

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, January 7, 1958, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Bryan
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Williams

Messrs. Fulton, Irons, Leach, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Johns and Deming, Presidents of the Federal Reserve Banks of St. Louis and Minneapolis, respectively

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Atkinson, Bopp, Marget, Mitchell, Roelse, Tow, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, 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. Daane and Walker, Vice Presidents of the Federal Reserve Banks of Richmond and Dallas, respectively; Messrs. Balles and Einzig, Assistant Vice Presidents of the Federal Reserve Banks of Cleveland and San Francisco, respectively; Mr. Parsons,

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Director of Research, Federal Reserve Bank of Minneapolis; and Mr. Bowsher, Economist, Federal Reserve Bank of St. Louis.

Chairman Martin referred to the revised drafts of minutes of the meetings held on December 3 and December 17, 1957, stating that since these drafts were distributed Mr. Fulton had asked that an additional revision be made on page 28* of the minutes for December 17, to change the word "retail" to "department store" in the second full sentence on that page, and that in the absence of objection the minutes for the two meetings would be approved incorporating the additional change requested by Mr. Fulton.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on December 3 and December 17, 1957, were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period December 17, 1957 through January 1, 1958, and a supplemental report covering commitments executed January 1 through January 6, 1958. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that open market operations and the state of the market had been covered thoroughly in the preliminary and supplementary reports that had been delivered to the members of the Committee and that he had little to add. He did wish to call the Committee's

* Refers to mimeographed copy. In typed copy, reference should be to page 33, fifth full sentence.

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attention to the fact that dealers' positions in Government securities recently had been running about \$1 billion higher than before the discount rate change in November. This suggested that there were about \$1 billion of securities in the market to be distributed, over and above any other supplies. Mr. Rouse went on to say that he was grateful to the Reserve Banks for accelerating the daily wire reports on bank reserves and float that were approved at the last meeting of the Committee. There had been a few problems, but the wires were now giving an accurate picture of the previous day's reserve balance.

With respect to Treasury financing, Mr. Rouse reported that the Federal National Mortgage Association planned to announce the terms of its \$750 million financing later today or tomorrow. Meanwhile, the Treasury planned to continue offering an additional \$100 million in each of the four bills auctions in January, and toward the end of the month the Treasury planned to announce the terms on its February re-funding. Mr. Rouse said that he knew of no plans for a major cash financing, but a good many Government agency financing operations were scheduled for this month. The Treasury estimated that the net cash to be raised in the Fanny Mae financing plus the money from the additional bills would be sufficient to carry them through February. It might be necessary for the Treasury to sell some of its free gold, but if this were done, it planned to transfer the funds to the Stabilization Fund, which would not affect bank reserves or open market operations.

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Mr. Leach asked if the present level of dealer inventories, with bill rates down to 2-3/4 per cent, did not suggest that dealers are carrying this thing a bit too far. Mr. Rouse pointed out that bill rates backed up to 2.85 per cent in the auction yesterday, and dealers acquired another \$400 million bills in the auction. At the same time, demand for bills was good and dealers reported that they were selling about \$150 million a day. At this rate, they might be able to work off their positions without difficulty. In Mr. Rouse's opinion, a bill rate 1/8 per cent below the discount rate was all right; but as Mr. Leach had suggested, a rate 1/4 per cent below the discount rate was going a bit far in view of the supply of bills in the market. Of course, he added, the drop to 2-3/4 per cent occurred all on one day, when the dealers guessed that Chicago banks would be bidding heavily for the new bills. Mr. Allen remarked, and Mr. Rouse agreed, that the Chicago banks actually did not bid for or obtain an unusual amount of those bills.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period December 17, 1957, through January 6, 1958, were approved, ratified, and confirmed.

Chairman Martin referred to the letter from Congressman Wright Patman dated December 23, 1957 that had been distributed before this meeting in which Mr. Patman requested that the data relating to transactions in the System Open Market Account during the period March 1951

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to the end of 1956, sent to Mr. Patman on November 12, 1957, be placed on punch cards and tabulated so as to produce various summary totals of figures by days and months and to compute average prices for the respective periods at which purchases or sales of securities were effected. Chairman Martin suggested that a letter be written to Mr. Patman informing him of the time-consuming nature of this task and of the expense that would be involved, that the Committee was prepared to go forward with such a job upon the request of the full Committee on Banking and Currency of the House, but that in the absence of a request from the full Committee it would seem inappropriate for the System to undertake such a large job of preparing data for an individual member of the Congress.

Mr. Hayes stated that this request had been discussed at some length at the New York Bank and that he was concerned about it for several reasons. His main concern was that the tabulations of data specified in the request at hand did not seem likely to provide useful information. Apart from the expense angle, Mr. Hayes said that he was disturbed about the handling of such requests which seemed to put eggs, apples, and oranges together, in a manner that could not produce significant results. His question was whether it would not be preferable to offer, perhaps to the Chairman of the Banking and Currency Committee, to cooperate with the Committee in finding out what the Committee was seeking to know and in trying to help arrive at a basis for producing meaningful results.

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Chairman Martin stated that he thought this point was well taken and that it should be a part of the letter he had in mind. His main point, however, was that a request of this nature should be from the full Committee on Banking and Currency and that if that committee wished to pursue this type of inquiry the Federal Reserve would cooperate. It was his impression from Chairman Spence that the full Committee on Banking and Currency might not wish to support a continuation of the types of requests that had been received from Mr. Patman upon numerous occasions in recent months.

Mr. Hayes said that he agreed completely with this approach and his thought was to make clear that unnecessary labor that went into preparing meaningless data produced no benefit either for the Banking and Currency Committee or the Federal Reserve.

Chairman Martin called for other comments on the handling of this letter, and no additional suggestions were made. He then suggested that the Secretary of the Committee undertake, with the Manager of the System Account, to prepare a draft of reply to Mr. Patman along the lines of the discussion with the understanding that when the letter was in satisfactory form for dispatch a copy would also be sent to Chairman Spence. It was understood that this procedure would be followed.

Chairman Martin next referred to a draft of letter to Mr. Patman in reply to his letter of November 26, 1957 asking for further

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information relating to operations of the System Open Market Account and of dealers in United States Government securities. The draft of reply, prepared in accordance with the discussion at the meeting of the Committee on December 3, 1957, had been distributed by the Secretary on December 27, and at this meeting a memorandum containing two suggestions for editorial revisions in the letter were presented and discussed. Following the discussion, the letter to Mr. Patman was approved unanimously in the following form, with the understanding that a copy would also be sent to Chairman Spence of the House Banking and Currency Committee.

Your letter of November 26, 1957 asking for further information relating to operations of the System Open Market Account and of dealers in United States Government securities has been discussed at meetings of the Federal Open Market Committee. Some of the information you request is not reported to the Federal Reserve and hence cannot be furnished by us. Some is given to the System Account on a purely voluntary and strictly confidential basis and hence it is not within our discretion to transmit it. Some is available to the Federal Reserve System because it is fiscal agent of the United States, and the Treasury, rather than the System, should be approached for such data. Finally, one major portion of the data you request could be made available in the detail you wish only with immense effort. In this case we suggest an alternative which may serve your purpose equally well. To the extent practicable from the standpoint of the amount of work involved, and with proper consideration for the confidential nature of some of the data, the Committee desires, of course, that you be furnished with information that will be useful in your analysis of System Account operations. Your several requests are discussed in the order in which your letter presented them.

1. Your request for copies of the record of the amounts of purchases and sales of Treasury bills and the

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prices bid or offered by each dealer for each security on which the System Account solicited quotations on each day of trading over the past three years would require an immense amount of work, especially since it would be necessary to accompany such a record with memoranda explaining the background of the operations and the reasons for the actions taken, if you were to obtain an understanding of the situation reflected by the data. It would appear, however, that your purpose might be served by having the information (with the accompanying explanatory memoranda) for selected dates, rather than for the entire three-year period. If this strikes you as practicable and you wish to select a number of days for each of the three years--say a dozen days a year--preceding December 31, 1956, we would have the material prepared for you as promptly as possible. You now have the photostatic copies of the sheets showing transactions, so that you would be in a position to select days when the Account was active.

2. Your second request refers to the tabulations transmitted with my letter of November 12, 1957, showing each transaction of the System Open Market Account with each dealer in Government securities from the period of the Treasury-Federal Reserve Accord in March 1951 to the end of 1956. You now ask for similar records of each transaction of the System Account for the period from the end of 1956 through June 30, 1957.

