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 26, 1960, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman 1/
Mr. Allen
Mr. Balderston
Mr. Deming
Mr. Erickson
Mr. Johns
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Bopp, Bryan, 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. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thomas, Economist
Messrs. Jones, Marget, Mitchell, Noyes, Parsons, and Roosa, Associate Economists

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

Messrs. Eastburn, Hostetler, Daane, Tow, and Einzig, Vice Presidents of the Federal Reserve Banks of Philadelphia, Cleveland, Richmond, Kansas City, and San Francisco, respectively

1/ Entered meeting at point indicated in minutes

Mr. Larkin, Assistant Vice President, Federal Reserve Bank of New York
Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Economist, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 12, 1960, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period January 12 through January 20, 1960, and a supplementary report covering the period January 21 through January 25, 1960. Copies of both reports have been placed in the files of the Committee.

In commenting on developments since the preceding meeting, Mr. Larkin made substantially the following statement:

Developments since the last meeting of the Committee have been set forth in the written reports previously distributed. I would like to emphasize, however, the sharp drop in short-term interest rates and the substantial reduction in the System Account holdings that have occurred since the last meeting. The average three-month Treasury bill rate in yesterday's auction was, in round numbers, slightly below 4-1/8 per cent compared with about 4-5/8 per cent two weeks ago. Moreover, I am informed that the rate has dropped to 4 per cent on the offered side in trading this morning. The rate on six-month Treasury bills was slightly less than 4-5/8 per cent in yesterday's auction as against almost 5 per cent two weeks ago. This issue may be down to about 4-1/2 per cent in the market this morning. This sharp decline in short-term rates has occurred despite the substantial decline in System holdings over this period. This decline amounts to almost $1 billion on a delivery basis over the

two weeks. Needless to say, there has been a tremendous demand for Treasury bills. This demand has stemmed largely from nonbank investors, including corporations, public bodies such as States and municipalities, and also individuals. Individuals showed a large interest in the most recent auction of one-year Treasury bills.

The market is now focusing on the approaching Treasury refunding of over $11 billion February certificates, of which the System holds about one half. Market expectations point to an optional exchange offering of two issues--a one-year certificate and a four-five year note. The rate expectations are in the neighborhood of 5 per cent.

The market for bankers' acceptances has recently been under less pressure and dealers' portfolios have been reduced. However, rates on bankers' acceptances have not followed Treasury bills downward. We have had the strange situation over the past few days of one dealer having moved acceptance rates lower by 1/8 per cent, with the other four dealers declining to follow this move, leaving their bid rate at 5 per cent.

There is just one further matter that I should like to call to the Committee's attention, and it has to do with a technical situation in the Government securities market. The large scale interest in Government securities on the part of individuals, which first found real reflection in the so-called magic fives and other recent high-coupon obligations, has also resulted in a large number of small transactions executed by dealers. The dealers claim that these transactions have taxed their facilities, which have been designed over a period of years for wholesale distribution, rather than retail distribution in small amounts. In an effort to spread out the amount of back office work, some of the dealers announced yesterday a new procedure in the handling of so-called small transactions. Effective February 1, they will put transactions of less than $25,000 on a skip-day delivery basis. That is, delivery and payment on these small transactions will be made on the second business day following the execution of the transaction in contrast with regular, or next-day delivery that has hitherto prevailed in the market.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period January 12, 1960, through January 25, 1960, were approved, ratified, and confirmed.

During the course of Mr. Larkin's comments, Mr. Hayes joined the meeting.

The staff economic review at this meeting took the form of a visual-auditory presentation, the participants in which included Messrs. Thomas, Young, Marget, and Noyes along with Messrs. Garfield and Williams of the Board's Division of Research and Statistics. Subsequent to the meeting, copies of the text of the presentation and the related charts were distributed to the members of the Committee and placed in the Committee's files.

Mr. Noyes opened the presentation with the following statement:

> In recent weeks the spotlight of economic news has moved from the steel strike to the budget. Certainly the shift from a cash deficit of $13 billion in fiscal 1959 to an approximate balance this year and the prospect of a substantial surplus for next year is dramatic. This shift reflects, in considerable part, important developments in the general economic situation.
>
> For more than a year after the recession low in April 1958, the physical volume of industrial production rose rapidly and without interruption to a level in May and June 1959 appreciably above the previous high in 1957. By December, production was close to the May-June level of 166 and in January output is expected to rise further to about 168.
>
> Taking a quick look at the whole postwar period, we see that the broad general sweep of industrial production has been upward--most rapidly during the early postwar years and the Korean War period--and that this broad upsweep has been interrupted by three recessions--in 1949, 1954, and 1958. The Board's recently revised index shows somewhat more growth than the earlier index, reflecting inclusion of the rapidly growing utility industries along with manufacturing and mining, and, more important, upward adjustments based on study of comprehensive Census data.
>
> The 1958 recession was sharper than those of 1954 and 1949. The subsequent recovery was rapid from the start and

only a year and a half after the recession began a new high was reached. Part of the rapid rise reflected the laying in of stocks of steel for some months before the plants closed down last July--more stocks than anyone guessed at the time.

During the strike, total industrial production declined sharply as steel output slowed to a trickle and output levelled off in most industries not directly affected by the strike. Housing starts, by summer already edging off following an extraordinary advance, declined sharply in early autumn but they recovered part of the decline at year-end. Nonagricultural employment declined temporarily from highs reached earlier, and so did retail sales, but they should turn up this month as autos become more readily available. Sensitive materials prices, which early in this recovery period had risen a little more than in the 1954-55 recovery period, showed little change after spring last year. Common stock prices declined after reaching new highs in early August, recovered when steel production was resumed in early November, and most recently have been declining again.

Interruption in economic expansion and uncertainties concerning prospects during the strike period were reflected not only in stock markets but in financial markets generally. After rising moderately in early 1959, the active money supply--demand deposits and currency--levelled off in late spring and, except for a temporary advance in July, subsequently showed little change. From spring to autumn, turnover of deposits also remained relatively stable, and then it advanced somewhat. In security markets, the strike provided an occasion for investors to re-evaluate profit and stock price prospects relative to the high returns available on bonds and other fixed claims. The spread between bond and stock yields, which had widened considerably over the first half of 1959, did not increase much after midyear. Short-term interest rates increased further, partly because Treasury financing was concentrated in short- and intermediate-term securities.

Now near-capacity output at steel mills is beginning to ease shortages and is providing steel for expanded output of autos and other metal products. Industry officials have stated that no immediate general increase in steel prices is expected. The new contract, they estimate, involves increases in employment costs per manhour of around 3-1/2 to 3-3/4 per cent per year. This increase is substantially below those of other postwar steel settlements. Also, it appears to be similar to or somewhat below increases negotiated in

other industries recently. One important change in the contract is a revision in the escalator clause limiting sharply the amount of any automatic wage increases to offset possible cost-of-living increases.

Meanwhile, in Western Europe and elsewhere abroad, production and consumption have risen to new highs, and available resources are being utilized more fully, probably reducing the intensity of foreign competition, which has been one of the factors tending to limit price advances in this country.

The presentation continued with discussion of recent developments abroad and their relation to the United States balance of payments, followed by a review of demand forces operating in the domestic economy, price trends and prospects, the extent of utilization of resources, and the developing situation in the financial area.

