A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, December 13, 1955, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Sproul, Vice Chairman
Mr. Balderston
Mr. Earhart
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Erickson, Johns, and Powell, Alternate Members of the Federal Open Market Committee

Messrs. Williams, Bryan, and Leedy, Presidents, Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Daane, Hostetler, Rice, Roelse, Wheeler, and R. A. Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 16, 1955, were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period October 4 to December 7, 1955, and at this meeting there was distributed a supplementary report covering commitments executed December 8-12, 1955, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

In response to Chairman Martin's request for comments, Mr. Rouse stated that he would like to emphasize the content of the first paragraph of the supplementary report which, in effect, indicated that the difficult period which developed last week had been passed successfully but that the underlying tone of uncertainty was still a cause of concern.

Chairman Martin stated that he had observed from Mr. Rouse's report of System transactions with dealers during November that, of the total of $167 million of Treasury 2-5/8 per cent certificates of indebtedness purchased on a when-issued basis, $90 million had been acquired from one dealer, whereas the largest purchase from any other dealer was $12 million. The dealer who had sold the $90 million to the System had indicated in his weekly letter issued shortly after the purchases the belief that the Federal Reserve was not "in the market" for such securities and that such buying as had taken place was for the account of the Treasury. Chairman Martin asked that Mr. Rouse comment on this situation.

Mr. Rouse stated that while he did not have the full details of the transactions in question, purchases were made both for the System account and for the account of the Treasury. The System account did more business with this dealer than with any other dealer. This dealer, Mr. Rouse said, had come to the conclusion that the Treasury's exchange offering announced on November 25 was very attractive and had recommended participation in it very strongly. Accordingly, Mr. Rouse said, the dealer seemed to feel that he had a commitment to help make the offering a success. Mr. Rouse described some of the transactions in which the dealer in question had participated and concluded his comments by stating, in response to a further question from the Chairman, that he did not think that the dealer knew at the time that the trading desk was buying 2-5/8 per cent certificates for System account.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the transactions for the System account during the period since November 15, 1955 were approved, ratified, and confirmed.

Members of the Board's staff then entered the room for the purpose of assisting in the presentation of a review of the economic and credit situation. The script of the review was sent to the members of the Committee following the meeting, and after the presentation the staff members who had entered the room in that connection withdrew.

The staff review brought out data showing that during 1955 economic activity in the countries of the free world generally has been at a high level and rising, and it emphasized that monetary and fiscal authorities everywhere have been faced with the problem of checking actual or potential inflationary developments. In concluding the presentation, Mr. Thomas commented on credit problems under present conditions of economic activity in the United States at levels close to capacity operations. He said that further expansion in total output could proceed only at a slackened pace, although there might be significant increases in some areas as others leveled off or even declined. In that situation, use of credit must be more moderate than over the past year if Federal Reserve policy to promote sustainable growth on a noninflationary basis was to be achieved. Should credit demands by consumers, business, and State and local governments continue to exert pressures for further credit and monetary expansion at a rate beyond the possible growth in output, additional measures of restraint would be required. If restraints already imposed or in process moderated further credit demands, including deferment or abandonment of some programs because of increased interest rates and limited credit availability, further credit restraints probably would not be needed and some relaxation might be in order. If the general economic situation should appear to shift to a less ebullient stage, the System would be in excellent position to modify its credit and monetary policy in the direction of less restraint by not absorbing as many of the reserves that normally flow back to the banking system early in the year. Mr. Thomas expressed the view that at present developments still seemed to point to the need of a firm hand on the reins to keep the pace of advance within tolerable limits.

Chairman Martin said that the period since the last formal meeting of the Committee on November 16 had been very interesting. There had been an increase in discount rates which had been well received by the business community in the light of the general credit policy being pursued. He suggested that today there should be discussion of the adjustments, voluntary or involuntary, that may have been made in the Committee's activities by meetings held on November 30 and December 8 under telephone conference arrangements, and of the adjustments in the money market that would be taking place over the year end. It was important, he said, that all members of the Committee realize that they were dealing with a very complicated situation involving both the velocity of money and its volume and their relationship to the general business situation. Chairman Martin expressed the view that the Committee had met the situation to date very well. However, it should be extremely careful about getting any fixed judgments as to the nature of what it was accomplishing: the Committee must not exaggerate or overestimate the importance of monetary policy in the general picture. He suggested that the situation be discussed in the light of the economic information presented by the staff, of conditions in the individual Federal Reserve districts, and of the money market situation. Since this might be the last formal meeting of the Committee during 1955, it would be helpful if the discussion would include general consideration of the Committee's policy over the year-end, as well as specific suggestions both as to the direction of policy and as to the implementation of whatever policy was agreed upon.

Chairman Martin then called upon Mr. Sproul who made a statement substantially as follows:

1. The economic situation and the economic outlook continue to call for a restrictive credit policy. Production is still rising, but demands for raw materials and many manufactured products tend to expand as rapidly as production, if not more rapidly, with resulting upward pressure on prices. There also appears to be a high degree of confidence in future economic developments, on the part of both consumers and businessmen, which reinforces the immediate situation. A speculative tinge is added by the urge toward mergers and the prevalence of stock-splits with resulting stock market activity.

