

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, March 3, 1959, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Deming
Mr. Erickson
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Bryan, Alternate for Mr. Johns

Messrs. Bopp, Fulton, and Leedy, Alternate Members of the Federal Open Market Committee

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Jones, Marget, Parsons, Roosa, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Special Assistant to the Board of Governors
Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Ellis, Storrs, Baughman, Tow, and Walker, Vice Presidents of the Federal Reserve Banks of Boston, Richmond, Chicago, Kansas City, and Dallas, respectively

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Messrs. Balles and Einzig, Assistant Vice Presidents of the Federal Reserve Banks of Cleveland and San Francisco, respectively
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia
Mr. Brandt, Economist, Federal Reserve Bank of Atlanta

In the agenda for this meeting, the Secretary reported that advices of the election by the Federal Reserve Banks for a period of one year commencing March 1, 1959, of members and alternate members of the Federal Open Market Committee had been received and that it appeared that they would be legally qualified to serve after they had executed their oaths of office. Prior to the meeting, each newly elected member and alternate member except Mr. Johns had executed the required oath of office.^{1/} The members and alternate members were as follows:

J. A. Erickson, President of the Federal Reserve Bank of Boston, with Karl R. Bopp, President of the Federal Reserve Bank of Philadelphia, as alternate member;

Alfred Hayes, President of the Federal Reserve Bank of New York, with William F. Treiber, First Vice President of the Federal Reserve Bank of New York, as alternate member;

Carl E. Allen, President of the Federal Reserve Bank of Chicago, with Wilbur D. Fulton, President of the Federal Reserve Bank of Cleveland, as alternate member;

Delos C. Johns, President of the Federal Reserve Bank of St. Louis, with Malcolm Bryan, President of the Federal Reserve Bank of Atlanta, as alternate member;

^{1/} Mr. Johns executed the oath of office on March 5, 1959.

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Frederick L. Deming, President of the Federal Reserve Bank of Minneapolis, with H. G. Leedy, President of the Federal Reserve Bank of Kansas City, as alternate member.

Upon motion duly made and seconded, and by unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 29, 1960, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Wm. McC. Martin, Jr.	Chairman
Alfred Hayes	Vice Chairman
Winfield W. Riefler	Secretary
Elliott Thurston	Assistant Secretary
Merritt Sherman	Assistant Secretary
Kenneth A. Kenyon	Assistant Secretary
Howard H. Hackley	General Counsel
Frederic Solomon	Assistant General Counsel
Woodlief Thomas	Economist
Homer Jones, Arthur W. Marget, George W. Mitchell, Franklin L. Parsons, Robert V. Roosa, Parker B. Willis, and Ralph A. Young	Associate Economists

Upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after February 29, 1960.

Upon motion duly made and seconded, and by unanimous vote, the selection by the Board of Directors of the Federal Reserve Bank of New York of Mr. Rouse as Manager of the System Open Market Account was approved.

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The minutes of the meeting of the Federal Open Market Committee on February 10, 1959 were then presented for approval. Chairman Martin called attention to the fact that there had been a change in the voting membership of the Committee since that meeting, four of the present members having served as alternate members during the past year. Some years ago, he noted, it had been the practice to have a meeting of the outgoing Committee in late February of each year in order to ratify actions taken up to that time. However, Counsel had advised that such ratification (including the approval of minutes for a meeting of the outgoing Committee) could be done by the new Committee equally as well as by the old one, and since 1952 this practice had been followed. The Chairman said that, while there was no question as to the appropriateness or legality of the present procedure, he was mentioning the point at this time in order that all members of the Committee and the Reserve Bank Presidents not currently serving as members would have in mind the basis for the procedure now being followed.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on February 10, 1959, were approved.

Chairman Martin referred to a memorandum distributed under date of February 25, 1959, relating to the procedure authorized at the meeting on March 2, 1955 whereby, in addition to members and

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officers of the Committee and Reserve Bank Presidents not currently members of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or of a Federal Reserve Bank with the approval of a member of the Committee or other Reserve Bank President, with notice to the Secretary.

At the Chairman's suggestion, it was understood that this subject would be considered later during this meeting, along with the question of distribution of the weekly open market report prepared by the Federal Reserve Bank of New York and the reports prepared by the Manager of the System Open Market Account prior to each meeting of the Federal Open Market Committee.

At Chairman Martin's suggestion, consideration was then given to the continuing authorizations or statements of operating policies of the Committee customarily reviewed at the first meeting in March of each year, and the actions as set forth subsequently in these minutes were taken concerning the matters that had been listed in the agenda for review at this meeting.

It was agreed unanimously that no action should be taken at this time to amend or terminate the resolution of November 20, 1936, authorizing each Reserve Bank to purchase and sell, at home and abroad, cable transfers, bills of exchange, and bankers' acceptances payable in foreign currencies to the extent that such purchases and sales may be deemed to be necessary or advisable in connection with the establishment, maintenance, operation, increase, reduction, or discontinuance of accounts of Federal Reserve Banks in foreign countries.

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It was agreed unanimously that no action should be taken at this time to amend or terminate the procedure for allocation of securities in the System Open Market Account, as adopted pursuant to the action of the Committee on June 11, 1953, it being understood that the re-allocation to be made as of April 1, 1959, would be based on the ratios of each Reserve Bank's daily average of total assets to the total for all Reserve Banks for the period March 1, 1958-February 28, 1959.

Unanimous approval was given to continuation of the authorization to the Manager of the System Account to engage in transactions on a cash as well as a regular delivery basis.

The Committee approved by unanimous vote a renewal of the existing authorization to the Federal Reserve Bank of New York to enter into repurchase agreements with nonbank dealers in United States Government securities, subject to the following conditions:

1. Such agreements
 - (a) In no event shall be at a rate below whichever is the lower of (1) the discount rate of the Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of three-month Treasury bills;
 - (b) Shall be for periods of not to exceed 15 calendar days;
 - (c) Shall cover only Government securities maturing within 15 months; and
 - (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.
2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.
3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System Open Market Account.

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The Committee approved by unanimous vote a renewal of the authorization to the Federal Reserve Bank of New York (last renewed March 4, 1958, and amended December 2, 1958) to purchase bankers' acceptances and to enter into repurchase agreements therefor. The authorization was as follows:

The Federal Open Market Committee hereby authorizes the Federal Reserve Bank of New York for its own account to buy from and sell to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, at market rates of discount, prime bankers' acceptances of the kinds designated in the regulations of the Federal Open Market Committee, at such times and in such amounts as may be advisable and consistent with the general credit policies and instructions of the Federal Open Market Committee, provided that the aggregate amount of such bankers' acceptances held at any one time by the Federal Reserve Bank of New York shall not exceed \$75 million and provided further, that such holdings shall not be more than 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York.

The Federal Open Market Committee further authorizes the Federal Reserve Bank of New York to enter into repurchase agreements with nonbank dealers in bankers' acceptances covering prime bankers' acceptances of the kinds designated in the regulations of the Federal Open Market Committee, subject to the same conditions on which the Federal Reserve Bank of New York is now or may hereafter be authorized from time to time by the Federal Open Market Committee to enter into repurchase agreements covering United States Government securities, except that the maturities of such bankers' acceptances at the time of entering into such repurchase agreements shall not exceed six months, and except that in the event of the failure of the seller to repurchase, such acceptances shall continue to be held by the Federal Reserve Bank or shall be sold in the open market. Such repurchase agreements shall be at the same rate as that applicable, at the time of entering into such agreements, to repurchase agreements covering United States Government securities.

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The Committee approved by unanimous vote the continuation without change of the existing authorization for fixing the rate charged on special short-term certificates of indebtedness purchased direct from the Treasury pursuant to paragraph (2) of the Committee's directive, whereby such rate would be $1/4$ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchase.

The Committee reaffirmed by unanimous vote the authorization for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account temporarily in case the Federal Reserve Bank of New York was unable to function, such authorization having first been given on March 1, 1951, and having been renewed in March of each year since.

The following resolution to provide for the continued operation of the Federal Open Market Committee during an emergency was then reaffirmed by unanimous vote:

In the event of war or defense emergency if the Secretary or Assistant Secretary of the Federal Open Market Committee (or in the event of the unavailability of both of them, the Secretary or Acting Secretary of the Board of Governors of the Federal Reserve System) certifies that as a result of the emergency the available number of regular members and regular alternates of the Federal Open Market Committee is less than seven, all powers and functions of the said Committee shall be performed and exercised by, and authority to exercise such powers and functions is hereby delegated to, an Interim Committee, subject to the following terms and conditions.

Such Interim Committee shall consist of seven members, comprising each regular member and regular alternate of the Federal Open Market Committee then available, together with an additional number, sufficient to make a total of seven, which shall be made up in the following order of priority from those available: (1) each alternate at large (as defined below); (2) each President of a Federal Reserve Bank not then

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either a regular member or an alternate; (3) each First Vice President of a Federal Reserve Bank; provided that (a) within each of the groups referred to in clauses (1), (2), and (3) priority of selection shall be in numerical order according to the numbers of the Federal Reserve Districts, (b) the President and the First Vice President of the same Federal Reserve Bank shall not serve at the same time as members of the Interim Committee, and (c) whenever a regular member or regular alternate of the Federal Open Market Committee or a person having a higher priority as indicated in clauses (1), (2), and (3) becomes available he shall become a member of the Interim Committee in the place of the person then on the Interim Committee having the lowest priority. The Interim Committee is hereby authorized to take action by majority vote of those present whenever one or more members thereof are present, provided that an affirmative vote for the action taken is cast by at least one regular member, regular alternate, or President of a Federal Reserve Bank. The delegation of authority and other procedures set forth above shall be effective only during such period or periods as there are available less than a total of seven regular members and regular alternates of the Federal Open Market Committee.

As used herein the term "regular member" refers to a member of the Federal Open Market Committee duly appointed or elected in accordance with existing law; the term "regular alternate" refers to an alternate of the Committee duly elected in accordance with existing law and serving in the absence of the regular member for whom he was elected; and the term "alternate at large" refers to any other duly elected alternate of the Committee at a time when the member in whose absence he was elected to serve is available.

Unanimous approval was also given
to a renewal of the resolution set forth
below authorizing certain actions by the
Federal Reserve Banks during an emergency:

The Federal Open Market Committee hereby authorizes each Federal Reserve Bank to take any or all of the actions set forth below during war or defense emergency when such Federal Reserve Bank finds itself unable after reasonable efforts to be in communication with the Federal Open Market Committee (or with the Interim Committee acting in lieu of the Federal Open Market Committee) or when the Federal Open Market Committee (or such Interim Committee) is unable to function.

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(1) Whenever it deems it necessary in the light of economic conditions and the general credit situation then prevailing (after taking into account the possibility of providing necessary credit through advances secured by direct obligations of the United States under the last paragraph of section 13 of the Federal Reserve Act), such Federal Reserve Bank may purchase and sell obligations of the United States for its own account, either outright or under repurchase agreement, from and to banks, dealers, or other holders of such obligations.

(2) In case any prospective seller of obligations of the United States to a Federal Reserve Bank is unable to tender the actual securities representing such obligations because of conditions resulting from the emergency, such Federal Reserve Bank may, in its discretion and subject to such safeguards as it deems necessary, accept from such seller, in lieu of the actual securities, a "due bill" executed by the seller in form acceptable to such Federal Reserve Bank stating in substantial effect that the seller is the owner of the obligations which are the subject of the purchase, that ownership of such obligations is thereby transferred to the Federal Reserve Bank, and that the obligations themselves will be delivered to the Federal Reserve Bank as soon as possible.

(3) Such Federal Reserve Bank may in its discretion purchase special certificates of indebtedness directly from the United States in such amounts as may be needed to cover overdrafts in the general account of the Treasurer of the United States on the books of such Bank or for the temporary accommodation of the Treasury, but such Bank shall take all steps practicable at the time to insure as far as possible that the amount of obligations acquired directly from the United States and held by it, together with the amount of such obligations so acquired and held by all other Federal Reserve Banks, does not exceed \$5 billion at any one time.

Authority to take the actions above set forth shall be effective only until such time as the Federal Reserve Bank is able again to establish communications with the Federal Open Market Committee (or the Interim Committee), and such Committee is then functioning.

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By unanimous vote, the Committee reaffirmed the authorization given at the meeting on December 16, 1958, providing that System personnel assigned to the Office of Civil and Defense Mobilization Classified Location (High Point) on a rotating basis have access to the resolutions (1) providing for continued operation of the Committee during an emergency and (2) authorizing certain actions by the Federal Reserve Banks during an emergency.

Chairman Martin noted that there was being presented to the Committee for review the resolution adopted on June 21, 1939, requesting the Board of Governors to cause its examining force in the future to furnish the Secretary of the Federal Open Market Committee a report of each examination of the System Open Market Account. He commented that the procedure then established had been followed up to the present time, that there had been no suggestion for a change, and that it would seem appropriate to continue the procedure without change.

There was unanimous agreement that no action be taken to change the existing procedure.

Chairman Martin then presented for the approval of the Committee the following continuing operating policy that had last been reaffirmed at the meeting on March 4, 1958:

a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

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Upon motion duly made and seconded, and by unanimous vote, the foregoing statement of policy was reaffirmed.

There was also presented for the consideration of the Committee the following continuing operating policy that had last been reaffirmed at the meeting on March 4, 1958:

b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

Mr. Hayes recalled that at the meeting on March 4, 1958, he had stated that while he would not vote to approve the statement in its present form, he would vote to approve a similar statement if it included the qualifying phrase "as a general rule" after the word "shall" in the second line and after the word "shall" in the fifth line. However, the other members of the Committee were not disposed at that time to make those changes.

Mr. Hayes said that, without going into the merits of the matter, he continued to have the same reservations as a year ago. There was no acute problem, but he had not changed his view that there should be more flexibility in the statement.

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Thereupon, upon motion duly made and seconded, the foregoing statement of policy was reaffirmed, Mr. Hayes voting "no" for the reason he had indicated.

There was next presented for consideration the following continuing operating policy:

c. Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Mr. Hayes noted that at the meeting on March 4, 1958, he had also expressed a reservation concerning this statement of policy. He had then taken the position that he would vote to approve the statement if it were amended to substitute the word "primarily" for the word "solely" in the second line and if the qualifying phrase "as a general rule" were inserted after the word "shall" in the fourth line. He would also have been agreeable to alternative wording as suggested by Mr. Bopp at that meeting. Some change along the lines he had then suggested would be satisfactory to him, but he still dissented from the present wording and would prefer not to vote for the statement in its existing form.

