

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 23, 1955, at 10:45 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Earhart
Mr. Irons
Mr. Mills
Mr. Leach
Mr. Shepardson
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Sproul
Mr. Vardaman
Mr. C. S. Young, Alternate for Mr. Fulton

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

Mr. Bryan, President of the Federal Reserve Bank
of Atlanta

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Rouse, Manager, System Open Market Account
Messrs. Daane, Hostetler, Rice, Roelse, Wheeler,
and Young, Associate Economists
Mr. Carpenter, Secretary, Board of Governors
Mr. Mitchell, Vice President, Federal Reserve
Bank of Chicago
Mr. Koch, Assistant Director, Division of
Research and Statistics, Board of Governors
Mr. Miller, Chief, Government Finance Section,
Division of Research and Statistics, Board
of Governors
Mr. Gaines, Securities Department, Federal Re-
serve Bank of New York

Approval of the minutes of the meeting of the Federal Open Market
Committee on August 2, 1955, was deferred until the next meeting to afford

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absent members of the Committee who were present at that meeting time to review the minutes.

Before this meeting there had been sent to the members of the Committee a report of open market operations prepared at the Federal Reserve Bank of New York covering the period from August 2 to August 17, 1955, inclusive, and there were distributed at the beginning of this meeting copies of a supplementary report prepared at the Bank covering operations during the period August 18 through August 22, 1955. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period August 2 to 22, 1955, inclusive, were approved, ratified, and confirmed.

Chairman Martin then called on Mr. Ralph Young for a statement on the current economic situation. Mr. Young made substantially the following comments which were a digest of a staff memorandum sent to the members of the Federal Open Market Committee under date of August 19, 1955:

The economic situation continues to be one of demand pressure in the industrial sector and supply pressure in the agriculture sector. Over-all price stability in this country and abroad appears very much to be the product of a compensation of demand and supply forces as between these two major sectors of activity. In this country and in other important industrial nations, the high levels now attained by industrial output have generated such strong credit demands, with accompanying upward pressures on interest rates, that steps of restraint on undue monetary expansion have become more general and overt.

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This economy's gross product for the second quarter has been notched up one more time and is now put at 385 billions. With the additional gains registered since then, a preliminary guess for the third quarter figure is 390 billions.

The Board's index of industrial production for July remains uncertain, i.e., whether the final figure will be 140 or 141. Preliminary data for August suggest another index point rise, but this guess does not allow for the effects of recent storm and flood damage along the central and north-eastern Atlantic seaboard, or for shutdowns in copper fabrication due to copper shortage.

A feature of industrial output that merits special comment is that, after the general rise in activity which has already taken place, more industrial groups seem to be producing close to apparent capacity. This situation affords some basis for expecting a slowdown of advance in the months ahead. One needs to weigh such an expectation in the light of the rising momentum of business plant and equipment expenditures, the relative balance in this business upswing between expansion in finished goods output and materials output, and the comparatively moderate growth thus far of business inventory holdings. On the latter point, despite the rise of inventories which has now occurred, average stock-sales ratios have been relatively stable in recent months.

Retail sales, after seasonal adjustment, were 2 per cent above June and 9 per cent over a year ago. Sales of furniture and appliances rose very sharply, a development finding sympathetic response in very recent output data for these areas. Other large gains were made in apparel and general merchandise. Department store figures for August suggest a fall-back in retail sales to May-June levels, but unfavorable shopping weather may account for this result.

Newspaper comment suggestive of some weakening in the automobile sales picture calls for special examination of facts in this area. Early August industry reports show sales of new cars 40 per cent ahead of last year, and, while stocks are up 28 per cent and at a new high, stock-sales ratios are under a year ago. Used car sales are still running 20 per cent over last summer, although stocks are up 17 per cent. These figures are roughly as of the industry's production cutbacks for model changeover, with new model introductions from 30 to 60 days off.

Free market prices of used cars, i.e., prices at dealers' auctions, have continued to show little change after allowance for depreciation rates typical of this time of year.

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With automobile sales relatively active and sales of other hard goods up, consumer instalment credit in July is estimated to have advanced by another half billion. The most recent information reaching us about terms shows 36 months maturities on new cars to be quite common in most sections of the country, and the predominant maturity in industrial areas along the eastern seaboard. Customer equities on new cars, from a historical standpoint, are generally running on the thin side.

While over-all spending for new construction remains at a high level, residential construction has been easing off. With real estate markets continuing active, with few unsold houses in builders' hands, and with vacancies reportedly low, this development appears primarily related to a tightening of mortgage credit, especially with regard to new lender commitments. However, shortages of building materials in some areas and advancing construction costs have no doubt also affected the slowdown in residential starts.

With demand for industrial products strong and costs rising, prices of materials and finished products have both been rising with price increases for finished goods much more frequent than earlier. Average prices of farm products since mid-June have fallen 4 per cent and currently are 8 per cent below a year ago. The price for farm products declines have been mainly in hogs and grains on the domestic side and in cocoa and coffee on the foreign side. Cattle prices have changed little over the past two months.

Strength continues to feature the labor market, with unemployment down to less than 4 per cent of the labor force. Seasonally adjusted nonfarm employment is expected by labor market specialists to show a further rise in August. Agreements negotiated in major industries are showing larger wage rate increases than in other recent years. The impact on pay envelopes of some of the more recent and more important of these settlements is only beginning to be felt.

The materially improved business conditions of recent months point to higher tax collections for the Government. Although expenditures may run above earlier estimates, a surplus of 2 billion or better is now indicated for the current fiscal year.

The capital markets remain active with corporate volume up but with State and local government issues off, partly on account of the rejection of bids on several offerings.

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Common stock prices have leveled off, on reduced trading volume about 4 per cent below July peaks. Increases in stock market credit for two months have been quite moderate, and the number of margin accounts showing debit balances changed little in July, after many months of apparent increases.

Bank credit, as shown by the statements of weekly reporting city banks, has increased considerably over the past month. With security portfolios showing little change in balance, the increase has reflected expansion in most types of loans. Security and agricultural loans, however, have declined some recently for special reasons. The all important points about recent banking developments are that private credit expansion has been strong in the period of usual seasonal slack and likewise there are indications that money supply growth has picked up again. Turnover of demand deposits has continued at the high levels reached in mid-spring.

Market interest rates, after an interruption of upward movement early in August, recently have again shown an upward tilt. The movement, however, has been somewhat uneven as between different types of paper. Uncertainty with respect to future levels of longer-term yields has tended to raise liquidity preference of institutional investors and this has evidently been a special factor in holding down yields on Treasury bills recently.

