A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, December 2, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Fulton
Mr. Irons
Mr. Leach
Mr. Mangels
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

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

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

Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Daane, Wheeler, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Molony, Special Assistant to the Board of Governors
Mr. Koch, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Acting Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Ellis, Roosa, Mitchell, Jones, Tow, and Rice, Vice Presidents of the Federal Reserve Banks of Boston, New York, Chicago, St. Louis, Kansas City, and Dallas, respectively

Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Messrs. Anderson and Atkinson, Economic Advisers, Federal Reserve Banks of Philadelphia and Atlanta, respectively
Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 10, 1958, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the Federal Open Market Committee on November 20, 1958, in approving the recommendation of the Manager of the System Account that System holdings of $7,857 million of Treasury certificates of indebtedness due December 1, 1958 be exchanged into $5 billion of the 3-3/8 per cent Treasury certificates of indebtedness to mature November 15, 1959 and $2,857 million of the 2-5/8 per cent Treasury notes to mature in May 1961, these securities having been offered for exchange in the Treasury refunding announced November 18, 1958, was ratified.

Upon motion duly made and seconded, and by unanimous vote, the sending of a letter to Congressman Patman on November 26, 1958, in reply to his inquiry of October 1, 1958 concerning purchases and sales of Government securities for foreign accounts, Treasury investment accounts, and member bank and other accounts was ratified. The letter, which was signed by Chairman Martin, reads as follows:

In your letter of October 1, 1958, concerning the photostatic ledger pages showing transactions in the System Open Market Account during 1957 and earlier years, you refer to "the purchases and sales of the account acting as agent for

foreign banks," and you inquire whether the photostatic pages omit "those instances where the Open Market Account made the transaction with a dealer or with some other account." You also ask that we advise you whether the photostatic pages "are incomplete, and......in what respects they are incomplete, if any."

The ledger pages are a complete record of every transaction in United States Government securities in which the System Open Market Account was a party between March 1951 and December 1957. The System Open Market Account does not act in the capacity of agent in any transactions in Government securities, and the transactions for other accounts consequently are not included in the ledger records of System Open Market Account operations unless the transactions are directly with the System Account.

Purchases and sales of Government securities for foreign accounts and for Treasury investment accounts are made by the Federal Reserve Bank of New York as agent for those accounts. In addition, the other Federal Reserve Banks act as agent on occasion in acquiring securities for their member banks. You will recall that my letter dated November 14, 1957 responding to your letter of August 27, 1957, transmitted a complete list of all transactions in United States Government securities executed by the Federal Reserve Banks during the year 1956 for foreign accounts, Treasury accounts, and member bank and other accounts. The listing shows the date of each transaction, its size, the particular issue bought or sold, and the price at which the transaction was completed.

The Federal Reserve Banks are being asked to compile similar information for the calendar year 1957. As you know, the preparation of this material represents a large amount of work and it will be several weeks before the task is completed. However, the listings of the transactions will be furnished as soon as they are available.

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 November 8 through November 25, 1958, and a supplemental report covering the period November 26 through December 1, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Reporting on open market operations since the preceding meeting, Mr. Rouse stated that the Treasury refunding operation had been completed with less attrition than expected--$414 million. The new issues had continued to retain premiums over issue price despite the general decline in Government securities prices that began last Wednesday. The average rate in yesterday's Treasury bill auction was 2.806 per cent, and the new bill was trading at 2-3/4 per cent, somewhat higher than at the time of the last meeting. This rise in bill rates reflected a seasonal buildup in the supply of the new six-month bills.

Mr. Rouse commented that the System had supplied about $490 million net in reserves since the last meeting. The past three weeks had been difficult, with airline strikes and wide movements in required reserves, currency in circulation, and the Treasury balance rendering reserve estimates highly uncertain. Free reserves averaged $36 million over the period. However, despite heavy purchases of bills over the past two or three days, it now appeared that there might be average net borrowed reserves for the current statement week. Member bank borrowing from the Reserve Banks exceeded $1 billion last Wednesday despite the absence of any great tightness in the market.

Mr. Rouse noted that average net borrowed reserves, in the amount of about $40 million, were projected for the current statement week. Some repurchase agreements had been written yesterday and

perhaps some would be written today, although this was questionable in view of the comfortable position of the money market.

Mr. Robertson inquired of Mr. Rouse why he would think it desirable to raise the level of reserves this week, and Mr. Rouse stated that if average net borrowed reserves should be published it might well be taken by the market as a change in the direction of policy. He felt that this would be unfortunate in view of the fact that the distribution of the Treasury's new issues was still in process and also in view of the advent next week of the new six-month bills. Mr. Robertson then stated that he had misunderstood Mr. Rouse and had thought that the latter mentioned average free reserves of $40 million for the current week rather than average net borrowed reserves in that amount.

Mr. Rouse informed the Committee that the Irving Trust Company had decided to begin operations as a broker in Federal funds and that the bank would try to keep its Federal funds operations separate from the management of its own money position. He added that participation of Irving Trust in the Federal funds market would be in addition to the participation of Garvin, Bantel and also of Mabon and Company, which recently entered the field. He stated that Irving Trust Company, with its wide network of contacts, should add something constructive to the Federal funds market.

Mr. Rouse also stated that the new six-month bills would be auctioned for the first time next Monday. He said that he had been thinking of these bills as additions to the securities in which open market operations could be conducted but that he planned to stay out of the market for the new bills for a while in order to permit a market to develop independently of System influence. On the basis of the desirability of permitting the market for the six-month bills to stand on its own feet, he had advised the Treasury against permitting commercial banks to pay for their awards of such bills by credit to Tax and Loan Accounts.

Mr. Thomas stated that the market was interested in knowing whether the System would or would not deal in the new six-month bills. To stay out of the market altogether for the next few weeks might mislead the market into thinking that the System was not interested in buying or selling the new bills. Therefore, he said, it might be well for the System to deal in the new bills in a small way to let the market know that it was prepared to conduct transactions in them. He did not contemplate operations on a scale that would tend to dominate the developing market for the six-month bills.

Mr. Rouse suggested that a memorandum on this subject could be prepared at the New York Bank and sent to the members of the Committee for discussion at the next meeting if that were desired.

Chairman Martin suggested that it might be useful if each member of the Committee would comment on the question of a six-month

bill during the usual "go-around" today. He thought Mr. Thomas had a point on whether during the course of the next couple of weeks the Federal Reserve would want to let the market get the idea that the Account had stayed out of the market for these bills. Personally, he thought it would be unfortunate to have an argument on the "bills only" matter start if that could be avoided.

Mr. Rouse, in response to a question by Mr. Allen, stated that the new bills would begin trading on a when-issued basis next Tuesday. The System Account would probably be purchasing bills for reserve purposes next week and question would arise whether to buy the six-month bills.

Mr. Robertson inquired as to the minimum amount of six-month bills that could be purchased to show the System's interest, and Mr. Rouse replied that it was difficult to say what the minimum would be; depending on how the offerings came in, he would guess that $15 or $20 million might be the right figure. Mr. Robertson then inquired whether the System might get into an embarrassing position by specifying a limit as to the amount of six-month bills to be purchased, and Mr. Rouse replied that he did not think so. The important point, he said, was that if the market should seek an answer as to whether the System was interested in the new six-month bill, he should be in a position to give the market an affirmative answer.

Chairman Martin said that he did not think the amount was important, if it came to an affirmative answer; mere dealing in the

new bills was the important thing. He then inquired whether the Committee wished to pursue the discussion at this time or whether each member would like to comment on the subject during the "go-around."

Mr. Hayes replied that he would favor the latter procedure, and it was understood that it would be followed.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period November 8 through December 1, 1958, were approved, ratified, and confirmed.