Chairman Martin inquired whether any others wished to record dissent from the existing wording of either this policy statement or

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the preceding one, and there was no indication of such a desire.

Thereupon, upon motion duly made and seconded, the foregoing statement of policy was reaffirmed, Mr. Hayes voting "no".

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 February 10 through February 25, 1959, and a supplementary report covering the period February 26 through March 2, 1959. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse stated that the money market had been generally firm over the past three weeks. Tendencies toward ease developed on a few days despite the generally tighter statistical reserve position, but these were met by sales of bills. Nearly \$300 million bills were sold during the past three weeks and \$43 million were redeemed, much more than offsetting a net rise of about \$67 million in repurchase agreements. The principal matter of interest over these weeks was the Government securities market, which had given a good account of itself. Good nonbank demand brought recent new issues to premium quotations and carried bill rates down by 20 to 30 basis points before demand dried up last week. This demand disappeared very quickly, and bill rates rose sharply on Tuesday and Wednesday. The System's sales of bills were a factor in the performance of the bill market early last

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week, but not the main factor. Rates moved downward again at the end of the calendar week, reflecting the investment of part of the proceeds of the recent Chicago-O'Hare Airport bond offering. Average rates in the bill auction yesterday were 2.82 per cent for the three-month bill and 3.11 per cent for the six-month bill.

Mr. Rouse went on to say that after the reserve projections attached to the supplementary report on open market operations had been prepared yesterday, word was received of a downward revision, dating back to February 1, in the level of required reserves. This meant that each net borrowed reserve figure shown in those projections should be reduced by \$43 million.

Mr. Rouse noted that the markets for corporate and municipal bonds had had a good tone and that the calendar of new corporate issues had been light. In the case of two recent corporate offerings--the Duquesne Lighting and Illinois Bell Telephone issues--underwriter bidding was strong and resulted in relatively low reoffering yields: 4.25 per cent on the Duquesne issue and 4.32 per cent on the Illinois Bell Telephone issue. Neither issue afforded much protection against early call, and thus far not more than 20 per cent of either offering had been distributed. In the municipal market an issue of \$103.5 million New Housing Authority bonds went very well at yields up to 3.60 per cent in tax-free interest. In general, better feeling was evident in the corporate and municipal markets. Looking ahead, the

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principal problem would be Treasury financing, for it appeared that the Treasury would have to be in the market frequently during the balance of this year.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period February 10 through March 2, 1959, were approved, ratified, and confirmed.

Chairman Martin then turned to Mr. Young, who made a statement on the economic situation supplementary to the staff memorandum distributed under date of February 27, 1959. Mr. Young's comments were substantially as follows:

We can summarize the economic situation about as follows:

- (1) Each month productive activity shows further gain, with accompanying improvement in income, employment, and labor market conditions.
- (2) Consumer and business spending continues irregular advance, with slow but steady strengthening of investment-type buying.
- (3) Each successive survey of consumer and business expectations shows mounting optimism and also steady spread of inflationary expectations.
- (4) Industrial prices, led by prices of industrial materials, maintain upward tilt, with the average of wholesale prices held stable only by declining prices of farm products.
- (5) Continuing investor confidence in high levels of stock prices increasingly points to a stock market really in orbit.
- (6) Successive reports from foreign industrial countries are confirming an onset of upward swing in activity for them.

In short, the picture is one of budding inflationary boom. Total national product for the first quarter is estimated at \$464 billion, up \$10 billion or 2-1/2 per cent from the fourth quarter.

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With the gains evident for February in output of steel, aluminum, copper, construction materials, and producers' equipment, the February index of industrial production should rise at least one index point and possibly two points, with a one to two point further rise in the index likely for March in view of the elimination of work stoppage influences in glass and autos. At present writing, a first quarter average for the industrial production index of 145 seems more than a possibility; indeed, we now regard it as a likelihood.

The value of real estate construction put in place in February, seasonally adjusted, fell off slightly from January, reflecting declines in nonresidential construction. Also, housing starts in January, seasonally adjusted, fell back from 1.43 million to 1.35 million units. Contract awards and trade reports, however, continue to indicate strong construction activity and the recent bulge in FHA applications and VA appraisal requests more than likely foreshadows maintenance for the present of high level housing starts.

Further gains in employment in trade, State and local government, and steel and related industries, along with continued high employment in construction, suggest further moderate strengthening of the labor market. Judging from unemployment claim figures, however, which have about moved seasonally, no large dent has been made since mid-January in the unemployment lump.

The results of three expectational surveys, recently becoming available, carry portents for the future. The first is the NICB-Newsweek survey of new manufacturing appropriations for plant and equipment expenditures. It shows for the fourth quarter a significant turnaround in these appropriations by durable goods industries.

The second is the Dun and Bradstreet survey of businessmen's expectations for the near-term future, taken in late January. It shows the highest level of business optimism regarding sales and profits since late 1955. Although the majority of businessmen still expect their own prices to show little change, the survey reports a significant further jump in expectations of rising prices.

The third survey is the Board's survey of consumer expectations, plans, and finances. Preliminary data from this survey show that 55 per cent of consumers expect general business conditions to be good in 1959, compared with 32 per cent in 1958 and about 60 per cent in the period 1955-57. About 61 per cent expect prices to rise in 1959, compared with 47 per cent in 1958 and about 16 per cent in 1953-54. The proportion of

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consumers reporting income increases and improved financial positions over the preceding 12 months rose somewhat from early 1958 to early 1959 but remained slightly below the 1957 proportion, while the proportion expecting further income increases during 1959 reached a new high.

Consumer plans to purchase houses are considerably higher than in 1958 and about the same as the previous peak in 1955-56, and consumers plan to spend a record amount for the houses that they purchase. They plan to buy about the same number of automobiles as in other recent years, but plans are for fewer new cars and more used cars than in any recent year except 1958. Prospective purchasers of new cars plan to buy more expensive cars than in other recent years, but purchasers of used cars expect to spend somewhat less. Consumer plans to make housing additions and repairs rose to a new high, but plans to purchase household goods showed little change.

In conclusion, the following observations may be pertinent. The economy has now about attained the preceding cyclical high in industrial production and is exceeding it in terms of aggregate output of goods and services. As expansion continues, business demands for fixed capital and for stock may be expected to gain in strength. It is at this stage of the cycle that upward pressures typically start to mount on costs and wholesale prices of products other than farm products and foods.

In the 1949-50 recovery, average industrial prices did not show any significant advance until industrial production was far above its November 1948 peak. In the 1954-55 expansion, industrial prices did not show significant rise until the July 1953 production peak had been exceeded. This pattern of cyclical advance in industrial prices is not uniquely associated with the post-World War II period; it has been characteristic of cyclical experience through modern history.

This year, the response of industrial prices to increasing demands has been at least as prompt and as strong as in the two preceding postwar expansions. Increases have been fairly widespread, encompassing finished products as well as materials. Such a development-- though not atypical--is disturbing in several respects. For one thing, unemployment is still sizable and at 6 per cent of the labor force is larger than at the comparable phase of the two preceding cycles. Second, productivity gains in manufacturing were substantial last year; unit labor costs declined some; and corporate profits rose sharply to close to prerecession levels by year end. Third, pressures on capacity--here and abroad--are by no means as yet acute. The sharp rise in the steel operating rate to some extent reflects precautionary buying against a possible strike

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rather than any corresponding increase in final demands for steel products. Finally, the whole climate, including that of the stock market, savors of an inflationary psychology taking form well ahead of inflationary boom but capable of inducing it.

In other words, the economy appears poised for a price runup in anticipation of real pressures from actual demands for labor and for goods. In an optimistic climate and on the basis of financial resources now in being, such a runup could be validated in markets for a time, but the costs in ensuing instability would be high.

Mr. Balderston asked Mr. Young for his view as to whether the rate of improvement since the business turnaround in April of last year had been typical and also for his view as to whether the supposed letdown in February was real.

Mr. Young replied that the pattern up to this point in terms of output of goods and services had been just about typical when measured against the record of business cycles going back into the last century, which showed that in periods of advance of output there tended to be recurring changes of pace. At first the pace would be rapid, then would slow down a bit, and then pick up a bit before reaching a level from which further gain tended to be difficult and slow in coming. There had been quite a bit of comment in February about future prospects, with a good many qualifying observations and some skepticism expressed about forces that would carry expansion forward, but it seemed to him that this kind of observation was rather typical in an expansion period. The source of the expansion movement was never clear until the expansion had gone very far; then one could

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see in retrospect where those forces came from. Actually, it was a matter of a little here and a little there, which together added up to a lot.

A staff memorandum on the outlook for Treasury cash requirements had been distributed under date of February 27, 1959. With further reference to credit developments, Mr. Thomas made a statement substantially as follows:

Credit developments so far in 1959 have been characterized by relatively light credit demands from business--both long-term and short-term--but large demands from governments--Federal, State, and local. Individuals' borrowings against mortgages seem to be continuing in large volume and consumer credit, after increasing more than seasonally in the late months of 1958, showed substantially less than the usual seasonal contraction in January and probably also in February.

Business loans at city banks have contracted approximately the usual seasonal amount since the end of the year, although somewhat less than in the same period last year. Increases may begin, however, if inventory buying expands. Bank loans on securities have shown a larger decline this year than in the two previous years. New corporate issues of securities have been in much smaller volume so far this year than in the same period of other recent years. New issues by States and local governments, however, offered or scheduled for offering this month total only about 10 per cent less than the unusually large volume of last year's first quarter. A large volume of new issues by State and local governments is still scheduled for future offering.

The Federal Government borrowed over \$5.5 billion in the first two months, while redeeming about \$3.0 billion of debt obligations. After retiring tax anticipation securities maturing this month, the debt will show a net decline of only about three-quarters of a billion dollars, compared with decreases of \$2-1/4 billion and \$1-3/4 in the same quarter of the two previous years. Moreover, in

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the next quarter the Treasury will have a net cash deficit, necessitating further borrowing, in contrast to surpluses that have been customary in other years.

In the aggregate, total loans and investments of commercial banks seem to have declined by at least the usual seasonal amount--if not more--in the first two months of this year. Not only have loans contracted, but bank holdings of U. S. Government securities have also declined, notwithstanding that the contra-seasonal net borrowing by the Treasury has been principally in the short-term market. Banks have subscribed for the issues offered for cash, but they have sold securities in the market or redeemed maturing issues in larger aggregate amounts than their subscriptions.

The money supply has declined by about the usual seasonal amount for the year to date. In contrast to this time last year, when they were increasing sharply, time deposits have shown little change this year. Nevertheless, over-all liquidity of the economy has evidently continued to expand. Adding to the rapid growth in demand and time deposits that occurred in 1958, nonbank holders have considerably increased their holdings of short-term Government securities in recent weeks.

Purchases of securities, largely by nonbank investors, have been responsible for the improved tone of the Government securities market since the conclusion of the latest Treasury financing operation. Holdings by dealers, as well as by banks, have been reduced in the past few weeks. Yields on Government securities have declined from the record high levels reached around the middle of January, with the sharpest decreases in medium-term issues. Rates on short-term issues also declined, with sharp drops at first in the 3-months bills, as investors sought liquidity in view of uncertainty as to the course of longer-term rates, but later the decrease spread to the 6-months bills and then to other short-term issues. In the past week short-term rates have risen somewhat, as mid-March cash needs approach, but longer-term issues have continued firm.

Greater strength in securities markets has developed, although there has been some further tightening in the reserve position of banks. In February net borrowed reserves of all member banks averaged about \$60 million, as indicated by revised figures, which show that country banks' required reserves have been less than had been estimated. Nevertheless excess reserves at country banks have declined to a somewhat lower level than is customary. Reserve city banks have continued relatively tight. New York City banks, on the other hand, have had somewhat more comfortable reserve positions in

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recent weeks than earlier in the year. Transactions in Federal funds have been particularly large in recent weeks, indicating considerable variation in the distribution of available reserves.

It should be kept in mind that market interest rates are still high relative to the level of member bank borrowing and to the discount rate, as compared with previous periods. They appear also to be high in view of the absence of an increase, seasonally adjusted, in total bank credit.

Estimates of reserve needs for the next few weeks indicate that net borrowed reserves may continue below \$100 million until the latter part of the month, if changes in deposits and currency, as well as in other reserve factors, show the customary seasonal variations. Estimates prepared by the New York Reserve Bank indicate a much larger volume of demands on reserves during the next three weeks. The major reason for this difference is an implication of a larger increase in deposits and currency than is assumed in the estimates of the Board's staff.

There is a reasonable basis for uncertainty and differences of judgment as to the course of deposits at this time. Treasury tax and loan accounts will no doubt decline sharply in the next two weeks and the subsequent increase from tax receipts will be less than usual because of the large amount of tax anticipation certificates to be retired. The question is whether other deposits will increase as much as or more than usual prior to tax payments and decline less later. Businesses have smaller tax liabilities this month than in other years and relatively larger holdings of tax anticipation securities, as well as other short-term securities and fairly good-sized deposit balances. They should not need, therefore, to build up balances by borrowing or selling securities to banks in the same amounts as in other years. It would follow also that business deposits might not decline as much as usual when taxes are paid. Over a period of four or five weeks, the net result should conform to the usual seasonal pattern. If it does not, then System operations may need to be adjusted accordingly. What will actually happen, however, is still a matter of conjecture. So far, no reason for a shift in System policy moves is indicated.

This situation illustrates the type of development that might be expected to occur at other times this year when large cash payments are being made. It poses a problem with respect to System policy. It would appear that the economy has adequate liquidity to finance further expansion. Under the circumstances further growth in the money supply may be

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unnecessary for some time, or at least not until there is evidence that monetary needs may be unduly retarding growth. Pressures upon the money market and upon banks may be expected to develop when the public finds it necessary to draw upon time deposits, or liquidate securities, or borrow at banks in order to obtain additional cash.

It would appear that there are no such pressures at present. The System, however, should be prepared to resist them if they should arise to a degree that endangers stability. Restraints can be applied by making it necessary for banks to borrow any additional reserves desired and by having a discount rate that is close enough to market rates to penalize any such borrowing. It would probably be advisable to establish such a rate even before the need arises, particularly since the Treasury financing schedule limits the periods when an increase in the rate would be possible even though appropriate for other reasons.