Mr. Thomas concluded the presentation with a statement substantially as follows:

Recovery in production and employment from strike levels has been rapid and a new high for gross national product of nearly $500 billion is expected for the first quarter of 1960. Unquestionably it will go higher before the year is over. It could approach a level as high as $520 billion by the end of the year without placing undue strains on available resources. A major question is whether the expansion will be sustainable or whether it will go so fast and so far as to bring about widespread advances in prices and important imbalances in the economy with unfortunate consequences later.

A question of particular concern to this group is: How much credit will be needed to permit adequate expansion to occur and still prevent the development of unsustainable credit commitments? Growth in the money supply since last spring has been limited in part by Federal Reserve actions. At the same time monetary needs were held down by influences growing out of the strike and the gradual wearing down of cash balances that had been built up in excess of current transaction needs in 1958. Velocity of money increased early in the year and again at the end of the year.

In addition, higher interest rates have brought forth a substantial volume of funds for lending from nonbank sources so that credit supplies in the aggregate have been exceptionally

large. Much of the nonbank lending and investment has been in liquid form representing what are in effect money substitutes. Considering the financial and business situation generally, it seems likely that demands for bank credit will again increase and if expansion proceeds moderately and in an orderly manner, it might occur without resurgence of price increases and speculative developments such as often characterize this stage of cyclical expansion. But this prospect is not assured.

The postwar period as a whole has seen economic activity and prices of goods, services, and capital assets under strong demand pressure. This pressure was fed by an exceptional supply of bank deposits and other liquid assets at the end of the war and a continuing large flow of credit. It was accompanied by diminishing fear of unemployment and of incurrence of debt by consumers and businesses, and of financial losses from sharp economic reverses. As each postwar recession proved short-lived and moderate, many people came to believe that rapid growth in the economy was assured, and that creeping inflation was almost inevitable.

In 1960 we may again be faced with cumulative expansion in demand and strong upward pressures on prices. Unlike 1956, when auto production and housing starts declined while business capital expenditures were rising sharply, 1960 may be a year when rapid business inventory accumulation, expanding business fixed capital outlays, rising net exports, and strong consumer preference for new cars may all hit with great force at once, while residential building may level off or decline only a little.

If this should happen, demand pressures on industrial capacity margins and existing supplies may be intensified, bringing about resurgence of inflationary price tendencies and also revival of speculative investment in capital assets other than fixed-income obligations. While the margins of unused capacity and unutilized manpower available to meet such reinforced demand pressures are larger now than in 1954-55, these margins are still not very great.

These margins of capacity could be eliminated rather quickly if monetary and other financial conditions were to permit a concentrated surge of demand to develop and to encourage inflationary expectations. Last year the money supply increased little and by the end of the year was lower relative to GNP than at any other time in the postwar period, although still higher than in the 1920's.

While the money supply rose little last year, there was a rise of 6 per cent in the rate of money turnover and there was a substantial further increase in holdings of other liquid

assets. The higher velocity of money enabled the economy to transact a larger volume of business with little increase in money balances, while the increase in holdings of other liquid assets indexed a growing volume of funds invested in a form permitting ready transfer to other uses if inflationary expectations are resumed.

Conceivably, however, the view in financial markets that has generally prevailed in recent years might not be resumed. The higher interest rates and the abnormal shift in relationships between bond and stock yields might bring about a re-evaluation of the capitalized value of income from capital assets. Moreover, it might turn out that the economic situation before the strike was not as expansive, nor our international payments problem as temporary, as many observers have thought, and that the strike was in fact a dramatic reflection of fundamental change in business and financial appraisals of our domestic and international prospects. If this should prove to be true, resurgence of activity on the basis of inventory rebuilding could not be long sustained.

A more hopeful possibility for 1960 than either an inflationary upsurge or an early reaction is that we shall be fortunate enough, now that recovery from the strike has been largely achieved, to have further expansion in demand come serially instead of all at once. In much of the postwar period, economic developments have been characterized by this sort of rolling adjustment rather than by concentrated changes in which all major sectors move together.

For this year, it would be hoped that inventory accumulation, contributing to an initial rise in general activity as output of autos and other metal products rises, would soon slow down. Such a decline in the rate of inventory accumulation would make available resources for other prospective increases, including larger consumer expenditures generally, increased State and local government outlays, continuing expansion in capital outlays, and increased net exports. A developing Federal Government surplus should facilitate the financing of larger expenditures in these areas.

Returning to the question raised earlier, how can bank credit and money supply changes be geared to permit and foster the most desirable of these developments? With fiscal policy contributing to the supply of savings rather than to the demand for them, the task of monetary policy should be easier in 1960 than in 1959. Treasury debt retirement may reduce some of the liquidity in the economy, particularly that of business, whose larger tax payments will be a factor in the budgetary surplus. Perhaps some renewed growth in cash holdings will be needed, although prevailing high interest rates may continue to draw existing balances into more active use.

It is evident that to date, prevailing restraints on credit expansion have not been too severe. Credit developments in December indicated the strength of demands. It appears highly likely that in the immediate future credit demands will be so vigorous as to require continuing restraint in order to avoid excesses. Available data for January to date, however, show an appropriate seasonal reversal in bank loans and total credit. In addition, the marked easing in bill rates in the face of very heavy System sales indicates the absence of very strong demand pressures so far. These developments suggest that additional restraints are not yet needed. The feeling of tightness in credit markets seems to be acute and it is appropriate to consider whether there is a risk of not supplying the basis for enough bank credit. Can we continue to rely on growth of savings, increasing velocity of the money supply, and the willingness of member banks to increase their borrowings to meet the credit demands needed to support the amount of expansion in economic activity that may appropriately occur in the year ahead? The whole situation at home and abroad is a dynamic one and calls for the closest scrutiny of current developments in shaping policy actions.

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

In general I think we can find encouragement in the economic developments of the past two weeks, granted that no firm judgment of the outlook can be based on so short a period. Business has continued to improve, but at a moderate rate, while there have been fewer signs of strain in the credit and capital markets than there were a few weeks ago.

Most of the recent improvement in business may be looked on as the natural result of the steel settlement and the rapid recovery of both output and deliveries in that industry. It looks now as if steel inventories would be pretty well replenished within the next three months. Meanwhile, there are some doubts as to the buoyancy of demand for automobiles and for consumer durables in general; and the initial fears of inflationary results of the settlement are giving way to some extent to increased talk of price competition. The stock market has been losing ground, with some continuing disposition on the part of investors to give a little more attention to bonds. The decline in housing starts may lessen, for a time at least, the pressures for long-term funds.

I realize that it would be quite premature to conclude that the threat of a boom, supported by inflationary credit

growth in 1960, has been removed. There is a tendency at this season of the year for business attitudes to be less buoyant than at other seasons, and there is also a general tendency for interest rates to move lower. We shall have to watch carefully developments of the next few weeks and months to see whether the present moderate tendencies are merely seasonal; but at least there is more hope than in some time that Federal Reserve policies of the last eighteen months are beginning to show results, with strong support now from the prospective budget surpluses.

The most recent data on bank credit suggests some slight slowing in January of the vigorous expansion of loan demand witnessed in December. As we have noted before, the money supply showed almost no growth in 1959, but if we average the results of 1958 and 1959 we find a more or less "normal" growth for the two-year period. The banks are of course much less liquid than at the start of the two-year period. It is harder to judge the present degree of liquidity of the non-bank sector, with larger corporate holdings of short-term governments offsetting to some extent the clearly reduced liquidity in terms of bank deposits alone. All things considered, I would hope that the seasonally adjusted money supply could be allowed to expand moderately in the next few months but within the general framework of our policy of credit restraint. Perhaps we should give some attention to the desirability of a slight growth in total reserves, on a seasonally adjusted basis, along the lines of Mr. Bryan's and Mr. Johns' comments at the last two meetings.

