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, October 16, 1956, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Mills
Mr. Powell
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Bryan, Alternate
Mr. Fulton, Alternate

Messrs. Allen, Leach, and Mangels, Presidents of the Federal Reserve Banks of Chicago, Richmond, and San Francisco, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Vest, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Parsons, Roelse, and Young, Associate Economists
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Roosa, Assistant Vice President, Federal Reserve Bank of New York
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York

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

Chairman Martin noted that Mr. Allen, President of the Federal Reserve Bank of Chicago, was attending a meeting of the Federal Open Market Committee for the first time, and he outlined briefly for Mr. Allen the procedures customarily followed in conducting these meetings.

Mr. Robertson stated that a volume containing the record of Federal Open Market Committee participation in Operation Alert 1956 had been assembled and was being sent by the Secretary to all members of the Committee, to each Reserve Bank President not currently a member of the Committee, and to the members of the staff who ordinarily work on open market matters or who had special assignments in this connection during Operation Alert 1956. He suggested that the Committee authorize the Secretary also to furnish copies of the report to Mr. Arthur S. Flemming, Director of the Office of Defense Mobilization, and to Mr. James W. Allison, Special Consultant, who is assisting the Board in its emergency planning preparations for commercial banks.

> Mr. Robertson's suggestion for transmission of copies of the report to Messrs. Flemming and Allison was approved unanimously.
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> Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on September 11 and 25, 1956, were approved.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations during the period June 28 through October 9, 1956, and at this meeting a supplementary report covering commitments executed October 10 through October 15, 1956, was distributed. Copies of both reports have been placed in the files of the Committee.

In response to Chairman Martin's request, Mr. Roosa commented on developments in the open market during the period covered by the

supplementary report beginning on Wednesday, October 10. Mr. Roosa said that, while transactions for the System open market account had been nominal in amount during this period, much had happened in the market. The Treasury's special bill was successfully auctioned on Wednesday, at an average rate of 2.627 per cent, and had since traded most of the time in a range between 3.06 per cent bid and 3.02 per cent offered. The results proved that use of the auction technique was indeed the right answer in present conditions. The Treasury's regular bill was auctioned on Monday of this week at an average rate of 3.024 per cent, and presumably would begin trading this morning just under that rate. The money market, after easing slightly on Wednesday, returned to full tightness on Thursday and Monday (Friday was a holiday) with Federal funds at 3 per cent.

Behind this calm recital, Mr. Roosa said, there was some tension that deserved comment. There were no problems on Wednesday, and the account bought nothing and had no calls for repurchase agreements. But trading in the new bills on a "when-issued" basis began early Thursday--at least an hour before the market's usual opening time--and there was general unsettlement, with talk running in all directions. Offerings of the special bill as high as 3.20 per cent were mentioned. Word began to pass around that trading above 3-1/8 would mean a Monday auction around 3.15 or 3.20, and if no show of concern were forthcoming from the System, that would portend a discount rate increase and, for the banks, "taking another licking

on a Treasury issue." In that setting, he said, the account decided at 10:30 to ask for offerings. The special bill was excluded, when the question was asked, on the ground that the account was buying what was available for regular delivery. It bought something from every dealer who offered--a total of $31.6 million, for Monday delivery. From then on, the market found itself, Mr. Roosa said, and the trading range was established which has continued until now. Repurchase agreement requests were, in the end, so small they could be passed over without repercussions. The reserve effects of the account's purchases were offset by other sales for foreign accounts, so handled that they were not "shown around" the market and had no adverse rate repercussions.

Continuing, Mr. Roosa said that tension was resumed on Monday (yesterday). Would the regular bill go at 3.10 or higher, and renew the expectations of a signal to raise the discount rate? Given the reserve projections, he said, the account did not want to buy if that could be avoided and, in the end, it avoided doing so. However, it took advantage of a large foreign purchase order and bought from the dealers who were pressing the "high rate school"--whose prices were, of course, also the best for the foreign client. The account made one repurchase agreement for $12 million. By 2:00 p.m. the sentiment had so clearly jelled around the "low rate school" that the account could comfortably enter its own tender at a rate calculated to run off the System's $32.6 million bills maturing next Thursday.

Looking ahead, Mr. Roosa noted that we were now entering the period of peak float. The projections show a staggering increase, but estimates of float around Columbus Day are especially difficult, and the feel of the market would have to be the guide for the account. Dealers got $395 million bills in the auction. However, New York City bank holdings of bills before these two auctions were down to $4 million, and the breadth of the bill market might be narrowed by the unavailability of borrowed bills for short selling.

The recent experience points up two questions for the period ahead, Mr. Roosa said, and the Account Management would appreciate a discussion of these at this meeting. The questions were:

1. Would the Committee be concerned if Treasury bill rates rise further, leading to a belief in the market that the discount rate must soon be raised again, and perhaps setting off expectations of another round of rate increases through the credit and capital markets?
2. If there would be such concern, what relative emphasis (both for buying and for selling) should the Account Management give, from day to day, to these rate developments, to the degree of reserve tightness in the money centers (particularly New York and Chicago), and to the over-all statistics of bank reserve positions?

Chairman Martin suggested that this was a question that should be discussed as a part of the program for open market operations during the next few weeks, and it was understood that the topic would be considered later during this meeting.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period June 28 through October 15, 1956, were approved, ratified, and confirmed.

Prior to this meeting a staff memorandum on recent economic and financial developments in the United States and abroad had been distributed under date of October 12, 1956, to all members of the Committee. At this time, at Chairman Martin's request, Mr. Young summarized the current economic situation substantially as follows:

Domestically, the over-all economic picture continues to be one of general expansion of activity, rising average prices for industrial commodities, and high confidence in both near-term and longer-term business prospects. Abroad, strength remains the noteworthy feature of the situation. In particular areas, adjustments in activity and prices may be noted which run counter to general trends. With the world economy in the advanced phase of an expansion era, this selectivity in development calls for close watching, for, historically, diversity of component trends is an early indication of general leveling off and later reaction.

