasury will need about $3.5 - $4 billion cash early in October. It will probably have to announce the terms of its financing in the latter part of September. Two issues mature November 15 and the Treasury will have to refund them early in November. If the Federal Reserve is to take affirmative action without interfering with Treasury financing, it will have opportunities to do so within the next three weeks, and within a shorter period near the middle of October.
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> Business developments, credit developments, and money market developments counsel some overt action of further restraint. Should the discount rate be raised within the next few weeks? Public discussion indicates that a number of people expect an increase in the discount rate and in the prime rate in the not too distant future. As the demand for credit increases and short-term rates advance,

increased pressure can be expected at the discount window.

The Federal Reserve should not so act, however, as to jeopardize action by the Congress on the proposed legislation to remove the limitation on the maximum interest rate on U.S. Government bonds. If there is still a possibility of Congressional action at this session, it would seem well for the Federal Reserve to avoid overt action at this time which might possibly raise extraneous issues and jeopardize the legislation. Since it is generally expected that the Congress will recess within the next couple of weeks, this basis of uncertainty should be soon removed. If the Congress does not act on the bill, the prospect of the Treasury having to do all its financing in short-term issues is another factor counseling further steps to restrain the creation of too much bank credit. If it is already clear that the Congress will not act on the bill, this fact, coupled with business, credit, and money market developments, would counsel overt Federal Reserve action soon.

The steel strike is of course an important uncertainty. Steel does not play as large a part in the economy of the Second Federal Reserve District as of other Districts. We would not want to suggest action that might be embarrassing to other Districts or that might be unwise in the light of the developing situation in other parts of the country. We look forward to hearing the discussion on this point around the table.

The same reasoning that leads us to our views regarding the discount rate would apply to a change in the directive. If a change in the discount rate is appropriate, a change in the directive should also be considered.

If such changes seem appropriate, it would also seem desirable for the System to move toward greater restraint through open market operations. The Manager might feel his way along to accomplish this. If no overt action is appropriate, it would seem desirable to maintain about the status quo with respect to open market operations.

At this point Chairman Martin reported having received advice that the First National City Bank of New York had raised its prime rate from 4-1/2 per cent to 5 per cent.

Mr. Bryan reported that statistics for the Sixth District becoming available since the last Committee meeting reflected continuation of the upward movement of the economy. In a number of cases, the district figures were up by fractions more than the comparable national figures, and only two items failed to show improvement. Construction contracts were running less than in 1958 and there had been some increase in the percentage of insured unemployment. Loan demand in the district was extraordinarily strong in all sectors, and borrowings from the Reserve Bank were running well above the Bank's "appropriate" percentage of total System discounting. From the district figures and the national statistics, he could discover no serious effects of the steel strike as yet. Some rumors were heard to the effect that metal-working industries would shortly be out of steel, but thus far no one had been able to verify these rumors. With the ending of the steel strike, there might be a very ebullient economy, going in the direction of boom, which would argue for further restraint on the part of the Federal Reserve System. However, he had difficulty in reaching that conclusion because it seemed to him that the Government securities market, for reasons in part unrelated to System policy, was in a situation where disorder verging on chaos could easily develop. He was bothered, therefore, about exercising further restraint on the general ground that such a course might at some point force the System to put reserves into the banking system to a greater extent than if further restraint were avoided at this time. Subject to change in the light of arguments that might be expressed around the table today, his preference at the moment would be not to change the discount rate.

He would move delicately in supplying seasonal requirements for reserves.

Mr. Bopp's comments were substantially as follows:

Business activity in the Third District is holding up well despite the impact of the steel strike. The Pennsylvania Department of Labor and Industry estimated that by last week 215,000 persons in that State had been idled by the strike, of whom 147,000 were steel workers. Secondary unemployment has increased only about 6,000 in the past two weeks. A special survey by the State Employment Service of practically every major user of steel in the Philadelphia metropolitan area revealed that none had been forced to curtail employment. Furthermore, most of the major users anticipated no difficulty for weeks ahead. Some small producers are beginning to feel the pinch, but few expected to be forced to cut employment by the end of August--yesterday. The potential impact in the event the strike is not settled is indicated by the fact that over 200,000 factory jobs in the Philadelphia area are vitally dependent upon steel supplies.

Unemployment in July, which does not reflect the strike, was 7 per cent in the District, as compared with 5.2 per cent nationally. New unemployment claims and continued claims in Pennsylvania declined in the latest two weeks.

Department store sales for the week ended August 22 were 12 per cent below a year ago, primarily because of unfavorable weather for shopping. Sales in the past four weeks were 1 per cent above a year ago, and for the year to date 7 per cent above last year.

There was little change in total loans of District reporting banks in the past two weeks. Business loans were off slightly. Holdings of Governments increased, presumably reflecting purchases of the recent tax anticipation bill. Total deposits were up, a substantial increase in Government deposits more than offsetting a decrease in private demand deposits.

The reserve positions of the large Philadelphia banks have been somewhat easier during the past two reserve weeks. Their basic reserve deficiency averaged around $50 million, and daily average borrowing from the Reserve Bank was $26 million and $31 million, respectively. District banks were net sellers of Federal funds in the latest reserve week for the first time since early May. Borrowing from the Reserve Bank by country banks has been decreasing; the daily average for the latest week was $5 million.