For the next two weeks I would think that open market operations should be directed toward maintaining about the same degree of pressure on the money market and on bank reserves. We should probably guard against interpreting lower Treasury bill rates as an accurate measure of reduced money market pressure, in view of the large part played in the Treasury market by corporate funds and the fact that the banks as a whole remain in a very tight position. As usual, I would hope that the Manager would be given ample leeway in carrying out the general policy of maintaining the approximate existing degree of restraint.

No change in the directive seems to be called for. The same reasons which led to our decision at the last meeting to take no action on the discount rate are of course still valid. While last Thursday's one per cent increase in the British bank rate may have a considerable influence on the flow of short-term funds between the United States and Europe, I don't think that it calls for any offsetting move on our part in the near future. There will be an opportunity to reconsider the

> rate question after completion of the Treasury's February refunding, by which time we shall have the advantage of broader evidence of economic and credit developments following the strike settlement. Meanwhile the decline in market rates of interest has brought the discount rate into better alignment with our open market policy as reflected in market pressures and the level of market interest rates. The System is now in a good strategic position from which to move if we find that we must deal with inflationary credit demands as we get further into 1960. For the time being, watchful waiting would seem to be our best course.

Mr. Erickson reported that the First District business situation continued to show improvement. Although year-end figures were not yet available on production, construction, or employment, the Business Week survey for 1959 indicated that New England had an increase in personal income of 7.8 per cent over 1958, which was higher than the national average. However, according to the Department of Commerce survey figures for the three previous years, the New England area was slightly under the national average. The December survey of mutual savings banks indicated a deposit increase of 5.1 per cent, the lowest year-ago comparison since February 1958. From that point, the comparisons rose to almost 7 per cent in October 1958, but since then there had been a decline each month in the rate of increase. Even so, the rates of gain had not dropped to the low point of the previous boom period of 1957. During the past two weeks, district banks were moderate sellers of Federal funds and there was slightly greater use of the discount window. Borrowings during this period averaged $5 million higher than in the previous period, due primarily to borrowing by some of the larger city banks.

Mr. Erickson indicated that he would not favor a change in the discount rate or in the policy directive at this time. As to open market operations, he would continue to maintain the same degree of restraint, neither easing nor increasing restraint in any way.

Mr. Irons said that following a moderate strengthening in December, which resulted in making 1959 a record year, Eleventh District developments in early January indicated further moderate growth. The banking situation appeared to be a little tighter than in the preceding few weeks. District banks lost deposits rather sharply during the first three weeks in January, there was some decline in loans, perhaps about seasonal, and heavier member bank borrowing reflected increasing use of Federal Reserve credit by three or four of the larger banks. Whereas borrowings had previously been running about 5 or 6 per cent of the System total, during the past two weeks they were in the range of 10 to 12 per cent.

Mr. Irons thought that he detected a few straws in the wind indicating increasing concern among businessmen and bankers with respect to consumer credit. A scattering of letters and comments from country bankers and officers of a few of the larger banks revealed some concern about the rapid growth of such credit.

Mr. Irons said that he was quite satisfied with open market operations during the past two weeks. Taking into consideration all factors, including the imminent Treasury financing and interest

rate developments, he favored continuing to maintain the status quo as nearly as possible, with no change at this time in the discount rate or the policy directive. In open market operations, he would continue to maintain about the same degree of restraint, with the Manager of the Open Market Account given sufficient leeway to meet situations as they might arise in the market. He was hopeful that there would be no increase in the degree of restraint; if it were necessary to have deviations, he would prefer that they fall on the side of easing.

Mr. Mangels commented that there had been no particularly unusual developments in the Twelfth District in the past two weeks. The research people thought they sensed some modification of the feeling of optimism that had existed earlier with respect to a general business boom during the coming year. However, district employment in December was higher than in November, when employment was already at record levels. The December rate of unemployment in the Pacific Coast States, 4.4 per cent, was the lowest since the late summer of 1957. For the first two weeks in January, district reporting banks showed a $450 million increase in demand deposits but a drop in time deposits of $266 million, mostly out of savings accounts at California banks. The decline represented 3.2 per cent of total savings deposits as of the end of 1959, whereas the banks had expected that they might lose as much as 10 per cent. Most of the funds appeared to have gone into Government securities and into

savings and loan associations now paying dividends at the rate of 4-1/2 per cent. As of the end of the year, savings and loan associations were borrowing almost $700 million from the Federal Home Loan Bank of San Francisco, but they repaid between $200 and $300 million by January 15. The repayments were made principally out of new money obtained from savings deposits at commercial banks and from payoffs of outstanding loans. Reporting banks showed a loan decline of nominal amount in the first two weeks of the year and sold Government securities to the extent of $150 to $160 million; the decline in loans was about half as large as during the same period in 1959. Purchases of Federal funds were running about twice the rate of sales. Borrowings at the Federal Reserve Bank increased in the first three weeks of 1960, and were about three times as large as during the comparable period of 1959, averaging $115 million per day. Whereas borrowings normally run from 3 to 4 per cent of the System total, during this recent period they reached 13 per cent of the System total. Some of the borrowing by city banks reflected the substantial loss of savings deposits.

Mr. Mangels said he continued to feel that there should be no change in the discount rate at the present time. He was rather pleased that the level of net borrowed reserves turned out to be somewhat lower than the goal seemingly indicated at the January 12 Committee meeting. He would not recommend any substantial increase in net borrowed reserves, preferring to regard $400 million as a ceiling for the next

two weeks, and he would favor no change in the policy directive at this time. An influence reflecting itself in his comments was the fact that the Treasury was coming into the market.

Mr. Deming reported that at a recent meeting of steel warehouse executives in the Twin Cities it was generally agreed that shortages of structural steel were disappearing rapidly and all types of steel stocks in the region might be rebuilt nearer the beginning than the end of the second quarter. Cold-rolled sheets and bars were still short and manufacturers buying directly from mills still encountered difficulty in getting enough of specific types of steel, but even this picture seemed to be changing rapidly. District sales managers of automobile manufacturers who serve most of the Ninth District from the Twin Cities also met recently, and it was reported that stocks of new cars at dealers had built up more rapidly than anticipated. Most of the participants reported that January sales thus far were well below quotas, and there was talk of special promotions in February. The used car market was dull. Managers of Minneapolis and St. Paul Builders Exchanges, who serve the Ninth District, reported that building plans filed with them in January indicated a high level of nonresidential construction activity in the first half of 1960, probably higher than in the comparable period of 1959.

Mr. Deming pointed out that the seasonal high in unemployment in the Ninth District comes in the early part of the year. Estimates

by the Minnesota Department of Employment suggested a somewhat lower level of unemployment in January, February, and March 1960, than in the same months of 1959, and a substantially lower level than in the first quarter of 1958. Nevertheless, it was anticipated that unemployment would be 20-25 per cent larger than in the same high months of 1956 and 1957. Farm operations were at a seasonal low, but moisture conditions were better and the snow pack in the Montana mountains was large. Although cash receipts from marketings continued to run well behind a year earlier, the gap had narrowed somewhat, apparently reflecting seasonally large cattle movements at favorable prices. Farm machinery dealers and distributors expected sales to be off from 1959 levels by one-third to one-half in the areas hit by last summer's drought, and from one-fourth off to even in other sections. Farm land prices showed some signs of leveling off.