In connection with Mr. Young's statement, Mr. Leach said that, from conversations with businessmen in his district, it appeared that increases in minimum wages in conformity with legislation recently approved by the Congress to become effective next March were already beginning to have some effect in industries in the Fifth District where increases made in the furniture industry were creating pressure for increases at other plants. He added that since a very large proportion of the workers in the furniture, textile, and other industries in the Fifth District have earned less than \$1 per hour in the past there will be cost pressures in these

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industries as well as in the steel industry where prices have been increased as a result of recent wage agreements.

At Chairman Martin's request Mr. Koch made a statement with respect to the prospective member bank reserve situation as follows:

The reserve position of member banks has changed markedly since the Treasury refinancing around the turn of the month. During the last two full weeks in July the outstanding level of free reserves averaged about a positive \$250 million. During the first three weeks of August, on the other hand, the level averaged about a negative \$175 million. The change occurred largely by allowing market forces, particularly an increase in currency in circulation and a decrease in float early in the month, to have an effect in reducing reserves. In addition, however, the System reduced its holdings of Treasury bills by allowing some to run off at maturity and selling others. Currency in circulation increased in June, July, and early August at a seasonally adjusted annual rate of about 5 per cent, after having shown little net change on balance for many months.

In the current week ending August 24 the average outstanding level of free reserves is likely to show a decline of approximately \$100 million due mainly to System operations, including another run-off of Treasury bills and the carry-over effect on a daily average basis of last week's reduction in System bill holdings. In the next week ending August 31 market forces, particularly the usual end-of-month decrease in float and the pre-Labor Day outflow of currency into circulation, are expected to lead to a further reduction in bank reserves by perhaps an additional \$100 to \$150 million. In the week ending September 7 a continuing pre-Labor Day outflow of currency into circulation may drain a further 200 million from bank reserve positions. In the week ending September 14 market forces are likely to have little effect on balance on reserves. Thus, assuming no further Federal Reserve open market operations, market forces would likely produce a decline in outstanding free reserves to an average level of approximately minus \$600 million during the early part of September.

In the week ending September 21 the usual mid-month increase in float should produce a sharp temporary rise in bank

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reserves. This review of prospective bank reserve developments carries us past the next scheduled meeting of the Committee.

In opening the discussion of system credit policy, Chairman Martin stated that at times like the present the formulation of policy may be largely a question of techniques and procedures and he doubted that it was possible completely to separate over-all policy from techniques and procedures. He said he had reviewed the minutes of the last meeting of the Committee, which he felt was a very useful and constructive meeting, and was impressed that the differences of opinion were in the area of the degree of restraint to be applied rather than in the over-all policy that restraint was necessary.

He inquired whether any member of the Committee would wish to change the current policy as stated in the directive issued to the Federal Reserve Bank of New York at the last meeting which provided among other things, that open market transactions would be for the purpose of restraining inflationary developments in the interest of sustainable economic growth. Upon an indication from all of the other members of the Committee that no change was called for in the policy stated in the directive, he turned to the problem of actions to be taken to carry out that policy and in that connection made substantially the following statement:

The important questions have to do with techniques and procedures. I have reviewed my statement at the last meeting of the Committee and would like to comment on my remarks

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at that time. What I say will not change the general basis of what I said then. I think the wage cost push is still with us and the psychology that that creates is still with us. I would emphasize a point that I think we exaggerated at the time of the last meeting. We used the terms "theatrical" and "dramatic" in connection with the amount of the discount rate increase. I question whether an increase of either $1/4$ or $1/2$ per cent could be characterized in that way. What I was trying to say at the last meeting was that the action should be decisive and clear. We might have differing views as to whether an increase of $1/2$ per cent is dramatic or theatrical. I would not want to imply that the action was either dramatic or theatrical but rather that it would be clear and decisive.

One of the points I made in my statement at the last meeting was on inventories. I think inventories are rising much more rapidly than we realize. Our inventory data is the poorest we have and the lack of adequate information will become apparent at a time when it will cause us the most trouble. I realize that that comment is in the area of projection but I think it is true.

I want to comment on the philosophy of restraint. Behind the wage cost push is a sort of general conviction, one that has been growing for a number of years, that inflation, if not desirable, is something that it is not politically feasible to hold down. There are those in Wall Street who assume it will not be politically feasible to restrain inflation, that the economy has an inflationary bias, and that they might as well resign themselves and relax and enjoy it. I want to present my own thinking on that point. I have been in the Government now for 10 years and I am fully aware of Government pressures. There are margins of error in all these things, but it is perfectly clear to me that it is politically feasible and practicable, if judgment is sufficiently wise, to restrain a situation before it develops. It is much more difficult in my judgment to restrain a condition after it has developed. I believe we should approach the problem of credit policy with that philosophy. In other words, it is possible to restrain a person before he does something, and while he may not like to be restrained he will forgive you for it later, but if he goes ahead and does something and then you act to pull him back your action becomes a form of punishment for what he has done that is not feasible in a democracy.

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We can never recapture the purchasing power of the dollar that was lost because of the war. That is not politically feasible or economically desirable. Such a loss usually occurs in a relatively short time. In the present circumstances, when we are faced with another period of increases in prices, I believe that any margin of error should be resolved in the direction of tightness until we are certain that the policy should be changed. No one can project the future. We don't know whether we are going to have the high level of fall and Christmas trade that we think we are but the production picture is moving upward and confidence is projected all along the line. If we let it get out of hand we may be in a position of "too little too late" for a long time to come and may be faced with the inevitable "bust" that some people think will come in any event because of the inflationary bias in the economy. We have reached a point in the present phase of the economy where there are going to be a good many bearish statements. These are the "dog days", i.e. this is the end of August. This is the season when there is usually a certain amount of bearishness.

The contribution that the members of the Committee are making in their statements in these meetings is very helpful and useful. It is important to get the various points of view on the table and analyze them. There will be differences of opinion because no one has perfect wisdom or judgment particularly in this field. Therefore, it is a question of exercising the best judgment we can bring to bear.

