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 Monday, January 28, 1957, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Erickson
Mr. Fulton
Mr. Johns
Mr. Mills
Mr. Powell
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Vardaman

Messrs. Allen, Bryan, Leedy, and Williams, Alternate Members of the Federal Open Market Committee

Messrs. Leach and Mangels, Presidents of the Federal Reserve Banks of 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. Abbott, Hostetler, Parsons, Roelse, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York

Messrs. Storrs, Mitchell, and Tow, Vice Presidents, Federal Reserve Banks of Richmond, Chicago, and Kansas City, respectively; Mr. Einzig, Assistant Vice President, Federal Reserve Bank of San Francisco; Mr. Ellis, Director of Research, Federal Reserve Bank of Boston; Mr. Anderson, Financial Economist, Federal Reserve Bank of Philadelphia; and Mr. Atkinson, Economist, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 8, 1957 were approved.

Upon motion duly made and seconded, and by unanimous vote, the action by the members of the Committee, taken as of the close of business January 22, 1957, in increasing by $300 million the authorization to the Federal Reserve Bank of New York to make sales of securities from the System open market account under paragraph (1) of the directive approved January 8, 1957, was approved, ratified, and confirmed.

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 January 8 through January 22, 1957, and a supplementary report covering commitments executed January 23 through January 25, 1957. Copies of both reports have been placed in the files of the Committee.

Mr. Rouse stated that by Thursday of last week the operations of the System account had achieved in terms of figures the position indicated by the discussion at the meeting of the Committee on January 8, although the market had not regained the spirit of restraint that had been contemplated by the Committee at that meeting. As of today, he felt that the market was back in the position that the Committee had hoped for.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period January 8 through January 25, 1957, were approved, ratified, and confirmed.

Mr. Young's statement on the business picture, made at Chairman Martin's request and as a supplement to the staff memorandum distributed under date of January 25, 1957, was as follows:

> The economic situation domestically remains one of intensive utilization of manpower and other resources and of demand pressure on price levels. Recent reversals in credit market conditions, together with more selective price and market developments and with the seasonal uncertainties characteristic of this time of the year, is prompting wide reconsideration of business forecasts. Compared with a month ago, more recognition is being given to the fact that the momentum of advance in recent months has been in considerable measure price illusion. Consequently, reservation is being expressed more frequently than at year-end about full year prospects. Abroad, output and employment generally continue at high levels, with price trends most typically on the up side.
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> Wholesale prices domestically have registered another impressive gain of .7 per cent since mid-December, putting the current level 4.5 per cent above a year ago and 6 per cent over mid-1955. Finished industrial prices advanced little over the month, while prices of industrial materials and farm products and foods rose further. Among industrial materials, some striking diversity was shown. Finished steel prices rose, but the price of steel scrap declined from its very high peak. Prices of copper and aluminum scrap have weakened, as have also lumber prices. Strength in farm prices has reflected mainly higher prices for livestock; grains have continued at about last spring levels. Consumer prices at mid-December showed a further increase and were 3 per cent above a year earlier.
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> Industrial production for January is now guessed at about the same level as December. Steel output is up from December as is also output of autos and petroleum. Paperboard, lumber, and diversified consumer durables outputs, however, are down. Output of industrial equipment continues at capacity.
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> The automobile market has been aptly described by a Detroit economist as not as bad as the Wall Street Journal makes out and not as good as the industry would like to have it. Sales to customers for the first twenty days of January ran about 3 per cent under a year ago, and, while stocks rose to about 600,000 units, they were still better than a fifth

under last year. Used car sales this January have held close to last year's January rate, and used car stocks have been a tenth under last January's level. Used car prices, after allowing for depreciation, continue about steady.

Consumer instalment credit in December rose between $200 and $300 million, about the same as in October and November. The average new car note is now about $200 higher than a year ago, with the average used car note up about $100. The proportion of cars sold on credit late in the year was about the same as in late 1955.

Housing starts in December maintained an annual rate of just over 1 million units, about the level of the preceding three months. On the other hand, mortgage lending has been off some over this same period, although for the whole year 1956 it was not far under the record 1955 volume. Discounts on VA mortgages increased further in December and new FHA 5 per cent mortgages have been generally priced at 98. It is too early to judge the impact of the new FHA rate on the availability of mortgage funds. Mortgage offers and application for standby commitments fo FNMA continue in large volume despite further FNMA actions to curtail demand for its funds.

Nonfarm employment by the latest figures has continued to hold at record levels, about a million higher than a year earlier. In early January, however, there was a more than seasonal increase in claims for unemployment benefits. The work week in December was little changed from preceding months. Weekly earnings, at a record of 84 dollars, were nominally 5 per cent higher than in December 1955, but they had risen only 2-1/2 per cent over the twelve month period in purchasing power.

Retail sales in December, seasonally adjusted, ran about 4 per cent ahead of December 1955. For department stores in January, sales are now estimated to be down from December but still moderately above last January.

The dollar value of business inventories in November, as in October, showed a higher rise than the average of preceding months for 1956, but the rise was about in line with the rise in dollar sales.

In the United Kingdom, activity remains high, with demand pressures on price levels still marked. Sterling has been strong and credit market conditions somewhat easier.

Activity in Germany, which had been slackening in pace, has shown pickup most recently. Also, price pressures have again been in evidence.

France is experiencing intensive use of resources and rapid monetary expansion. Manifestation of inflationary pressures in price indexes is being partly avoided by price ceilings, subsidies, and other devices, but it has not been avoided in international

transactions. In consequence of inflationary pressures, French gold and dollar reserves have suffered a further substantial drain.

Mr. Thomas next presented a review of the credit situation and outlook substantially as follows:

Credit developments during January have moved in the opposite direction from those in December, and have been just as spectacular and surprising. December's sharp rise in interest rates has been followed by an equally sharp decline; the increase in bank loans by an even greater decline; the tight tone of the money market by a feeling of ease. The concern that Federal Reserve operations designed to meet seasonal needs in December may have made possible undue credit expansion has been belied by the contraction that followed. This contraction occurred notwithstanding a continued state of relative ease in bank reserve positions reflected in a decrease in member bank borrowing to the lowest level since early 1955.

Some concern has been expressed that the decline in member bank borrowing may have given a false indication of a shift in System policy and been a factor in the more ebullient market for bonds of all kinds. Like the opposite and equally incorrect view evident in December when rising interest rates were attributed to a feeling that System policy was getting tighter, the current interpretation represents a propensity for market participants to treat symptoms as causes, instead of seeking the real underlying causes. Whether this feeling will lead to undesirable consequences can be established only by the course of events. So far the trend of bank credit would indicate that credit liquidation has been an important cause of the easier situation. The ease has not stimulated undue expansion--at least not yet. Further reasons for the change in tone in capital markets in the face of very heavy demands are not easy to appraise.