In supplementation of the staff memorandum distributed under date of November 28, 1958, Mr. Young made the following statement on the economic situation:

> Recovery in domestic economic activity--a broadly based recovery--is continuing. While some observers have been reading recent business data as suggestive of hesitation or slowing of pace in activity, the weight of statistical evidence is on the side of fairly well sustained momentum in upward climb.
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> Business expectations, as expressed in the November Dun and Bradstreet survey, were more optimistic with regard to near-term sales and profits gains than at any time since early 1955. Equity investor expectations, as reflected in the recent sharp run-up in stock prices following a fairly sharp break in prices, apparently embrace faith that future corporate earnings will validate current high levels of stock prices.
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> With model changeover and labor trouble out of the way in the automobile industry, the November index of industrial production is almost certain to reach 140 and possibly 141. While steel mill operations were unchanged from October, production of nonferrous metals rose further. Also there were gains in business equipment lines and crude oil production. Electric power production rose further in November, but freight car loadings were about stable.

Construction activity in November at least remained at peak levels from current trade reports, and the forward look, according to a recent joint Commerce-Labor Department survey, is for further climb in new construction work. The heavy current demand for mortgage money, particularly residential mortgages, has been reflected in some further rise in mortgage yields.

Reflecting the general rise in industrial and construction activity, new orders for machine tools, electrical equipment, construction machinery, and other durable goods in October rose significantly further--a full 5 per cent. Also, liquidation of manufacturers' inventories apparently ended in that month.

The labor market has shown additional improvement. Of the 149 major labor market areas, the number classified as substantial surplus areas fell from October to November from 89 to 83. While both initial and continued claims for unemployment compensation have risen in November, the rise has apparently been no more, and perhaps a little less, than consistent with seasonal trends.

Personal income in October held about even with September, reflecting a decline in payrolls in industries subject to strike shutdown approximately offsetting a rise in proprietors' income, and in payrolls of transportation, service, and Government activities. With work stoppages less of a factor in November, fresh advance in personal income is to be expected.

After declining from August to September, retail sales again advanced in October. Durable goods sales showed improvement from September and nondurable goods sales were close to the August record. In November, department store sales only averaged about the reduced September-October level, but sales at automotive outlets apparently rose sharply. For the mid-November reporting period, new auto sales were up nearly three-fifths from the same period in October, and the indications from industry sources are that sales for the full month will exceed those of November last year. Used car sales were also up sharply, about 5 per cent higher than mid-October. Industry forecasts of sales for the 1959 models are being lifted somewhat on the basis of consumer response to the new models.

Consumer instalment credit, on the basis of preliminary estimates, began to rise in October. Automobile credit declined further but this decline was more than offset by a rise in credit on other consumer durable goods and in personal credit. Some 60 per cent of new car credits are currently on a 36-month basis, suggesting mounting pressure for a break-through to 42-month

financing. Lenders generally deny that they will accede to these longer terms.

Wholesale prices of industrial commodities have been rising much more and on a wider front than was earlier thought. The comprehensive mid-October average recently released shows average industrial prices up 1.4 index points since June, and the November weekly index shows a .2 per cent further rise--to a level exceeding by 1.7 per cent the prerecession high. The importance of such a rise in GNP figures is important to understand. A change of .5 per cent in industrial prices is the equivalent of $700 million, annual rate, in terms of gross national product spending. And it is to be remembered here that prices of services and construction costs are also tending to rise.

The rise in industrial commodity prices since June has thus far been offset by declines in prices of agricultural products. Hence, the index of wholesale prices of all commodities has held approximately stable.

The consumer price average in October showed stability for the third consecutive month. The main changes from the September index were a half per cent decline in food prices offset largely by a rise in auto prices. Fall declines in food prices, it may be noted, have been smaller than anticipated on the basis of supply forecasts.

The sum of all of these domestic indicators is for the attainment this fourth quarter of a GNP annual rate of around $450 billion, up $11 billion from the third quarter. This would be a new high measured in current dollars; in physical volume GNP would still be 1 per cent or so lower than the record volume of the summer a year ago.

Domestic recovery has now gone far enough to be on the verge of a new expansion period, with the potential of a significant penetration into new high ground. In the 1954-55 upswing at this stage, our rate of capacity utilization in manufacturing was 85 to 87 per cent and our unemployment rate, seasonally adjusted, was 4.5 per cent. This time our rate of industrial capacity utilization appears to be substantially lower--roughly 10 percentage points lower, and our unemployment rate for a larger labor force is 7.1 per cent. Thus, we have the resource potential of a longer and bigger expansion period than in the last cycle--if only we can maintain a condition of over-all financial equilibrium.

Abroad, recent indications point to little change on average in levels of activity. In Europe, further liquidation

of steel inventory has taken place, and recession continues to characterize textiles. In Germany, the October index of industrial production, seasonally adjusted, jumped up by 3 per cent, mainly reflecting increased construction and output of consumer durables and machinery. In France, there is evidence of a new weakening in the external position; at least, speculation against the franc is again on the rise. In recognition of a current state of doldrums generally in European industry and trade, the British and Dutch discount rates were recently lowered further. In Canada, industrial output this fall has not yet reattained the recovery high of last spring; automobile market developments and heavy industry work stoppages, however, have mainly accounted for the setback in recovery.

Mr. Thomas then made the following statement on financial developments:

Except for gyrations in the stock market, developments in the financial area have shown no particularly striking features during the past month. They may be briefly summarized.

1. Stock prices, after rising sharply in the first half of November to new high levels, declined sharply for three days and then recovered much of the loss. Currently, averages are higher than they were a month ago. Trading activity has continued at a high level of close to 4 million shares daily. Yields on high grade stocks, on the basis of dividends paid in the past year, are below 3-1/2 per cent. Dividends have covered a larger portion of profits than at any time in many years, so that, notwithstanding greatly improved prospects for corporate profits, it seems unlikely that dividends will be increased much, if any, during the next several months or year. Stock market credit expanded further in October. Margin requirements were increased to 90 per cent the middle of the month.

2. Bond yields held relatively firm through October and November, and in fact declined somewhat from the high levels reached early in October. This decline in yields, meaning a rise in bond prices, more or less coincided with rising stock prices, but in the past week daily movements in prices of bonds have tended to be opposite to those of stocks. The volume of new capital issues has been somewhat lighter in this quarter than in earlier quarters of this year.

3. In contrast to the decline in bond yields, short-term money rates have tended to rise since early November. They have been influenced by usual seasonal factors, as well as by the sizable actual and prospective additions to the supply of short-term issues from Treasury offerings of tax and regular bills. Moderate, almost imperceptible, tightening in the reserve positions of banks may also have had some effect on short-term rates. On the basis of past standards, however, the level of market rates continues high relative to the Federal Reserve discount rate and to the current volume of member bank borrowing. Federal Reserve policy, therefore, has probably not been an important factor in current credit and money market developments, except that System operations have moderated the effect of seasonal and other temporary factors.

4. Needed Treasury financing has been successfully accomplished in this period of improved market tone. The Treasury cash balance, which declined in the first half of November, increased sharply in the latter half. Attrition on the exchange operation is somewhat less than had been estimated. If additional bills at the rate of $200 million a week, or something equivalent, are sold in connection with the issuance of the new series of 26-week bills, additional cash needs in January will be relatively light--less than $2 billion. A heavy refunding operation will be necessary in February, and additional cash will have to be obtained in April, following retirement of tax bills in March. Government expenditures will continue at a high level and there is little likelihood of obtaining any substantial reduction in the deficit until receipts increase in the next fiscal year.