2. As anticipated, the demand for loans at member banks has continued strong, particularly for business loans. The banks have met this demand by further sales of securities to nonbank investors and to some extent by increased borrowing at Federal Reserve Banks. It appears that the demand for loans has been larger at central reserve and reserve city banks, while the flow of deposits has been away from these banks, so that "country" banks have been able to meet the substantial demands made upon them without the same relative strain on their reserve positions.

3. Interest rates at short term have risen fairly rapidly, and more slowly at longer term, a not unusual development in a period of increasing credit restraint. More important perhaps than the actual amount of the increase in long rates has been the appearance of some congestion in capital markets and of uncertainty in the minds of dealers and investors concerning the period ahead. This uncertainty had an influence upon market behavior in connection with the Treasury's recent refunding and cash offering.

4. When the process of immediate digestion of these offerings has proceeded a little further, the Treasury will be out of the way as a complicating influence in the credit situation, assuming that the January C.C.C. financing will not be too large in amount and not too difficult of absorption by the banks. From here on, with a substantial cash surplus in prospect for the second half of the current fiscal year, fiscal operations will be

working on our side, in the sense of exerting some restraining influence on the economy, that is, unless the prospect of a surplus induces increased Government spending or anticipation of a tax cut induces increased consumer spending.

5. During the latter part of December the banking situation will be under the usual year-end pressures. The money market now appears to be convinced that no relaxation of credit restraint is to be expected. It is doubtful whether the capital market has yet fully adjusted to the signal of continued and perhaps increased restraint given by the recent increase in the discount rate. In the circumstances it would seem unnecessary for us to consider further affirmative restrictive measures until the completion of year-end adjustment, but we should act to regain in some degree the level of pressure we had reached before the Treasury financing. In the light of present reserve projections, which are somewhat confused by uncertainties as to year-end adjustments and the Treasury's receipts and expenditures, this would call for allowing some maturing bills to run off, and possibly for some sales during the remainder of December if sales can be effected within the confines of a policy of maintained pressure. Presumably this would be followed by heavier redemptions and perhaps some sales in January. Meanwhile, if there should be temporary and undesirable increases in pressure in the money market, relief could be given by the use of repurchase agreements which we, as authorized by the Committee, have indicated could be expected to be available through the year end.

Mr. Erickson stated that Mr. Thomas had summed up his views in his comments on the credit situation. A "tight rein" should be kept on the situation. The Committee recently had lost some of its flexibility, Mr. Erickson said, but the difficult period of the Treasury's financing was now out of the way and he hoped the flexibility that the Committee had prior to the financing could be regained. During the period of the next few weeks, the Committee might let bills run off and if necessary sell some securities; if the market seemed to tighten too much, the Committee could use repurchase agreements to meet temporary needs.

Mr. Irons said that conditions in the Dallas District showed a mixed trend. Employment is very strong and the labor market rather tight. Production of petroleum and related industries is very strong. Construction is showing some decline, largely due to lower residential starts, and agriculture is, of course, a case in itself. Retail trade seems to be moving quite strongly. Banks in reserve cities generally report that demand for credit continues at the strongest level they have known. This demand comes from all types of borrowers and for all types of purposes. Banks insist that although loans are rising, the System's restrictive policy is having some effect and is causing them at least to defer some loans which would have been made under different circumstances. The general feeling in the district, Mr. Irons said, is one of optimism. He did not detect any fear of the future. He had the impression that there was some question as to how well 1956 model automobiles were selling, although such sales did not appear to be particularly bad. He thought the general conditions in the Dallas area were not very different from the over-all national situation. On the basis of the economic review presented this morning, he felt the Committee should maintain a degree of restrictiveness and, to the extent it could do so, it should attempt to regain the position it had before the Treasury's problem intervened toward the end of November. He would assume that the System account should be able to meet the situation as it developed. During the remainder of this year, he would not be much more restrictive than the Committee had been prior to the Treasury's financing but would move back to that degree of restrictiveness. After the turn of the year, the Committee should observe whether there had been any tendency toward liquidation of bank credit or lessening of economic activity and then consider the extent to which it felt credit should be modified.

Mr. Earhart said that he was in accord with the views expressed thus far this morning. The Twelfth District still seemed to be in a boom. The supply of clerical labor seemed to be very short. Banks were finding continuing demand for loans and some of them had voluntarily talked with the Reserve Bank as to the possibility of being able to discount freely over the next several weeks. The banks seemed very much afraid, Mr. Earhart said, that at some point the Reserve Bank might be talking with them if they did not talk with the System first. Mr. Earhart suggested that the Committee should attempt to get back to the approximate degree of restraint it was attaining toward the end of November.

Mr. Leedy said that he did not differ with the views expressed thus far. The Kansas City District was peculiarly affected by the situation in agriculture, he said, but there was nothing in the credit field that could be done to help in that situation at the present time. He noted that the Secretary of Agriculture might be modifying some of his views as to the agricultural program and that after the first of the year efforts might be made to relieve the present unsatisfactory agricultural situation. Mr. Leedy said he did not think a situation in the agricultural segment of the economy so much less satisfactory than conditions in the rest of the economy could be permitted to continue indefinitely. Creditwise, demand at the Kansas City Reserve Bank had recently appeared to be heavier than in other parts of the country. This reflected a special situation in Oklahoma where personal property was taxable as of the end of November and there had been a large exodus of bank balances from the principal cities of Oklahoma in anticipation of this date.