Turning to monetary policy, I have been concerned about whether we should raise the discount rate now or defer a decision until after the next meeting of the Committee. On balance, I believe it is preferable to defer a decision at this time.

There are indications that an increase in the discount rate would be appropriate. An important one is that September is probably the longest period for the remainder of the year in which the System will be free to act without interfering with Treasury financing. Treasury borrowing at short term will increase liquidity and the money supply. The money supply, seasonally adjusted, rose substantially in July and has increased more since the trough of the recession than in the same period following the 1953-1954 recession. Market rates on Treasury bills have moved well above the discount rate.

There is also evidence that current restraint may be sufficient to counteract existing and near-term prospective inflationary pressures. Percentagewise, the increases in consumer instalment credit, residential mortgages, and bank loans to business have been considerably less than in the same period of the upswing following the 1953-1954 recession. The availability of credit has been diminished not only by System pressure on bank reserves but also by high loan-to-deposit ratios which many bankers are reluctant to see go much higher. Most market rates are already above their 1957 peaks. Foreign competition is exerting fairly strong pressure against price increases of international trade products, and there seems to be fairly widespread determination to avoid another round of inflation.

There are significant advantages in deferring discount rate action until after the strike is settled. The seriousness of the inflationary threat will depend in part on the terms of the strike settlement. A substantial wage increase would almost certainly result in widespread fear of price increases. Deferring an increase until after the strike is settled would make possible a more accurate appraisal of the job to be done and would give the System more leeway for a decisive increase in the discount rate if needed to counteract the spread of inflation psychology. It would also avoid the adverse reaction likely to result from an increase in the rate while the economy is in the grip of the strike. If the Treasury does not need to borrow until mid-October, as now appears likely, there should still be time for discount rate action after the next meeting of the Committee.

For the next three weeks, I believe we should maintain about the same restraint as in the past two weeks. I would not favor a change in the directive at this time.

Mr. Fulton said that he had nothing new to report from the Fourth District regarding the steel strike. While the strike of course had the effect of throwing out of work many railroad workers, miners, and transportation workers, there was thus far no substantial unemployment resulting from shortages of steel. Steel warehousemen were experiencing no great surge of orders and the steel companies reported having had no comments from their customers. However, orders were now coming into the steel companies strongly for flat-rolled and strip steel for the fourth quarter. These products had been inventoried in considerable quantity by the automobile industry, but some other users apparently were not quite as fortunate. Rather surprisingly, there appeared to be a low rate of delinquencies in the payment of phone bills and loans in steel towns. There was no shortage of nonferrous metals, so industries depending on them were in good shape. New orders for machine tools were down slightly in July from June, but were still considerably higher than a year ago. While the backlog of orders had increased, shipments were lower due to reluctance on the part of purchasers to take delivery. In the rubber industry, where wage contracts were up for negotiation, the companies were reported to be negotiating vigorously and hoping to get a settlement. Due to the 80-day strike earlier this year, it was hoped that a recurrence of work stoppages could be avoided. There was talk of a settlement providing an increase of about eight cents an hours, and if such a settlement were proposed to the workers it was believed that they might accept. With orders for tires heavy, the companies had been working on a six-day basis to restore inventories, which had gotten quite low.

Mr. Fulton said that construction was down a little in the district although commercial and educational building construction was up. The cause of the slight downward movement was attributable mostly to a reduction in heavy engineering contracts. Department store sales were down 2 per cent in the past week, apparently due in large part to very hot weather. For the year to date, sales were 7 per cent above a year ago.

Turning to the financial picture, Mr. Fulton reported that commercial loans in the Fourth District were up. Investment portfolios were lower in order to permit the banks to make new loans. The banks had been coming to the discount window rather freely, but not to the extent that might have been expected, and borrowing was less than the 10 per cent of the System total normally expected in the Cleveland District. Part of this might be due to the fact that the Reserve Bank had discussed borrowings with some of the member banks.

Mr. Fulton stated that he would not like to see a change in the discount rate at this time, his reasoning being quite similar to that of Mr. Bopp. He would prefer to wait until after the termination of the steel strike in order to see what type of settlement was made and its potential effect on the price structure. At such time, a forthright action could be taken by the System if the settlement was not one that promised to permit a reasonable degree of price stability. He felt that the present degree of restraint, without relaxation, was appropriate and that the directive might be left in its present form.

Mr. King observed that Mr. Treiber had outlined two alternative approaches to the question of policy and said that he would be in agreement with the one which suggested avoidance of overt action for the moment. Such an approach appeared to him to carry more possibility of aiding the Treasury in obtaining the interest rate ceiling legislation that it so badly needed, and he felt that any action on the part of the System should be weighed in the light of possible passage of such legislation. With that factor in mind, he found himself in agreement with Messrs. Bryan, Bopp, and Fulton regarding the directive and also the discount rate.