Of recent facts meriting highlight mention, those relating to prices call for first attention. Among industrial commodities, advances continue to spread at the semi-finished and finished levels. Since mid-August, the rate of rise in average industrial prices has been about 6 per cent per annum or about the same rate as occurred from mid-1955 to April 1956. The earlier rise featured marked increases in prices of primary materials, whereas the recent rise, except for steel and steel scrap, has occurred more heavily at or near the end product range. Prices of farm products, reflecting seasonally higher marketings of livestock, have declined a little in recent weeks, but still average slightly higher

than a year ago.

Employment continues close to recent record levels and, with seasonal withdrawals from the work force, unemployment has declined to 2 million. With hours of work up slightly, with weekly earning at a new high 4 per cent over a year ago, and with new important wage advances granted in such key industries as coal, southern textiles, and meat packing, the only word description of the labor market is strong.

Personal income for August was at a $328 billion rate and up further in September, with the wage and salary component up particularly and other components up some.

While department store sales in September maintained their advanced July-August level, total retail sales fell back about 2 per cent, to the level of a year ago. Durable goods sales were off from August by 6 per cent, accounted for by a decline in sales of automotive outlets of 11 per cent. Sales at non-durable stores were unchanged for the month but up 7 per cent over a year ago. Scattered reports for early October suggest that department stores sales may be running this month a bit off from July-September levels. The latest report on department store stocks shows them 9 per cent ahead of a year ago.

September sales of new autos were down an eighth under August and a fourth below a year ago. With output down sharply for model changeover, stocks were reduced to about 400,000 units. Used car sales also declined in September from August, and sales and stocks were both 25 per cent under September of last year. With model changeovers virtually completed, output at half a million new passenger cars is scheduled for October with a still higher assembly rate for November. While preliminary indications of new model receptions is reported by manufacturers to be encouraging, two items of new car market intelligence suggest caution. The first is that used car prices softened noticeably in September. The second is that intra-industry sales predictions have been lowered considerably.

Output and sales of major household items in September continued to hold up at the advanced summer level.

Consumer instalment credit expansion averaged about $175 million a month during the third quarter but, with auto sales off sharply in September, was probably less than this amount last month. Repossession rates for new cars, reckoned as a per cent of number of accounts acquired over the preceding six months, are up markedly from mid-1954, the rates reached being as high as those attained at any time since the early thirties. Used car repossession rates are up sharply from 1955 levels and are slightly above the postwar high average for 1954.

The Board's index of industrial production for August has been revised upward from late figures to 142, and the September index is now being estimated at 144, the same as the previous high reached last December. With steel output pressing capacity limits, output of producers' equipment expanding, auto assemblies rising, and textile output picking up, a further rise in the index is to be expected for October and November.

Agricultural prospects have been improving, and crop output is now expected to be only a shade under that of last year. Prospects for cotton, tobacco, oil crops, hay and forage and vegetables have all improved over the past month. Total output of meat, though down from the first half of the year, is expected to exceed last year's record output for the full year.

Construction activity has been stable at peak levels over the past three months. In September, industrial construction was off a little, contract awards were down some from the high August level, and housing starts were off considerably to a seasonally adjusted annual rate of one million units. Construction costs in the industrial and commercial area rose further but in residential construction they declined for the first time in some months. While mortgage lending continues in volume only slightly below the highs of the spring and summer of 1955, reports of tightness of mortgage funds and especially of new commitments continue to be frequent. In recent weeks, discounts on FHA and VA mortgages have increased somewhat further in fact, and offerings for purchase by FNMA have risen sharply.

Business inventory accumulation slowed down greatly over the summer months to about a third of the monthly increase of $600 million for the first half of the year. Resumption of a faster rate of accumulation is to be expected for fall months.

Manufacturers' new orders in August were up sharply to close to the record level of last December. Unfilled orders continued to rise and at the month-end were $10 billion higher than a year earlier.

The National Industrial Conference Board and Newsweek Magazine are collaborating on a new series of capital appropriations by large corporations, the first results of which have just been released. The importance of the first published figures is in their confirmation of a strong appropriations underpinning for further growth in capital expenditures.

Preliminary data on U. S. Foreign trade indicate that exports in August exceeded the previous peak of June. Imports for the month were down, but are apparently up for September.

The continued large exports surplus of recent months has been accompanied by a large outflow of long-term private capital.

Late data on activity abroad confirm further easing of inflationary pressures in England and Germany, continuing inflation in France, and high level activity, with weight on the side of demand pressures, in most other industrial countries. Sterling seems to be riding out the confidence and other foreign exchange strains induced by the Suez crisis; the mark continues to index Germany's balance of payments strength; and the Canadian dollar is giving signs of response to disparities in U. S. and Canadian financial policies.

Chairman Martin next called upon Mr. Thomas who noted that recent financial developments had been described in detail in the memorandum from the Board's staff dated October 12 and in the report of the Account Management distributed before this meeting. He therefore presented a summary of the principal developments in this area during the past three weeks in substantially the following form:

(1) Of special interest has been completion of Treasury borrowing of $1.6 billion through the sale at auction of a special 91-day bill. The auction was considerably oversubscribed and practically all the awards were to banks, which bid at a price that enabled them to sell the bills at a higher yield and still obtain some return from the tax and loan account carry. The average yield of the auction--2.63 per cent--and the current market yield--a little over 3 per cent--give the banks some profit and also indicate remarkably close market pricing consistent with a discount rate of 3 per cent. A market yield of as much as 3-1/8 per cent would not have been out of line. A rise in the market yield on Treasury bills to above or around 3 per cent was to be expected as a result of the additional bills issued and in view of the demands on the money market. Yesterday's auction for the regular bill was at an average yield of 3.02 per cent. This experience attests to the effectiveness of the auction method of raising funds as against the procedure of attempting to guess the market by offering a fixed coupon.