There are differences of opinion on the discount mechanism and how it should be used, whether the System should lead and make the market or otherwise. That question should be discussed this morning. I am going to ask Mr. Riefler and Mr. Ralph Young to present their thinking on this subject. I happen to agree with their views. Mr. Young's statement may appear to some presumptuous because of his direct advocacy of a point of view but the presumption is mine. I did not have time to write a statement but I agree with what he will say. It is important that we get on the table the question of the relationship of the discount rate to market rates and whether we should proceed to make the discount rate effective by negative free reserves of say \$400 or \$500 million or whether it would be wiser to pursue the course of increasing the discount rate as a lead factor. That involves problems that are inherent in the history of monetary policy. To cite one such problem, one of the points in the

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Treasury-Federal Reserve accord was that it was agreed that there would be no change in the discount rate for the balance of the year 1951 unless conditions radically changed and that the discount rate would be used as a pivot for Treasury re-financing. That is typical of the framework in which some of our views get shaped from time to time when we make compromises. Sometimes they are wise and sometimes unwise. We never should be carried away by pure logic. We should always think in terms of the statement in the foyer of this building that we do not have, and we will never have, a clean sheet of paper to write upon.

I will now call on Mr. Riefler and then Mr. Young, after which the meeting will be open for any comments that any of the members may wish to make.

Mr. Riefler's statement, during which he referred to a flannel board chart which he had prepared for use in another connection, was substantially as follows:

If you are going to exert further restraint on the market, the question is how to apply the restraint. In the past, the procedure has been to initiate restraint through open market operations by reducing available free reserves. When the market rate finally went above the discount rate as a result of this action, it constituted an almost automatic signal for an increase in the discount rate. If pressure is kept on free reserves under these conditions, the market rate will climb up again, probably above the discount rate. In this approach, there is always a problem of circular reasoning as to the reason for raising the discount rate.

Almost each time in the past when the System has followed this procedure of restraint, namely, of leading with open market operations, thus producing negative free reserves and a firming market, we have gotten into a position where the discount rate was not a penalty rate, i.e., it was below yields on short-term open market obligations. This creates an incentive for member banks to adjust reserve deficiencies through discounting rather than through disposal of securities in the market. It also makes it technically possible for banks to borrow from the Federal Reserve and use the funds to buy highly liquid market paper at a profit. While most banks do not do this, the absence of a penalty rate has created a problem for us of

administering the discount facility in such a way as to prevent member bank abuse of the discount privilege by over-borrowing. Historically the record is quite uniform with respect to that problem. If you go through the Board's records covering the five times when the System has acted to firm the market--1920, 1923, 1926, 1928-9, and 1952-3--there are long discussions about over-borrowing. It was particularly acute in 1920-21. I do not recall the problem arising in 1923, but it became active again in 1926 and led to the discussion in the 1926 Annual Report which more or less promulgated the philosophy embodied in the recent revision of Regulation A, "Advances and Discounts by Federal Reserve Banks", as to when it is appropriate for member banks to borrow.

In 1929 there was the "knock down drag out fight" within the System about direct action and forbidding borrowing member banks to carry brokers' loans. In 1953 we had the problem again in the form of borrowing for the purpose of avoiding taxes. The point I want to make is that serious problems in administering the discount mechanism have arisen recurrently during periods of restraint when the discount rate was not a penalty rate.

There is another approach to restraint that the System has never taken. Under this approach the System could avoid exerting so much pressure through open market operations as to raise market rates actually above the discount rate. Rather, open market operations would be used to maintain a volume of negative free reserves sufficient to make market rates of interest highly responsive to the discount rate, but not in such large volume as to raise, say, the bill rate above the discount rate. That procedure would always keep the discount rate in the position of being a penalty rate, something like it is at the present time. Under this approach, the discount rate would be used to lead in applying a policy of restraint. Market rates would still move up but after the discount rate was increased. I think bill rates would move up proportionately with the discount rate but not above it if the negative free reserve position were maintained between \$200 and \$300 million. Bill rates would move up with the discount rate because it would be less costly for banks to adjust to temporary shortages by selling bills than by discounting. To summarize, under this approach we would lead with changes in the discount rate and market rates would firm following the change, instead of the traditional approach of bringing pressure through open market operations until market rates rose and then raising the discount rate.

(Indicating on the chart.) Since the Treasury-Federal Reserve accord in 1951, we have had positive free reserves in every year except one. June 1952 to June 1953 was a year of negative free reserves. This chart shows that it takes a very large volume of negative free reserves to put the market bill rate above the discount rate. During that one year we had very large negative free reserves and we had bill rates moderately above the discount rate. We changed the discount rate once in that period, and as a result the bill rate moved up also. That year, however, is an exception. The normal position has been for the bill rate to be below the discount rate and to remain there in the absence of a very heavy negative free reserve situation. What I am suggesting is that the Committee might consider the possibility of keeping the discount rate a penalty rate during a period of restraint. With a discount rate of 2 per cent and a somewhat firmer market than we have now the bill rate would average 1.80 - 1.90. With a 2-1/4 per cent rate and the same general level of negative free reserves, the bill rate could be expected to go to 2.10 - 2.15. Other market rates would adjust to that level of bill rates. As a result, we would be exerting as strong restraint on the credit situation as we would if we operated first through the open market to raise bill rates above the discount rate, but we would not lose the posture of a penalty discount rate and would have less difficulty in administering the discount function.

Mr. Ralph Young read the following statement:

Aside from questions of timing of action and of market risks incident to a stronger vs. more moderate action, one of the points of emphasis in the last meeting's discussion was the danger of getting "the discount rate and open market operations out of tandem." Mr. Sproul made this point, but it was also expressed, if I am not misinterpreting his remarks, by Mr. Bryan. Underlying the point, I would gather, is the view that a proper or normal level for the discount rate in this sort of economic situation is one more or less continuously in touch with short-term market rates, and that no discount rate should be established at a level higher than the one to which we are prepared to see short-term rates rise or moderately exceed. Any other rate level would be anomalous, inconsistent with the discount rate practices and traditions of the System, and misleading to the market. In other words, we would not be "meaning what we

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say," as Mr. Bryan put it, if we had had a discount rate level of 2-1/4 per cent and a market rate level for Treasury bills, say of around 2 per cent.

I want to say here that I recognize that this viewpoint has a case in its favor and agree fully that it finds some authority in historical patterns. But the System is feeling its way in a new and different situation and it must be experimental. I personally feel that the Committee ought to reexamine this traditional view and, if considerations of merit warrant, depart from it. I would suggest that there are some considerations of merit which ought to be weighed.

The basic tradition of central banking is that the discount rate in boom times ought to be a penalty rate. In the System's formative period, as I recall the record, a central question of System credit policy was how to make the discount rate a penalty rate. In this connection, it is rewarding investment of time to reread the discussion of discount rate policy in the Board's annual reports of the Twenties.