Mr. Shepardson commented that there appeared to be general agreement on what the various indices showed and on the direction in which the System should be looking. Thus, the question seemed to be largely one of timing. He was not as optimistic as some others might be regarding the price situation and inflationary pressures. The price rise was going on continually, as indicated by the gradual upward crawl of consumer prices, and the wage situation was not good. Every day, reports were seen of new settlements that would add to costs. While claims no doubt would be made to the effect that these settlements were not inflationary and that the higher wages would be absorbed in increased productivity, he questioned such claims seriously and feared that costs were being built up to the point where the situation would explode. With the steel strike in progress, he realized that there might be some advantage in waiting to see what eventuated, but it was his feeling that regardless of how the strike was settled, there would still be pressures ahead. Therefore, a strong affirmative position on the part of the System probably would do no harm and possibly would be helpful in bringing about a more favorable situation. The pending interest rate ceiling legislation was, of course, an unknown quantity, and it might be argued that it would be unwise to muddy the waters until that was settled. On the other hand, it might be said that a failure of the System to act in the face of clear economic indications would be an evidence of backing water, and the System should not get into such a position.

Mr. Shepardson felt that there might possibly be a little time for the System to delay, but he hoped that the delay would not be long. Personally, he would prefer prompt action, and in any event the difficulty often experienced in getting prompt implementation after action is decided upon should be borne in mind. Therefore, all concerned should be laying the ground work for action as promptly as possible after a decision was reached.

Mr. Shepardson said that he would favor a change in the discount rate shortly. He would also favor maintaining the present degree of restraint and meeting seasonal reserve needs reluctantly. Mr. Thomas had indicated that seasonal needs in the next few weeks probably could be met through repurchase agreements, and he hoped this course would be possible. It seemed to him essential to stay ahead of the game. He hoped that the System might stay ahead of the situation better than it did following the 1953-54 recession, with a view to forestalling the results that came to pass later. The legislative situation might suggest the advisability of going slow for a week or two. When that situation was clarified, however, he would act promptly.

Mr. Robertson stated that the situation seemed very clear. The Committee was sitting on the edge of what might be almost a volcano. The economy would be burgeoning out and the System would find itself behind the game. Therefore, he felt that it would be a mistake to wait for the steel settlement before moving to a more restrictive position. It would be easy to delay on the grounds that the political situation and the strike situation loom large in the picture, but the System ought to make its decisions on the basis of economic factors, and concerning them there seemed to be no dispute. As he saw it, this was a time when the System ought to be moving, and he would like to see the discount rate increased without too much delay. Although there would be about a month in which to act without interfering with Treasury financing, it is never possible to get action "tomorrow." He would be reluctant in meeting seasonal reserve needs and would reduce the availability of credit to some extent by moving up the level of net borrowed reserves. Looking at the policy directive, he could not see offhand any change that would strengthen it. If there was a way to do so, however, he would be willing to go along with such a change.

In conclusion, Mr. Robertson expressed the view that the System ought to adopt an affirmative position of restrictiveness in order to keep on top of the potential inflationary situation ahead. Otherwise, the System would get behind the game and might never catch up--repeating the mistakes of a few years ago.

Mr. Mills said that in his opinion the immediate problem facing the Open Market Committee was that of diagnosing developments in the U. S. Government securities market and their bearing on the System's monetary and credit policy. As he saw them, those developments confirmed abundantly the concern he had expressed on earlier occasions to the effect that System policy was unduly restrictive. It had now, as regards the Government securities market, produced a situation that threatened disorder and demoralization. His concept was that the System's objective continued to be one of fostering longer-term economic growth and stability, and in his opinion there was a real question whether the System was moving consistently with that objective. If there was any doubt about the desirability of producing a credit availability that would sustain the seasonal needs of the economy, he would like to bring out that this had always been a fundamental purpose of System policy. As he understood it, the System had always met the legitimate seasonal needs of the commercial banking system when the latter was in receipt of demands for credit. Beyond that, he felt that one must look back on economic developments in the past year and take into account the fact that there had been a recovery from recession. That recovery, now moving into new ground, brought about a rise in the gross national product that had desirable and legitimate foundations. If, therefore, the System were to follow a monetary and credit policy over the years that had the aim of fostering economic growth and stability, he would question a restrictiveness that did not take into account the increase in gross national product. The restrictiveness that had stemmed out of System policy stood, if not corrected, to interfere with the kind of economic accomplishments on which the country had set its sights. With regard to comments favoring continuance of about the existing degree of pressure, that is, the status quo, he wished to call attention to the fact that discounts at the Federal Reserve Banks were running to a level averaging over $1 billion. In spite of that level of discounts and the reserves that were introduced incident to Treasury financing, there was still a level of net borrowed reserves in the area of $500 million. That level of net borrowed reserves constituted persuasive evidence that the System was persistently tending to contract the credit base. The efforts of the member banks to maintain their reserve positions had been fruitless, even with use of the discount window, and in consequence the current high level of net borrowed reserves existed. If it continued, it would produce insistent and growing cumulative pressures that would create additional complications for the Treasury in its financing and provoke a very unsatisfactory situation in the U. S. Government securities market.

Mr. Mills said that his own thinking obviously would favor modifying the kind of policy that the System had been following. Inasmuch as that policy had been instrumental in creating the conditions that technically argued for an increase in the discount rate, and since he felt that the policy was faulty, obviously he would not favor increasing the discount rate.