In response to a question about the expectations for Treasury financing, Mr. Thomas referred to the information contained in the staff memorandum dated February 27, 1959. He went on to say that the Treasury was raising another \$100 million through addition to the March 12 bill offering and that this, he understood, might continue for a number of weeks if necessary. Estimates indicated that the Treasury would need about \$4 billion in April, and whatever was not obtained through the bill offerings would have to be obtained through other means. There would be a refunding operation in May and there might be cash needs in June, depending on how much cash was raised in May.

Mr. Rouse said he understood that the Treasury wanted to consult with its advisory committees on the 18th or 19th of March,

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with a view to making an offering the following week and obtaining payment March 30 or 31. The Treasury would again consult its advisory committees during the week of April 19 on the refunding operation and presumably would make a fairly early offering after that. It was understood that the Treasury probably would come to market in May, and he felt it would have to borrow in June because of large demands in the first week of July.

Chairman Martin said that Mr. Rouse had accurately outlined information given to him (Chairman Martin) by Secretary Anderson and Under Secretary Baird. The Treasury hoped to announce the next financing March 19 or 20 and would then anticipate a schedule such as Mr. Rouse had outlined, with a little leeway on either side.

Mr. Hayes commented that what had been thought of as the April financing apparently was to be moved ahead a little and finalized at the end of March. This would leave a gap of 18 or 19 days between that date and the next financing.

Chairman Martin commented that the program for June was uncertain. However, it was more likely than not that the Treasury would have to come to the market in June.

Mr. Hayes then made the following statement of his views on the business outlook and credit policy:

Since it seems to me that the System faces a very hard decision at this time with respect to the discount

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rate, most of my remarks will be directed toward an attempt to summarize the issues involved in that decision as I see them.

First, as to the business outlook: This is much the same as at our last meeting, with business expansion likely to continue at a moderate rate. At this juncture it is not possible to gauge accurately how the year's pattern of business activity may be affected by the current distortion in the steel industry and by the steel strike, if it eventuates. While retail sales have been very satisfactory, there is no evidence that consumers are really in an enthusiastic buying mood. Business sentiment is guardedly optimistic, probably more "guardedly" than in the past month or two; and neither the demand and supply situation nor recent price developments suggest an inflationary atmosphere. (For example, the nonfood component of the consumers price index declined in January for the first time in a year.) Last week our directors, discussing the business situation, were unanimous in an appraisal along these general lines, stressing the absence of any noticeable expansion in plant and equipment spending programs and the probable continuance of conservative inventory policies in most industries for some months to come. They were encouraged by the recent sharp gains in productivity, and the consequent upward trend of profits, but they saw no early solution to the serious unemployment problem.

There seems to be nothing in this business picture that would warrant any overt move which could be interpreted as indicative of more intensive credit restraint. Nor do recent bank credit changes support such an action. The behaviour of business loans so far this year, both in city banks and in the banking system as a whole, has been anything but exuberant; and the decline in total loans and investments of city banks has been about in line with the average of recent years.

It is only when we view the prospect for vast additional cash financing by the Treasury through the remainder of 1959, with all that this could imply in the way of excessive growth of the money supply, that we find real cause for concern and perhaps cause for action in the discount rate area. We now estimate that \$5 to \$6 billion must be borrowed by the Treasury between now and the end of June, and about \$15 billion in the second half of the year. Obviously we should try to encourage a smooth flow of the new securities through the banks, acting as underwriters, into the hands of nonbank holders. Fortunately this process has been taking place in recent months, aided by the rise in interest rates which has already occurred. The Treasury's continual excursions to the market will of themselves

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tend to push short-term market rates higher over the remainder of the year. The question is whether we should anticipate this tendency by moving the discount rate up promptly to 3 per cent, thus serving notice of our determination to prevent the Treasury's program from causing a dangerous expansion of the money supply--or whether to delay action until a further rise in market rates has established a clearer case for a technical adjustment of this magnitude to bring the discount rate into line. Our problem has not been made easier by the tendency for 90-day Treasury bill rates to decline during the past month, as temporary excess funds have sought investment in the shortest instrument--for unfortunately the market still tends to look at the 90-day Treasury bill rate as the short-term market rate, whereas if they were to look rather at a complex of short-term rates, including the 6-month bill, they would find a wider spread above the 2-1/2 per cent discount rate.

At their meeting last week our directors discussed the pros and cons of a rate change at great length. I tried to present the arguments on both sides as objectively as possible, in order to get a very free expression of views in this preliminary discussion. I would say that all of the directors approached the problem with an attitude of extreme caution; and that the majority were averse to a rate increase, primarily because in their judgment it would be unwise to "rock the boat" when recovery is proceeding satisfactorily but with very few inflationary overtones. Fears were expressed as to the bad psychological effect at a time when the country is concerned over continuing heavy unemployment. Fear was expressed that a discount rate increase might trigger a prime rate increase which would be damaging to further recovery--although one of our banker-directors doubted whether the prime rate would follow us at once in the absence of greater loan demand than is now in evidence. It was also suggested that a rate increase might not be looked upon as helpful to the Treasury's financing problem, which is difficult at best; that we should be reluctant to give Congress grounds for arguing that the Fed is causing a sharp rise in carrying charges on the national debt, when it is faulty fiscal policy which is really to blame; and that we might have a very hard time "selling" a discount rate rise as a technical adjustment to bring the discount rate closer in line with market rates, because of the absence of a very clear-cut disparity. The thought was expressed by one industrialist that corporate funds will probably continue to be reasonably abundant for the purchase of new Treasury issues, because of the high level of profits and the probable absence

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of any upsurge in inventory or plant and equipment expenditures. Another director questioned whether nonbank buying would be greatly stimulated by a higher discount rate.

I pointed out that the opportunities for rate action are likely to be few and far between for the remainder of this year; that if we failed to act within the first two weeks of March, the earliest next opportunity might be well along in April. However, there was general reluctance on the part of our directors to make a move sooner than might be desirable on economic grounds, merely because we fear an excessive growth of the money supply at some future date and because we expect Treasury financing to inhibit discount rate action during late March and much of April. Most of the directors would lean toward awaiting the development of clear-cut reasons for apprehension before moving the rate.

I confess that I am greatly puzzled as to what is the right solution to this problem. I suspect that the impact of the Treasury's vast financing program will in any case bring about an upward trend in short-term interest rates during the coming months. Thus the early establishment of a 3 per cent rate might conceivably be looked upon as a technical adjustment to a rate level which, if not actually here today, is very likely to arrive in the near future; and it would have the advantage of demonstrating to this country and to the world our awareness of the threat inherent in deficit financing and our determination to defend the value of the dollar. If, as I believe, any increase in the discount rate under present conditions should be regarded by us and explained to the public as a technical adjustment, it would be helpful for New York to be one of the first Banks to act. But at the same time I share some of the doubts of our directors and would feel much better if the timing of the Treasury's program were not tending to "rush" us in our decision. I would anticipate some considerable difficulty in persuading our directors to act on the rate this week or next. Perhaps it would be just as well to defer action until the second or third week of April, even though the open interval at that time will be shorter than we would ordinarily like. A second alternative, which might be indicated if early action is preferred by the System as a whole, would be to limit the rate increase to 1/4 per cent in order to make it clear that only a technical adjustment is intended. I would like to hear how the other Presidents and the Governors view this problem before making up my own mind as to what to recommend to our directors.

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With respect to open market policy, I would not like to see any conscious move toward greater restraint but would expect the pressure of Treasury financing to bring about some increase in Treasury bill rates and would not interfere with such a trend. I think the directive might well be left as it is.

Mr. Erickson said that upon his return from South America he had reviewed economic developments with his staff and that the accelerated pace of activity evident several weeks ago did not seem to have carried through in the month of February, for improvement nationally and in the First District appeared to have proceeded at a much milder pace than before. First District production, employment, construction, and department store sales were up slightly compared with the same period last year, while savings deposits were not increasing as much as last year. During the last two weeks there had been greater use of the discount window by country banks than last year; 50 banks were borrowing on one particular day.

From a reading of the minutes of the last two Committee meetings, Mr. Erickson said, it appeared that the System was confronted with a difficult question of timing. Balancing the pros and cons, he would lean toward doing nothing on the directive or the discount rate at this time, waiting to see what happened by the time of the next Committee meeting, and then possibly acting on the discount rate in April. In open market operations, he would lean on the side of restraint even though that produced higher net borrowed reserve figures than indicated.

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Mr. Erickson then commented briefly on his trip to South America during which he visited eight central banks.

Mr. Irons said that he viewed the over-all economic situation about as Mr. Young had pointed it up in his statement. There was continuing strength and continuing gradual expansion in most of the major indicators of economic activity. He could not see very clearly the reasons for some of the lessening of optimism among economists that had been reported in the press recently. As Mr. Young had said, it was difficult to tell just what triggered recovery, for it was usually a lot of little things accumulating into an expansive force which first broadens recovery and then extends gradually into a general expansion of economic activity.

Mr. Irons continued by saying that the Eleventh District seemed to be following the national pattern, with gradual strengthening at a high level of activity. Retail trade was holding up well and nonagricultural employment was showing gradual improvement. Crude oil production was up a bit, but refining had declined somewhat, due in large part to a strike at one of the large refineries which was settled yesterday. The aircraft industry had sustained some setback, particularly in the Dallas area, as the result of the Defense Department's shift of emphasis from manned aircraft to missiles, and it appeared that as many as 6,000 workers might be laid off by the first of June. However, a substantial number of those already laid off

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had moved to other places and recruiters from other sections of the country were now working in the Dallas area. Agriculture had been doing fairly well.

Eleventh District business loans, Mr. Irons said, had increased a little more than last year, but generally the banking trends were close to the usual seasonal movement. There was not much borrowing from the Reserve Bank, and very little on the part of country banks. Larger banks were tending to use Federal funds rather than borrow from the Reserve Bank.

Turning to open market operations, Mr. Irons expressed the view that in the last three weeks the Account Manager had done about the right sort of job; he had maintained a reasonable degree of restraint in the face of some large shifts in statistics, a maldistribution of reserves, and other disturbing factors. The discount rate was the difficult problem right now and probably the decision on it would have something to do with what open market policy should be. In his opinion, open market policy should maintain the degree of restraint that had prevailed, with any doubts resolved on the restrictive side, and the degree of restraint should be consistent with an interest rate structure appropriate to the discount rate structure. Viewing only the banking picture, there was not too strong a demand indicated for an increase in the discount rate. The economic situation was going along well and possibly the seeds of further inflation were

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being sown, but at the moment the situation did not seem too pressing. However, if no move on the discount rate were made now, the System might be barred from moving in the reasonably near future, for it had been the position of the Committee that whenever the Treasury got near to coming into the market the status quo should be maintained. On balance, therefore, he would favor taking advantage of the present opportunity to increase the discount rate to 3 per cent. He agreed with Mr. Hayes that it would be desirable for the New York Bank and a number of other Banks to move together, but a matter of a week did not seem to make too much difference. While he wished that the System could move on the rate whenever it desired without regard to the Treasury situation, in view of the current ground rules the System must adapt itself and take advantage of whatever opportunities were presented to it.

Mr. Mangels said that West Coast business activity had shown further moderate expansion during January. Construction was particularly strong, with payrolls reflecting a general increase. Insured unemployment from December to January declined 8 per cent, there was a rather heavy demand for copper, and lumber continued strong. Department store sales were relatively strong through February and automobile sales showed small gains. The agricultural situation was not quite as favorable as for the country as a whole; large numbers of livestock were on feed and in many cases operations were being conducted without

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profit or even at a deficit. For the three weeks ended February 18, bank loans increased somewhat, with half of the increase in real estate loans, but in general loan demand was rather light and for the next three to five months no heavy demand for bank credit was expected. The banks reported no great demand for loans to pay taxes. Demand deposits and time deposits fell during the period mentioned, and district banks were beginning to feel somewhat pinched for funds. The particular bank he referred to at the last Committee meeting had now indicated to its branches that they should be more selective in making real estate loans. The large banks on the West Coast had been net borrowers of Federal funds, but use of the discount window was scattered and intermittent.

Regarding policy, Mr. Mangels saw no reason to change the degree of restraint existing at present. On the discount rate, he was somewhat uncertain. There had been a full discussion of the rate at the meeting of the San Francisco Bank's executive committee last Wednesday and four of the five directors present were quite definitely opposed to an increase at the present time. Comparing the situation today with October 23, 1958,* the effective date of the last San Francisco increase, the directors noted that total employment had increased only slightly, total unemployment had risen, the wholesale and consumer price indexes had increased only slightly, and the money supply was about the same. City bank loans and investments

* The Board approved an increase to 2-1/2 per cent at certain Reserve Banks on October 23, 1958; the effective date at San Francisco was November 6, 1958.

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showed a 1-1/2 per cent increase, and the rate of borrowing from the Federal Reserve Bank was not substantially different. While Treasury bill rates went up in the past few days, they had been somewhat below the October level, and commercial paper and bankers' acceptance rates showed no change. Rates on finance company paper and loans to Government securities dealers were up, but call loans on stock had not changed in rate. Therefore, the directors felt that there was not much in the statistics to justify a discount rate increase at this time. If, however, other Reserve Banks acted before the next meeting of the San Francisco directors (March 11), he felt that the latter would go along. There might be some question whether a 1/2 per cent increase would be in order or whether a 1/4 per cent increase would present a more logical basis for action.

Mr. Mangels concluded by saying that he considered the policy directive satisfactory.

Mr. Deming said that business sentiment in the Ninth District continued to indicate a measure of optimism, tempered by the fact that most of the available current indicators had registered no particular advance either in January or February. While a case might be made that the rate of recovery had slackened somewhat since December, the strong winter seasonal trend almost obscures real trends in the Ninth District, there had been a more severe winter this year than usual, and this was thought to be the factor that had produced

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such slowdown as seemed apparent. With a high level of work in prospect, actual construction work had been delayed by an unusually deep frost line, and it also appeared that the lake ore shipping season would be delayed because the ice was very thick and the boats probably would not be able to get in or out as early as usual. On the other side of the picture, employment and banking were moving about in line with normal seasonal developments and agriculture was continuing to show strength. The 12 per cent gain in farm income in 1958 apparently was carrying over into 1959, thus far, and prospects for farm machinery sales were good for the coming year. Bank deposits were up and demand for bank credit was running roughly according to the usual seasonal pattern.