The broad conclusions of System experience in the Twenties, the record shows, was that in this country it was not feasible to attempt to make the discount rate function as a penalty rate. Our banking conditions were too unique. It was more practical to rely on the bankers' tradition against borrowing and reluctance to remain continuously in debt, and to set the discount rate level in close relationship to the rates on the most liquid paper in the market--generally just under 90-day collateral and 4-6 months commercial paper rates and slightly over bankers acceptance and short-term U. S. security rates. Because of the tradition against member bank borrowing and reluctance to stay in Reserve Bank debt, the discount rate was made effective by open market sales which occasioned increased discounting. Conversely, the effectiveness of the discount rate was relieved by open market purchases which decreased discounting. Discount rate policy was a matter of adjusting rate levels to changes in market rate levels in response to pressures on, or relaxation of pressures on, member bank reserve positions. Reserve Bank discount rate levels, therefore, followed but did not lead the market. They were never, or practically never, penalty rate levels.

I appreciate that this generalized description of Federal Reserve discount rate principles as they took form over the Twenties is an over-simplification, and there are facets of the matter, such as Federal Reserve influence over the bankers acceptance rate, and perhaps other interrelations between open market policy and discount rate policy which I am leaving out of account.

It suffices for the moment to emphasize two things: first, this pattern of discount rate operation crystalized by trial and error experiment. Second, there is a vast difference between banking conditions now and what they were then. The System needs some trial and error experiment in the light of present banking conditions. It needs in this period to reevolve a pattern of discount rate policy.

Today, the money market does not present to financial institutions and corporate investors a cluster of alternative, liquidity forms of varying rate attractiveness. Instead, we have a market in which a single kind of paper, the Treasury bill, is serving as the dominant or pivotal liquidity instrument. The Treasury bill serves not only as the main liquidity instrument for the operating adjustments of banks, but also as a common instrument of adjustment for other financial institutions and for business corporations. Moreover, today the large corpus of intermediate and long-term Federal debt in the market makes for a sensitive, sympathetic value relationship between Treasury bills and other Federal debt. This in turn makes for a whole market more closely integrated value-wise than during the Twenties. Consequently, instead of a systematic array of short-term market rates for reference in discount rate policy as in the Twenties--none of which could be accurately described as dominant, we have today a single short-term rate that is a pivot in a very realistic sense. Other short-term rates, as I observe the market, most often take their cue in movement from the Treasury bill rate.

The System needs to give some thought to another important difference in financial environment between the Twenties and the present. In the Twenties discount rate policy had to find a compromise solution in part because of continuing large volume of member bank discounts--in a sense a legacy from war and postwar finance of World War I. The present banking situation follows a long period of little or no reliance on discounting, and discount experience since the accord has shown a high degree of credit sensitivity to a relatively small volume of member bank borrowing. And thanks to the System's careful review of its discount window experience and its reformulation of discount principles based on that experience, this sensitivity seems likely to be extended.

This all leads up to the suggestion that the System is now in a situation where it can deliberately experiment with a penalty discount rate. By that I mean a discount rate that is kept a margin above the Treasury bill rate in the market.

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As a student of Federal Reserve history, I would not regard this as getting "discount rate policy and open market operations out of tandem" or as "not meaning what our discount rate says." Rather, I would regard it as taking advantage of the current financial environment for the System to get into the tactical position with respect to the pivotal short-term market rate that central banking precepts, developed out of long experience indicate that the System ought to establish and to maintain in boom periods, if at all practicable.

The System discount rate policy in relationship to Treasury bill rates in the 1952-53 episode was most certainly experimental. It was definitely an experiment, I should say, in the pattern of System discount rate tradition. In retrospect, the System treated the Treasury bill rate for reference purposes as one of a number of related liquidity rates, though not clearly as the dominant liquidity rate. The System followed the market rather than leading it and penalizing the use of Reserve Bank credit by means of the discount rate. It relied on the tradition against borrowing and the reluctance to stay in debt to restrain undue credit expansion. And the System was surprised that borrowing for profit went on and that monetary expansion during the period of build-up in member bank debt was so rapid. Future historians of System policy will certainly find reason to question whether the discount rate policy pursued two years ago was the wisest one that could have been followed.

In the present situation, it seems to me, the System's discount rate policy can well be different. The System should experiment with another approach. It should establish a discount rate level and maintain a level that will make the rate a penalty rate in relation to the Treasury bill rate, the dominant short-term rate in the market. It can then broadly govern the volume of reserves needed for growth through open market operations while at the same time restraining an undue credit expansion financed primarily on borrowed reserves. An undue bank credit expansion that is a *fait accompli* cannot later be contracted by counter measures, at least, not without serious deflationary dangers of chain-reaction potential. The argument is, then, that the System should act now, while there is an opportunity to act, to assume and maintain a position of credit market leadership. It should not let the bubble on top of the boom develop in so far as its tactics can help to prevent it.

Psychologically in the market, it can be questioned whether this approach would give rise to undue confusion. The market

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would quickly come to understand the meaning and common sense of firm leadership. The market is not now completely free of confusion as to rate policy. Moreover, there will always be some difference of views in the market as to current trends in credit policy, for differences in market judgment are an attribute of a well functioning and healthy market. But to important segments of the market at the present time, a penalty discount rate in the sense in which I am using it here, would make System leadership in a volatile economic situation crystal clear.

Chairman Martin requested that, if there were no objection, the two statements be incorporated in the record of this meeting. He repeated that he was in sympathy with the point of view that they expressed and believed that the suggestion should be considered throughout the System.

Mr. Earhart asked whether there was any reason why copies of the two statements could not be given to the directors of the Federal Reserve Banks for their use in considering the action to be taken with respect to the discount rate. It was his view, in which Mr. C. S. Young concurred, that the two statements were the kind of material that could well be given to the directors.

Mr. Mills made substantially the following comment on the proposal presented by Messrs. Riefler and Young:

It is appropriate that, in reviewing their operations, the Federal Reserve Banks should consider the suggestion that Messrs. Riefler and Young have made. However, in making those reviews the Banks should look at the question whether the concept of a penalty rate to discourage member banks

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from borrowing in order to take advantage of a rate differential is applicable at this particular time. The question of timing is what we should give our thought to and not to the theory of the desirability of a penalty rate. We should look at the penalty rate against the structure of yields in the market and also against the position of member banks which would be affected by the institution of a penalty rate.

