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, August 16, 1960, at 10:00 a.m.

PRESENT: Mr. Balderston, presiding
Mr. Bopp
Mr. Bryan
Mr. King
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Hayes
Mr. Allen, Alternate for Mr. Fulton

Messrs. Irons, Leach, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Erickson, Johns, and Deming, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Messrs. Brandt, Hostetler, Marget, Noyes, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the 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. Ratchford, Mitchell, and Einzig, Vice Presidents of the Federal Reserve Banks of Richmond, Chicago, and San Francisco, respectively
Mr. Gaines, Assistant Vice President, Federal Reserve Bank of New York
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia

Mr. Coldwell, Director of Research, Federal Reserve Bank of Dallas
Mr. Stone, Manager, Securities Department, and Assistant Secretary, Federal Reserve Bank of New York
Mr. Bowsher, Economist, Federal Reserve Bank of St. Louis

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

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 26, 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 July 26 through August 10, 1960, and supplementary report covering the period August 11 through August 15, 1960. Copies of both reports have been placed in the files of the Committee.

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

The lowering of the discount rate at five of the Reserve Banks last Thursday and Friday had only a moderate impact on the market for Treasury securities, as was also the case after the Board announced the changes in Regulation D. To be sure, prices of Government notes and bonds were marked higher on Friday and bill rates moved lower. These movements, however, just about offset the developments on Thursday when note and bond prices had declined and bill rates had risen. On Monday there were no very significant changes in prices of notes and bonds, but bill rates again moved higher. In yesterday's auction, average issuing rates of 2.278 and 2.621 per cent were established for the new three- and six-month bills, 6 and 16 basis points higher, respectively, than a week ago. As the written reports point out, this development is mainly a reflection of the heavy inventories of Government securities--particularly the longer-dated bills--that Government securities dealers had built up partly in anticipation of the large reinvestment demand expected to stem from the Treasury's August financing operation. The first part of this payoff took place only yesterday, and the remainder will occur on August 23 when the FNMA issue matures. Nevertheless, dealers have been disappointed in the volume of demand they have seen in the market and have had some difficulties and expense in financing their positions. The split discount rate was, of course, reflected in the Federal funds market, which, for all practicable purposes, has been two markets since last Friday. The demand for funds in districts where the discount rate has remained unchanged has been apparently great enough to keep the supply of excess reserves in such districts from spilling over into 3 per cent districts in any volume. With the New York banks under pressure and unwilling to pay 3-1/2 per cent for funds, borrowing at the New York Bank jumped from $17 million on Thursday night to $340 million at the close of business yesterday. Banks in other 3 per cent districts may also have shifted from the funds market to the discount window to meet their reserve needs.

There are certain problems that loom on the horizon to which I should like to call the Committee's attention. The first has to do with the changes in the amount of vault cash that can be counted for reserve purposes on August 25 and September 1. While this will bring about a more or less instantaneous change in bank reserve statistics, it is by no means clear how soon this will be reflected in the actual availability of funds in the money market. As you will recall, there was a period of considerable uncertainty that surrounded the last change in Regulation D, and that experience would suggest that statistics be treated with more than usual caution and that special attention be paid to the actual developments in the money market over the period ahead.

Also, I should like to call the Committee's attention to the spread sheet that accompanies the supplementary report which indicates a very substantial bulge to $920 million in the banks' free reserve position in the week ending September 21, mainly in reflection of a rise in float. This bulge can represent a complicating factor as far as our operations are concerned inasmuch as a further estimate now suggests a drop to under $500 million the following week. I hope that we can deal with this mainly through repurchase agreements, since at the present time the Account holds only $51 million of the September 15 bills.

Yesterday was the payment date for the Treasury's August financing operations. While there was little doubt about the success of this operation from the financial standpoint, a careful analysis will have to be undertaken before any final judgment can be made on the relative advantages or disadvantages of the cash refinancing technique that was used for the first time. There were a good number of complaints from large corporations and other investors who held the maturing issue and who were unable to continue their investment as they desired. The Treasury has received quite a number of objecting letters, most of which have been answered directly, and in this same connection we understand they are planning to publish the text of a reply made to the Iowa Bankers Association. A number of these complaints have to do with the 100 per cent allotment to the Federal Reserve System and to foreign central banks and foreign governments. There were also a number of problems in making allotments, and it may be necessary to take a second look at the list of subscribers who were entitled to full allotment on the certificates.

Finally, I wish to report that dealer holdings of Treasury securities are currently about twice as large as what we have come to think of as their usual position, even allowing for additions to the dealer list. The weighting is in short-term securities. A considerable amount--although we have no way of measuring it--of longer Treasuries are in the hands of other investment dealers, and there have been sizable amounts of all high-grade bonds--Treasuries, municipals, and corporates--bought for cash by stock exchange houses and others, including their customers. These purchases, like the excess dealer holdings, represent a large-scale speculation based on the conviction that the System will continue to promote still easier money. It is somewhat reminiscent of 1958, although without quite the flavor that Garvin, Bantel & Co. and "rights" provided.

The swollen positions of the dealers are, as suggested in the supplementary report, probably mainly responsible for the tightness in the money market.

Thereupon, upon motion duly made and seconded, the open market transactions during the period July 26 through August 15, 1960, were approved, ratified, and confirmed.

Mr. Noyes presented substantially the following statement with respect to the economic situation, the credit situation, and the money supply:

The information which has become available since the last meeting of the Committee reflects very little change in the over-all economic situation. Sometimes little over-all change is the result of fairly substantial counterbalancing movements in various sectors, as it was in the summer of 1957, but in the present instance, the over-all sideways movement reflects very little change in any of the important components. Little or no change in industrial production, construction activity, employment, retail trade, and prices--and, for the period as a whole, in the stock market--all support the generalization that economic activity has been going forward at a rate which is about the same as that which prevailed at the end of the second quarter.

Whether this sort of sideways movement has favorable or unfavorable overtones depends to a large extent on the expectations which preceded it. Those who anticipated the beginnings of a strong upward push in the second half, spurred by an increasing volume of investment expenditures, could certainly find the past six weeks disappointing. On the other hand, analysts who were concerned that many leading indicators were pointing down may feel reassured, both by the course of actual developments and by upward revisions in a number of preliminary figures for June.

Perhaps the most disappointing information which has become available in recent weeks relates to the second-quarter performance of corporate profits. Not only is our current estimate down from the very high year-ago level and from the first quarter, but the decline appears to have been quite general, rather than concentrated, as might have been expected, in metal and metal-processing industries. This disappointing profits picture will undoubtedly dampen the enthusiasm of many companies for capital expansion in the period ahead.

On the positive side, final takings appear to be holding up very well, and the general observations which Mr. Koch made at the last meeting regarding the inventory situation seem to be equally pertinent today. The available data do not suggest excessive inventory accumulation at any stage in the process of manufacturing and distribution, and in some lines--especially steel--inventories have been reduced further.

An important element in the continuation of the relatively high level of activity which has prevailed has been the maintenance of consumer demand. There have been some doubts expressed as to the likelihood that consumer purchases will continue at this level, and these doubts have been supported to some extent by recently published reports of two surveys taken around midyear. Both the University of Michigan and the National Industrial Conference Board survey results were generally interpreted as reflecting a decline in consumers' intentions to purchase major durable goods, although the NICB survey did show some increase for new automobile purchases. We have just received preliminary results from the quarterly survey of buying intentions conducted for us by the Bureau of the Census, which was in the field during the week of July 17-23. In general, these results are not as pessimistic as those of the two earlier surveys, although they do suggest some decline from the previous survey in April. They do not indicate any substantial concern on the part of the public generally toward the economic outlook, as indicated by the fact that the proportion of consumers expecting income increases over the next twelve months is somewhat higher than a year ago, and the same as in April of this year. Taken at their face value, the survey results would suggest that consumer demand is likely to be close to the levels of recent months, but is unlikely to provide any additional stimulus to economic activity.

In credit markets, the most noteworthy developments of the past few weeks have been the success of the first test of the Treasury's cash refunding technique and the two steps taken by the Federal Reserve System last week. In July, bank credit expanded by about $2 billion as net acquisitions of Government securities overbalanced considerably a $700 million decline in business loans. A business loan decline is not unusual in July, but the magnitude this year was larger than any other for which comparable data are available. In early August this fall-off in lending appears to have been reversed, at least for the time being.

On balance, market interest rates have shown substantial further declines since the last Open Market Committee meeting. There has been some backing up of rates since early August, particularly in the Government securities market, but most yield series are nevertheless still close to their lows for the year.

Yield declines since midyear have been most pronounced in medium-term Treasury issues, which are currently nearly half a percentage point below end-of-June levels; while yields on long-term bonds have dropped about one-eighth to one-fifth of a percentage point over the same period.

Although Treasury bill yields also declined sharply from mid-July to early August, much of this change represented a reversal of the advance that had occurred earlier in July at the time of the Treasury cash financing. This is illustrated by the fact that the average rate of 2.28 per cent resulting in yesterday's auction of 90-day Treasury bills was almost identical to that resulting in the second week of June, while yesterday the 6-month bill average of 2.62 per cent was 12 basis points above the second week in June.

