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 Wednesday, November 16, 1955, at 10:45 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
Mr. Vardaman

Messrs. Erickson, C. S. Young, and Johns, 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. Vest, General Counsel
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. 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 Reserve Bank of New York

Mr. Mitchell, Vice President, Federal Reserve Bank of Chicago

Secretary's note: Mr. Powell, alternate member of the Committee, planned to attend this meeting but was unable to be present because his plane was grounded.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 25, 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 25 to November 9, 1955, inclusive, as well as a supplementary report covering commitments executed November 10-15, 1955, inclusive. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Sproul noted that Mr. Rouse had been delayed in reaching the meeting, and it was understood that discussion of the report would be deferred until he arrived.

Chairman Martin called upon Mr. Ralph Young for a statement on the economic situation concerning which a staff memorandum had been distributed under date of November 10, 1955. Mr. Young reviewed the situation in summary form, making a statement substantially as follows:

Currently, the economy is at a stage of bulging, even inflationary, industrial prosperity. Broad advance still features industrial output, though the pace of advance is slower than earlier as capacity output is being approached in more and more lines. Markets for industrial commodities are very strong, with demand pressures manifested in a quite slow rise in business inventories, in a climbing backlog of manufacturers' orders, and in a spreading of industrial price increases. The labor market shows every evidence of further tightening. Also, business, financial, and consumer confidence and optimism are once again on the ebullient side. While agriculture is less prosperous

than last year, it is still relatively well off. Furthermore, with the peak of livestock marketings almost passed, the decline in farm prices would seem to have largely run its course. Continued over-all price stability on the basis of offsetting movements of farm and industrial prices is thus a less likely prospect. With further substantial expansion in business capital investment now indicated, demand pressures on the industrial side are such as to point to some lifting of the average commodity price level.

As to the specifics of the situation:

The Board's index of industrial production is now put at 142 for September and about the same for October. At this early point, the November index is expected to reach 143.

The further rise in industrial output reflects additional advance in production of metals and fabricated durable goods and a new high for the output of nondurables.

With automobile model changeovers now complete, automobile production is proceeding at earlier advanced rates. New model reception is reported as favorable and, although dealers are shaving prices to buyers, dealer margins are stated by trade sources to be profitable on reasonable volume basis. In October, new car stocks showed little change, as output approximated sales. With used car sales holding one-fourth above a year ago, dealer stocks of used cars showed an appreciable decline. Downward used car price adjustments recently, except for older cars, seem to be about consistent with new model introductions.

Output and retail sales of household durables have generally been maintained at advanced levels.

Instalment credit expansion proceeds apace, with credit terms--at least on the downpayment side--showing some tendency to stabilize.

Retail sales, over-all, were off slightly in October, reflecting mainly lower sales by auto dealers. However, they were still about an eighth above a year ago. Department store sales have held at high September levels until recently, when adverse weather conditions have reduced sales in some areas.

Manufacturer sales in September, while a little under the August level, ran a fifth larger than a year ago with increases for the year quite general. New orders ran ahead of sales again, bringing the backlog of orders to $53 billion, or 10 per cent over last year at this time.

Business inventory growth has been exceptionally moderate, considering the momentum of the upswing, and recently price increases have played a greater part in the inventory value rise. The month-end value of stocks for September was only 4 per cent over a year ago.

Value of new construction in October at just under $42 billion was off slightly from record spring and summer levels. Construction for business purposes continued to rise. New housing starts continued at a 1.2 million unit rate. But value of contract awards were off from the high September volume, reflecting mainly reductions in public works and utility awards.

The McGraw-Hill compilation of plans for next year's business plant and equipment expenditures clearly reflect the pervasive optimism of businessmen, even though some window dressing element may be present in the figures. The plans would indicate a 10 per cent increase from the fourth quarter of this year to the fourth quarter of next year, assuming an even time spread of the expenditure pick-up. This percentage increase is no greater than for this past year, but the economic situation which is called upon to absorb the increase is altogether different than a year ago.

Labor market figures show a further rise in total employment, manufacturing employment, hours of work, and earnings, all spelling still greater tightness of supply in relation to demand.

In agriculture, livestock prices have declined further, declines affecting both hogs and steers. Grain prices have adjusted to support prices, but recently cotton has firmed some to above the support level.

Cash returns from farm marketing are continuing about 4 per cent under last year, and, with farm expenses not changing much, farm net income is down even more. Farm debt in these conditions is showing a fairly substantial rise--up 10 per cent over last year.

Despite the indicated price, income, and debt developments for agriculture, confidential reports confirm a continuing, though gradual, general rise in farm land values.

Industrial prices have been rising about 1 per cent a month since mid-year and already indicated and prospective increases appear likely to sustain this rate of advance in months immediately ahead. Crude rubber prices have advanced again; also copper scrap, and London futures for copper. At some producers, carpet prices and some cotton textile prices have been marked up recently. Other recent price advances of note include crude oil, newsprint, cement, tin cans, new model autos, tires and tubes, and a variety of other items. Expectations of a further steel price rise are widespread.