Mr. Leach made substantially the following comments:

> The first break this year in the continuity of the uptrend in manufacturing man-hours in the Fifth District occurred in July with a decline of 1.5 per cent. The drop in this significant indicator of economic activity was due principally to shutdowns in the steel industry. The impact of the strike in the Fifth District has been most pronounced in Baltimore where cessation of operations at Bethlehem's gigantic Sparrows Point plant and at other steel mills put over 28,000 employees out of work. In addition, over 3,700 workers in other industries in the Baltimore area were idle at the end of August as a consequence of the steel strike. Secondary unemployment has been severe also in certain areas of West Virginia where 8,200 workers were out of work because of the strike at mid-August. Despite the steel strike, however, manufacturing employment in the District rose

slightly in July, both in durable and nondurable goods. Indicative of the strong position of the textile industry was the rise in cotton consumption by District mills in July to an all-time high--some 3 per cent better than the previous high in July 1942. Department store sales in August are estimated to have held at the near-record level of the preceding month.

The usual late summer pickup in business borrowing at District reporting banks appeared in the second and third weeks of August despite the steel strike. Banks relied somewhat less on borrowings and more on liquidating securities to meet the August loan demand than in immediately preceding months.

If I knew when the steel strike will end and when Congress will act, if at all, on the interest rate ceilings, I would be better able to make positive recommendations as to policy, but I do not know these things. I believe there is great underlying strength in the economy, but I think further tightening of credit at this time would be unwise. While I would not increase the discount rate at this moment, I think that the Reserve Banks should be prepared to act promptly, and as unanimously as possible, on the discount rate if the situation should change in the next three weeks. The existing degree of restraint should be maintained through open market operations. I would not favor changing the directive at this time.

Mr. Leedy said that, having been away from the Tenth District for the past couple of weeks, he could give no first-hand report on conditions. However, it was quite evident from the available statistics that the economy of the district continued to be strong. Bank loans continued to advance and the high level of borrowing from the Federal Reserve Bank was continuing.

It seemed to Mr. Leedy that the question of a change in the discount rate involved solely a question of timing. At present the rate was obviously out of line with other market rates, and the action reported this morning on the prime rate would further intensify the need and pressure for action on the discount rate. However, he felt that this particular juncture was not the time for the System to act. First, there were the uncertainties connected with the steel strike, and the longer the strike continued the greater those uncertainties would be. Second, in the past three weeks there had been a marked change in rates on Government securities, particularly in the short end of the market. The System, he felt, should not subject itself to the charge that it had jumped in precipitately and contributed to the trend that was occurring in the Government securities market. As he understood it, there would be a period of freedom following the next meeting of the Open Market Committee for action on the discount rate. On that assumption, it seemed to him that it would be a mistake for overt action to be taken in the meantime. For the present, therefore, he would favor maintaining the status quo, neither relaxing pressure on bank reserves nor tightening the pressure. However, unless there should be a marked change in the present picture, it appeared to him that by the time of the next Committee meeting the System might be faced with the necessity of moving on the discount rate even though the steel strike had not yet been settled.

Mr. Allen commented as follows with respect to Seventh District developments:

> No significant changes in business trends in the Seventh District have been reported in the past two weeks. Consumer spending, as measured by department store sales, faltered somewhat, probably due more to the humid, disagreeable weather and timing of promotions than to a change in consumer intentions to spend.

As to residential construction, Chicago is the only major center in the District to reflect the advanced level of home construction characteristic of the country as a whole. Building in Chicago continues at recent levels, with rather surprising strength in apartment units.

The employment situation is as good as can be expected during a model changeover time for autos and during a steel strike in an area heavily oriented to metalworking. What might be called a placid attitude seems to prevail in businesses not yet affected by the steel shut-down, but vulnerable to a longer-term interruption. If a settlement is not in sight shortly after Labor Day, the employment outlook will deteriorate rapidly.

Despite disturbances in the money market accompanying the latest upsurge in short-term money rates over the past two weeks, banks in the Seventh District still show little evidence of increased pressure. Loan volume of our weekly reporting banks has continued to rise, with most of the growth in business loans. These banks have reported some deposit gains recently but most of their loan funds were acquired through continued net sales of Governments and other securities.

Business loans at our large banks were up $38 million in the two weeks ended August 19 and, in addition, loans to sales finance companies increased by $22 million. National figures for the two August weeks also show substantial growth in lending to business and to finance companies ($280 million). A mid-August bulge in business loans, in part reflecting seasonal credit needs by dealers and processors of farm commodities, has been apparent in reporting bank data in every year since 1954, but this year it follows a six-week period of almost steady expansion. Use of bank credit by manufacturers of metals and metal products has not receded from pre-steel strike levels. Reports from our large banks indicate that although repayments of inventory loans by metals producers are high, outstandings have been maintained because of a continued high volume of new loans to the metals industries.

Except for the temporary effects of purchases of the additional issue of March tax bills, investments of our weekly reporting banks have moved sharply downward throughout this month so that total credit outstanding at these banks is down somewhat. While total loans rose by roughly $100 million from August 5 to 19, securities were off about $130 million.

Reserve positions of Seventh District city banks have eased somewhat in the past two weeks. Central reserve city banks reduced borrowings and showed net sales of Federal Funds

> last week, and their basic net deficit averaged about \$25 million, compared with \$50 million two weeks ago. The net position of reserve city banks has also improved markedly in recent weeks. Reduction in borrowing has been accompanied by substantial net sales of funds--a large portion of which has gone to New York in response to heavy demands there. In the week just ended, net sales of Federal Funds by two Detroit banks averaged \$80 million per day. These banks have enjoyed strong deposit inflows; extensive use of this money in the Federal Funds market indicates that its effect is expected to be quite temporary.
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> Pressures on country banks, on the other hand, continued to intensify. The number of country banks borrowing at the discount window reached a new high of 72 in the first half of August and the volume of borrowing continues to creep upward.