Mr. Deming recalled having reported at the January 12 meeting that at the close of 1959 district bank loans were up and deposits and security holdings down as against a year earlier. He said that in 1959 loan-deposit ratios rose from 46 to 58 per cent at city banks and from 42 to 46 per cent at country banks, giving a total district ratio of 50 per cent at the end of 1959, the highest since 1932. Borrowings from the Reserve Bank and from other sources were quite heavy throughout the year, particularly in the second half; during this period total loans at district city banks

rose less than half as much as at all city banks and business loans actually declined in contrast to a national gain. These points underlined Mr. Deming's feeling that Ninth District banks lost substantial liquidity in 1959. In the first two weeks of January, however, city banks showed deposit gains in contrast to the experience in early 1959.

Turning to policy, Mr. Deming said that the phrase "watchful waiting," as used by Mr. Hayes, represented about what he would suggest for the next two weeks. He would favor no change in the discount rate or in the policy directive at this time, and he would like to see open market operations conducted as close to the pattern of the past two weeks as possible. Any deviations, in his opinion, should be on the side of ease, and there should be no further tightening.

Mr. Allen made the following statement with respect to Seventh District developments:

> The stronger bond market and the weaker stock market do not appear to reflect a deterioration in general business sentiment in the Seventh District. January is expected to show a further increase in total output and employment to new records on a seasonally-adjusted basis. General merchandise sales appear to have continued strong in January. Housing permits in the Chicago area improved relatively in December in that they were only 13 per cent less than in the year-earlier month in contrast to a 55 per cent drop in November.
>
> However, automobile sales are regarded as disappointing. The daily sales rate for the second 10 days of January, not yet available, is thought to have been up about 10 per cent from the 16,900 rate of the first 10 days, still considerably below the hoped-for figure. Unless sales improve before long, production cutbacks seem certain.

> Sales of new farm machinery declined in the last quarter of 1959 compared with the same period in 1958, but some of our manufacturers of such machinery continue to expect a very satisfactory year in 1960.
>
> The contraction of loans at weekly reporting banks has been less in the Seventh District than in other parts of the country. Loans at our banks in the first two weeks of January were down only half as much as last year, whereas in other districts they have dropped twice as much as last year. Our banks have continued to liquidate Government securities and holdings of Treasury bills by Chicago money market banks are nominal. That is understandable with the reserve positions of the Chicago central reserve city banks under pressure. On the other hand, our reserve city and country banks are in an improved position and their use of the discount window has declined. Only 56 out of more than 900 country member banks borrowed in the period ended January 13, the fewest since early October.

Mr. Allen said that in the absence of untoward developments, he would favor continuing through the next two weeks the policy agreed upon by the Committee at its January 12 meeting. He would favor no change in the discount rate or the policy directive at this time, and he would endeavor to maintain approximately the same degree of restraint that had prevailed during the past two weeks.

Mr. Leedy reported severe winter weather in the Tenth District during the past ten days or two weeks, with a snow cover over virtually the entire area. For agriculture, this was on balance a healthy situation, particularly for winter wheat. As in neighboring districts, there had been less liquidation of loans this year than in the comparable period of 1959, this being particularly true with respect to the business loan category. In that category, however, there was smaller growth late last year than throughout the nation generally.

As in the San Francisco District, there had been a decline in savings deposits at Tenth District banks. One might have expected something of a clamor for an increase in the maximum permissible rate of interest, but in the Tenth District there had been no such clamor. Presumably the banks were hopeful of tax equalization legislation to improve their competitive position vis-a-vis the savings and loan associations.

Mr. Leedy said he subscribed to the comments made previously at this meeting that favored continuing the policy of the past two weeks.

Mr. Leach reported that Fifth District business conditions had shown continuing expansion, with little or no evidence as yet that the expansion was being sparked by speculative activity. The textile industry continued to be an important element of strength; orders had been booked into the second half of the year, and even beyond in some instances. The outlook for the furniture industry was the best in years, with unfilled orders at the highest level ever reached. A preliminary estimate indicated that district cigarette production in December set a new record for a single month; the fact that cigarette consumption continued to increase faster than population augured well for the future growth of the industry. Bituminous coal production in the closing weeks of 1959 established new production highs for the year.

Mr. Leach said that Fifth District member banks ended the year 1959 in a much tighter position than a year earlier. Loans

were up 12 per cent, security holdings were down 8 per cent, and the loan-to-deposit ratio advanced 5 percentage points. He was convinced from talking with bankers and from seeing instructions issued to loan officers in State-wide institutions that System policy was pinching at most of the sizable banks. Borrowings from the Reserve Bank this month, averaging around $20 million, were no higher than in corresponding periods of the last two years, but this was due in large part to certain actions taken by the Reserve Bank in recent weeks in the administration of the discount window. Although district banks reported that thus far they had not seen too much increase in the way of loans to build up inventories, they expected it. This was one of the factors making them feel that they were in a tight position.

As to policy, Mr. Leach expressed the view that the imminent Treasury financing clearly called for maintaining an even keel. He would not want to be any tighter at the moment, however, even if the Treasury financing was not in the picture. As he saw it, System policy was biting to about the right extent. The System was in a good position to wait and not get any easier or tighter at the present time.

Mr. Mills said he was puzzled about the slight flavor in today's discussion that veered toward stimulating some increase in the money supply but in the same breath recommended a monetary policy of status quo. He was unable to reconcile the two objectives,

because to maintain the status quo policywise apparently would produce a level of negative free reserves somewhat in excess of $500 million for the current reserve week. Therefore, as illustrated by the figures, maintenance of the status quo obviously would mean no relief from the pressures that the commercial banking system and the economy in general had been subjected to by System monetary and credit policy. He felt personally that operations in the current reserve week, although they fulfilled the directive given by the Committee at the January 12 meeting, had produced pressure against reserves that was undesirably severe.

Mr. Mills said he concurred with those who had commented that they would not favor an increase in the discount rate at this time. He believed, however, that the Committee should give some careful general thinking to possible, though unlikely, developments in the international position of the United States that would follow in the wake of the Bank of England's bank rate increase, and the discount rate increases effected recently in Sweden, Denmark, and Western Germany. The concern he felt did not attach so much to the reasons that occasioned those increases as to what was perhaps a fundamental downward break in the stock market. If that trend continued, and if it should widen, it was possible that there would be a very substantial liquidation of foreign investments that had until now been placed in the market. If that should occur, the question would immediately arise as to whether those funds would

be repatriated or whether conditions in the United States would be such as to encourage their reinvestment here in short-term United States Government securities or other eligible liquid investments of high quality.

Mr. Mills then said that he would like to place before the Committee a redical line of thinking that could be disputed over the weeks to come but perhaps might be in a direction in which the System would at some point find it advisable to consider moving. Accordingly, he presented the following statement:

> Premature action to raise the discount rate at the Federal Reserve Banks as a defensive measure to hold foreign funds in the United States would be a mistake. The domestic situation calls for a more moderate, rather than a more restrictive, monetary policy, and if the discount rate were raised, the increased pressure that presumably would be exerted on commercial bank reserve positions by System actions taken to make the higher rate effective could seriously dislocate the economy. For that matter, there are no fully persuasive reasons to believe that the English and West German financial situations are so robust as to encourage a repatriation of funds out of the United States solely to obtain higher investment returns. Therefore, an attempt to anticipate an outward movement of foreign funds from this country by Federal Reserve System actions on the discount rate would probably be regarded as lack of confidence in the dollar on our part and, as a result, could produce the very outflow of funds whose prevention had been aimed at.
>
> Acceptance of this reasoning contemplated that Federal Reserve System policy would not recognize the increase in the Bank of England's rate at this time. If, after a waiting period, there was tangible evidence of the movement of funds out of the United States in volume, the discount rate at the Federal Reserve Banks should be raised dramatically from 4 per cent to 5 per cent or 5-1/2 per cent as a signal that our financial

authorities were taking a firm hold of the situation and were prepared to take whatever further measures might be necessary in order to protect the integrity of the dollar as the world's key currency. Response to such actions could be expected to dissipate any concern felt about the dollar abroad and to reverse whatever outward movement of funds was then in progress.