Each year, pursuant to the requirements of the last paragraph of section 10 of the Federal Reserve Act, a record of policy actions taken by the Board of Governors of the Federal Reserve System and by the Federal Open Market Committee, together with the reasons underlying those actions and the votes taken in each instance, is made public in the Board's Annual Report to the Congress. Until that record is made public in the Annual Report, which is published in the spring of each year, the policy directives of the Federal Open Market Committee are regarded as current and are handled in the strictest confidence. It is true that weekly statistics showing the condition of the Federal Reserve Banks are published and that to a greater or lesser degree individuals make justments on the basis of those reports as to the policy actions taken by the Committee. My letter of September 10 stated that the Federal Open Market Committee felt that it would not be proper to divulge information regarding Committee policy decisions and operations for the current calendar year. It continues to be the judgment of the Committee that disclosure of its policy decisions should come in the manner that has been followed

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for many years in carrying out the provisions of section 10 of the Federal Reserve Act, namely, in the Annual Report to the Congress covering the year most recently ended. For this reason, it believes that it would not be desirable to furnish the information regarding operations of the System Account pursuant to the policy directives issued during any part of the year in which the directives were issued. If, however, you so request, we will undertake to prepare tabulations of the transactions not only for the first half of 1957 but for the entire calendar year, to be submitted at substantially the time the Board's Annual Report is published.

3. You note that the names of foreign central banks were deleted from the tabulations transmitted with my letter of November 12, and you ask why the names of such banks with which the System Account has traded in the past should be withheld from the House Banking and Currency Committee.

To be certain that the situation with respect to the 1700 odd pages of tabulations sent with my November 12 letter is correctly understood, I wish to emphasize that there were very few deletions from those sheets and that all of the names appearing on those schedules were names of dealers in United States Government securities. In some instances, those dealers are also domestic commercial banks. However, the distinction between deleting and retaining names was a distinction between investors in securities and dealers in securities, and there was no intention of distinguishing between foreign and domestic banks per se.

Transactions between the System Account and dealers are in a different category from transactions between the System Account and the Federal Reserve Bank of New York, acting on behalf of and under instructions from its depositors. In the first place, many central banks and international institutions maintain accounts with the Federal Reserve Bank of New York. Such central bank accounts are operated by the Federal Reserve Bank of New York on behalf of all of the Reserve Banks. Transactions for these accounts have traditionally been held in strict confidence for substantially the same reasons that, as a matter of policy, banks in general hold in strict confidence transactions on behalf of any of their depositors. This confidential relationship between bankers and depositors has been considered to be especially necessary with respect to operations of foreign central banks, whose deposits with the Federal Reserve Banks largely represent monetary reserves of their countries. Disclosure of such operations would be of interest to many persons who follow political and economic developments in

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foreign countries, but such disclosure might well have serious repercussions and imperil the confidence that foreign countries place in the Reserve Banks.

Secondly, you state that you understand that "it is no secret that the System Open Market Account trades with foreign central banks, acting at times as agent for such banks." Actually, this is not strictly correct, and the relationship to which you refer is not between the System Account and the foreign banks. The Federal Reserve Bank of New York acts only upon instructions, specific or standing, from its foreign depositors in handling their accounts. Orders to buy and sell securities are given by the depositors to the Foreign Department of the New York Reserve Bank, which in turn transmits them to the Securities Department of that Bank for execution. Such orders usually are executed by the Reserve Bank in the open market, but the foreign customers have been notified that they may be executed with the System Account at the discretion of the Manager. They are carried out with the System Open Market Account only when the Manager of the Account so directs for the purpose of coordinating the foreign transactions with current open market operations that are being executed pursuant to the directives of the Federal Open Market Committee. The initiative in executing transactions with the System Account rather than in the market in no manner lies with the foreign correspondent.

4. With respect to your request for data from the daily reports of operations received from United States Government securities dealers, these reports are furnished by the dealers on a purely voluntary basis and in the strictest confidence. It would not be within the discretion of the Federal Open Market Committee or the Federal Reserve Bank of New York to disclose information in connection with these reports.

5. You also request a tabulation of dealer borrowings with a breakdown by types, sources of credit, terms, and rate. Such data are not available to the Management of the System Account.

6. The answer to your next request is the same--we have no data showing dealer financing of their own customers to carry Government securities. By way of comment, I might say that it seems highly doubtful that dealers do finance their customer holdings to any significant extent although there might be an occasional transaction of that kind. The dealers have difficulties enough in financing their own portfolios of Government securities without assuming added burdens in financing customer holdings.

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7. Finally, you request information concerning dealer tenders for Treasury bills in the weekly auctions. In handling tenders in the bill auctions, each Federal Reserve Bank acts as fiscal agent for the Treasury Department. A request for data relating to the tenders should, therefore, be directed to the Treasury Department.

Mr. Fulton, whose train had been delayed in reaching Washington, entered the room at this point accompanied by Mr. Balles, Assistant Vice President of the Federal Reserve Bank of Cleveland.

At Chairman Martin's request, Mr. Young presented a summary statement on the current economic situation, as more fully reviewed in a staff memorandum dated January 3, 1958, on Recent Economic and Financial Developments in the United States and Abroad. A copy of the staff memorandum, which had been distributed before this meeting, has been placed in the files of the Committee.

Domestically, economic activity continues to be characterized by general cyclical recession, comparable in pace of output contraction to that experienced in the 1948-49 and 1953-54 recessions.

More is known now about the over-all decline in GNP after the third quarter. Both the dollar and physical volume of total product were off about \$6 billion, annual rate. Most of the fourth quarter's decline was associated with inventory liquidation, since final purchases of product receded only moderately.

With inventory liquidation a dominant feature of the past quarter, declining sales of manufacturing industry were to be expected. November sales were down 2-1/2 per cent from October, with declines widespread among both durable and nondurable lines. Sales declines outpaced inventory reduction; hence, stock-sales ratios rose significantly further. New orders on durable goods manufacturers in November were about the same as in the preceding two months, but they were well below the volume of shipments, so that order backlogs were cut back further.

Industrial production for December, on a seasonally adjusted basis, is given a preliminary estimate of 137. Declines

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were again widespread, with automobile assemblies this month working on the downside.

The automobile market generally has been disappointing to producers, with new car sales off significantly and used car sales off moderately from a year ago. Recently, used car prices have slipped back some. Repossessions on installment sales have reached historically high ground and seem still to be edging upward.

Other sales at retail, after a slow start in early December, apparently picked up sharply in the latter half of the month. Sales at department stores, seasonally adjusted, reached a new high, about 1-1/2 per cent above December of last year and 4 per cent ahead of November.

Construction activity in December continued at about record levels, with increases in residential construction again offsetting declines in industrial construction. While the price situation for newly constructed houses appears to be fairly firm, recent field reports indicate that prices on used houses continue to drift downward and also that selling time on new and used houses has slowed perceptibly. Vacancy rates, however, continue low and shortages of rental housing are reported. Although the secondary mortgage market appears to have bottomed out, no general loosening in the availability of residential construction or mortgage money has apparently set in as yet.

Unemployment at mid-December is reported at 3.4 million, up 200,000 from mid-November.

A continuing high level of new claims filed for unemployment benefits indicates further substantial unemployment rise since midmonth. For the third week of December, over 550,000 new claims were filed, the highest December figure for the postwar period. Toward the month end, some 2 million workers, or 60 per cent more than last year, were receiving unemployment compensation benefits.

Wholesale commodity markets in December were generally stable, the average holding about the level prevailing since midyear. Consumer prices for December are expected to show some further rise, reflecting further advances in prices of services and recent increases in retail meat prices.

Available data on international trade indicate that further decline occurred in November. Whether the decline in Western European industrial activity reported for October continued in November is not yet clear. Information has only become available for Germany and for that country activity was up in both October and November.

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With regard to the economic outlook, an increasing number of observers seem to be taking the sanguine view that recession will be mild and its duration not much longer than midyear. This optimistic viewpoint places great weight on the following factors; (a) adjustments in output, inventory, material prices, and manpower utilization that have already taken place; (b) the revived strength of residential construction; (c) the continuing growth of State and local government expenditure; (d) the prospect for higher armament expenditures; (e) the strength of consumer demand in the face of declining personal income; and (f) the resistance of European industrial activity to recessionary tendencies in world trade and in the U. S. economy. While this view of the outlook may prove to be a correct one, it would seem premature to accept it now. More testing of price levels, inventory holdings, excess margins of industrial capacity, consumption and housing demands, and international trends would seem to be called for, as well as a more definite consensus on a revised national security program, before too firm a commitment to any future pattern of economic development is made.

Chairman Martin next called upon Mr. Thomas who made a statement on recent financial developments substantially as follows:

The picture of the economic situation portrayed by Mr. Young shows that a lessening of restraints on credit has been appropriate. In the financial area the response to the reduction in Federal Reserve Bank discount rates has been remarkable. It has been followed by two striking financial developments. The first is the sharp decline in interest rates and the second is a substantial increase in bank credit. The two are to some extent interrelated, but in a sense are conflicting. Both could hardly happen contemporaneously unless there were an easing of monetary policy. Hence, they can be largely attributed to the policy change and are the types of response that would tend to make the policy effective in "cushioning adjustments and mitigating recessionary tendencies in the economy."

