

A meeting of the Federal Open Market Committee was held on Monday, August 4, 1958, at 3:00 p.m. This was a telephone conference meeting and each individual was in Washington except as otherwise indicated in parentheses in the following list of those participating:

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Irons (Dallas)
Mr. Leach (Richmond)
Mr. Mangels (Chicago)
Mr. Mills
Mr. Shepardson
Mr. Vardaman
Mr. Treiber, Alternate for Mr. Hayes (New York)
Mr. Allen, Alternate for Mr. Fulton (Chicago)

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Young, Associate Economist
Mr. Rouse, Manager, System Open Market Account (New York)
Mr. Kenyon, Assistant Secretary, Board of Governors
Mr. Keir, Acting Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Chairman Martin asked Mr. Rouse to review for the Committee conditions in the Government securities market, the color, feel, and tone of the market, and his plans for operations in the System Account.

Mr. Rouse replied that, to put the matter briefly, he might say that in a sense the Account Management had run out of a directive from the Committee, for redundant reserves had been recaptured. For the past four day he said, the market had not been very active and

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movements pricewise had been of a rather minor character, although today's price movements were probably a little wider than during the last three days of last week. There was some activity in Treasury bills at a definitely higher bill rate. The market began to feel a little sluggish last Friday due to a lesser availability of funds, largely stemming from a redistribution of deposits from the city to the country banks, and the market today reflected this same degree of relative tightness. The Treasury bill market had moved up 18 to 20 basis points, and in today's auction the average rate apparently would be a little above 1.15, with a stop-out at 1.20.

Mr. Rouse said that on the basis of the New York Bank's projections average free reserves for the current statement week would be about \$381 million, but for the following week the average would be about zero, primarily reflecting an increase in required reserves because of the increased Treasury tax and loan account balances resulting from sale of the tax anticipation certificates. Estimates of the Board's staff were higher, being \$565 million for the current statement week and approximately \$300 million for the following week, attributable principally to differences in estimates of required reserves. In this connection, he noted that recently the estimates of the Board's staff had developed to be somewhat the more accurate.

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Looking ahead, Mr. Rouse saw no real tightness in the money market. It appeared that funds were available below the discount rate.

Chairman Martin stated to Mr. Rouse that he thought the latter had handled the situation very well over the past few days, and Mr. Rouse commented in terms that the actions taken to recapture redundant reserves had reflected the views expressed by the members of the Open Market Committee.

Chairman Martin then said that the situation appeared to contain some elements of danger from the standpoint that System Account operations might overshoot their mark. When the figures came out, they might constitute something of a shock and the Manager of the Account therefore should be given considerable latitude, for he might want to buy for the Account in the next few days. Lower reserve levels should be sought, but in as orderly a way as possible and without undue disturbance to the Government securities market. It was possible that there might be another difficult period of open market activity.

Mr. Rouse stated that there was always that possibility, as the Committee realized in the discussions toward the end of last week. Nevertheless, the Committee had felt that the Account should sell as many bills as it could last week, and then, as Chairman Martin had suggested, do what was necessary.

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Chairman Martin then stated that when it came to a possible change in the policy directive there was some question in his mind about taking such action at a telephone meeting. There would be differences among the members of the Committee with regard to what certain words actually meant. Therefore, it seemed to him that it would be preferable to give the Manager of the Account maximum leeway within the framework of the existing directive and leave the directive unchanged until the meeting of the Committee on Tuesday, August 19.

Reference was made by Mr. Rouse to the comments made by the Committee members at the meeting on July 29, following which the Chairman said that, speaking for himself, he would want to give the Manager whatever authority he needed to move in the direction that the Committee was discussing at that meeting without causing any more disturbance in the market than necessary. The important thing, he said, was to have a meeting of the minds as to how operations in the Account were going to be conducted rather than to worry about exactly what was said at the last meeting. The Chairman then asked for expressions from the other members of the Committee, with the understanding that the comments would supersede what was said at the July 29 Committee meeting.