Consumer prices have been showing little change, although prices of commodities other than foods and of services have been edging up. Sears, Roebuck & Co. have stated that the average of prices in the company's forthcoming catalogue will be up 2 per cent from the mid-year edition.

Abroad, trade and industrial development seem best characterized as showing some further advance but with greater unevenness of trend. In some cases, as in Britain, capacity operations offer obstacles to further advance. Wholesale prices in a number of countries have been registering some advance. Among the more important items of foreign news are the indications of a gradual lifting of adverse financial clouds over Britain.

Mr. Thomas stated that the situation presented in the economic review was reflected in financial developments and in the money market. It was becoming clearer that the economy was operating very close to capacity and that the possibility of further growth was much more limited than a year ago. Hence, some slowing of credit growth would be needed if consumption and production demands were to be kept in line with productive capacity. The pressures of demand on limited supplies were beginning to appear in rising prices of industrial materials and products, Mr. Thomas said, and the ebullient economy was showing signs of inflation.

Mr. Thomas noted that since the meeting on October 25 there had appeared some ease in the money market. To some extent this had been attributed to rumors of a shift to an easier credit policy. However, his view was that the appearance of ease could be partly explained by a more active use of the available money supply to purchase securities. Such increased use of available money is a result to be expected in a period of high interest rates, Mr. Thomas said. Within the past few days there had been some tightening in the money market more in accordance with the restricted bank reserve position.

Credit demands continue heavy, Mr. Thomas pointed out; consumer credit has expanded at an unprecedented rate; mortgage demand continues

very large, and there are complaints of difficulties in obtaining funds. New capital issues were exceptionally large in October and quite substantial in November, and the calendar for the period ahead is also heavy. Business loans at banks continue to increase, compared with declines in the same period last year.

Mr. Thomas reviewed changes in bank condition figures, noting that within the past year commercial banks had increased loans by nearly $12 billion but reduced holdings of Government securities by over $7 billion. Thus, there had been a decline in the liquidity of the banking system, but on the other hand there had been an increase in the liquidity of the economy which had expanded holdings of both cash and Government securities. Individuals, businesses, and institutional investors had used funds to purchase Government and other securities which they considered to represent liquid assets. Apparently, about $5 billion of Government securities had been absorbed by public and private pension and trust funds, and corporations and individuals had each added about $1 billion to their holdings. In addition, nonbank investors had acquired substantial amounts of other securities and mortgages.

Mr. Thomas also noted that the money supply had increased during the past year, although at a slower rate than during the three preceding years. Since January, the growth had been at a seasonally adjusted annual rate of barely 1-1/2 per cent, but the rate of turnover of deposits had increased. There had been greater activity in security markets and common stock prices had risen to the previous high level.

Net borrowed reserves recently have been running around $600 million to $700 million and, while there would be some reduction in borrowed reserves during the next few days, the level was expected to average above $500 million for the current reserve week. In the absence of open market operations it was anticipated that net borrowed reserves would be somewhat lower in the next statement week and then would increase to around the billion dollar level in December. Purchases or repurchases of Government securities by the System of around 1/2 billion dollars would maintain something like the present pressure on the market. Pressure could be increased by forcing banks to borrow more of their needs.

Mr. Rouse entered the room while Mr. Thomas was presenting his statement.

In response to Chairman Martin's question, Mr. Rouse said that he had no comments to make on the reports of open market operations prepared at the New York Bank and distributed prior to this meeting, and none of the members of the Committee raised any questions in connection with the reports.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period October 25-November 15, 1955, inclusive, were approved, ratified, and confirmed.

Chairman Martin stated that before proceeding with discussion of open market operations, he wished to comment on a telegram he had sent to the President of each Federal Reserve Bank under date of

November 9, 1955 suggesting that, without implying that action should be taken on the matter, there be a full review of the discount rate by the directors of the Reserve Bank at their next meeting. That wire, Chairman Martin said, was sent out in accordance with the general thought that the Federal Open Market Committee should be the focal point of discussions of all aspects of System credit policy. The wire should not be construed as indicating that any position had been taken by the Board regarding a possible change in the discount rate; it was sent with the thought that it would be desirable if all of the Presidents could be adequately prepared to discuss the problem of the discount rate at today's meeting. Chairman Martin then called upon Mr. Sproul who made a statement in which he brought out the following points:

1. There seems to be little question about it--businessmen and consumers have thrown off, for the present, doubts about the economic situation which may have been created by the President's illness.
2. Consumer spending and borrowing continues in high gear, the savings ratio is down to the lowest level of recent years, demand for business loans is still high, and plans for business spending for plant and equipment during 1956 are substantially, even dramatically, higher than in 1955.
3. At the same time we are obviously nearer to current ceilings on production and employment than we have been for some time past.
4. Combined with a generally optimistic attitude about the outlook, as reflected, for example, in the stock market which has recovered most if not all of its September-October losses, and with the fact that increased costs are still working their way through the economy, this is a situation which might well be headed for higher prices and the possibility of speculative excesses.
5. To be sure, the statistics of the recent past don't make an ironclad case for further anti-inflationary measures. The pace of physical expansion is slower than it was. Clear evidence of either an upward wage-price spiral or of widespread

material or employment bottlenecks is still lacking, although there are some evidence of both. While inventories are increasing, they are increasing less than sales (this may be involuntary) and at a slower rate than earlier in the year ($2.5 billion annual rate in the third quarter, compared with $4.5 billion in the second quarter). It might indeed still be argued that, except for the agricultural situation, we are enjoying an almost ideal state of production, employment, income, and prices. But part of our job is to try to help keep it that way, and recent pressures suggest the possibility of an outbreak on the upside, which we could help to prevent becoming a movement of prices rather than of production.