Issuance of the new Federal budget does not provide a basis for complacency as to the subsidence of inflationary pressures. For the past year the fiscal position of the Government has been a counter-inflationary influence of considerable import. The new budget provides for a fairly substantial expansion in cash outgo during the next year or more that is not fully covered by an increase in receipts.

A significant feature of the budget is the steady increase in cash expenditures not covered in the conventional budget with a narrowing excess of extra-budgetary receipts over such expenditures.

The additional expenditures for goods and services by the Federal Government will be a stimulating factor and the smaller excess of receipts will reduce the counteracting effect of the surplus. There will be a smaller reduction in Government securities held by the public, thus reducing the amount of investment funds released for meeting other borrowing demands. Compared with a reduction of $6 billion in calendar year 1956, the reduction in 1957 is likely to be less than $4 billion. These differences, it should be noted, however, are relatively small and prospects are for a continued surplus in contrast to deficits in the three previous fiscal years. Moreover, it is highly likely that receipts may turn out to be larger than the published estimates; on the other hand, expenditures may also exceed estimates.

If the increase in the regular weekly bill issue by $100 million, announced for this week, is continued through the full cycle of 13 weeks and the February 16 special bill is refunded with an issue maturing after June, the Treasury's new borrowing needs for this fiscal year may be adequately covered. If receipts exceed the official estimates, as seems likely, and expenditures do not increase beyond those estimates, some additional debt could be retired in June or borrowing needs in July reduced.

The sharp decline in yields on Treasury bonds has brought them down close to the levels of early last autumn, but the entire yield structure is still higher than it was at any time before late last August. The drop in yields was particularly sharp in the case of medium and short term bonds, which had previously shown the largest rises. With the decline in long-term yields more moderate, the hump in the yield curve apparent since last summer has been almost wholly eliminated. This change gives rise to the possibility that the Treasury might find it feasible in the forthcoming refunding operation to offer as part of the exchange an issue with a longer-than-one-year maturity.

With all the decline in bond yields and notwithstanding the low level of member bank borrowings, it is significant that Treasury bill yields have continued above the discount rate. This is in contrast to developments in January of last year, when bill rates quickly fell below the discount rate, although member bank borrowings were at a high level and in fact increased somewhat. This difference no doubt reflects

the increased reluctance of banks to borrow or remain in debt, owing to the higher discount rate, the reduced liquidity positions of banks, and perhaps to other factors. It may also reflect the smaller holdings of Treasury bills by corporations and their reduced ability to absorb bills. Dealers' holdings of bills are substantially larger than they were a year ago.

Performance of the capital market has been one of the most unexpected features of this month's surprising developments and its significance is difficult to interpret. The record volume of new corporate and state and local government issues, which it was feared would create a bad case of indigestion in the market, has been absorbed so readily as to engender confidence and hope. It should be recognized, however, that this absorption has been accomplished at a level of yields which two or three months ago would have been considered very high. It appears that the supply of long-term funds available for investment has increased considerably. This is partly a seasonal, beginning-of-year development and may partly reflect the holding back of investment while yields were in the process of rising. Proceeds from savings bond redemptions and a rebuilding of dealer inventories were evidently other sources of demand. Whether the easier reserve position of banks is a cause or effect is difficult to determine.

Indications are that business corporations will continue to be rather substantial borrowers in the capital market and also from banks. Their needs grow out of large prospective capital expenditures, the levelling out of corporate profits, the further drawing down of funds accumulated for taxes, and the sharply reduced holdings of cash and other liquid assets. State and local governments also will continue to be heavy borrowers. The trend of demands for mortgage funds is more uncertain, but, if builders are correct in their views that principal restraint on building is financing of home buying, then there is likely to be a demand for all funds available. The raising of permissible rates on insured and guaranteed mortgages should increase demands from these sectors of the market. All of these demands will press upon the available supply of savings and probably also on the banks. This will raise questions as to the appropriate amount of bank credit that might be made available.

Liquidation of bank loans since Christmas indicates that most of the unprecedented credit demands in December were to cover temporary needs for cash. Why these were so large is largely a matter of conjecture. Changes in business loans in December and January generally followed a seasonal pattern on

a somewhat wider scale than usual, except for a further increase in borrowings by public utilities. Payment for the large new issues of securities this month is expected to provide for some further reduction in business loans at banks. Consumer credit demands, though moderately large, seem still to be increasing at a slower rate than last year. Loans on securities have been considerably reduced.

Bank holdings of Government securities have been influenced by refunding of the January 16 special bill issue. A considerable portion of the new issue was taken by city banks. Last week's figures for New York and Chicago indicate substantial curtailment in bill holdings. Holdings of Treasury notes and bonds by banks have continued to decline moderately.

Credit expansion in December, together with a decrease in U. S. Government deposits, resulted in a larger than seasonal growth in deposits of businesses and individuals and estimates indicate that these deposits have shown little decline so far in January. The increase in time deposits since early December has been noteworthy. U. S. Government deposits at banks, however, have declined sharply and are at an exceptionally low level. With the rebuilding of Treasury tax and loan accounts and perhaps some further decrease in bank bill holdings, demand deposits adjusted may be expected to decline in coming weeks in accordance with usual seasonal trends. Demand deposit turnover continued at a relatively high level in December.

Nearly all factors other than System operations have combined to increase the supply of or decrease the demand for bank reserves in recent weeks by even larger amounts than were expected. Among these are: the return flow of currency, which was greater than seasonal; a reduction in member bank required reserves due principally to the decrease in Treasury tax and loan deposits; and the decrease in the Treasury balance at the Reserve Banks. As a result, and notwithstanding very large sales of securities by the System, member bank borrowings declined to the lowest level since early 1955 and member banks showed an average net free reserve position for a four week period.

The reserve picture is in the process of changing drastically this week. It is likely that member bank borrowings may increase to well over three-quarters of a billion dollars during this calendar week. Net borrowed reserves may average close to $250 million in this statement week and to $400 million or more next week in the absence of further System operations. It is difficult to know what effect so sharp a change may have on the money market. Since additional reserve funds are likely to be available around the middle of February, any System operations to relieve immediate pressures might well be of a temporary

nature. Perhaps the needs of the situation may be met through repurchase contracts, which can be run off later. In March there may again be temporary needs for reserve funds; the amount will depend upon the tone of the markets, the magnitude of credit demands, and the state of the economy at the time.