With respect to policy, Mr. Allen said he was inclined to agree with Mr. Shepardson, for he was pessimistic as to what might occur when the steel strike was settled and therefore did not see much point in waiting for the settlement. Accordingly, he felt that action should be taken on the discount rate, and very soon. The increase in the prime rate was an additional factor that must be taken into consideration. While the Seventh District was an important steel area, the Chicago Bank would not be embarrassed if a Reserve Bank in some district where steel was not so important a factor wanted to take action on the discount rate. As things stood, however, the Chicago directors might prefer not to be the first to raise the rate. Directors' meetings were scheduled for September 3 and September 17, and he felt that September 17 might be the very latest that action should be taken unless developments in the interim produced a noticeable change. He would favor continuing the existing degree of restraint in open market operations. This degree of restraint had helped to produce an atmosphere in which, in his opinion, the discount rate should be raised, and raised soon.

Mr. Deming presented the following comments:

The economic situation in the Ninth District is not significantly different today from what it was two weeks ago. The effects of the steel strike are still largely localized along the iron ranges and to a degree are masked by an excellent tourist season. We are informed, however, that unless iron mining is resumed by mid-September the iron country will be in great difficulty for the remainder of the year and into 1960. An informed source tells me that under the most favorable weather conditions lake shipping cannot run beyond December 15, and the long-range weather forecast indicates that it may well close up before then. Some rail shipments may be made but not much ore will be moved by rail, partly because it cannot be mined and processed in cold winter weather, partly because rail facilities are inadequate to move much ore, and partly because rail movement is quite expensive.

The agricultural picture continues to worsen. Crop estimates as of August 10 were lower than earlier estimates. Drought conditions prevail over much of the Dakotas and into eastern Montana. Ranges and pastures are very dry, with some livestock liquidation beginning to appear. Small grain production in the Dakotas is expected to be only half that of 1958. It is true that 1958 was a record year, and that District output of grains in 1959 will be close to the 10-year average, but this is not much comfort to the farmer who has lost his crop nor to the bank that financed him.

As a matter of fact, the farm picture had apparently brought about some tapering off of the economic upswing in the District before the steel strike began, and we anticipate more slowing down in the rate of gain as the year advances.

On the national scene two factors aside from the steel strike influence our thinking--continued high unemployment and relative price stability so far. As we see it from such study as we have given employment-unemployment data, unemployment today is widely distributed both industrially and geographically. In July, 46 of 149 major labor areas

> had unemployment rates of 6 per cent or more. For comparison, in the 1954 recession there were but 53 major surplus labor areas and in 1956-57 only about 20. No doubt some, perhaps a substantial part, of the unemployment is structural, but the dispersion would seem to argue that a substantial part would be susceptible to increasing aggregate demand and thus that it can serve as a strong base for further growth in the economy without pressing severely on the labor supply.
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> These conditions in the District and the nation cause me to believe that credit policy should not aim at additional restriction at present. I would not like to see relaxation of pressure, but neither would I favor any increase in pressure. I believe that it would be a mistake to change the discount rate now, even though there seems to be some market expectation that a change is imminent. An overt act at this time would be hard to explain economically as well as politically and probably would compound the Treasury's difficulties. I see no need to change the directive.

Mr. Mangels said that there were over 80,000 workers in the Twelfth District idle on account of strikes, the highest figures since 1954. While the effects so far had been slight, one could foresee that in the relatively near future the effects of these strikes would be more detrimental. Although total retail sales increased substantially in the first three weeks of August, stocks were becoming depleted rather rapidly due to the teamsters' strike. The merchants had stocks in warehouses but no means of getting them to the retail stores. Auto sales in the first ten days of August were at a rate 5 per cent higher than in July, which in turn was ten per cent higher than June. In the two weeks ended August 19, bank loans increased $136 million, somewhat less than in previous periods. Bankers reportedly were declining to make new loans and in some cases were beginning to call some outstanding loans. While they talked a great deal about the tightness of money, perhaps the reason for restraint was more a concern about loan-to-deposit ratios and the desire to get into a more satisfactory position. Borrowings at the Reserve Bank had been quite nominal, totalling only $12 million last Thursday. District reporting banks were rather large net sellers of Federal funds last week and it was expected that they would continue to be net sellers this week.

Turning to policy, Mr. Mangels said he recognized that there was a heavy demand for credit and that the period of seasonal increase was ahead. With the settlement of the steel strike, there would probably be a further increase in the demand for credit to take care of the resumption of business and expansion of operations. However, his thinking was along the lines of that expressed by Mr. Deming. At this point the System should not ease in any way, but it should be cautious about any increase in restraint. A period was being entered when the Desk should have considerable latitude for the exercise of discretion, based somewhat on the feel of the market, particularly with the Government securities market in its present condition. The directive seemed satisfactory. With regard to the discount rate, his thinking before the announcement of the change in the prime rate was that the System could afford to wait until October, and he was still of that opinion.