Mr. Treiber said that he was in agreement with the general appraisal by Chairman Martin of the difficulties with which System

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open market activities might be confronted. The international situation was still delicate, adjustment was still going on in the market, weak holdings of securities were still overhanging the market, and some holders of the 1-5/8 per cent certificates were seeking to dispose of them. The commercial banks would be gradually completing the underwriting process on the tax anticipation certificates by selling as demand developed. While he believed that there should be less ease than had prevailed, say a month ago, on the other hand he would want to avoid tightness that would cause any kind of unsettlement. He was delighted at the economic upturn that had become evident during the last couple of months and would like to see it continue at a stable rate. There had been adjustments of rates throughout the markets and he would not want to see them pushed too far by monetary action. It seemed desirable to have a continuation of free reserves at about the current level, say \$300 to \$400 million, without creating a feeling of tightness and while, of course, being alert to market developments.

Mr. Irons said he felt that what the Account had done in the past few days was entirely in line with the directive and the instruction given by the Committee. In his opinion the Account had done an excellent job in recapturing the reserves that the Committee regarded as redundant. It had accomplished the task quickly and apparently without untoward consequences thus far. He agreed with

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Chairman Martin that it was undesirable to move too fast and that one could not ignore the possibility of problems developing in the market as the figures unfolded. The important thing was the longer-run objective, even though it might be necessary to deviate from it from time to time, and judgment with regard to any such deviations should rest with the Manager of the Account. He should have a very considerable leeway to meet short-run spot situations as they appeared to be developing in the market, even though for a short period he was deviating from the major objective on which all of the members of the Committee appeared to be in substantial agreement. Mr. Irons said that he did not have any figure for free reserves in mind. The direction in which the Desk had been moving was desirable and in line with the major objective.

Mr. Mangels recalled that at the Committee meeting on July 29 he had said that he was hopeful of free reserves getting down to about \$500 million. In other words, something not too far from that might be satisfactory. He had not been thinking in terms as low as \$300-\$400 million, and he felt that somewhere between \$400 and \$500 million might be better. The Chairman had expressed the thought that System operations might have gone a little too fast, and the same thought had been in his own mind. He would consider it desirable to aim for free reserves between \$400 and \$500 million, with whatever latitude was needed by the Desk.

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Mr. Allen stated that the Desk had been more successful than he had thought possible in getting rid of redundant reserves. However, just because it had gotten rid of them he did not think that a change in the directive until the next Committee meeting was necessary. He would leave the directive alone. He felt that the Manager of the Account should have considerable latitude with respect to free reserves, going between \$300 and \$600 million in the light of market conditions.

Mr. Leach expressed the view that what had been done by the Desk was fine and that it was fortunate that the Desk had found it possible to get rid of redundant reserves so quickly. General policy, he felt, ought to be one of less ease. He thought that the estimated \$381 million free reserve level was all right for this week, and that next week there would not be too much of a problem, although free reserves should not be allowed to get down to zero. While he was in favor of a lower level of free reserves, he would not want to get there too rapidly, for he would not want to upset the market. If there was an understanding that the Committee was working toward lower levels of free reserves, and if some figure was kept in mind as a general benchmark for the Manager of the Account, that in his opinion was about as good a directive as the Committee could give. As to the policy directive, he felt that it would be difficult to agree on language over the telephone.

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His thought would be to suggest \$400 million of free reserves just as a benchmark, with plenty of leeway to vary from that level. As he had said, he would not want free reserves to get down to the zero level.

Mr. Vardaman said that the primary objective of the Desk, as expressed in the last Committee directive, was to eliminate redundant reserves. That having been accomplished, there was the problem of establishing an interim policy to last until further notice or until the meeting of the Committee on August 19. He would dislike to change the policy directive at a telephone meeting, and it seemed to him that the best that could be done was for all of the Committee members to express their thoughts. For his own part, he would say that the objective of the Desk from now on should be to see that redundant reserves did not return and to maintain free reserves in a range somewhere between \$400, or perhaps \$300, million and \$600 million, with the understanding that the Desk had to have the very broadest leeway in operating the Account.