(2) Notwithstanding a large volume of new offerings, the bond market has had a better tone, and yields on outstanding issues have been relatively stable. Terms of the new issues have had to be carefully tailored to meet investor preferences, however, including some fairly long noncallable provisions. Treasury bonds showed some declines in yields, especially on the medium-term issues that had previously been weak. Some of the more recent new corporate issues, however, priced fairly closely, have moved rather slowly. The calendar of prospective new issues continues large.

(3) Short-term money rates have tended to rise further in contrast to the steadier tone in the bond market, and despite a somewhat easier reserve position for banks as a whole. This trend in the short market can be explained by the additional Treasury offering and by the continued tight reserve position of banks in New York and also in some other cities, as well as by the relatively strong demand for bank credit.

(4) Stock prices have recovered somewhat in October, following a declining tendency in August and September. There has been little further change in the volume of stock market credit.

(5) The Treasury cash position has continued in line with earlier expectations. The deficit has been smaller than in the same period of other recent years, with receipts much larger than, and expenditures about the same as, last year. The Treasury may be able to get through this year with as little as $1 billion of additional borrowing, but there is still some uncertainty, especially with respect to CCC loans that might be turned in by banks. Since these give a return of only 2-3/4 per cent, banks may wish to turn them in to the Treasury, but since a large portion of them are held by country banks, which at this time of the year have funds available, turn-ins may not be substantial.

(6) Bank loans have continued to expand and investments to contract, but both movements have been at a slower pace than in the same period last year. Since mid-year, total loan expansion has been less than in the same period of any recent year except 1954. The business loan increase of about $1 billion at banks in leading cities was appreciably less than in 1955 but larger than in 1953 and almost as much as in 1952. Loans on securities have shown a continued contraction, while real estate loans have increased less than in 1955 and in 1954, and all other loans have shown little change in contrast to rather substantial increases in the same period

of most other recent years, reflecting largely changes in consumer credit, but perhaps also less lending by banks for other purposes.

(7) Interest rates charged on customer loans by banks in September reflect the increase in the prime rate made in August. The average rate at New York City banks at 4.20 per cent represents an increase of about 1/4 of a point since June of this year and a full point from the level maintained from mid-1954 to mid-1955. Increases at banks in 11 southern and western cities to 4.53 per cent were smaller, amounting to little over 1/8 in the quarter and little more than 1/2 a point since mid-1955. It appears that the banks reporting interest rates made about the same number of loans in the first half of September as a year ago, but the dollar volume was about a fourth larger. Most of the increase was in loans of $200,000 or more, but all computed size groups, except loans of less than $10,000, showed increases, particularly at banks outside New York.

(8) Analysis of the financial position of corporations shows a marked decline in their liquidity in the first half of 1956. In the 12 months ending June, they reduced their holdings of Government securities and increased borrowings while adding large amounts to inventories. With continuation of capital expenditures at a high level and with seasonal inventory expansion, corporations are likely to continue to need external financing, particularly if they build up liquidity reserves against seasonal accrual of tax liabilities. It remains to be seen to what extent they will add to their holdings of short-term Government securities or other liquid assets to build up tax reserves or whether they will use accumulations to meet current financing needs, thus further deteriorating their liquidity positions, but postponing some of their borrowing needs until next spring.

(9) Demand deposits showed a somewhat greater than seasonal increase in September, but the growth for the third quarter as a whole was less than seasonal, and that for the past twelve months was quite small, with banks in leading cities actually showing a decrease for the year. Turnover of deposits, however, continues relatively high and the trends of economic activity and prices indicate no undue shortage of money.

(10) Reserve needs of banks during the past three weeks have been somewhat smaller than had been projected, reflecting smaller increases both in required reserves and in currency needs. Moderate System open market operations have served to keep net borrowed reserves of member banks at around $200 million. However banks in New York City, and in a number of other cities,

have continued fairly heavily in debt. Some of the borrowing has been from the Reserve Banks and a considerable amount from other banks, with very large transactions in Federal funds. Such transactions serve to distribute available reserve funds among the member banks before turning to Federal Reserve credit, which adds to the total supply of reserves. Country member banks have had a relatively small volume of borrowing since mid-September.

(11) Demands for reserves during the next three months will be determined largely by seasonal factors, but will, of course, also reflect any extra-seasonal credit demands. (Charts were presented which showed weekly variations in reserves and the principal factors affecting them, together with projections based on normal seasonal and growth assumptions for the next three months. These projections are summarized on a table distributed.) During this week and next, the usual mid-month float and return flow of currency, together with recent System open market purchases, should supply more than adequate reserves to cover requirements growing out of the tax and loan account payment for the new Treasury financing. On several days excess reserves are expected to exceed borrowings. After next week, there will be wide variations in the supply of reserves, due largely to fluctuations in float, but the level of net borrowed reserves will probably average little, if any, over $300 million in November. In December less than 3/4 of a billion dollars of additional purchases for the System account should be sufficient to meet normal reserve needs. In the meantime, repurchase contracts may be appropriate for meeting short-term variations. Some question may be raised as to whether the reserve positions projected will be adequately restrictive in view of the strength of the economic situation and possibility of even greater ebullience developing after the election.

Chairman Martin suggested that the Committee proceed with comments by the individual members and the other Reserve Bank Presidents with a view to a discussion of the open market policy that should be followed during the next few weeks.

Mr. Hayes made a statement along the following lines:

(1) The general business situation can still be characterized as moving in an upward direction, especially as measured by industrial production and price trends.