We are very conscious of the fact that commercial banks, taken as a group, are in a very less liquid position than they have been accustomed to in recent years. In the past, when the market rate rose above the discount rate, very few member banks took advantage of the rate differential to expand their holdings of bills. Of course, there were some shining exceptions but under present conditions a bank will look hard and twice before borrowing from a Federal Reserve Bank to expand a bill portfolio. If that was done, when the bank's statement was published, it would be revealed to analysts and others that its liquidity had dropped and that Federal Reserve funds were being used to sustain operations. You will find that, by and large, banks are not inclined to do that.

You have another situation to consider in this connection and that is that the structure of rates in the short-term area of the Government securities market is leveling out at a yield substantially above the discount rate. With that condition as it now exists, if the bill rate should rise above the discount rate, although it is unlikely that banks would discount to buy bills, they could be tempted to discount to maintain their asset position in other issues on which the yields have risen over the last few months, or to avoid the liquidation of those securities at a loss where faced with depreciation. It seems obvious that under these circumstances a penalty discount rate would have to be set at such a high level in relation to the rates on 1956 to 1958 maturities that in the process the market for U. S. Government securities would be damaged.

So, my thesis is that although a penalty rate is eminently desirable theoretically, before such a decision is made it is essential to look at all of these other factors that inject themselves into the problem. Again, for example, if the discount rate was raised abruptly at the present time before being confirmed by a higher interest rate trend having been established in the market, the market might be seriously unsettled.

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And if it should then become necessary to correct a disorderly situation, you would undo the benefits sought from moving precipitously to a penalty rate. In other words, timing of a change in the discount rate would seem to be the essence of the problem, and in considering timing it is necessary to bear in mind the fact that System policy is getting an increasing and accumulating assist from public comments of what the System's intentions are, which of itself is a restraining factor coming to our help in implementing the policies which we wish to make effective by reducing any necessity for hurrying to make another change in the discount rate.

Referring to the question which had been raised with respect to the statements of Messrs. Riefler and Ralph Young, Mr. Earhart said that, on the basis of the discussions that had taken place, his directors would be reluctant to move to increase the discount rate immediately because we have not yet seen the effects of actions already taken.

Mr. Johns commented that the Young statement made reference to the statements made by Messrs. Sproul and Bryan at the last meeting of the Federal Open Market Committee and expressed the view that the two statements would not be as informative to the directors as they should be unless they were accompanied by the Sproul and Bryan statements. Therefore, he asked if there would be any objection to the latter statements being excerpted from the minutes of the Committee and furnished to the directors of the Federal Reserve Banks.

This point was discussed in the light of the confidential character of the proceedings of the Federal Open Market Committee and the difficulties which that created in relation to the information that should be made

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available to the directors of the Federal Reserve Banks in their consideration of discount rate action. It was also considered in the light of the fact that the Riefler and Young statements related wholly to the question of Federal Reserve discount policy which is in the field of the direct responsibilities of Federal Reserve Bank directors. The suggestion was made that the Riefler and Young statements could be distributed as proposals which they had made, that the reference in Mr. Young's statement to the statements of Messrs. Sproul and Bryan could be dropped, and, if necessary, the points with respect to the discount rate raised in the statements by Messrs. Sproul and Bryan could be presented to the directors without reference to the statements themselves or to the minutes of the Committee thus avoiding the precedent of taking excerpts from the minutes. If that suggestion were followed, the statements of Messrs. Riefler and Young would be handled in the same manner as other statements or memoranda with respect to the discount rate had been handled in the past.

Chairman Martin stated that, in the light of the discussion, it might be wiser not to circulate the Riefler and Young statements, that the Presidents had the ideas presented therein and if they desired to use them in discussing the question of the discount rate with their directors they would be at liberty to do so. He asked that the two statements go into the record of this meeting since he felt it was important that the proposal be considered by those present as well as by the directors of the Federal Reserve Banks.

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Mr. C. S. Young asked if there would be any objection to the Presidents making a report to the directors based on the comments in the four statements with respect to discount policy without reference to the statements themselves and it was indicated that there would be no objection to that procedure. Chairman Martin also said that perhaps, by the time of the next meeting of the Committee, a document could be prepared in a different form that might be useful.

Mr. Erickson expressed the view that member banks no longer had the same reluctance to borrow that they had in the 1920s and 1930s and that therefore a penalty rate would mean more today than in earlier periods. He inquired whether the other Presidents shared in that view. Several questioned its correctness, Messrs. Earhart and C. S. Young stating that they saw no material change in the attitude of banks on this point. Mr. Earhart also said that his Bank's experience with a penalty rate years ago was not at all good, that member banks were penalized when the banks had to borrow, and that the penalty rate eventually had to be waived. Mr. Leach said in his experience only a small number of banks would borrow at a given time, that some were very willing to borrow, that some borrowed reluctantly, that others would not borrow at all, and that the number in the last category was still large.

Chairman Martin then called for the views of the members of the Committee on the open market policies to be followed pending another meeting of the Committee.

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Before discussing that subject, Mr. Treiber commented on the question of the use of the discount rate. He observed that the differences expressed at this meeting were differences in degree; the question is not one of extremes. He questioned whether the market rate on Treasury bills should be looked upon as the focal point in the short-term market and said that there were a number of other factors that should be considered, such as the degree of liquidity of the banks, the demand of corporations and other nonbank investors for bills, the supply of bills in the market, and the whole structure of rates. The fluidity of the money market is such that if there were a discount rate substantially above market rates there would be very little use of the discount facility. If banks were not as reluctant to borrow as they were in earlier periods, as Mr. Erickson has indicated, the banks were reluctant to stay in debt, and the administration of Regulation A has tended to encourage that reluctance. If the relationship of short-term rates and discount rates were such that the banks were to borrow to obtain needed reserves, the borrowing would become a restraining effect which would be lost if the discount rate were moved substantially higher than short-term market rates. He made the further observation that in making intelligent decisions on the discount rate it was necessary for the directors of the Federal Reserve Banks to know what current open market policies are in order to bring about the necessary degree of correlation between discount policy and open market policy.

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On the question of an appropriate discount rate at this time, he said that the situation was not the same as in 1953 when bill rates and other short-term rates were above the discount rate. We might now approach the problem by saying that the discount rate should lead in signaling Federal Reserve policy as it had done a few weeks ago, and be followed by open market action tightening the market so that short-term rates would rise and fluctuate around the discount rate. If further pressure is needed, a further increase in the discount rate might lead again. He said that in a period of restraint he would want to avoid having the discount rate "stick" much above short-term rates and unsupported by the pressure of open market action.