5. Commercial bank credit showed no striking changes in November. Banks increased their loans but reduced their holdings of Government securities in the first three weeks of the month. This reduction, however, was more than offset by a sharp increase in the last week, amounting to about $1.2 billion at city banks, reflecting additions of new Treasury tax bills. At the time of the early October offering of $2.7 billion of bills, city banks showed an increase of only about $600 million in their bill holdings. During the past month holdings of other securities declined substantially at city banks, probably reflecting retirement of some large local Government issue.

Business loans at city banks increased in November compared with a decrease in November 1957, but this year's

increase was less than in most other years. Real estate loans and other loans at banks showed marked increases. Loans on securities also increased somewhat, particularly in the last week.

The first of the midmonth reports for all member banks showed that at country banks there were increases both in loans and in other securities in the first two weeks of November, with no change in holdings of Government securities. Country banks also added to their reserves and their balances with other banks. Because of the absence of data for other years it cannot be known whether these changes were in any degree seasonal.

6. Demand deposits adjusted, after showing a much greater than seasonal increase in October, which largely offset the August and September declines, increased somewhat further in the first half of November. Decreases in New York and Chicago were more than offset by increases elsewhere, particularly at country banks. Again, it cannot be determined to what extent this may be a customary change for the period. In the latter half of November, demand deposits at city banks increased further. Currency in circulation increased a little more than is usual for November. On balance, it appears that the money supply held close to the high level reached in October.

Time deposits at city banks declined further in November, reflecting in part seasonal withdrawals customary at this time, as well as some further drawing down of time balances other than savings in New York.

7. Along with the seasonally adjusted increase in demand deposits in October, the rate of deposit turnover continued at close to the level maintained since June. This rate is about 2 per cent below the third quarter 1957 peak and above that for the fourth quarter of last year. The relationship may also be expressed as a ratio of the money supply to the gross national product. The GNP is estimated at about $450 million for the fourth quarter of this year--or 1 per cent above the peak quarter of 1957. The present money supply at $138 billion, seasonally adjusted, is about 30.7 per cent of that volume. This represents a decline from 31.5 per cent at the bottom of the recession in the second quarter of this year, but is still a little above the 30.3 per cent figure for the third quarter last year. That was the lowest ratio since 1931, but a substantially lower level was customary in the 1920's.

It may be concluded that by recent standards the present money supply is closely in line with economic activity. Further monetary growth may be appropriate as activity increases, but policy actions permitting additions should be determined on the basis of the tenor of the prevailing psychology attitudes and expectations and by the quality and vigor of credit demands--not by any mechanical quantitative guides. History shows that the forces which cause relatively small variations in the turnover of money can be the strategic determinants of the course of events.

8. Bank reserve needs recently have fluctuated widely as a consequence of Treasury financing and seasonal market factors, and System operations have been adjusted accordingly. The seasonal growth in currency and an increase in required reserves, caused largely by additions to Treasury deposits last week, exerted a net drain of about $900 million on reserves in November. System holdings of securities showed a net increase of almost the same amount. Loss of reserves due to international movements slackened, as a continued moderate gold outflow was largely counterbalanced by withdrawals from foreign balances at the Reserve Banks. Member bank borrowings generally declined during November, but have increased considerably during the past week. Borrowings, however, have averaged less than $500 million, while excess reserves have been slightly higher, leaving free reserves of less than $50 million during most weeks.

Further seasonal reserve drains may aggregate as much as half a billion dollars by the last week of the year, followed by a roughly corresponding return flow in the early weeks of 1959.

Conclusion.--Although expansionary forces in the credit area have not been vigorous during recent weeks, the underlying basis for a stimulus to renewed expansion continues to exist in the broadening economic recovery and the continuing Government deficit. Further tightening of restraints does not seem necessary at this time, but any tendency toward expansion should be permitted to press against reserve availability. If this occurs, a further increase in the discount rate would be appropriate to bring it into line with market rates and augment the restraint of borrowing.

The Chairman then turned to Mr. Hayes, who presented the following statement of his views on the business outlook and credit policy:

Evidence of a slower pace of recovery has appeared in the last three weeks. While the termination of major work stoppages in the automobile industry may be expected to give a new lift to the index of industrial production, there have been more signs of a leveling off in other lines than at any time since the recovery began. In my view this does not constitute cause for alarm. Rather the outlook seems to be for a continuation of moderate gains in production and income without significant inflationary overtones--but the possibility of a sidewise movement cannot be ruled out, especially if some shock should occur to business confidence.

Evidence of the recovery's loss of momentum may be found perhaps most clearly in the more restrained tone of business comment, and also in the leveling off in the steel industry, in figures on unemployment and average hours worked, and in personal income and consumer spending statistics. Transitory influences such as strikes apparently have accounted for only a part of this tendency.

Elements of strength in the business picture include the prospect of continuing high levels of Government spending, the favorable construction outlook and some improvement in new orders, especially for machinery. The automobile industry continues to express confidence in the prospect for a substantial increase in sales, but the response of the public to the new models is still unclear.

As for prices, the over-all outlook for stability remains good. Farm prices have resumed their downward trend, after a brief upturn, and record crops seem likely to exert continued downward price pressure in this sector. A temporary phase of upward pressure on non-ferrous metals has been reversed. Even the prices of services--the most recalcitrant element in the whole price picture--are not, for the time being, rising at anything like the speed of recent years.

A look at recent bank credit developments is likewise reassuring. Declines in bank holdings of Government securities in recent weeks have been responsible for a drop in total loans and investments of reporting banks. The trend of business loans, while stronger than in 1957 or 1954, is

much less buoyant than in 1955 or 1956. Bank liquidity has dropped considerably since the summer peak and although still well above the level of the fall of 1957, is also much lower than in 1954. As we compare the period since mid-1958 with the first half of the year, there is a sharp contrast with respect to total loans and investment of all commercial banks, which rose only $1.5 billion in the four months ending with October, as against nearly $10 billion in the first half. Our estimate for the money supply as of the end of 1958 has been revised downward and now indicates a gain of less than 2 per cent for the calendar year--a gain which seems rather low, if anything, for a period when we have been trying to promote recovery. While there has been some comment to the effect that nonbank investors will be unable to finance so large a part of the Federal deficit in the coming months as they have in the recent past, I can see some reason, notably in the favorable trend of retained earnings and the absence of buoyant spending plans for plant or inventory, to expect the favorable nonbank market for Governments to continue for some time.

All of this points to the wisdom of avoiding any change in our present basic credit policy. At recent meetings there has been some discussion as to whether, once the need of maintaining an even keel for the Treasury was past, it might be advisable to tighten credit somewhat further. Granted that the absence of Treasury financing will give us a freer hand in the coming weeks, I think that it would be a serious mistake to adopt any more restrictive policy than is now in force. Basically the economy appears to need the very modest degree of support provided by current monetary policy. Maintenance of a small free reserve position has not led to any excessive expansion of bank loans during the recovery to date. Moreover, there seems to be little likelihood of a surge in demand for goods and services on the immediate horizon, and the inflation psychosis seems generally to have diminished, with some assistance from a sharp, though temporary, decline in the stock market.

Our emphasis in the next few weeks should be on maintaining the present degree of ease as indicated by the feel of the market. However, while I see no need of a specific target figure for free reserves, I am a little disturbed to note that wide errors in the projections this week may result in our reporting net borrowed reserves, on average, for the first time this year. There is a risk that a development of this kind may be interpreted as a change in policy when in fact no change is intended--and to my mind it is clear that no

> change is desirable. Hence I would hope that free reserves would be kept sufficiently high to avoid the risk of their dropping below zero into net borrowed reserves, on average, for any reporting period.
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> For similar reasons I would urge that the discount rate and the directive remain unchanged.
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> On the matter of the six-month bills, I find that I am in sympathy with both Mr. Thomas and Mr. Rouse. I think I like the idea of regarding these bills as a normal means of investment for the Account. Perhaps it would be well to show our face a little bit, but not to the extent of interfering with a normal development of the market for these bills. I think we should give the Manager of the Account discretion to proceed accordingly.