Consumer demand is well sustained, while unemployment has reached the lowest level since 1953. A good many price increases are still being reported, especially in the area of finished and semi-finished goods.

(2) However, the inflationary pressures in the economy appear a little less intense than they were some weeks ago in the immediate aftermath of the steel strike settlement. Sentiment is a little more cautious, with attention being focused more on developments indicative of a possible diminution of upward pressures. Among these developments may be mentioned the recent easing of several important raw material prices which, taken in conjunction with the leveling off of non-residential contract awards and machinery orders, the hesitancy of the stock market and the uncertainties of the election, suggests at least the possibility that capital expenditures may not be as important a source of additional strength to the economy next year as they have been in 1956.

(3) Housing activity has at best stabilized and may decline further as a result of financing difficulties and perhaps some falling off in basic demand. The automobile industry is of course the major question mark in the immediate economic outlook, and it is too early to appraise the degree of public acceptance of the new models.

(4) While there has been no clear test of consumer reaction to recent price increases, consumers appear to be increasingly concerned over the price outlook. In the field of consumer nondurables, and some durable goods as well, demand has apparently leveled off in the last few months.

(5) It is encouraging for the long run to note the less rapid rate of inventory accumulation, which, if it continues, would suggest somewhat diminished pressure on available physical resources.

(6) As for bank credit, the growth in total loans in the third quarter, while substantial, was much slower than in the first half of 1956 and in the third quarter of 1955. Business loans accounted for more than the entire increase in the last three months, but here again the rise was less than a year ago. It is interesting to note the extent to which recent gains in bank loans have been concentrated in New York. From the middle of 1956 to the first week of October, New York City banks accounted for three-fourths of the total increase in business loans of the weekly reporting member banks. This pattern, perhaps to be expected when capital outlays by the larger corporations are such a major expansionary force, may be modified somewhat in the next two months if seasonal needs outside of New York make themselves felt as expected, and if the recent rough balance between investor demand and the volume of new capital issues should continue.

(7) The Treasury will be coming to the market around mid-November to refund the December 1st maturity and probably again in early December to complete its cash borrowing program, so that assistance to the Treasury will be a System consideration for most of the balance of 1956. These borrowing operations will by themselves have the effect of putting additional pressure on the market. This suggests that a further restrictiveness in credit policy during the next two months will not be needed unless there is additional new evidence of inflationary dangers sufficiently intense to outweigh the usual need for maintaining an even keel during Treasury operations.

(8) In the capital markets interest rates have leveled off and a large volume of new issues is being absorbed by investors on the present rate plateau. On the other hand, these markets are in a sensitive condition, which might be accentuated if pressure were increased much at this time in the money center--particularly if the Treasury bill rate should climb much above 3%, giving rise to inevitable questions as to further discount rate moves, and making lenders less willing to accept the present rate structure as a reasonably stable basis for doing business.

(9) Reserve pressures in the banking system have come to bear with particular force on the central money market. The New York banks have already been forced to a position where a major realignment of their portfolios is necessary and is now going on. Unless and until reserve pressures are more broadly distributed, further restraint expressed in larger net borrowed reserves might have undesirable effects on the capital and money markets.

(10) The general state of the economy still calls for maintenance of a policy of credit restraint. As seasonal credit demands press against the available supply of funds there may be an automatic tendency toward further tightening outside of New York, and we would not be averse to seeing somewhat greater use of member bank borrowings to meet a part of these seasonal needs. During the next few days net borrowed reserves will be subject to wide swings because of the influence of float and changes in required reserves. However, in determining the need for open market operations, we should be guided primarily not by any figure of net borrowed reserves, but by the "feel" of the market, having in mind not only the Treasury's financing problems but also the desirability, from our own viewpoint as to monetary policy, of preventing any further appreciable tightening of the New York market that might again unsettle the capital markets and intensify the demand for short-term credit. The relationship between prevailing Treasury bill rates and the discount

rate will bear close watching in this effort to appraise the "feel" of the market. Specifically on Mr. Roosa's questions, the Committee should be concerned if bill rates rise further and the market begins to speculate on another discount rate increase at this time. These developments would be undesirable of themselves, and would in fact signify excessive added tightness in the market. We believe that both the bill rate and the general degree of money market tightness must be watched, and that any decided increase in either should be checked. So long as neither is increasing, on the other hand, we believe that cautious efforts should be made toward restoring the statistical position of bank reserves to that prevailing during the first half of September.

(11) Under present circumstances we would be opposed to any change at this time in either discount rates or reserve requirements.

Mr. Bryan said that there had been no changes in the economic situation in the Sixth District that needed to be called to the attention of the Committee at this time. He did not disagree with the estimates of the national situation as presented by Messrs. Young and Hayes. Mr. Bryan went on to say that it seemed to him difficult to argue either for an easier credit policy or for a more restrictive credit policy than the Committee had been following. It was necessary to wait for developments before making any overt or large moves in credit policy. His preference would be to maintain approximately the present degree of restraint but to judge that restraint largely on the behavior of money rates and the behavior of the money market. Personally, Mr. Bryan said, he would be sorry to see the bill rate go sufficiently above the discount rate to create speculation regarding a discount rate change at this particular time.

Mr. Fulton presented information indicating that economic activity in the Cleveland District continued at a very high level. However, the automobile business which was becoming increasingly important in that area appeared to be developing some degree of caution that it possibly did not have a few weeks ago. Mr. Fulton said he believed the degree of restraint that was now being applied to the economy was about appropriate. The lack of liquidity of banks and the high loan portfolio would have a restraining influence on further bank loans. Mr. Fulton said he was not greatly concerned about variations in float because he felt bankers appreciated this factor and would not look upon reserves that might be supplied just now through float as a continuing source of funds. He would observe changes in the bill rate rather than in the net borrowed reserve figure, feeling that the bill rate should be close to the discount rate and should not be permitted to rise inordinately above the discount rate because of the unsettling effects such a rise would have on the capital markets. Mr. Fulton said he would like to see the same degree of restraint that the market now feels maintained for the next few weeks, with operations being geared to feel of the market.