Today's sale of $300 million of gold by the International Monetary Fund to the Treasury in exchange for non-interest bearing notes and the monetization of that gold will at first result in an increase in the Treasury balance at the Reserve Bank. It will have no immediate effect on bank reserves as long as the Treasury keeps a correspondingly larger balance than it otherwise would, but when the Treasury balance declines, presumably as the IMF redeems the notes and pays out the funds, reserves will be increased. As this happens, the System will need to consider appropriate offsetting action.

Taking a longer run viewpoint, the question facing this Committee during the coming year is: Should bank credit to meet the essential cash needs of the economy be supplied less restrictively this year than last and can this be done without adding to upward price pressures? Business financial needs for investment expenditures may even be larger this year than last, while liquid assets available to be drawn upon are much smaller, hence borrowing needs will continue large. Will businesses want to replenish their cash balances? To what extent can deposit turnover be expected to increase further? State and local governments will probably want to borrow more, while the Federal Government will retire less debt. Consumer credit growth may be somewhat larger than last year. Will the rate of current saving be adequate to meet these demands? Are past savings available for shifting into more active investment to the same extent as in the recent past? On balance, the situation still seems to be one of pressures on the expansionary side requiring continued restraint on credit growth, but perhaps more care to avoid becoming too restrictive.

In response to a question from Mr. Powell, Mr. Thomas said that the annual rate of demand deposit turnover in cities outside leading financial centers was 22.5, seasonally adjusted, in December 1956, the same as in November. This rate was about 8 or 9 per cent above the rate of turnover in December 1955, he said, and was very close to the

rate that prevailed during much of the 30's although it was somewhat lower than the rate that prevailed in the 1920's.

Chairman Martin next called upon Mr. Hayes, who made a statement on the economic and financial situation and outlook as follows:

1. There has been additional evidence recently that the economy may be losing some of its upward momentum. While these data are not sufficient to support a forecast of a downward turn as a clear nearby prospect, they do suggest that we may be entering a period of sidewise movement when we must be especially alert to signs of a definite trend.

2. To the auto industry, which was already giving cause for some doubt early this month, we can now add important segments of the steel industry where capacity is outrunning demand. In marked contrast with forecasts only a few weeks ago, it is now expected that the over-all operating rate will drop materially below 100 per cent of capacity within a few months. The slight advance of 1 point in the Federal Reserve index of production since October has reflected a highly mixed picture with some industrial groups rising while others remained unchanged or declined. Inventories were accumulated at an accelerated rate in the fourth quarter of 1956.

3. A tendency for total capital expenditures to level off is evidenced by recent figures for factory construction contracts, new machine tool orders, and freight car orders, together with scattered announcements of postponements of plant construction projects.

4. There are cross-currents in the area of prices, with higher costs showing up in increased prices for finished goods both at wholesale and at retail, in contrast with a softening trend for a number of primary product prices. Even in the area of consumer prices, continuance of the upward tendency is open to question in view of added signs of consumer resistance. Reports of an impending general steel price increase are diminishing, following the recent increases in prices for some bottleneck items, and prospects for an eventual increase would doubtless fade if the operating rate should drop appreciably. Buyers' markets are appearing in more and more segments of the economy, this development being dramatized currently by the breakdown and abandonment of several "fair trade" price agreements.

5. Reports on member bank credit have been extremely interesting in the past three weeks. Business loans of all reporting member banks, after a fourth quarter rise of $1.6 billion, or close to the increase of a year earlier, fell by $705 million in the three weeks to January 16, 1957, a post-war record decline for the period comparing with a drop of $355 million a year ago. A rapid decline in security loans has also occurred, so that about three-fourths of the fourth quarter rise in total loans has been wiped out. Total loans and investments were off by $1.4 billion--somewhat more than a year ago--and this drop would have been much greater if the banks had not been called upon to help underwrite the special June Treasury bills for which payment was made on January 16. Loans and investments of the New York City banks fell by $468 million in the January 23 week. The rapid repayment of bank loans suggests that the rise in December was largely seasonal and that cumulative credit restraint has been effective in limiting growth of credit beyond seasonal needs. Despite the striking recent decline in loans, it is quite possible that heavy tax borrowing will occur again in March this year.

6. Three weeks ago we felt serious concern over the outlook for the capital markets, in view of the very heavy calendar of new corporate and municipal offerings. Subsequently, the highly successful outcome of most of the new January offerings has brought about a vastly changed atmosphere in the capital market, although the schedule of new issues due in the next few months is still large. While it is difficult to draw conclusions on the strength of one month's experience, the success of the recent offerings may mean that savings are closer to being in balance with demands for long-term credit than we had previously thought.

7. Our policies must take careful account of the Treasury's very large financing program for the weeks immediately ahead. This program includes the refunding, perhaps to be combined in one operation to be announced this week, of about $10.7 billion of certificates and notes, including $5 billion held by others than the Federal Reserve System and U. S. Government accounts. In addition, it will be necessary to refinance the $1,750 million special bills maturing February 15, and unexpectedly large cash needs have caused an increase in the size of the regular weekly bill offering.

8. Through open-market operations the System has succeeded in absorbing reserves in a record amount since the December peak, and only a fortuitous combination of a persistently low Treasury balance, a sluggish decline in float, a rapid return of currency

from circulation, and a sizable drop in required reserves reflecting the lower loans and investments has prevented this absorption from being translated into a sizable figure for net borrowed reserves. Such a figure is likely to develop within a few days in any event, without further open market sales by the System.

9. Both the uncertainty of the business outlook and the Treasury's program point to the desirability of maintaining about the degree of restraint determined upon at the last meeting of the Committee rather than any intensification of restraint. We should keep a tight rein on the banks' reserve position through appropriate open market transactions, and while it is hard to set a target in figures, I would think that net borrowed reserves might range anywhere between 0 and $400 million depending upon the "feel" of the money and capital markets and the immediate requirements of the Treasury's financing program. To the extent that funds may have to be provided by the System in the next two weeks, repurchase agreements would seem to offer the best mechanism for achieving the desired results, provided dealer positions and needs make this possible, but outright purchases may be necessary.

10. It seems to me that nothing in the present economic situation would justify any overt signal that the intensity of our restraint is being materially altered in either direction. I would therefore be strongly opposed to any increase in the discount rate at this time, quite apart from the consideration that such an increase would be of very questionable wisdom at a time when the Treasury faces a major financing problem.