The decline in interest rates, which is probably the sharpest on record for so short a period, has been widespread in the open markets for money, i.e., in yields on securities and open market paper, but has not yet been reflected in what may be called the administered rates--bank loans to customers

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and mortgages. Yields on outstanding long-term bonds are back to approximately the lowest levels of last February but still generally above levels prevailing before mid-1956. Thus it is difficult to say that rates are low by any postwar standards, though they were not high relative to the 1920's.

The sharpest declines have occurred in yields of those issues that had previously risen most--particularly medium-term U. S. Treasury securities and State and local Government issues. There was some hesitation in the declining tendency during the mid-December period of heavy liquidity needs, but only bill rates showed any increase and that was short-lived.

These changes in prices and yields of securities have been due more largely to anticipations rather than to any actual change in basic demand and supply factors. In this sense they may be speculative. To some extent savings held idle awaiting investment have been put to use in recognition of the view that interest yields had reached a peak and would fall. To a large degree the buying of securities has been based on bank credit. Since mid-November city banks have increased their holdings of Government securities by about 1.5 billion, of other securities by \$300 million, and their loans on securities by nearly \$700 million. Much of the increase in security loans has been to dealers in Government securities, which have also borrowed from other sources, including \$600 million in repurchase contracts at the Federal Reserve Bank. Outright purchases in the System Account also increased by over \$400 million.

As a result of the increases in holdings of securities and in loans on securities, accompanied by a substantial seasonal rise in commercial loans, total loans and investments of banks in leading cities increased by over \$2.9 billion in the five weeks ending December 31, using partial figures for the latest week. This is twice the increase shown in the corresponding period of each of the two previous years. While much of the increase may be attributed to seasonal factors, the marked turnaround from the contra-seasonal declines shown in October and November is striking. Much of it is no doubt to be attributed to a changed climate of viewpoint. A large portion of the increase in bank holdings of securities and also in dealer positions has been in Treasury bills, which have helped to meet the seasonal liquidity demands, while the growth in other issues, which may be considered as speculative, has been much less though substantial.

Issues of new securities continued in fairly substantial volume during December, although the calendar was light during

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the holiday period. A heavy volume of issues is scheduled for January.

Many of the funds supplied by the increase in bank credit have gone to build up Treasury balances and it appears likely that the private money supply failed to show the usual seasonal growth in December. It is difficult, however, to draw definite conclusions as to money supply figures around the end of the year because of the wide variations that can result from differences in reporting days. Figures for the four weeks ending December 25, for example, show a much smaller increase in demand deposits adjusted at city banks than for the period ending December 26 last year, but preliminary figures for the five weeks ending January 1 show a much larger increase than in last year's period ending January 2. Deposits are generally drawn down before Christmas, increase sharply in the subsequent week, and are drawn down again in the early days of January.

It seems most likely that the money supply will have shown a net decline for the year 1957. Yet the build-up of Treasury deposits in December, which is not usual for that month, may supply the basis for a shift of funds to other deposits in the next few weeks when the Treasury balance will be sharply reduced. Some of the funds, however, may be used to reduce loans at banks. If banks have adequate reserves, they will probably endeavor to maintain the total of their loans and investments. In brief, recent policies have established the basis for maintaining the privately-owned money supply, even though the result has not yet been attained.

In the first half of January the total cash balance of the Treasury will probably be reduced from about \$3.6 billion to \$1.5 billion, notwithstanding continued new borrowing of \$100 million a week on Treasury bills and the obtaining of nearly \$200 million of cash from the new FNMA issue. Additional borrowing and perhaps the use of the Treasury's free gold will be needed around the middle of February to keep the balance from falling much below the \$1.5 billion level. Because of debt ceiling limitations, not much borrowing will be possible until the middle of February, then about \$1 billion of new borrowing may be sufficient to hold the line until the end of March, although at times in the early part of February and again in March occasional borrowing on special certificates from the Federal Reserve may be needed. The amount of such special borrowing could be reduced by the use of free gold or the willingness of the Treasury to let its balance decline further.

In the six weeks ending January 1, the System supplied over \$1 billion of reserves through open market operations,

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including \$600 million of repurchase contracts. Reserve needs due to the seasonal currency expansion were fully as large as, if not a little in excess of, seasonal estimates, and the increase in required reserves was larger than had been projected. Net borrowed reserves were reduced during the course of December to negligible amounts in the last two weeks. Member bank borrowings remained close to \$700 million, while excess reserves increased to that level. It may be said that the System supplied abundant reserves and that they were put to use through credit expansion.

Estimates of member bank needs for the next few weeks based on an assumption of the changes in Treasury balances that have been indicated and on normal seasonal changes in money in circulation, private deposits, and other factors, show the abundant availability of reserves usual for the early weeks of the year.

Some of these will be absorbed by maturities of outstanding repurchase contracts of about \$400 million this week and next. Beginning in the third week of January banks would have free reserves of \$400 million or more, unless absorbed by reductions in System holdings of bills through sales or runoffs at maturity.

Free reserves would rise to well over \$700 million in February and March, if the Treasury borrows from the System on special certificates in the amounts indicated or permits its balance at the Reserve Banks to decline below \$500 million.

Bills held in the System account now amount to about \$900 million. Sales of \$400 million will be needed this month to reduce free reserves to around zero. Additional sales would be required to reestablish net borrowed reserves and particularly to offset any special borrowing by the Treasury in February and March. It appears that sales of half a billion and more at times can be made without exerting restraint on the credit situation.

If the recent attempts by banks to maintain credit volumes should come to an end and bank credit should decline more than seasonally, then excess reserves should be permitted to accumulate. The Treasury bill rate, and other money rates, would decline further. In that event, in order to encourage banks to make any temporary reserve adjustments through borrowing rather than through credit liquidation, a further reduction in the discount rate would be appropriate.

Chairman Martin noted that we were approaching the time of year when the Committee would be making the annual review of its several

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continuing operating policies and techniques. He felt it would be appropriate to report this morning on the progress that had been made by the Special Committee appointed to study Mr. Mills' suggestion at the meeting on January 8, 1957, that the increment in the System Open Market Account during the year 1956 be converted into longer-term securities. As recorded in the minutes of the meeting on March 5, 1957, the Special Committee (Messrs. Martin, Hayes, Allen, Balderston, Erickson, and Szymczak) had been authorized to broaden its study to include a review of all of the operating procedures that had been presented in the report of the Ad Hoc Subcommittee as discussed at the meeting on March 4 and 5, 1953, with the exception of the matters relating to the housekeeping aspects of that report. In so far as the Special Committee was concerned, Chairman Martin said that thus far it had made very little progress. It was hoped, however, that when it met again on January 28, 1958, it would come to grips with the problems it had been studying. In any event, it was the Chairman's view that there should be a complete discussion of the problems the Special Committee had been studying at the time of the meeting in March when the new members of the Federal Open Market Committee elected by the Federal Reserve Banks for the year beginning March 1, 1958, assumed their duties. In anticipation of that, Chairman Martin suggested that it now be understood that a meeting of the Federal Open Market Committee would be

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held on Tuesday, January 28, 1958, that the meeting following that would be scheduled for Tuesday, February 11, 1958, and that the meeting at which the members of the Committee would be changed be scheduled for Tuesday, March 4, 1958, with the understanding that the afternoon of that day and as much of Wednesday, March 5, 1958, as might be necessary be devoted to meetings of the full Committee for the purpose of discussing the matters contained in the Ad Hoc Subcommittee report and the current operating procedures and techniques for the System Open Market Account.

Mr. Leedy said that if a Federal Open Market Committee meeting was held on February 11, a meeting of the Conference of Presidents would be held on February 10, 1958.

Chairman Martin also referred to the report that had been received by the Federal Reserve Bank of New York from the New York Clearing House Association (the so-called Temple Report) dated October 22, 1957, copies of which had been distributed to members of the Federal Open Market Committee by Mr. Hayes under date of November 15, 1957. This report, he noted, was an indirect outgrowth of the recommendations contained in the Ad Hoc Subcommittee's report, and he suggested that Messrs. Riefler, Thomas, Rouse, and Roelse be requested to review the report of the New York Clearing House Association with a view to having a preliminary discussion of its contents at the meeting of the Federal Open Market Committee to be held on

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Tuesday, January 28, 1958. The Chairman noted that in discussing this with Mr. Hayes, the latter had suggested the possibility of including a representative of the Treasury Department on this staff committee but that he (Chairman Martin), after discussing the matter with Secretary of the Treasury Anderson, felt that it would be wiser for the Open Market Committee to come to grips with the problem discussed in the Clearing House report before bringing in a Treasury representative. After the Open Market Committee had reached some tentative basis for its views as a Committee, the report might be taken up with the Treasury and after that, if it seemed desirable, there could also be meetings with the dealers in Government securities at which representatives of both the Treasury and the Federal Reserve would be present.