6. We have, of course, been allowing the seasonal demand for bank credit to press against available reserves during recent weeks, and member bank borrowings are higher, net borrowed reserves are higher, the money market has been tighter, and the tendency of most short-term rates of interest has been upward. In other words, a policy of credit restraint has been maintained and even increased, but it has not worked through as effectively as might be desired, either in terms of the supply of bank credit or in the capital markets. Particularly in the municipal and corporate bond market, during most of the past several weeks, there has been more buoyancy than two or three months ago, with some issues which were then withdrawn because of unsatisfactory bids coming to the market at equally favorable or more favorable rates.

7. One thing that has worked against the effectiveness of existing credit policy has been the widespread opinion, following the President's illness, that credit restraint had reached its peak and that relaxation was in the offing as 1956 approaches. The published figures of open market operations have begun to dispel this belief, I think, but until the last few days they seemed slow in taking hold. Another increase in the discount rate might confirm the continuance of restraint and help ward off possible speculative excesses which now appear more likely than they did a few weeks ago. We can't allow rumors to make policy but, at times, they do become part of the climate in which policy is made.

8. Treasury operations are again about to become a complicating factor. The Treasury will be in the market to refund a $12 billion December 15 maturity at the end of this month or early in December, and it will probably have to follow that up with up to a $1 billion cash borrowing before the middle of December. Avoidance of an unsettled market during the period of Treasury financing means we shall have to stand aside, pretty much from mid-November to mid-December. If it were not for this factor, I would favor postponing further restrictive action until we have had a little more time to observe the results of what we have already done, which appears to have begun to take hold during the past week.

9. In all the circumstances, however, it seems to me to be the part of prudence and wisdom to increase the discount rate to 2 1/2 per cent now, putting a little more cutting edge on the relatively high level of borrowing which I assume we shall expect to maintain, for the present, through open market operations. If such an increase in the discount rate has too great an adverse effect, particularly in the capital markets, of course, we may have to give temporary relief through open market operations. The way for an increase in the discount rate has been somewhat prepared, however, by the increase in our repurchase rate from 2 1/4 to 2 3/8 per cent on November 10, and the "shock" of an increase in the discount rate should not be so great, given the prevailing broad optimism about the economic future.

10. Gradual consistent pressure, when further expansion of bank credit may go into increased prices rather than into increased production (as it has already been doing, for example, in the building industry) seems to me to be the way to try to have a boom that doesn't "bust".

Mr. Szymczak inquired whether Mr. Sproul's statement to the effect that an increase in discount rate should not be made between mid-November and mid-December because of the forthcoming Treasury financing indicated that he did not favor an increase in the rate at this time, or whether it should be taken to indicate that the rate should be increased immediately.

Mr. Sproul responded that he felt the rate should be increased at once since, unless the increase were made this week, it probably would have to wait until after the Treasury financing.

Mr. Szymczak said that he favored an increase in the discount rate at this time. He would then observe the situation closely until the first part of 1956 to see what happened as a result of seasonal changes and political developments that might affect the economy. Also, he would pursue an even tighter policy in the open market than had been

followed recently, although he felt the open market account should be in a position to furnish additional reserves to the money market for a temporary period if an increase in the discount rate resulted in too much tightness.

Mr. Erickson commented on conditions in the Boston district, stating that activity there did not seem to be "boiling" as much as in other districts. In speaking of consumer instalment debt, Mr. Erickson noted that the percentage of the United States total of such debt held in New England was larger than the percentage of the country's consumer income in that region. Consumer debt at member banks in New England had increased by 19.2 per cent since December 1954, compared with an increase of 15.1 per cent for the United States as a whole. Mr. Erickson cited an instance of a mutual savings bank which had asked a Boston correspondent for a written confirmed line of credit for a period of one year for which it was willing to pay a commitment fee, in order to be sure that it would have funds available to meet its needs for mortgage advances during that period. He went on to say that, considering the economic situation and the psychology of businessmen and the general public, he proposed to recommend to the Board of Directors of the Boston Bank at its meeting to be held next Monday that it increase the discount rate. Mr. Erickson said that he also believed that the Open Market Committee might well follow a somewhat tighter policy than it has been following.