Mr. Shepardson commented on his observations of conditions in the drought area of the Southwest on a trip through that section last week, stating that in western Texas, Oklahoma, parts of Kansas,

and eastern Colorado the drought was getting progressively worse and there was no sign of relief. Planting of wheat in Kansas was far behind normal. The large livestock areas in western Texas and eastern New Mexico had been largely denuded of animals. On this point, Mr. Shepardson said there was not the feeling of distress that might have been anticipated since the market had been fair and stock had been moving out fairly satisfactorily, most ranchers getting out without excessive feeding costs. However, even if the area should now start to receive rain, something like three years would be required to re-establish the carrying capacity of the ranges sufficiently to justify restocking. This meant there would be a movement of light cattle from the area for some period of time, and this had been borne out by a down turn in cattle prices. As to credit conditions in the drought area, producers did not feel that they were in too bad shape, Mr. Shepardson said, country bankers reporting that deposits were holding up and that agricultural loan repayments were being met. He also noted a tendency for women living on farms to seek employment in cities and suggested that this may have been a factor helping to hold up income and to enable farmers in the area to keep current.

As to national credit policy, Mr. Shepardson said that the situation still justified a continuation of the existing degree of restraint. While he would not intensify restraint, at the same time he would not relax pending determination of what might develop following the election to be held on November 6.

Mr. Robertson said that if it were not for one factor he would be arguing today that the Committee should have a tighter policy than it has had. His feeling was that the Committee had been too easy right along and certainly that had been the case during the past three or four months. Inflationary pressures still seem to be very strong, Mr. Robertson said, and the one factor that would cause him to veer from the view that greater restraint was needed was the fact that the election was only three weeks away and he did not feel it possible to determine accurately at this time the attitude the public will have toward purchases of the new model automobiles, or toward other uses of their incomes. As a result, this was a rather stagnant period: the Committee should not try to tighten the market but it certainly should not loosen it, and if there were to be error it should be on the side of tightness rather than of looseness. Mr. Robertson said that his hope would be that the existing degree of restraint could be continued until after the election, when it should be possible to see more clearly what economic developments were in prospect.

Mr. Mills said that his comments would relate to the questions raised by Mr. Roosa as to the Committee's attitude toward a rise in Treasury bill yields and also as to its attitude toward System open market account sales and purchases of Treasury bills as a means of offsetting fluctuations in float. In his opinion, an oversimplified

answer to these two questions is for the Committee to adhere to its established principles for conducting open market policy and thereby exert its efforts toward seeing that the seasonal and other appropriate reserve needs of every class of member bank are met. In so doing, a degree of credit restraint can be maintained comparable to that ruling over the past two or three weeks. That kind of policy objective seemingly would allow interest rates to adjust to a supply of reserves that would in its own right serve to temper any tendency for the Treasury bill rate to rise sharply.

In that connection, he pointed to a significant development that was disclosed by the statement of Condition of the Weekly Reporting Member Banks for the week ended October 3. Examination of that statement, Mr. Mills said, shows a rather abrupt reduction in the amount of "loans by banks" while at the same time the total of "borrowings by banks" had increased measurably, concentrating in the area of Federal Reserve Bank discounts which rose substantially at the same time as there was a reduction in borrowing from other sources. In his opinion, this situation might be traced in part to the usual seasonal demands for credit that are absorbing country bank and reserve city bank reserves and in part to the illiquidity of large city banks who have been obliged to throw back to country bank and reserve city bank correspondents loans that they would ordinarily carry for their accounts.

As this combination of circumstances has tended to withdraw reserves from the Federal funds market, Mr. Mills felt that central reserve city banks might be starved for reserves because of the lack of Federal funds and, therefore, forced to resort more heavily to the discount facilities of the Federal Reserve Banks. He also felt that this condition might be accentuated on October 17 and October 18 when country banks and reserve city banks, who were the largest subscribers to the new Treasury tax anticipation bills, must have the necessary reserves available to support their purchases and related Tax and Loan Accounts. All told, he felt that the situation required close attention as it contained the possibilities of excessive money market tightness at a time of tenseness in businessman psychology and questioning as to future business prospects.

In view of the Treasury's recurring financing requirements between now and December, it was Mr. Mills' opinion that System actions should focus on providing a flow of reserves to the commercial banks that would be consistent with the System's general credit policy and at the same time conducive to the success of the Treasury's operations. Every effort should be made to prevent any repetition of the progressive kind of tightness that reached a climax in late November and early December 1955.

With respect to Mr. Roosa's second question, Mr. Mills felt that as far as possible open market actions should ignore fluctuations

in float, whose temporary reserve effects are now familiar to the commercial banks and do not influence their permanent investment policies. In line with that reasoning, it was his thought that until Treasury bill purchases become necessary seasonally to provide additional reserves with which to support legitimate bank credit expansion and the outflow of currency, the Manager of the Open Market Account should confine purchases and sales of Treasury bills to the minimum possible. Mr. Mills concluded his statement by saying that he felt rather disappointed that the System bid yesterday to allow the run-off of $32 millions of Treasury bills at their maturity on Thursday of this week.

Mr. Leach commented that recent Fifth District economic developments included an improvement in cotton textiles marked by an expansion of the order backlog. The improved feeling was partly due to expected increases in wages which subsequently had taken place, and partly to Administration assurance that future Japanese textile imports would not be concentrated on a few products. This would spread imports over a larger number of items and they would not have so much effect on mills making the items previously being imported. Order backlogs now go into or through the first quarter of 1957, and mill inventories are expected to decline. Profits are expected to be reduced initially under the new cost-price structure.