11. The precautionary clause which was added to (b) of the directive at the last meeting no longer seems appropriate. It is therefore suggested that this clause be eliminated. The question of whether a different qualifying clause should be added might be left for consideration after the members of the Committee have given their appraisals of the current situation and prospects.

Mr. Erickson said that conditions in the Boston District still remained generally good, although they were not as buoyant as they had been months ago. Nonagricultural employment in November was lower than in October. Manufacturing indexes of textiles, leather, and primary metals were lower in November than earlier in the year. Construction

awards for the year as a whole were above the 1955 total, but in December awards were 28 per cent lower than a year earlier. Freight car loadings declined 8 per cent in December. Bank loans declined materially during January, the decrease this year being larger than in January of 1956. Mr. Erickson said that in view of the local situation as he observed it in New England and in view of national conditions, he would not favor a change in the discount rate at this time. He would not make any change in the Open Market Committee's policy but would maintain restraint at the level that had existed last fall, using open market operations and repurchase agreements as needed.

Mr. Mangels reported that thus far during January the Twelfth District economy had operated on a reasonably satisfactory basis. Savings funds had increased moderately, and banks had opened a substantial number of new accounts. Approximately 75 per cent of the savings accounts in Twelfth District banks were now subject to a 3 per cent interest rate and an additional 17 per cent to a rate of 2-1/2 per cent; very few banks were paying 2 per cent or less. Some funds had come into savings accounts in banks from savings and loan associations, although the rate of dividends paid by such institutions also had been increased, and some of the increase in savings deposits reflected redemptions of savings bonds.

In the Pacific Northwest where agriculture and lumbering predominate, Mr. Mangels reported very little optimism. Bankers expect some softening in loan demand and feel that corporate borrowers will

be in better position in March of this year than they were a year ago to take care of their tax needs without large borrowings. Consumer credit demand has not been as large as a year ago, and automobile sales have not been as satisfactory as expected. A Portland Branch director reported new car sales down 5 per cent from a year ago and used car sales down 10 to 15 per cent; his expectation was that for the year 1957 as a whole new car sales would be somewhat below 1956. In California, demand for bank credit did not differ greatly from that in the Northwest, and no large demand for tax purposes was anticipated. Slower sales of houses were reported in some sections of the Los Angeles area, and for California as a whole sales of automobiles also were slowing. One large San Francisco bank reported December financings of new cars for dealers 20 per cent below a year ago, and a decline also was recorded in over-the-counter financings for individuals. Weakness in department store sales recently was reported in the Pacific Northwest, and a small increase in California reflected higher prices. Recent postponement of plant construction by General Electric Company and General Motors Corporation in the Pacific Coast area apparently represented a general reassessment of their expansion programs. Borrowings at the Reserve Bank continued small. Mr. Mangels referred to an editorial that appeared in a Pacific Coast publication recently in which it was stated that "while the Federal Reserve might be putting on the brakes, the labor boss was at the wheel with the accelerator pressed to the floor."

Mr. Mangels' conclusion was that there was some uncertainty in the picture but that inflationary pressures were still predominant and quite strong. If consumer spending does not come up to expectations there might be some reaction in the way of smaller investments in inventories and in plant expansion. If this were to occur, the Federal Reserve should anticipate such a development rather than wait until it had gone too far. Mr. Mangels said that he would concur generally in the policy views expressed by Mr. Hayes although he would think that a $0-100 million range for net borrowed reserves might be more appropriate than a $0-400 million range. He would not change the general philosophy of the Committee at this time but he felt the restraint to be applied now should be slight. He would not recommend a change in the discount rate at present.

Noting that the Ninth District was experiencing mid-winter weather, Mr. Powell stated that the snow pack in mountain areas was now reported to be only about 50 per cent of normal. Currently farm income was somewhat larger than a year ago, and agricultural credit was reported to be ample at country banks. Farm machinery sales were expected to show some increase this spring over a year ago. In non-agricultural areas, industrial employment was high and this reflected a good level of activity in the type of industrial specialties manufactured in the Ninth District. Iron mining was unusually high for the winter months but copper mining in the western part of the

district had declined. Electric utilities were selling more industrial power than ever before, the only exception to this being reported from lumber producing areas. Bank deposits were up somewhat and borrowings at the Reserve Bank were quite low. Interest rates being paid by Ninth District banks on time deposits were creeping up but not many were yet paying the 3 per cent maximum permitted.

Mr. Powell said he could see nothing to indicate that the Committee should now increase restraint on the market. He would be inclined to maintain the present measure of restraint through open market operations, but he would not increase restraint and would not favor an increase in the discount rate at this time.

Mr. Allen said that the automobile year, while still young, had progressed to the point where industry officials say privately that instead of selling 6.2 million cars in the 1957 season as previously hoped, it now appeared that 6 million was more likely to be the figure or that there might even be no improvement over the 5.8 million sold in the 1956 model year. New car inventories represent a 30-day supply at the present rate of sales, a high level for this season. Both production and purchases of materials are being geared to this situation. Employment in Michigan is now reasonably full and is expected to continue that way for the next few months. Sales of farm machinery in November and December showed some improvement over a year ago but in recent weeks there has been some slowing, and manufacturers now expect sales in 1957 will not exceed 1956 totals by more than 5 to 10 per cent.

Business loans by banks in the Seventh District did not increase during the last six months of 1956 in proportion to the nationwide increase. This was because of the relatively large importance of metals manufacturers and sales finance companies in the Seventh District, whereas the industries that increased their borrowing most--petroleum, chemicals, public utilities, and others--are relatively unimportant in the Seventh District borrowing figures.

Mr. Allen said that the larger Seventh District banks anticipate no decline in their business loans between now and March 31; some expect an over-all increase of 3 to 4 per cent from the present level. As for the discount rate, Mr. Allen concurred in the views already expressed that no change should be made at this time, and he felt that open market operations should attempt to continue about the present degree of pressure.

Mr. Leedy reported substantial moisture in some of the drought stricken areas of the Tenth District as a recent favorable development. He felt it clear from the economic report this morning that there was some leveling off in economic activity nationally, but there was not yet a positive indication of downward pressures which would justify a change in the general policy the Committee had been following. For the immediate period, Mr. Leedy felt the Committee should attempt to do what it contemplated at the last meeting, that is, it should apply pressure on bank reserves somewhat comparable to that which existed before seasonal requirements came into the picture last November and early in December. He would not be too much concerned about any particular figure

but felt that operations should indicate that pressure was being applied. He would make no change in the discount rate at this time. He was inclined to feel that the Committee's directive should be changed by deleting from clause (b) the part that was revised at the preceding meeting calling for recognition of unsettled conditions in the money, credit, and capital markets and in the international situation.