Mr. Mills said that he was very much in agreement with Chairman Martin's reasoning which would, as he understood it, contemplate tapering down on free reserves but always bearing in mind the risks that were involved if doing so would produce too tight a market. Especially in his own mind was the probability that a recovery, if it took hold, would at some point involve an expansion

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of commercial bank credit to commerce and industry. When that point was reached, it would be necessary to have a reserve atmosphere that would accommodate those needs, with the greater part of an expanding volume of bank credit provided for by commercial banks from their recently increased holdings of United States Government securities. If that were done, and if the expansion of bank credit contained within reasonable limits, System policy would have permitted the divestment of such securities without creating a market so tight as to defeat its own purpose by involving the commercial banks in heavy depreciation costs. The commercial banks must be in the forefront of System policy decisions formulated to avoid a market tightness that would handicap their operations. In addition, there were the approaching and continuing needs of the Treasury which the System has a first responsibility to accommodate.

Mr. Shepardson said he was extremely gratified that the Desk had been able to recapture redundant reserves so promptly. This had been accomplished far more expeditiously than he had thought possible. With regard to the directive, he felt that it was still adequate to meet the situation, and he would prefer not to change it at a telephone meeting. The Committee seemed to be in agreement that the trend should be in the direction of less ease than had prevailed, but he was concerned that the movement

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not be too precipitate. The differences in the reserve projections of the Board's staff and the New York Bank indicated uncertainty as to what level might eventuate. In the circumstances, he would leave considerable leeway and discretion in the hands of the Management of the Account with a view to maintaining a favorable market atmosphere, generally trending in the direction that the Committee had discussed.

Mr. Balderston said that he too was gratified with the results that the Desk had been able to achieve in so short a time. Because of the differences in the reserve projections of the New York Bank and the Board's staff, he had the feeling that the Committee should leave discretion with the Desk, but he would hope that between now and August 19 the Desk could aim at some reduction of free reserves, using as a guide \$200-\$400 million. He noted that the projection of the Board's staff was \$296 million during the week when the New York Bank estimated net borrowed reserves of \$9 million. Therefore, he felt that the Committee could not pinpoint a target for the Desk and merely must indicate a general direction. He hoped it would be possible so to conduct operations as to preserve a neutral attitude, which to him meant neither ease nor restraint until the Committee could see more clearly how business was going to be after Labor Day. Until that time he would like to see neutrality, which in about a month should mean free reserves of zero.

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Chairman Martin said that he thought the main point was the matter of atmosphere and conditions in the Government securities market. There was some question in his mind about Mr. Balderston's free reserve range of \$200-\$400 million, but in any event he did not think the level was as important as the nature of the market that resulted from it. He recalled that the Committee had experienced great difficulty from being more or less tied to a free reserve figure of \$500 million. One should be careful, he said, about projecting anything. He said that he would like to have Mr. Rouse's feeling about trying to move in the direction of less ease, but doing so with a minimum of upset to the Government securities market.

Mr. Rouse said that much depended on what expectations were generated in the market. Last week average free reserves were at the level of \$530 million and this week they would be more like \$400 million, but he did not think that would cause much disturbance. It was really a matter of playing by ear. He thought that the Account Management understood what the members of the Committee had in mind and that the Management could get along without any change in the directive at this time. In the sense that Mr. Vardaman pointed it up, to keep from having redundant reserves would be quite a good directive. As he saw it, the Desk could function with that understanding, and the Committee

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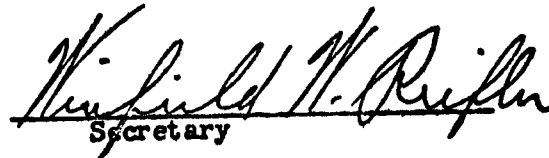
could get together quickly if necessary.

Chairman Martin then asked Mr. Rouse if he felt sure that he had a sufficient understanding of what was in the minds of the Committee members in order to proceed, and Mr. Rouse replied in the affirmative. It would, he said, require a good deal of leeway.

Chairman Martin then stated that he thought it was clear that the majority of the Committee did not want to tie the Management of the Account to any precise free reserve figure.

In conclusion, Mr. Rouse said that he would proceed according to his understanding of the Committee's thinking.

Thereupon the meeting adjourned.


Secretary