With respect to the general question of current Federal Reserve credit policy, Mr. Treiber made a statement substantially as follows:

Since the last meeting of the Federal Open Market Committee the economy has shown continued strength. Nevertheless, recent statistics indicate a less rapid rise in the rate of expansion in the third quarter of 1955 than in the first two quarters. We will probably see more expansion in the fourth quarter.

The present lessening of the rate of expansion should reduce the pressure in the economic system and foster orderly expansion later in the year. However, the possibility of a price-cost spiral accompanied by speculative inventory accumulation and heavy credit usage are important threats.

There are encouraging developments in certain of the special areas with which we have been concerned. The stock market has lost its head of steam, at least for the present. As for residential real estate credit, declining applications for home mortgages and a reduced willingness on the part of

lenders to make mortgages may be expected gradually to reduce net mortgage extensions. While there is no doubt that consumer credit has been expanding rapidly this year, with automobiles playing the major part, the anticipated reduction in automobile production should slow down consumer credit expansion.

The principal need for commercial bank credit will be from business and industry for normal seasonal credit needs and for increased inventory called for by the increased business tempo.

The higher discount rate at Cleveland has been interpreted as an indication that the System would not hesitate to increase the rates at the other Reserve Banks further if such action seems called for. This has created uncertainty which, in turn, has constituted an additional factor of restraint.

Bank liquidity has been reduced; this will be a restraining factor.

The Federal Reserve System should continue to exert a steady pressure on credit expansion. Continuing steady pressure over a period of time actually brings increasing pressure. Rates do not necessarily adjust immediately and fully. As time passes, different groups take action or refrain from taking action, and this in turn affects other groups.

We have not yet seen the full effect of the two increases in the discount rate this year and the accompanying open market policy. Our action has not yet been fully reflected in market rates--both short-term and long-term.

Some of the additional reserves needed this summer and fall should come through increased member bank borrowing. We have already experienced increased borrowing--the highest sustained borrowing since May 1953. In the last three weeks member bank borrowing has averaged between \$750 and 850 million, with excess reserves of about \$600 million confined largely to the country banks. In the same period, free reserves have averaged between minus \$100 and minus \$200 million. As we experience increased member bank borrowing--with borrowing by a greater number of banks although not always the same banks--and the accompanying pressure on banks to get out of debt to the Federal, there will be increasing credit restraint.

Projections for the next three weeks made by the New York Bank show increasing reserve losses totaling several hundred million dollars. Borrowing should play an important part in supplying the needed reserves. If all needed additional reserves

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were to be acquired through increased borrowing, we would have borrowing of between \$1 and \$1-1/4 billion. This might put a severe strain on the banking system and particularly on the central money markets. Some outright purchases of Government securities by the System may be called for.

Some repurchase agreements in the first half of September may also be in order, but the amount would probably not be large in view of the small dealer positions.

There has been a strong demand for Treasury bills by business corporations and other nonbank investors. Part of the strength appears to be due to purchases by investors who want to have their funds in short-term securities, having in mind a possible decline in the market value of long-term securities. In the last few days there has also been a good market for short-term Government obligations other than bills.

It would seem desirable in the first instance to let the banks get needed reserves by additional borrowing or by selling securities to nonbank investors. As this process continues, short-term Government securities are likely to become available in the market in increasing amounts and at declining prices; in this setting, outright purchases for the System Account would be in order.

If the banks have to sell Government securities (primarily notes and short bonds) too rapidly, we might see an unfortunate price erosion in the capital market. Timely purchases by the System should avoid such a development.

Because of the special situation keeping up the price of Treasury bills and the dearth of Treasury bills in the portfolios of the city banks, the purchase by the System of short-term Government securities other than Treasury bills may be desirable.

The present economic and credit situation calls for steady and increasing pressure on the expansion of bank credit. The program just outlined should produce the desired pressure.

Mr. Erickson stated that he liked very much Chairman Martin's approach to the philosophy of restraint, and felt that we should lead rather than lag in System actions. He shared the Chairman's concern about inventory accumulations and about the wage cost factor and what might be happening to prices. He was also pleased with the degree of tightness that had

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been brought about in the market during the last few weeks. He hoped that greater use would be made of the discount facility and, in the present circumstances, he would not hesitate to tighten the credit situation further.

Mr. Irons concurred with the view that the System should lead in its actions and expressed the opinion that the recent action increasing the discount rate did lead to some degree. He was pleased at the increasing steady pressure on the market. He had hoped that the bill rate would move closer to the discount rate, but he questioned whether in the peculiar circumstances existing in the market it would be reasonable to expect that result or whether it would be desirable to try to induce it as that might unduly tighten the market. He believed that increasing pressure should be applied as needed and he realized that judgment on that point was the difficult question. There were few signs of lessening activity in the economy and he was concerned with the steady increase in consumer credit and in the lengthening of instalment terms. The economy was moving into the season when there was a strong demand for consumer credit and, in spite of the fact that the automobile industry was in a period of model change, he questioned whether there would be any reduction in the growth of consumer credit. The economy is going into the fall period with full utilization of capacity, a tight labor market, a less liquid condition in the banks, and a tighter money situation. With the existing strength in the economy a further tightening of the credit situation in his opinion

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would not have as damaging an effect as failure to bring about a further tightening, and it was his view that if the System has to lead one way or another it should lead toward further restraint.

Mr. Earhart was in agreement that there should be a policy of gradually increasing pressure and that this condition would result if the System continued the present policy of not supplying reserves through open market operations. He was certain that if conditions were such that member banks had to borrow, the degree of restraint would be increased. His judgment was that the discount rate should not lead in the sense of stepping up the rate to where it would be a penalty rate under all conditions, but that market rates and the discount rate should be kept as close together as they have been during the last two weeks. He felt that without further open market action there would be an increasing amount of restraint and that possibly within about two weeks the discount rate might be moved up to 2-1/4 per cent. He added that unless something developed at this meeting that changed his mind, his recommendation to his directors at their meeting tomorrow would be that they take no action to increase the discount rate and that they consider the matter again at the meeting two weeks later.