Mr. Earhart said that he favored an increase in the discount rate to 2-1/2 per cent and would so recommend to his directors. He also said that the members of the research staff at the San Francisco Bank were opposed to an increase of the discount rate at the present time. His reasons for favoring the increase had been well stated by others this morning, Mr. Earhart said, and in addition, banks in the Twelfth District seemed to be going ahead fairly freely in meeting credit demands and some of their use of the discount facilities had reached the stage where the borrowing was for more than temporary contingencies. This raised the question whether the Reserve Bank should "close the discount window" just a little by cautioning banks with respect to the programs they were following. Mr. Earhart recalled the difficulties which arose as a result of admonishments against extended use of the discount facilities in the spring of 1953 and stated that in his opinion if the impression were created that the Reserve Banks were closing the discount window a little, that might create a tighter situation than would be caused by an increase in the discount rate. His preference was to have an increase in the rate rather than to resist too strongly the borrowing of banks at the Reserve Bank. While he would prefer to be able to wait a week or two to see whether the actions already taken by the System were having enough effect in the short-term money market and in the capital market, he felt that in view of the timing of the Treasury's financing, action in raising the discount rate was called for at this time.

Mr. Irons said that conditions in the Dallas District were booming. There had been a resurgence of confidence among businessmen during the past few weeks. A survey that the Dallas Bank had made in 82 counties and parishes of the District during the past two weeks showed almost without exception that the picture was one of very strong confidence. Bankers, businessmen, and farmers anticipated stronger business this year-end than a year ago and were highly confident about the first six months of 1956. Agriculture was in fairly good condition, although many farmers in the Dallas District were discontented and disgruntled. This feeling seems to be associated with the belief that the farmer is not sharing in the boom to the same extent as industry; in addition, the farmer is unhappy about the price developments for farm products. From the standpoint of income, many farmers are better off than last year and banks were expecting farmers to pay off loans which had been carried from earlier years. Demand for credit in the Dallas District currently is stronger than at any earlier time although banks, which are under considerable pressure, are resisting these demands and are culling their loans. Mr. Irons described the discussion of the discount rate at the meeting of the Dallas directors last Thursday in the light of the telegram received from Chairman Martin. While he recommended reestablishment of the rate but without any attempt to press the matter, he said, he thought most of the directors would have voted against an increase in the rate at that time unless he had developed an unusually strong case in support of an increase. Mr. Irons stated that he felt

an increase in discount rate at this time would have its greatest impact initially in the capital markets and that it would seem more appropriate under these circumstances if such an increase originated in New York. Some of the Dallas directors had indicated that if the New York Bank increased its discount rate, they would be willing to follow promptly with an increase at the Dallas Bank. Mr. Irons stated that he would be prepared to call a special meeting of his Board and recommend an increase in the discount rate, assuming that action were taken promptly by other Banks, including New York.

Mr. Leedy said that Mr. Sproul had "covered the water front" and that he agreed one hundred per cent with his analysis of the situation and his suggestion for moving further in applying restraints. The only variation from what he understood to be Mr. Sproul's position was that, quite aside from consideration of the Treasury's financing needs, he (Mr. Leedy) felt that an increase in the discount rate was called for at this time.

Mr. Young said that in the Chicago area his contacts with leading businessmen during the past few days caused him to be prepared to recommend to his directors at their meeting tomorrow morning that the discount rate be increased. While he did not anticipate a unanimous vote, he felt the increase would be approved.

Mr. Leach recalled that at the meeting on October 25, he was quite satisfied with the results of the Committee's general policy except for the increase in prices of long-term Government securities. He thought

that increase would be temporary. The Richmond Bank's directors met last week and at that time considered the discount rate, after receiving Chairman Martin's telegram. They voted unanimously to renew the existing rate of 2-1/4 per cent. After describing the consideration which led to this decision, which was in accordance with the recommendation he had made at that time, Mr. Leach said that he was impressed with the change that has taken place very recently in the psychology of the public and businessmen at a time when we were approaching capacity. There had been a notable change in psychology during the past week or two. In view of the fact that this was probably the last chance for the System to increase the discount rate before the end of the year, Mr. Leach said that he now expected to recommend to the directors an increase of 1/4 per cent in the rate. As to open market operations, Mr. Leach said that several hundred million dollars of reserves would be needed before the end of the year and he thought these should be largely supplied through the discount window and through repurchase agreements. Outright purchases should be used only if the situation became quite tight. He referred to Mr. Earhart's comments regarding "tightening up" at the discount window, stating that his bank had given a great deal of consideration to this possibility over the past few weeks. However, he was hesitant to give the impression among banks at this time that the discount window was being "closed" somewhat, feeling that such a development might have more effect than anything else the System could do to bring on a sudden tightening. For these reasons, he expected to wait until the end of the season

when some of the banks which had been borrowing continuously were paying off their loans, at which time the situation would be discussed with them.

Mr. Vardaman said that he would not comment on whether the discount rate should be increased until all of the Reserve Bank presidents had expressed their views. He wished to emphasize what Messrs. Earhart and Leach had said about the discount window: if there were to be further tightening, it should be done by direct means, such as an increase in the discount rate and in open market operations, and not by partly closing down the discount window.