If, in the course of these events, an anti-cyclical easier monetary policy should be called for by a deterioration in domestic economic conditions, the Federal Reserve System should be able to take technical actions that would continue the emergency-raised level of the discount rate at the Federal Reserve Banks at the same time that the availability of credit was expanded substantially. Maintenance of the emergency discount rate would signify that our financial authorities had every intention to defend the international integrity of the dollar while they were simultaneously seeking to stimulate the economy with easier credit conditions, whose effects would prevent the "export" abroad of recessionary influences in this country. These seemingly conflicting objectives would be attained by increasing the supply of reserves needed to expand bank credit by encouraging member banks to discount heavily at the Federal Reserve Banks. Notice would be given that under existing conditions the prohibitions against continuous borrowing would be suspended. Accordingly, the supply of reserves would be increased through a major expansion of member bank discounts, but as they would have been made at the emergency high discount rate, the purposes for which it had been established would be preserved. Moreover, as it would be necessary for the member banks to recover the high cost of their Federal Reserve Bank discounts, they could be expected to charge relatively high rates to their borrowers, thereby tending to produce a structure of interest rates appropriate to encouraging investment. In the process of adaptation to a massive use of member bank discounts, Federal Reserve System open market policy actions would be necessary from time to time to offset temporary shortages or surpluses in the supply of reserves occasioned by fluctuations in the use of the Federal Reserve Bank discount windows and so that a predetermined level of reserves could be maintained.

Attention should be paid to the fact that liberal discount privileges at the Federal Reserve Banks should call forth a flow of advances on intermediate- and long-term U. S. Government securities as collateral. Inasmuch as such advances would be made at the par value of U. S. Government

> securities trading at a discount, the effect on the market should be favorable at a time when market strength would be psychologically desirable. Furthermore, an improvement in the U. S. Government securities market that was engendered by the knowledge that banks were being relieved of pressure to sell securities in order to finance new loans and investments would also strengthen the receptiveness of the market to whatever sales the System Open Market Account might see fit to make from time to time. A further factor that would redound to improved market sentiment for U. S. Government securities would be that any letdown that should occur in business conditions would witness an automatic increase in corporate liquidity, together with a corresponding incentive for corporations to invest in high quality short-term investments.

Mr. Robertson expressed agreement with the policy of watchful waiting referred to by several of the Committee members. He thought that quite obviously this was not the time to change the discount rate or the policy directive. However, he would not align himself with those who felt that this was a time for easing. Instead, it seemed to him that the situation called for maintaining as even a keel as possible.

Mr. Shepardson commented on a meeting yesterday in Chicago which was attended by institutional lenders in agriculture, particularly those lending on farm mortgages. The price of farm land, he noted, had been on a rising trend almost without interruption and almost uniformly across the country for several years. However, in the last quarter of 1959 there had apparently been a definite change. The sentiment of the group that met yesterday, which included representatives of most of the major insurance companies, the farm

credit agencies, and the American Bankers Association, indicated at least a leveling off of prices, and in many areas a significant downturn. Demand for the very top-level farms--those that had been sought as investments by "Main Street farmers"--appeared almost to have vanished; prices on such farms were reported to have fallen off $150 to $200 an acre from the levels of $600 to $700 an acre that prevailed six months ago. Also, there had been a drop of $50 to $100 an acre in some of the lower-priced farm land; in the wheat country of Montana, land that sold previously at around $250 an acre was reported to be selling in a range from $125 to $150. A number of those at the meeting said that whereas they heretofore were lending freely on the appraised value of land without too much regard to the owner's operations and without looking closely at his operating statement to see where the funds for repayment were coming from, they were now cutting down or refusing entirely loans that did not show from the operating statement a good probability that the operator would be able to pay them down from funds accruing out of his operations. In addition, several persons mentioned the increasing reluctance of banks to extend term credit on equipment and livestock purchases, with the result that some of those applicants were now coming to the mortgage lenders to get term credit. Where there were outstanding mortgages at favorable rates compared with the present market, almost all of those present reported that whenever an adjustment or extension of borrowing, particularly in the form of term credit, was requested, they were adjusting the rate upward. In most cases lenders were

requiring the new rate to be on the basis of a complete renegotiation. Many participants reported no significant resistance to higher rates from borrowers seeking to purchase additional holdings to increase their units. In summary, it appeared that there had definitely been a turn in farm land prices and that more careful consideration was being given to the earning capacity of the farmer in extending credit. From the standpoint of the increasing cost-profit squeeze faced by agriculture, it seemed fortunate that prospective borrowers were getting a more realistic appraisal of what land was worth.

Mr. Shepardson agreed that this was a period in which the System should be watching developments closely. For the period immediately ahead, he would favor maintaining the status quo as nearly as possible.

Mr. King made several references to material in the economic presentation given at this meeting, including the portion dealing with the position and trend of corporate earnings in relation to earnings during past periods of recession. He indicated that he would be interested in studying this portion of the presentation further. While he did not feel that the country was close to a general recession, he did feel that it was moving nearer and nearer to one all the time. With reference to comments in the presentation regarding the possibility of a change in public expectations with respect to inflation, he noted that Mr. Larkin had mentioned the increasing number of individuals going into Government securities. It was encouraging to him that more individuals and smaller concerns

were going into Government securities for this would give them an increased stake, so to speak, in the United States, a development which would be healthy. Mr. Shepardson's remarks on farm land prices also seemed to him an indication that the public was turning toward an expectation of less inflation. At the livestock show in Denver last week, he (Mr. King) felt that he detected quite a bit of apprehension. He thought it healthy that people throughout the country were actually a little doubtful about a boom developing to the extent that one had been talked about and more or less expected earlier. During the steel strike, he said at Committee meetings that he did not think the steel strike was a major dent in the economy or that there would be a wild boom following settlement of the strike, and he was still of that opinion. He was inclined to discount some of the reported optimism on the part of businessmen, for they naturally desired to be optimistic, and he was more inclined to think about such things as the portions of the chart show relating to the downward trend of corporate earnings.

Mr. King said that he would not suggest any change in policy at this time and instead would favor continuing on an even-keel basis. He realized that it was almost asking the impossible to request the Account Management not to make any errors on one side or the other. Thus, if it came to resolving doubts, he would prefer to resolve them on the side of ease. This was the first time he had made this suggestion, but he believed the System was in a

position where it should not do anything to dampen the possibility of the economy going forward and achieving the greatest possible sound growth. Since there was some doubt as to how much growth would or would not be sustainable, he would err on the side of allowing growth, particularly in view of the encouraging indication that people did not appear to be talking inflation as much as they had earlier. This feeling was apt to manifest itself in the actions of the legislative bodies. In summary, this might be the big break that the System had been looking for in terms of a change in public sentiment.