Mr. C. S. Young said that the discount rate was the only item on the agenda for the meeting of his directors on Thursday and he was satisfied that no change would be made at that time. He felt that if an error was to be made it should be in the direction of increased tightness

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but that we have not yet seen the full effect of the increase in the discount rate to 2 per cent. He questioned whether the present bill rate was a real market rate. He had asked nonbank purchasers of bills whether they would buy anything other than bills, and the reply was a negative one because they wanted short-term bills which were liquid. Even if the rates on other issues were as much as 1/2 per cent higher, he said, these people would not buy them. There were a number of treasurers of big industrial concerns that have funds to invest and they want to put these funds where "they can get their hands on them." He questioned whether further action should be taken on the discount rate this week.

Mr. Leach explained that the fact that the Federal Reserve Bank of Richmond was the last to increase its discount rate to 2 per cent did not indicate any reluctance to make the change. When he learned that Cleveland had established a 2-1/4 per cent rate and some of the other Banks a 2 per cent rate he felt he should not attempt to get action before the next regular meeting of his directors at which time the matter could be carefully reviewed. When the meeting was held, he said, the decision was made that the increase to 2-1/4 per cent should be in two steps rather than in one. However, he thought that, if the present expansion continued, when the directors met in September they would favor a 2-1/4 per cent rate. They would not favor such an increase now because it would be too soon after the recent increase. Speaking personally, he was very much pleased with the System's policy in August when the pressure on the market

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gradually increased with the resulting change in the volume of free reserves. Representatives of his Bank had talked to a number of the larger banks in the Fifth District to ascertain what effect System policy was having and it appeared that the banks are currently more selective and are exercising more restraint in their lending policies. On the question of the relationship between the bill rate and the discount rate, he felt the small supply of bills in the market, the unusual nonbank demand, and the tendency of more people to purchase bills pending the rate adjustment in the long-term market, were tending to impair the usefulness of the bill rate as an indicator of the present degree of market tightness. He would like to see a substantial part of the additional reserves needed in coming weeks supplied through the discount window because in his opinion that would mean increased pressure on the borrowing banks because of their reluctance to borrow. Such a policy would also result in increased pressure on other banks because they would have to sell securities at a loss to make additional loans. In his opinion the Committee would have to get accustomed to looking at larger amounts of negative free reserves. Mr. Vardaman referred to the comment made by Mr. Erickson about the reluctance of banks to borrow and stated that the Federal Reserve Banks through their educational programs should instill in their member banks that it is no disgrace to borrow, and that borrowing is a proper use of the discount facility and is one of the best insurance policies in the System. He hoped that banks would be encouraged to borrow when it is proper to do so.

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On the question of timing of a further increase in the discount rate, he expressed regret that all Federal Reserve Banks had not increased their rates to 2-1/4 per cent following the last meeting of the Federal Open Market Committee. He felt that the pattern of fall and winter spending was now taking form, that not only were inventories increasing in accordance with that pattern, but orders were being placed, and that these orders would govern the borrowing needs of customers of banks later in the year. Unless the System gave some warning now it would be unfair to the economy to squeeze the banks too tight after the manufacturers had put the orders into production and the local merchants were committed. He had the strong hope that within the next two weeks the discount rate would be increased to 2-1/4 per cent and, if that did not have the desired effect, a further increase to 2-1/2 per cent would be made.

Governor Mills expressed what he regarded as being the general tenor of the meeting that it is difficult to look beyond the next two or three weeks. He felt that over that period the System should move in the same direction it had been moving or gradually increasing market pressure and should be very alert and increase the discount rate when there is convincing evidence of need of such action.

Mr. Shepardson concurred in the feeling that had been expressed that continuing pressure should be applied. While agriculture prices had declined somewhat, crop prospects were excellent and with the decrease in

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the number of farmers that has been going on he felt that the income of the farmers was holding at a respectable level and that there was not the weakness in the general agricultural picture that might be indicated by the declines in prices. Farmers were in a strong position generally and with other factors of the economy operating at a high level he saw need for continuing restraint.

Mr. Bryan agreed that if further tightening action is to be taken it should be taken "sooner rather than later." He would like to be able to see more clearly the effects that were being produced by actions that had already been taken. It appeared to him that, because of Treasury financing in October, the decision would have to be made to stay on a 2 per cent rate or to increase to 2-1/4 per cent without knowing the effects of the recent discount rate increase. He did not believe that System actions had been too restraining. While banks were "talking an excellent game of restraint", he said, there were evidences in the reports of bank loans and in other ways that banks are continuing to increase loans. On the question of the relationship of the discount rate and open market rates, he would want to study the proposal made by Messrs. Riefler and Young. He did not think there was any theoretical solution that would say at all times and under all circumstances what the relationship of the discount and market rates should be. There might be times when a market rate well under the discount rate would serve a very useful purpose and other times when a market rate which had been pushed above the discount

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rate would also serve a useful purpose. He questioned the desirability of referring to the rate as proposed by Messrs. Riefler and Young as a penalty rate. He was disappointed by the fact that during the past two or three weeks open market operations had not been used with vigor to force the bill rate above the discount rate. In his opinion that would have several advantages. If the market goes up, because of the demands for funds or other reasons, it has a substantial arbitrage effect through the entire market. He regretted the fact that the Federal Reserve Banks and the Board were contemplating a further rate increase without knowing what the effects of recent increase were going to be. The question at this meeting, he said, regardless of whether the discount is to be 2 or 2-1/4 per cent, is at what point and in what considerations will the System begin to supply reserves to take care of the seasonal needs of the economy. It was his view that more vigorous action to tighten up on the supply of reserves should be taken than has been the case. He said that statement not as a criticism of any individual but as a statement of desirable policy.

Mr. Johns concurred in the views expressed by Mr. Bryan that the commercial banks are not pursuing tight loan policies. He also expressed the desire to study the suggestion made by Messrs. Riefler and Young. One of the things about the proposal that concerned him was that there were still something over \$2 billion of Treasury bills in the hands of banks

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and a penalty rate as outlined would be a penalty rate for banks that did not have bills while banks holding bills could obtain additional reserves by foregoing a yield of what happened to be the current market rate on bills. He assumed that if the System adopted a penalty rate it would want that rate to apply to banks that held bills as well as to banks that did not.

Mr. Powell stated that in the Ninth District, which is predominantly agricultural, the Federal Reserve Bank had surveyed the retail sales in a number of small towns and had found a very real reduction in the volume of sales indicating that the farmer has been suffering from low prices when industrial prices have been rising. On the question of credit policy, he felt that if no action in the open market were taken over the next three weeks it would have a very considerably restraining effect since it would increase substantially the amount of negative free reserves. It was his view that the Committee could maintain the desired degree of tightness by supplying only a part of reserves that would be needed to meet credit needs over the remainder of the year. He referred to the various indicators of the effects of tighter credit policy and stated that his Bank's appraisal of the situation was that no action on the discount rate should be taken at this time but that the System should see what the full effects of the recent increase would be. It was his view that probably open market operations could provide the necessary amount of restraint.