Mr. Hayes said that his reason for suggesting that the Treasury be brought into the analysis of the Temple Report at this stage was that he understood this report dealt largely with the subject of financing of dealers in United States Government securities by the banks. He had not thought of the Temple Report as having grown out of the Ad Hoc Subcommittee report but understood that it was the result of a request by former Secretary of the Treasury Humphrey, made on the occasion of a meeting in New York at which Mr. Humphrey had indicated that he did not think the banks were doing their part in financing dealers. Mr. Hayes said he did not feel strongly on

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the question, but he had been inclined to think it would be desirable to have Treasury representatives participate in the discussion of the Temple Report.

Chairman Martin said that, to clarify the point as to the origin of the Temple Report, Secretary Humphrey's suggestion at a meeting of the Clearing House Association in New York was a direct result of a conversation that he (Chairman Martin) had had with the Secretary on the report of the Ad Hoc Subcommittee. He had cleared this point with Mr. Humphrey recently. Mr. Humphrey subsequently talked with Mr. Sproul and the suggestion that resulted in the formation of the Temple Committee later was made at a Clearing House dinner which the Secretary attended.

Mr. Hayes said that he had not been aware that the background included the Ad Hoc Subcommittee report; in any event, he said he agreed it would be desirable for the entire Open Market Committee to go into the details of the Temple Report. Returning to the Chairman's earlier reference to the January 28 meeting of the Special Committee, Mr. Hayes said there was some question whether the full report by the staff committee that had been studying the facts of the experience with present operating procedures would be available by January 28, although Mr. Roelse was trying to expedite the completion of that report. (This staff committee, which was appointed at the meeting of the Federal Open Market Committee on May 23, 1956, pursuant to a suggestion made by Mr. Sproul at the meeting on May 9, 1956, consisted

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of Mr. Harold V. Roelse, Chairman; Mr. Tilford C. Gaines, Secretary; Mr. J. Dewey Daane; Mr. Robert Holland; and Mr. Donald C. Miller, with Mr. Riefler as Secretary of the Federal Open Market Committee expected, ex officio, to keep in touch with the committee's work.)

Chairman Martin said that, while this was a point to be considered, his suggestion was that the whole subject be moved out from the Special Committee that had been considering it to the full Open Market Committee by the time of the meeting in March when the new members would assume their duties. He felt that the report of the staff committee on experiences with operating procedures could be sufficiently summarized by January 28 to permit at least a preliminary discussion of the subject at that time.

After further brief discussion, it was understood that the program suggested by Chairman Martin would be followed and that at the meeting of the Federal Open Market Committee on January 28 there would be a preliminary discussion of the report submitted by the New York Clearing House Association, while at the time of the meeting to be held on March 4, 1958, the members of the Committee and the Presidents of the Federal Reserve Banks who were not members of the Committee would plan to be in Washington on both March 4 and March 5 in order to permit a full discussion of the matters that had been under study by the Special Committee appointed pursuant to Mr. Mills' suggestion at the meeting on January 8, 1957.

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Chairman Martin then turned to the discussion of the current economic situation and credit policy, and Mr. Hayes made a statement of his views substantially as follows:

It is now clear that the current recession is attributable largely to a decline in business plant and equipment expenditures, aggravated by an inventory cycle. What is not clear, however, is whether these influences are likely to spread to consumer spending and thus to produce a cumulative recession. There is uncertainty as to the probable speed of inventory adjustment, particularly by manufacturers. There is also much uncertainty as to the amount and timing of the expected increase in defense spending--although it does not seem probable that this will be a significant factor for several months at least. We should recognize the wide range of possible ways in which the recession may develop, and we would doubtless be prudent to assume that the next upturn may be a fairly long way off--to be preceded either by a continuing gradual decline or perhaps by a sideways movement after the current decline has run its course.

I shall not try to enumerate the various statistical developments on which these conclusions are based. Most of the recent data have been discouraging, but consumer spending in the Christmas season was well sustained and showed a less adverse reaction of consumers to bad news than might have been feared. Apparently one of the so-called "built-in stabilizers"--the tendency of transfer payments to offset much of the effect of greater unemployment and shorter hours--has been a significant sustaining influence.

Price developments in the last month or two have been disappointing, in that the upward trend has reasserted itself after several months of relative stability and in spite of the general slackening in business activity.

Bank credit has expanded more rapidly in the last three or four weeks than a year ago, thus reversing, at least temporarily, the typical pattern of recent months. For one thing, the growth in business loans was almost as large as last year--possibly because during periods of seasonal pressure, such as tax dates and the year-end, the present low level of corporate liquidity forces a relatively heavy borrowing program, whereas during other recent periods in which corporations have had no unusual disbursements to make, the lower level of business activity and prospects than a year ago has been controlling. There is also a

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possibility that expectations of a further decline in long-term rates may have induced some corporations to shift back to bank borrowing temporarily in the hope of obtaining still lower rates later on, and that this shift may have been facilitated by some easing in bank lending policies. Another factor making for additional bank loans has been the very high level of dealer inventories of Government securities, with greater recourse to banks, especially in New York, and less to non-banking corporations for financing the additions to these inventories. Bank holdings of Government securities have recently increased much more sharply than last year. Nevertheless, the total money supply at the year-end was probably about 1% less than at the end of 1956.

We are again approaching a time when our policies will have to take account of the Treasury's financing activities. Apart from the FNMA issue to be offered this week, I have in mind the very large refunding to be announced probably a few days after our next meeting--with the possibility of an announcement of a new cash financing. Our forecasts of Treasury receipts and expenditures make it seem more than ever essential that the debt limit be raised by several billion dollars at the earliest opportunity.

As for monetary policy, the System is faced with difficult decisions as to how fast it should push the easing of credit and as to the most appropriate sequence of use of the various instruments of policy. Clearly the present recession calls for a general policy directed toward assuring an adequate volume of credit for all potential borrowers with economically sound credit needs. This policy would be consistent with the evidence that business recession exists and that it may become more severe during 1958. To the extent that the quest for liquidity by banks and others affects the supply of and demand for credit, it might be necessary for the System to lean somewhat more heavily on the side of easier money than would otherwise be the case to achieve any given effect on the economy. On the other hand, we should stop short of injecting so much liquidity into the economy that it would be hard to recapture restraint if inflation should emerge again as the major problem--and we should also avoid creating a sloppy money market or a needlessly low structure of interest rates that would have adverse longer-run effects on savings and on investment returns.

I think that our policy should be directed toward further relaxation of restraint on bank reserves and the money market and that open market operations should be used to this end. It might be appropriate to think of zero net borrowed reserves as an initial benchmark, with

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free reserves of perhaps 100 or 200 million later in the month, especially if our actions to absorb excess reserves result in tight conditions in the money market. We should, I believe, from this time forward avoid any weekly averages showing net borrowed reserves, although daily deviations in that direction need not be avoided. As long as the weekly averages show net borrowed reserves, our policy can be interpreted as one of still maintaining a restrictive credit policy in some degree. This could be accomplished simply by failing to push outright bill sales as aggressively later in January as would be necessary to fully offset market factors making for greater reserve availability. Present projections suggest that after the run-off of repurchase agreements modest outright sales should suffice.

As for the discount rate, I recognize that if any change is to be made within the next few weeks, it should be done fairly promptly to avoid confusion in connection with the expected Treasury financing program. However, I feel strongly that the recent reduction in the discount rate has already led to a downward adjustment of market rates that, if anything, has proceeded too rapidly, and I can see no benefit from our taking aggressive action at this juncture to drive them down further. I think there is no cause for concern if the Treasury bill rate should stay well below the discount rate, especially during January when seasonal factors are acting as a strong depressant of the bill rate. In my judgment it would be best to leave the discount rate unchanged at this time. If economic conditions should continue to worsen and should later justify a lower rate, a reduction could be effected in February or March after the Treasury is out of the market.

We have had occasion recently to review in the New York Bank the question whether margin requirements under Regulations T and U might appropriately be reduced. It is our opinion that the present 70% requirement is abnormally high and that a prompt reduction to 50% would be justified both in terms of recent stock market performance and the use of stock market credit, and in terms of general credit policy.

I think there is wide acceptance of the view that reserve requirements are unduly high and that some reduction would be in order at such time as it would be consistent with our general monetary policy. A suitable opportunity may present itself after the return flow of funds to the banking system early in the year has run its course. I would suggest that the Board of Governors give consideration at that time--assuming that recessionary tendencies are then

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still dominant--to a reduction in reserve requirements, including some reduction in the present geographical differences in requirements, especially between central reserve city and reserve city banks. While some such move would seem desirable per se, I would also hope that progress might soon be made in reaching general agreement on a new and more equitable over-all system of reserve requirements.

Mr. Johns said there was little for him to report from the Eighth District that differed materially from the national picture except for the deterioration in cash farm income in certain portions of the district, particularly parts of Missouri and Arkansas. He described this deterioration, which had resulted largely from a decline in income from the cotton crop, as of intense local interest and as having little national significance, though it does have some. It had affected the local banks, which were not receiving pay-offs of last year's loans.