This brings us to the money supply, and I would like to call your attention to the chart entitled "active money supply" which has been distributed. The black line shows the familiar end-of-month series by which we have measured money supply movements in the past. The red line above is the new semimonthly average of daily figures which has been developed in recent months, and which we expect will supplant the old series after a brief period of testing. You will note that there is very little difference in the direction or amplitude of change over longer periods, but that the new series brings out some significant movements that were lost in the end-of-month series and reduces the magnitude of other fluctuations that was attributable to the single date character of the old series. The data on which this chart are based and a brief description of some of the technical changes will be circulated within the System in the forthcoming issue of Banking Developments, and we hope to publish the back data and release current figures regularly on the new basis some time this fall. I should add that we are especially grateful to Mr. Abbott of the Federal Reserve Bank of St. Louis for his work on this project.

As I am sure you have already noted, in terms of the familiar series the seasonally adjusted money supply increased $300 million in July, on top of the $600 million increase in June. This increase is especially noteworthy in that it occurred in a period when the Treasury balance was being maintained at higher levels than usual. As is apparent from the chart, the new series showed both a smaller decline in the preceding months and a smaller increase since the end of June.

In the period since the last meeting--or to be more specific, for the three weeks ended August 10--free reserves averaged about $170 million. In the same period total reserves fell from $18,762 million to $18,509 million--a drop of about $250 million. We estimate that a decline of about $340 million in total reserves, after allowing for changes in the Treasury's tax and loan balance and for seasonal factors, would have permitted the maintenance of the same seasonally adjusted active money supply as prevailed at the beginning of the period. In other words, the net effect of all factors affecting bank reserves, including the System's operations, was to supply about $90 million more reserves than would have been needed to maintain the seasonally adjusted money supply at the July 20 level. We can conclude from this that in the circumstances which prevailed in this particular period, the maintenance of a free reserve level of around $170 million resulted in the net availability of reserves sufficient to permit an expansion in the seasonally adjusted active money supply of somewhat more than half a billion dollars.

If you will look at the last column which has been added to the reserve projections, you will see similar figures projected for the period ahead. These projections indicate that if the Treasury's tax and loan account moves as expected, required reserves will have to increase in the next three weeks by a little more than $200 million (the difference between

$18,428 million and $18,638 million) to support the same seasonally adjusted level of active money supply which could have been supported, but which may or may not have actually prevailed, in the week ended August 10. The projections would also indicate that to bring about this level of total reserves for the week ended August 31, the System would presumably have to absorb on balance approximately $100 million of reserves during the coming three weeks after allowing for expected changes in other factors affecting member bank reserves.

The highly tenuous nature of the estimates of both the total reserve target and the volume of System operations is obvious. In the first place, if the behavior of the Treasury's tax and loan account is not as projected, or the implicit seasonal adjustment of the money supply, on a weekly basis, is not accurate, then the total reserve target itself could be wide of the mark in either direction--by much more than $200 million. The System operations needed to accomplish the appropriate change in total reserves are subject to even greater margins of error in projection--the net amount of gold flows, the timing and amplitude of fluctuations in float, and many similar factors can result in large differences between the actual figures and projections prepared in advance, as the period progresses. In other words, it is literally impossible to quantify in advance either the change in total reserves or the volume of System operations which would be necessary to maintain the existing level of the seasonally adjusted money supply or to increase or decrease it by a specified amount.

On the other hand, it does appear possible, in retrospect, to determine with reasonable accuracy whether the net effect of all factors affecting member bank reserves, including System operations, was such as to provide more or less reserves than were needed to support the level of the seasonally adjusted money supply which prevailed at the beginning of the period. However, whether such an analysis adds substantially to the insight which can be gained from observation of the movements of the money supply itself on a semimonthly basis is at least open to question. After spending considerable time working over the data, my own judgment is that an appraisal of the impact on the money supply of levels of reserve availability that have prevailed in the recent past can be made best in terms of the behavior of the money supply itself, rather than the reserve base available to support it. If the level of free or net borrowed reserves which has prevailed has produced changes in the money supply other than those intended by the Committee, then it should be adjusted in the direction indicated. While the level of total reserves is a logical link between the two, it does not seem practical to use it directly as a guide for current operations, on the one hand, nor does it seem to shed light on the impact of past policy actions which is not revealed by an examination of the course of the money supply itself. I should add that this is a highly tentative conclusion, which I come to somewhat reluctantly, and only very recently, and which I might well wish to modify after further study.

There ensued an exchange of comments between Mr. Bryan and Mr. Noyes with a view to clarifying some of the points covered in the concluding portion of the latter's statement.

Mr. Marget then presented the following statement:

One of the main concerns these days of most of the headline writers on international finance seems to be the matter of gold outflow from the United States. Gold outflow is not a matter to be silent about, necessarily. But one would like to see discussion of the matter kept in perspective; and, whatever else may be said of much of the recent public discussion on this point, it can hardly be said to have distinguished itself as having retained a proper sense of either perspective or proportion.

Why does gold flow out of a country such as the United States? Broadly speaking, for one of two reasons.

In one group of cases, gold outflow could be the result of a decision on the part of a holder of an existing dollar balance to convert that dollar balance into gold because he has lost confidence in the future value of the dollar in relation to gold. To the uninstructed, this is the only case conceivable; and this is why, in 1958, when there was a gold outflow from this country of some $2.3 billion, it was represented for months (and, unhappily, it is still sometimes described, in retrospect) as a kind of "flight from the dollar." The only trouble with that description of what is supposed to have happened in 1958 is that, as we all know, it doesn't happen to fit the facts. What the facts show is that in 1958, instead of there having been a net conversion of $2.3 billion of existing foreign-owned dollar balances into gold, there was an actual increase in the total of foreign-owned dollar balances of over $1 billion.

This notion of gold outflow as the result of the conversion of existing dollar balances into gold because of a general preference for gold over dollars fitted the facts even less well in 1959. In that year, the total gold outflow (exclusive of the United States contribution to the International Monetary Fund) was just under $700 million. Instead of existing foreign-owned dollar balances declining by that amount, these balances actually increased by $2.8 billion.

What of 1960? The total of gold outflow from January to June of this year was very small: $125 million in all. Again, moreover, there was an increase--not a decrease--in the amount of foreign-held dollar balances, this time by something over a billion dollars over the six months.

Quite obviously, then, during this whole period of gold outflow from 1958 through June of this year, there was no net conversion of existing foreign-held dollar balances into gold. There simply was no "flight from the dollar," or anything resembling it.

What about July and thus far in August of this year? There has been, undoubtedly, a very sharp step-up in the rate of gold outflow. In July alone the gold outflow amounted to over $175 million, and for August thus far the figure is $110 million. Since the first of July, then, a total of $285 million, as against only $125 million for the first six months of the year. Has this intensified gold outflow since the first of July been matched by a corresponding decline in the total of existing foreign-held dollar balances? The fact is that we do not yet know the answer to this question even with respect to the month of July, the figures for which we should have in a week or two. But surely a reasonable sense of perspective would suggest that, after two and a half years of gold outflow without the corresponding decline in foreign-owned dollar balances that would indicate a wide-scale conversion of existing dollar balances into gold as the result of a preference for gold over dollars, some other kind of thing may be happening.

What was happending during the period for which we do have figures showing that foreign-owned dollar balances increased at the same time that gold was flowing out was, as we now see quite clearly, that we were having a balance-of-payments deficit which had somehow to be met. It was met partly by the payment of gold, but also partly by the transfer into foreign ownership of dollar balances. Since, we now know, there was no concerted effort to convert existing foreign-owned dollar balances into gold, it follows that if we had not had a balance-of-payments deficit there would probably have been no net gold outflow. The basic moral, then, ought to be very clear: the surest way to avoid having to worry about losing gold is to see to it that our foreign accounts are in balance.

I have put these simple considerations forward because they seem to me to provide the background against which one has to judge the significance, for policy purposes, of the intensified gold outflow that we have been witnessing in July and thus far in August. Let us assume, for the sake of argument--though it is anything but clear that the assumption corresponds strictly with the facts--that the whole of such changes in capital movements as have occurred since June is attributable to the intensification of a divergence in the level of interest rates as between this country and abroad. Would it automatically follow that we must expect every such divergence in the levels of interest rates to lead to a corresponding increase in the volume of gold outflow plus an increase in foreign-owned dollar balances? The answer, obviously, is no: that it depends, to begin with, on what is happening to the items other than capital movements that make up our total balance of payments.

The point can be illustrated by the balance-of-payments estimates for the second quarter of this year that were released some days ago by the Commerce Department. Disappointment has been expressed, in some quarters, that the over-all deficit for the quarter, at an annual rate of close to $3 billion, was not much different from the over-all deficit during the first quarter. But I suggest that quite a different light is cast on this result if we recognize a further fact; namely, that as between the first and second quarters of this year there was an increase in capital outflows of around $1 billion; and that the reason why this did not result in an increase in our over-all balance-of-payments deficit for the quarter was that there was an improvement in our trade balance of nearly $1 billion (annual rate). And if we take the past year as a whole--beginning with the improvement in our balance-of-payments position that set in around the middle of last year--we find that an increase of around $2 billion in capital outflows and other payments has been prevented from being registered in a corresponding deficit in our over-all balance of payments because the improvement in our trade position (particularly as the result of the increase in our exports by around $4 billion, annual rate) has been about twice as large as the increase in capital outflow.