Mr. Irons said that his appraisal of the national situation was quite similar to that expressed by Mr. Young and others. Despite the steel strike and other uncertainties, the situation appeared to be one of unusual strength. In the Eleventh District, activity was continuing at a high level, although with some tendency toward leveling off. This tendency, apparent in three or four sectors of the economy of the district, might be a purely seasonal thing. It may be of significance that industries such as petroleum and aircraft, which are important to the district, are operating below year-ago figures on a national basis. In the petroleum industry, for example, allowables had been set at nine days for September and probably would be set at nine or ten days in October. Also, while department store sales in July and August were well ahead of a year ago, July was at just about the same level as June. Unemployment, as a percentage of the labor force, was running lower than the national average. In agriculture the outlook was very promising, and 1959 should be an excellent year. Around mid-August, some of the statistics again showed an upward tendency, particularly department store sales, refining, and possibly employment.

On the financial side, Mr. Irons said there appeared to have been some tempering of the demand for loans, the loan growth recently having been slower than in recent previous periods. Loan-to-deposit ratios were still very high. Borrowing at the Reserve Bank ran somewhat lower during the last two or three weeks than during the preceding six-week period. While bank reserves were still under pressure, it did not appear that the pressures had been intensified. Demand deposits were up in August, reflecting a substantial increase in Government deposits and some increase in deposits of individuals, partnerships, and corporations. Bankers indicated that they were being selective in the granting of credit.

Mr. Irons commented that his thinking with regard to policy was marked by uncertainty. He felt that the performance of the Account Management had been excellent, was in agreement with the degree of restraint maintained during the past two-week period, and believed that the same degree of restraint should be continued. To the extent that deviations might be necessary, he would be inclined to prefer that they be on the side of restraint rather than ease, always keeping in mind that the Management of the Account must have freedom to respond to the feel of the market. That might prove to be difficult with the market in its present stage of weakness. Almost anything might happen and the Account Management must be alert to the situation as it developed. The reserves needed for seasonal requirements must be provided, but perhaps with reluctance.

Turning to the discount rate, Mr. Irons said he would have preferred to be in the position of recommending that the rate be left at its present level for a few weeks. However, he was not sure that the market would permit this. In other words, he could not say today that he would favor leaving the discount rate alone until

September 22, the date of the next meeting of the Committee. The bill rate was close to 4 per cent, the prime rate had been raised to 5 per cent, and other rates in the market seemed likely to adjust accordingly, with the result that there would almost be no alternative to a discount rate change. Accordingly, while he would not today recommend a change in the rate, he could hardly say that he would not favor raising the rate at any time during the next three-week period, for he did not know how much longer this action could be deferred if the System wanted to be realistic about the situation. The System might find itself with a rate thoroughly out of realistic alignment with other market rates. In view of recent market developments, he would not look upon a change in the discount rate as an overt act on the part of the System. He was not impressed by the thought that the steel strike should be regarded as an important reason for deferring rate action. On whatever terms settlement might be made, the ending of the strike would be stimulative to economic activity and the question was really one of degree.

Mr. Irons expressed concern about the Government securities market, for he doubted whether the present situation could be regarded as a temporary one. He only hoped that conditions would not grow worse. The situation in the Government securities market was to him quite an important factor when thinking in terms of the discount rate. While he had no implusive urge to rush out and change the discount rate, the facts of life and the state of affairs in the market might lead to a situation that would require doing something before September 22. Therefore, his position was almost one of watching on a day-by-day basis. It might be that developments in the market a week from now would point to a rate increase, and under such circumstances an increase in the discount rate would hardly constitute an overt action. Under such conditions, the System certainly could not be criticized on the grounds that it had led the way. Mr. Irons saw no impelling reason for changing the directive at this time. While he might not object to a change, he felt that the present directive would serve appropriately for the forthcoming period.

Mr. Erickson reported some easing in the pace of over-all expansion in the First District but no pronounced weakness. The slowing down might be due to a number of things, including seasonal factors, the weather, cumulative effects of the steel strike, and possibly a natural letdown from the earlier pace. Credit demands were still very strong.

Looking at monetary policy for the next three weeks, Mr. Erickson felt on balance that a question of timing was involved. He thought it proper to wait a little while longer on the discount rate and on a change in the directive, and he would maintain the same degree of restraint as had prevailed during the past two weeks. He would supply reserves reluctantly. The announcement of the change in the prime rate, which he had not thought would come so soon, tended to change the picture somewhat and might force action on the discount rate at an earlier date than he had had in mind. It tended to remove the quality of overtness from anything that the System might want to do.

Mr. Szymczak recalled that two weeks ago he thought the international situation, the status of pending legislation on interest rate ceilings, and the uncertainties in the Government securities market, together with certain other factors in the economy including the steel strike, suggested that it might be better to wait than to do anything on the discount rate or through open market operations. At this point, however, he doubted whether any legislation on interest rate ceilings would be obtained at this session of Congress. The best to be looked for apparently was legislation authorizing the President to increase the rates on savings bonds. If the steel strike should end, inventories would have to be built up quickly.

With the strength evident in the economy, Mr. Szymczak felt that the most that could be done toward helping the Government securities market might be to take slightly more restrictive action through open market operations, thus tending to produce net borrowed reserves of $550 million or even a little higher. He would change the discount rate to 4 per cent as soon as possible. The market, he felt, had already discounted a change in the rate. In substance, the System might help the most by doing whatever it was going to do as quickly as possible and then getting out of the picture.

Mr. Balderston said that his views were similar to those expressed by Messrs. Treiber, Allen, Irons, Erickson, and Szymczak. However, he would be inclined to change the directive at this time. He was unhappy about the continuance of a directive that had been in force for a long time when, in his view, the situation called for increased restraint.