Mr. Johns said he saw no substantial evidence that the pace of recovery had been interfered with or that there had been hesitation, except such as may have been caused by management-labor disputes. He was not inclined to feel any real doubt about the progress of recovery in the immediate future and perhaps in the somewhat longer run. With reference to the analysis of price behavior presented by Mr. Young, for some time he had been dissatisfied with explanations indicating a fair degree of price stability, because industrial commodity prices were up and were being offset for the time being only by the price decline in agricultural products. He believed, therefore, that reasons for complacency about current price behavior were rather hard to find. As a result of these and other considerations, he continued to hold the view, which he expressed at the last Committee meeting, that it would be in order for Federal Reserve policy to be on the side of a gradual although not dramatic tightening. In his opinion, the System should be on guard against any possibility of creating the

impression that monetary policy had hesitated or been relaxed. Of course, there were questions of timing involved, for there had just been a period of Treasury financing and there would be others, and he did not see a time for several months in the future when it might not be possible to argue that under an even-keel policy the Federal Reserve was prevented from doing anything. However, he was not satisfied with the idea that the System should be locked in for any such period of time. In summary, while he did not wish to make a specific recommendation he was considerably disturbed about the integration of an even-keel policy and the System's monetary policy in the light of conditions as seen at the present time.

With regard to the 26-week bills, Mr. Johns thought it would be unfortunate if an impression developed that the System had a policy against dealing in them. In general, it was his view that the Desk ought to treat the 26-week bills much like other Treasury bills and govern itself accordingly. If the longer-term bills were offered at a price that was satisfactory, he would not hesitate to buy them, and he would not put any limitation on the amount that could be held in the Open Market Account portfolio.

Mr. Bryan said he had nothing of importance to report from the Sixth District, where the statistical series were behaving about the same as nationally. Recovery was continuing, except perhaps in one State--Louisiana--where nothing dramatic had happened but a whole

series of small things caused the unemployment figures not to look as good as in the rest of the district.

Turning to System policy, Mr. Bryan said he could see at the moment no argument at all for easing. Neither could he see much of an argument for pursuing a policy materially different from the one that the System had recently been following. It seemed to him that the situation was one in which the System should continue to maintain a policy posture about as at present. With regard to the 26-week bills, he would be rather strongly in favor of making such purchases as in the eyes of the Manager of the Account would convey to the market an indication that the System would trade in those bills and would regard them as a proper instrument for effecting open market policy.

Mr. Bopp said that developments in the Third District were not greatly different from those in the country as a whole except that recovery was proceeding at a somewhat slower pace. The rate of unemployment, for example, continued to be higher than the national rate. With regard to the immediate prospects of inflation, he was struck by the fact that the individual going into equities in an attempt, presumably, to protect himself against inflation often purchased securities of a company whose management did not appear to behave the same way. Consumers were not going heavily into durable goods, and management was not going heavily into the building

of inventories. He was impressed by the data presented by Mr. Young about excess capacity both industrially and as related to the labor force.

As to monetary policy, Mr. Bopp said that he thought there should be no change in the present position on the availability of reserves, in the discount rate, or in the directive. As to the 26-week bills, he agreed with the views of Mr. Bryan, which he understood to be essentially the same as those of Mr. Johns.

Mr. Fulton stated that in the Fourth District progress from the recession was still on the slow side. Steel production was below the national average and the industry seemed to see nothing that would increase the rate precipitately, although it hoped that the automotive industry would get into substantial production and order more heavily. At present, that industry was buying only for current production. While projections were on the basis of about 5.5 million cars this year, one man prominent in that field had indicated informally that 5.2 million would be an excellent year. In a further comment on the steel situation, Mr. Fulton said that a considerable volume of steel products was now being imported from abroad. For example, steel pipe was coming into Texas from Germany. While there was no evidence that manufacturers were inventorying steel, there was some prospect of accumulation early next year in anticipation of a strike which at present seemed inevitable. In the machine-tool industry, a substantial pickup in orders in October

appeared to have been attributable to a prospective increase in prices in November. District department store sales were still running below a year ago, and Christmas season buying activity was not as much as merchants had been hoping for. While employment had risen and unemployment was diminishing, the progress was very gradual. All in all, recovery had not been as rapid in the Fourth District as nationally.

Mr. Fulton expressed the view that monetary policy should be extended from the degree of restraint that had prevailed in the past few weeks. Free reserves in the zero to $50 million range were in line with his thinking, and it would not be advisable to change either the discount rate or the directive at this time. As to the 182-day bills, he suggested that the Account take them into position in the same manner as other Treasury bills.

Mr. Shepardson expressed the opinion that the present gradual rate of recovery was all to the good because the latent feeling in so many areas about the threat of inflation made it desirable not to have too explosive or rapid a movement. Like Mr. Johns, he was much concerned about the continuing upward crawl in prices. He noted that one might easily look at the general average and overlook the divergent trend of agricultural prices that had been masking the trend in practically all other categories. The System, he felt, should be endeavoring to restrain that trend by whatever means might be available.

Turning to the situation with respect to reserves, Mr. Shepardson said that he regarded recent developments as desirable. At this point, he felt, the Committee should consider further restraining action of a moderate type such as Mr. Johns had suggested. What he had in mind was a constant pressure that would leave the System in a position to prevent an explosive inflationary development, for it was better to have the situation in hand than to try to recover later. For these reasons, he hoped that there might be a trend toward a somewhat lower level of reserve availability in the period ahead, and that one might expect a further increase in the discount rate in the not too distant future. On the 26-week bills, it seemed appropriate to take the matter in stride, taking some of the bills into position without any specified limit.

Mr. Robertson said that his views were similar to those of Mr. Shepardson and that he shared the fears expressed by Mr. Johns. It was only a couple of years ago, he recalled, that we were complacent about price changes that were covered up in the averages, and he hoped that there would be no complacency this time. He was rather glad that by accident the reserve position had gotten into the area of net borrowed reserves, and he would hope that the level of reserves did not bounce back too fast because of System actions taken in an effort to prove that the movement that had taken place was simply an accident. Certainly net borrowed reserves had come about by accident, because

they were not in accord with the target mentioned at the last Committee meeting, but he would prefer to explain the situation on that basis, if necessary, and move on further into negative free reserves since he considered it necessary to take advantage of every period when the System was free, from the standpoint of Treasury operations, to establish as much of a firm rein as possible. While he would do nothing drastic, he wanted to make it clear that the System was maintaining a posture of restraint and not ease.

On the 26-week bills, Mr. Robertson said that he did not wish to take any position at this time because he had not thought the matter through to his own satisfaction and did not know the answer. He hoped that the Manager of the Account would not be called upon to make any purchases at all during the few days that the new bills would be available before the next Committee meeting, and that the matter could then be discussed again. However, he was willing to abide by the majority view.

Mr. Mills said that he thought the discussion of economic conditions this morning indicated the desirability of continuing a policy of moderate restraint over the expansion of commercial bank credit. With regard to the implementation of such a policy, he suggested that natural forces be allowed to do the work for the System instead of taking positive actions. In the remaining weeks of this year it was reasonable to anticipate a natural tightening in the market and a strengthening of interest rates which need not be offset by System action unless the

degree of tightening should indicate that remedial attention was necessary. What he had in mind, Mr. Mills said, essentially corroborated the reasoning of Mr. Thomas and was that the System should be the one voice to speak quietly in all of the clamor of loose talking and loose thinking affecting the financial markets. The most constructive way for the System to act without ostentatious display would be to let the interplay of natural forces bearing on monetary policy, market psychology, and market conditions develop with a minimum of interference. Mr. Mills said he would join with those who would operate in the new 26-week bills in the same manner as the Account operates in conventional bills.