Mr. Leach said that since the preceding meeting of the Committee there had been virtually no signs of increased economic activity in the Fifth District and that further evidence of weakness had appeared in the textile, lumber, and construction industries. A spot check of automobile dealers in the larger cities revealed that January sales were "disappointing" although dealers in Chrysler products generally reported a better experience than did others. Tobacco growers faced discouraging income prospects for 1957 as acreage allotments had been cut back by 20 per cent and support prices for certain varieties of tobacco had been reduced by 50 per cent.

Mr. Leach went on to describe developments in tobacco production, which is of especial significance to the Fifth District and particularly to the State of North Carolina, which produces two-thirds of the total flue-cured tobacco and looks to flue-cured tobacco for more than half its cash income from farm marketings. Despite successive acreage cutbacks, production has been maintained at a high level through various devices to increase yields. Of particular significance has been the

increased planting of new tobacco varieties that produce higher yields per acre of the mild, light-colored leaf traditionally considered the highest quality for cigarette production. While cigarette production shows year-to-year gains, new techniques are resulting in more cigarettes per pound of tobacco, and the widespread use of filter tips--accounting for about 30 per cent of 1956 sales--has modified standards of quality. Efforts to get added taste through the filters have led to increased buying emphasis on the darker, stronger grades. Mr. Leach noted that these are the same grades that, because of price and quality, had previously been attractive to foreign buyers. In brief, he described the current situation as one of excessive supply and unbalanced production.

With respect to Committee policy, Mr. Leach said that despite the signs of a slow-down in the upward momentum of the national economy, he still did not see sufficient evidence of weakness to warrant a departure from the Committee's over-all policy of restraint. Without wanting to be tied to a single indicator of the degree of restraint desired, he suggested that an appropriate policy at this time would be reflected in a limited amount of net borrowed reserves. This would be in line with what the Committee contemplated at its meeting three weeks ago and net borrowed reserves might range from zero to $200-300 million, depending upon Treasury financing and conditions in the market. Mr. Leach said that he felt it would be a mistake to increase the discount rate at this time. Also, he felt that because of the substantial

reduction in loans since the first of the year and the changed atmosphere in the capital markets, it might be well to delete from clause (b) of paragraph (1) of the Committee's directive to the New York Bank the reference to unsettled conditions in the money, credit, and capital markets and in the international situation.

Mr. Vardaman said that Mr. Hayes' review of the national picture presented about what he (Mr. Vardaman) had found in the southeastern part of the United States. Since October, he had traveled pretty well over 14 States, and during the past ten days he had traveled through 7 States. He had noted an enormous change in the psychological approach since last October; at that time, there was great optimism in the Mississippi Valley and the southeast, but at present, it seemed that "the air had gone out of the balloon." He now observed a feeling of doubt and discouragement, and he described conditions in some fields of small business as disastrous. The backwash of these conditions could be expected to affect big business, such as the automobile industry where sales were proving quite disappointing.

Mr. Vardaman expressed the view that banks had gone further in increasing interest rates than was warranted by the rise that had taken place in the discount rate. He felt that the psychological phases of the Committee's actions would have more importance in the next 30 to 90 days than actual operations. Perhaps now was not the time to do anything in the way of changing the Committee's policy, but it was his view that some indication by the Committee that funds would be available

later on would be helpful. Mr. Vardaman said that he could not concur in any actions that would make for further tightening, and he urged that the Committee seriously consider whether now or within the next three weeks was the time to "release some of the brakes."

Mr. Mills said that it would not appear to him that January 1957 was a great deal different from January in earlier years, in that there was a low degree of economic visibility. To pattern the Committee's operations to what it could now see, he shared the views that had been expressed that System policy should continue to maintain a degree of credit restraint. This would contemplate the reappearance of negative free reserves but with the level of negative free reserves to be watched very carefully as they rise so as to observe their reaction on the Treasury bill rate and on the capital markets. If those reactions should indicate a too severe pressure on bank credit and on capital market conditions, the Committee should modify its policy accordingly. Mr. Mills also said that he would not favor an increase in the discount rate at this time.

Mr. Robertson said that he was unable to see any lessening in the inflationary pressures that had been present for some time. The Committee could easily overweigh the possibility of consumer resistance to price increases, he said, and nothing that had been presented this morning indicated a need for lessening the degree of restraint that had been contemplated by the Committee at its meeting on January 8. It was Mr. Robertson's view that the Committee should maintain at least that degree of restraint and perhaps in order to achieve that degree it

should set a target in the form of a negative free reserve figure since, if the Committee did not set a target, he feared that it was not likely to get the desired restraint. He would do nothing on the discount rate at this time.

Mr. Robertson then commented on the operations of the System account since the last meeting, emphasizing that he did not wish to have his remarks taken as criticism of the Account Management. Over the past three weeks, he said, it had seemed to him that open market operations had been carried on much too timidly. Just as had been the case during 1956, we had tended to fear deflation resulting from Committee actions, much more than we had tended to fear inflationary results. It seemed as though the Account Management had been almost overwhelmed by the feel of the market: they had acted too slowly and had done too little, and had given greater weight to the feel of the market than the condition of the general economy would warrant or than was called for by the Committee's directive. Mr. Robertson suggested that after the meeting on January 8 of this year there should have been early action to absorb reserves.

Looking ahead, he was aware that the market might tighten itself during the next week or so, but he hoped that the Committee would boldly, not timidly, maintain the degree of restraint contemplated January 8. He hoped that the account would be reluctant to enter into any outright purchases or any repurchase agreements until that degree

of restraint had been achieved; by following such a course, the System might now undo some of the harm that had been done in the past. Too often during the past, open market operations had brought on "ease" just before a Treasury financing with the result that the Treasury had offered securities at too low a rate--securities which then dropped below par as we tightened the reserve picture. He hoped we could avoid this in the future.

Later in the meeting, Mr. Robertson added the comment that he would not be happy with an open-mouth policy such as Mr. Vardaman had intimated, one that indicated publicly that the System would make credit available at a later date, just as he was not happy about what seemed to be an open-mouth policy in the article by Mr. Dale in today's New York Times.