Mr. Deming said that, like others who had already expressed themselves, he had a degree of uncertainty in his mind as to the proper current course of credit policy. He felt that open market operations had been about right, he would like to see them continued in about the same way, and the directive seemed to him adequate. With respect to the discount rate, the arguments regarding the question of an increase at this time had been presented pro and con. On balance, however, the argument for making a change at this time because the System might be blocked in the future seemed to him persuasive. While he doubted whether the Minneapolis directors would object strenuously to a recommendation to change the rate

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upward, neither did he feel that they would take action at this time with any great enthusiasm. Due to personal situations, it would be impossible to have a meeting of the board of directors before Friday, March 13, the date of the next scheduled meeting.

Mr. Allen said that notable developments in recent weeks on the plus side appeared to be the rapid increase in steel order backlogs and the continued evidence of strength in consumer income and buying. On the other hand, the rate of new auto deliveries remained slower than many had anticipated and unemployment continued fairly substantial. Seventh District steel companies were operating at effective capacity, but analysis indicated no appreciable rise in steel inventories in the hands of users in January. There probably was some increase in February. Department store sales in the district were running spectacularly ahead of last year and were excellent by any standard; when the record for February was in, it might be found that such sales exceeded the record month, August 1957.

Continuing, Mr. Allen said that deliveries of American-made autos in the first 40 days of 1959 averaged only a little more than 16,000 per selling day, a rate equal to about 5 million on an annual basis, but Detroit experts were still estimating that 5-1/2 million American-made passenger cars would be sold in 1959. They expected 1959 production to be around 5-3/4 million, with the difference going into export and inventories. The peak production quarter would

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be the present one, at 1,600,000 plus. As to installment terms on automobiles, a sample of Seventh District member banks indicated a substantial stretch-out in maturities in the past two years. In January 1957, only 8 per cent of all contracts were for periods in excess of 30 months; in January 1958 the proportion was 22 per cent; and in January of this year it was 47 per cent.

New claims for unemployment compensation for the first six weeks of 1959 in the Seventh District States were from 22 to 42 per cent lower than last year, compared with a drop of 17 per cent nationally. Except for Iowa, however, these claims were substantially higher (from 7 per cent in Indiana to 50 per cent in Michigan) than in the comparable period two years ago. The Michigan situation, including both its fiscal and its unemployment difficulties, would doubtless continue to receive a good deal of national attention in the months ahead. During 1958, unemployment in Michigan averaged 14 per cent of the labor force and local experts did not expect the situation to improve in 1959. The situation was the result of a number of factors--decline in defense work, labor-saving capital expenditures, a continuing shift of industry to other States, and a tendency to use overtime rather than to hire additional workers.

Loans and investments of Seventh District reporting banks declined \$93 million in the three weeks ended February 18, with almost

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all of the decline in Government securities. The banks showed stronger business loan demand relative to both 1957 and 1958 than did reporting banks throughout the nation; most business categories, led by metals firms, were borrowing more than last year. Use of the discount window by country banks had been heavy recently by standards of recent years, with 63 country banks borrowing in the first half of February. A large number of the borrowing banks were in the cattle feeder area.

Mr. Allen said that he would not suggest any change in the policy directive and that he would like to see the operations of the Desk continue about as they had been, with any doubts resolved on the side of restraint. As to the discount rate, he rather agreed with Mr. Irons. There should be coordination of the implements of monetary policy and consideration of that one factor would call for an increase in the rate. As to the magnitude of increase, he would favor 1/2 per cent or nothing. As to timing, if the System were completely free his own preference would be to do nothing for a couple of weeks, or perhaps as long as four weeks, a view in which he perhaps was influenced largely by his feeling that it would be difficult to get the Chicago directors to act unless there was unity of action throughout the System. Some of the directors, he noted, had in mind the unemployment situation in the Detroit area. However, he did not know whether the interval in April would be long enough to provide assurance that discount rate action could be taken in that period, and if it was

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necessary to gamble--as it appeared might be the case--he would guess that business would continue to improve to such an extent as to suggest acting now on the rate.

Mr. Leedy said that, contrary to the national pattern, business loans at Tenth District banks had been receding at only a fraction of the rate of decrease that occurred last year. All categories of borrowers except wholesalers had either been borrowing more or repaying less than in the preceding year. The reserve position of the country banks in particular had been tighter recently due to a greater than seasonal run-off of deposits, especially interbank deposits. This had been accompanied by strong demand for credit at the discount window, and borrowings at the Kansas City Bank were running about 16 per cent of total member bank borrowings.

Mr. Leedy stated that district retail sales through the latest report period were 11 per cent ahead of the year-ago level, compared with a gain nationally of 9 per cent. Livestock interests, including cattle, sheep, and hog producers, were being hurt by lower prices, and inventories in each category showed a substantially higher increase from last year than for the country generally. Another factor, as far as the economy in the agricultural areas of the district was concerned, was the recent announcement by the Department of Agriculture of lower support prices for the spring planting crops.

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Turning to policy matters, Mr. Leedy felt that the time was here for the System to move on the discount rate. In fact, as indicated by discussion at recent Committee meetings, he had felt that there should have been an increase earlier, although he was cognizant of the difficulties that had existed for some time in making an adjustment. His own reasoning was based more on the economic situation than on the change in the interest rate structure. The review of economic conditions at this meeting seemed to him to underline the great and developing strength of the economy, and there was also the important matter of public psychology that had been asserting itself in the stock market. For these reasons, as he had indicated at the last Committee meeting, he would hope that the effect of a discount rate increase would not be undercut by any effort to make it appear as solely a technical adjustment. He felt that the market was expecting a rate increase; if it were not made in the period immediately ahead when the road was clear, the System might be misleading the market. The System had been charged before with pulling the rug from under investors immediately following a Treasury financing, and such a charge might be made again if the rate were changed in the rather short period available following the next Treasury financing.

Mr. Leedy suggested that the Account Management continue to attempt through open market operations to maintain a level of \$100 million of net borrowed reserves, with some variation around that

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figure. He would not endeavor to increase that figure materially at this point and instead would rely on an adjustment of the discount rate. The discount rate change, if made, should be an increase of 1/2 per cent.

Mr. Leach recalled that at the February 10 meeting of the Committee he said that although some recent data on the Fifth District economy were disappointing, it appeared that over-all business activity was still moving forward. Economic reports now becoming available made it clear that the district economy was continuing to expand. Seasonally adjusted nonfarm employment showed widespread increases in January, with the total up 0.6 per cent, while manufacturing man-hours showed broad and sizable December to January increases, particularly in durable goods industries. After a period of uncertainty following the recent wage increases in the textile industry, it now appeared that at least a part of the increase in cost in this highly competitive industry would be passed along in higher product prices. A possible break with the hand-to-mouth policy long adhered to by textile buyers was indicated by the general interest being shown in third and fourth quarter business and by the advance orders placed by some buyers for those periods. Cigarette production reached an all-time seasonally adjusted high in December and probably improved further in January, while the furniture manufacturing industry reported January and February as "terrific" months, with high-level profitable operations under way. Bituminous coal production was at a better rate than at

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the bottom of the recession but still seemed low in view of current steel production rates and improved industrial operations. Utility demand had been weak enough to cause discussion of price reductions and efforts at freight concessions as a defense against shifts to oil.

Mr. Leach said he was conscious of the fact that discount rate action had not kept pace with open market operations, primarily due to Treasury financing considerations, at least in recent weeks. There would now be a breathing period before the next Treasury financing, and he felt that the System should take advantage of it to increase the rate to 3 per cent. While the bill rate was now only 2.81, it seemed probable that it would soon be higher because of prospective Treasury and other demands for funds. His chief concern was about the possibility that a discount rate increase might be interpreted as a move toward more restraint than was intended. Although he believed that a confirmation of present restraint, or even slightly greater restraint, would be in order, he would not want to signal a substantial intensification. He would be happier if action could be taken when the bill rate was higher than at present, but he would not care to delay action beyond March 12, by which day more than half of the Reserve Banks had directors' meetings scheduled. While he shared some of the reservations expressed, he felt that the time was here when discount rate action should be taken.

Mr. Mills said he detected a problem in the conduct of System monetary and credit policy that happily was in an incipient stage at

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present but which, if unattended, could spread out with serious consequences. He then presented the following statement:

In setting objectives and appraising the effects of monetary and credit policy, the time has come to give prime consideration to the results of sighting policy actions at sustaining some predetermined level of negative free reserves over a lengthy period of time. The unhappy experience of last year, when \$500 millions of positive free reserves were set as a continuing goal of policy actions, was reflected in a supercharged growth in the money supply. Similar results may occur in reverse if some level of negative free reserves is consciously maintained by policy actions for a continuous period of time, in that the ultimate effect on the money supply of maintaining any fixed level of reserves seems to be comparable to the results obtained from compounding interest. This is true because the commercial banks must adjust their positions to whatever level of reserves is set by Federal Reserve System policy actions, and in doing so under existing conditions of a negative level of free reserves the consequence is to set up a cumulative force contracting the outstanding volume of commercial bank credit. The fact that the volume of discounts at the Federal Reserve Banks has not risen in proportion to the pressure that has been exerted by System policy actions on the supply of reserves offers proof to this theory by indicating that the commercial banks restrain their credit operations in response to System policy rather than expand their loans and investments, all of which is in accordance with the dictated principle that Federal Reserve Bank discounts should be temporary in character.

As long as the Federal Reserve System is intermittently supplying reserves to sustain commercial bank Tax and Loan Accounts on the occasion of U. S. Treasury financings, the contractive pressures of a negative level of free reserves serve the worthwhile purpose of compelling commercial bank divestment and redistribution of U. S. Government securities acquired from Treasury offerings and preventing an unwanted expansion of bank credit. However, when the time should come that reserve support to Treasury financing is no longer needed as frequently as is now the case, the full effect of a Federal Reserve System policy of maintaining a constant level of negative free reserves would come into play and a

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deleterious contraction of the money supply would set in. As this is a process that only takes place over a period of time, it is not immediately apparent, but by the same token can be safeguarded against well in advance by appropriate prophylactic actions.

Applying the theory thus submitted to the present situation suggests that care be taken to avoid a rigid posture of maintaining a continuous level of negative free reserves, both because of the overly contractive influences inherent in such a policy and because complacent commercial bank adjustment to an unchanging Federal Reserve System policy tends to accelerate its effects beyond those intended. Inasmuch as the System's present policy is in itself persistently contractive, any greater pressure is unnecessary and might be unwise. In fact, the occasional appearance of positive free reserves over a weekly reporting period should not be shunned in that no real relaxation in pressure would have occurred and a variation from constancy could be psychologically desirable for the banking and investment fraternity to observe.

A 3 per cent discount rate as an alignment with a corresponding structure of market interest rates is to be desired, especially for its influence toward making the United States money market more attractive for the investment of foreign funds and thus acting as a check against the future outflow of gold. However, if the ground swell of economic developments continues to indicate a lessening in the demand for commercial bank credit and long-term capital, together with an ample supply of investment funds, it may become necessary to fall back from a 3 per cent discount rate. Furthermore, heed should be paid to the natural influences tending to relax credit tensions by whatever moderation of Federal Reserve System policy can be made without lowering the guards against forces making for a renewed wage-price spiral or loosening such grip as it is possible to hold over speculative fervor in the stock market.

In further comments, Mr. Mills suggested bearing in mind that the pressure of a constant level of net borrowed reserves evokes a response that compels the commercial banking system to contract loans and investments. If, in the process of that contraction, the banks

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were to restore their reserve positions, with some margin of excess reserves, and if the System then proceeded to extinguish the excess reserves, the commercial banks in turn would have to respond by contracting their outstanding credits. There would be set in force a cycle of restrictive influences such as to hold the threat of boiling down the money supply to a point that would be inconsistent with the economic growth and resurgence of economic activity that, within its limitations, it was the purpose of the System to foster.

Mr. Robertson said it seemed to him that the economy was moving upward very rapidly, especially if one looked at the whole picture through the glasses one should have on in January and February, a period of the year when an observer is apt to be misled. As a matter of fact, there seemed to be inflationary overtones all through the picture. Therefore, if the System failed to take advantage of every opportunity to adopt a more restrictive position, it might find itself in the sad position of one who waits and weeps. In view of the impending Treasury financing operations, he felt that the System should move toward a more restrictive position rather fast. While he did not have in mind becoming startlingly more restrictive, he would like to see net borrowed reserves in the neighborhood of \$200 million by the date the decisions on the next Treasury financing were made.

With respect to the policy directive, Mr. Robertson said that he saw no need for a change of any kind. He realized that a change in

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the discount rate would originate at the respective Reserve Banks. For his own guidance, however, he had set down some of the aspects of the economic situation that seemed to him to provide a basis for increasing the rate at this time. He then read the following statement:

The principal aspects of the economic situation which justify an increase in Federal Reserve Bank discount rates at this time:

1. General economic activity has recovered to above the level of the peak reached in 1957, with further expansion in process. Although unemployment is still larger than is desirable, the lag in this area is due to improvements in productive efficiency, which provide the basis for further advances in output and in over-all levels of living.

2. The general level of commodity prices has been stable or rising slightly, notwithstanding declines in prices of farm products and the increased productivity of industry. This is because prices of finished industrial products have continued to advance, reflecting in large part rising wages, but also to some extent increased profits.

3. Continuation of such price increases might build up buying resistance on the part of domestic, and particularly foreign buyers and endanger the sustainability of economic growth.

4. Maximum sustainable growth in economic capacity requires a moderately large volume of investment, financed out of savings. The current course of economic events is favorable for investment and in addition the government will continue to be a heavy borrower. Adequate savings to cover these demands should be encouraged. Hence, the present situation calls for a relatively high level of interest rates.

5. Current conditions are conducive to the undertaking of speculative commitments. Advances in stock prices and in real estate values are indications of these trends. Credit should not be too readily available for financing such commitments, which are threats to economic stability.

6. Resumption of a belief in the inevitability of inflation encourages borrowing and discourages lending.

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These attitudes may be expected to cause interest rates to rise. Rising rates should not be resisted by making Federal Reserve credit available at low rates, but should be permitted to occur in order to set up correctives to the inflationary tendencies.