Mr. Leach reported that while recovery apparently had continued at a moderate rate in most Fifth District industries, a significant improvement had occurred in recent weeks in textiles, the district's largest industry. This developing textile strength was across the board--cotton gray goods for both apparel and industrial uses, finished fabrics, and synthetics. Knitting mills in general were operating at the best levels this year and producers of women's seamless hosiery and knitted tights were encountering delivery problems despite full-capacity operations. It remained to be seen whether the improved market for textiles would be allowed to progress, so far as the mills were concerned, or whether it would be smothered by sharply stepped-up production. Increases in nonagricultural employment had occurred in both manufacturing and nonmanufacturing businesses but the gains were

extremely thin. Production of bituminous coal in the four weeks ending November 8 was down slightly from the comparable period a month earlier as foreign shipments continued their downward trend, and seasonally adjusted department store sales for the first three weeks of November were below October levels. Business loans at weekly reporting member banks had risen more than seasonally in each of the past four weeks; the over-all increase far exceeded gains in comparable periods of the previous three years and had taken place on a broad base. About 75 per cent of reporting banks had experienced heavier loan demands in the last four weeks. Gains were reported for eleven of the twelve categories of business loans.

Mr. Leach said he could see no developments in the continuing moderate expansion of production and consumption that would warrant a change in System policy, but that one could not avoid concern over inflationary dangers. Substantial additional reserves would be needed between now and the end of the year to enable member banks to meet seasonal and other credit needs. While he did not favor any material change in policy, he thought that member banks should obtain some needed reserves through temporary borrowing from the Reserve Banks. Since December is traditionally a month for borrowing, he also felt this would be a good time to go over on the side of net borrowed reserves to a modest extent. This would mean that repurchase agreements and direct purchases would be used to supply the bulk but not

all of the needed reserves, that borrowings from the Reserve Banks would rise above recent levels, and that net borrowed reserves would again appear in the weekly statements. In other words, the System would not make any great effort to avoid them. In view of the underlying strength of the widespread upward expansion now occurring, he did not think a moderate increase in borrowing would deter further desirable recovery. He would not favor an increase in the discount rate at this time.

On the 26-week bills, Mr. Leach expressed the opinion that the System should at least indicate a willingness to buy, and even buy a small amount. He would not treat them just like other bills in the beginning because he saw something to the argument that the new bills should find their own level in the market.

Mr. Leedy reported beneficial rains and snows in the Tenth District recently that were needed for surface conditions. This had brought improvement in the outlook for winter wheat and other fall-seeded crops. Cash receipts from farm marketings for the first nine months of this year for the country generally increased 11 per cent from last year, but in the Tenth District the increase was 32 per cent. Mr. Leedy commented that he could not derive any satisfaction from the fact that the stability in commodity prices was at the expense of agricultural commodities. Based on incomplete estimates for October, gains in nonfarm employment in the district had been better than the

customary seasonal gains but the level of nonfarm employment remained below that of a year ago. Department store sales increased sharply over November a year ago, and the general expectation was for a record Christmas season. Loans in all categories at weekly reporting member banks were above a year ago with commercial and industrial loans showing a particularly marked increase. The Kansas City Bank had been having more than its normal share of member bank borrowing, but the picture was distorted by the November 30 tax assessment date in Oklahoma which involves substantial deposit withdrawals and causes the larger banks in Tulsa and Oklahoma City to borrow from the Reserve Bank heavily.

Mr. Leedy said that the general economic situation would seem to require the System at least to continue the policy of restraint that it had been following. Some seasonal factors would exert restraint on the reserve position of the banks, and he would subscribe to the view that the System should not undertake to offset them fully. He found it difficult to believe that publication of a nominal net borrowed reserve figure would be interpreted as a real change in System policy. In this connection, he pointed out that it would be difficult after the first of the year to maintain even the present position. Accordingly, he had the feeling that the Desk ought to be operating in the direction of getting as quickly as possible to a net borrowed reserve position, allowing some time for redistribution of the securities recently sold by the Treasury. On the 182-day bills, he had the feeling that the Desk should not indicate any reluctance to purchase. While it should not

be aggressive with regard to transactions in those bills, neither should it give lip service only. It should make purchases when offers seemed appropriate, with the objective of creating a feeling in the market that the System considered those bills in the same light as the ordinary 91-day bills.

Mr. Allen stated that in the Seventh District there was a tendency to be impressed by the part of work stoppages in slowing down the rate of increase in general activity and less inclination to feel that the slowing down indicated any basic weakness in the business recovery. This was because the district had had such a big share of strike trouble--notably in the automobile and farm machinery industries. All of the important strikes had been in durable goods lines where demand had been strong or improving, or where, as in autos, new models were being introduced.

Mr. Allen reported considerable disagreement in Detroit with regard to the 1959 automobile sales forecasts and said that those who a month ago predicted a 5-1/2 million car year were now less confident of that estimate. Sales in the second 10 days of November were at a daily rate of 16,196 compared with a rate of 11,600 in the first 10 days. Therefore, even if expectations of an 18,000 daily rate in the last 10 days were realized, November would wind up with total deliveries of 383,000, or approximately 15 per cent behind November 1957. Production in November was estimated at 533,000 units, and in December at 594,000, while in the first four months of 1959 production of over

500,000 cars per month was currently scheduled. If the production figures for the next three months were realized and if sales were at a daily rate of 18,500, the inventory at March 1 would be 687,000 cars compared with 881,000 on March 1, 1958. If sales were at a daily rate of only 17,000, the inventory at March 1 would still be less than a year ago. This seemed to add up to the probability that production would be substantial and steady at least through February.

Mr. Allen said that in recent weeks steel production in the Chicago area had been at 88 per cent of capacity and in Detroit at 90 per cent of capacity, while the national average rate in November was about 75 per cent of capacity. In the four weeks ending November 22, department store sales were about even with last year in the district, which represented improvement, but the district was still behind the national figures. The corn referendum had been of great interest in the area and the net result seemed likely to be an increase in the acreage of corn in 1959. Major banks in the district reported that business loans in only three categories were running noticeably above a year ago. As to reserves, the larger Chicago banks continued to maintain a net surplus position, although smaller than before. The discount window was doing about its normal share of total System lending, but the aggregate figures remained small. More country banks borrowed in the first half of November than in any period since last March.

Turning to policy for the next two weeks, Mr. Allen expressed the view that the System should try to stay about where it had been for the last two weeks but be poised for more restrictive action, which it appeared to him might be called for before too long. He would not be disturbed by net borrowed reserve figures if they should appear. As to the 26-week bills, he felt that the System should show a disposition or willingness at the first opportunity to use them as a medium for effecting monetary policy. At first, however, the Account should buy as few as possible.

Mr. Deming reported that one of the few areas of weakness in the Ninth District--copper production--was being reduced. In Montana, Anaconda was reported to be at about full-scale operations and if the price level should hold or improve it appeared that even the marginal producers in the Upper Peninsula might expand production somewhat. With regard to Mr. Young's comment about excess capacity from the standpoint of the labor force, Mr. Deming noted that the Minnesota employment authorities were currently estimating that unemployment in the State would remain higher than normal until next fall despite the reclassification of the Twin City area to one with only moderate labor surplus. Putting it another way, it was not expected that nonagricultural employment would reach previous peak levels until about next September. City banks were showing about the same amount of seasonal expansion in business loans as prevailed in 1955, somewhat more than in 1956 and 1957. Business

loans at such banks were now about 7 per cent higher than at this time last year. At the discount window, more country banks were borrowing but the total amount was not large.