Mr. Fulton stated that the pace of Fourth District business activity was quite brisk. The steel mills were putting out a lot of material that was being taken and used; inventory building was going on apace. After describing the results of an election held at a steel company that did not enter a contract with the union on the terms of the general settlement, Mr. Fulton went on to say that Fourth District building activity had increased sharply since the first of the year, while the increase in department store sales was greater than the national average. Auto sales were brisk throughout the district, and there seemed to be the prospect of a good year. Bank loans had declined, but not to the same extent as last year, thus bearing out the earlier statements of bankers that they did not expect any substantial decline and that loan demand, which was quite strong, would take up any slack. Consumer credit and mortgage

credit were both in great demand. While member banks were borrowing somewhat more heavily, borrowings were running at only 6 to 7 per cent of the System total, as against the 10 per cent that might be regarded as proportionate for the district. As to expectations, businessmen appeared to have no apprehensions about the first half of this year but were wondering what would happen in the second half when steel inventories again became adequate.

Mr. Fulton agreed with the view that neither the discount rate nor the directive should be changed at this time. He did not have the feeling that any substantial downturn in business was impending. The expectation of businesses appeared to be to spend substantial sums for improved equipment and for promotion of their products; in general, businessmen were acting as though the economy was booming, which he thought it was. In these circumstances, he would continue the degree of pressure that had been maintained recently and not err too much on the side of ease. That could become cumulative, and in his opinion it was not in the best interests of the System to trend constantly into an easier position.

Mr. Bopp reported that Third District business and financial trends in recent weeks were similar to those of the nation. Steel mills in the Philadelphia region were operating at 102 per cent of capacity, which was moderately above the 95 per cent rate nationally. The secondary effects of the strike on employment had about disappeared; in Pennsylvania, secondary unemployment existed to a

measurable extent in only one industry, metal products. There was a fractional increase in district manufacturing employment from November to December according to preliminary data, and total employment was 3 per cent higher than a year ago. New unemployment claims in Pennsylvania had been moving seasonally in the past two weeks but were substantially below the levels of both 1958 and 1959. District department store sales had been strong; sales for the past four weeks were 12 per cent above last year's high level. Automobile sales in Philadelphia showed the effect of the shortages in December; according to preliminary data, they were more than one-third below a year earlier. The large Philadelphia banks had been under somewhat greater reserve pressure in the past few weeks. Their daily average basic reserve deficiency was $68 million as compared with $47 million in the previous two weeks, and the increased pressure was reflected in their total borrowings. Daily average borrowings from the Reserve Bank rose from $36 million to $65 million. Country banks also increased their borrowings from the Reserve Bank from $9 million to $16 million. Total borrowing by district member banks was 8.8 per cent of the System total in the latest week compared with 6.4 per cent and 4.4 per cent, respectively, in the preceding two weeks.

Mr. Bopp expressed the view that although the time might come, perhaps this year, when the Committee would want to modify the even-keel policy during Treasury financings, that would be only if economic developments clearly were in the direction of rapid

expansion. He did not see such a development at this point. Accordingly, he favored continuing the present degree of restraint, with no change in the directive or the discount rate.

Mr. Bryan said he could see nothing in the Sixth District developments that appeared to be of great significance as against major national trends. The latest figures showed activity still going up, but they were definitely related to national trends. Most of the time in the past few years the district had seemed to grow at rates greater than the national growth rate, but it appeared that this might be coming to at least a temporary halt. District banks appeared to be very illiquid, and borrowing from the Reserve Bank continued at levels disproportionate to reserve resources. The latest figures showed that district borrowings were more than 16 per cent of the System total, against the figure of about 5 per cent that would be indicated on the basis of total reserve positions. It was being found necessary to call some of the loans on the instalment plan. The round-up of the economic situation at the most recent directors' meeting seemed slightly less enthusiastic than it had been in other months, with one director quite definitely pessimistic as to the outlook in his line of business.

After referring incidentally to certain statistics compiled by private sources which seemed to cast some doubt on the future course of business, Mr. Bryan said that he sensed a real shift in inflationary

psychology. This was noticeable in the situation with regard to land prices that had been discussed by Mr. Shepardson. While one could analyze that development on the basis of a reappraisal of earning power, he felt that it also reflected to a considerable extent a shift from the psychology that had made people willing to buy farm land, regardless of income prospects, as an inflationary hedge. It was his impression that the country was in a situation of great economic strength but certainly not of unlimited boom, and he believed there was danger of a rather extensive and perhaps abrupt shift in psychology that might change things in a substantial way in the equity markets. As to the discount rate, he certainly would not want to take any action at this time.

Mr. Bryan then referred to the chart on reserves that he had placed in the record of the Committee meeting on December 15, 1959, and in that connection made the following statement:

> At this time, having been favored once before by permission to place a chart in the record, I would like permission to place in the record the same chart (but with additional information) and a related chart. The first, among other things, shows the seasonally unadjusted figures as well as the seasonally adjusted figures previously presented. The second chart shows certain growth rates from points related, in two cases, to Committee changes in the Committee directive and, in one case, December, our last full month of experience.
>
> At this time, moreover, if the Chairman and my colleagues will bear with me, I would like to begin an experiment in drawing an instruction to the Desk in quantitative terms, based on total effective reserves. In making this attempt it would seem fair to me to say that in the period from June 1958 through December 1959

we essentially allowed no growth in total reserves, a policy justified as a mopping-up operation because we had previously effected a very large excess, based upon a long-run trend line, in the growth of reserves. The justifiable mopping-up operation seems to me to be completed.

We are now confronted with a situation of great economic strength, but not immediately a situation of unlimited boom.

Accordingly, I would conclude that a policy of restraint is still justifiable. But I would also conclude that the time has come when we should allow some growth of reserves. Such a growth of reserves should in my judgment be less than the 3.6 per cent reserve-growth of the postwar period, for it is clear that such a rate of growth has permitted an undesirable degree of inflation in the postwar period and, I would conclude, is inappropriate to a period of great economic strength.

Thus I would suggest that the rate of growth in total reserves that we contemplate for the time being be at 2 per cent.

Translated into concrete terms this would put the total reserve figure, seasonally adjusted, at something over $18,700,000,000 for January. Since it would hardly be appropriate to ask the Desk to attain such a precise figure on a daily average basis, I would also suggest that there be a certain plus or minus latitude to the goal stated. Just as a suggestion, I would think we might well say that we are aiming for a total reserve figure, on a daily average basis, between $18,650,000,000 and $18,750,000,000. This would allow latitude for the Desk to adjust to conditions in the money market as they develop, and, at the same time, would give us a quantitative instruction centered on a slow and restraining growth rate in total reserves.

In suggesting such a goal I should say that in January, through Wednesday of last week, we have had daily average actual reserves of $19,059,000,000. This has put actual total reserves in January well above the figure that would have been indicated by a 3.6 per cent trend line, and, up to last Wednesday, above the 3.6 per cent trend line even on a seasonally adjusted basis.

The result has been a definite easing in the money market--if we are to be permitted to measure such easing by the objective test of rates. Thus, in suggesting a goal for daily average reserves in January, the goal suggested, although it calls for a restraining rate of growth in the total reserve position, does not permit what I would regard as the excessive rate of growth that, up to last Wednesday,

had been permitted in the total reserve figure.
Let me make clear that I am not asking that the Committee adopt the suggestion that has been made. I am merely experimenting--and hope that the Committee will permit me to experiment from time to time in the future--to determine whether the total reserve concept represents a practicable foundation on which the Committee could base instructions (a) in quantitative and, thus, in measurable terms; (b) in terms of a phenomenon, namely total reserves, that are determinable by the Reserve System even after the influence of items not determinable by the System; (c) avoid qualitative terminology as represented by such indefinable terms as tone, feel, ease, tightness, and so on; and, at the same time, (d) leave the Desk with sufficient latitude to accommodate itself to the practical administration of the Account and to conditions as they unfold from meeting to meeting.