Mr. Mills said that he concurred in the desirability of moving promptly to a 2-1/2 per cent discount rate and maintaining, and if possible increasing, the pressure on bank reserves. This must be done with a very open-minded attitude and with careful consideration of the liquidity position of commercial banks and of their reaction to such changes. As indicated by the discussion this morning, the acquisition of Treasury bills by corporations and institutional investors has been at the expense of bank deposits, and central reserve cities have felt the brunt of that situation most severely. There may possibly be a "psychology of uncertainty" that might change to fear if the System were to act too aggressively, regardless of the desirability of the objectives of such action. Further, on the assumption that the New York and Chicago Reserve Banks will move to a 2-1/2 per cent discount rate tomorrow, the Committee must be conscious of the fact that yesterday's moderate sales of $37 million

of Treasury bills gave evidence of this sensitivity of the market through an immediate downward price pressure on the market. Mr. Mills suggested that in this situation perhaps the Manager of the Open Market Account could comment on the way in which open market operations during the reserve week starting tomorrow should be correlated with an increase in the discount rate. As natural forces in the reserve picture are going to ease the market tomorrow and during the rest of the current week, if the discount rate were increased Thursday, this might be a very happy circumstance. It might be desirable to suspend any Treasury bill sales for Thursday and Friday with the thought that natural forces could be allowed to reassert themselves next Monday in order to obtain the degree of tightness that might be desired. This would allow two days of fleeting ease for the market to adjust to the change in discount rate and would avoid implying that the change in discount rate was being accompanied by very agressive open market sales of Treasury bills.

Mr. Rouse commented on the prospective easing in the reserve situation during the rest of this week, noting that the picture was expected to shift back next Monday to net borrowed reserves of around $600 million to $650 million. Mr. Rouse said that his thought would be perhaps to continue some sales of bills today for delivery tomorrow, and if the rumors of a discount rate change were persisting today, this probably would be sufficient having in mind the extremes contemplated in net borrowed reserves. He estimated net borrowed reserves would average around $300 million for the week ending November 23 and $700

million for the week ending November 30. Mr. Rouse thought the slightly easier situation suggested by Mr. Mills between now and the end of this week would not be undesirable, if a change in the discount rate were announced tomorrow. He would be inclined to do nothing beyond what is done in the market today.

Mr. Robertson stated that he agreed with the views expressed at this meeting and he presented a memorandum expressing his views, reading as follows:

> At the last meeting, I advocated a policy more restrictive than the one theretofore followed. At that time it was my judgment that the key financial and economic facts called for an increase in the discount rate rather than a higher level of negative free reserves. The events since then have tended to confirm my judgment that an inflationary situation was threatening and that anything short of a rise in the discount rate would be an inadequate gesture to curb such a threat.
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> In the two weeks ending November 9, free reserves dropped from a negative level of $303 million to $446 million and then to $577 million. On Wednesday, November 9, negative free reserves were over $900 million, and on November 10, repurchase agreements were entered into at 2-3/8%, 1/8% above the discount rate. Despite these restrictive Open Market developments, credit and capital market conditions had not until this week tightened materially. The Treasury bill rates at first did not rise, but actually declined further to almost 2%. Only this week have they regained a level around the discount rate, and then only by virtue of a volume of negative free reserves in excess of what was contemplated by the Committee at the time of the last meeting.
>
> Intermediate and long-term Government bond yields have risen only moderately, and corporate and municipal yields have remained relatively unchanged. The feeling continues widespread in financial markets and in the business community in general that credit restraints will not be tightened any further.
>
> This feeling has not only affected money rates and bond yields, but has also affected investment and spending as well. October saw the largest monthly volume of municipal and corporate financing for many months, and all major types of bank

loans also continued to increase rapidly. New financing in November is continuing very high. Such new financing at attractive rates has meant additional funds available for spending by business, consumers, and state and local governments.

It is at least questionable whether the recent rates of increase in consumer credit, real estate credit, and business loans can be maintained. If they cannot, the impact on future levels of business activity will be serious.

Although there has been some rise in Treasury bill rates this week as a result, in part, of the higher volume of negative free reserves, it is questionable whether even the present degree of restrictiveness can be maintained by continuation of this level of negative free reserves. The market becomes accustomed to any given level of reserves and the pressure resulting therefrom tends to diminish with time. This is particularly true at this season of the year.

I am aware that discount rates, as such, are not within the province of the Open Market Committee, but the Open Market policy of this Committee must be geared to action on the discount rate. I still feel that the System's policy of restraint should be greater rather than lesser, and that the best means of achieving this end is through an increase in the discount rate.

It seems to me that a rise in the discount rate is necessary to convince the public that the Federal Reserve is going to exercise restraint when such restraint is called for by the over-all economic situation.

Failure to raise the discount rate could, in the existing situation, contribute to an inflation that is very likely already in process--except for the agricultural area, price rises are already widespread and are becoming more so. Such a failure will not prevent the adjustment in money rates and bond returns that is bound to come if business is as strong as our economists portray, but it may postpone it, probably to a time when the maladjustments would be even more acute than now and when an adjustment would be even more disrupting than now.