With respect to Committee policy, Mr. Johns said that he was in substantial agreement with the views expressed by Mr. Hayes. While he continued to be reluctant to make policy recommendations in terms of net borrowed reserves, Mr. Johns said that these figures did have some value and that a target such as Mr. Hayes had suggested would seem appropriate to him. More importantly, however, he would be reluctant to see interest rates react from their downward trend and move upward, and he would recommend that open market operations be conducted so as to prevent that happening. He would not wish to give any impression that policy was tightening even a little, but he was not now prepared to say that policy should be significantly easier, although he might have a different view at the next meeting of the

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Committee. For the present, he would like to hold about where we are and if this meant zero or some positive free reserves this would be satisfactory. He would not wish to have interest rates move up.

Mr. Bryan said that since the preceding meeting of the Committee there had been a further rise in insured unemployment in the Sixth District. The agricultural situation seemed to be worsening with the arrival of new figures showing cash receipts from farm marketings down 34 per cent as against the same time a year ago. Deposits at agricultural banks in rural areas in the district currently were well below last year and the year to year comparisons were becoming increasingly unfavorable. Agricultural banks in the Sixth District would have a heavy farm loan carryover, Mr. Bryan said, with further increases in loans collateralized by real estate. District production, trade, and financial developments, however, do not suggest a rapid acceleration of the present recessionary movement in the nonfarm economy.

With respect to national policy, Mr. Bryan said that the absence of clear, further economic deterioration would hardly appear to justify any policy of "pulling all the stops" at this time. Accordingly, he would not favor any further downward revision of the discount rate; and, although he believed the System should be alert to every opportunity to reduce reserve requirements, he could not urge such a policy in the light of the seasonal factors now operating.

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After commenting that no further change in the Committee's directive seemed needed at this time, Mr. Bryan continued his statement substantially as follows:

At the same time, I believe that the reserve position of the banking system needs to be eased through Open Market policy. We end the year with total reserves actually less than or negligibly different from what they were at the same time last year. The meaning of this situation is that the American banking system is less or at best no more able to support a deteriorated economy than it was at the end of 1957, when we were faced with the boom. If allowance be made, as I believe it must be made, for a growth factor in the economy, then the reserve situation is in my judgment quite unsatisfactory.

Accordingly, it would seem to me to be wise policy not to attempt an entire offset of seasonal factors tending to ease bank reserve positions. On the contrary, I would like to see the Open Market instrument operated in such fashion as would give us positive total-reserve comparisons when measured against year-ago dates. Such a policy would mean that we would not be primarily concerned with security-market yields--certainly not be frightened by "sloppy money"--and pay little or no attention to free reserves. I would like to see the situation allowed naturally to ease itself, even if, just for a figure, the bill rate drifted to 2.50 or below. At such a figure, I would be inclined to make sales and to review, in another few weeks, what our total reserve position on the year-to-year figures may prove to be in the light of our actions.

In advocating such an objective and method of action, I believe that it has certain advantages in avoiding dangers:

(a) It brings us back to a basis of action compatible with our Continuing Statements of Operating Policy, which must shortly be reviewed again;

(b) It avoids what I consider the grave danger that an increase in free reserves may occur, not because the credit situation has bettered but because the economic situation has worsened;

(c) It avoids the hazard of sales based on estimated magnitudes at a time when, aside from our usual difficulties of estimation, the meaning and extent of market factors seasonally affecting bank reserves are both especially elusive;

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(d) It will avoid what I regard as the greatest of all dangers, namely, that we will underestimate the effects of the present illiquid position of the American banking system and thus cause us ourselves to be satisfied with a policy inadequate to the task of making the banking system a dynamic factor in economic recovery.

In closing this statement I would like to say that our policy in the month of December seems to me to have been correct in trending the free reserve position downward towards zero. But I note that it has been inadequate in making any measurable impact on member bank borrowing, only a moderate impact on bank liquidity as measured by excess reserves, and I am disturbed by the fact that most of our policy in December has been effected by repurchase agreements.

I doubt that repurchase agreements, while a useful instrument, have any important function as an expression of monetary policy in combatting economic recession. At the moment, about the only beneficial effect that I can see in RP's is in permitting dealers to carry inventories, and it is arguable that that permission, when carried to the extent that we have used it, actually conceals from us the tightness of the monetary situation and entices us into thinking that we have done more to ease than we actually have.

Mr. Williams said that a single sentence summary of his report was that business activity continued to slow down. Contrary to this summary, department store sales during the four weeks of December were five per cent higher than a year earlier, and for the first eleven months of the year the total showed an increase of one per cent. Factory employment continued a downward trend. Unemployment in the State of Pennsylvania had been rising reflecting in part a seasonal trend. Employers were not expecting this trend to change before early spring. Automobile registrations were running below last year. In banking and finance, earning assets and deposits rose in the three weeks ending December 25 and business loans were up in this period with most of the increase accounted for by sales finance companies

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and utilities. Borrowings from the Reserve Bank were about the same as a year ago.

The continuing slowdown in business activity indicated to Mr. Williams that some further easing of open market policy would be desirable. He would view as an appropriate target for policy during the next three weeks a program that would keep the long-term bill rate at about 2.8 per cent with member bank borrowings in the \$400-\$500 million area and net free reserves perhaps around \$100 million. Any tightening, even temporarily, should be avoided. There should be no change in the discount rate at this time.

Mr. Fulton said that there was a pronounced feeling of disappointment in the heavy industries of the Cleveland District at this time regarding orders and production. The steel industry was operating at about 50 per cent of capacity, which was uneconomic. Orders for pipe which had been sold out into 1960 had practically disappeared through cancellations. Oil companies were not buying because of restricted production and they were also waiting for cheaper money. Warehouse inventories of steel were high at present, whereas users of steel generally had low inventories. No upturn, either in the steel industry or in the machine tool industry, was looked for in the immediate future, and it probably would be the fourth quarter of 1958 before such upturn developed. Unemployment was noticeably higher, but department store sales during the Christmas season were very good. Loan demand was holding up although banks now anticipate a gradual diminution in their

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loan totals during the next several months. Collections were being well maintained except in the case of wholesale loans to automobile dealers. There was talk of real estate money becoming more available, but portfolios were quite full. Contracts on new automobiles for thirty-six months or longer were a substantially smaller percentage of the total than had been the case earlier.

Pessimism seemed to be outrunning business at this time. Mr. Fulton said, the same as optimism earlier had outrun the statistics. His conclusions as to policy were that the discount rate should not be changed, that the Open Market Committee should maintain as near zero free reserves as possible, and that it should err on the side of ease. Some positive free reserves would be appropriate. Mr. Fulton would also like to see the bill rate a little under the discount rate.

Mr. Shepardson said that Mr. Fulton had covered a good deal of his opinion. Certainly there were many indications of some further down drift in business. On the other hand, we were still at a relatively high level. It could not be expected that year after year we would continue to make higher records, Mr. Shepardson said, and he was not disturbed at some little down drift. There was a good deal of uncertainty as to the Government's program and other spending programs and, with that uncertainty, it would be unwise to make other moves that would indicate a further easing of credit. Noting that Mr. Hayes had made a statement regarding the effects of changes in

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interest rates on future savings, Mr. Shepardson said that he would not wish to see interest rates drop to a point that would retard improvement in the volume of savings.

In view of the situation as he observed it and at the risk of seeming to be a "stick-in-the-mud," Mr. Shepardson said that he would not wish to see the Committee ease the situation materially further. He thought the target that had been mentioned of free reserves around the zero level should be adequate. There had already been a material drop. This would mean, Mr. Shepardson said, that he would not favor a change in discount rate at this time or any material further increase in free reserves. The zero target would seem appropriate.

Mr. Robertson then made a statement substantially as follows:

Since our last meeting, when I cautioned the Committee against easing too fast--believing that there exists a danger of exaggerating adjustments at a high level of economic activity into a major recession--we have seen a continuation of downward movements in some areas. The index of industrial production has moved down two points to 137, gross national product dropped by a \$6 billion annual rate figure below the third quarter level (though in fairness, one must point out, as did the staff in its memorandum to the Open Market Committee, that this drop from \$439 billion to \$433 billion is largely attributable to a shift from a moderate rate of inventory accumulation in the two preceding quarters to a modest liquidation (the word "modest" is my own), and unemployment has increased.

At the same time we have witnessed increases (1) of department store sales in December (to a new high), (2) of consumer prices (.45%), (3) in bank credit (exceeding that of December last year), (4) in residential construction (close to the level of late '56), (5) in consumer installment credit, (6) in rents, and (7) in outlays for construction.

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In addition, both demand deposits and time deposits increased in commercial banks during the year--e.g., time deposits increased \$5.5 billion in '57 as compared with \$2.2 billion in '56.

This does not add up to an entirely one-sided picture, but rather one of adjustments with recessionary tendencies.