7. Expansion of bank credit last year was at a rate that was more rapid than necessary for sustained economic growth at a level consistent with reasonably full utilization of resources. The money supply during the past year increased at a rate of 3-1/2 per cent and is adequate for further growth at turn-over rates that have prevailed in previous periods of prosperity. In addition a 10 per cent growth in time deposits has augmented the liquidity of the economy. Expansion of bank credit has thus not only helped to finance the recovery of consumption and investment but has established the basis for further growth.

8. Although some slowing down in the rate of bank credit and monetary expansion has occurred in recent weeks, the general liquidity of the economy has continued to increase as the public has used available funds to acquire short-term Treasury securities in large amounts.

9. Any further tendencies toward bank credit expansion should necessitate increased borrowing of reserves by member banks at discount rates that are kept in touch with market rates. Additional reserves may be supplied through open market operations when deemed appropriate for further sustainable growth, but only after a higher level of member bank borrowing and higher discount rates have been established.

10. Discount rates are still much further below prevailing open market short-term rates than is usual or appropriate in a period of economic expansion. They should be brought more closely into line with the market.

11. If action is not taken now, the timing of prospective Treasury financing operations may preclude the opportunity to take any action for several months.

Mr. Robertson also commented that although there was a period in April when discount rate action possibly could be taken, the System would be faced with those problems that arise from taking such action too soon before or after a Treasury financing operation. Accordingly, he felt that the dangers involved in failing to act at this time were too great to warrant the risk. If the System failed to act, it might be in a

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position where it would regret not having the discount rate at an appropriate level from which to work in trying to offset the forces that he thought were developing.

After expressing agreement with the views stated by Mr. Robertson, Mr. Shepardson said it seemed to him that at this season of the year one was likely to worry about things not moving quite as fast as desired and to fail to take account of the slackening inherent in the winter season. The continuing pressure on wages and prices concerned him a great deal. While much concern was being expressed about unemployment, he felt that it would be corrected more effectively by price adjustments to stimulate demand than by putting out more funds in the hope of creating employment when there was not the consumer demand. At present, he noted, there was a high consumer level of income. Thus, there was money to spend but only as consumers spent the money for goods and services would there be a real incentive for the expansion of productive facilities. With those things in mind, he felt that the System should keep up with the procession rather than wait for historical evidence. In his opinion, it was highly important to move toward a little more restrictive level than had prevailed. Reports recently had indicated that the feel of the market was not quite as tight as the statistical figures would indicate, or as he felt might be desirable. Hence, along with early action on the discount rate, he would favor moving toward somewhat greater restraint through open market operations.

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Mr. Fulton said that steel continued to make the news from the Fourth District. This week the mills were expected to produce the largest amount of steel ever produced in one week. Some mills were booked solid through June and customers were clamoring for delivery. In a recent survey of purchasing agents, almost half of the respondents said that they were acquiring inventories, not only steel but other lines, so as to avoid being embarrassed if a strike occurred this summer and also because inventories had been low. On the other hand, the respondents did not want to guess at operations for the second half of the year. In contrast to the steel industry, the machine-tool industry was rather dismal. Backlogs were a little over three months but the amount of tools shipped was quite small. The automobile industry was now rebuilding to some extent rather than buying new machine tools, and other industries could follow the same alternative.

With further reference to district developments, Mr. Fulton said that department store sales since the first of January were 3 per cent above the year-ago level. Contract awards were up for residential and other types of construction. The bad feature continued to be the unemployment situation, which had not changed substantially. Manufacturing employment had not increased in total.

Mr. Fulton said that although he shared Mr. Hayes' reservations as to increasing the discount rate, he did not believe that

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any change should be labeled a technical adjustment. A discount rate change was an indication of Federal Reserve policy and it would be, and possibly should be, considered as overt action on the part of the System. He noted that some time ago financial writers were speaking of the probability of a discount rate increase and the market was conditioned to it. Recently, press articles had indicated that the rate might not change for some time, no particular reasons being advanced except that the System had not acted according to earlier expectations. He agreed that this was an appropriate time to increase the discount rate, adding that the System might not for some time have another opportunity as clear cut as at present. The fact that a 3 per cent rate would be slightly above the bill rate seemed to him only incidental because it appeared almost inevitable that the bill rate would rise whether or not the discount rate was increased. Corporations having funds in the form of bills were likely to cash them for the purpose for which they acquired them, which was liquidity, in order to pay for inventories being acquired and taxes. Noting that the next meeting of the Cleveland directors was scheduled for March 12, Mr. Fulton expressed the conclusion that within the next week the discount rate should be increased to 3 per cent. He also indicated that he was quite satisfied with the Committee's policy directive as it stood.

Mr. Bopp said that Third District department store sales were good. The employment situation remained the big cloud in the district,

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with incomplete data for January showing unemployment at 11 per cent of the labor force, a somewhat higher rate than a year ago. The chief banking development had been an exceptionally large loss of deposits by Philadelphia banks. As a result, the banks had been running large and increasing basic reserve deficiencies which, to an increasing extent, they had been meeting through the Federal funds market rather than through borrowing at the Reserve Bank. Mr. Bopp said he regretted that short-term market rates had eased from their mid-January levels. If they were still at those levels, an increase of 1/2 per cent in the discount rate could be made as a technical adjustment, but at present market rates such an increase might be interpreted as more than a technical adjustment. He did not feel this could be justified on purely economic grounds in the light of current rates of output relative to capacity in terms of both facilities and labor force. This led him to raise whether it might not be desirable under similar circumstances in the future to pay more attention to short-term rates in open market operations, even if this involved concurrent sales of short securities and purchases of other securities to meet possible problems of reserve availability.

Mr. Bopp expressed the view that the System should act with unity on the discount rate and said that on this basis he would be prepared to recommend an increase of 1/2 per cent to the Philadelphia directors. He was not sure, however, whether he could convince them

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of the appropriateness of such an increase in the light of current market rates. They were to meet this Thursday, as were the New York and Chicago directors, and in view of the Third District unemployment situation he would not want Philadelphia to be the only Bank to announce an increased rate. The policy directive seemed to him satisfactory.

Mr. Bryan said that recovery was continuing and, although there was nothing immediately explosive or ebullient, the situation had the earmarks of developing into an inflationary boom at some time. He was at the point of believing that the System should exercise more restraint but that, because of the factor Mr. Bopp had mentioned, it should not move overtly on the discount rate until it had prepared the short-term market. Since late in January a considerable volume of net borrowed reserves had been attained, but the monetary situation, as measured by some criteria, had actually eased. From around 3 per cent in mid-January, the three-month bill rate had gone down to the present levels and only recently had it begun to show signs of tightening. Even the longer rates had eased. In the circumstances, his inclination was to use the forthcoming period to take advantage of natural forces in the market that might tighten rates, including a tightening of the short bill rate above 3 per cent.

Mr. Bryan went on to say that his views were probably influenced by the fact that action by the Atlanta Bank to increase its discount

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rate at this time would probably require great persuasion on his part. It would have to be done subsequent to action by the New York, Chicago, and other Banks on the tag-along theory. On two or three occasions, he had tried with limited success to explain to the directors the matter of a technical adjustment of the discount rate to open market rates. At the moment, one of the big problems was to get into the public mind the relationship between fiscal policy and the value of Government securities. A 1/2 per cent discount rate adjustment now might draw a veil between this relationship and attract to the System the criticism that in his judgment was bound to come. In all the circumstances, he would favor moving quickly during the forthcoming period to use the open market instrument in such a way as to increase short-term market rates. If that were done, it might be possible to use the brief interval in April to change the discount rate, but if the System went into that period with a bill rate only slightly above or at the discount rate of 2-1/2 per cent, it could not make a move. On the other hand, if the bill rate were above 3 per cent at that time he felt that a move on the discount rate could be made.

Mr. Szymczak said that the lack of rapidity of the recovery, particularly at this time of year, and the situation with respect to unemployment and the Treasury bill rate did not suggest tightening on the part of the System through open market policy or the discount rate.

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However, with the Treasury coming to market quite soon, and again in the following month, for a large amount of money, if action on the discount rate is to be taken it should be taken soon. That, therefore, is his position at this time.

Mr. Balderston suggested that confusion in people's minds because of the psychology of the moment did not appear warranted by the facts. Personal income was 3 per cent above the peak of August 1957 and the index of industrial production may have attained in the month of February the peak reached in the summer of 1957. In short, at a rather early stage of the recovery the country was already back to the top of the previous movement. Using that to give him perspective, he had the feeling that the System ought to take at once any overt action it was going to take, and make the action decisive so that people would know where the System stood. He would be inclined to delay use of open market operations for further restraint until the banking situation made the need apparent. Corporations were now very liquid and this obviously had an impact on the bill rate at the moment. However, just as soon as those corporations used their liquidity for the payment of tax bills and accumulation of inventory they would return to the commercial banks for credit and the demand would be heavy. Then the member banks would be coming to the Federal Reserve as the lender of last resort. At some time, as yet unforeseen, he felt there would be a need to increase the net borrowed reserve figure. What he was doing in his own mind was to

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attempt to separate the Federal Reserve action that would make the front pages and which he felt should be taken soon, namely, an increase in the discount rate in the amount of 1/2 per cent, from the more delicate and less obvious actions through the open market which could be taken just as appropriately at a later time.

Chairman Martin commented that when it came to critical periods the problem was always one of struggling for logic and it was not possible to meet all of the requirements that all would like to have. Mr. Irons, for example, had spoken about the rules of the game, which in fact were forced on the System, first by a pegged Government securities market and now by a large Treasury deficit. The System's problem would be much easier if it were not for such factors.

It was at a time like this, the Chairman said, that the System must face up to the complexities of its organization. While there might be some question whether the System was organized properly, it was necessary to work with what existed and not with what some would like the situation to be. As a general rule, Reserve Bank directors' meetings were spread over a period of weeks, and there would not be a conjunction unless the Board set the meeting dates for every Federal Reserve Bank. From time to time in the past, the System had relied on the New York Bank or some other Reserve Bank

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to act as a leader to pull the thing together, but at present the situation was difficult because there would be different judgments, as in fact there were around the table today.

In his own judgment, Chairman Martin said, the economic factors now called for an increase in the discount rate. Easter sales expectations were sufficiently clear in marketing circles today to warrant enthusiasm regarding the business picture. He would not attempt to evaluate the steel situation in the light of the strike possibility, but the Wall Street Journal today reported operations at the highest point in the history of the country in terms of tonnage output, and this in spite of auto sales that were disappointing. The point of concern to him, the Chairman continued, was the very real problem with respect to the sale of Government securities. The System had not acted decisively or clearly enough to be a real asset to the Government securities market during the last six or seven months. In his opinion, it would have been preferable to increase the discount rate before the last Treasury financing instead of having newspapers talking about whether the System would or would not act on the rate at an appropriate time. Now there was again a period calling for judgment, but he questioned whether there would actually be a period as long as three weeks in April within which the System would be free to act. In the circumstances, the point Mr. Leedy had made about "pulling the rug" became a very difficult problem. A year ago, and he believed also at succeeding meetings, he had pointed out that

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it was easier to go down than up; the System tended to pull itself together on the down side more quickly than on the up side. As Mr. Bryan had brought out, the critical problem at the moment was to relate fiscal policy and the financing of the Government debt. However, the System, which earlier had deferred raising the discount rate principally because of the fact that the Treasury was in the market, now had before it the question of not doing what it would have done previously except for the Treasury financing.

Chairman Martin continued by expressing the view that the System either must face up to its responsibilities or take the position that monetary policy could not work in an environment like the present and that it was necessary to look for other controls to meet the situation effectively. He doubted the advisability of eliminating monetary policy as a part of the aggregate and saying that under certain conditions it could not work. What Mr. Bryan said with respect to preparing the market or what Mr. Bopp said regarding the short-term rate was another way of approaching the matter. To a large extent, however, the Committee must depend on the Desk for administration of prescribed policy, since obviously the Committee as a whole could not supervise the activities of the Desk on a day-to-day basis. With reference to the point made by Mr. Mills, he noted that the nature of the System organization was such as to produce a tendency toward inflexibility. To put it another way, there was a tendency to fall into the status quo pattern rather automatically. The job was to try to keep out of

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that pattern and to maintain flexibility to the extent possible, for the System must not get frozen into a pattern and stay there. On the discount side, for example, it would be possible to go down as well as up if circumstances should warrant.

Returning to the Treasury's problem, Chairman Martin again commented that a matter of judgment was involved. However, he questioned whether there would be any practical way of taking overt action through April or May, or possibly even June. There ought to be some reasonable period of even keel before the Treasury went to market in order that all of the misinterpretations coming from a discount rate action at this time might be gotten out of the way and the market could assess the action. Therefore, the earlier the action was taken the better it would be, particularly since business straws in the wind were likely to compound the problem for the Treasury. If the discount rate were increased on March 5, effective March 6, there would be a period of two weeks for market adjustments. If there were another period of uncertainty as to whether the Federal Reserve would act on the rate, with some commentators saying that it should act and some saying that the Federal Reserve was being dictated to by the Treasury, it seemed to him that the System would have abdicated any role except passive acceptance of the course of the market. In essence, what he was saying was that in his judgment the organization of the System was on trial in periods like the present. It was a question whether in the limited periods available for action a

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situation like this could be explained to Reserve Bank directors in twelve different cities, none of whom had all of the information available to the Open Market Committee. The problem was one of pulling the System together so that the decision would be clear cut, whether it be right or wrong, for one could not fiddle with markets such as now existed. In his view the Government securities market had been badly damaged by the fiddling of the last few months, and that was a matter for which the Federal Reserve had some responsibility. Where the matter would end up he did not know, but personally he would like to see those Banks whose directors were to meet on Thursday of this week take action on the discount rate and dispose of the matter, for he felt that this would be better for the System, even realizing that many misinterpretations would be placed on the action. He would be glad if Mr. Hayes were to express his (Chairman Martin's) personal judgment to the New York Board of Directors for he would like them to know what he thought about the situation. Certainly, if a move were made on the discount rate and the business situation were to collapse, the System would be blamed, but that was the risk that must be run. If the System failed to move when it had knowledge of the difficult Treasury financing ahead, it might be in a position of not having taken the one opportunity presented to it to adjust the discount rate closer to a realistic alignment with the market. In this connection, it should be noted that there was not just one bill rate, and he felt it was correct to say that the aggregate of short-term rates had been close to or above 3 per cent for a long time.