On the other hand, a moderate increase in the discount rate (e.g., a quarter of one per cent) would tend to restore flexibility in the use of this instrument. It would now have a psychological significance, which should be an attribute of movements in the discount rate, but which will be largely lost if we wait until after a rise in the rate is past due and partly or wholly discounted. There are times, and I think this is one of them, when it is better to lead with the discount rate than to follow.

There is very little time remaining in this year within which action on the discount rate can be taken without seriously interfering with Treasury financing activities. It would seem to me that failure to act in the next few days will mean that there can be no action at least until after the end of the year.

If the discount rate is raised, it is possible that a sharp rise in money rates and bond yields would ensue, but this is less likely now in view of the increase in the level of the bill rate during the past three days and the present level of member bank borrowing from Federal Reserve Banks. Furthermore, if the general business situation is as strong as our economists picture it, the chance that such a rise would lead to undue financial stress is very slim. Even in the remote chance that it would, we have the means to combat such a development. If general business is, in fact, on the brink of a downturn, an increase in the discount rate at this time might precipitate the turn. But no facts before us today warrant any such economic prognosis. If the recent McGraw-Hill survey, which forecasts business plant and equipment expenditures for 1956 at 13% above those a year ago, is anywhere near the mark, something will have to give, in an economy already operating at capacity.

Consequently, I feel that there are inflationary pressures present which should be checked <u>now</u> by a firmer monetary policy--one firm enough to curtail spending and thus dampen price pressures. The best instrument to use at the moment is the discount rate policy. The rate should be raised. The risks involved in raising the rate are less than those involved in failing to act.

If the discount rate is not raised, then it seems to me that Open Market policy should be geared to achieve somewhat greater restraint over the next few weeks than that prevailing even in the past few days, notwithstanding the fact that, in view of the projection for free reserves during the next two weeks, this is likely to be difficult to achieve.

Mr. Shepardson said that he was thoroughly in accord with the views expressed, particularly with those given by Mr. Leedy. He had thought an increase in the discount rate was desirable, regardless of the pending Treasury financing. Mr. Shepardson went on to say that agricultural prices had stabilized somewhat recently but as far as he could see there was no prospect of improvement in general agricultural

prices as long as heavy, burdensome surpluses were overhanging the market. The best help the System could give agriculture, he felt, was to try to prevent further increases in the prices of things the farmer has to buy.

Mr. Fulton said that the Cleveland Bank directors discussed the discount rate at their meeting last week reaching a consensus that it should be raised but did not act to increase it feeling that they did not wish to take the lead in such action at this time. The Cleveland District is on an "overtime" basis, Mr. Fulton said, even in the formerly depressed coal mining industry, and large plant expansion programs are under way.

Mr. Williams said that a recent survey of conditions in the Philadelphia District confirmed the need for an increase in the discount rate at this time.

Mr. Bryan described the discussion of the discount rate at the meeting of the Atlanta Bank's directors last week, following receipt of Chairman Martin's telegram. The directors were inclined toward an increase in the rate, he said, and much of their discussion was whether the increase should be 1/4 of 1 per cent or more. One of the questions asked but never answered was, if the Federal Reserve System does not act for further restraint under the conditions that now exist, under what conditions would it act? It was clear that the directors felt that action should be taken, Mr. Bryan said, and they were prepared to act promptly

to increase the discount rate, provided other Reserve Banks took similar action.

Mr. Bryan also suggested that, in terms of the longer run picture, the System might consider whether we have not now passed an all-time low in the monetary returns on savings. He suggested that this subject might be profitably discussed in terms of the shift of income distribution in the United States, the tendency of population figures to increase, and the volume of savings that would be necessary in order to produce a capital endowment for the next generation that would be equivalent to that available for this generation.

Mr. Johns commented on a discussion of the discount rate at a meeting of the directors of the St. Louis Bank last Thursday, at which time Chairman Martin's telegram of November 9 was brought to their attention. The directors re-established the existing rate at that time. Mr. Johns said that at the time of the directors' meeting, he had just returned from a vacation and he made no recommendation for a change in the rate, partly because he wished to have the benefit of a discussion at this meeting and partly because he wished to review and analyze the data that had become available to him on the situation upon his return. He had now reached substantially the position indicated by the views expressed at this meeting, and he planned to recommend to his directors that the discount rate of the St. Louis Bank be increased to 2-1/2 per cent.

Mr. Balderston concurred in the general views expressed during the meeting.

Chairman Martin said that he concurred in the view that the discount rate should be increased. However, he stated that it would be most unfortunate to have anything in the way of a panic develop among banks during this period and, while it was desirable to increase the discount rate, that did not mean that the supply of money also should be decreased during this period. He felt that an increase in the cost of money and a decrease in the supply of reserves did not have to take place at the same time. This was a problem to be considered by the Manager of the Open Market Account, Chairman Martin said, and he reiterated the view there should be nothing in the way of a panic, and nothing should be done that would risk developing a feeling of panic on the part of banks regarding their ability to use the discount window. This did not mean that the System was giving up any principles regarding the discount window. The System should do what it could to restrain excesses at this time, but it should not put undue pressure on the supply of reserves during the period in which the money market and banks were adjusting to an increase in the discount rate just preceding the Treasury financing that would be announced at the end of November or early in December. Chairman Martin also said that if the discount rate were not increased at this time, he seriously doubted that a change could be made until some time after the turn of the year.