Mr. Shepardson said that since the meeting on January 8, he had attended the drought conference in Wichita, Kansas, at which representatives of 15 States were present for the purpose of developing recommendations for relief of the drought situation. While the group was too large to complete the task effectively, its work was interesting and encouraging, and the general attitude was one of trying to find a method of forestalling recurrence of the distress that has resulted from drought conditions that have affected the area in recent years. This would include studies of land use and water conservation as well as feed reserves and other insurance features designed to mitigate the effects of drought and other natural disasters. The conference did not expect too much

help from credit in dealing with the problem, feeling that in the long run undue extension of credit was likely to bring on additional difficulties rather than to solve the problem.

As to the general situation before the Committee this morning, Mr. Shepardson said that on the basis of the discussion at the January 8 meeting, he would have anticipated a more highly inflationary level at the present than seems to have developed. At the earlier meeting, he had expressed the view that the System should be prepared at this meeting to face an increase in the discount rate. As conditions had actually developed, there seemed to have been some lessening of the pressure. However, Mr. Shepardson said he thoroughly agreed with Mr. Robertson that there was still a good deal of inflationary pressure: there was an incipient or latent pressure that could very easily develop again if the System gave any evidence of a change in policy away from restraint. The economy had lost ground on the price situation, and it was still faced with price increases. By all means, he said, the Committee should attempt to maintain the degree of restraint that had existed earlier, and it should give no signal of easing.

Mr. Fulton described the Cleveland District machine tool and road building machinery industries as operating at high levels. The steel industry was also operating at a high rate on the basis of the new figures of capacity. Except for materials in short supply such as oil pipe and plate, demand for steel items had not been quite so good recently; appliance, automobile, and other manufacturers using

sheets were cutting back their orders. Steel warehouses were well stocked and were not buying for inventory. Mr. Fulton reported a steel industry forecast of operations at 92 per cent of capacity during the first quarter of this year, a slightly lower rate during the second quarter, a sharply lower rate during the third quarter, and a slight increase from the third to the fourth quarter of the year with, however, total production during the second half of 1957 sharply lower than in the first half. He noted postponement of several plant expansion programs in the District, it being his feeling, however, that these represented simply more realistic timing for construction of plants so that they would become available more nearly at the time when the capacity would be used. A small increase in unemployment also was reported. Mr. Fulton stated that price pressures continued upward and that the steel industry expected an increase in basic steel prices in mid-year. Although they were still present, inflationary pressures were being subdued to some extent, and any move to relax credit restraint would be followed quickly by an inflationary movement in the economy.

As to policy, Mr. Fulton felt the Committee should maintain a firm hold on the money supply in the weeks to come, but he would not change the discount rate at the present time. Negative free reserves in the $200 million area would seem appropriate, depending upon the feel of the market.

Mr. Williams said that to the extent he could judge, there had been little change in the business picture in the Third District in

recent weeks. Department store sales in January were running about 3 per cent ahead of sales in corresponding weeks a year ago. Unemployment compensation claims were down during the first half of January from December but were higher than a year ago. Mr. Williams pointed out that factory employment in the Third District had not regained the peak 1953 level, contrary to the country as a whole, adding that this reflected losses from the District to other areas of plants in a number of industries, especially hosiery and apparel. Business loans of reporting member banks in the Philadelphia District declined during January slightly more than a year ago but at about the same rate as for the country as a whole.

Mr. Williams expressed the view that there should be no change at this time in the Committee's policy of restraint; operations should work toward a net borrowed reserve position, but there would be some fluctuation. The discount rate should remain unchanged for the present. This was a time when the System should be very sensitive to changes in climate as well as in statistics, Mr. Williams said, but pending such changes we should continue to try to achieve the degree of tension intended in the January 8 directive.

Mr. Bryan noted that there were some trouble spots in the Sixth District. As Mr. Leach had reported for the Fifth District, the textile industry was having its difficulties in the Sixth. Construction had dropped rather sharply. However, retail trade had been at record levels and above January 1956, and employment remained at a record level.

Banks continued under pressure and there had been a good deal of borrowing at the Federal Reserve during the past month. Loans had declined no more than seasonally since the first of the year and in a good many categories they were still going up.

In the national picture, Mr. Bryan said that we were in a situation in which there were crosscurrents, and in which it was easy to catalogue soft spots that could give cause for concern. However, at present it seemed to him that for every soft spot that could be enumerated, we could enumerate a strong spot in the economy. As he saw it, at the moment the elements of strength were greater in number and probable magnitude than the elements of weakness. We were still dealing with an economy that tended to be inflationary, one in which we were still getting many administered price increases.

Mr. Bryan described the Committee's policy since the January 8 meeting as a policy of "inadvertent ease." The behavior of the bill rate and of the capital markets indicated a considerable ease that we did not have before that meeting. This bothered him, Mr. Bryan said, for several reasons. There was the heavy calendar of Treasury issues coming up and there was the contemplated sale of gold by the International Monetary Fund. If we should get a Treasury issue closely priced on the market and if the Committee then went into the market to create a climate in which the issue would go over, monetary restraint would be largely lost. He felt that the Committee was confronted with the problem of getting an additional level of restraint

into the market and getting it in fast, so that a climate of expectations would not be created that would eventually force it to negate a policy of restraint. This could not be done by use of the discount rate at the moment, Mr. Bryan said, but would have to be done through open market operations. The projections indicated a situation that would tighten itself naturally, but if this did not prove to be the case or if the projections should go as wrong as they had at times in the past, the Committee should actively see to it that greater tightness did develop. The Committee should get back to a bill rate of around 3.25 and should get there quickly.

Mr. Johns recalled that on January 24, 1956, the Committee modified its directive to provide that in conducting open market operations, account should be taken of any deflationary tendencies in the economy; it deleted that provision from the directive on March 27, 1956; and in April, the discount rates at ten of the Federal Reserve Banks were increased by 1/4 of 1 per cent and at two Banks by 1/2 of 1 per cent. Mr. Johns went on to say that he was not sure what there was about January that made it impossible accurately to appraise what was going on in the economy but that it did seem to be a month in which it was dangerous to take radical decisions. Therefore, he was not disposed to take one in January of this year. He referred to the question posed by Mr. Thomas in his statement earlier in this meeting as to whether the System should supply the reserves needed for

sustainable growth with more or less reluctance than heretofore. Mr. Johns said he was not prepared at the moment to try to answer that question. He sensed some lessening of the optimism that existed throughout 1956, but he was not yet ready to say that the Federal Reserve should supply these funds with less reluctance. He would like at this time to take about the same position that he had taken and that the Committee had taken three weeks ago in its decision to recover the degree of restraint that existed late in November and early in December. He would like to see this done without an increase in the discount rate at the present time. He was reluctant to try to pinpoint a figure of net borrowed reserves but suggested a range around the $200 million figure.