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Mr. Thomas commented that throughout 1956 the bill rate was consistently below the discount rate. A bill rate $1/8$ or $1/4$ per cent below the discount rate with net borrowed reserves around \$100 million was more normal than otherwise. If the discount rate were moved to 3 per cent, there might not be any rise in the longer bill rate.

Chairman Martin then said, with respect to the problem of technical adjustment, that certainly the more logical situation was for the discount rate to be slightly above the going rate. He doubted that the System would want to abdicate its responsibility for policy in the absence of such a relationship. He felt reasonably clear in his own mind that the System should not wait; rather, he thought that the System should express to the world clearly where it stood.

Chairman Martin said that he was not particularly concerned at this juncture with respect to open market operations. While he would not want to be inflexible, neither would he care to see any overt easing in the level of reserves. Instead, he would prefer to have doubts resolved on the side of restraint. At the same time, if a discount rate adjustment were made he would not want actively to permit the conviction to grow that the change meant a greater degree of restraint on reserves.

The Chairman then summarized the meeting by stating that he understood all to be in agreement that the policy directive should be

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continued without change. The majority would favor an increase in the discount rate to 3 per cent at the earliest possible moment. The consensus seemed to be to maintain about the same level of restraint as at present, with any doubts on the part of the Account Management resolved on the side of restraint. He then asked whether there were any comments on this summary.

Mr. Hayes commented that he doubted whether recent articles in the New York and Washington papers about System policy being in a state of suspended animation had exerted much effect on the trend of market rates, for the main factor had been heavy buying by nonbank investors. He also had some reservations about the idea that simply because the System thought a discount rate of 3 per cent was right a couple of months ago, was ready to move, but was inhibited by the Treasury financing, that meant per se that the System should feel the same way now. The fact was that credit demands had been more modest than any foresaw at the beginning of the year; at least, that was the way he interpreted the economic comments today. The Committee was always entitled to re-evaluate the situation at every meeting, and various factors might cause a change of mind. Further, he had a little feeling about the apparent disposition on the part of some members of the Committee to anticipate business developments. While there appeared to be a general line of reasoning that recovery was going to speed up and that there was going to be a sharp price rise, practically

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no evidence of this had appeared as yet. The question was whether the situation justified a really overt move, and he did not think that it did. The System was always in the position of having to take chances, and he was inclined to feel that the chances involved in waiting for the 18 or 19 day period in April were no greater than those involved in the possibility of something going wrong by moving to 3 per cent right now. He liked the idea of the System moving together but not the idea of the New York Bank moving ahead of most of the other Banks.

Chairman Martin commented that he had meant to bring out that the New York, Philadelphia, and Chicago Banks were the only ones with directors' meetings scheduled for this week. To this, Mr. Hayes responded that the public might not realize the situation; if a move were made, he would prefer to have most or all of the Banks move at one time.

Chairman Martin replied that the System was not organized in that manner. At times in the past it had relied on the money market bank for leadership, but in the last few years the money market bank often had not been the leader. He also wanted to make it clear that he had not intended to imply that anyone was committed to move now simply because some had felt that the System should have moved earlier. His own judgment was that the System should move now, for he happened to think that the situation called for such action, even though there would be some difficulties from the public relations standpoint.

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There had been such difficulties when the San Francisco Bank first moved to 2 per cent last August and there were some difficulties when the discount rate was raised to 2-1/2 per cent. However, subsequent events had vindicated both increases, and in his judgment they would also vindicate a move to 3 per cent at this time.

Mr. Hayes commented that the New York directors would meet on the 5th of March and on the 12th, and that the latter date would have the advantage of permitting a closer coordination of timing with the other Reserve Banks.

Chairman Martin responded that it would also have some disadvantage. The date would be closer to the date when the Treasury would next come to market, and discount rate action then would cause that much more ferment. Earlier, there had been discussion about the possibility of moving around the 19th or 26th of February, but the action had been deferred in order to provide a little more breathing spell because the Treasury had experienced in its refunding what was regarded publicly as a failure. From the standpoint of both the Treasury and the market, he felt that the earlier discount rate action was taken--if it were going to be taken--the better it would be.

Mr. Hayes remarked that he was thinking of whether the New York directors would be willing to act ahead of the other Banks. He felt quite sure they would be reluctant.

There followed some discussion concerning the meeting dates of the respective boards of directors, during which, at the suggestion

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of Mr. Allen, it was understood that the statements made by Messrs. Thomas and Young this morning would be reproduced and copies made available to the members of the Committee and other Reserve Bank Presidents today.

With reference to comments that had been made about the recent stability of the price index, Mr. Shepardson commented that although the aggregate index might be showing little change, it was hard to ignore the news of increases in prices and wages appearing in the papers almost daily. These increases, he noted, would ultimately show up in the index.

The comment was made in this regard that nevertheless the index had been on a plateau for some time.

Chairman Martin then inquired whether there were any other comments, and none appearing, he suggested that the directive to the New York Bank be renewed in its present form. He also commented that there were certain to be rumors crystallizing on Thursday and that caution far beyond the usual degree should be observed, particularly as to calling any special meetings of directors.

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)

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for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to fostering conditions in the money market conducive to sustainable economic growth and stability, 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.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, March 24, 1959, at 10:00 a.m.

At the request of the Chairman, Mr. Young made a statement with regard to the status of the joint Treasury-Federal Reserve study of the Government securities market. After reviewing the personnel assigned key roles by the Treasury, the Board, and the Federal Reserve Bank of New York, he said thus far those engaged in the study had been absorbed principally in planning questionnaires, the program of consultations, and getting the working papers in process. He next discussed the evolution of the questionnaires and noted that in their present form

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more work than had first been contemplated would be involved for the Reserve Banks with respect to collection, tabulation, and compilation procedures. Planning and instruction documents would be finished as soon as possible with a view to avoiding any greater imposition on the time of Bank personnel than necessary. As to the consultations, the general public relations document had been drafted and was now under consideration. In addition, Treasury and System staff assignments, which he outlined, had been completed for the respective working papers and for other assignments. Mr. Young concluded with the comment that in all of the staff discussions up to this point a very fine spirit of cooperation had been exhibited.

Chairman Martin commented that apparently good progress was being made and that the Treasury was enthusiastic about the work being done.

The meeting then recessed and reconvened at 1:45 p.m. with the same attendance on the part of members and alternate members of the Committee and other Reserve Bank Presidents as at the morning session. From the staff of Committee, Messrs. Riefler, Sherman, and Rouse were present.

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The meeting of the Federal Open Market Committee reconvened at 1:45 p.m. with the following in attendance:

Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. Daming
Mr. Erickson
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak 1/
Mr. Bryan, Alternate for Mr. Johns

Messrs. Bopp, Fulton, and Leedy, Alternate
Members of the Federal Open Market
Committee

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

Mr. Riefler, Secretary
Mr. Sherman, Assistant Secretary
Mr. Rouse, Manager, System Open Market
Account

Chairman Martin said that the purpose of this session was to discuss the problem of the number of persons attending meetings of the Federal Open Market Committee and having access to its records. It came about as a follow-up to the discussion that had taken place after the regular session of the Committee's meeting on January 27, 1959, at which time he had reported on a recent investigation into alleged leaks of information regarding certain decisions of the Board of Governors,

1/ Mr. Szymczak withdrew during the discussion.

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the investigation having been made by representatives of the Senate Permanent Subcommittee on Investigations, of which Senator John L. McClellan is Chairman. The Chairman went on to say that since January 27, some individual members of the Committee or Reserve Bank Presidents had spoken to him on this subject and one or two suggestions for a change in procedure had been made to him, but he had no idea of the general thinking of the group concerning the present procedure. It had occurred to him that, if the present procedure were to be changed, a possible means of dealing with the question would be to follow the present procedure at each meeting up through the presentation of the economic and credit reviews by Messrs. Young and Thomas, after which there would be a session limited to the members of the Committee and their alternates, the Presidents not currently members of the Committee, the Secretary and an Assistant Secretary, and the Manager of the System Account. In that limited session, the regional reviews and comments on policy and the discussion leading to a policy decision would take place.

Continuing, Chairman Martin said that the Committee desired to get as much in the way of useful comment and independent judgment as was possible in reaching its decisions, but at the same time it wished to safeguard its procedure against a charge that there were so many people present at Committee meetings or who had access to its decisions that it constituted an unsound arrangement from the

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standpoint of possible leaks of information. A review of the present list of those having access to minutes of the Committee might be used by a critic to convey the impression that too many persons had access to Committee records.

The Chairman went on to say that Mr. Fulton had made a suggestion to the effect that the Reserve Bank economists might meet separately prior to the meeting of the Federal Open Market Committee. In his (Chairman Martin's) opinion, this would not be desirable for reasons that he stated. He then suggested that each of those present express his views on the general problem, and he called first upon Mr. Bryan.

Mr. Bryan said that to his mind the problem was an extraordinarily important one. It was necessary to define the terms of the problem before the Committee could arrive at a correct solution. He then made a statement substantially as follows:

1. The problem needs to be approached as a value judgment, appraising risks against gains.

2. A fundamental in the situation, as I see it, is the temper of the times. The temper is such that public men and institutions are not innocent until proved guilty but are guilty until they can prove themselves innocent.

The attack on public men and institutions by scandal-mongering and allegations of scandal everywhere masquerades as patriotism. The degradation of the public taste is now so great that such masquerades are generally accepted at face value.

We can expect no letup in the attacks. We can expect no letup because it is to the political or monetary self-interests of our attackers. On the political side, attacks on public institutions such as the Federal Reserve System

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are, generally speaking, politically cost free and are thus indulged in whenever they promise even the slightest possible advantage. This situation partly proceeds from a fundamental and irremediable defect in our constitutional arrangements, which relieve a member of the legislative branch of responsibility for utterances on the floor and, in practice, relieve him of responsibility off the floor of the legislative assembly. On the monetary side, there is quite evidently a profit to be gained by the press in scandal-mongering and the allegation of scandal. As one distinguished publisher has said to me simply, "It sells papers." Then he went on to say that the press could not be made responsible in this country because it has succeeded in cutting down the libel laws and the interpretation of libel to such an extent that, practically speaking, they are unavailable to any public man or institution.

Much more could be said on this subject. But the point is sufficiently made that the System can expect mounting and increasingly savage attack not merely upon its policies, wherein a host of thoughtful men will arise to defend us, but upon allegations of wrongdoing and scandal, wherein we can rely only upon ourselves and our ability to prove our innocence.

3. The point that we must have firmly in mind and keep hold of is that these scandal-mongering attacks will not be related to facts or to our actual innocence. They will be related, instead, to the political or monetary self-interest of the attackers. We must, in my view, have clearly in mind the fact that our task is not only that of being innocent. Our task is also that of proving our innocence. Unless we approach our current problem with a completely cynical understanding of this point, then in my judgment we are going to arrive at erroneous conclusions.

4. The next point to be realized is that under our present organization and procedure the number of people involved in the knowledge of decisions is so great that the task of proving our innocence is impossible--note that I am distinguishing between the knowledge of decisions and the decision-making process.

5. In the light of these circumstances the problem, I think, is to preserve the participation of many informed minds in the decision-making process but to reorganize our procedure in order to:

- (a) make certain that we are clearly within the statute; and,

- (b) reduce dramatically the number of people who have knowledge of actual current decisions at the time they are made; and,
- (c) handle the materials of the Committee under such security regulations, or such noncurrent status, as materially to reduce the possibility of unauthorized use or to make such knowledge and possible use of little or no significance.

The advantage of (a) would be that, by staying as strictly within the statute as possible, we would materially reduce the profitability of merely whimsical attack. If we stay clearly within the statute, or its necessary and unavoidable implications, we rest on the solid foundation of the legislative branch's own considered decision; and we give ourselves the enormous advantage that is gained by anyone in an argument when he can cite on his side the fact that, "The law says..." By staying clearly within the statute, we practically assure ourselves that debate on a change of the legislative branch's previously considered decision will be on a much higher level of policy than will be true if we are accused of taking advantage of the law's silences. On the other hand, if we take advantage of the law's silences, without clear necessity, then we immensely increase the difficulties of our defense, either by ourselves or by those who are our admirers and advocates. For such reasons, which could be greatly extended and illustrated, I believe it extraordinarily important that we give a strict interpretation to the statute and the clear implications of the statute, and that our use of the statute's silence, when it exists, rests upon paramount necessity.

The advantage of (b) is that it would materially improve our chances of proving our innocence as against charges of leaks and scandal--which is the prime and overriding requisite in my judgment. The advantage of (c) is the same.

The handling of the operating procedures of the Open Market function, and the minutes and other materials that it necessarily produces, with a rigid sense of responsibility, would be generally regarded, both by our critics inside and outside the legislative branch, as a necessary extension of our more narrowly defined responsibilities under the statute.

6. In specific terms, accordingly, my approach to the organization of the Open Market Committee would be as follows:

- (a) As for the Presidents, I think that only those who are members and alternate members should be present at the meetings. This would be either entirely within the statute, or so completely within the clear necessity of the statute (for orderly continuity of the Committee's work at the annual change-over of membership) as to be essentially beyond criticism.

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In my opinion, the presence of the nonmember, non-alternate presidents cannot be defended on the basis of the statute. I do not believe that their presence can be defended on the basis of necessity for orderly continuity of the Committee's work. I do not believe that their presence can be defended on the ground of mustering the total intellectual resources of the System in the process of decision-making; for I think it clear that several other devices could be utilized that would quite as effectively muster for the use of the Committee the opinions of the nonmember, nonalternate presidents. Indeed, I believe that a considerable case could be made out for the idea that it would be wise to have some of the presidents standing a little aside and a little independent of the group discussions out of which decisions are currently taken.

There is, to be sure, an advantage to group discussion and group evaluation of differences in points of view and emphasis. On the other hand, there is some advantage in having some of the Presidents uninfluenced by the group discussions and group evaluations, arriving at their evaluations by more independent procedures; and I would deem this advantage considerable for two reasons. First, the Presidents by their almost constant preoccupations with current monetary affairs, are among the country's better critics and commentators on current policy, and they are practically speaking the easiest and most properly accessible to the FOMC on current problems, so that a measure of independence in the judgments of some of them could well be of great value. Second, the Governors, the President members and alternate members of the Committee, together with some of the officers of the Committee would still be a group large enough to represent a diversity in points of view, oral emphasis, and a balanced evolution of a group judgment. Moreover, in this connection, the absent Presidents would not be deprived of participation in the decision-making process by means other than their presence at meetings: they would only be deprived of immediate knowledge of taken or impending decisions.

(b) As for staff, it is certainly a necessity of the statute that the work of the FOMC must involve a mechanism for recording its deliberations and decisions and for professional economic, and legal advice.

It is not necessary, nor in my view does it contribute anything to the decision-making process, which is the important value that we must preserve, for there to be extensive staff knowledge of actual decisions currently arrived at. Accordingly, as to staff, my approach would be as follows:

(1) The economists of the President members and alternate members of the FOMC can very well have their responsibility for briefing their Presidents, as now, on the economic developments in their several Districts and nationally, and of considering with their Presidents the various policy factors entering into decisions. There could be no objection, I feel, to their being present at the economic and financial presentations made to the FOMC. I believe, however, that they should withdraw once general discussion starts and decisions are either taken or impending decisions forecast.

(2) There can be, as I see it, no objection to the Board's staff participating in the same way--and perhaps there should be a few exceptions made, but very few, for individuals whose presence at the entire meeting is deemed important. Certainly anyone remaining at the entire meeting, I believe, if not a member or alternate member of the Committee, should be an officer of the Committee.

(c) As for the production of minutes of meetings in the offices of the Board of Governors, it seems to me that the procedure ought to be under rigid, written controls with at least an annual procedural checkup.

(1) As for the Banks that are not represented on the Open Market Committee, I believe the minutes should not go to them until the minutes are noncurrent. Just how much of a time lag should be involved I do not know. The important thing is that there should be enough of a lag that decisions have already resulted in action, either revealed or foreshadowed in published statistics or in discount rate action by the Banks that are members or alternate members of the FOMC.

(2) As for the forwarding of minutes to the Banks that are represented as members or alternate members on the FOMC, I think that could be done promptly as at present, but I believe that access to the minutes should be rigidly confined to the President and his associate economist and released from a security file to such associate economist only upon a charge-in and charge-out system initialed by and under control of the President personally. They could, of course, under regulation, be released to others when they are noncurrent.

(3) I have not considered in detail the daily wires or reports of the Account Management. However, as is sufficiently indicated, I would put them under rigid control, making errors, if errors are to be made, on the side of rigid rather than lax procedure.

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The advantages of (c), (1), (2), and (3) are to be found in reducing radically the number of persons currently informed of decisions at the time they are taken. There is, however, an incidental advantage of considerable importance.

I believe there is a mine of information to be had from analyzing the System's weekly statement, loan statistics, money rate trends, and so on. I believe that if some of the System's personnel, economists and Presidents alike, were working these mines a little more assiduously we would find the effort vastly rewarding; and, if the easy out of simply being "in the know" were removed from time to time as the Committee's membership changed, some of us might be tempted to do a little more pick-and-shovel work in an effort to find out precisely what the System was doing.

I guess I should speak personally on this point, but I think a little more pick-and-shovel work would strengthen my own intellectual muscles a good deal, for on a good many occasions I have found that when I got to reviewing statistics I had quite a different impression of System policy than I received from the 'round-the-table discussions of what we were doing or thought we were doing.

7. The foregoing discussion simply indicates an approach and omits many items of detail. There is one major point on which I will not evoke much sympathy and will not argue at length.

I believe that the mechanism for fixing the discount rate should be altered and the power to fix the discount rates for the several Banks should be placed either in the Board of Governors or in the Federal Open Market Committee. The present mechanism was wholly logical when it was established; but in my view it is anachronistic, does not correspond either to the economic facts or the mechanistic facts of rate determination, is frequently embarrassing, and is destined sooner or later to lead us into grave difficulties.

For better or worse, we now have a national money market and a national monetary policy. The discount rate should be operated in harmony with our other instruments, and the men having responsibility for the other instruments should not be able to avoid the assumption of responsibility for the discount rate.

The important thing in connection with the local Boards of Directors of the Federal Reserve Banks is in keeping an able body of men who, by their questions, assist in making the presidents and executive officers of those banks look alive and, by their training and experience, bring to the banks

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points of view and information of vast use for policy decisions. It is not important, and provocative of great misunderstandings, to leave the actual legal responsibility of fixing the discount rate in the hands of the local Boards of Directors.

8. The point of view adopted in these notes leads to Draconian measures. Such measures are herein suggested not because of any natural liking for them but because I believe them to be of paramount necessity in view of the temper of the times and indicated, in any event, by a logical and necessary interpretation of our statutory responsibilities.

Mr. Bopp said that his approach differed somewhat from that of Mr. Bryan. First, he felt it important that everyone having access to open market information be a person whose integrity was beyond question. There was also the matter of judgment, and if there was ever any doubt about an individual's judgment, regardless of the level of his position or his responsibility, there would be no option but dismissal. Second, a sense of participation in the open market process was important in terms of morale. Third, in terms of training, access to pertinent information was of value and this would include the opportunity to observe and listen to discussions at these meetings. Therefore, Mr. Bopp said, he would be inclined to retain the present procedure even if there were difficulty in defending it. He felt that leaks or threats of leaks would persist regardless of the number of persons involved in the meetings or having access to the records.

Mr. Fulton said that he had been disturbed by the number of persons that had been present at meetings during the decision-making

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process. He would agree that a number of Mr. Bryan's points would be helpful if adopted. He would be quite inclined toward the suggestion that members of the staff who did not participate in the decision-making discussion withdraw from the meetings prior to that portion.

Mr. Shepardson said that he, too, was inclined to agree with much of the procedure suggested by Mr. Bryan. It was not clear to him just how much the training of persons who did not participate in the policy discussion was furthered by having them present throughout the meetings, and he was inclined to agree that it might be better for them to withdraw after the economic review was presented. Mr. Shepardson said that he would not agree, however, with the suggestion that the Reserve Bank Presidents who were not currently members or alternates of the Committee should withdraw prior to the decision-making discussion. As to the availability of the minutes, Mr. Shepardson said that his feeling would be that after a limited period--perhaps a few weeks after a meeting--access to the minutes and other records could be defended for those persons working on open market matters. In general, his feeling was that the Committee should take every possible precaution to eliminate or at least to minimize opportunities for criticism such as had arisen on some occasions in the past.

Mr. Robertson said that he thought Mr. Bryan had stated a very good case. All he needed to do was to state where he did not

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agree. He did not think this an "open and shut" matter on either side. It was a matter of weighing the means by which the Committee could accomplish the job before it with the least amount of justifiable criticism regarding leaks. This meant that the Committee must be able to justify to itself its procedures for letting others than members of the Committee have access to information. With respect to the Presidents who were currently not members of the Committee, he completely disagreed with Mr. Bryan's suggestion for having them withdraw from the meeting prior to the policy decision process. Any advantages from such a procedure would be greatly outweighed by the advantage of having them present for the purpose of maintaining continuing familiarity with open market information from month to month and year to year. With respect to the staff, Mr. Robertson felt that all members should be treated exactly alike regardless of whether they were from the Board's staff or the Banks. What he meant was that if staff members from the Banks were to withdraw after the economic review, the same procedure should apply to those who were staff members from the Board. It could be argued that there were advantages to be gained from having the staff withdraw, Mr. Robertson felt, in that they might have a more independent view than if they were present during the policy discussions. His conclusion was that it would be preferable for each Reserve Bank to be represented at every meeting, and if the President of a Bank were unable to be present, then one

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other member of the Bank's staff (an alternate member of the Committee, a First Vice President, an economist, or some other person) should be there so that that Bank would have a first-hand contact with what went on at the meetings.

With respect to access to minutes and reports, Mr. Robertson said he was not bothered. The more that persons working on open market problems were familiar with this material, the better the advice available to the Committee and the Presidents was likely to be. The minutes did not usually reach the members of the Committee for a week or ten days after a meeting, and it seemed to him that their availability offered little danger of leaks. He would continue to make available the minutes of the meetings to the members of the staff at the Reserve Banks and at the Board, and he noted that every one of the persons now on the list for such access had been vouched for by a member of the Board or by a Reserve Bank President. Mr. Robertson said he did not think the System was ready at this time to adopt the suggestion that Mr. Bryan had made regarding a change in responsibility for the discount rate and he would not now favor it.

Mr. Robertson later added the comment that he also thought there should be an understanding that no member of the Committee and none of the Presidents who attended meetings of the Committee should discuss any open market decisions with the directors of a Reserve Bank. This might be the case at present, but in his view the board

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of directors of a Reserve Bank should not have access to any of the open market information that was not made available to the Committee's staff.

Mr. Mills said he did not know how the Committee was going to resolve all the different shades of opinion coming out of this discussion. His own view would be to accept the procedure suggested by Mr. Bryan, with several modifications. The first of these would be that all of the Reserve Bank Presidents should attend the open market meetings. He felt there would be no good reason for them to bring with them their economists, if the economists had access to the proceedings of the meeting at a later date and were available for consultation with the Presidents at that time. However, excluding the Bank economists from the meetings should not, in his opinion, be extended to excluding the officers of the Committee from the Board's staff who were elected at the regular meeting. That would eliminate the election of the associate economists as officers of the Committee and would limit the officers to the Secretary and Assistant Secretaries, the Economic Adviser, the Director of Research, and the General Counsel and Assistant General Counsel. Mr. Mills said that he felt rather like Mr. Robertson regarding the minutes, that they represented water over the dam, and when they were distributed to the Presidents and members of the Committee there would be no objection to opening them to others for their educational value and

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interim guidance between meetings, it being understood that this would be done with discretion and by limiting access rather rigidly. As far as the discount facility was concerned, Mr. Mills' view would be quite different from that of Mr. Bryan. He had a strong feeling that this was the heart of the Federal Reserve System, and the merit of its decentralized organization rested on director participation. The essence of that participation was deliberating in the discount rate decisions. While this produced rough spots, his belief was that the advantages of preserving the present system immeasurably outweighed the disadvantages.

Mr. Leach said that he thought all of the Presidents should be invited to attend the open market meetings. He felt that, if he had not been in attendance at meetings in recent years, he would have been at a considerable disadvantage in not having had the benefit of these discussions, especially on some occasions when he went to his directors with certain recommendations. He did not feel too strongly about the present arrangements for the staff to attend, but he did feel that each President needed to have some person in his Bank with whom he could freely discuss open market matters and to whom the minutes would be available. It seemed reasonable to him that each President should bring one economist with him to the meetings, including that part concerning policy discussions. The Committee could operate without having the economists present, but there was an advantage to a Reserve Bank President to be able to talk with his economist about

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all aspects of the meetings, and it certainly kept the economist on his toes and interested in what was going on. For his part, Mr. Leach said he would undertake to defend that arrangement, which he believed to have much advantage, although he would agree that the Committee could operate on a more restricted basis. As to the minutes, he was inclined to feel that some time limit might be placed on making them available. For example, it seemed to him that after three months there was very little danger in making the minutes available to the members of the staff now having access to them.

Mr. Leedy said that he felt strongly that the Reserve Bank Presidents should attend the meetings of the Open Market Committee even when they were not members. A President would be tremendously handicapped if he did not have that privilege. As to material distributed, he would divide that into the minutes and other data. He would be in favor of limiting access to the minutes to the man who accompanied the President to the open market meetings, and he could see no need to make them available currently to others, although there would be no objection to making them more widely available after a time. As to the materials, other than minutes, Mr. Leedy said he could see no reason to limit their distribution more than was now done. As to attendance at these meetings, the Committee seemed to be talking about seven persons, since five Associate Economists had been selected from the Banks as Committee officers. If the economists were to come to the meetings, Mr. Leedy said

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he felt they should be privileged to attend the meetings throughout. He would doubt the value of their making the trip to Washington merely to be present at the preliminaries. If attendance were limited to one economist from each Reserve Bank (and Mr. Leedy thought there should be one man who attended regularly rather than to have rotation), and if the Reserve Bank President had the responsibility to see that there was no violation by the man who accompanied him of the rules with respect to dissemination of information, there would as a practical matter be no exposure to the kind of thing the Committee was attempting to guard against. Like Mr. Leach, he felt it of value to have a man on his staff with whom any aspect of the open market operation might be discussed. He thus came out pretty much in the same position as Mr. Bopp. He would eliminate making the minutes available to the rather long list of persons who now appeared to have access to them and would make them available to one man at each Reserve Bank who was selected to work with the President, and if the President wished to bring that man to the meeting he should be permitted to attend the meeting throughout.

Mr. Allen said that Mr. Mills had expressed substantially his feeling. He personally doubted whether the associate economists should attend the meetings. He also felt that there was not much value in having an economist come to Washington only for the economic review. While he enjoyed discussing these problems with the men on

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his staff, he believed their opinions were of more value if they were given on the basis of their own analysis, rather than after listening to the reports at the meeting. In sum, Mr. Allen said that he did not think the economists should be at the meetings, and he definitely felt that all of the Reserve Bank Presidents should attend. At the Chicago Bank the list of persons having access to the minutes was small, and he would favor letting them see the minutes when they were distributed about a week after the meetings.

Mr. Deming said that he came out close to the position indicated by Mr. Mills. He started from a somewhat different basis than that indicated by Mr. Bryan. The charges of leaks seemed to cluster more around the discount rate than open market operations, Mr. Deming noted, adding that some 300 persons had some knowledge of a discount rate matter and an almost impossible task was faced in trying to cut down that number in view of the structural organization of the System. Thus, when it was suggested that a half dozen persons be eliminated from the forty odd persons who attended an open market meeting, there was not much to talk about. Mr. Deming said he could not say there was much training value from the standpoint of the economic staff of the Bank in either reading the minutes of an open market meeting, or sitting in on the deliberations. He agreed there was no strong point in bringing a man into Washington just for the economic presentation. However, he felt that it was

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of value for the person advising the President to have current access to all the material that was available. For this, he would limit minutes access to the President of the Reserve Bank and one economic adviser. Also, for the report of open market operations, he would limit access almost that closely. For miscellaneous materials such as the economic and credit review, he could see no particular reason to place any limitation on distribution within the System. As for attendance at meetings, Mr. Deming said he would be entirely agreeable to the suggestion made by Mr. Mills on the grounds that it would put the Committee in about as reasonable a position as it could expect to be in. This, together with reducing the number of persons having access to the minutes and report of open market operations, would cut the list to better public relations size. In response to a question by Mr. Hayes, Mr. Deming added the comment that there seemed to him to be no value in having an economist come to Washington for the meetings, except as he could get training by sitting in the meetings and thus be of greater help to the President in the future. He particularly felt that attendance by the economist only for the economic presentation would not justify the trips to Washington. Thus, while he wanted the man advising the President to have access to all the material under discussion, Mr. Deming would confine attendance at meetings so as to exclude all of the associate economists.

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Mr. Mangels said that he agreed with about the position described by Mr. Deming. He could see no advantage in having a man come to Washington just to hear the economic and credit review. As to distributed material, he noted that the wire summarizing the 11:00 a.m. daily telephone call should be treated with as great a degree of confidence as other open market materials. However, he would wish to have the minutes and any of the other open market materials made available not only to his economist, but also to the First Vice President of his Bank.

Mr. Irons said that, as for attendance of his economist at the Committee meetings, he thought it was probably a matter of indifference either to the economist or to himself. He felt strongly that if the economist were not going to participate in the entire open market meeting, the expenditure for bringing him to Washington just to hear the economic review would not be justified. Mr. Irons said that his view on this was partly dependent on whether he would have the privilege of discussing with his economist when he returned from an open market meeting any of the matters that had been taken up. He did not think the economist should be excluded from access to information if he was to be expected to serve as an associate economist. Quite as important as the minutes was the question of how freely the President might discuss the matters taken up at open market meetings with persons with whom he originally consulted

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closely. A President should not operate in a vacuum if the System hoped to have an effective working group. There was always this question of how best to use people and how to be secretive and still get full return out of the work. Mr. Irons said he would be inclined to agree that, on a strict legalistic basis, perhaps Mr. Bryan had the answer. However, even if that were adopted, he did not think it would stop the charge of leaks of information upon occasion. He felt it extremely desirable for all of the Presidents of the Reserve Banks to be continually exposed to the discussions that went on in open market meetings. The question boiled down to trustworthiness, Mr. Irons said, and the System would have to defend that trustworthiness when called upon to do so. He could see no basic difference between a President serving as a member of the Committee in 1959 and not being a member in 1960. It might be noted, Mr. Irons said, that virtually all of those involved in open market matters were persons who had been cleared for top secret material on emergency defense operations. On balance, he was inclined to agree with what he understood to be Mr. Bopp's view, with the possible exception that it was a matter of indifference whether the economists attended the open market meetings or not.

Mr. Erickson said that he felt all of the Presidents should continue to attend the meetings. If attendance by the economists at the meetings were to be limited to the presentation of the economic

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reviews, he questioned whether this would have enough value to justify their coming. If that were done, he would have no objection to any of the Board staff members sitting in on the meetings even if the Bank economists did not attend, provided they withdrew at the time the discussion of policy started. As for the material sent out and discussion after the meetings, Mr. Erickson thought this question should be left largely to the Presidents. The list of those at the Boston Bank having access to open market material was one of the smallest in the System and he had contemplated adding one or two names to it.

Mr. Rouse said that his general thinking had been much along the lines expressed by Mr. Bopp. There was an educational value to the present procedure, and since each person designated to attend the meetings or see material was selected by a Reserve President or a member of the Board of Governors, he could be considered to be thoroughly trustworthy. The point Mr. Irons had mentioned that virtually all such persons had been fully cleared for security purposes seemed to be a good additional test that could be cited. So far as attendance at meetings by the associate economists was concerned, Mr. Rouse said that if their presence was limited to the economic review prior to the go-around at which the Presidents and Board members reported and commented on conditions and policy matters, it might not be worthwhile to have them come at all. On the other

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hand, so far as the Account Manager was concerned, he felt it almost essential for him to have the nuances and shades of the full discussion in carrying out the intent of the Committee.

Mr. Hayes said he found himself in strong sympathy with the views expressed by Messrs. Bopp, Irons, and others, except that he was inclined to go a little farther in that direction. The problem of leaks was going to be with the Committee always, and it seemed to him that there was grave danger of exaggerating it and of handicapping the Committee in accomplishing its main objective. The matter of trust was of great importance in the Committee's functioning. All of those selected must, of course, be people who could be trusted, and if ever any reason for doubting a person developed those responsible would take Draconian measures. Up to that point, Mr. Hayes felt that each President should have considerable leeway to consult with persons who might assist him in this function. This implied that such persons should be given the opportunity to see what was going on in the open market meetings. He felt strongly that all of the Presidents should be at the Committee's meetings, not only because it was vital to them but because this gave the Committee a better feel of what was going on over the country and thus helped it in arriving at its decisions. On the matter of associate economists, Mr. Hayes said that personally he felt there was nothing wrong with the present procedure. He would

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have thought that any President of a Reserve Bank would want to have an economist present at the meetings who would get the flavor of what went on. In his own experience, it had been definitely useful to have an opportunity to discuss matters with a person who had been present and who knew the whole process of the Committee meetings. Even though the economist might later have access to papers including the minutes of the meetings, Mr. Hayes doubted that this would serve the same useful purpose as actual attendance. In addition, Mr. Hayes said that he did not believe the Committee should treat the associate economists from the Reserve Banks any differently from the Board's staff economists. If the Board staff members were present, he felt that the staff members working closely with the Presidents also should be present. With respect to the minutes, Mr. Hayes said that he had much sympathy with the view expressed by Mr. Robertson that after a period of time there was not much danger in making them available to selected additional persons, and for this reason he would not be inclined to change the present procedure. In short, for the sake of having a well-trained group of Presidents and senior staff members, he felt that there must be reliance on the integrity of the persons concerned. In his judgment, the Committee could successfully meet the problem under discussion without a change in the present general procedure.

Mr. Balderston said that he did not think the Committee had met the problem in the past. There had been an allegation by a

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member of the staff of Senator McClellan's Permanent Subcommittee on Investigations that in his observation the procedure to guard against leaks was not sufficiently tight. His position might seem reasonable to the uninformed in the light of the distribution of open market records to a list of 86 persons. Now that the gist of this comment had been relayed to the public by two newspaper columnists, the whole System has been given unfavorable publicity. Mr. Balderston favored a plan not far different from that suggested by Mr. Bryan. He would restrict the actual decision making and immediate knowledge of those decisions of the Committee on a "need to know" basis. He realized that this might seem at first glance to interfere with the desire to get an adequately trained group through-out the System and also with the desire to have unity within the System. The first of these objections did not seem to him valid. As to the second, the open market meetings should serve two purposes; first, for the determination of open market policy, and second as a System assembly devoted to exchanging views as to district and national economic affairs and what should be done about them. However, this purpose had been marred somewhat in that it had become the custom in the go-around to make statements as to recommended policy along with the reports of economic conditions. If the Committee wanted to take rather extreme measures while it was free to do this on its own, his suggestion would be to have all of the

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Presidents attend the meetings while the regional accounts were being given. Also, it was of great value to be able to discuss at these meetings all of the instruments of monetary policy including reserve requirements and discount rates, as well as open market operations. The procedure that had developed in this respect represented a great improvement during the past few years and this accomplishment should not be lost. When it came to the actual making of decisions to guide the Desk for the ensuing three weeks, Mr. Balderston felt that if the Committee wished to have the cleanest answer to any criticism, it could have the voting members of the Committee go into executive session at the end of the other discussion. What he was suggesting was that the Committee conduct itself just as it had been doing up until the last 15 minutes of the meeting and then to have the twelve individuals who by statute constituted the Committee meet to decide upon their directive to the Desk. When this decision had been made and summed up by the Chairman, it would be known only to 14 persons-- the 12 voting members plus the Manager of the System Account and the Secretary of the Committee. Then, if there were any leak, only 14 persons could have known what the action had been. Mr. Balderston said he also thought something should be done about the large volume of material that was distributed in connection with the Committee's work. It was true that this material did not offer much danger a week or so after it had been distributed, but if it were dangerous at the time it was issued, perhaps it should be signed for and placed

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under lock and key as part of the procedure for distributing it.

Mr. Balderston said that he was suggesting that the Committee should look to its procedures so that it would not appear to be as lax as the comment of the investigator for Senator McClellan's Committee indicated the Board of Governors appeared to be.

Mr. Hayes said that he had some difficulty in visualizing the nature of the executive session of the voting members of the Committee that Mr. Balderston had suggested, which he gathered would be confined to determining the wording of the directive and authorizing its issuance.

Mr. Balderston responded that his thought was that any President or Committee member should stop short in his comments during the go-around before expressing what he thought the level of net borrowed reserves should be, that he should leave the final part of his thinking on the policy decision until the executive session.

Chairman Martin remarked that this would not be an easy thing to do. He then invited the other staff members present to express their views.

Mr. Riefler said that he felt strongly that real benefit resulted from having each Reserve Bank President attend the open market meetings, even though some were not voting members, and from having each one accompanied by a person with whom he could discuss any of the matters that came up. What bothered him was that during

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the past few years the procedure had gone somewhat beyond that concept. The list of those attending the meetings, and particularly of those having access to minutes and other Open Market data, had been expanded considerably, and he felt that it would be desirable to make a careful review of the list of persons authorized to have access to Open Market data.

Mr. Sherman noted that since the 30's the Committee had moved from an extremely limited attendance at meetings and availability of minutes to the present much extended basis. This had been for reasons with which all were familiar. Perhaps the swing had gone farther than was needed to accomplish the purpose, and some cutting back might be appropriate. With respect to access to Open Market records, the list looked larger than it was in practice, since at least some persons were listed only because of rare need to see some specific record. As for the suggestion that circulation and control of the minutes might be more rigid, Mr. Sherman commented that the existing procedure could well be reviewed but that a close control of the minutes had always been followed in their preparation and distribution.

Chairman Martin then commented that the discussion of this topic had taken considerable time but that he felt this essential in view of the question that had been raised. Whatever the majority decided was necessary should govern the procedure to be followed in the future. Personally, he still was not convinced that the present operating procedure was wrong. Mr. Bryan had put the case for a more

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restrictive procedure as strongly as it could be put but his (Chairman Martin's) judgment was that the methods the Committee had been pursuing were the right ones. This was true for training purposes, for development of information useful to the Committee, and for other reasons. He felt that, in general, the Reserve Bank Presidents were pursuing the right course under the existing system. It had been something of a shock to him to find that these procedures were being criticized. However, he had noted that some of those who attended the meetings and sat on the sidelines took notes of the discussion. In his view, this was a mistake. He felt that only the person who prepared the official record should make notes during the meetings.

As to attendance and procedures in general, Chairman Martin said that it seemed to him that, from the individual Reserve Bank President's point of view, it would be disastrous to go back to the limitations that had existed in the past. He recalled that when he first came to the Board he found that there were at least one or two Bank Presidents who did not discuss the subject matter of open market meetings with anyone in their Banks. His reaction had been that those men could not get any real feeling or understanding of the problems or make a contribution unless they had someone with whom they could frequently discuss these things on a fully informed basis.

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As to the Reserve Bank directors, all of us got exasperated at times with the unwieldy nature of the System. At times, he wondered whether the System might be holding out a fraud to the public on whether there was adequate participation by the directors of Federal Reserve Banks in System matters. There was the problem of how to get the System to pull together, and each individual President had a problem in knowing what to say to his directors. The Chairman cited a comment by one individual director that had come to him from the outside that indicated a complete lack of understanding of the discount mechanism. He realized that the Presidents had a very difficult job, but his own view was that if the Banks were going to get the staff to participate and to develop, they would go much farther by having some of them in at these discussions. Recognizing that Mr. Bryan had stated the case for restriction as clearly as was possible, even if all his suggestions were adopted the charges of leaks would not be eliminated and their adoption was not going to enable the System to prove its guiltlessness or that it had not violated its trust. As to the list of persons having access to Open Market records, Chairman Martin said that he thought it would be desirable to review it in terms of putting on to each President the responsibility for considering carefully the person or persons with whom he wished to consult on these matters. Perhaps it would not be necessary to keep such a list, if the individual Reserve Bank Presidents assumed this responsibility.

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Mr. Bryan said that as he had listened to the thoughtful discussion of the problem, he had been impressed by the emphasis on the advantages from many points of view of the present organization and procedure. He shared an appreciation of those advantages and wished to make clear his hope that they could be preserved to the greatest extent possible. At the same time, he would re-emphasize what he believed to be the overriding importance of other considerations at present. The discussion had correctly emphasized the trustworthy character of personnel at all levels dealing with Federal Open Market Committee matters. He shared that emphasis on trustworthiness but could not agree that it eliminated a requirement for far more rigid procedures than the Committee now had. It could be said that the personnel of the System was of extraordinarily high caliber, but it still had elaborate audit and examination procedures in order to prove that nothing had gone amiss. This was done not merely to protect the Banks but to protect the personnel. If the Banks were at such pains to prove their accounting records were correct and that the cash was all accounted for, then wasn't it even more important, he asked, in the System's responsibility for monetary policy, to go as far as possible in proving that no charge of scandal was well taken. Mr. Bryan also said that he also doubted that these matters could be left to the discretion of the Reserve Bank Presidents as had been suggested during this discussion. The Federal Open Market

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Committee was a statutory body and he believed it the better part of wisdom for the Committee as such to take the responsibility for its procedure and security regulations.

Mr. Robertson said that he did not think the discussion of this problem could be pulled together at this session. Various points of view had been expressed, and in his opinion it was now necessary to have these views put together by the Secretary and to have the whole subject reviewed again after all of those present had had an opportunity to study the minutes.

Chairman Martin stated that this was his view, and Mr. Bryan suggested that it might be desirable in the interim to have a small committee appointed to study the matter and present a recommendation to the full Committee.

Chairman Martin stated that before doing that he felt it would be preferable to have the record of this discussion prepared and distributed, and after all of the members of the Committee and all of the Reserve Bank Presidents had had an opportunity to review it and consider the subject further, call another meeting for the purpose of carrying forward the discussion.

There was general agreement with this suggestion.

Thereupon the meeting adjourned.


Secretary