Mr. Leach said that he had made an effort to obtain information regarding the continued inventory accumulations of nondurables

through some of the directors of the Bank in advance of the time when statistics would be available. One director reported that one of the largest mail order concerns and other large distributors of soft goods sensed a change in this situation; distributors were currently placing limited orders for apparel items and were looking to a reduction in inventories and to a faster turnover. The director noted that this contrasted with the relatively liberal order policy that was being followed a year ago, when these firms anticipated higher prices. Both this director and a textile manufacturer reported that inventories were being held down, partly because of the reduced availability of funds for carrying inventories. Mr. Leach noted that this information from businessmen, along with the reports that bankers were screening loans, tended to confirm that the System's credit policy was having the effects it had been looking for. The information might indicate that the problem of speculative inventory accumulations would not become very large in the soft goods industries, Mr. Leach said, adding that a shoe manufacturer informed him that he anticipated that inventories would be reduced regardless of whether sales fell off.

As to credit policy for the immediate future, Mr. Leach said he thought there should be no relaxation or intensification of the pressure that had been the Committee's objective in recent weeks. The objectives of the Committee have been right, and it was now accomplishing about as much as it could hope for. He would not be worried about

statistical ease or even some actual ease for a short period resulting from float. He would not wish to increase the degree of tightness and bring about a disturbance in the capital markets, Mr. Leach said, and he hoped the bill rate would not be much, if any, above the discount rate.

Mr. Allen said that economic conditions in the Seventh District included an excellent harvest of agricultural products except in the western part of Iowa where the country had suffered from drought. Cattle slaughter had increased which might mean the beginning of a reduction in breeding herds, and it suggested that the supply of low quality beef might become quite large, with a depressing effect on prices. Mr. Allen also commented on the automobile situation, noting that two major manufacturers that had announced prices for new models had come out with increases averaging something like five or six per cent. He reported discussions indicating some feeling in the industry that the increased prices would be a retarding factor on sales, while others believed that the new model automobiles would sell well despite the higher prices. The steel wage settlement has not yet had its full effect, in the opinion of the automobile industry, Mr. Allen said, and a further increase in costs was anticipated within the next few months.

Turning to bank credit, Mr. Allen noted that business loans of Seventh District reporting member banks had increased $50 million since mid-year, compared with an increase of $225 million in the corresponding

period a year ago. The increase in loans to seasonal borrowers (food, liquor, and tobacco firms; commodity dealers; textile firms; and retail and wholesale trade) was larger this year than last year, he said, which would indicate that banks were taking care of their regular customers. Loans to sales finance companies and to metals firms declined considerably.

With respect to the questions raised by Messrs. Hayes and Roosa as to bill rates, Mr. Allen said he did not think it would be desirable to intensify the amount of restraint at the present time. He disliked the kind of speculation that would develop when the bill rate got higher than the discount rate, although he recognized that it could be argued that the uncertainties would have virtue. Mr. Allen suggested that there might be some deflationary factors in the economy at the present time and that the possible situation Mr. Roosa had mentioned might take care of itself without need for concern about the rate on bills.

Mr. Powell said that economic conditions in the Ninth District were quite good. The District had gone through the year with little or no harm for the season as a whole from drought, and this year's farm income would be quite satisfactory. Employment was at an all-time high, with manufacturing continuing active and retail trade at a high level. Mr. Powell noted that the volume of savings was not up to the demand, although it was not less than a year ago. This was because demand for long-term capital had been larger than the savings

could supply, and the District was feeling the same pinch in investment funds that other parts of the country reported. Banks continue in comfortable position and current borrowings from the Federal Reserve Bank were small. Mr. Powell said he would be sorry to see Treasury bill rates above the discount rate for long. He did not think the Committee could depend on commercial banks to help much with the program for controlling inflation, and if they saw a favorable opportunity they would buy Treasury bills, even if they found it necessary to borrow at the Federal Reserve Bank to carry them. To permit the bill rate to rise above the discount rate might bring on a policing problem. If it appeared that the Treasury bill rate was going to rise and stay up, it would be desirable for the System to work toward an increase in the discount rate as a protective measure for the restraint program. This was not a problem at the moment, Mr. Powell emphasized, and he would recommend that the existing degree of restraint be maintained.

Mr. Mangels said that comments on the Twelfth District economic picture would be a repetition of reports he had made at the last two meetings. Further modest improvement was continuing, even in the residential construction field and in automobile sales. With reference to residential building, Mr. Mangels reported comments of bankers loaning in that field who felt that the most optimistic estimates indicated housing starts during the next calendar year of about 800,000 units, or a reduction of about 25 per cent from the estimated starts during 1956. The Twelfth District labor market continued very tight, Mr.

Mangels said, noting that the recent classification of the San Francisco-Oakland area as one in which there were more jobs than job seekers brought the District's three principal metropolitan areas--Los Angeles, San Francisco-Oakland, and Seattle--into the category of tight labor areas.

Bank loans continued to increase but in the past three months the growth was more modest relative to the national picture than earlier this year. Borrowings at the Reserve Bank continued modest. Banks continued to be net lenders and on October 3 were selling an excess of Federal funds. Although there was a degree of tightness, Mr. Mangels said that it was not being felt as much as in some other districts. He felt that the Committee's action concerning the economic situation, the Treasury's needs, and other factors, should be to maintain a healthy climate for Treasury financing and at the same time maintain a degree of restraint. He did not think the situation should be tighter than recently, and he would be inclined to supply reserves to take care of normal seasonal expansion toward the end of this year. He would not change the discount rate at present and would observe developments in the rate situation during the next few weeks with a view to further consideration later on of the need for a change in discount rate.