Mr. Leedy went on to say that he considered it unfortunate that the Treasury had felt it had to suggest to the Committee that the Committee assist in the recent financing. However, he thought that the Committee had done what it should have done in acceding to the Treasury's request and purchasing the 2-5/8 per cent one-year certificates on a when-issued basis as of December 8. He assumed that with the publication of the weekly figures in the condition statement this week, an appropriate announcement would be made which would give some positive assurance that the action taken did not represent a departure from policy with respect to confining purchases for the System account to bills and avoiding purchases of securities involved in a Treasury financing. Without some such statement, Mr. Leedy felt that the System would be open to a charge that it was again a captive of the Treasury Department.

As to current credit policy, Mr. Leedy subscribed to the view that the Committee should as soon as possible return to the point of applying pressure on the reserve position of banks at the level that had existed before the Treasury's financing. Further, to the extent that any additional funds might be required, if it were at all possible such credit should be extended through repurchase agreements rather than otherwise.

Mr. Leach said he knew of no significant differences between the economic situation of the Fifth District and in the country generally except perhaps in connection with the impact of the new minimum of a dollar an hour in wages which would become effective next spring. This factor would have more impact in the Fifth District than in some others because of the substantial numbers of workers in the textile, furniture, and other industries who were now below the minimum. As to credit policy, Mr. Leach felt that the Committee should continue a policy of restraint. He did not see how restraint could be increased between now and approximately mid-January. However, the Committee might then wish to consider seriously a change in policy if conditions continued in the direction they have been going. Mr. Leach thought perhaps some of the actions already taken by the Committee had not yet had their full effect in the capital markets. He would try to regain what the Committee had lost in connection with the Treasury financing but would not put on any additional pressure until some time after the end of the year. This would seem to be an appropriate time for use of repurchase agreements to take care of temporary tightening in the market.

Mr. Powell said that the Ninth District was feeling the continued and somewhat increased effects of the agricultural depression. Recently, retail trade in that area has turned down. This differs from what is happening in the rest of the country, he said, and he noted that agricultural borrowings are up and are being watched carefully by bank examination departments to see whether the increase is just seasonal or whether farmers would not be able to pay off seasonal borrowings. At the moment, banks are borrowing less from the Federal Reserve and Mr. Powell associated this with the fact that the crop movement had been substantially completed. Banks are much interested in whether the Federal Reserve will "turn off the spigot" if they really need funds later at the discount window. He commented again on the depressed situation in retail trade, expressing the view that inventories will become bothersome to stores in January. While Mr. Powell felt that there should be no increase in credit restraint measures in the Ninth District, he suggested that in the country as a whole restraint should be kept at substantially the recent levels. He was sorry that restraint had been eased off any at the time of the Treasury's financing, and if the Committee could recover its position that would be desirable. He doubted that this would be possible between now and the end of the year but thought that after the turn of the year there might be an opportunity to recover the earlier degree of restraint.

Mr. Mills said that the consensus of opinion seemed to be a middle-of-the-road policy in System actions through the rest of the year that appealed to him as being very well adapted to the needs of the situation. In other words, where there has come about an increase in the supply of reserves, it becomes necessary that the Committee recover within reason its earlier position; but in doing so, it should allow sufficient latitude to relieve the congestion in the new securities market by allowing dealers to reduce their inventories and, with that, the atmosphere created in that type of operation. This would also serve to allay some of the uncertainty that is prevalent in the minds of the investment fraternity regarding System policy and the general condition of the market. To implement that sort of policy, as Mr. Sproul had suggested, would require presumably some run off of bills and possibly some sale of bills, with resort to repurchase facilities as the balancing feature to pick up any unevenness. Mr. Mills also suggested that, for the purpose of helping to relieve pressure at the year end, the mechanism for handling repurchases over the year end might call for permitting the maximum period to extend beyond the existing 15-day period--perhaps to 20 or 25 days--with the understanding that this additional authority would be cancelled automatically at the end of January.

Chairman Martin asked that Mr. Rouse comment on Mr. Mills' suggestion for lengthening the maturity of repurchase agreements.

Mr. Rouse stated that in accordance with the understanding on November 30, the New York Bank had given dealers to understand that repurchase facilities would be available through the year-end period. This general impression was now held by the dealers, he said, and while the suggestion made by Mr. Mills would help give assurance on the point, it was not essential.

There followed a brief discussion of the projections of net borrowed reserves during the next few days, after which Chairman Martin called upon Mr. Robertson.

Mr. Robertson stated that he thought the economy outside the agricultural area was in the midst of a boom. This called for restraint. During the next four weeks it would be practically impossible to get the degree of restraint that the Committee had had up to the Treasury's financing, he said, but it should strive toward such restraint. This meant the Committee must sell securities in the market. The amount of run-off available was very slight, and one could not predict at this time what the situation would be over the next three weeks. For this reason, he felt the Manager of the System Account should be given a free hand, under a general instruction that he should act to get back to the degree of restraint that existed before the Treasury's financing, if possible to do so--and he doubted it would be possible.