Mr. Szymczak said that he felt the Committee should be prepared to act when any weaknesses were seen in the economy. He did not see weaknesses developing at the present time, although he was mindful that the Committee should watch automobile sales and production as well as construction very carefully. These should be observed constantly, not only as a means of seeing how they affected the credit field, but also how they affected other areas of the economy. He referred to Mr. Bryan's comment that the Committee had recently followed a policy of "inadvertent ease." Mr. Szymczak suggested that the market had thought the ease was by design, that it suspected developments that had caused the Committee to leave sufficient reserves in the market to offset something that the market did not see clearly. While the market might be correct, Mr. Szymczak said that he could not see anything at the present time

indicating that the economy was not going to continue at a high level. The Committee should continue to absorb reserves even though a negative reserve position developed. He would not allow the negative free reserves to get too high, but they might range in the $200-400 million area, depending on conditions in the market. The System should not increase the discount rate now, but it should watch developments over the next three weeks to see whether the situation developed in a way to require that the System act on the discount rate.

Chairman Martin said that he had not much to add to the picture. Over the past weekend he had reread the minutes covering meetings during the past 18 months. He gathered that Mr. Johns also had been reading the minutes. The Chairman said that he could have made a comment similar to that Mr. Mills had made on the low degree of economic visibility in January of each year. He reported listening to a talk by a bank economist a few days ago on the outlook for the next year at the end of which a comment was made that the forecast could be summed up as saying that "we would just sag along in 1957." The Chairman said that he could see exactly what was meant by this statement.

Chairman Martin went on to say that Mr. Robertson had brought out on the table something that should be brought out, something that he knew the Manager of the System Account and Mr. Hayes would wish to have before the Committee. These innermost thoughts should be discussed and no one should be sensitive about hurting any other person's feelings in commenting on the handling of the account; the subject was too important not to be discussed fully. He, too, had been a little fearful

earlier this month that the Committee's operations were being handled too timidly, the Chairman said, but he had revised thatfeeling after having been in New York recently and, in any case, he had not pressed the point too much earlier. The men on the desk have an extremely difficult problem, he said: the Committee has been trying to recapture something that perhaps could not be recaptured because of forces at work that were bigger than the System account, or there might be forces of which we were not cognizant.

After referring to the problems growing out of Treasury financing, Chairman Martin noted that, if certain things were not done at just the right moment, the Committee might be defeated in what it was trying to achieve. This was a poor time to make long-term projections of the business outlook, he felt, but it was a good time to try to maintain the status quo. Personally, he had been exasperated with recent stories in the press about changes in Federal Reserve policy; he mentioned two recent talks he had given and pointed out that no matter what he said, the newsmen tried to twist his comments into something different, because there was no news in them otherwise. As to policy, he was convinced that patience was the thing that was needed at this time to unravel the knot. The consensus of the Committee seemed clear: that we should endeavor to follow the policy that we thought was to be followed three weeks ago but which some now felt had not been followed. This was a difficult period, Chairman Martin said, and his thought was to

attempt to maintain the status quo until the Committee could see more clearly into the spring developments.

Referring to Mr. Johns' comments, the Chairman said that he was one of those who was timid on the short-run outlook in January a year ago, although he had not been timid on the longer-run outlook. Now, and until the Committee had obtained a clearer view of developments, he hoped we would follow the policy we had been trying to follow the past few weeks. We should avoid trying to "make business." Improvidence and imprudence were present in the economy and their effects had to be washed out sooner or later, but this could not be done by putting in more credit. Chairman Martin concluded this part of his comments with the statement that his understanding of the consensus of today's discussion was that the Committee wished to maintain the policy that was agreed upon at the meeting on January 8, and there was no indication of disagreement with this statement.

Chairman Martin then turned to the directive, noting that Mr. Hayes had suggested deleting the second part of clause (b) of paragraph (1), calling for recognition of unsettled conditions in the money, credit, and capital markets and in the international situation. His own view was that it would be unfortunate to eliminate the instruction to take cognizance of conditions in the capital markets and then have a knot develop, or have the Treasury's forthcoming financing fail. He could see no objection to leaving the words in and, on the whole, felt that

the Committee would be wiser to continue until the next meeting with the directive in its present form.

Mr. Rouse said, in response to the Chairman's question, that his inclination was to take out the phrase as suggested by Mr. Hayes. He had no suggestion for changing the dollar limitations in the directive.

Mr. Hayes said that he had considered the desirability of substituting some language for that part of clause (b) of paragraph (1) under discussion, for example, an instruction to keep alert to any deflationary developments that might emerge. He was not sure whether it was worth while to spell out the directive in detail. Mr. Hayes also mentioned that he was pleased that the Chairman had called attention to the exasperating consequences of the Treasury financing in mid-January. He noted that at the time of the Treasury's refinancing of the special bills maturing January 16, the Account Management was effectively kept from disposing of bills in the market for a few days and was faced with the fact that dealers and banks underwrote $1 billion of the new securities. It was quite possible that the Federal Reserve would have to do something to assist if problems developed in the Treasury's refunding in February.

In further discussion of the directive, Chairman Martin expressed the view that since the preceding meeting there had been a disorderly market on the up side, brought on by conditions beyond the control of the Committee. This was likely to occur at any turning point. He suggested

the possibility that the Treasury might announce its February refunding shortly, that on the basis of projections there might be a tightening in the market a little later, and that if these developments occurred the Committee might find itself in a position where it felt it necessary to enter the market. Should these developments take place, the Chairman thought that the Committee would prefer not to have taken action at this meeting to change the directive in a manner that would indicate that its only concern during the next three weeks was with inflationary pressures.

Mr. Leedy said that he felt as Chairman Martin did, but he wondered whether it might be possible to delete the phrase referred to by Mr. Hayes and to substitute therefor an instruction to "take account of changing conditions in the money, credit, and capital markets."

Chairman Martin responded that such wording would meet his point.

Messrs. Mills and Williams stated reasons why they would prefer to retain the existing wording of the directive at this time, and Mr. Hayes said that he would have no objection to leaving the directive in its present form. After several other members of the Committee had expressed similar views, it was agreed that no change in the wording would be made at this meeting.

Mr. Rouse referred to Mr. Robertson's comments earlier in the meeting, stating that he had not taken them as critical of the operations of the System account but rather as pointing up the difficulties experienced in carrying out Committee wishes during the recent period.