The Chairman stated that the material presented by Mr. Bryan would be taken under study.[1]

Mr. Johns said he found nothing in Eighth District statistics that was particularly significant. In the past two weeks, he had endeavored to find out whether in the business community of the district there were many "reluctant optimists." Outside the agricultural sector, which deserved special consideration, he had discovered little or no evidence of flagging optimism. Farmers, plantation owners, and operators were, of course, not wildly enthusiastic. They contemplated continued high costs, if not steadily rising costs, and the price picture was uncertain. For some reason, as yet unexplained, member bank borrowing had risen sharply in the past week and stood at $108 million at the end of

1/ Copies of the two charts referred to by Mr. Bryan are attached to these minutes.

the week. This represented not only rather large increases in borrowing by reserve city banks but also some increase on the part of country banks. It appeared, at least in St. Louis and Memphis and to a lesser extent in Louisville, that city banks were not feeling very easy. At Memphis it also appeared necessary to face again the condition that cotton loan demand was becoming steady and constant throughout the year rather than seasonal. This probably meant that the Reserve Bank had some work to do on the problem of member bank borrowing in the southern reaches of the district.

Mr. Johns said that while he would like to go along with Mr. Hayes' concept of watchful waiting, as he understood that concept, he would be inclined to keep a rather firm and steady hand on monetary policy. He would suggest truly watchful waiting, moving neither in one direction nor the other.

After commenting that the papers presented by Messrs. Mills and Bryan deserved study, Mr. Szymczak expressed the view that at the present time there was nothing in the economy appearing to require a basic change in monetary policy. In his opinion, however, the seasonal situation required some easing of the position of the banks. He pointed out that this season of the year is apt to be rather dull, and that some easing therefore might be helpful. On the other hand, since the economy was still on the expanding side and he felt that this would continue, he would favor no fundamental

change in monetary policy. While these views might at first seem contradictory, he pointed out that it is not feasible to change basic monetary policy on a month-to-month or quarter-to-quarter basis. Instead, the Committee must look at monetary policy on an over-all, long-range basis. If the Committee was continually changing its record, that would be hard to explain either outside or within the System. With this explanation, he would recommend no change in basic policy and some easing through open market operations.

Mr. Balderston said he was fearful that the Committee members, in reading the stock market figures from day to day, might tend to get carried away by the pessimism that is to be expected in the first two months of the calendar year. He expected February to be a month in which there would be a lot of pessimistic expressions; when it came to March he was not sure. He had been told of some companies being advised by their counselors not to approach the capital markets in January and February because the Treasury was at the trough, so possibly it might be found that resort to the capital markets in March would be as heavy as in March 1956. In short, he had a suspicion that the System might wake up from this period of pessimism to find the recovery in full swing from March onward. Because of his hope that the System would not be pulled off base, he would suggest maintaining an even-keel policy, with no easing.

Chairman Martin expressed the view that, unless the Committee was certain it wanted to make a change, the even-keel philosophy

ought to prevail during a period of Treasury financing, and such a period was imminent.

The Chairman then said it seemed clearly the consensus of this meeting that no change in the policy directive or the discount rate was called for at this time and that the Desk should come as close to perfection as it could in adhering to an even keel.

Mr. Mills inquired whether the Chairman would care to qualify his statement of the consensus with an indication as to whether errors should fall on the side of ease or of tightness. He (Mr. Mills) had detected a trend of sentiment during the go-around in favor of moving to errors on the side of ease, but he had not attempted to keep count and did not know whether that was the majority view.

Mr. Szymczak commented that his position was related to what the Desk had been doing during the past two weeks.

Following comments by Mr. Larkin on open market operations in relation to changes in the level of net borrowed reserves during the past period, Chairman Martin said that operations of the Desk seemed clearly to have been intended to maintain an even keel. He doubted whether the Committee, in a situation where its thinking was in the direction of further restraint, would want to make the Treasury's problem more difficult by saying that doubts should be resolved on the side of tightness. The question, he suggested, involved a matter of deliberateness. It was desirable to express shades of differences,

but he questioned whether there was any precise way of defining them. The Desk, he observed, already has enough difficulties.

The Chairman again expressed the view that it ought to be the intent during a period of Treasury financing, unless the Committee wanted to make a fundamental change in its policy, to try neither to complicate nor help the Treasury's problem. Rather, it should be the aim to give the Treasury as closely as possible a fair test of the market.

Mr. Shepardson suggested that this would mean maintaining as nearly as possible the degree of restraint at which the Committee had been aiming.

Mr. Mills said that this was what bothered him, and that he could see where the Management of the Account might have serious difficulties. During the first two reserve weeks of the year, he surmised that more by accident, because of natural factors operating in the market, than by deliberate design, the degree of restraint, as measured by net borrowed reserves, dropped into the $400 million range. Then in the past week net borrowed reserves were brought up, consistent with the Committee directive, to around $500 million. In these circumstances, the Desk might find it difficult to sense what the Committee's meaning was; whether, if natural factors tended to increase the supply of reserves, the Desk should permit that increase or move against it deliberately and bring net borrowed reserves to some higher level.

Mr. Larkin said that the lower net borrowed reserve figures were inadvertent; the Desk was just trying to keep up with the changing situation in the market.

Mr. Hayes commented that some of the remarks made at this meeting pointed up the danger of placing too much emphasis on the net borrowed reserve figure. The Committee had talked from time to time about not paying quite so much attention to that figure, but nevertheless there was an inclination to give it perhaps too close attention. Personally, he did not feel that the Committee should ever define its objective in terms of one figure, because it was necessary to think about various elements in the situation. The fact that the Account sold a large volume of securities in a week was important, to his mind, and represented an important offset to the fact that net borrowed reserves wound up at a somewhat lower level. Among other things, the Desk must consider the feel of the bill market and the feel of the banks, along with what was being said by the banks and others. It was not a game that could be played in terms of one figure.

Chairman Martin said this was quite a valid point. He went on to say that he had not detected in the go-around any desire to change the existing policy by design. Instead, the Committee was talking about a trend. While it was true that some would prefer more ease, he felt the spirit of the even-keel philosophy vis-a-vis the Treasury should be that the Desk would not consciously make

errors on the side of ease or of restraint. The Treasury financing would not involve a very lengthy period, and it was directly ahead. He would prefer this morning that the Committee renew the current directive and let it go at that.

Mr. Mills said that he again wished to submit his proposal that clause (b) of the directive be changed to provide for "fostering sustainable economic growth and expanding employment opportunities while guarding against inflationary credit expansion."

Mr. King commented that the intent of his previous remarks was more in the direction of avoiding errors on the side of tightness than resolving doubts on the side of ease.

Mr. Larkin said that as he caught the sense of the meeting, it was more important to avoid further tightness than to resolve doubts on the side of ease.

In reply, the Chairman said to Mr. Larkin that, to sum up, the Committee wanted the Desk to be "perfect."

Mr. Larkin commented that he felt the suggestion of Mr. Bryan deserved further consideration and that it would be studied at the New York Bank.