None of us wants a recession, let alone a depression--not even to purge us of our past sins of inflation. No one wants to see people unemployed. We should cushion economic adjustments and mitigate recessionary tendencies in the economy in order to avoid undue unemployment, among other things. But we should do so with an eye to the future--a future which, in my opinion, will present for us inflationary problems of a magnitude greater than those of the last decade.

Any action we take should be so contrived as to preclude (if possible) (1) the feeling on the part of industry that we will provide all the money necessary to enable it to pass on to the consumer the amount of additional costs resulting from wage negotiations (as has been the case in the past), and (2) a feeling on the part of the people as a whole that we (the Federal Reserve) are so fearful of a recession that we will panic at the first sight of one and yet go to any length to put a floor under each succeeding inflationary rise, irrespective of the cause. No one will admit that that is what we are doing or what we have done in the past. Certainly we did not have that intention. But we should be aware and try to avoid that result.

Put another way, in dealing with a business recession of questionable magnitude and duration, we should not take our eyes completely off the long-term problem of inflation. We must remember that today there are in the economy many built-in stabilizers which will tend to mitigate the severity and consequences of economic slide-offs. For example, there was a time when unemployment even at present levels would have meant much more economically than it does today; witness the fact that two million of the unemployed are receiving unemployment benefits in dollars.

In walking the tight rope between inflation and depression the monetary authority must not have too strict a criterion of success. A very few months ago we were "fighting inflation." If there has been some pause in the necessity for the fight, possibly we should feel gratified rather than frantically taking steps to bring back the conditions we were so recently fighting.

This Committee needs to guard against being unduly influenced by statements of economists in the public press.

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These people feel impelled to say something whether they have anything to say at all and are subject to mob hysteria. They are particularly dangerous at this time of year when they feel especially impelled to say something about the forthcoming calendar year. It may be important to keep our eyes on the current facts rather than on forecasts which have a very poor historical record.

If rising prices be looked upon as an indicator of excessive total demand and falling prices as an indicator of inadequate demand, we see as yet no indication of a need for change in monetary policy. Neither wholesale prices as a whole nor consumer prices have declined.

In the light of the foregoing, plus my personal belief that the present recession is not nearly as serious as many economists and many writers portray it, and that the economy will turn around more rapidly than many seem to think, my counsel would be to maintain an even keel position, neither to increase nor to diminish the degree of tightness or ease which is presently being maintained with respect to bank reserves.

I am not urging that we take a backward step--one can never undo what has been done--but merely that we do not move further in the direction of ease until and unless we are more certain than I am that the increased availability of money resulting therefrom will be used for the positive purpose of cushioning recessionary tendencies rather than merely for the purpose of facilitating speculation in government bonds, the price of which has been drastically affected by our previous actions.

Mr. Mills said that in his opinion the admirable exposition that Mr. Thomas had given of the movement of reserves, the level of Federal Reserve Bank discounts, and the changes in the composition of commercial bank assets could be taken as a proper guide for near-run System policy. In that connection, he pointed out that negative free reserves had been reduced from an average of \$464 million last September to where there were positive free reserves at present. This was concrete evidence that the Federal Reserve System had made credit available in adequate quantities for the economy's needs and had also developed a supporting climate

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to the November reduction in the discount rate.

It could be important in policy formulation, Mr. Mills suggested, to bear in mind the System's experience that there is a very definite lag from the time reserves are made more freely available until the time that their effects begin to work through the structure of commercial bank lending and investment activities and on through the general economy. On that thesis, and emphasizing that the month of December always produced marked temporary fluctuations in the demand for bank credit that cloud the credit picture, the System's earlier actions might not be reflected fully before probably the latter part of this month. It could then become apparent that the effect of the System's previous actions had produced a greater degree of credit ease and maneuverability for the commercial banking system than the actual reserve figures before us might themselves indicate.

Mr. Mills cited the over-all willingness of commercial banks to retain U. S. Government securities in the face of a rather high level of borrowings at the Federal Reserve Banks as a development that gave promise of what should be the ultimately sustaining effects of the System's actions on the money supply. If bank loans should run off rather rapidly in January, it would then be in order to supply reserves so as to encourage commercial banks to expand their investments in U. S. Government securities and hence to nourish the money supply.

In accordance with his reasoning, Mr. Mills felt that if free reserves were held at around the zero level, they would be

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adequate to maintain the money supply and to permit reasonable freedom in commercial bank loan and investment activities. On that basis, he also thought that the interaction of the supply of reserves on interest rates might positively confirm an interest rate structure by the end of the month that had not been colored by the speculative factors that have influenced interest rate movements in recent weeks. If it was then reasonable to believe that the general interest rate structure had stabilized at a level below the present 3 per cent discount rate, a further quarter per cent reduction in the discount rate might be considered.

Mr. Leach said that the Fifth District economy continued in a recessionary movement. Production of textiles was curtailed in December, with shutdowns at Christmas of as much as a week. Prices in the hosiery industry continued on the weak side, and it was apparent that further elimination of production facilities must occur before the industry would be on a solid footing. Bituminous coal production in the district for the four weeks ended mid-December was 8 per cent under the previous four weeks and 12 per cent under a year ago. Declining employment and hours worked and increased unemployment claims corroborated signs of weakness in individual industries. Further corroboration was to be found in the behavior of business loans of district reporting member banks which had increased \$20 million during the last four weeks of 1957, compared with \$50 million in the corresponding period a year earlier.

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Mr. Leach went on to say that in such a recessionary period as Mr. Young had described there should be no doubt as to the System's posture. He favored a flexible credit policy and he felt we had one. Such a flexible policy should find expression in easier credit conditions. Interest rates have declined sharply, Mr. Leach noted, and if they were the sole indicator of credit conditions one might say that the System had eased sufficiently. The decline in rates had clearly outrun reserve availability, however, and some further easing in reserve positions seemed appropriate. He did not know how long the recession would last or how severe it would become, but he had the definite impression that more easing would be required and he saw some advantages in increasing reserve availability at this time rather than later. Mr. Leach said that he was not talking about much more ease, but as a bench mark he suggested \$150 million of free reserves, and he would favor moving to this position well in advance of the forthcoming Treasury financing. While he advocated a little more easing in the reserve position of member banks, Mr. Leach said that he wished to make it clear that he would not want the System to be excessively easy and thus to compound the problems of the future when we would again be combatting inflationary pressures. He could see no need to change the Committee's directive at this time, and he would not favor a reduction in the discount rate now.

Mr. Leedy said that a few developments in the Tenth District were contrary to the national trend. Tenth District cash receipts

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from farm marketings were up slightly this year over 1956, in contrast to the small decline in the nation. The explanation for the rise in the Tenth District was to be found in cattle marketings: increased cash receipts from livestock marketings had more than offset a decline in returns from crops. There had been a marked reduction this year in the Soil Bank Program and winter wheat acreage seeded was 26 per cent higher than a year ago with a preliminary crop estimate 49 per cent higher.

In banking developments district business loans continued to rise in the last few weeks of 1957. The reserve position of banks improved materially and borrowings from the Reserve Bank were reduced. Unemployment in the Tenth District had continued to rise but the rate seemed to be significantly lower than the national rate. Department store trade during the Christmas season was higher than in 1956.

As for System policy, Mr. Leedy felt that a program of ease should be continued in the period ahead although the System Account should offset the accumulation of reserves that would result from the seasonal developments this month. The aim should be for something better than a zero reserve position and should continue on the plus side, but the System should not contribute to any further sharp decrease in interest rates. The large holdings of Government securities dealers indicated some speculative activity in anticipation of a further decline in interest rates. Mr. Leedy felt that before too

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long it might become necessary to reduce the discount rate, but he would not suggest a change at this time.

Mr. Allen said that the development most worthy of mention at this time was in the retail trade field. Preliminary data indicated an upsurge in buying in the last few weeks before Christmas which carried sales for December well above the same month in 1956. This was true not only in major Seventh District cities but in the United States as a whole. While these preliminary figures covered only one economic area, they indicated a change in direction for the first time in four months and showed that the American people at this point were not frightened to the extent of curtailing expenditures.

Mr. Allen noted that leading figures in the automobile industry were reducing their 1958 production estimates downward in their public utterances, and he said that the downward reductions were even greater when they were speaking privately. One leading figure in the industry said privately last week that before the winter was over General Motors would undoubtedly cut production as Ford and Chrysler already had done. This individual had expressed the belief that the automobile business could improve by the end of the year if the Federal Reserve and Walter Reuther would relax, and he did not expect Mr. Reuther to relax. Mr. Allen said that Seventh District information on automobile credit differed from the situation

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found by Mr. Fulton, with reports from Seventh District bank lenders indicating a further softening in terms during November. The proportion of long-term contracts was continuing to increase, and available data on collections suggested a further rise in delinquents.