Mr. Deming said that Mr. Thomas' views expressed his own feeling with regard to policy; namely, to let the credit expansion press on reserve availability and to be poised to move on the discount rate. He saw no reason to treat the 26-week bills appreciably different from ordinary bills.

Mr. Mangels said that Twelfth District business activity continued to expand but at the moderated rate that he reported at the last Committee meeting. Residential and heavy construction were now reflecting only seasonal changes, contrasted with some rather sharp increases during the past summer. Lumber and agriculture were somewhat on the favorable side although neither was in an expansionary area. Farm cash income in the district for the first nine months of this year was about 5 per cent over 1957, approximately one-half the gain experienced nationally. Retail trade picked up somewhat in late October and early November but automobile sales were still down, with dealers handicapped by lack of stock. The unemployment situation showed the first major improvement in October since the first of this year, the rate dropping to 7 per cent compared with 7.5 per cent in September. The employment situation continued strong in all manufacturing activities related to defense production.

Continuing his review, Mr. Mangels said that in the three weeks ending November 19 the increase in bank loans in the district was double

the increase for the same period in 1957. While commercial and industrial loans were beginning to show the expected seasonal upturn, the heaviest increase was in real estate loans, and banks had indicated that such loans probably would continue to increase through April or May of next year. It was also reported that insurance companies and some pension funds were again beginning to show an interest in purchasing real estate mortgages. Some bankers expected an increase in loans due to inventory buildup, while others did not. Demand deposits showed an increase but time deposits dropped for the reasons mentioned by Mr. Thomas and also because of the paying out of Christmas funds. On November 26, ten banks were borrowing from the Reserve Bank, all but two of them reserve city banks, but the aggregate of borrowing was nominal. Banks in the district were net borrowers of Federal funds, contrary to past experience, with purchases about double sales.

Mr. Mangels expressed the view that System policy could best mark time for the next two-week period and that free reserves should continue in the range of zero to $50 million. He would not be inclined to move too rapidly to net borrowed reserves. The directive was still satisfactory and he would not favor changing the discount rate at this time. As to the 26-week bills, he would favor purchasing them in modest amounts according to the judgment of the Manager of the Open Market Account.

Mr. Irons reported that Eleventh District business continued to expand and that there had been further improvement in the employment and unemployment situation, in industrial activity, and in

department store trade. Agricultural conditions continued very favorable. It was expected that the district cotton crop would be about 14 per cent above last year and in the State of Texas about 17 per cent higher. The crude oil situation was better, with production now on a 12-day allowable basis. During the first three weeks of November department store sales were up, and there was optimism about the seasonal business ahead. Borrowing from the Reserve Bank was less than might be regarded as the Dallas Bank's normal proportion of the System total. A few country banks were coming to the discount window, and some city banks were in for a day or two. Bank loans continued to move up in the past three-week period, with strength in consumer credit and real estate loans, a moderate increase in business loans, and quite a wide variation among types of business loans.

Turning to the national picture, Mr. Irons said that the recovery appeared to be continuing and broadly based. He had no qualms about its gradual pace, and the tone of his own thinking had been stated by Mr. Johns. It seemed to him that most of the moderate nature of the recovery could be attributed to strike situations. New housing starts were very high along with other types of construction, the unemployment situation was improving, and inventory liquidation had about come to an end. In many areas there appeared to be some tendency toward inventory accumulation and businessmen were referring

to the possibility of shortages more than previously. It now appeared that the industrial production index would be up two or possibly three points in November. He had no apprehension about the business situation and did not think that the movement of the price structure was such as to generate complacency.

Mr. Irons subscribed largely to the view that this was a period when increased credit demand might be expected and the System should permit some of the pressure to be felt. If market developments should tend to produce net borrowed reserves, he would not take offsetting action just because of a desire to have free reserve figures perpetuated. While he was not unhappy about the operation of the Account during the past few weeks in the light of the even-keel policy, he would be willing, in fact, would like to see, a move toward a little more firmness in preference to so-called moderate restraint, which might be interpreted as almost a minor degree of ease. On the 26-day bills, he felt that the System ought to let it be known by its actions that those bills were an eligible instrument in which the Account would deal if it seemed appropriate, and there should be no limitation on transactions in the bills if the Management felt it desirable to buy them. They should be treated as an instrument in which the Account would operate according to the dictates of judgment.

Mr. Erickson said that the latest available statistics in the First District indicated further recovery but at a slower pace. There

was continued strength in electric power output and department store sales and there were spurts in construction activity, but automobile sales were lagging. There was a continued disposition to save, as evidenced by the fact that in October total life insurance sales ran 11 per cent over last year. In the past two weeks there had been more activity at the discount window than at any time in the recent past, most of the borrowing being by banks in the larger cities.

As to policy, Mr. Erickson suggested that the System should continue to maintain a posture of restraint. He saw no need for change at this time in the directive or in the discount rate. After expressing the opinion that the Desk had handled itself well in the last three weeks, he said that he would favor keeping free reserves within the range of zero to $50 million. However, if they fell into the area of net borrowed reserves in a modest way, he would not be inclined to take positive action to change the situation. As to the 26-week bills, he would leave it to the Manager of the Account to indicate that the bills were an instrument in which the System Account would deal.

Mr. Szymczak said he had the feeling that the Desk should try to maintain a free reserve position, unless it were found during the next two weeks that placing money in the market to hold the position above zero would add too much to the money supply. In that event, he would let reserves go to zero or below. In other words, he would prefer a free reserve position but would not take extreme measures to

maintain it if the strength of the demand for credit should be such as to cause net borrowed reserves. If possible, he would let market forces determine the situation. Mr. Szymczak expressed the opinion that the 26-week bills should be treated the same as any other bills. As soon as possible and if convenient to do so, he would buy some of those bills without waiting to have to answer questions about whether the System would buy and to what extent. He would let the purchases speak for themselves.

Chairman Martin said it appeared from the discussion that there was again fairly close agreement around the table. Personally, he subscribed to the view of those who would favor some increase in the degree of restraint, with the proviso that due consideration must be given to the problems of the Treasury. He liked Mr. Mills' point about letting market forces operate.

The Chairman saw grave danger in becoming complacent about the price situation and said he believed the System ought to be poised, as far as possible, to take effective action whenever and wherever the price situation seemed likely to get out of hand, for otherwise it might become too late for the System to be very effective. At the same time, it must be remembered that the Treasury was about to issue a new type of bill. It would be unfortunate to have articles appearing in the press purporting to give intimate information regarding policy discussions and decisions, he said, noting that the System was being

charged with being a sieve of information. With a meeting of this size, one could see how those charges arose, but the System must not let its critics consume it with that kind of charge. Whatever the disadvantages of meetings as large as this, it was necessary to have these discussions in order to get all views in the System and he was convinced that the advantages outweighed the disadvantages.

Chairman Martin again expressed the view that the System could not afford to become complacent about price trends, nor could it afford to let anyone get the impression that its attitude was just neutral. Market forces, he noted, would make for a tightening at this time of the year, and all the System had to do was to let the market forces play. He would hope that, without aggravating the problem of the Treasury in floating the new bills, the System might try to let the forces of the market play as far as possible in the direction that he understood had been clearly indicated by a majority of the Committee. This would not represent a conscious change of policy; it would amount to taking advantage of a year-end opportunity to let the forces of the market frame themselves. If they did not develop as anticipated, there could be further discussion at the next Committee meeting on December 16 but it was his feeling that they would frame themselves between now and the end of the year. It was very important, he repeated, not to lessen whatever influence the System had by letting anyone get the impression that it was disposed to temper a policy of restraint. He found himself unimpressed by statements that there was no inflationary

impact in the economy at the moment. Such a thing builds up, he said, and he felt that it was building up at this time. He anticipated another difficult period ahead and expressed the hope that the situation would not be complicated by having the System's actions interpreted in the press and elsewhere in such a way as to create more difficulties for the System and the Treasury. He urged, therefore, that care be exercised in making any comments to the press or others concerning the course the System was following.