Mr. Balderston then suggested that clause (b) of the directive might be changed to read somewhat along these lines: "to restraining actively such speculation and price advances as are inimical to sustainable growth and expanding employment opportunities." Such wording, which would contrast with that used in time of recession, would exhibit a little more vigor and realistic concern about the speculation evident in certain areas of the economy, such as real estate and the stock market. As to open market policy, Mr. Balderston indicated that he would favor more restraint rather than less.

Mr. Balderston said that he would favor increasing the discount rate to 4 per cent before the next meeting of the Open Market Committee, but after Congress had had an opportunity to aid the Treasury by the passage of legislation relative to interest rate ceilings. There was some chance, he believed, that Congressional leaders might not prefer to go home and leave the Treasury in its present plight, with no alternative except to increase further the liquidity of the economy. As long as there was even a small chance of getting legislation, he would not want to see it diminished by System action during the next few days.

However, he would prefer to see such action as the System might decide upon taken before the adjournment of Congress, for that seemed to him the courageous and forthright thing to do. With the prime rate at 5 per cent and the bill rate approximating 4 per cent, the System was left in an almost inexplicable technical position.

If there was continued reliance on the discount window, reluctant borrowers might become less reluctant as time went on, thus making the administrative problem increasingly more difficult for the discount officers. Also, he noted, System Account portfolio holdings were now at an all-time high of $26.5 billion. Taking a look at what had happened since April 1958, it could be seen that the Open Market Account portfolio increased $2.5 billion, member bank discounts and advances increased $1 billion, and excess reserves had gone down $.3 billion. On the other side of the picture, gold holdings decreased by $2 billion, currency in circulation increased by $1.5 billion, with some evidence of tax avoidance in that increase, and required reserves increased by $.3 billion. On top of this basic problem was the "near money" situation to which he had referred at previous Committee meetings. Since April 1958 the increase in bills held outside of financial institutions was in the order of $13 billion, of which about $6.2 billion was in the hands of corporations. That $6.2 billion should be considered in the light of the tax obligations of such corporations. Their tax liabilities may have gone up from perhaps $18 billion to $23 billion, which might explain most but not all of the bill holdings by corporations.

In the light of the fiscal policy that the Treasury seemed forced to follow at the moment and in the light of the speculative pressures in the economy, it was Mr. Balderston's conclusion that more restraint rather than less was indicated, especially if technical considerations required a change in the discount rate very soon. In summary, his conclusions were quite close to those of Mr. Treiber.

Chairman Martin commented that he had come into this meeting less clear in his own mind as to exactly what ought to be done than at any other recent meeting of the Committee. This was partly because he found it difficult to separate the monetary politics from the economics of the situation. It was hard to know exactly what the cross currents were, and he was no better informed than the other members of the Committee concerning what might happen with respect to the interest rate ceiling legislation. However, one aspect of the present situation was clarified somewhat by the action of the First National City Bank on the prime rate this morning. He had no idea this was coming, and had hoped it would not. He now questioned whether the System could be in the position of ignoring the market and continuing to sit on the sidelines, as it had been doing for some time. While there was a question whether the current trend in interest rates would continue, it was also questionable whether the System could continue in a strong position if it waited until after the next Committee meeting to act, assuming that it was going to act. The Treasury would begin its meetings with the banking and investment advisory committees at the end of September. With the steel strike, political implications, and other factors in the picture, it would perhaps have been desirable to have a waiting period. However, assuming that the present range of bill rates was going to continue and that other banks would follow First National City in raising the prime rate, there would be a real administrative problem for the System with member bank borrowings in the neighborhood of $1 billion. It would be possible, of course, to move in the opposite direction, as Mr. Mills suggested. This would involve deciding that the degree of tightness of System policy had not been warranted and moving aggressively toward ease to validate a lower level of interest rates. Assuming, however, that the majority did not want to move toward validating a lower level of rates and was not dissatisfied with current policy, the question that concerned him was whether the Federal Reserve should lead or follow or do neither--just rock along.

The question, the Chairman repeated, was whether the System could disregard the state and trend of the market, including the prospect that the bill rate might go to 4.25 per cent, and say that because of the steel strike and other factors it would be content to maintain a discount rate of 3-1/2 per cent. To him this did not seem practicable or desirable. Also, it seemed questionable whether, under those conditions, a change in the discount rate could be regarded as an overt act on the part of the System.

Chairman Martin said he was not certain whether he could go along in the thought that additional pressure should be put on the market. There was some question in his mind as to what would be achieved other than to complicate and further upset a market that was likely to have a good many cross currents without such action. He did not think that the market was disorderly or on the verge of being disorderly at this time. The market, however, had a good idea as to the likely trend of interest rates based on trends in the economy that it saw developing. Under such conditions, he had some question about putting additional pressure on the market. Instead, he would prefer to see about the present degree of pressure continued, with no overt action as to the level of reserves. Assuming, however, that the current bill rate turned out not to be just a temporary phenomenon, a question on which more light would be shed by the auction this Friday, the next ten days or so might produce a situation where a change in the discount rate clearly was called for. Assuming that the current level of interest rates was maintained, he would be disposed to favor an increase in the discount rate to 4 per cent some time soon after Labor Day irrespective of developments with respect to the steel strike or political implications.