Mr. Szymczak said that this was a difficult situation. On the one hand, all reports indicated a high level of economic activity and

there appeared to be little doubt that a high level of activity would continue, tending toward inflation with prices generally moving on the up side. The economy was not without some uncertainties, however, depending on sales of new model automobiles and the effect that such sales would have on production and employment. We could not know at this time how much effect the increases in prices of automobiles would have on their sales; both world and domestic psychological tensions were increasing, all of which would have an effect on our economy.

Mr. Szymczak said that he thought the Account Management and the New York Bank had done a good job during the past several weeks. This had been a difficult period in the market when at times there was ease generally, but in the New York market considerable tightness. As for the immediate future, Mr. Szymczak said he would normally offset fluctuations in float through open market operations. In this instance, however, he felt that the New York Bank had correctly allowed the account's bills to run off this week, and this run-off should be sufficient at this time to deal with the rise in float without additional sales of bills. Mr. Szymczak then commented on three items in the domestic economy which he felt demanded attention: (1) the Treasury's need for new money; (2) seasonal demands for credit during the rest of this year; (3) the situation with respect to bill rates. These three factors would call for buying rather than selling, since it

appeared that the market would soon tend to become tighter. When this developed, Mr. Szymczak said he would purchase bills to supply the reserves needed, not only for these three reasons but partly to keep the psychological factors from affecting the money market.

Mr. Balderston said that he could see the complexities in the situation referred to by Mr. Szymczak. These stemmed from the mixed nature of the reports that were beginning to come in. On the one side, he was concerned about the commitments to increase wages and to build more office buildings and plants. He felt that a portion of the economy was over-committed and that trouble would ensue. On the other hand, he sensed some almost imperceptible changes that would make the future one of great difficulty, especially in the light of the Treasury financing to come. He would hope that any psychological crisis might be avoided, especially in December when seasonal needs for credit might cause a sudden tightness that was not desired. He did not like the prospect of positive free reserve figures in November and felt such a development would be misinterpreted.

With respect to the question raised by Mr. Roosa as to what should be done with the bill rate, Mr. Balderston said that personally he would be unhappy if for any reason the System were to attempt to peg the bill rate at 3 per cent. A rise in the bill rate to 3.10 or 3.12 per cent might lead to unfounded rumors that would presage a rise in the discount rate, but Mr. Balderston said that he would

regard that as a minor difficulty compared with the obvious fallacy of pegging the bill rate at any figure. We had learned from sad experience that the pegging of Government bonds had, as former Chairman Eccles had expressed it, produced an "engine of inflation." He would like to see the free market allowed to operate to the extent compatible with the Committee's policy, even if the bill rate were to rise to a figure as high as 3-1/8 per cent.

Mr. Robertson asked Mr. Roosa to indicate more fully why the bill rate might rise above the discount rate, and Mr. Roosa responded that if the System account were to sell bills in the magnitude implied by the projections of reserves for the immediate future with a view to offsetting the expansion of float, an increase in the rate could be expected. In the atmosphere that we have been through, a rise in the bill rate above the discount rate would be taken as a signal for a change in the latter and would run the risk of a disorderly advance in bill rates. Looking to a period three weeks ahead, Mr. Roosa thought there was a continuing risk that there would be selling pressure in the short area and that there might be attempts to dump the new special bills as quickly as that could be done. This selling might generate an increase in the rate on long bills. Mr. Roosa emphasized that his remarks were not intended to give the impression that he was advancing a recommendation of what should be done; he merely wished to indicate that there was a problem on which the Account Management felt the need for an expression of the Committee's

views. He would not wish to have anyone think that he had suggested a peg in the bill rate. However, if the bill rate was to be a guide in the circumstances described, and if the account was to pursue a restrictive objective of vigorously selling into a rise in float, there was the risk that the bill rate would be forced up and the Committee would then have to be prepared to encounter sentiment in the market to the effect that an increase in the discount rate was imminent. It was not merely that there would be discussion of an increase in the discount rate, Mr. Roosa noted, but it was the spread of that conviction with its ramifications in the capital market that would pose a problem for the Committee, just as had occurred in August before the discount rate increase. This was not a matter of a pegged bill rate, Mr. Roosa reiterated, but was a question whether the account should limit its actions in order to avoid a development such as he had outlined. This was the type of question that might arise at the trading desk and one on which it would be helpful to have some discussion by the Committee.

Mr. Robertson said that it looked to him as though existing forces might cause the bill rate to decline rather than to rise.

Mr. Roosa agreed that a rise in the volume of float in the immediate future would have this tendency. The problem he was talking about was one that might arise if the account attempted to sell into the rise in float; if the Committee felt that the account should

not be concerned about the rise in float that was already starting to show, the bill rate might tend downward and the problem he had presented might not arise.

Mr. Robertson said that the action the account had taken to let maturing bills run off this week was highly desirable. Also, he personally would not be concerned if the bill rate were to move above the discount rate in the circumstances described, so long as it did not go substantially higher and did not remain there for a long period of time.

Chairman Martin said that the comments today indicated a clearer consensus than the Committee had shown at the last several meetings. It seemed apparent that no one present was suggesting a change in the directive to the Federal Reserve Bank of New York. The questions concerned details of operations that revolved around the word "feel." It was very difficult for the Committee to furnish guides to this, the Chairman said, but he was glad that Mr. Roosa had raised the questions as he had, and he felt that Mr. Mills had highlighted the problem when he discussed it in the framework in which the Committee had tried to operate. Mr. Balderston's point that we do not wish a pegged market was one that all agreed upon. It was necessary to be particularly careful in a period like this not to permit pressures resulting from the Treasury's needs to cause the Committee to do something that would bring about a situation which would give the Treasury a false idea of its problem when it

came to the December financing. The consensus appeared to be that an even keel should be maintained as far as possible during the next few weeks, Chairman Martin said, but he did not think the Committee could ignore the bill rate and if it went to, say, 3.25 per cent the pressures might generate a panicky condition. On the other hand, the Committee was face to face with a situation in which, if it permitted the market to take control of the discount rate because the bill rate rose a little above it, the Committee would not be permitting market forces to have the effects they should have.