Mr. Balderston said that he was concerned that the System go into the Treasury financing period able to discharge its secondary obligation to the Treasury by keeping an even keel during the period of the Treasury's financing. However, it should go into this period with as much tightness as the System could contrive to exert without deceiving the market. He noted that there had been a rise of 3-1/2 per cent in the industrial component of the wholesale price index since June of this year and that this meant that the rise has been at an average rate of 7/10 per cent each month. While it was true that the rise between July and September immediately after the big wage settlements was at double the rate of October and November, the fact was that heavy individual demand was being enlarged by consumer credit of doubtful quality, and this was being superimposed upon heavy corporate demand. The suspicion that businessmen might be altering their expansion plans for plant and equipment has been answered by McGraw-Hill and other surveys of next year's expectations. For these reasons and because the System's secondary obligation to the Treasury would inhibit its freedom of action shortly, Mr. Balderston said that he believed that the System should proceed at once to increase the discount rate to 2-1/2 per cent.

Chairman Martin said he did not think it possible to pinpoint precisely the reaction in the market to an increase in the discount rate or to say what the adjustments in the market would be between such an increase and the Treasury announcement of its financing. The point

he wished to make was that this is clearly a situation where the System does not want to have both an increase in the discount rate and simultaneous appearance of a strong reduction in the supply of money. He did not object to considerably increased restriction, but it seemed to him that if both the increase in the rate and a reduction in the supply of money took place at this particular time it could compound the situation in a way that the Committee did not wish. We have a limited period before the Treasury financing. Whereas he would normally be in favor of open market operations to reinforce another credit action, in the present situation he would favor giving the desk some latitude in deciding how far to go in this period of adjustment.

Mr. Sproul said that he would like to emphasize two points that had come up in the discussion. First, it would be quite undesirable and a great mistake in his opinion to have any indication of a "shutdown" at the discount window at this time. Secondly, Mr. Sproul thought the Committee would have to continue its open market operations in the light of what the reaction to an increase in the discount rate might be without any preconceived idea as to what net borrowed reserves should be. He said that he had been a little disturbed by the implication some of the members of the Committee had given this morning of aiming for even greater tightness in open market operations. He did not think the Committee should now commit itself to an even tighter policy until it had had an opportunity to observe the reaction of the market to a change in the discount rate. His concept, Mr. Sproul said in response to a question

from Mr. Robertson, was that the Committee should maintain about the situation that has developed during the past three weeks, but it should not say that there should be a particular figure of net borrowed reserves at the time of a change in the discount rate, particularly since the capital markets within the past few days have begun to react to what the Committee already has done through its open market operations.

Mr. Robertson said that he would agree that it was not desirable to set a level or even a range of net borrowed reserves, because it was not possible to see what the pressure would be at any given level. He thought, however, that the Committee should maintain at least the degree of tightness that had existed during the past few days. In other words, it should maintain an even keel in relation to the last few days.

Mr. Sproul said that he agreed with Mr. Mills' suggestion that it might be appropriate, in terms of carrying out monetary policy, to have a little less tightness during the rest of this week as a means of helping to iron out the adjustments after announcement of the increase in the discount rate.

Mr. Robertson said that he agreed completely with this view also, but that for the next three weeks as a whole, the desire to maintain an "even keel" did not mean that the measure should be what had happened over the last three weeks, but rather the last three days.

Chairman Martin said that the only place where he would differ with Mr. Robertson--and the difference might be only one of emphasis--would be his emphasis on giving the Management of the Open Market Account

latitude in carrying on operations during this period of adjusting to the rate increase. He would not be concerned if the operation did not achieve the recent degree of tightness in the period between the increase and the Treasury financing. What he was suggesting, he said, was trying to move in the direction of maintaining tightness, but avoiding having the two forces of an increase in cost of money and a decrease in supply of reserves present at the same time the Treasury was getting ready to announce its financing. This was a very difficult situation, he said, and the Committee should not minimize the difficulties that would be presented to the Management of the Account in this period.

Mr. Robertson said he did not disagree--that he was in full accord with giving the Management of the Account latitude along the lines suggested by the Chairman.

Mr. Shepardson referred to the understanding at the meeting on October 4, that "the Committee desired to maintain the degree of restraint that it had been trying to maintain . . . and that . . . doubts should be resolved on the side of tightness rather than of ease." He suggested that the current understanding might be the same, except for omission of the provision that "doubts should be resolved on the side of tightness rather than of ease."

Chairman Martin said that this suggestion could be put in the minutes, but that he did not think it needed to be adopted, and there was no disagreement with this comment. He then inquired whether the

directive to be issued to the Federal Reserve Bank of New York needed any change.

Mr. Rouse stated that the wording of the directive seemed appropriate to the objectives of the Committee as discussed at this meeting and that he had no suggestion for change in any of the existing limitations in 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.