The Chairman said that personally he did not see any reason to change the directive at this time. While he would have no strong objection to a change, he would hesitate at this juncture, with the steel strike and other factors in the picture, to assert definitely that the System was going to put additional pressure on the market. This was a matter of judgment and he could only express his own view. Nevertheless, the Committee must be alert and alive to what was going on, unless it wanted definitely to change its policy.

Chairman Martin expressed agreement with Governor Balderston's thought that it would be desirable to act on the discount rate, if possible, before the adjournment of Congress rather than to take such action just after adjournment. However, such things can not be timed precisely. He had reached the conclusion that it is good politics to do what you think is right.

The Chairman suggested that the System not retrace its course at this juncture unless it believed that the course it had been following was wrong. Instead, the System should follow the course forward to a sensible and intelligent conclusion. Personally, he would not want to intentisy restraint at this time, but he would recognize the realities of the present market. It was hard for him to see how the System could justify waiting on the discount rate for three or four weeks if the commercial banks were going to 5 per cent on the prime rate and Treasury bill rates were in the area of 4 to 4-1/4 per cent. To wait too long under such circumstances would make all the System's points about changes in the discount rate appear to be Alice in Wonderland operations and would open the floodgates to contentions that discount rate policy was not needed, just administration of the discount window.

The Chairman then raised the question of resolving the cross currents at this meeting and said that, if the Committee so desired, he would be prepared to take a vote on the question of leaving the directive in its present form.

Mr. Robertson commented that it would make a difference, in considering the directive, whether the Committee wished to move toward more restrictiveness on reserves. As he understood the discussion, the large majority did not favor moving in that direction. The directive should not be changed to indicate overt action if such action was not going to be taken.

Mr. Balderston said that he thought Mr. Robertson was correct. That was why, at the outset of his remarks, he (Mr. Balderston) indicated that he thought he was out of step with the majority of the Committee in his feeling on this point. He felt definitely that the majority did not want to change the directive or to increase the degree of restraint.

Mr. Szymczak said that he would favor increasing the pressure on reserves somewhat, but not much. He would like to see net borrowed reserves rise to perhaps $550 million but not much more than that. He would not change the directive, which he thought was satisfactory.

Mr. Shepardson said that he liked the phraseology Mr. Balderston had suggested for the directive. However, he felt that such a change probably would be more in order at the next meeting than this one.

Chairman Martin commented that he thought this statement was quite correct. He said that in endeavoring to summarize the meeting he had tried to recognize monetary politics, economics, and various statements around the table. In doing so, it struck him that it would not be well to change the directive at this point. If this meeting were one that was reported to the public, he did not think that justification could be shown for a change.

The Chairman then stated that, if there were no serious dissents, the present wording of the directive would be retained. No comments were heard in response to this statement.

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 restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities, 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.

Turning to the level of reserves, Chairman Martin stated that it appeared the Manager of the Account would have to use his own judgment. Mr. Szymczak apparently was the only member of the Committee who would like to see net borrowed reserves go up to $550 million.

With regard to the discount rate, the Chairman noted that agreement on the rate is not a subject for action at meetings of the Open Market Committee. It could only be said that a majority of the members of the Board of Governors evidently would be disposed to look with favor on an increase in the discount rate some time after Labor Day.

Mr. Robertson added the comment "soon after Labor Day and before Congress adjourns."

At the instance of Mr. Treiber, there followed comments as to the dates when directors' meetings were scheduled at the respective Reserve Banks.

Chairman Martin noted that the discussion at this meeting had included references to future actions that might or might not be taken.

For this reason particularly, he urged caution on the part of those in attendance with respect to discussing the meeting with other parties.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, September 22, 1959, at 10:00 a.m.

Chairman Martin then referred to the discussion at the Committee meeting on August 18, 1959, regarding the appropriate degree of accessibility to the discount window for member banks acting as "underwriters" in connection with Treasury financings and inquired whether anyone had additional points that he would like to make at this time. There being no comments in response to this invitation, the Chairman indicated that he thought the matter could be left as it stood.

At the Chairman's request, Mr. Leach commented, for the information of those present, concerning a visit paid to the Federal Reserve Bank of Richmond on Friday, August 21, by Congressman Patman and several of his colleagues from the House of Representatives. Mr. Leach also referred to a letter received subsequently from Congressman Oliver of Maine, a member of the group, in which Mr. Oliver raised a number of questions with respect to the status and operations of the Richmond Bank. Mr. Leach said it was the intention of the Bank to answer those questions to the best of its ability on an independent basis but that copies of the Bank's reply would be sent to the Board and to the other Reserve Banks.

Chairman Martin also referred to letters sent recently by the Under Secretary of the Treasury to the Board and the Reserve Bank Presidents requesting comments regarding suggestions of Senator Javits of New York relating to a "peace bond" campaign as part of the savings bond program. The Chairman said that it might be well for the Presidents to send copies of their replies to the Under Secretary to the Board for its information.

At least one of the Presidents indicated that he was considering taking advantage of language in the Under Secretary's letter which suggested that a reply was optional. Question was raised with the Chairman whether he had in mind that the Open Market Committee should respond, and Chairman Martin replied that he did not envisage such a response unless the Committee was disposed to make one or unless Senator Javits should pursue the matter.

The meeting then adjourned.

Winfield W. Riefler

Secretary