Chairman Martin went on to say that his own thinking was that the Committee should guard the free market as zealously as it could. It would always have suggestions from others as to what the market ought to be, but the more the Committee let the forces of the market operate and the closer it kept its actions to the reserve situation, the better.

As to the immediate future, Chairman Martin said that he was inclined to think Mr. Robertson had described the problem correctly, that is, that a rise in float would tend to cause bill rates to decline; but the problem for the longer future was going to be very difficult. The recent Treasury financing had been complicated, but in Chairman Martin's judgment it demonstrated that the auction method was correct. However, the "fine pencil boys" did not really see what they were getting into and this was one of the things that the Treasury may not

have fully appreciated. This was not a criticism of the Treasury's financing program, the Chairman emphasized, although in his opinion the Treasury could have offered a larger amount of bills ($3 billion rather than $1.6 billion) and such an offering would have made for a better market all around. The offering that had been made had come out with an average rate of 2.627 per cent, the Chairman noted, but 3-1/8 per cent was a perfectly fair opening price for the bills. The market had been confused in this period, Chairman Martin said, and if the Treasury were to come along a little later with an offering of another billion dollars of bills in the same way, there might be similar confusion. In carrying on operations during the period ahead, his plea would be for the Account Management to use its judgment on the questions raised by Messrs. Hayes and Roosa. If in hindsight the account made mistakes in exercising that judgment, Chairman Martin said that he as one member of the Committee, particularly because he had been a broker, would have a sympathetic understanding of the difficulties that the account faced.

Mr. Hayes said that he agreed with the approach indicated by Chairman Martin. He had wanted to be as clear as possible about the Committee's reaction if an undue tightening should develop or if some positive free reserve figures developed. He gathered from the comments this morning that some members of the Committee would ignore a positive free reserve figure while others would like to have the account maintain

a net borrowed reserve figure, and he was still not quite clear as to the course to be followed.

Chairman Martin responded by stating that, if in the judgment of the Management of the Account, the positive free reserve figures were necessary in relation to maintaining the same degree of tightness that the Committee had been trying to have, he would not be bothered by their appearance. This was what the Committee meant by speaking of the "feel of the market." All members of the Committee might not agree on the level of free reserves or net borrowed reserves at which that degree of tightness would be obtained, but for the immediate period ahead the Committee must rely on the judgment of the Management of the Account. The Chairman reiterated the statement that he as one member of the Committee would be on the side of condoning any errors of judgment that might be made by the Account Management in trying to carry forward on this basis. He added that it was very easy to be on the outside looking in and to make criticisms, but it was also very difficult to make a judgment as to just what should be done at any given time.

None of the members of the Committee indicated a view different than that expressed by the Chairman.

Mr. Roosa then mentioned a point of procedure in connection with the possible purchase of the new special Treasury bills maturing January 16, 1957. These bills would come within range, under the System account's normal procedures, for regular delivery transactions

today. Three aspects might enter the decision, other than the obvious favorable considerations:

1. The System account has not, as a matter of policy for several years, bought securities newly or recently issued by the Treasury (other than regular Treasury bills)--i.e., it has avoided direct support to a Treasury issue.

2. This special bill may be considered the first installment of a June tax anticipation instrument, and the account has not, as a matter of policy, bought any Tax Anticipation issues.

3. Any concentration of the account's January redemptions in this special issue might pose peculiar problems for the needed refunding in January, assuming that the rollover would not merely be into another 91-day bill. The mere presence of this issue in the market should add to the availability of other January issues, in any case.

After some discussion of this question, Mr. Roosa suggested that since it should not prove necessary for the System account to buy the special bills during the next three weeks in any event, this period would give the Committee an opportunity to see if these bills were trading off the yield curve. If they tended to trade above the yield curve, the System account could then purchase them when purchases become necessary. Chairman Martin stated that he did not see any reason why the account should not deal in the tax bills. He agreed with Mr. Roosa's suggestion, however, pointing out that this simply implies that purchases would be on the general basis of "best price." He also agreed with a comment by Mr. Szymczak that it was important that the Committee not allow the money market on the basis of System operations to distinguish between the regular weekly bills and the special bills recently offered. None

of the members of the Committee indicated disagreement with these views.

> 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.

In a discussion of the time for the next meeting of the Committee, agreement was reached on a tentative date of Tuesday, November 13, 1956, at 10:00 a.m., partly for the reason that Tuesday, November 6, would be a general election day.

Chairman Martin stated that Congressman Patman hoped to issue a press announcement shortly, stating that the Subcommittee on Economic Stabilization of the Joint Economic Committee would hold a public hearing during the first two weeks of December, at which time the members of the Board and the Presidents of the Reserve Banks would be present to give testimony on present monetary policy and the basis of its development during the past six or eight months. In a discussion of a date for such a hearing it was agreed that a meeting of the Federal Open Market Committee would be held at 10:00 a.m. on Monday, December 10, 1956, and that the members of the Board and the Presidents would plan to be in Washington on Tuesday, December 11, 1956, for the purpose of meeting with Congressman Patman's subcommittee.

Mr. Robertson suggested that at the meeting scheduled for November 13, a special committee be appointed to review the report being distributed today on Operation Alert 1956 with a view to submitting its comments to the entire Federal Open Market Committee for later discussion, and it was understood that this topic would be placed on the agenda for that meeting.

Mr. Balderston expressed the view that discussions of questions such as those raised by Messrs. Hayes and Roosa regarding the operation

of the System open market account were most helpful in improving communications between the Committee and the Account Management and said that he hoped similar discussions could take place in the future. There was general concurrence in this view.

Thereupon the meeting adjourned.

Secretary