Mr. Shepardson said that the situation seemed to him to call for trying to recover such ground as was lost during the period of the Treasury financing. This would be desirable so that the Committee could be in as strong a position as possible after the turn of the year. He said that he was impressed with Mr. Sproul's comment to the effect that the prospects of a budget surplus might induce increased Government spending or that anticipation of a tax cut might induce increased consumer spending and add to the boom situation that now exists. Mr. Shepardson felt such a result was very definitely in prospect, and that was reason for the Committee to try to regain a position from which to apply restraint.

Mr. Fulton said he agreed with Mr. Shepardson and the statement by Mr. Sproul. In the Cleveland District, activity was running "full steam ahead." This was true in the steel, chemical, and other industries where materials were in short supply. There was also a short supply of labor. Retail sales have increased very substantially in the district, he said. He felt it important that the Committee get back as rapidly as possible to a position where it could hold a tight rein on the rapidly advancing boom.

Mr. Williams said that the general attitude toward business activity of industrialists in the Philadelphia District was one of high confidence. Some businessmen expressed concern about high prices, particularly of steel, and there were some comments showing concern as to the automobile situation. In general, however, confidence was running high. Mr. Williams also said that the general standing of the Federal Reserve in the Philadelphia District is high and that there was widespread approval of the actions the System was taking in trying to restrain the situation. He detected some screening of loans among banks but there would be more of it if it were not for the interbank competitive situation.

Mr. Bryan said that there had been an extended discussion of the economic situation at the Atlanta Bank's meeting of directors last Friday, led chiefly by the directors themselves. The discussion indicated the existence of an economic boom from one end of the district to the other. The agricultural situation is deteriorating and is serious in various spots, Mr. Bryan said, but this is not showing up except sporadically in figures of banks in the agricultural areas. Retail trade is going forward in large volume. While bankers talk restraint and talk of screening loans, Mr. Bryan questioned whether they were actually applying as great a degree of restraint as such comments indicated.

Mr. Johns said that he assessed the situation as one of boom, notwithstanding the fact that the St. Louis District was perhaps having more than its share of surplus labor areas, and notwithstanding the fact that the agricultural sectors of the district economy were somewhat unhappy--especially cotton traders, for example. He was inclined to view the situation as having somewhat dangerous aspects for the future. The larger banks were revealing a good deal of apprehension as to what policy would be at the discount window over the year end and were indicating that in some cases they would have to borrow during that period. While he had not seen fit to give them any assurances, he had not talked with any of them recently about their borrowings and some of them seemed to have lost part of their apprehensiveness. Mr. Johns said he felt that there should be no relaxation and that the Committee should restore as rapidly as possible the degree of restraint that existed before the Treasury financing.

Mr. Szymczak suggested that the Committee should continue the policy which it had been following between now and the end of the year; that it should allow bills to run off to the extent possible and perhaps sell some if that would not cause an extreme situation in the market. Repurchase agreements should be used to meet temporary needs to the extent possible over the year end.

Mr. Balderston stated that he would favor restoring the degree of tightness that existed in the market before the Treasury financing, even if this involved selling of bills from the System open market account.

Chairman Martin said he thought it was valuable to have discussions of this sort although he realized that by the time the last persons called upon spoke many of their ideas had already been presented in the discussion. He then called for any further comments, and Mr. Shepardson stated that in keeping with the idea of screening loans at commercial banks it might be desirable if the Federal Reserve Banks would do some screening of loans at the discount window.

Chairman Martin stated that this was a pertinent comment. However, he felt this would create a very difficult administrative problem particularly at this time.

Mr. Szymczak stated that he agreed there was much to the point Mr. Shepardson made, but he doubted whether it was feasible to carry it into effect at this particular tine. This was a tight period with year-end adjustments coming up, and if member banks were given the idea now that the System was screening applications for discounts, that might result in their developing a feeling such as that which existed in 1953 regarding "closing" the discount window. This could create additional uncertainty, Mr. Szymczak said, in a market that was already fidgety.

Mr. Leach said that he had a very definite feeling that the Reserve System would not wish to do anything along the lines of Mr. Shepardson's suggestion until after the end of the year.

Mr. Leedy said that he thoroughly agreed with Mr. Leach's comment; to make any move in the direction indicated by Mr. Shepardson might create a feeling that the discount window was "coming down."

Mr. Johns stated that he agreed with this view.

Mr. Robertson said that he thought it would be equally bad for any Federal Reserve Bank to attempt to urge any member bank to aid a Treasury financing with an implication that the discount window would remain open.

Mr. Sproul referred to the discussion on December 8, at which time it was understood that a majority of the Committee favored indicating to the banks that the discount window would be available to them for the purpose of underwriting Treasury bills to the extent that reserves were needed to carry them. There was no assurance of continued or excessive availability of the discount window, he said. On the broader question of discount administration, Mr. Sproul said he did not believe the discount windows should ever be shut or that action should ever be taken that would imply the window was shut. If borrowing threatens to become excessive, or if the borrowing privilege is abused, the Federal Reserve System should use higher discount rates and firm administrative techniques, but it should never shut the window.

Chairman Martin stated that he thought this view was correct.