After pointing out that for the country as a whole business loans of weekly reporting member banks had risen 3.4 per cent in 1957 compared with 18.1 per cent in 1956, Mr. Allen said that in the Seventh District, the increase was 4.6 per cent in 1957 compared with 20.6 per cent in 1956. While business loan growth had been slow, investments in Governments and other securities and loans on securities had taken up the slack, at least at the large banks. In December, total credit growth at weekly reporting banks for the entire country amounted to \$2.4 billion, \$700 million more than a year ago, while in the Seventh District the net increase was only slightly above December 1956.

While on the subject of banks, Mr. Allen stated that from time to time during the past year several of the Reserve Bank Presidents had told him that policing of their discount windows had been made more difficult by complaints on the part of their larger banks that one of the large Chicago banks was a continuous borrower. Mr. Allen said that if as appeared likely that bank did not borrow or buy Federal funds today or tomorrow, it would mean that for four consecutive periods it would not have borrowed or purchased Federal funds, but on the other hand had sold Federal funds in substantial amounts.

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Turning to the question of Committee policy, Mr. Allen said he was still much concerned about the increase in consumer prices. He did not think this Committee or its actions had caused that rise and he did not think the Committee could take actions which would eliminate the other factors that had caused it, but he considered this rise so much more important than anything else that he would not like to see the Committee take any action that would contribute to a further rise in consumer prices. He would go along with the comments of several others in that he would dislike any further easing of the situation. At the preceding meeting, the Committee had decided on a target of zero negative free reserves and he would like to continue with that target.

Mr. Deming said that a lazy downward drift continued to characterize the Ninth District economy. There was no evidence that this downtrend had quickened in the past few weeks. Banking developments reflected the general economic situation. Credit had become somewhat easier. The largest savings bank in the district had reduced its rate on conventional mortgages and in general mortgage money was more available.

As to prospects, Mr. Deming said that the farm picture was bright: winter conditions had been good and the outlook for the winter wheat crop was excellent. Present estimates indicated a wheat crop in Montana 31 per cent larger than in 1957. Mr. Deming also reported two other developments which he thought worthy of note.

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First, one major manufacturing concern which had furloughed its workers called a substantial number back earlier than had been expected at the time the furlough began. Another major concern now contemplated something less in the way of layoffs than had been expected. The second factor that he thought worthy of note was that the largest bank in the district, which was organized along divisional lines, had just finished its divisional roundup on loan prospects, and the conclusion was that the total loan increase in the first part of 1958 would be as great as in the first part of 1957. Mr. Deming added the comment that this bank's management suspected the total result even though it did not particularly question the divisional estimates.

On the policy side, Mr. Deming said he also felt that the interest rate movement had gone a little too far a little too fast. Consequently he would not follow a policy at this immediate time aimed at or resulting in an even lower rate structure. He would not like an immediate change in the discount rate. However, he believed that open market operations should be conducted so as to leave a small positive free reserve level. If the downturn in rates that we had seen thus far represented more adjustment than would normally have been expected as a result of credit action, a positive free reserve position would not be inconsistent with no further decline in rates.

Mr. Mangels said that basically the Twelfth District was not as pessimistic as reports indicated for some other areas. The

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district had been experiencing a continuation of activity on the down side, but there was some indication of modification in the downward movement although no firming was yet apparent. The downtrend may have been overemphasized, he said, noting that in general the level of activity was still high even in some of the weaker areas. As to unfavorable factors, Mr. Mangels noted reductions in nonagricultural employment because of layoffs in the aircraft and related defense industries, adding that probably there would be further reductions. This had been mainly from natural attrition and lack of replacement of workers rather than from wholesale layoffs. Steel operations in the district were at 79 per cent of capacity. Mining companies had reduced production, some by lowering hours worked and others by reductions in the number of persons employed. In November, building permits declined from October and were below a year earlier. On the favorable side, Mr. Mangels reported that between October and November there was no change in unemployment in the district. For the first time in four years there had not been a seasonal increase in prices of Douglas fir lumber and one large plywood manufacturer had just announced a \$2.00 a thousand reduction in prices. On the whole, Mr. Mangels said that the lumber industry in the Northwest was considerably more optimistic at present than it had been a year ago about the next year's outlook. Department store sales in December were at the December 1956 level. Automobile sales were holding up fairly well, and agriculture was in very good shape although prices were down

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somewhat. The shipbuilding industry in both the Pacific Northwest and in southern California had shown considerable improvement.

With respect to banking, Mr. Mangels noted that a year ago bankers did not know too well what their borrowers' requirements would be and were conservative in their attitudes. Now they feel they have adequate loanable funds and are in position to take care of their customers in meeting expected demands during the next 30 to 60 to 90 days. One large San Francisco bank was now planning to expand its real estate mortgage portfolio by \$15 to \$20 million in the coming year. Pressure for loans was not nearly as great as a year ago according to some reports, Mr. Mangels said, although banks expect that the total outstandings will stay fairly close to the existing level. There was some talk of a reduction in the prime rate within the next 30 days and large corporations were currently operating on a hand-to-mouth basis, hoping to take advantage of any reduction that might come.

Although there were indications that there might be a little further slowdown, Mr. Mangels said that the problem seemed to him to be whether further credit ease would be constructive in the overall situation or whether the injection of more funds would merely generate speculation. His feeling was that the System should be cautious in supplying additional reserves; he would keep the free reserve level around zero but would prefer small amounts of negative free reserves rather than to have positive free reserves. He would

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make no change in the discount rate at this time, and he thought the Committee's directive was satisfactory in its present form.

Mr. Irons' appraisal of the national situation was that there had been further tapering off. This had been reasonably moderate in amount and the picture was not showing signs of cumulating. It was more in the nature of a rolling adjustment. He could see no disturbing dangers of an accumulating movement as of the moment.

As for the Eleventh District, the confidence quotient was not on the pessimistic side. A substantial majority of businessmen with whom this had been discussed in the past few days anticipated that 1958 would be a better year than 1957. A minority of perhaps 25 to 30 per cent anticipated a less satisfactory year. Most businessmen reflected a cautious optimism for the coming year. Those who were quite pessimistic were usually ones who were suffering substantial paper losses in the stock market, Mr. Irons noted, or ones who recently had traveled east of the Mississippi River.

Eleventh District department store sales in 1957 were 2 per cent ahead of 1956. Employment in December was above a year ago and above November but the increase was not as much as it had been a year ago. The number of insured unemployed had continued to increase somewhat. Construction activity had been maintained at a high level throughout 1957 and in December was 25 per cent ahead of November. Mortgage bankers were optimistic and felt that funds would be more available in the next year than they had been in the past year.

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Residential builders were particularly optimistic as to the outlook for \$10,000-\$12,000 houses. The oil industry felt that there might be improvement in 1958. Agriculture was in reasonably good shape. In summary, Mr. Irons found the outlook good or better in most areas. Banks were in a strong position and expecting strong loan demand. Deposits were up as of the most recent call date except in Dallas where a decline was shown because banks did not do so much window-dressing this time. Mr. Irons went on to say he did not mean to be painting a picture of another boom in the offing, but his was not a pessimistic report as had been indicated for some other parts of the country. Recent changes in the defense program were beginning to be felt with new orders having been received by Dallas District firms within the last ten days.

Mr. Irons said he would not advocate pressing ease or shifting further in the direction of ease at this time. Neither would he like to see a change in the discount rate or in reserve requirements in the immediate future, although he recognized it might be a difficult three or four week period. He had been satisfied with the degree of restraint achieved in the past three weeks, and he would hold a steady hand for the next three weeks, hoping that about the same degree could be continued for the present. The Desk should operate on the feel of the market. If possible, he would like to see the short-term interest rate structure somewhere around the

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discount rate. He agreed with the statements of Messrs. Robertson and Mills on that point.

Mr. Szymczak said that he felt the Federal Reserve had been pursuing the correct policy and that it should continue to pursue that policy, leading to zero free reserves and, as required, to a small amount of positive reserves. He did not think there should be a change in reserve requirements at this time. He did not think the Open Market Committee should move too fast because it would be disturbing to the interest rate structure and to the market, but it should not tighten up on the policy that it had been pursuing recently. With respect to margin requirements, Mr. Szymczak thought it would be desirable for the Board of Governors to undertake a discussion of that subject at an early date with the view to finding out whether this was a time for any change as had been mentioned by Mr. Hayes. Mr. Szymczak also said that he thought eventually the discount rate should be changed but that we were foreclosed from any such move for several weeks.

For the long-run, Mr. Balderston would like to see the money supply increasing again as an aid to fostering economic growth. This goal seemed to him to become more important as deposit turnover declined. The problem, however, centered in the timing of actions to achieve this objective.