The Chairman then noted that there had been no suggestion for a change in the directive. Nor had a specific target for free reserves been indicated, although the majority appeared to favor letting market forces move in the direction of negative free reserves.

Mr. Hayes said there were certain things that puzzled him about some of the expressions of opinion. He found it hard to reconcile what Mr. Mills had said about maintaining moderate restraint, and what Mr. Leach had said about making no change in policy, with the idea of letting the seasonal increase in credit demand have the effect of tightening the market. It was his impression that in the past the System had followed quite steadily a policy of meeting seasonal demands through open market operations.

After Mr. Leach commented that his reference had been to no "material" change in policy, Mr. Hayes said he felt that a failure to meet seasonal demands through open market operations would be

interpreted by the market as a real change in policy, one which, if decided upon, should be entered into knowingly and with open eyes. He would also be troubled about the wording of clause (b) of the policy directive--to fostering conditions in the money market conducive to balanced economic recovery--for, if inflation was regarded as the main problem, it seemed to him that this wording in the directive was perhaps misleading. While he did not think himself that inflation was the main problem at this particular time, he had the feeling that a number of those around the table did. He found it hard to see how the Committee could tighten its policy in the face of factors such as excess capacity, the unemployment picture, and doubts about the automobile outlook.

Mr. Shepardson suggested that the phrase "balanced recovery" was the key to the directive. While there was some excess capacity and unemployment, there was also the price crawl. As he saw it, the objective was to foster a balanced and continuing long-term recovery rather than too precipitate a recovery.

Mr. Hayes then asked whether the System could afford to concentrate its attention on one factor, for there were three or four objectives that he considered about equal in importance, to which Mr. Shepardson responded that he did not think the System could afford not to concentrate on the price factor.

Chairman Martin commented that he too was anxious to get the unemployed back to work, but in his judgment a balanced recovery would

not come about if price pressures in the economy were ignored or if they were strengthened through following an easy money policy. On the latter point Mr. Hayes stated that he was advocating a policy of "staying where we are" and not easy money.

Mr. Szymczak inquired whether a matter of degree was not involved. He would agree that the System should supply some reserves, but not to the same extent as heretofore. He suggested that the establishment of a target for reserves tended to set up an artificial goal. While he felt that there would be a seasonal demand for credit and while he would favor supplying some reserves through open market operations, he would not try to force the reserve figures to hold above zero continually and indefinitely--to do so would get into a box like the one last spring when a target of $500 million of free reserves was used.

Mr. Rouse commented that yesterday the Account Management took no action to buy in the bill market in the face of projected net borrowed reserves. On the basis of the reserve figures distributed this morning, it turned out that the market was the important thing rather than the figures. However, he thought that the sense of the meeting favored a tighter feel.

Mr. Thomas observed that there was a risk of going too far in offsetting quantitative seasonal factors, because they were not divided evenly among banks--some were under pressure, while others were not.

Market rates should be permitted to have some effect so as to draw money to where it was needed from where it exists. If the System were to supply money automatically to everyone desiring funds for temporary purposes, this might result in a lot of money running around trying to find use. He wondered if there was not a tendency to go a little too far in trying to base an even-keel operation on a given figure of net borrowed or free reserves and whether the figures should not be permitted to fluctuate a little.

Chairman Martin said he thought this point was well taken.

Mr. Johns stated that inasmuch as the Committee was going to meet again in two weeks, he wondered if it might not be appropriate simply to instruct the Desk to stay out of the market for the next two weeks. If the projections were reasonably accurate, this would mean that the reserve figures would bounce around somewhat from day to day, but he was not sure whether attempts at daily adjustment were necessary or entirely effective.

In response, Chairman Martin expressed the view that the Committee must always leave discretion with the Manager of the Account to a certain degree and not say hands off despite whatever situation might develop. Mr. Szymczak agreed, as did Mr. Robertson who said that he also agreed with the Chairman's earlier summary of views expressed at this meeting.

The Chairman then referred again to his concern about not giving a false impression of System actions which would complicate

the Treasury's problem with respect to the new bills. If it were not for this concern, he said, he would favor an even more positive course.

In further comments, Mr. Szymczak referred to the limitations on the role of monetary policy and Mr. Hayes said that this pointed up the risk he saw in tightening policy at this time. No one, he said, could expect monetary policy alone to deal with the price threat.

Chairman Martin then called for further comments and, receiving none, stated that there appeared to be general agreement on the course to be followed in the next two weeks. Mr. Shepardson inquired whether this contemplated letting market forces tend to increase restraint, to which the Chairman responded in the affirmative, with the understanding that this would leave latitude for the exercise of discretion by the Manager of the Open Market Account.

In response to a question from Mr. Szymczak, Mr. Rouse stated that he thought he understood the sense of the meeting, that he had in mind what Mr. Shepardson had said, and that the Treasury's financing was involved.

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 fostering conditions in the money market conducive to balanced economic recovery, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

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

Mr. Robertson referred to efforts made by the supervisory agencies to combat the "window-dressing" of condition statements by some commercial banks. While much progress had been made, he said, it was sometimes charged that the Federal Reserve System aided and abetted "window-dressing" at year end through the use of repurchase agreements. It was his suggestion that between now and the next meeting of the Committee the Account Manager give thought to ways and means of offsetting that criticism if it seemed to be a justifiable one. There would then be an opportunity for further consideration of the matter before the end of the year if necessary.

In accordance with discussion at the meetings of the Committee on July 8 and 29, 1958, there had been distributed under date of November 19 a memorandum dated November 17 from Messrs. Thomas and Marget discussing reasons for Federal Reserve open market operations in bankers' acceptances and guides for such operations. A copy of the memorandum has been placed in the Committee's files.

Commenting on the memorandum, Mr. Thomas referred to the acceptance market as an important sector of the money market, one close to monetary policy both now and historically. The relationship had been diminished by the growth in use of Treasury bills but it still was close enough to suggest that monetary policy should use the acceptance as one of its instruments. The System should not, in his opinion, discriminate against acceptances by refusing to operate in them on the basis that the acceptance market was now sufficiently on its own feet. Furthermore, it appeared that the System could operate in acceptances fully as much as it had been without the danger of domination that occurred in the 1920s. In fact, some additional operations in the acceptance market might be appropriate, particularly at the time of year marked by seasonal credit demands. Generally speaking, variations in acceptances outstanding conform to seasonal variations in the demand for bank reserves so the System could add to its holdings in the latter part of the year, reduce those holdings in the early part of the next year, and conform to both monetary policy and the needs of the acceptance market.

Mr. Hayes expressed the opinion that Messrs. Thomas and Marget had done a splendid job in clarifying the historical background and the present position of the acceptance market. As he read it, the memorandum pointed to the desirability of operating in the acceptance market in somewhat larger volume. He would suggest that the Manager of the Account be authorized to purchase and hold acceptances at any time up to 10 per cent of the total amount of acceptances outstanding as revealed by the latest report at his disposal. This would be with the understanding that if reasons should appear to suggest going beyond that limitation, the Manager could come to the Committee, state the reasons, and ask permission to exceed the limitation. At present, 10 per cent of acceptances outstanding would be about $120 million, and he would not expect the Manager would go immediately to the 10 per cent. However, such a limitation would provide more leeway to use acceptances when seasonal forces were strong and when their use was generally in keeping with open market policy.