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Governor Szymczak said that, regardless of the various points made at this meeting, the Committee was faced with a practical situation in which (1) one Federal Reserve Bank has already established a 2-1/4 per cent rate, and (2) the Treasury will have to come into the market for additional funds in October and again in December for new funds and a refunding operation. In view of all of the factors in the picture he favored a further increase in the discount rate to 2-1/4 per cent as soon as possible. The present level of negative free reserves, the fact that the recent increase in the discount rate and even an increase to 2-1/4 per cent had been largely discounted by the market as indicated by market reaction, the fact that the amount of reserves that will have to be supplied to the market between now and the end of the year to take care of credit needs of the economy and Treasury financing can not be determined at this time,--all these factors call for an increase in the discount rate to 2-1/4 per cent, and he favored such action as soon as possible so as to permit the market for Government securities to adjust--so that the Treasury can determine the nature of its financing in the latter part of September.

Mr. Martin inquired whether there should be any change in the directive to be issued to the Federal Reserve Bank of New York.

Mr. Rouse stated that if there should be a further increase in the discount rate or a bad effect from increased shortages of reserves, a market situation could develop which would call for increased open market operations. For that reason, he suggested that the Committee might

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wish to increase to \$1 billion the amount stated in paragraph (1) of the directive.

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.

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Chairman Martin said that it would not be possible to specify at this meeting exactly the level of negative free reserves that should be maintained over the next three weeks but that the level should be in the direction of continuing restraint.

Mr. Rouse stated that the feeling of the New York Bank was to allow free reserves to decline to a point where there would be quite apparent market effects before injecting additional reserves through open market operations. In that connection, he said that if the Federal Reserve Banks or the Board should sense any bad effects from open market operations or that effects beyond those desired appeared to be developing in any district the New York Bank would appreciate hearing about it. He said that the Federal Reserve Banks and the members of the Board might have conversations which would disclose developments which might not come to the New York Bank in a period which might involve a delicate market situation.

In response to a statement by Mr. Riefler that, as he understood it, the New York Bank during the next three weeks would not purchase additional securities and would continue to allow maturing bills to run off without replacement, Mr. Rouse stated that he had felt that it would be inconsistent with his understanding of the Committee's intentions to bid for Treasury bills in the weekly refundings at a rate below 2 per cent. However, if the situation should reach a point where it was necessary to go into the market to supply reserves it might be necessary to buy bills at

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less than 2 per cent. Therefore, the question as he saw it was not as much one of rates as it was one of the availability of reserves. It was brought out that the projections made at the Board and at the Federal Reserve Bank of New York as to the future member bank reserve position did not take into account any run off of the System's holdings of maturing bills. However, Mr. Rouse said that the amount of System holdings of the next three weeks were not large.

Mr. Martin stated that the question of the point at which reserves would be supplied in the existing situation was the heart of the present problem of open market policy. He said he had not been able to discern any meeting of minds at this meeting on that point. He was inclined to favor an immediate increase in the discount rate to 2-1/4 per cent and felt that failure to increase the rate was a factor of confusion and uncertainty in the market which complicates the problem with respect to free reserves. Under present conditions, with a shortage of bills in the market, he would not like to rely solely on forcing the bill rate up to the discount rate by increasing pressure through negative free reserves. Therefore, he felt that the Committee should take something of a middle course which was about all that could be done in the circumstances.

Mr. Rouse stated that his preference, should a shortage of bills develop, would be to purchase what the banks have to sell, i.e., short-term securities other than December rights, instead of buying bills at the

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current rates. Something could be accomplished, he said, through repurchase agreements at some point if the severity of restraint increased. He interpreted it to be the sense of the Committee that the New York Bank should not buy bills at a rate below 2 per cent.

Chairman Martin stated that we faced a difficult problem, but that he would have no hesitation to purchase bills below 2 per cent. Mr. Rouse commented that if the problem was regarded as solely a question of reserves and acquisitions were looked at from that standpoint such purchases would be fine. Chairman Martin's response was that if the market tightens enough bills would probably be available. While the question was not further clarified by further discussion, Mr. Rouse stated that he thought the New York Bank could function satisfactorily in the light of the discussion at this meeting. Chairman Martin then stated that, if there was no objection, the discussion would conclude on that uncertain, and in a sense, rather unsatisfactory note. He said that everyone should continue to study the problem and feel free to communicate with Mr. Rouse at any time.

Chairman Martin then referred to the replies to letters received from Congressman Patman which were mentioned at the last meeting of the Committee. He said that the suggestion had been made that copies of the letters be sent by the Board to the members of the Federal Advisory Council and the Chairmen of the Federal Reserve Banks for their information and that, in the absence of objection, that would be done.

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Reference was then made to the understanding at the last meeting that the authority to the New York Bank to enter into repurchase agreements with dealers covering United States Government securities would be considered at each meeting of the Committee. Mr. Rouse stated that the range of rates in the existing authorization was regarded by the bank as minimum rates, that the going rate in the market on loans to dealers was 2-1/2 per cent, and that if the situation called for repurchase agreements during the next three weeks, he would be inclined to make them at 2-1/4 per cent. The ensuing discussion brought out the point that such action would be within the terms of the existing authorization and no objection was made to it.

At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, authorization to the Federal Reserve Bank of New York was renewed as follows with the understandings (a) that the authority would be used sparingly in entering into agreements at rates below the discount rate, and (b) that the Federal Open Market Committee will consider at each meeting the extent to which repurchase agreements covering Government securities were to be authorized and the rate or rates at which such agreements are to be undertaken:

CONDITIONS FOR REPURCHASE AGREEMENTS
PRESCRIBED BY THE FEDERAL OPEN MARKET COMMITTEE

As Approved August 23, 1955

The Federal Reserve Bank of New York is hereby authorized to enter into repurchase agreements with nonbank dealers

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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 stated that ordinarily the next meeting of the Committee would be held on September 13 but that Governor Balderston would not return from Europe until the evening of that day. For that reason he (Chairman Martin) suggested that the next meeting be held either on September 14 or 15. Some of the members having indicated that a meeting

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on September 14 would be more convenient to them, there was unanimous agreement that the next meeting should be held on that date.

Thereupon the meeting adjourned.


Secretary