Minutes of actions taken by the Board of Governors of the Federal Reserve System on Thursday, August 18, 1955. The Board met in the Board Room at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Vardaman
Mr. Mills

Mr. Carpenter, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Young, Director, Division of Research and Statistics

The following matters, which had been circulated to the members of the Board, were presented for consideration and the action taken in each instance was as indicated:

Memorandum dated August 12, 1955, from Mr. Hostrup, Assistant Director, Division of Examinations, recommending that the resignation of Curtis B. Morrow, Assistant Federal Reserve Examiner in that Division, be accepted effective August 10, 1955.

Approved unanimously.

Letter to the Comptroller of the Currency, Treasury Department, Washington, D. C., (Attention: Mr. G. W. Garwood, Deputy Comptroller of the Currency), reading as follows:

> Reference is made to a letter from your office dated June 2, 1955, enclosing photostatic copies of an application to organize a national bank at Bovina, Texas, and requesting a recommendation as to whether or not the application should be approved.
>
> Information contained in a report of investigation of the application made by an examiner for the Federal Reserve Bank of Dallas indicates that the proposed capital structure of the bank would be satisfactory. The territory to be served by the bank is reported to be rather restricted and, in view of the proximity of two other banks in neighboring towns, considerable doubt is expressed as to the

prospects of the institution obtaining a satisfactory volume of business and earnings. There is some question also regarding the competency of the active management. While it appears that the bank would provide somewhat more convenient banking services to the residents of the community, the unfavorable factors seem predominant, and the Board of Governors does not feel justified in recommending approval of the application.

The Board's Division of Examinations will be glad to discuss this case with representatives of your office, if you so desire.

Approved unanimously.

On August 10, 1955, the Board advised the State and Treasury Departments that it would be willing to extend the current Scandinavian trip of Mr. Thomas, Economic Adviser to the Board, to include a brief trip to Iceland, for the purpose of appraising measures to combat inflationary tendencies, if Mr. Thomas was able to make the necessary arrangements. Mr. Thomas subsequently informed the Board, through the State Department, that he would be agreeable to undertaking the assignment. He suggested first arranging a meeting in Oslo with the Governor of the central bank of Iceland on the occasion of the latter's forthcoming visit to Oslo. In a message to the State Department, the United States Minister to Iceland concurred in the plan proposed by Mr. Thomas.

Prior to this meeting there had been circulated to the members of the Board copies of a memorandum from Governor Szymczak dated August 17, 1955, recommending, in view of developments, that the Board authorize Mr. Thomas to undertake the assignment and that appropriate letters advising

of the Board's action be sent to the State and Treasury Departments.

Following comments by Governor Szymczak, the recommendations contained in his memorandum were approved unanimously.

Reference was made by Governor Balderston to the approval given by the Board on August 15, 1955, to the installation of telephone mobile equipment in one of the Board's automobiles. Installation of such equipment had been suggested to agencies of the Government by the Office of Defense Mobilization.

Governor Balderston reported having been advised by the Division of Administrative Services that the telephone company originally furnished the incorrect tariff for this service and that the monthly charge would be $25 rather than $10.

Following a discussion, Chairman Martin suggested that a decision on whether to go ahead with the installation be deferred until the return of Governor Robertson.

This suggestion was approved unanimously.

Minutes of actions taken by the Board of Governors of the Federal Reserve System on August 17, 1955, were approved unanimously.

There followed a discussion of System monetary and credit policy in the light of current and prospective business and financial developments.

At the request of the Board, Mr. Riefler reviewed developments in the money market since the recent discount rate increase. He said that the

Treasury bill rate, which had moved up to a 1.85-1.90 range, was acting in a manner consistent with precedent and that in general the market seemed to be operating as an efficient indicator of Federal Reserve policy. After raising the question whether enough restraint was being exercised, he said that under present circumstances it would be relatively easy to raise the bill rate to around 2.25 through open market operations designed to produce and maintain negative free reserves at a level of around $500 million. He went on to say that he would prefer to see further restraint achieved through an increase in the discount rate since if the bill rate were to go above the discount rate, accompanied by heavy borrowing, member banks would find it cheaper to discount than to adjust their reserve positions through the market. In that event, problems of the use of the discount window similar to those of 1952-53 would be likely to arise.

Mr. Young then commented on the continued strong business trend and said that the price picture, except for agricultural prices, seemed to be one which held the strong possibility of further advances. He then discussed discount rate policy throughout the history of the Federal Reserve System and out of that record concluded, like Mr. Riefler, that a situation such as the present suggested the use of techniques which would hold the discount rate above the bill rate and provide the reserves necessary for economic growth through open market operations.