After Mr. Thomas stated that in his view the present $50 million limitation was too low relative to the existing volume of acceptances, Mr. Allen made the following statement:

1. Acceptances have been and still are useful instruments in financing foreign trade, even though the amount of acceptances outstanding is much smaller relative to the total dollar volume of foreign trade than it was in the 1920's.

2. Because acceptances are useful in financing foreign trade, the System should be interested in promoting their

usage. Such promotion involves holdings of acceptances by the System, but if promotion of the acceptance is our primary object, System holdings must be adjusted (bought and sold) according to the condition of the market and not to effectuate monetary policy.

3. There is nothing wrong with System holdings of acceptances as an instrument of monetary policy provided we adopt that as our purpose. However, if we buy and sell to effectuate monetary aims we cannot at the same time treat promotion of acceptances as our primary object.

4. Since we cannot deal in acceptances with both friendship to the acceptance market and effectuation of monetary policy as equally important objects, we must make one of them our first choice. So long as we make a choice, I do not think it is terribly important which we choose. However, my own choice is friendship to the acceptance market because in the matter of monetary policy we have Treasury bills available in such substantial amounts and with such a wide range of maturities.

5. If my choice is adopted, our holdings of acceptances will never be large. We will be slow to buy, always keeping pressure on the market to develop new customers, and we will sell whenever the market will take what we have in portfolio.

6. Obviously, if my choice is accepted the current authorization to the Desk to buy acceptances would not be increased.

Mr. Robertson then made the following statement:

The proposal presented to us in July 1958 was to raise from $50 million to $75 million the maximum amount of bankers' acceptances to be held in the System account. This was a quantitative proposal, but in the course of discussion it transpired that a qualitative change also was contemplated by the proponents--namely, that we should participate in the acceptance market as an instrument of monetary policy.

In some ways the attitude of some members of our staff regarding Federal Reserve activity in the acceptance market reminds me of a boy with a new knife. Originally he wanted the knife so that he could learn how to throw it. He was given the knife with the warning that he must not use it in that way but only to sharpen pencils and to whittle. A few days later he is discovered carving huge chunks of bark from valuable shade trees in order to leave his initials for posterity. When his father remonstrates, he asks whether that is not what a knife is for, and why they gave it to him if they did not want him to use it?

I have reviewed our actions in this field, and the relevant documents and discussions, since the original proposal almost five years ago. The latest discussion is that in the November 17, 1958 memorandum prepared by members of the staff. The reason originally advanced for our participation in the acceptance market--to "free demand generally from administered rate constriction"--has long since been abandoned, and, as the November 17 memorandum concedes, the magnitude and flexibility of the acceptance market have gotten along very well on their own. But the proponents continued to press their proposal for new reasons, and in 1955 the Committee agreed to "participate in a very modest way in order to show the interest of the central banking organization."

A beachhead having been established, the next steps were to spread out and bring in more fire power. The "interest of the central banking organization" certainly could be displayed "in a very modest way", as we intended, with a portfolio of $25 million. But after a while we were persuaded to raise the limit to $50 million, and now an increase to $75 million is being sought. Even more important, in my judgment, is the change that apparently has occurred in the nature of our participation in the acceptance market, which is now presented to us for semiformal recognition. When we authorized the holding of acceptances for the purpose I mentioned, the Chairman explicitly stated that the System "should avoid any 'finagling' in the market". But now, as disclosed by the November 17 memorandum, our acceptance activities are sought to be justified on the ground that they may lead to changes in acceptance rates, which in turn may "affect the prime loan rate of leading banks and thereby speed the response of that rather sluggish rate to many market changes."

Keeping fundamentals in mind, let us be mindful of the fact that our open-market operations are designed to affect credit conditions by raising or lowering the level of bank reserves. Under present-day conditions, the short-term Government securities market provides an ideal vehicle for these operations. There has been nothing presented to this Committee to support any contention that our open market operations would be more effective because we bought $190 million of Treasury bills and $10 million of acceptances, rather than $200 million of bills.

I confess that several readings of the November 17 memorandum have not enlightened me as to either the usefulness of our participation in the acceptance market from the viewpoint of monetary policy, or how our participation would contribute

to a more flexible acceptance market. There is some suggestion, as I mentioned before, that increased System activity might indirectly affect the prime loan rate. With respect to that, I can only say that it seems to me that this result would be improbable and--more important--that if it did occur it would be undesirable; that would be the very thing--the "finagling"--that we intended to avoid when we decided to hold a modest portfolio of acceptances simply as a token of the central bank's interest in the acceptance market.

The November 17 memorandum seems to state also (page 2) that the System's chief concern should be "with the development of a broad and flexible market". This shifts the ground to the third question to which the memorandum is addressed--namely, the "Need for Federal Reserve Participation". But on that point, the memorandum concedes that the acceptance market, on its own, has developed very well during the last decade and that rates on acceptances have become quite flexible without Federal Reserve interferences. If, as the memorandum states, a broad and flexible market for acceptances is the nub of our interest, it is difficult to see any justification for the central bank's tinkering with a machine that is running very efficiently on the basis of the incentives and the judgment of an independent market.

We are all subject to the temptation to exercise our powers broadly and forcefully. This is a temptation that an organization like the Committee must resist with particular strength. In many areas, we have made great efforts to encourage the developments of markets that could stand on their own feet without our support. Here we have a market that has developed and grown independently in a very healthy manner. It is impossible for me to see how the natural strength and flexibility of that market could be improved by "more active Federal Reserve participation" to use the currently popular euphemism.

This point--the "need for Federal Reserve participation" is dealt with in pages 7 to 11 of the November 17 memorandum, and I should be grateful to have pointed out to me any argument therein that tends to establish that expanded Federal Reserve participation in the acceptance market is desirable as a means of promoting the development of that market. The memorandum refers to the benefits of "a moderate position in bankers' acceptances on the part of the Federal Reserve". However, that already exists by virtue of our present portfolio of acceptances; the instant question is whether we should hold a still larger amount and whether we should abandon the original

purpose of showing, in a very modest way, the interest of the central bank. It is my sincere belief that no sound justification can be advanced for either the quantitative increase or the qualitative change, and that by adopting these proposals, we would be gaining nothing but an opportunity to prove our virtuosity in the art of central banking by playing upon still another instrument, and that the proposed change in policy could easily lead to a situation in which a healthy, broad, flexible, and--above all--independent financial market could lose these attributes, which we have been so eager to develop in other markets. To me, this is a striking example of a situation in which we should exercise self-restraint and resist the impulse--in ourselves or in our staff--to become a more important participant in a healthy self-reliant market, on the paradoxical theory that its independent depth, breadth and resiliency can be enhanced by increased governmental interference.

I have discussed not only the substantive question now before us but also its genesis, because it seems to exemplify a danger against which we should be constantly vigilant not only with respect to acceptance activities but in all our fields of action. But to recapitulate the situation with respect solely to the substantive merits of the instant proposal, it must be borne in mind that the Federal Reserve Act requires our open-market operations to be governed (1) "with a view to accommodating commerce and business", and (2) "with regard to their bearing upon the general credit situation". As far as the general credit situation is concerned, our objectives can be carried out quite as effectively, and more simply, in the Government securities market. As far as the accommodation of commerce and business is concerned, that means, in this case, the scope and flexibility of the acceptance market. But the acceptance market is flexible, self-reliant, and growing without our "support", and increased Federal Reserve participation, particularly if designed directly to affect rates, is likely to diminish rather than enhance the strength of that market. In other words, if the proposal before us were adopted, we would be disregarding the statutory mandate as to the proper objectives of our open-market operations.

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