Mr. Robertson said that while the majority feeling expressed during the discussion on December 8 was that the banks should be given assurance that the discount window would be open for carrying Treasury bill acquisitions, he felt it was a perversion of the discount function as well as a perversion of the auction market mechanism. It amounted to getting the Federal Reserve Banks into the position of being security salesmen in connection with a Treasury financing. Growing out of such a procedure was the implication that to the extent banks aided the Treasury financing, the discount window would be open. He reiterated that he thought the procedure was a bad one, notwithstanding the fact that a majority of the Open Market Committee favored it during the discussion on December 8.

Mr. Mills said that he would add that the great virtue of the discount window is that the transactions are "man-to-man" individual transactions and allow a meeting of the minds on those transactions that is not possible in multiple operations. He recalled that he was one who proposed that, where there appeared to be an emergency, the

Reserve Banks might indicate to member banks that the discount window would be open to assist them in carrying the Treasury tax anticipation bills. In an atmosphere such as had existed, he felt that this was appropriate and desirable, if it could be accomplished without sacrifice of some other authority or some other policy which was essential to the System. In this case, he could see no way in which there was a sacrifice of policy or a loss of control. The ability to discuss with individuals and work out arrangements with individual banks provided a safeguard against abuse or loss of authority.

Mr. Robertson thought that perhaps the difference of opinion on this point was whether the situation constituted an emergency.

Mr. Szymczak said that he did not think any of the members of the Committee liked the situation but that it had existed and the time in which to try to meet it had been very short. In the light of that situation, the Committee's decision was to advise the banks that those who controlled the borrowings intended that the discount facilities be available to the extent that the banks that purchased the tax anticipation bills were losing their position and finding themselves in a tighter position because of the purchases of such bills. He thought it was the right thing for the Committee to have done under those circumstances.

Mr. Johns said that his earlier comment to the effect that the St. Louis Bank had not given assurances to member banks about the discount window should not be taken as indicating a critical attitude of any actions taken elsewhere in connection with this problem. In their particular situation, he felt that the St. Louis Bank had other ways of accomplishing the desired result.

Chairman Martin said that Mr. Shepardson had raised a key question about the discount window but that he thought the discussion that had already taken place revealed the difficult administrative problem that would result if Mr. Shepardson's suggestion were carried out. He did not believe the System could have a hard and fast rule in a matter such as this, and he thought that it was a problem on which there should be further discussions from time to time.

Mr. Shepardson said he agreed with this view, adding that he was not criticizing any past actions taken. He had made his suggestion because, in his visits in other parts of the country last week, he got the impression that some bankers had already gone pretty far in their use of the discount window and were expecting to continue to use it.

Chairman Martin said that the tenor of the discussion at this meeting regarding the policy to be followed indicated that there was almost unanimous agreement on the general policy, as had been the case at the last few meetings of the Committee. His understanding of the views this morning was that there be no change in the Committee's general policy of restraint on the situation as followed recently. This would also include the understanding that in the present situation the desk should have some latitude in deciding how far to go in applying restraint.

In response to a question from Chairman Martin, Mr. Rouse stated that he had no suggestions for change in either the authorization for repurchase agreements or the general directive to be issued to the Federal Reserve Bank of New York.

Thereupon, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System open market account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to restraining inflationary developments in the interest of sustainable economic growth, 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;

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time

to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate $500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

The following authorization was approved by unanimous vote:

The Federal Reserve Bank of New York is hereby authorized to enter into repurchase agreements with nonbank dealers in United States Government securities subject to the following conditions:

1. Such agreements
   (a) In no event shall be at a rate below whichever is the lower of (1) the discount rate of the Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of three-month Treasury bills;
   (b) Shall be for periods of not to exceed 15 calendar days;
   (c) Shall cover only Government securities maturing within 15 months; and
   (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.
2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.
3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System open market account.

Chairman Martin then made a statement substantially as follows:

I think there are other aspects of the situation which we should discuss. Before that, I wish to comment on the money market as I see it. I think we should be very careful in our thinking. It is impossible to measure the psychology of the market. That does not mean we do not have to measure it, but I think we have to look at the market in relation to actions and in relation to trends. When we raise the discount rate after a long period of time, and when some of us think it might have been wiser to have raised it earlier (that is just a matter of judgment and does not mean that anyone with that opinion was right), and when we have this matter of timing and of Treasury requirements and Treasury needs, this Committee must be extremely sympathetic to those who are confused about the state of the market.

This does not mean we have to be overly cautious or unwilling to take a position. However, we must observe the forces developing at all times. When we get to the end of the boom, we may see a dramatic situation--something perhaps in the way of explosion. I for one do not think we are anywhere near the end of the boom, although we may be in for an adjustment. But when the end of the boom comes, it may be with an explosive force which will have its effects in the money markets or in a combination of factors affecting the money markets.

In the past couple of weeks, we have all seen these factors. We have seen a slow and delayed reaction to some of the actions taken earlier, such as the increase in the discount rate. We have seen that at times the yield on Government securities is almost meaningless because of cross currents in short-term and other yields. Those things have to be borne in mind.