Chairman Martin concluded the discussion by stating his understanding that, with one dissent, the Committee desired to renew the existing directive in its present form, and no dissenting comments were heard in response to this statement.

Thereupon, upon motion duly made and seconded, the Committee voted, with Mr. Mills voting "no", 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.

Observing first that the Treasury had not discussed the matter with him, Chairman Martin referred to the holding by the System Open Market Account of approximately $5.5 billion of the $11.363 billion issue of Treasury certificates of indebtedness maturing February 15, 1960. If the Treasury should offer in exchange the choice of a

shorter and a longer issue, he pointed out, this would present the question whether the System should subscribe entirely to the shorter issue. If that course were followed, it might appear as though the Treasury had priced the issue for the convenience of the System.

The Chairman said he felt that the Treasury probably expected the Federal Reserve to go to the short end of the market. However, looking at the matter from the management standpoint, it was his feeling that the Account might well take 1/3 of the exchange in the longer issue and 2/3 in the shorter issue as a means of dividing the bulk. When it got to a point where the Federal Reserve held as much as $5.5 billion in any one issue, this made a pretty big load. The broad problem was one that the members of the Committee should be studying; he had referred at the January 12 meeting to the matter of the 2-1/2 per cent bonds of 1961. As far as he could see, the Committee would not be violating any principle if it wished to split the subscription in the forthcoming exchange, and he therefore wished to put the matter on the table for consideration.

Mr. Hayes said that he had not studied the matter in detail, but he liked the general idea of splitting the exchange.

Mr. King recalled that the Committee recently had a similar question before it and decided to stay on the shorter side. Since that time he had studied the problem further and, in the light of such study, he felt that his preference would have been different. He would heartily endorse the plan suggested by Chairman Martin.

The Chairman commented that this was not a vital matter but he thought it would make some sense to split the subscription.

Mr. Mills commented that this would have the advantage, also, of showing variation in the System's thinking. This time the System would be moving out on the longer side, while on other occasions it had moved from long to short.

Mr. Mills then moved that a splitting of the subscription in the manner suggested by Chairman Martin be approved, and Mr. Johns seconded the motion.

Thereupon, the motion was put to a vote and was approved unanimously.

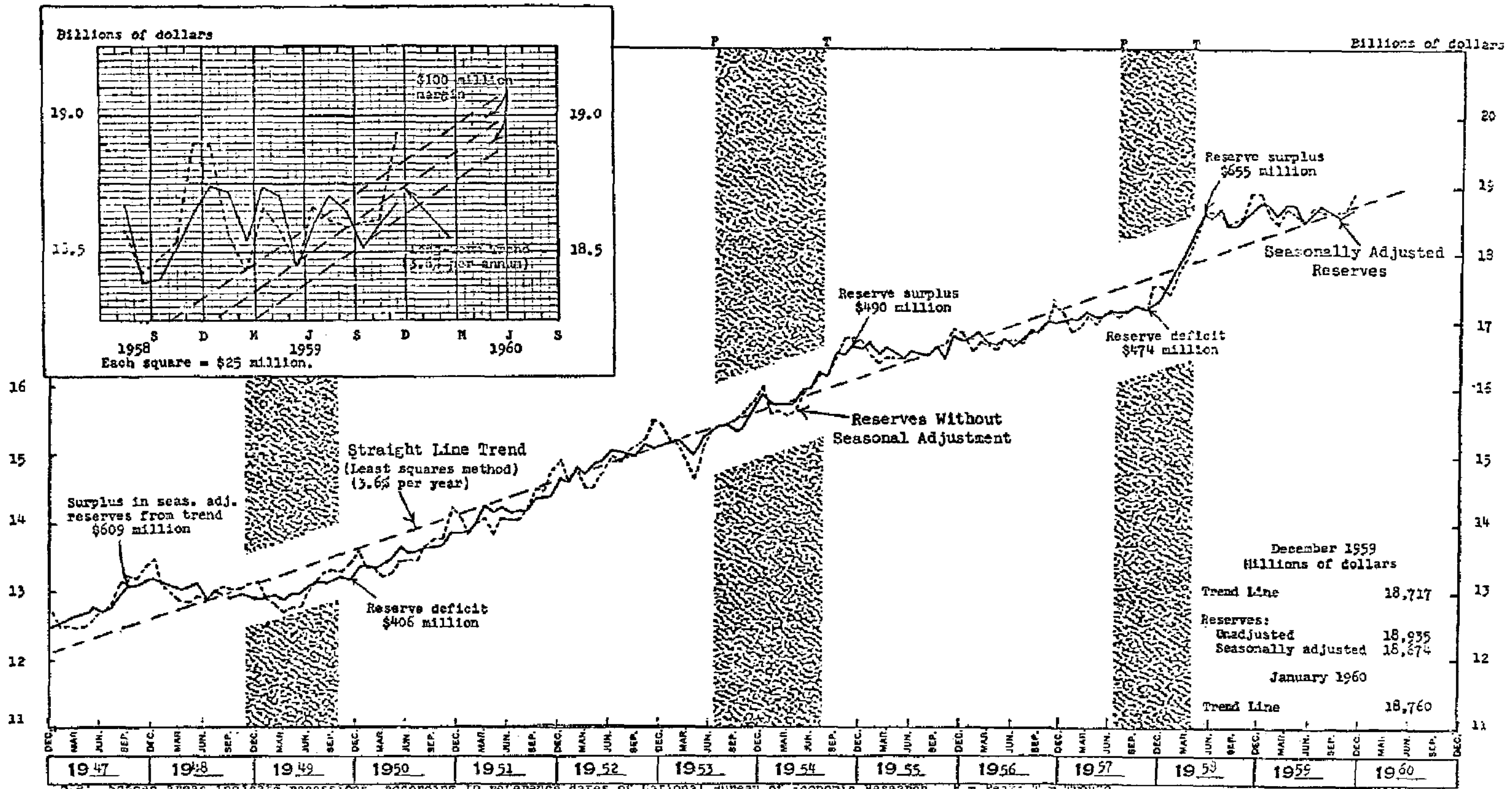
It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, February 9, 1960, at 10:00 a.m.

The meeting then adjourned.

Ralph A. Young
Secretary

Correction of seasonal factors made: January 1, 1960

Effective Reserves
(Monthly averages of daily figures)



Note: Shaded areas indicate recessions, according to reference dates of National Bureau of Economic Research. P = Peak; T = Trough
Trend line exhibits an annual growth of 3.6 percent per year or $43 million per month.

Last month plotted: December 1959
Method of computation described on reverse side.

Reserve figures are total member bank reserves (monthly averages of daily figures) adjusted for changes in reserve requirements and for seasonal influences. No effort was made to remove the expansion potential of total reserves resulting from shifts in deposits among classes of banks and between types of deposits subject to different requirements through April 1958.

Method of computation: For May 1958-December 1959, figures used are actual member bank reserves, adjusted for seasonal influences. Monthly values of effective reserves for January 1947 through April 1958 (when reserve requirements were last changed) have been derived by (1) obtaining the ratio of average required reserves to average deposits subject to legal reserves for May 1958-April 1959; (2) multiplying actual reserves by the percentage the above ratio is of the ratio of required reserves to deposits subject to legal reserves for each specified month; and (3) adjusting the values for seasonal influences. Trend based on monthly values January 1947 through August 1959.

Alternate Growth Rates of Effective Reserves (Seas. Adj.)
Using Actual Reserve Levels (Seas. Adj.)
For August 1958, June 1959, and December 1959 as Starting Points[1]