The dilemma was that on the one hand the System should prevent the forces of recession from accumulating or from feeding on

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each other, especially in view of our adverse position in the cold war. On the other hand, Mr. Balderston felt that the economy could scarcely have purged itself of the wastes that had emerged from 1955-1956. This would be true even if the current recession were just an inventory recession. It was his belief, however, that the causes of the present difficulties extended beyond inventory imbalance and included excess capacity, compounded by foreign difficulties. In addition, wage negotiations in the coming months should be conducted in a noninflationary atmosphere without the illusion on either side as to the possibility of wage increases being passed on as price increases. Moreover, the sudden change in interest rates may have brought on expectations that the System would not wish to foster.

Mr. Balderston favored no change of discount rates and a zero target for negative free reserves for the immediate future. He supposed, however, that as in January of 1957 the free reserves would be substantial during the January return flow of funds, whatever the Account Management tried to do.

Chairman Martin said he thought the go-around had posed the problems for the Committee very clearly. We were dealing in small degrees. The Chairman regretted again that we had gotten into the use of net borrowed reserve figures. We talked about zero, \$50, \$100, and \$150 million, but under present conditions he thought these figures were quite meaningless. He agreed with Mr. Szymczak

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that the Committee had been pursuing the correct policy, and he certainly did not want any additional ease at the moment, but he also did not want to see the policy we had been following vitiated. That would confuse the public by making them think that the System might be returning to a tighter policy than had been followed in recent weeks. Mr. Balderston had pointed up this problem. Mr. Leach had expressed the feeling that we probably would get to an easier position. Chairman Martin said he would not put it in figures, but if we were pursuing a correct policy his personal preference would be to err on the side of ease rather than tightness, and he thought that would be consistent with the present position.

The Chairman suggested that the Committee should also bear in mind the projections with respect to the Treasury. While we could not forecast what the future would hold, there seemed to have been a resurgence of confidence around the end of the year. When he came through New York last week he observed a resurgence of confidence--even an impression that there might be a boom--because deficit financing of the Federal Government might become a factor soon. Some of the stock market operators had turned their sights around, although the Chairman said that he personally thought they were wrong.

In this connection, Chairman Martin suggested that all of those connected with the Committee should study the reports of the British Bank Rate Tribunal on the alleged leak very carefully. Events were moving very rapidly and the System could be subjected to sudden

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pressure to reduce the discount rate when the Treasury was about to go to the market. The only consistent position for the Committee, he felt, was to try to maintain a reasonably even keel during a period of a Treasury financing. The Federal Reserve must be very careful to do what it could to protect the bankers who were on the boards of directors of the Reserve Banks from being in a position of having inside information that could be used in this type of a market. This applied to margin requirements also. We must realize that speculators can profit or appear to profit if a leak or a charge of a leak gets out. He believed the best way to handle this situation would be to think of this in terms of an even keel for the System, even though there might be violent forces of gloom or the reverse, in the period of the Treasury financing which was not too far off.

The Chairman's reason for highlighting this point was that a number of the comments this morning had projected policy forward. It could be argued that it would have been better not to have changed the directive at the November meeting of the Committee before the last Treasury financing and to have tried to maintain about the same money market conditions during the period of the financing as before. However, we had done what seemed necessary, and what he was saying now was that it was necessary to bear in mind the Treasury's problem in the light of what had ensued at that time. He felt it very fortunate that we did not have a British bank rate leak, considering the people who were roaming around Washington at that time. He did not think we

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could approach the Treasury financing without realizing that these movements come very sharply and quickly.

With further reference to Committee credit policy, Chairman Martin said he recalled no one suggesting a change in the directive at this time. In implementing policy, he would be disposed to follow what he took to be the views of Messrs. Hayes, Leach, and Bryan, although he did not wish to pinpoint a figure. He thought there should be positive free reserves because this seemed to be the only consistent position. However, he would not want free reserves to be so positive as to indicate that the Committee was actively pursuing a more easy policy than it had been pursuing to date. The Chairman said that he recognized this was a difficult order to give to the Manager of the System Account in the light of the magnitude of funds floating around. He then asked for other suggestions as to the matter of degree and how to clarify the Committee's views, calling specifically on Mr. Rouse for his comments on operations.

Mr. Rouse said that both the Board's projections and those of the New York Bank indicate that this period should not be as difficult as last year. As of now, it looked as though the reduction in the System Account would have to be in the range of 1/4 to 1/2 billion dollars, largely through runs-offs rather than through sales, in order to maintain about the current position. The projection of average free reserves for this statement week was shown as plus \$30 million, but during the week the range might be from negative \$300 million to

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as much as positive \$300 million. Mr. Rouse said he thought the Desk could operate along the lines the Committee desired.

Mr. Allen noted that the Chairman had made the point that we should maintain an "even keel" during the Treasury financing. He inquired whether this indicated that, since we had eased up a little for some time, we should continue to ease.

Chairman Martin said this was not quite what he had in mind. What he was trying to say was that if there was to be additional ease, it had to come in the next couple of weeks on the positive side rather than waiting until after the Treasury financing was announced, or perhaps until the meeting to be held on January 28. Things are moving very quickly, he noted, and it might be that by January 28 a majority of the Committee would want to change the directive. He did not think we could make a change at that time in view of the Treasury financing. If he were carrying on the operation, he would operate with a little more positive reserves in the next couple of weeks but thereafter he would be moving toward an "even keel" right straight through the Treasury financing.

Mr. Allen said that he did not disagree, and he inquired as to how long the Chairman had in mind for this period of the Treasury financing. Chairman Martin responded that he thought it would be necessary to consider the period from the time of the Treasury's announcement of the refunding to several days after payment for the securities, and he asked Mr. Rouse for his views.

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Mr. Rouse said that he thought it would be necessary to allow a week or 10 days after the payment date. There was a certain amount of underwriting that would have to be done, and this should be the minimum period to allow for distribution of these securities to be completed. He went on to say that he thought the Treasury announcement on the refunding might come about February 1 and the new financing announcement might be simultaneous with the refunding.

Mr. Hayes commented that he thought the Committee had a pretty free rein for the next couple of weeks.

Chairman Martin said he might be overly sensitive, but since he might be up on the Hill at any time during the next couple of months he thought it very important not to be in a position of having taken decisions on actions to be taken in the future. In view of the speculative nature of this period, it was not only very important to avoid any leaks but also situations subject to leak.

Mr. Leach remarked that, in effect, we were fixing policy for the next five weeks, and Chairman Martin replied that it amounted pretty much to that.

Mr. Allen said that he would go along with making free reserves available in the plus \$100 million area during the next two weeks, contrary to what he had said earlier. However, he questioned whether at this time the Committee wished to determine that it will neither add to nor subtract from reserves in the period following our next meeting.

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Mr. Hayes suggested that the "even keel" of January 28 would be to stay where we were at that time.

Mr. Shepardson said that this was not the way he had understood the Chairman's statement. His impression was that the Chairman had in mind a line or a direction for continuing ease.

Chairman Martin stated that this was not what he intended. This could not be measured precisely, he said, but he did not think that during the Treasury financing the Committee should be either increasing or decreasing the degree of ease.

Mr. Shepardson inquired whether the Chairman felt that between now and the Treasury financing announcement there should be some further easing and, if so, whether it was correct that he would rather do it now than two or three weeks later.

Chairman Martin stated that this was correct. He would rather, in a moderate way, continue the policy we were now pursuing by having moderate positive reserves. He did not wish to cite a figure, but he did not think this was a status quo period. The return flow of currency started too many eddies in the stream and he thought that we were dealing with a rushing torrent.

Turning specifically to the Committee's directive and instructions to the account, Chairman Martin said that it was clear that all agreed there should not be a change in the directive at this time. He thought that the Manager of the System Account could be given some further guidance with respect to operations in this period, and he

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suggested that the majority appeared to be on the side of slight positive reserves. This was not a very firm majority, however, and if the question were put to a vote it might be by a majority of only one or two. He questioned whether this was the type of thing that the Committee should be voting on but he had no desire to keep anybody from putting anything into the record to express his views. He noted that the minutes would show the statements that the individuals had made during the meeting.

Mr. Hayes stated that he thought the System Account could operate along the lines of the Chairman's comments.

Mr. Robertson said that he would like the record to show that he was in complete agreement with respect to maintaining an "even keel" during the Treasury's financing operations. The comments he had made heretofore would go to the immediate future; he would not ease off in the next two weeks.

Chairman Martin stated that he thought that this had been a good go-around and that if there were no further comments the directive would be approved in its present form.

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,

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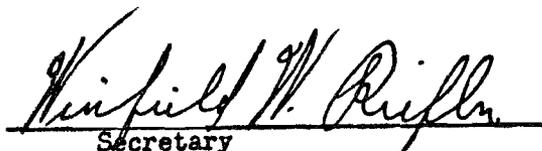
as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to cushioning adjustments and mitigating recessionary tendencies in the economy, 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.

The Chairman noted that the next meeting of the Committee would be held on Tuesday, January 28, to be followed by a meeting on Tuesday, February 11. On March 4, the Committee would meet at the time the newly-elected members assumed their duties and would plan to stay over on March 5.

Thereupon the meeting adjourned.


Secretary