He stated that the System account had sold securities in this period when some of his immediate associates on the trading desk were quite apprehensive of the effect of such sales. On a number of days some of those concerned felt the account was taking a substantial risk in going as far as it had. This point of view could be expected from persons very close to the market, Mr. Rouse said. He, being a little further removed from the market, might have a different feeling, and when he was in Chicago and talked by telephone with those on the trading desk in New York he had noted a difference in feeling. As it had turned out, Mr. Rouse said, the risks those on the trading desk had been concerned about actually had not materialized.

Mr. Robertson responded that Mr. Rouse had stated correctly the point he was trying to make; that the pressures on the "trading desk," resulting from the so-called "feel of the market," were so great as to sway the judgment of those in charge of the operation. He went on to say that had he been on the desk he might have made exactly the same errors that were made, and that he was merely trying to bring out the point that he had expressed.

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, while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation, and (c) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

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

(3) To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate $500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

Chairman Martin referred to the question that had been raised at the meeting on January 8 in connection with the suggestion made by Mr. Mills that the Committee study whether the past year's increment in the size of the System's portfolio should be converted from Treasury bills into longer-term U. S. Government securities. He suggested that this and related questions be studied by a special committee which would include, in addition to himself, Messrs. Hayes, Allen, Balderston, Erickson, and Szymczak.

Chairman Martin's suggestion was approved unanimously with the understanding that the special committee would report at a later meeting.

In a discussion of the date for the next meeting of the Committee it was agreed that a meeting would be held at 10:00 a.m. on Monday, February 18, 1957. It was also tentatively understood that the annual organization meeting of the Committee would be held on Tuesday, March 5, 1957.

Chairman Martin then presented a question that Secretary of the Treasury Humphrey and Under Secretary Burgess had asked him to take up with the Committee. Specifically, some thought was being given to the issuance of optional securities, one of which might be a three-year obligation, in exchange for the 2-5/8 per cent Treasury certificates maturing February 15, 1957, of which the System account now holds approximately $5 billion. The Treasury officials felt that if the option were offered and the System were to exchange some portion of its maturing holdings for the longer-term securities, such action would be helpful to the Treasury. Chairman Martin said that some of the leading dealers in Government securities also had indicated that such action by the System would be helpful. He also said that the inquiry by the Treasury in no way contemplated a change in the general System policy that it would confine transactions to short-term securities, preferably bills. Reasons advanced for the procedure were that acquisition by the System of some of the longer-term securities in an optional offering

would indicate that the Federal Reserve was sympathetic with the pricing of that particular issue and that it would give some encouragement to the market for redistribution of the securities. He commented that personally he was not impressed with an argument for lengthening the term of the Federal debt through use of the System's portfolio.

In response to Chairman Martin's request for comments, Mr. Rouse said that he had not heard recently from the Treasury on this question, although Mr. Burgess had mentioned it a couple of weeks ago. He noted that Treasury maturities during 1960 were relatively light and that a three-year security would fit into the maturity schedule.

Mr. Allen said that in his judgment sizeable maturities of Government debt must be taken into consideration because they can affect the money market and anything that affects the money market must be taken into consideration. If, as Mr. Rouse had stated, a three-year security would add a maturity in a year of relatively small maturities, that would help to even out the Government maturity schedule and would thereby appear to be beneficial to the money market. On that basis Mr. Allen said he could support a proposal for the System to take three-year obligations in exchange for some of its holding maturing February 15, although his basic feeling was that the System should restrict itself to securities maturing within a year.

Mr. Robertson asked that the staff members comment on reasons why such a procedure would not be desirable.

Mr. Thomas pointed out that if the System was not dealing in longer-term securities, it would not make a great deal of difference what it held other than bills. However, if the System held a substantial volume of the longer-term securities and if it was believed that it might deal in them, that fact might be a hindrance to the market rather than a help.

Mr. Riefler said that a central bank enjoyed public confidence in its operations to the extent to which it had a liquid portfolio. This suggestion of the Treasury would be a small departure from liquidity. It seemed to him that the question was one of psychology. He did not think there was much case for doing what the Treasury asked on the grounds of bringing about better distribution; the case for doing it was that it would indicate some approval on the part of the Federal Reserve of the pricing of the securities. The case against doing it was that apprehension might be raised that the securities might be sold by the System account and thus come back to load the market.

Mr. Hayes said that taking the longer-term securities offered in an exchange would have no bearing on whether the System account would deal in them in the future. On the other hand, it could be argued that there was some advantage to the System to have some distribution of maturities in its portfolio if the System ever wished to deal in securities other than bills. The Treasury's proposal would give the System a little more diversification.

Mr. Robertson suggested that the Treasury must feel strongly about the matter or it would not have made the request. He inquired whether this feeling was based on the grounds that it would help give better distribution to the securities and improve the confidence in the market.

Mr. Rouse noted that unless the exchange of some of the System securities into the three-year obligations were to be made public while the offering was open, it could have no effect on this refunding.

Chairman Martin stated that there was no indication that the System's acquisition of such securities would be made public until after the exchange had been completed, and it was his feeling that the procedure would have an effect on the public only to the extent that it might have a bearing on future issues.

Mr. Vardaman said that this would represent a break in the policy that the Committee had been following for some time, and the market would wonder when the next step would be taken. From the psychological standpoint, he felt the proposal undesirable on the grounds that if acceptance by the System of the longer-term securities were to be taken as now indicating its approval of the rate, a failure by the System to take such securities in a later offering might well be interpreted by the market as indicating an unfavorable view of that offering.

Mr. Robertson concurred in this view. He felt the present problem was not large, but the future consequences might be troublesome--

more so to the Treasury than to the Federal Reserve.

Mr. Allen said that some members of the Committee had raised a point which seemed important to him, namely, that if the System were to take the suggested three-year Treasury obligations, the public might be led to believe that the System had assisted the Treasury and would do so again, and such a public belief would not be desirable. Mr. Allen said that the word "assist," which he had heard here today, was disturbing to him.

Mr. Szymczak said that he could not get concerned about the question one way or the other.

Chairman Martin said that he did not feel this was a big problem for the System in any event. To the extent it was a problem, it was one for the Treasury. His feeling was that if the Treasury really wished to have the System take the longer securities as a matter of helping in the financing, it was the type of thing on which the System should not be inflexible. He suggested, therefore, that he discuss the matter further with Treasury officials with a view of indicating that there was some difference of opinion among the members of the Committee concerning the proposal.

After some further discussion, it was understood that Chairman Martin would discuss the matter along the lines indicated, and if the Treasury then desired the System to take longer-maturity

securities in an optional offering, he would communicate further with the members of the Committee.

Thereupon the meeting adjourned.

Secretary