It is this type of consideration which helps to explain why, while of course we must pay close attention to international capital movements, and to the effect which monetary policy may be expected to have on such movements, in many ways the more basic question is whether the monetary policy being pursued is such as to affect adversely the movements in our trade account. At a time when inflationary pressures are strong and the trade account is seriously deteriorating, a policy of monetary ease would obviously represent the height of irresponsibility. But, equally obviously, the situation is entirely different when inflationary pressures are not strong, when there is widespread evidence of the existence of the kind of competitive pressures which we need to maintain if we are to maintain our international trade position, and when we find in the trade account itself evidence, not of steady deterioration--of the kind that we had up to the middle of last year, for example--but of steady improvement.

The net of the argument, then, is that a country in a strong reserve position which is giving evidence not only of a sensitiveness to the competitive forces which may be expected to bring about steady improvement in its trade position, but also of actual and sustained improvement in the trade position, can afford to take steps in the direction of monetary ease which countries less favorably situated in these respects cannot afford to take. This proposition holds with equal force even when--as may very well be the case in the period immediately ahead--the geographical distribution of the recipients of new claims on the United States economy is such as to make it likely that a larger percentage of these new claims on us will be taken in the form of gold than in the form of increased dollar balances. The one kind of gold outflow that we could not stand is the kind which, as I suggested at the outset, so many people have assumed was occurring, particularly in 1958; namely, a gold outflow which would be primarily the result of a loss of confidence by the foreign holders of existing dollar balances in the soundness of the currency of the United States--which is to say, in the soundness of the policies pursued by the fiscal and monetary authorities of the United States. These foreign holders of dollar balances did not so act when the trends in our basic situation, with respect both to the internal fiscal position

> and the external trade position, were much less favorable than they are as of now. If, contrary to present expectation, they were so to act, this country would be confronted with a policy dilemma which would be very serious indeed. But it would not be fair to say that that kind of policy dilemma is before us as of now.

Mr. Allen raised the question of having Mr. Marget's statement available for presentation at the next meeting of the directors of the Chicago Reserve Bank, and other Presidents likewise expressed an interest in having the statement. No objection being seen with regard to the use of the statement in such manner, if desired, it was understood that copies would be sent to all of the Presidents following the meeting.

With respect to a further suggestion, relating to the possibility of making the statement available for wider reading, perhaps in the form of an article in the Federal Reserve Bulletin, certain points were raised by members of the Committee and by Messrs. Marget and Young which suggested that due consideration should be given to questions of timing as well as to the problems involved in converting a statement prepared specifically for presentation at a meeting of the Open Market Committee into an article suitable for general public consumption.

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

> Recent information on the business situation has done little to resolve the uncertainties as to which direction the economy may take. Business activity is high and prices are

relatively stable. While the economy continues to produce at a record level, there are divergent movements in modest amounts in the various factors that make up total demand. Employment and unemployment statistics for July show a slight improvement over June. There is, however, little reason to expect any substantial reduction in unemployment.

While wholesale prices have not changed significantly during the last year, the consumers' price index has been slowly moving upward; this movement is bothersome. The strong demand for bank loans during the first half of the year appears to have tapered off. The decline of business loans in July was importantly influenced by repayments by metal and metal-products firms--the same group that borrowed so heavily earlier in the year. Yet total loans and investments were up in July because the banks increased their investments at a much greater rate than in previous years. The banks were able to do this because the Federal Reserve made the reserves available. The shift away from loans toward investments has improved bank liquidity positions. The rise in total loans and investments in July was accompanied by a $300 million rise in the seasonally adjusted money supply; this is the second consecutive month in which the money supply has increased. The large Government deposits at the end of July provide a potential for a further increase in the money supply, aside from any increase in total bank credit. Thus a further increase in the money supply in August is probable. Total reserves, nonborrowed reserves, and required reserves have risen substantially in the last three months.

Forecasting business developments is an especially difficult job at this time, but such forecasting is not necessary for the determination of current credit policy. There is no evidence of inflationary pressure on prices, of inflationary credit expansion, or of inflationary psychology. The absence of such prospects and the unclearness of the business outlook counsel a relaxed credit policy. The Federal Reserve has been following a policy of increasing relaxation over the last six months. To this end it has taken a number of steps. Viewing these steps as a whole, they constitute an impressive list of relaxing measures in a period that is still marked by high business activity. It seems to us that open market operations should continue to be directed toward supplying reserves readily, resolving doubts on the side of ease. This trend toward further ease should be gradual, however, and not aggressive.

> Such a policy would be symbolized by free reserves in the neighborhood of the level of last week, with further expansion in total reserves and total nonborrowed reserves. As seasonal pressures develop in the central money markets in the next few weeks and as reserves are released through the reduction of reserve requirements and the use of more vault cash for reserve purposes, the Manager should rely principally on the feel of the market in order to achieve a steadily easy tone. Such reliance on the feel of the market is particularly important in view of the uncertainty, in the light of our experience with the vault cash release last December, as to the extent to which banks will use vault cash to meet their reserve requirements.
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> At the last meeting of the Committee Mr. Balderston suggested the possibility of deleting the word "moderate" from that part of the present directive that calls for "providing reserves needed for moderate credit expansion." We think that it would be appropriate to change the directive in this way.1/

Mr. Balderston commented that Mr. Johns had made available to him prior to this meeting a possible revision of clause (b) of the policy directive that the latter intended to suggest.

Mr. Johns having indicated that he would have no objection, copies of the proposed revision were distributed. The suggestion contemplated providing, in clause (b), that open market operations would be conducted with a view "to stimulating growth in economic activity and employment by providing reserves needed for bank credit expansion."

Mr. Erickson reported that there had not been much change in conditions in the First District. The New England production index had gone up from 118 to 124; the Reserve Bank had checked and could find nothing wrong because all of the component parts had increased. The New

1/ Quotation should read: "providing reserves needed for moderate bank credit expansion."

England purchasing agents' survey in July showed them slightly more optimistic than the national figures. Construction was still lagging, but there was a suggestion of an upward trend because the Engineering News Record showed engineering contracts in July up 19 per cent from last year. The seasonal gains in employment continued, primarily in the nonmanufacturing field. Manufacturing employment was still going down. Department store sales and automobile registrations continued good, while the vacation business this year was excellent. There was still a strong demand for consumer and real estate loans; less so at the moment for business loans. In the past three weeks District banks had been sellers of Federal funds except on two days, and the banks had rarely used the discount window. Average borrowings were less than $10 million per day during the three-week period.

Mr. Erickson said he was pleased by the Board's recent actions on vault cash and reserve requirements. As to the directive, he felt that he would prefer the suggestion made by Mr. Balderston at the July 26 meeting, namely, to omit the word "moderate" from clause (b). As to the discount rate, the Boston directors were scheduled to meet next Monday, and he anticipated that the directors would act at that time to reduce the rate to 3 per cent.

With regard to open market operations, Mr. Erickson said that in view of Mr. Rouse's comments regarding dealer holdings of Government securities, and also in the light of the comments by Mr. Noyes, he felt the Committee must leave it in the hands of the Account Manager to maintain the same degree of ease as had prevailed, with free reserves in the neighborhood of $200 million. If it should become necessary, he would resolve doubts on the side of greater ease. As he saw it, the forthcoming period would be a difficult one in view of all the factors that were to come into play.

Mr. Irons reported that conditions in the Eleventh District had not shown much change in the past three weeks. There were mixed trends, but the over-all level of economic activity was about as it had been. In some sectors, increases had been recorded. Industrial production in Texas was up a point and thus stood within 2 points of the all-time high, while construction contract awards moved upward in the latest month for which figures were available. The agricultural picture was favorable; it looked as though production would be larger than last year, which was a good year. There had been no substantial change in the petroleum situation. Production in August was on an 8-day allowable basis, and it appeared likely to continue at about that rate. Employment in July was down a little, but unemployment insurance claims in early August showed a declining tendency.

With reference to the banking situation, Mr. Irons said that loans and deposits were both down over the past three-week period and that unquestionably there had been some relaxation in the pressure on bank reserve positions. District banks were not borrowing heavily from the Reserve Bank; borrowing, which had been averaging around $14 to $16 million, was on the part of smaller banks for seasonal purposes. The major city banks had not been borrowing nor had they been using Federal funds so extensively.

On the whole, Mr. Irons said, conditions were good in the Eleventh District. He sensed no real pessimism but, on the other hand, no greater exuberance as yet. The general psychological reaction was that this was a time of uncertainty, not only because of the summer season but because of the forthcoming election and other things now in the picture. Therefore, the general attitude was one of caution.

As to credit policy, Mr. Irons said that the operations of the Desk during the past period had been quite satisfactory to him. The actions taken by the Board on vault cash and reserve requirements seemed to him to be actions that would add up to an impressive move toward ease. He viewed that trend with a little reluctance because such a trend tends to feed upon itself and build up. In saying this, however, he did not mean to infer that he did not favor what had been done. He favored a reasonable amount of ease but simply injected a note of caution because the situation could build up more than would be liked if the System was not careful.

With regard to the discount rate, Mr. Irons explained that at the Dallas Bank no meeting of the Board of Directors is held in August except on special call. Further, it is not the practice for the Executive Committee to act to change the discount rate. The next meeting of the Board of Directors was scheduled for September 8, with an Executive Committee meeting to be held on August 25. If enough directors were available, the meeting on August 25 might be converted into a meeting of the Board of Directors and action perhaps would be taken on the discount rate. Otherwise, the rate might not be changed prior to the September 8 meeting.

As to policy for the next three weeks, Mr. Irons said that he was still a little concerned about the possibility of additional rate declines. He would prefer to maintain about the degree of firmness that had prevailed, although he would not object to erring on the side of ease if necessary. In general, he felt that it might be well to take stock of what had been done and to give the actions already taken an opportunity to take effect before continuing to move in the direction of ease. Of the alternatives suggested with regard to the directive, he would prefer just to delete the word "moderate" from clause (b).

Mr. Mangels said that in the past three weeks not too much new Twelfth District information had become available. The information made available was rather mixed, leaning somewhat on the side of weakness. Three States in the District showed declines in employment, while the other States showed increases, with the result that July was at about the same level as June. The unemployment figures reflected a somewhat more difficult situation. In the State of Washington, unemployment was at the rate of 8.6 per cent in July against 7.8 per cent in June. There had been declines in lumber, shipbuilding, and metals manufacturing, with a slight increase at aircraft production plants. The aircraft increase was contrary to the experience in southern California, where employment was at an 8-year low. However, electronic manufacturing industries in California were now picking up.

Continuing, Mr. Mangels reported that lumber prices were down, with inventories high at the mills. Nevertheless, two large plywood manufacturers had announced small price increases. Construction in June was higher than in May, but down from a year ago. Most of the increase in June was in public works, while there was only a modest increase in residential construction, which stood 17 per cent below a year ago. There were some expectations on the part of builders that the remainder of the year would see an improvement in residential construction. On the other hand, vacancy rates had increased in all Western States; the rate of 10.6 per cent for the second quarter was up 1 per cent from the first quarter and represented almost an all-time high. Steel production continued to move downward in July, and the first half of August found the mills operating at 48 per cent of capacity, somewhat less than the national rate. Department store sales were 3 per cent below a year ago, but there were some indications that automobile sales were picking up.

In agriculture, smaller wheat and deciduous fruit crops were anticipated, and there were still labor difficulties having to do with picketing of the orchards in California. However, the cotton crop apparently would be at a record level. Livestock people in California were somewhat concerned about the substantial increase in mutton and lamb imports, with the first third of 1960 showing an increase of 113 per cent over 1959. In 1956 about one million pounds of mutton and lamb were imported, while in 1959 the figure increased to 58 million pounds. Oregon lamb prices were now 16 cents a pound compared with 20 cents a year ago.

Mr. Mangels reported that demand deposits were down in the three-week period ended August 3, while there was a moderate increase in time deposits, including savings accounts. Loans and Government security holdings both were down. Borrowings from the Reserve Bank had been nominal, averaging about $10 million a day over the past two weeks.

Turning to policy for the period ahead, Mr. Mangels said he agreed that this was a period in which the Account Manager should be given more than the usual leeway because of the general uncertainties in the business situation and the fact that the recent changes in reserve requirements and vault cash allowances might require some revisions in the projections of bank reserve positions. In any event, however, he would lean toward the side of ease.

As to the directive, Mr. Mangels said that he would suggest changing clause (b) so as to provide for operations with a view "to encouraging monetary expansion to foster sustainable economic growth." In response to a question, he added the words "and expanding employment opportunities." Mr. Mangels went on to say, however, that he had no strong feeling in regard to the language he had suggested.

With respect to the discount rate, Mr. Mangels explained that the situation of the San Francisco Bank was somewhat similar to that of the Dallas Bank. The next meeting of the Board of Directors was scheduled for the first of September, with an Executive Committee meeting to be held this Thursday. Depending upon the views of those directors attending, it might be decided to poll the remaining directors by telephone; otherwise, consideration would be given to the rate at the meeting on the first of September.

Mr. Deming reported that the Ninth District banking picture had improved somewhat in terms of ease and liquidity. Bank deposits at both city and country banks now were about where they should be seasonally relative to the end of last year. This represented an improvement since they had been running below their normal level; but they still remained below the level of a year ago. Loan growth in July was smaller than a year earlier at both city and country banks, and the net result was an easier banking situation. This had been reflected in a sharp reduction of borrowing from the Reserve Bank. The recent vault cash action would release some reserves in the District; however, due to the fact that Ninth District vault cash relative to demand deposits tends to run below the national average, relatively fewer District banks would be affected than nationally and a relatively smaller amount of reserves would be released.

In agriculture, Mr. Deming said, the outlook was for a slightly less favorable crop than forecast a month earlier. Thus, while agricultural prospects were substantially better than a year ago, they had deteriorated somewhat in the past month due to overly hot and dry weather. Iron ore shipments from the Lake Superior region this year were now expected to total about 70 million tons. While this would be much better than in 1959, shipments would be smaller than in any other postwar years except the recession years of 1949, 1954, and 1958, and those years when shipments were affected by strikes.

Turning to the national picture, Mr. Deming said there seemed to be a tendency to emphasize all of the unfavorable developments that were occurring and to gloss over anything that looked favorable. As a result the atmosphere, both in the Ninth District and elsewhere, was one of more pessimism than he thought the facts warranted.

Mr. Deming expressed the view that System policy had been good and, on the whole, quite well timed, and in this comment he included the recent move on vault cash allowances and reserve requirements. He suggested continuing to maintain about the same degree of ease, or restraint, that had prevailed. Due to the obscurity of the outlook over the next four weeks, he agreed that the Manager of the Account should be given somewhat more latitude for the exercise of discretion than would normally be the case. As he understood it, the problem was not so much the statistics themselves as the problem of interpreting their meaning in terms of ease or restraint. A major problem, it appeared, would come after the next Committee meeting.

With respect to the directive, Mr. Deming said that he would prefer the suggestion of Mr. Balderston. He also raised the question whether the word "needed" was necessary in clause (b) of the directive.

Mr. Allen said that the Seventh District business picture seemed to include both favorable and unfavorable signs. Consumer buying had become somewhat less vigorous. On the other hand, some business economists and business leaders who had been expecting continued deterioration only a month or two ago now reported improvement in order trends, modest in most instances, but an improvement nevertheless. Thus, whereas in the spring many businessmen were disturbed about current trends and consumers appeared confident, the reverse was true at the present time. The lines in which it was heard that there had recently been a noticeable improvement in orders included copper products, aluminum extrusions, tool and die shops, metal fasteners, folding paper boxes, television and stereophonic equipment, electronics, mobile homes, and various wood products used in industry.

Airline travel was at a high level, and there had been a substantial growth in air express business. The Illinois Bell Telephone Company had advised that new installations were stronger in July and August than expected and that toll calls continued to run 5 to 6 per cent above last year, this being about the long-term growth rate.

On the other side, Mr. Allen said, retail sales of all stores in the country in July were 1 per cent below June, and in the last two weeks department store sales in both the Seventh District and the United States ran slightly behind last year. Recent nationwide surveys of consumer buying intentions showed a substantial drop in anticipations to buy major items other than automobiles. Automobile sales slipped below last year for the first time in July, when they were off 2 per cent. The car inventory remained near the million level, about the same as last year, but at that time dealers' stocks had been built up in anticipation of the steel strike.

In the field of bank credit, Mr. Allen reported that Seventh District banks showed a slightly stronger picture than all banks in the country. There had been some loan expansion in the last two weeks and a small net increase for the period since midyear. In this same period last summer there was an unusually strong rise, but it should be noted that loan levels, both in dollar amount and in relation to deposits, were now substantially higher than a year ago. The effects of progressively greater credit ease had shown up among all three classes of Seventh District member banks. The basic deficit shown by Chicago central reserve city banks was heavily concentrated at one dealer bank, and the reserve position of other large Chicago banks had improved. Both reserve city banks and country banks sharply reduced their use of the discount window in the past two weeks.

Mr. Allen said he presumed that the Chicago Board of Directors would vote for a 3 per cent discount rate at its meeting on August 18. The several moves in the field of monetary and credit policy toward greater ease, some of which would not become effective for a couple of weeks, seemed to him to be enough for now, and he would favor resting on the oars for the present. He would suggest trying to keep net free reserves in the area of $200 to $300 million until the next meeting.

Mr. Allen agreed that it would seem appropriate to remove the word "moderate" from clause (b) of the directive, as suggested by Mr. Balderston at the last meeting, and he also agreed with Mr. Deming that the word "needed" was not necessary.

Mr. Leedy reported that agricultural conditions in the Tenth District continued to be exceptionally good. Expectations had been exceeded, especially with regard to the wheat crop. The August 1 report of the Department of Agriculture showed very favorable conditions for the District, as it did for the country generally. Figures that had recently become available indicated that cash receipts from farm marketings in the Tenth District during June were 22 per cent larger than in June last year; crop receipts were 37 per cent higher and livestock receipts 10 per cent higher. The June increase caused cash receipts to be about 1.5 per cent higher for the first six months of this year than for the same period last year, while the comparable comparison for the nation was slightly on the minus side.

Excluding the State of Colorado, District employment in June was slightly below the level of last year but this decline could be more than accounted for by the serious and widespread construction strike in the metropolitan Kansas City area. For the four weeks ended August 6 department store sales showed a 1 per cent increase, although for the year sales were down about 1 per cent compared to the national increase of about 2 per cent.

Mr. Leedy commented that bank deposits continued to move upward during July. For the week ended July 27 reserve city member banks showed daily avarage deposits $143 million higher than a month earlier, of which about $72 million represented interbank deposits. Over the same period daily average deposits at country member banks increased $121 million, reflecting the unusually large wheat crop which was then being harvested. Loan demands continued to be moderate and borrowing from the Reserve Bank had been at a lower level, reflecting generally easier money market conditions and undoubtedly some increased use of Federal funds due to the more attractive rate.

As to policy, Mr. Leedy said it seemed to him that the System should be moving--trending a little further--in the direction in which it had been moving in recent weeks. Certainly there should be an avoidance of tightening reserves through using statistics and not taking account of the uncertainties involved in the counting of additional vault cash as part of required reserves. As he understood it, for the past period it was felt that a level of free reserves of around $200 million would be appropriate. For the month ahead, it was his view that a figure of perhaps $300 million would be more nearly indicative of the proper objective.

Mr. Leedy expressed the view that actions taken since the July 26 meeting had gotten policy ahead of the directive. It seemed to him that a change such as Mr. Balderston had suggested would be appropriate, along with leaving out the word "needed." However, he would be inclined personally to go a little further in order to indicate that policy was now moving actively in the direction of promoting the economy by making bank reserves more available. While the suggestion made by Mr. Johns would be agreeable to him, he would prefer language that would call for providing reserves to encourage bank credit expansion, or perhaps for "increasing the availability of bank reserves with a view to encouraging bank credit expansion." Such a change, it seemed to him, would afford a needed indication of the concern of the Committee about encouraging actively, or attempting to stimulate, the growth of the economy by making bank reserves more available.

Mr. Leach said that although prospects were clouded by scattered weaknesses and indecisive trends, the current volume of business in the Fifth District continued on a high level. There had been no large changes in economic activity in the Fifth District over the past month, but nearly all the changes that had occurred were downward. The characteristic picture of recent industrial activity appeared to be one of declines in unfilled orders and rises in inventories; this was particularly true in the cotton textile industry. The volume of orders received by furniture factories last month declined more than had been anticipated, and no improvement was expected until the next important market in late October. The easing situation in general in manufacturing was evidenced by the latest reports on man-hours and employment, both of which had slight but widespread declines. The seasonally adjusted index of debits fell 4 per cent during July--the second straight monthly drop--and July was the first month this year that debits had fallen below those of the corresponding month last year.

Mr. Leach went on to say that the past three weeks had brought signs of easing at District banks, even though the banks were slow to admit it. Borrowings at the discount window were light. Average outstandings were only $20 million in the past three weeks as compared with $67 million in the corresponding period of 1959. Reserve city banks had been out of debt to the Reserve Bank most of the time during the past two weeks and had been on the selling side in the Federal funds market.

Mr. Leach said he was well pleased with recent actions of the System and did not think there was need to do anything exciting in the immediate future. He would continue to maintain a comfortable atmosphere in the money market. Because of scheduled actions with respect to vault cash and reserve requirements, he would expect greater than usual variations in free reserves, but he hoped they would average at least $200 million in the period ahead.

Mr. Leach said it was his view that the Committee should not go too long at any time without changing the directive. In his opinion the directive should be modified when economic conditions changed and when Committee policy changed. Thus, he felt the Committee was at least six weeks too late in changing to the present directive. At present, however, this directive seemed about in line with what it appeared that the Committee proposed to do, that is, to foster substantial growth in economic activity and employment by providing reserves needed for moderate bank credit expansion. In the discussion around the table regarding the next four weeks, no one had suggested a policy going much beyond providing reserves to meet seasonal needs. If the word "moderate" were eliminated from clause (b), then the discussion should be in terms of free reserves of $300 or $400 million rather than $200 million. On the other hand, unless the thinking was in terms of substantial ease, the directive should not be changed to indicate a policy easier than was actually contemplated.

Mr. Mills said he admitted to being more pessimistic about the business outlook than others who had discussed conditions as they saw them. He sensed that in the future economic historians were going to look back at this period as one in which the earlier absence of a dynamic monetary policy contributed to a loss in forward economic momentum at a time when a major downward movement in the business cycle was brewing. Against that reasoning he wished to address himself to the two factors that he regarded as being of most importance to the Committee at this time. One was the money supply, while the other was the position of the United States Government securities dealers.

Mr. Mills then presented the following statement:

> Since midyear, the "Condition of Weekly Reporting Member Banks in Leading Cities" statements provide increasing evidence of a contraseasonal reduction in bank loans, which trend again raises puzzling questions about the money supply. The continued failure of a Federal Reserve System monetary policy to obtain an increase in the money supply in response to overt actions taken to inject additional reserves into the commercial banking system superficially would suggest more aggressive policy actions along similar lines. The arguments in favor of using the leverage of monetary and credit policy to induce an expansion in the money supply would be persuasive if the contraction in bank loans had come about through a forced liquidation of credit. If that had been the case, an effort to stimulate an expansion of bank deposits through monetary and credit policy actions would be in order so as to offset the current shrinkage of deposits that is consequent upon a contraction in bank loans which is especially apparent in the central reserve cities. However, there are reasonable grounds to believe that the contraction that is occurring in commercial bank loans and deposits is a reflection of the general slackening in economic activity and is in no wise a result of any forced liquidation of bank credit except as that term might be loosely applied to the policies of banks who are

unwilling to permit the level of their loans to rise higher, and in order to forestall such a happening are curtailing their outstanding loan commitments in some areas. Under such conditions indicating that the contraction of bank loans and deposits is the result of the conscious actions taken by borrowers to repay their loans rather than actions taken by the banks to demand loan repayments, it follows that aggressive actions taken by the Federal Reserve System, and intended to produce a bolstering influence on the sagging money supply, would have only a minimum effect in that direction, but could have a devastating effect in forcing down the level of short-term interest rates. The question, therefore, becomes whether it is better policywise to attempt to stimulate an increase in the money supply at the expense of producing an artificially low level of interest rates carrying an inflationary bias, or whether it would be wiser to recognize the downtrend in the money supply as a combination of reluctant lender and reluctant borrower attitudes which should not be interefered with.

In the light of current credit developments, Federal Reserve System policy makers would be well advised to avoid actions that would aggressively attempt to force an expansion of the money supply that would have the harmful effect of exerting unduly heavy downward pressure on interest rates to the detriment of commercial bank earnings at a time when their retention is necessary in order to strengthen bank capital positions. Everything considered, and particularly as an overly easy Federal Reserve System monetary and credit policy could be expected to produce only minimum effects toward expanding the money supply, it is essential that policy actions skirt the pitfalls that have been described. The kind of monetary and credit policy now called for is one that will continue to maintain a moderate volume of free reserves, with the free reserve level partly to be gauged by the movement of interest rates, to the end that the supply of positive free reserves will be brought down on such occasions as there are indications that monetary and credit policy actions may be causing interest rates to fall unduly. Furthermore, due to the fact that previous Federal Reserve System policy actions have permitted member banks to reduce their discounts at the Federal Reserve Banks to a low level, the expansive effects of a relatively low level of positive free reserves are now greater than at times when the member banks were more heavily indebted to the Federal Reserve Banks. Therefore, there is no longer any urgency to aggressively force new reserves into the commercial banking system.

Continuing, Mr. Mills said it was an impressive fact to him that the volume of Government securities currently held in dealer positions represented, percentagewise, a very considerable proportion of the expansion that had occurred in member bank holdings of Government securities since the time that the Federal Reserve System commenced to supply reserves more freely. He would judge that the dealer positions might represent perhaps one-third of the $6 billion increase. In a sense the dealer positions seemed to be both an overhang in the market and also an element of stability in the market, in that the dealers had outdone themselves in creating a market having breadth and depth. At a time like this it would seem to be the self-interest of the dealers to protect their investments and protect their positions. Their investment in United States Government securities at this very high level in a real sense tended to aid and abet System policy intentions in that the dealers would wish to retain those investments until the flow of investment funds into the market reached a point where they could move their securities into permanent hands. If there was rationality in that reasoning, dealer positions were in a sense important in maintaining the interest rate structure and would continue to be until those positions were lowered to a degree. This brought him back to his original thesis that a monetary policy objective combining both a lower level of free reserves and a fluctuating level of free reserves, say around $100 million or thereabouts, would be in order and would have the concomitant outside assistance coming from the position of the dealers in Government securities.

In reply to a question, Mr. Mills said that he would perhaps drop the word "moderate" from the directive, but that otherwise he would be inclined to leave the directive in its present form.

Asked what he would suggest with regard to reserves coming into the market through the actions on vault cash and reserve requirements, Mr. Mills said he agreed with Mr. Rouse that the reserves provided through a release of vault cash tend to work themselves through the banking system slowly enough that there might not be any immediate impact. If there was some seasonal increase in bank loans, this would tend to absorb a portion of those reserves. In his opinion the reserves supplied to the central reserve city banks through the forthcoming reduction in reserve requirements would have a much greater impact at the time it occurred. If reserves should be superfluous, they could be more easily withdrawn from the money market when they had gone into the position of central reserve city banks than any other market area.

Asked whether he would sell securities if free reserves for the banking system as a whole reached larger proportions than $250 or $300 million, Mr. Mills said that he might be so inclined. Here again, however, he would follow movements in interest rates and dealer positions closely.

Mr. Szymczak noted that many dealers apparently had bought and held securities looking toward a rise in prices, at which time they would sell on the basis that there would be larger free reserves. That was the time they would start unloading. In his opinion the holdings today were based on the expectation of a rise in prices.

Mr. Mills commented that the dealers must have a market and that the market in a sense would reflect the supply of reserves. By careful handling, he hoped that the interest rate structure might be maintained.

Mr. Szymczak then noted that many dealers apparently expected a greater demand than had come forth, and Mr. Mills commented that the dealers would not want to sell at a loss if they could help it.

Mr. Rouse commented that the dealers would try not to sell at a loss; they would endeavor to protect themselves. Thus far they had had an extremely profitable year, and they had quite a cushion on which to operate. He also noted that bidding on bills comes up every week. Some dealers would get to a point where, if they were not able to reduce their holdings, they could not bid for new bills. Thus there would be a higher bill rate in order to move the securities. The dealers could not go far beyond where they were now. In addition to carrying about $2 billion of securities, they were using another $500 or $600 million of credit in the form of a type of repurchase agreement called an investment repurchase agreement. He had not included that in the figures he used. Only a fraction was bank credit, the largest amount having been provided by nonbank sources.

Mr. Robertson commented that he hoped the Committee would not formulate policy on the basis of trying to outguess the dealers. As to the economy, he felt that the country was not on a marked downslide at the moment. However, the economy appeared to be on a fairly even level with perhaps a little sliding-down. Consequently, in the next month the System could afford to permit the actions that had been taken thus far to work in the direction of providing a relaxation that would enhance the growth of the money supply. As he saw it, there would be a fall upturn, and the System would not want to go so far that it could not switch the other way. In all the circumstances, he would recommend that the Desk not endeavor to offset all of the additional reserves that would come into the market through the actions that had been taken, but rather that it permit those actions to support the current trend to some extent without getting greatly easier. This would involve providing a greater latitude for the exercise of discretion on the part of the Manager than would be ordinarily the case, particularly in view of the statistical picture that would be presented. He would not let that statistical picture overbalance the feel of the market. Rather, he would try to hold the feel of the market, while permitting a moderate amount of ease to develop over the next month.

Mr. Robertson said he would carry this out by amending the policy directive in a way that would not merely take out or insert a word, for that would tend to overemphasize the importance of the particular word. Instead, he would prefer to see the policy directive expressed in a different set of words, such as "to encouraging monetary expansion to foster sustainable growth in economic activity and employment." This would carry out the view of Mr. Mangels and also that of Mr. Leedy, he believed. He was fully aware that the Committee probably would want to change this directive a month hence, or at least not too far in the future, because he expected the Committee to be swinging in the other direction. If he was wrong, however, that would not hurt anything. At this particular period the Committee could afford to be easy in view of the state of the economy and the lack of inflationary pressures at the moment.

In reply to a question, Mr. Robertson said he would prefer to use "encouraging" rather than "stimulating" in the directive at this particular juncture. In hindsight the word "stimulating" would have been fine if it could have been used two months ago.

Mr. Shepardson said he concurred with those who viewed the picture as one of fairly level activity with no widely divergent offsetting trends. There were some divergent trends, it was true, but in general the economy was moving along at a good level. The future was somewhat clouded by the impact of various factors, including uncertainty as to the fall upturn. However, with a high level of activity and the economy continuing on a plateau for the moment, it seemed to him there was no reason for any marked shift in the policy that the System had been pursuing. Current Committee policy, as set forth in the present directive, appeared to be in line with the comments around the table about providing for some expansion in the money supply. This, he thought, was desirable. Expansion should be permitted to take place at a rate that would not create an unduly easy condition and would not have a further depressing effect on rates. With uncertainty existing as to the timing of the effects of the vault cash release, he thought there was much to be said for giving a good deal of leeway to the Manager of the Account in appraising the effects of the released reserves as they came into the market. For that reason it was difficult to set a statistical free reserve target, whether it be $100 million, $200 million, or some other figure. In all the circumstances, he felt the Committee should ask the Manager to try to maintain about the same condition in the market--whether it be called restraint or ease--that now prevailed, taking into account the delayed effectiveness of the reserves released through the action on vault cash. He agreed with Mr. Irons that the Committee should be cautious about increasing ease too fast at the present time.

With respect to the directive, Mr. Shepardson said that he would not object seriously to removing the words "moderate" and "needed" from clause (b). However, he would prefer to leave the directive as it stood, since he felt that the present language more nearly expressed what most of the comments around the table today seemed to regard as the appropriate objective.

Mr. King said that Mr. Allen had expressed in his comments most of what he (Mr. King) would have said. He believed that the economy had been in a dip of some kind, but that this may have bottomed out and the economy was now rebounding. Thus, he was a little more optimistic today than he had been in some time. His contacts with small businessmen and small communities indicated that the economy may have bottomed out within the past two weeks.

As to open market operations, Mr. King said he thought that any effort to try to fix a target within a certain range of numbers would be rather hopeless and would not serve any purpose at the present time. He could not see that trying to work within a certain bracket of free reserves would necessarily produce any certain results. The situation would require discretion on the part of the Account Management, but in his view the situation also called for minimum action on the part of the Desk. The policy actions taken recently would have their effect in due course; and it seemed to him that a procedure of absorbing and supplying reserves alternatively would be rather fruitless. Accordingly, his views were on the side of a minimum amount of open market operations, although he would not want ease to develop to such a point as to set in motion all kinds of worries. To summarize, unless he was informed of errors in his thinking, his preference would be a minimum amount of open market operations, leaving the market to fluctuate pretty much on its own. In view of the fact that recent policy actions would result in injecting reserves, it seemed to him that it would be of questionable wisdom to put in those reserves and then withdraw them through open market operations.

Mr. King went on to say that he could not work up enthusiasm for changing three or four words in clause (b) of the directive periodically. In his view, the important thing was the consensus for open market operations developed at the respective Open Market meetings. He would be inclined to agree with any of the proposals made thus far, but he did not think there was a great deal of difference between them. While he was not stating this as a suggestion, his inclination would be to go so far as to leave clause (b) in a permanent form calling for open market operations with a view to fostering sustainable growth in economic activity and employment. He recognized that it had been the practice of the Committee to change clause (b) periodically. Even within this context, however, he did not see a great deal of need for any change at this time.

Mr. Hostetler said that the year 1960 probably had been a greater disappointment to people in the Fourth District than to people in any other district. This might explain why a certain recent policy action (reduction of the discount rate) was initiated in the Fourth District. On the other hand, at the end of July a meeting of industrial economists representing leading industries in the District was held at the Reserve Bank and the participants were nearly unanimous in expecting economic activity before the end of the year to reach a new record high in terms of the industrial production index.

Mr. Bopp said he did not have too much to report on Third District business developments and would say simply that there was nothing too encouraging in the picture. However, the reserve positions of member banks had eased significantly. The basic reserve position of Philadelphia banks had moved from roughly \$75 million net borrowed reserves to roughly \$30-\$35 million. In the past three weeks only one Philadelphia bank had borrowed from the Reserve Bank, and then only for one day.

Although he agreed with the thought that open market policy should not be changed significantly and that a change in the directive might not make much sense when one looked to the period ahead, Mr. Bopp recalled that three weeks ago the Committee felt that a change in the directive might not be appropriate in view of the Treasury financing. The theory of catching up therefore might make a change appropriate at this time. He was not too much concerned as to the precise wording, but on balance he would prefer something along the lines suggested by Mr. Robertson.

Turning to the discount rate, Mr. Bopp said that he and his associates at the Philadelphia Bank were surprised to read on the ticker on August 11 that some Reserve Banks had moved on the discount rate because at the time the news appeared on the ticker the Board's wire had not yet been received. He felt that in all probability the directors of the Philadelphia Bank would act to reduce the discount rate at their meeting this Thursday.

With regard to open market operations in the forthcoming four-week period, Mr. Bopp suggested that present conditions be maintained to the extent possible, with any doubts resolved on the side of ease. He agreed that the circumstances would require giving a great deal of leeway to the Account Manager. In view of the dealer positions and other matters that had led Mr. Rouse to say that the situation was perhaps reminiscent somewhat of the summer of 1958, it might be that the Account Management would have its work cut out and that sympathy for the Account Manager would be needed.

Mr. Bryan said he did not see anything in the economic situation in the Sixth District that required a report today. Neither did he believe he had any comments on the general economic situation that would add significantly to the discussion. One could make important arguments on the general thesis that the economy was bottoming out of its dip, or that it was going to move upward from the present plateau or whatever one might want to call it. However, one could also make important arguments that the economy was going into a downslide.

Mr. Bryan pointed out that he had never favored doing anything in recent months that went beyond the idea of providing a reserve base for moderate credit expansion. If the Committee wished to leave the policy directive essentially unaltered, he would think it appropriate to omit the word "moderate" from clause (b) of the directive, which would then fully express his own feeling. If, however, the Committee should decide to alter the directive further, he believed that it ought to change the linguistic approach. On the matter of giving a directive in terms of free or total reserves, or on the basis of any other concept, it seemed to him that this would be extraordinarily difficult at present because the market repercussions of recent actions taken by the Board were not yet known.

Mr. Bryan said he wished to point out that in August of last year daily average reserves were $18,613 million. Thus far this August, daily average reserves were about $18,500 million. Further, on the basis of the Board's staff projections circulated this morning, it appeared that the daily average for the full month of August would be well under $18,500 million. If so, the banking system of the country had less reserves with which to support credit expansion this August than last August and the policy was not one of ease as far as total reserves were concerned. This illustrated the difficulty in giving directions in terms of free reserves. Looking at the projections for the weeks ending August 24 and August 31, one noted some rather radical shifts in the components. A free reserve projection of $455 million for the week ended August 24, would result in an average of $18,373 million of total reserves; however, for the week ended August 31, free reserves projected at $305 million would produce a substantial rise in total reserves. The net result would be an average for the month well under the figure for last year. Therefore, if the Manager was expected to provide for moderate easing and some provision, say $50 million per month of total reserves, was to be made for secular expansion of the economy, then in the week ending August 24 the Manager would have to let free reserves run well above the figure of $455 million, and in the week ending August 31, he would have to allow another variation from the free reserve projection if he was to average out with anything remotely comparable to what he (Mr. Bryan) felt the result should be in terms of total reserves. One thing obvious was that the free reserve figure, if it had been projected at all accurately, would have to fluctuate radically to produce what, in his judgment, would be an appropriate total reserve figure.

Mr. Bryan said he would favor a direction to the Account Manager in terms of giving him latitude for the exercise of discretion; that is, telling him to manage free reserves, depending on the components, so as to provide for a moderate growth in total reserves.

Mr. Rouse noted that the daily average figure of total reserves through August 12 was $18,503 million.

Mr. Johns presented a statement substantially as follows:

> Without engaging in debate on the question whether the economy is in recession or on the brink of recession, it is generally agreed, I think, that production is substantially below practical capacity and that inflation is not an immediate problem. Economic activity is at approximately the level of 15 months ago. The current posture of monetary policy, which I take to be one of stimulating rather than restraining, is therefore, in my opinion, appropriate and worthy of continuance. It seems to me that recent policy actions by the Board of Governors in its exclusive jurisdiction, along with discount rate actions and operations carrying out the policy adopted by this Committee in its directive of May 24, all indicate clearly that the System is faced in the right direction.

With respect to the total reserves of the member banks, and for the purpose of arriving at a conclusion as to the size of desirable increments in the immediate future, I observe that in the period April through July of this year the increase in the supply of reserves, seasonally adjusted according to the Board's series, was at the annual rate of 5.6 per cent (the July figure is still preliminary). Our own figures indicate that this rate persisted in the first ten days of August. In my view such a rate of growth in reserves is appropriate, and I suggest it as our approximate objective, subject to review, of course, at the Committee's frequent meetings. I would again protest against permitting a free reserve target to divert us from this objective or distract us. I would urge that a free reserve target or range, if such there must be, should be appreciated and used as a means to an end and not as the definitive guide to open market operations. Free reserves should be caused or permitted to vary and fluctuate as needed in order to bring about the desired growth in total reserves.

As to the directive, I might point out that one of the disadvantages of having a suggestion for a change distributed at an early stage of the meeting is that this permits the suggestion to be shot at before there is an opportunity for the person making the suggestion to state his reasons.

Be that as it may, at the last meeting it was suggested that the word "moderate" be removed from clause (b) of the directive. I see no inconsistency between that word and recent developments in reserves and bank credit because I do not think bank credit expansion has been more than moderate. However, I support the suggestion for removal of the word "moderate." It is not a very precise word, but I think its connotations are, in present circumstances, on the wrong side. At this time I would prefer not to use a word which seems to suggest illiberality. I would prefer to connote generosity.

Two other words in clause (b) also merit scrutiny, I think. First, I suggest that for present purposes, and for the reason just mentioned, "stimulating" is a better word than "fostering." Perhaps I should say it is a stronger word. Second, it seems to me that at this particular time the word "sustainable" puts the objective of growth in activity and employment a bit out of focus. Of course we want growth to be sustainable in the long run, but in the present situation no cause appears for worry about too rapid or unsustainable growth. We are now concerned--or perhaps I should say I am--about lack of growth or possible contraction in activity and employment. For these reasons I suggest deletion of the word "sustainable" and in final result a revised clause (b) in the form previously distributed.

I think I agree with Mr. Deming that the word "needed" is not required, and I would agree to its deletion. Also, I would not object to Mr. Leedy's suggestion for use of the word "encouraging," unless it should be considered redundant to the idea we suggested by use of the word "stimulating."

I am in favor of a discount rate reduction, of course. However, I must confess to some unsettled feeling about the current actions. If it is true, as I have read, that the reduction to 3 per cent is only a technical adjustment to the market, I think it has to be said that less than the indicated technical adjustment has been made, unless we wish to imply that market rates are lower than we think they ought to be. If we do not intend such implication, why do we underadjust? I, myself, have argued in recent days--and I feel sure others must have--that to do more would flash a "scare signal." In the cold, gray dawn of the morning after, I wonder whether this is right. I wonder whether we tend to take ourselves too seriously and to overestimate our power to determine the attitudes of people who have attitudes about things like this. I wonder how good our conjectural attempts to psychoanalyze the public are. I wonder whether it might be altogether reasonable to assume that the public would take comfort and assurance from Federal Reserve action which is resolute and all that is indicated by facts visible to everyone. I wonder whether it would be more frightening to lower the rate a whole point at one time when such is indicated and the public is expecting rate reduction, or to take smaller steps in fairly rapid succession. The latter course, perhaps, could be nervously interpreted as meaning that the Federal Reserve sees or thinks it sees progressive degneration. Parenthetically, if degeneration should unhappily come, requiring bold action, and we have deferred action to catch up besides, we could find our difficulties compounded. Be all this as it may, I think the discount rate ought to be under 3 per cent, and I wish it were.

A special meeting of the St. Louis directors has been called for Thursday of this week. When I left the Bank yesterday, it seemed assured that a quorum would be present. These matters I have just presented may form the substance of the questions I will have to answer when the directors meet.

Mr. Szymczak said that, along with the others who had expressed the thought, he felt this was a time when the Account Manager should be given all of the leeway he had ever had. This was because of the policy actions taken recently and the question of their effects over the next four weeks. He agreed with Mr. Mills that a problem was created by the holdings of securities on the part of the Government securities dealers. He would not favor any sudden or abrupt change in interest rates; if a change should come, it should develop gradually and slowly.

Mr. Szymczak noted that the actions taken by the Board of Governors recently were announced as a further implementation of the law so far as the additional release of vault cash was concerned and as a first step in implementing the law so far as the reduction of reserve requirements at central reserve city banks was concerned. As announced, these actions were taken at a time when, in the opinion of the Board, there would be a seasonal need for credit. In other words, the Board was implementing the law at a time when it felt that the law could appropriately be implemented. It might be, of course, that the actions would supply more reserves than should have been provided.

Continuing, Mr. Szymczak brought out that the change in the discount rate was announced, as indicated by Mr. Johns, primarily as a technical adjustment. Perhaps the new rate was not quite at the point to which the adjustment should have been made, but it was a step in that direction. Thus far no one had said officially that the System was changing its policy, although each person might have different ideas as to what the actions meant and as to what actions the System should take.

In his opinion this was a time when the Manager should follow the same pattern. Therefore, if the total reserve pattern or the reserve position of the banking system was such as to affect the rate structure too greatly, this should be taken into account. On the other hand, if the vault cash release did not affect the money market excessively, that should be taken into account. The Account Manager should feel his way along until he could see the entire picture.

Mr. Szymczak added that when the System formulates monetary policy it does not want to disturb the financial structure of the country unduly. No one could know what was going to happen to the economy after early fall. Personally he felt that it would move upward, that it had gone down and would firm up somewhat, and that there would be some positive change upward if for no other reason than seasonal factors. Further, there would be Governmental expenditures for defense, and perhaps there were other things that could not be foreseen at the moment.

Accordingly, Mr. Szymczak said, it was his opinion that the System should feel its way at this time and watch the situation from day to day. He felt that the paper distributed recently from the New York Bank on the use of short-term securities other than bills was a good one, and he hoped that at some point it would be possible to discuss the matter further at an Open Market Committee meeting. He also felt that the actions taken by the Board on reserve requirements to this point had been good. On the question of their effect on the whole structure of reserves, one would have to wait.

Mr. Szymczak noted that the Board had been endeavoring to formulate a basis for the classification of reserve cities pursuant to the law enacted in 1959. When the Presidents received material bearing on this matter, he hoped they would review it seriously and give the Board the benefit of their thinking because this was something that also would affect the structure of the banking system. At some point, of course, it would be necessary for the Board to do something. It must move forward to eliminate the differential between the central reserve city and the reserve city banks, and to provide bases for the classification of reserve cities and the exemption of individual banks from reserve city requirements.

In summary, when talking about the possible reserve picture he wished to say again that he thought it would be necessary for the System to feel its way along. In his opinion, free reserves anywhere in a range from $100 million to $250 million would be all right. However, whether the figure was $100 million, $250 million, or even $300 million, he felt that open market operations must be guided pretty much by the effect rather than the figure.

Mr. Szymczak said he would prefer to leave the directive as it stood.

Mr. Balderston referred to the presentation by Mr. Marget earlier in the meeting and said his reaction was one of comfort as far as the prudence of the actions taken by the System over the past week was concerned but one of no comfort as to the longer-run future as long as a favorable trade balance of around $4 billion failed to wipe out the unfavorable balance of payments. He saw no long-run solution until a decision was made to bring home the soldiers and their dependents who were being supported abroad, thus leaving to others, to the extent possible, the financial burden of supporting troops, particularly in their respective countries. This country might have to provide the hardware, but it did not have to provide the men and their dependents and still pay for the burden of their upkeep. He merely threw this out as a word of caution in connection with the distribution of the explanatory statement presented by Mr. Marget this morning.

Turning to corporate profits, Mr. Balderston suggested that the second-quarter reports, as referred to by Mr. Noyes, were significant because a change in profits and expectations influences business decisions regarding plant expansion, inventory policies, and other things. He recognized that the second quarter of last year was exceptional, the $51.7 billion of profits recorded by corporations during that quarter having been the largest in history. He also recognized that the drop from the second quarter of 1959 to the second quarter of 1960 was only in the order of about $5 billion. While this was not very large in the aggregate, what impressed him was that corporations having no conceivable link with steel found that cost pressures had made it difficult to earn as much in the second quarter of this year as the comparable quarter of last year. Some 70 per cent of manufacturing corporations earned less in this quarter than in the same quarter last year, and in looking over figures provided by Miss Stockwell of the Board's staff he found that only four types of businesses had done better this year. Despite the fact that the second quarter of 1959 was an exceptional period, it gave him some concern that all of the other categories found it harder to make profits during the second quarter of this year than a year ago. Statistically, there was yet another unusual aspect of the matter. Only in three other postwar years--1947, 1949, and 1951--had manufacturing corporations failed to make a better showing in the second quarter of the year than in the first quarter.

With regard to the consensus of this meeting, Mr. Balderston said he gathered that the Committee favored a continuance of the current policy, giving to the Account Manager more than the usual freedom to follow the feel of the market because of the changes in reserve requirements that were to occur in the near future.

As to the directive, Mr. Balderston noted that the views expressed had been mixed. Of the members of the Committee, it appeared that six, other than himself, were inclined to make a change and that four were inclined to make no change. Of the other Presidents attending this meeting, it appeared that five favored a change and that one would not favor a change. He had the feeling that, of those who wished to make a change, the sentiment early in the meeting was simply to drop the two words "moderate" and "needed," but that later in the meeting, after there had been the benefit of further discussion, there was increasing sentiment for the adoption of wording along lines such as Messrs. Mangels, Leedy, and Robertson had suggested. More specifically, he sensed that perhaps there was some feeling toward going along with the language suggested by Mr. Robertson. He then inquired whether those who had spoken early in the meeting now would deem it preferable, after hearing the subsequent discussion and suggestions, to go further than merely to eliminate the two words he had mentioned.

Mr. Treiber said that this would be agreeable to him, while Mr. Erickson said although he had no fixed feeling his preference would be simply to omit the words "moderate" and "needed." Mr. Irons said he had no strong feeling and would be willing to accept the suggestion of Mr. Robertson, and Mr. Mangels indicated to the same effect. Mr. Deming stated that his views were similar to those of Mr. Erickson. Mr. Allen stated that he would be willing to omit the two words, but that otherwise he would favor no change, while Mr. Leedy stated that he would accept the Robertson proposal. Mr. Leach said that he would favor no change; if a change were to be made, however, he thought it would be better to adopt something along the lines Mr. Robertson had suggested, rather than just to omit the word "moderate." Mr. Mills said that he would accept the Robertson proposal.

Mr. Shepardson said that he would favor no change. If a change were to be made, however, he would do something other than just omit the word "moderate." With reference to the suggestion of Mr. Robertson, Mr. Shepardson proposed that clause (b) might read more smoothly if it provided for operations with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment."

Mr. King stated that he would prefer to leave the directive unchanged, and Mr. Bopp indicated that he would favor the Robertson proposal as modified by Mr. Shepardson. Mr. Bryan expressed a preference for leaving the directive unchanged but added that if a change were made he would prefer the Robertson proposal to the others that had been mentioned. Mr. Johns said that the Robertson suggestion would be agreeable to him, and Mr. Szymczak said he would favor no change in the directive.

The suggestion was made that, in the light of the discussion, it might be possible to accept by acclamation the language for clause (b) suggested by Mr. Robertson, as modified by the suggestion of Mr. Shepardson. However, there was an indication on the part of at least one of the members of the Committee who favored no change in the directive that it would be desirable to have the votes recorded in the minutes and in the policy record of the Committee.

Thereupon, upon motion duly made and seconded, it was voted, with Messrs. King, Shepardson, Szymczak, and Allen 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 encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

Mr. Balderston then inquired whether there were any comments on the consensus for open market operations during the forthcoming period as stated by him earlier during the meeting.

In discussion of this point, Mr. King raised the question whether the Committee could continue the policy that it had been following in view of the change agreed upon in the policy directive.

Mr. Robertson said he sensed that many of those at the meeting felt that the Desk should not endeavor to offset the whole amount of reserves that would be released through the action of the Board relating to vault cash and reserve requirements. Then, after noting that the record of the July 26 meeting indicated that the Committee was aiming at a given figure of free reserves, he asked whether the consensus today did not mean that the Desk would look more to the total picture. The figure of free reserves might rise, but this still might not represent any further easing.

Mr. Rouse noted that the figure might rise or that it might go down.

Mr. Balderston said he gathered from listening to the discussion today that the Committee desired to carry over the goals discussed at the July 26 meeting. The same goals would be carried over, but in view of the shifting situation the Committee desired to give the Account Manager more freedom.

Mr. Robertson suggested that the goals today included a qualification that the Desk would make errors on the side of ease.

Mr. Rouse stated the matter in terms of resolving doubts on the side of ease, a revision with which Mr. Robertson expressed agreement.

Mr. Shepardson said that, as he understood it, the goal was also to provide for some moderate growth in the money supply.

Mr. Rouse stated that this was to be hoped for although, as Mr. Noyes had pointed out, it was a little difficult to figure on. Mr.

Balderston commented that this was particularly true in view of the Treasury tax and loan account balance at the moment being larger than customary, to which Mr. Rouse added that the Desk should have an assist in that respect in view of the prospective payments by the Treasury.

Mr. Balderston then inquired of Mr. Rouse whether the general instruction was what he thought he needed for the next few weeks, to which Mr. Rouse replied that it sounded like a vote of confidence but that he was still a little fearful. He then stated that he had no questions.

It was agreed that the next meeting of the Federal Open Market Committee would be held in Washington on Tuesday, September 13, 1960.

Mr. Johns, speaking as Chairman of the Presidents' Conference, said he had been interested in the indication that material might be coming out to the Presidents at some point with respect to the study of the classification of reserve cities. In view of the fact that the Presidents' Conference would be meeting on September 12, he inquired whether there was anything the Presidents could do to prepare for discussion with the Board at the joint meeting of the Board and the Presidents the following day, if in fact it was intended to have discussion at that time. He noted that it was frequently found to be helpful to have time for a Committee or Subcommittee of the Conference to study such a matter and present suggestions to the Presidents.

It was indicated that material on the subject probably would be distributed to the Presidents within a week. Mr. Balderston commented in this connection that the material to be sent represented tentative suggestions based on tentative assumptions. The Board did not wish to send out just a blank piece of paper, and it would therefore send what was available with a request for criticism and ideas.

Mr. Szymczak commented that the Board had taken no position and that the material to be sent out was in the nature of a collection of working papers.

Mr. Johns suggested that it might be appropriate to refer the material to a Conference Committee, and that perhaps the Subcommittee on Legislation might pick up where it had left off in the latter part of last year.

Mr. Balderston replied that the matter of procedure would be one for the Chairman of the Conference and the other Presidents to decide. In any event, however, the Board would appreciate all of the help it could get.

The meeting then adjourned.

Ralph A. Young
Secretary