I want also to comment on the operation of the System account. I believe we should attempt to regain and to reassert the general degree of restraint we had prior to the Treasury's financing and this psychological atmosphere. We may not have assessed the atmosphere correctly, but we assessed it, nevertheless. Governor Robertson made a good point when he expressed doubt whether we could really reassert the degree of restraint we had. I too question whether we can in the immediate future, i.e., before the New Year, or whether we should if we could, because I think the operation may be too delicate to press that much. If we try to do so, we may get results that we do not want. I think we are more concerned with reasserting a trend than with any particular volume of reserves.

When it comes to the problem of Treasury financing, of course we have had differences of opinion. My view is that, the Treasury having appealed to us for assistance and the refunding issue having been priced correctly, we could be open to the charge of being "doctrinaire" if in this particular instance we had wanted to assert and to stick rigidly with those principles which we have enunciated and which I believe to be with us and which I believe in just as firmly now as when they were adopted. That does not mean for one instant that I doubt the validity of those principles. As I pointed out to the Treasury, there were complicating factors this time--the very recent increase in the discount rate as well as other factors in the market. Nevertheless, every time we give way in those principles we encourage the market to think that the System has been "panicked" into taking a position to bail the Treasury out. Ultimately, if we do that enough and pick up the Treasury issues, the charge can be made that it is becoming necessary for the Fed to pick up and establish the going rate on the securities. We have been through all of that before.

However, I don't think we have enough perspective on the market at the moment to be rigid on this principle. I think we are in a period of dangerous waters. It may be too late for credit policy to have the impact on price adjustments that may come in an explosive period of boom. But that is water over the dam and we cannot now concern ourselves with it.

We ought to start a process of thinking that cannot end today. We need further perspective on developments of the past few weeks. We need to come to further conclusions as to our really fundamental policy on this matter. If this was not an exception, we must explore it very thoroughly with the Treasury. From here on out we must be very careful in our thinking and in the way we handle these situations. I am assuming for the moment that this was an exception.

Now the question Gavin Leedy has raised is one we should discuss--whether we should make an announcement in connection with publication of this week's figures to the effect that this was an exception to our policy. So far as public announcements of policy are concerned, I believe we have made almost no public announcements of this Committee's policy other than those contained in the annual reports. My own thinking would be that we should have a general discussion of this question today. I have not decided in my mind whether we want to make a formal statement along the lines of Mr. Leedy's suggestion. I am not sure whether we want to bind ourselves by a formal statement. Perhaps we should have a discussion of the whole question at our meeting in the latter part of January when we have had a chance to think about the question with more perspective. It is most unsatisfactory to have a telephone meeting and to have to take a position as a Committee on something like this, although it seems to me that we have demonstrated that these telephone meetings can work. I don't think we have to be concerned about the mechanics of telephone meetings. We now know that when we are in the middle of a stream, we can act.

Mr. Robertson said that although the question of the recent purchases of 2-5/8 per cent certificates in connection with the

Treasury's financing would be discussed at a later meeting, he would like to present a memorandum commenting on these purchases with the thought that it might be helpful in later discussions of the problem. He then read a memorandum as follows:

> Two weeks ago we authorized the purchase of newly-offered Treasury certificates on a when-issued basis. This action was taken because the Treasury Department expected that, in the absence of System support, a very large amount of the maturing securities would be turned in for cash, and the Treasury wished to avoid such "attrition".
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> The Committee's action was based on the best judgment of a majority of its members, and the views I wish to present are in no sense a criticism of the Committee's action, but rather an examination of the matter for the purpose of presenting my ideas as to where the Committee now stands and in what direction it should proceed.
>
> The Committee decided in 1953 that "operations for the System account in the open market, other than repurchase agreements, be confined to short-term securities (except in the correction of disorderly markets) and that during a period of Treasury financing there be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturity to those being offered for exchange".
>
> It is unnecessary to dwell at length on the reasons underlying our policy in this matter. They were developed fully in the report of the Ad Hoc Committee and the subsequent deliberations of this Committee. For present purposes, it suffices to recall our conclusion that detachment of the Federal Reserve System from Treasury financing operations would be beneficial (1) to the Treasury in its ability to reach debt management decisions, (2) to the Federal Reserve in its ability to pursue single-mindedly the objectives of monetary policy, (3) to the development of a strong and self-reliant Government securities market, and consequently (4) to the nation's economy generally.
>
> By this means we intended to minimize the technical market repercussions that result in some degree from operations on the part of the Federal Open Market Account and that tend to hamper the development of a self-reliant private market for Government securities. It was recognized that operations for the Federal Open Market Account run

the danger, if executed through faulty techniques, of exerting an unduly disturbing or even disruptive effect upon the market for U. S. Government securities. This danger arises because of the large volume of such operations under a single control motivated by other than profit and loss considerations and because of the effect of such operations upon high-powered bank reserves. They thus could make it difficult for financial intermediaries, which are essential for the functioning of a self-reliant market, to know whether prices of Government securities were being established by competitive market forces or as the result of official actions.

Comparison of the record of various Treasury financing operations before and after the adoption of this policy clearly demonstrates its wisdom. An essential for the success of the policy, recognized and observed by the Treasury, has been the setting of terms on new Treasury issues attractive enough to elicit adequate market reception without Federal Reserve support. The Ad Hoc Committee report recommended that "the Federal Open Market Committee ask the Treasury to work out promptly new procedures for financing". This has been done to some extent, but the current experience indicates the need for further consideration of these procedures to avoid requests for emergency support action by the System.