Chairman Martin next inquired whether there was a suggestion for a change in the instruction to be issued in connection with repurchase agreements, particularly whether any change was needed in the provision that the rates on such agreements should be not less than (a) the discount rate of the Federal Reserve Bank on eligible commercial paper, or (b) the average issuing rate on the most recent issue of three-month bills.

Mr. Rouse felt that the existing provisions with respect to the rate were satisfactory for repurchase agreements that might be used between now and the next meeting of the Committee.

Thereupon, 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 suggested that it might be desirable to set the date for the next meeting of the Federal Open Market Committee on Tuesday, December 13, 1955, with a view to having a full scale review of the economic and credit situation at that time and with the further thought that the following meeting of the Committee might be held after the turn of the year. There was unanimous agreement with this suggestion.

Chairman Martin said that, without implying criticism of anyone, there was one other matter which he would like to mention at this time. An article on the Committee's policy had appeared in the magazine "Business Week" shortly after the meeting held on October 25, 1955, and the article contained comments reflecting so closely the substance of the meeting that he did not see how it could have been written without some person who was familiar with what went on at that meeting having discussed the matter. He reiterated that he was not implying that anyone had discussed the meeting and he said that he had complete confidence in all of the members of the Committee and the others who participated in the meetings. However, the article had impressed him and he felt it necessary that all those who participated in the meetings be extremely careful about their discussions about what went on in any such meetings.

Chairman Martin then called attention to a copy of a letter from Congressman Brent Spence, Chairman of the House Banking and Currency Committee, dated October 25, 1955, requesting comments by the Board of Governors on a bill, H. R. 569, introduced in the House of Representatives on January 5, 1955, by Mr. Patman, which proposed to increase to 12 the number of members of the Board of Governors of the Federal Reserve System and to provide that their terms of office shall be six years, and to abolish the Federal Open Market Committee and transfer its functions to such Board. Chairman Martin said that copies of Congressman Spence's letter and the bill had been distributed at this meeting and that he would appreciate suggestions or comments which might be of assistance to the Board in preparing a response which, he hoped, could be submitted to Mr. Spence not later than the first part of January. He also noted that Mr. Balderston had suggested that comments be sent in in time to be considered at the meeting of the Committee on December 13, 1955.

Mr. Sproul referred to the request made by Senator Douglas, first discussed at the meeting of the Committee on September 14, 1955, regarding a visit which the Senator proposed to make to the Federal Reserve Bank of New York, probably between October 20 and November 1, for the purpose of observing the handling of open market operations. He stated that Senator Douglas, accompanied by Dr. Achinstein, had visited the Bank on October 26, 27, and 28, in response to the invitation of the Federal Open Market Committee, which he as Vice Chairman of the Committee had sent to the Senator by letter dated October 6, 1955.

Mr. Sproul then described the visit in substantially the following terms:

Each morning Senator Douglas and Dr. Achinstein came to the bank at about 9:30 and had a preliminary talk with Mr. Rouse and me. At the first such meeting, I spoke to them of the possible adverse effects of publicity concerning their visit, which might be played up as a Senate investigation of open market operations with possible unfortunate repercussions in the Government securities market. I pointed out that if they attended the dealer conferences, or listened in on market telephone conversations which would necessitate disclosure of their being "on the line," there might be a flood of rumors. Senator Douglas said he wished to avoid anything of the sort and, so far as I know, no publicity attended the visit.

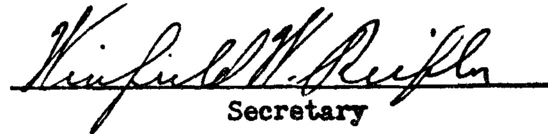
At 10 o'clock or shortly thereafter each day, they went to the trading room and stayed there the rest of the morning. After lunch at the bank, we usually went over any questions that had come up, and they would leave in the early afternoon.

The Senator's chief interest appeared to be how policy directives are translated into action, how operations are actually carried out in the market, and how the System is kept advised of open market operations. We showed them the forms and data we regularly use in analyzing the position of the banks and the money market each day, except the reports of individual dealer's position and volume. They also sat in on the eleven o'clock telephone calls to the Board and Federal Reserve Bank of Dallas (the latter was the other Reserve Bank being included in the call during that week), and were informed of conversations with the Treasury on its position, of our regular routine surveys of the market, of transactions which are carried out for System Account, the Bank's account, Treasury account and foreign or member bank account, and of the information which we supply regularly to the Federal Open Market Committee and to all of the Federal Reserve Banks.

The Senator appeared to be well satisfied with his visit and said he intended to report on it to his Committee. He gave no indication of his own views as to policy formulation by the Federal Open Market Committee or the method and means of conducting its operations. When asked what questions or criticisms he might have about our performance, he evaded the question. Dr. Achinstein largely sat by and let the Senator do the talking and ask the questions. His role seemed to be to observe and to pull together the information obtained, presumably to brief the Senator before each day's visit, and to help prepare a report for the Senator.

Chairman Martin stated that he was glad to have this report of Senator Douglas' visit and that he felt the Committee was indebted to Mr. Sproul and to the New York Bank for the manner in which they had handled Senator Douglas' request and visit.

Thereupon the meeting adjourned.



Secretary