Chairman Martin referred to the prevailing discount rate structure and stated that the Cleveland Reserve Bank would be under pressure to fall

back to 2 per cent unless other Reserve Banks moved to 2-1/4 per cent. He also said that under conditions like those existing at present, Federal Reserve policy should be clear and precise, and that in his opinion the margin of error ought to be on the side of severity rather than leniency. He pointed out that the Federal Reserve was not faced with the possibility of panic in the Government securities market or a business downturn and that the problem was one of whether the System was willing to run the risk of letting the situation get out of hand. Developments during the remainder of the year, he said, might be of such a nature that the System would find itself in a position where any action that might be taken would be too late.

Governor Mills mentioned reports in the press and elsewhere indicating growing tightness in the credit market under the influence of System policy and stated that the point might be reached where there would be reactions going beyond the degree of restraint that the Federal Reserve desired to exercise. The best plan, he thought, was to maintain a flexible position so that action could be taken as the need appeared. He felt that in the natural course of events reserves were likely to tighten further over the next two or three weeks, that this would bring forth pressure on long-term rates and bond yields, and that if the bill rate moved up to 2 per cent or above, there would be a clear indication of System policy to the financial public, coupled with a restrictive influence on new borrowings. If the bill rate should go to 2 per cent or higher and the Board continued to be of the opinion that further credit restraint was called for, a move might be made to 2-1/4 or even 2-1/2 per cent.

Governor Mills then withdrew from the meeting to keep another engagement.

Governor Szymczak pointed to differences in various segments of the price structure, with agricultural prices lagging, wholesale prices up, and retail prices running about on a level. He noted that credit was continuing to expand and said that to force banks into borrowing and then move the discount rate up would be a drastic and unpopular action. He expressed the view that it would be very unfortunate for Cleveland to move back to 2 per cent. In all the circumstances, he favored moving as soon as possible to 2-1/4 per cent and then watching reserve positions carefully.

Chairman Martin said that he came out in his thinking at about the same point as Governor Szymczak. With regard to the agricultural situation, he anticipated that despite prevailing price levels, total farm incomes would probably be larger this year than last year because of good crops. He added that the disparity between farm and industrial prices of course created a problem.

Governor Vardaman expressed disappointment that all of the Reserve Banks had not gone to 2-1/4 per cent and said that if the System waited until plans for the Christmas season were further advanced it might find itself in a position where adequate action could not be taken. He felt that a discount rate increase was the only move that could be made, aside from an adjustment of reserve requirements, which would serve as a warning

to the public. If the Reserve Banks did not act within the next two or three weeks to move to 2-1/4 per cent, he said that he would be willing to exercise the Board's prerogative and fix that rate. Failure to give a policy indication of restraint, he said, might be unfair to merchants who were reported to be accumulating large inventories for the seasonal trade.

Governor Balderston said that in view of prospective Treasury financing plans, he felt that the System should act on the discount rate not later than Labor Day. He saw the March discount rate action as having been well timed but on the other hand insufficient. In this connection, he called attention to the fact that before the Treasury-Federal Reserve accord it was the general practice to change the rate in steps of at least 1/2 per cent. He also said he was firmly of the belief that the discount rate should be a penalty rate to avoid troublesome administrative problems. Failure to use the rate forcefully and a treatment of the situation through reserves alone would amount to dealing with the supply side of the picture without restraining the demand for credit. A better course, he thought, would be to work on the demand side by affecting the price of money and at the same time to work on the supply side through reserves. In summary, he felt that the Board was at a point where it should use its influence on the Reserve Banks to establish a 2-1/4 per cent rate, since such a move would relieve the Cleveland situation and give a further signal to the public. He thought that actually the rate should be at 2-1/2 per cent but he saw

little hope that any of the Reserve Banks would establish that rate. If some of the Banks could not be encouraged to move to 2-1/4 per cent before Labor Day, he felt that the Board should use its prerogative and fix a rate of 2-1/4 or perhaps 2-1/2 per cent. If there seemed to be danger of the situation getting out of hand, he would favor going to 2-1/2 per cent despite possible disturbance to the Government bond market and the problems that would be created in the portfolios of individual banks. In conclusion, he expressed concern that after the middle of September the System might be frozen into a situation which would preclude further discount rate action until after the beginning of 1956.

Following further general discussion of the subject, the meeting adjourned.

Secretary