Features of the latest Treasury refunding operation that led to departure from established System policy may be considered as being of a special nature. They raise a question as to whether Treasury debt management procedures might be revised to avoid a repetition of such a situation. The special aspects of the recent situation are:

(1) The heavy cash needs of corporations and reserve needs of banks around December 15, the maturity date of the maturing issues, made many holders of those issues want to redeem them for cash on that date.

(2) The earlier exchange date for the new issues (December 8) would leave holders that sold rights or the new when-issued securities with cash earlier than planned or needed.

(3) The closeness of the pricing of the new issue to market prices, as they developed after the announcement of the offering (but were anticipated), gave little inducement for sale of rights or when-issued securities by holders not desiring the exchange.

The lessons to be drawn from this experience may be summarized as follows:

(1) Situations may occasionally develop in which a Treasury exchange offering, though priced attractively in the light of general market forces, might not be favorably received because of special and temporary market factors.

(2) Federal Reserve - or Treasury - purchases of rights or when-issued securities at or below par in such situations cannot assure a satisfactory exchange if holders of substantial amounts want cash at maturity. While such purchases, particularly if concealed, might stimulate confidence and induce some exchanges, there is a risk that they will also deter potential buyers that would otherwise be attracted by low prices. Moreover, if the market knows or suspects official intervention, the subterfuge would not produce the desired confidence effect.

(3) The Treasury should recognize and openly acknowledge the risk of substantial attrition and be prepared to meet it by contemporaneous or subsequent sales of securities for cash, rather than rely upon Federal Reserve efforts to produce an adequate exchange. The procedure followed in the current financing of an offering of a tax bill on an auction basis a week later provides an example of a combination that serves the purpose. With gradual resumption of substantial corporate tax payments on September 15 and December 15 and in view of other cash needs at such times, the Treasury might follow a practice of issuing bills to mature near those dates. New cash offerings could be made to raise needed funds at some appropriate subsequent date.

Parenthetically, even if the Treasury occasionally had to borrow directly from the Federal Reserve for a few days to bridge over any gap of timing, that would be preferable to direct Federal Reserve intervention in the market to aid a refunding operation. Such Treasury borrowing around December 15 would help supply reserves always needed at that time.

It might be contended that our recent action was not really a departure from our general policy on the ground that the Treasury thought that quick and exceptional action by the Federal Reserve System was required to deal with an exceptional situation. When our basic policy on this subject was adopted, we were aware that adherence to that policy would require the Committee to decline to support Treasury financing operations even though the Treasury itself might regard such support as essential from the short-term viewpoint of the "success" of the particular offering.

No doubt there are circumstances in which we would all agree that the System Account would be obligated to give support to a Treasury offering, just as we would be prepared to move into the intermediate and long-term areas in order to correct a disorderly market. However, ordinarily the mere prospect of a substantial attrition in connection with a roll-over offering is not a sufficient cause for Federal Reserve support. On the contrary, it is precisely the situation which, by our general policy, we decided does not justify our support. Unless we refrain from such action in such situations, our purported policy becomes worse than meaningless; it becomes misleading to the market.

Even through hindsight, it seems clear to me that no substantial damage would have been done if we had maintained our hands-off policy. At most, the Treasury might have had to increase its subsequent offering of tax bills. If the Treasury finds that it can call upon the Federal Reserve to bail out an offering that the market is unable or unwilling to absorb, there might be a tendency for the Treasury to be less careful in its analysis of the market's probable effective demand, in the light of any special factors such as those enumerated. That is to say, ready availability of Federal Reserve support is likely to work against the development and use of the best techniques of debt management, with the result that offerings that are unacceptable to the market for any reason might become more frequent. If that were to happen, we might be faced with a much more serious "attrition" - attrition of our fundamental objectives of having Open Market Committee actions governed solely by monetary policy objectives, and encouraging the growth of a strong independent Government securities market.

Chairman Martin suggested that Mr. Robertson's statement be included in the minutes of this meeting. The paper presented an excellent basis for further consideration of the problem, he said, and while he disagreed with some aspects of the paper, it would be desirable for the Committee to study the whole problem and discuss it at a later meeting.

Mr. Leedy said that his suggestion for an announcement regarding the purchases of 2-5/8 per cent certificates which would be reflected in the statement of condition of the Federal Reserve Banks to be issued this week was not intended to imply that any statement should be made which would commit the Federal Open Market Committee to a particular policy in the future. The market is aware of what the policy has been, however, and while it might not be necessary to make statements in all cases, Mr. Leedy said that he thought publication of the condition statement this week might result in some consternation regarding what had occurred in the light of what consistently had been done by the Committee during the period since the spring of 1953. An announcement such as he had in mind would give assurance to the market and to the banking system that the purchase of the when-issued securities in this case as shown by the weekly statement did not represent a change in the policy that has been followed since 1953, and that in this case such purchases served to assist credit policy in providing needed reserves to the banking system. Mr. Leedy said that while he did not feel that any change in the policy followed since 1953 was necessary it would be appropriate to reexamine it since conditions might have changed in the interval since its adoption.

Chairman Martin responded that there was a very real difficulty in phrasing a statement such as Mr. Leedy suggested. Generally speaking, he thought statements were not desirable and that it was preferable to let actions speak for themselves. Also, the same "sophisticated people" to whom such a statement would really be addressed are already well aware of the facts in the situation. His feeling, he said, would be that the Committee should not compound its difficulties and he would wish to see a draft of statement before he could feel that it would be desirable to issue one. His feeling was that any statement that might be issued would simply incite more comment rather than less.

Mr. Sproul then made a statement substantially as follows:

> First, I would like to say that I think it is desirable that there be further study and discussion of the relation between credit policy and debt management, not on the narrow basis of the recent Treasury financing and our purchase of when-issued securities in connection with that financing, but taking account of the whole area of this relationship. This is a matter which has had some discussion in the Federal Open Market Committee, and which it was understood would be the subject of further study by the members. In pursuance of this objective, the Federal Reserve Bank of New York has recently prepared and distributed one memorandum on the subject and I would hope others would be moved to consider it further so that we may develop a basis for conversations with the Treasury on the broadest possible grounds.
>
> So far as our recent purchase of when-issued securities is concerned, I have detected in some of the comments which have been made a seeming reversion to the idea that the directives which the Committee has adopted from time to time are a form of Mosiac law, rather than an experiment, as they were described by the Chairman at the hearings of the Flanders subcommittee of the Joint Committee on the Economic Report. But by the terms of Committee action they are only valid until superseded by other action of the Committee, which was done in this case under circumstances which recommended such action to a majority of the Committee. I do not think, myself, that this will mislead the market. One of my concerns has been that the longer we went without deviation from the general principle adopted by the Committee, the more likely it would be that when we did have to deviate it would be taken as a sign that a situation had developed which was more dangerous and critical than actually was the case, and that this would mislead the market.
>
> What has happened, as I see it, is that the principle adopted by the Committee, until superseded, was put to a real

test when question arose as to the success of an appropriately priced Treasury refunding, plus cash financing, at a time when a restrictive credit policy was being followed. It was decided that it would be consistent with our primary responsibility for credit policy to take account of our secondary responsibility for coordination of that policy with debt management, in so far as possible. This is not at all a commitment or precedent for "bailing out" the Treasury every time it comes to the market and on whatever terms. I continue to hold the view, of course, that under conditions of credit restriction when the Treasury has to come to market for large refundings, and when it is also faced with the necessity of some cash borrowing, it is unlikely that the market will always be able to make the massive readjustments which are necessary within the short period of the Treasury's offering; some form of underwriting of part of the transaction is likely to be necessary.

On the question of whether a statement should be issued about our recent purchase of when-issued securities, I am of two minds. Fundamentally, I am of the opinion that we must allow our actions to speak for themselves, particularly in view of the difficulty of phrasing a brief official statement which will adequately represent the views of all members of the Committee, each one of whom may have arrived at a decision by a different route, and because of the likelihood of misinterpretation of such statements no matter how carefully they may be worded. I have noted, however, that what we do here often seems to reach the press and the Government Bond services by one route or another, and I think that the pressure for information concerning these purchases may be very great. In the circumstances, I raise the question as to whether it would not be better to agree on an official explanation to be added to our public condition statements this week, to which all questions could be referred, with the understanding that no one here would comment on the purchases in any other way. So that you might consider this alternative, I have written out a possible explanatory note.

> "The statement this week indicates purchases of \$167 million certificates of indebtedness for System Open Market Account. Although it has for some time been the policy of the Federal Open Market Committee to avoid purchases of when-issued securities during a Treasury financing, the Committee decided, in this instance, that such purchases were consistent with its overriding aim of providing reserves to the banking system in accordance with the objectives of credit policy."

Mr. Mills said that with all respect to Mr. Sproul, he thought that a statement such as he had read would open the Committee to the challenge that if the 2-5/8 per cent certificates of indebtedness were purchased to provide reserves, the Committee could quite as easily have provided such reserves through purchases of Treasury bills rather than the certificates.

Mr. Sproul responded that his thought was only that the statement would say that the purchases that had been made were consistent with the overriding aim of the Committee to provide reserves to the banking system under its current credit policy. He recognized the difficulty of phrasing a suitable statement and he agreed strongly with the benefits of saying nothing, but he doubted that "nothing" would be said in connection with the present case.

There followed a further discussion of the possible desirability of issuing a statement commenting on the purchases of when-issued securities and of the question whether issuance of any statement on the matter could be avoided. In the course of the discussion, one suggestion was that the Chairman or Vice Chairman of the Committee be designated as the individual to respond to any inquiries regarding the purchases made last week. It became clear during the discussion that none of the members of the Committee desired a statement if its issuance could be avoided, and that it would be difficult to phrase a statement that would be acceptable to the Committee. The discussion concluded without a definite decision but with a consensus that no statement be issued.

Chairman Martin brought up the question of the date for the next meeting of the Committee and, after a brief discussion, it was agreed unanimously that the next regular meeting should be scheduled for Tuesday, January 10, 1956.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary