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, June 5, 1956, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Erickson
Mr. Johns
Mr. Mills
Mr. Shepardson
Mr. Szymczak (Latter part of meeting)
Mr. Vardaman
Mr. Fulton, Alternate
Mr. Leedy, Alternate
Mr. Treiber, Alternate

Messrs. Bryan and Williams, Alternate Members, 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. Thomas, Economist
Messrs. Abbott, Parsons, Roelse, Willis, and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Sherman, Assistant Secretary, Board of Governors
Mr. Miller, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York

Mr. Molony, Special Assistant, Board of Governors (First part of meeting)

Before this meeting there had been distributed to the members of the Committee a report covering open market operations during the period May 23, 1956 through May 30, 1956, and at this meeting a supplementary report covering commitments executed May 31 through June 4, 1956, inclusive, was distributed. Copies of both reports have been placed in the files of the Committee.

> Upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period May 23 through June 4, 1956, inclusive, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Young made a statement at this point on the economic situation, supplementing the staff memorandum distributed under date of June 1, 1956. Mr. Young's statement was substantially as follows:

> Latest data continue to confirm a sidewise movement for activity, some observers would say with a good bit of side-to-side roll. Downward adjustments in output of a few conspicuous lines, in prices of metals and rubber, and in common stock prices have commanded special press comment, as has also some evident lowering of business sights as to general economic prospects for the short-run.
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> But output in many areas has been maintained and in some sectors has increased further. Moreover, price mark-ups of fabricated items continue to be fairly numerous over a month's period and the recovery of farm product prices has been extended. Over-all, employment and output are about unchanged with credit demands generally continuing vigorous. Activity in important industrial countries abroad remains generally strong, with inflationary symptoms in some countries rather marked.
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> As to specifics of the situation:
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> (1) The Board's index of industrial production for May is being estimated at 141, down one index point from April. Auto output and output of supplying industries was off further and production of light trucks was under expectations; farm machinery output continued at reduced levels; steel was down because of the closings of strike-affected Alabama mills; appliance production was cut back as a result of competitive developments; and textile mill operations were somewhat lower, mainly on the synthetic side. Elsewhere, production generally held at earlier levels or rose further.

(2) Automobile sales in May were generally disappointing to the industry, but with sharp cutbacks in production, dealer stocks began to decline a little. Used car markets remained strong, with stocks continuing moderately downward and prices of late model used cars, after allowance for depreciation, moderately upward.

(3) Household durable sales were at a very high level in April--about 8 per cent above a year ago levels. At department stores in May, close to April levels for sales of these goods were maintained.

(4) Last meeting's report stated that preliminary figures on retail sales, seasonally adjusted, showed an overall decline of 2-1/2 per cent in April. The Department of Commerce will release corrected figures this week reducing this decline to 1-1/2 per cent. Considering that these figures are based on samples of varying adequacy and that seasonal adjustment methods yield only approximations, this corrected figure can be interpreted as showing little or no change. In May, department store sales are estimated to have risen one index point to 123, department store sales have fluctuated around 122 since late last summer.

(5) Consumer instalment credit in April rose about $250 million, with most of the rise in other than automotive lines. The proportion of new cars sold on credit was about 69 per cent compared with 57 per cent a year ago.

(6) Book value of manufacturers' inventories was up half a billion dollars in April, about the average of preceding three months, with much of the rise in expanding durable goods lines. Distributors' inventories--wholesale and retail--showed only a modest $100 million rise, with most of rise in nondurables at wholesale. Altogether available current inventory information is adding up to some deceleration of accumulation this quarter.

(7) The decline in durable manufacturers' new orders which had proceeded for four months halted in April, being succeeded by a small rise to a level about equal to current shipments.

(8) Total nonfarm employment in May, despite lay-offs in automobile and related industries, was about at earlier levels and unemployment was probably unchanged. Recently, new scattered lay-offs in electrical appliance, rubber, lumber, and southern textiles have been reported. In May there were 23 labor markets classified as having a substantial labor surplus, compared with 19 in March and 35 in April.

(9) In late May, wholesale prices averaged 4 per cent above a year ago and only 2 per cent below the record peak

in early 1951. Prices of farm products have now recovered to year ago levels. Prices of processed industrial commodities have continued to advance at a slackened rate, but this has been offset by pronounced weakness in some basic materials such as steel scrap, copper, and rubber and less promounced weakness in others. Markets for many industrial materials, however, have continued strong.

(10) Consumer prices rose slightly from mid-March to mid-April and market reports would suggest a further and somewhat larger rise to mid-May.

(11) In Western Europe, activity in major countries continues to press against capacity, with inflationary pressures manifest and apparently reflecting mainly heavy capital investment demand, in France supplemented by swollen military expenditures. Activity in Great Britain seems held down by capacity limits but credit restraints would also appear to be exerting some progressive restrictive pressure. The past year's gains for Japan have been striking, with demand pressures very strong and wholesale prices under considerable upward pressure.

A word in conclusion about the near-term outlook because two confidential pieces of information have come at hand bearing on it. First, very confidential information from the automobile industry indicates an industry target for dealer stocks at the end of August of 200 to 250,000 units, implying a liquidation before new model introductions in September of 600 to 650,000 units now in dealer inventories. This points to a sharp reduction in auto output in the period ahead, especially during July and August. If the industry adheres to this goal, as seems possible, a downward drag upon the Board's index of industrial production will result, caused by direct and indirect effects of auto output cutbacks. The index will likely fall about an index point a month in June and July, leveling out in August as auto parts manufacture then picks up for new models. Third quarter earnings of automobile manufacturers and parts suppliers will be adversely affected by these production developments, of course, and this has a chance of being reflected in equity values as the third quarter unfolds.

The other item of information relates to business capital expenditure plans. It is strictly confidential until released to the public late this week. The Department of Commerce--SEC survey of business plant and equipment expenditures will show a further rise in the annual rate of expenditures of about $2 billion-- about the same pace of rise reported for the past two quarters. The release will show expenditure plans up for every industry group. All groups will show expenditures at a record level except the commercial area, which slid off this second quarter from the first and will apparently not retrieve

> the first quarter level. No figures will be released at this time pertaining to spending plans for the fourth quarter, but a further rise in that quarter is suggested by this survey's results.
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> We can offset these two items of intelligence with the following results. Activity will continue to be supported over the months immediately ahead by the business investment boom while drastic readjustment is in process in the automobile industry. If the auto industry's "new look" takes hold in the fall, consumer durable goods buying and business investment will combine to provide, other things favorable, a strong expansive and perhaps inflationary stimulus to economic activity as a whole.

In response to a question from Mr. Vardaman, Mr. Young said that there was some indication that change-over to new model automobile production in late summer or early fall might be accomplished with little further rise in unemployment in automobile producing centers. Producers, he said, wished to avoid additional losses of workers to other areas or activities and may be expected, therefore, to make such adjustments as are necessary through reductions in hours of work rather than layoffs.

Mr. Young stated, in response to a question from Mr. Williams, that there had been impressive improvement in the market for used automobiles and, in view of the efforts of the industry to reduce dealer inventories of new cars sharply prior to introduction of new models, it could be anticipated that dealers would be in a position to get good prices for new model automobiles when they were introduced. This, Mr. Young felt, indicated a hope on the part of the automobile industry that it would be able to pass on rises in steel prices and other costs.

Chairman Martin noted that there had been considerable comment in the press recently about the financial difficulties of Studebaker-

Packard Corporation. At his request, Mr. Mills reviewed discussions that had taken place recently looking to the possible merger of that company with Curtiss-Wright Corporation and to the possible request of Studebaker-Packard Corporation for a loan under section 13b of the Federal Reserve Act to assist it in the interim. Mr. Treiber also commented briefly on preliminary work being done in connection with a possible application for such a loan, which would be filed with the Federal Reserve Bank of New York if the loan is formally requested.

Mr. Molony withdrew from the meeting at this point.

Chairman Martin next called upon Mr. Thomas, who said that it now appeared possible that the Treasury cash surplus for fiscal 1956 would exceed $6 billion and for calendar 1956, $9 billion. A cash balance at the end of the current month of more than $6 billion would cover the next six months' deficit with only $2 billion of borrowings in October. Mr. Thomas said that there had been some increase in demand deposits during the last two weeks, following a sharp decline in the preceding three weeks to an unusually low level. Some loan contraction at weekly reporting member banks took place in the last week of May and commercial loans have declined for two weeks. In the past five weeks, there has been little net change in commercial loans, and real estate and consumer loan expansion has been less than last year. Investment holdings have not been reduced as much as a year ago.

There has been a better tone in the market for new issues of securities, with a substantial volume of offerings in May and a large amount scheduled for June. Interest rates have been fairly steady after a marked decline in long-term rates early in May. Bank reserve positions were eased by Federal Reserve operations during the past two weeks with purchases of nearly $300 million, in addition to repurchase contracts. Net borrowed reserves have been around $400 million and bank positions have eased in New York and in reserve cities although tightness has increased at country banks. Looking ahead, net borrowed reserves may average less than $300 million this week and next; a very large increase in required reserves may be expected during the week of June 20 in connection with a sharp increase in deposits, but this should be fully covered by an increase in Federal Reserve float. Mr. Thomas said that it did not appear that there would be any great strain on the market until the end of June or early July, at which time the System would be called upon to give assistance.

Mr. Thomas went on to say that in accordance with the request at the meeting two weeks ago the staff had prepared some longer-run projections of reserve needs. He then presented charts showing member bank reserves and related items and commented on technical features of these charts on which projections of reserves were based. The net results of the projections, Mr. Thomas said, were that if normal seasonal trends occurred during the remainder of 1956, the System would need to supply about $1.8 billion of Federal Reserve credit (other than float) during the remainder of the year. This assumed continuation of net borrowed reserves at around $400 million. Most of the additional reserves would be needed after August except for temporary increases that would be called for late in June and early in July.

In response to Chairman Martin's request for comments, Mr. Treiber noted that the projections Mr. Thomas had presented assumed a straight line increase in the money supply. Another approach might be taken, he noted, basing the projections of reserve needs on a projection of the business outlook and the demand for credit that would thus result. Mr. Treiber stated that the New York Bank had worked out some figures on that basis and had come out with a somewhat lower estimate of reserve needs although it was not substantially at variance with the figure Mr. Thomas had given.

Mr. Thomas stated that he had come to the conclusion that the Committee's interest was primarily in the money supply and the projection of a supply that would not permit inflation. He felt it preferable to assume the money supply, rather than to try to estimate what the money supply would be on the basis of possible demand for credit.

Chairman Martin stated that the projections could be prepared on either basis and he thought it desirable to have them prepared on both approaches. In a sense, however, the approach mentioned by Mr. Treiber involved a consideration of the factors that the Federal Open Market Committee must consider at every meeting.

Chairman Martin noted that less than two weeks had elapsed since the preceding meeting of the Committee and that only ten days would elapse between now and the June 15 tax date. He felt it important to integrate the Committee's operations with the Treasury's operations, and he stated that yesterday Under Secretary Burgess brought up for discussion the question of the prospective Treasury surplus. This subject might be discussed in the course of this meeting, Chairman Martin said; he added that he was asking Mr. Rouse to make arrangements to discuss the matter with Treasury representatives after the meeting.

Chairman Martin noted that the Committee had not yet approved the minutes for the meeting held on May 23 and he read from the draft of those minutes the statement of the policy agreed upon at that meeting which, in addition to a modification of clause (b) of paragraph (1) of the Committee's directive, indicated that between the May 23 meeting and today's meeting operations should be carried on with a view to bringing about a downward trend in the volume of net borrowed reserves. It was his feeling, the Chairman said, that the account management had handled the situation well during this period and that the results were working in the direction the Committee had in mind.

Chairman Martin then called upon Mr. Treiber who made a statement substantially as follows:

> An atmosphere of uncertainty continues. The economy continues steady in the aggregate, with divergent trends

in individual areas. The forces of inflation seem reduced. More questions are being raised as to business expectations, especially for the third quarter. The stock market has declined. Employment is high and important labor negotiations are now going on. People are questioning whether there will be enough self-restraint on the part of labor in pressing its demands, and on the part of management in raising prices, to avoid another turn in the cost-price spiral.

With almost full employment, consumer spending has continued high, although the demand for durable goods has diminished. The expansion of consumer credit is not adding to the demand in the rapid way it did last year.

Capital expenditures are high, and are expected to be higher. Nevertheless, the recent McGraw-Hill survey showing substantially increased spending for capital purposes has not stimulated the ebullience which earlier estimates invoked. While housing starts are still high, there is little sign of further stimulation. Business construction is at record levels.

The trend of prices has been mixed. Sensitive commodity prices have drifted downward during May, mainly because of declines in certain industrial raw materials, e.g., steel scrap, copper scrap, and rubber. Prices of industrial finished goods, on the other hand, have advanced. Farm prices have advanced so that, on average, they are now back to the levels of a year ago.

There is considerable evidence pointing toward reduced business activity in the third quarter of 1956, followed by increased activity in the fourth quarter.

The capital markets are still seeking to find a trading base at which they can operate. The number of potential new offerings is substantial. Yields on new capital issues are likely to increase somewhat if dealers want to dispose of the issues promptly.

Demand for bank credit continues high. The demand in June may equal the high demand in March. On the other hand, the demand in the second half of 1956 is likely to be considerably less intense than in the second half of 1955.

Each new estimate of the Treasury's financial position shows a greater anticipated Treasury deposit balance at the end of June. The Board's estimates reported this morning are greater than those of the New York Bank. On the basis of the New York estimates, the Treasury will probably have to borrow for cash in August. It will probably want to borrow at that time about half of its estimated cash needs for the second half of 1956; on this basis the August borrowing may amount to a couple of billion dollars, part of which must be financed through bank credit.

The money market has been under less pressure in the last two weeks. We should continue to make it clear that needed credit will be available. Net borrowed reserves for the last two statement weeks have averaged $400 million. The outright purchase of $161 million of securities for System Account during those two weeks, plus repurchase agreements by the New York bank, have been direct evidence of the System's willingness of make needed credit available. Additional outright purchases of $131 million in the current statement week and a continuation of repurchase agreements have been further evidence of such willingness. Borrowing by member banks from the Federal Reserve Banks averaged about three quarters of a billion dollars in the last statement week, compared with about $1 billion in previous weeks. This is further evidence of lessening pressure. While credit policy should remain restrictive, the pressure upon credit availability should continue to be reduced to reflect the current balance between inflationary and deflationary pressures in the economy. Tightness or ease in the market is, of course, reflected in a number of areas such as interest rates, volume of member bank borrowing, and the attitudes of men.

There is likely to be a good deal of churning around in the money market in the middle of June. There will be heavy tax payments and heavy demands by corporations for bank credit. The Federal Reserve System might appropriately supply additional reserves as tangible evidence that the credit authorities do not intend to allow the demands for credit to generate a squeeze. Because of the large money market adjustments that must be made, a fairly liberal supplying of reserves would be helpful without signaling a policy of ease. Giving effect to the substantial Federal Reserve transactions already made this statement week, average net borrowed reserves for the week will probably fall in the $350 - $400 million range. Projections for the following weeks of June inditate less net borrowed reserves. Recognizing that net borrowed reserves are but one of many factors indicating the extent of the tightness of the money market, we should be alert to make additional purchases to prevent net borrowed reserves from exceeding the $200 - $300 million range.

The officers of the Federal Reserve Bank of New York believe that there should be no change at this time in the Bank's discount rate.

Mr. Erickson said that conditions in the Boston District remained favorable except for the weather. Employment in April was ahead of March of this year and of April of last year. Except for textiles, New England industries were doing well. Construction awards in New England during the first two weeks of May were ahead of a year ago by 15 per cent. Nonresidential contracts were up 25 per cent, and residential building was up 14 per cent. During the past two weeks there has been more active use of the discount window, Mr. Erickson said, adding that on one day 82 banks borrowed from the Boston Reserve Bank, more than at any time since the banking holiday in 1933. In a survey of automobile dealers, the first four dealers interviewed blamed the automobile manufacturers for their present predicament. One of those dealers criticized Federal Reserve policy but this was because it was costing him more money. Mr. Erickson said that he felt the discount rate should remain where it is--the Boston Bank's directors took that action yesterday by renewing the existing 2-3/4 per cent rate. For the next two weeks, Mr. Erickson suggested that the Committee supply reserves to the market even if net borrowed reserves dropped below $300 million.

Mr. Irons said that conditions in the Dallas District continued strong. He could see no evidence of real weakness or of any tendency for the adjustment going on in the automobile industry to cumulate. He described the situation as a strong side-wise movement. Less active use has been made of the discount window at the Dallas Bank during the past two weeks, Mr. Irons said, and borrowings have dropped from the $45-50 million range to $25-30 million. These borrowings continue to be by relatively few banks, Mr. Irons said: out of 590 country banks, probably 4 or 5 were using the discount window and those borrowings were largely for seasonal needs associated with agriculture. The bulk of borrowing is coming from 4 or 5 or 6 of the larger banks in the larger cities, but that also has lessened within the past two weeks. Mr. Irons said that in his judgment the situation was still much as described in the economic review. He would not recommend a change in the discount rate at this time. The Committee should provide reserves needed for seasonal and related factors, he said, but he would not be inclined to have the situation become easier than it has been during the past two weeks. The Committee should continue to have a real element of pressure on the reserve position of banks rather than a sharp movement toward ease. He would not wish to set any specific figure of negative borrowed reserves to be attained, but his comments might suggest negative free reserves more in the $350-400 million range than in the $250-300 million area.

Mr. Mangels said that the last two weeks have given no evidence of change in the Twelfth District's situation. Department store sales are holding up well, employment has been increasing, and automobile sales in April in California were only 13 per cent lower than a year earlier. Preliminary figures of automobile sales early in May indicated a decrease from a year ago not much greater than that in April. The general situation in the Twelfth District is still relatively good except in the northwest where lumbering is having something of a problem. Increases in bank loans at Twelfth District reporting member banks during the past few weeks have accounted for about a third of the national increase; the increase in real estate loans in the Twelfth District made up half of the national total.

Mr. Mangels referred to a business outlook meeting held at the San Francisco Bank last Friday and attended by representatives of finance and of the utility, steel, oil, lumber, and building industries. A steel company representative indicated that the West Coast inventory of steel was probably no greater now than a year ago and that a larger inventory might be healthy. This representative felt that the industry would operate at 85 per cent capacity in the third quarter and would be back to 91 per cent in the fourth quarter. Representatives of the petroleum and utilities industries were looking ahead to substantially increased needs for capacity in the next few years. The lumber industry anticipates further price declines and there is some concern that substitute materials may affect the demand for lumber for residential and other construction. A pessimistic note was expressed by the former president of the National Home Builders who estimated that housing in California this year would be 30 to 40 per cent below new construction in 1955. For the country as a whole, he thought housing starts would total not more than one million units this year. Sales of new houses are lagging, not as a result of a lack of mortgage money but because the effective demand is for homes selling in the $9,000-$10,000 price class, whereas the building industry can not now build houses to sell below $12,000-$12,500. In other words, the industry for various reasons has priced itself out of its current market. Gross farm income in California in 1955 was above 1954, Mr. Mangels said. Some increase in farm debt has taken place, but net worth of farmers has increased. The view was expressed that the Federal Reserve System would need to supply about $1-1/2 billion additional reserves this year, and some expressed the hope that this would be in the form of a reduction in reserve requirements. Mr. Mangels presented figures indicating that banks on the West Coast are not too tightly pressed. Three bank presidents who visited him recently felt that the discount rate should not be reduced and others have indicated satisfaction with the present rate. Mr. Mangels felt that the Committee's operations in the past two weeks had helped the general situation, including psychology. He suggested that the Committee continue about what it has been doing, furnishing reserves on a moderate basis and perhaps reducing net borrowed reserves further but not too substantially. Mr. Mangels noted that he still did not expect to recommend a change in the discount rate when the directors of the San Francisco Bank meet on June 13.

Mr. Leedy said that he had no significant changes to report regarding conditions in the Tenth District, and that he agreed with the views expressed thus far regarding the national economic situation. He felt the management of the System account had given an excellent account of itself since the last meeting. In view of the uncertainties in the picture and the tax date coming up shortly and because of the situation in the automobile industry, he felt that between now and the next meeting the Committee should make certain that needed reserves are supplied to the market. He would not go so far as to indicate a condition of ease, but reserves might be supplied a little on the liberal side. He would suggest no change in discount rates at this time.

Mr. Leach said that since the last meeting the Fifth District had shown small economic gains and losses with little net change. Loan demand continues strong and there is evidence that the feeling of tightness has spread to the smaller banks. He said that he had gotten this impression both from visits to banks and from the experience at the discount window of the Richmond Bank. Over Memorial Day holiday, 55 member banks were borrowing from the Richmond Bank, the largest number in the postwar period. Of the 114 banks that have borrowed this year, 2 had never borrowed before and 8 had not borrowed since 1934. During the next three weeks, Mr. Leach said that he felt the System's actions should continue to dispel any doubts as to our readiness to meet seasonal reserve needs including tax date requirements. There should be further outright purchases of Treasury bills and a lower level of net borrowed reserves--perhaps around $200 million. Special pains should be taken to see that net borrowed reserves do not get higher than the general level the Committee has in mind. This would represent an extension of the shift in emphasis adopted at the May 23 meeting of the Committee, but it would not require a change in the directive. Mr. Leach said that he did not expect to recommend to the directors of the Richmond Bank any change in the discount rate at this time.

Mr. Vardaman said that he had just returned from an automobile trip through the Midwest, the South, and the southeastern States on which he found almost universal support for current System policy and no criticism of the soundness of what the Committee was now doing. He said that he, too, had noted that tightness was spreading to smaller banks, and he expressed the opinion that an unfortunate maldistribution of credit facilities continues in some areas. This is not a Federal Reserve problem, Mr. Vardaman said, but he hoped that something could be done to bring about a more equitable distribution of loanable funds throughout the economy. Mr. Vardaman said that he hoped the System could assure the public including the banks that it would supply the needed funds during the next few weeks or months. The discount window should be kept open and the banks should be welcomed rather than frowned on for borrowing. He hoped that the rediscount rate would remain where it is and he especially approved the present situation with two banks having a 3 per cent discount rate while the others had a 2-3/4 per cent rate. Mr. Vardaman said that he thought this was one of the most healthy factors in recent policy moves. He felt that the System had accomplished to a large extent what it set out to accomplish: it had awakened the economy to the dangers of inflation.

Now the System could afford to coast along and not make conditions any tighter.

Mr. Mills called attention to the business situation at home and abroad and to the availability of credit, stating that these two factors argued for the injection of additional reserves and for taking advantage of natural forces that would reduce the level of negative free reserves to around $200 million. There were indications that business expectations and actual business performances were wavering, he said, and to the extent that that is true the Committee should guard against being misguided by the past momentum of the economy when actual conditions might be developing that would make future prospects less bright. He noted that Messrs. Erickson and Leach had brought out the fact that country banks in their districts were resorting to greater use of the discount windows and that excess reserves at country banks were drying up. Mr. Mills said that the reserves supplied during the past two weeks had relieved the situation and improved the tone of the Government securities market but that it would take time for those reserves, and such new reserves as are supplied, to spread out to country banks. He felt that the Committee should not be disturbed even though further additions to reserves at this time might temporarily produce a greater sense of ease than might otherwise be welcome, due to the fact that until they have become more widely distributed, the initial impact of a supply of new reserves falls on the money market. Accordingly, he would argue for a policy of supplying additional reserves either through direct purchases of Treasury bills or through natural factors that would bring negative free reserves down to around $200 million.

Mr. Shepardson said that he felt much the same as Mr. Mills had just indicated. Committee activities up to the present time have been getting the results the Committee has had in mind, he said, and there has been a healthy change in the atmosphere. We have reached the point where perhaps some easing of the pressure is indicated. The level of negative free reserves should be lowered possibly to the $200-250 million level. Mr. Shepardson said he was not sure about any particular figure but the level should come down from where it is. He thought the discount rate was serving a good purpose where it is and would not favor a change at this time.

Mr. Fulton said that the Cleveland District's economy was affected materially by the automotive situation and the weather had been an unfavorable psychological factor, but there were many factors of strength still present. He would not like to see net borrowed reserves so reduced as to indicate that the System had surrendered to some extent to inflation; the current steel wage negotiations were most important in that the settlement would be a bellwether for other industries. Net borrowed reserves around the $300 million level would be helpful at the present time, Mr. Fulton said, and would indicate the willingness of the System to meet all appropriate demands for credit, but would not give an indication that the System had completely changed policy or that it intended to supply reserves in such quantities as to let wages react to that stimulus.

Mr. Williams commented on business developments in the Philadelphia area to the effect that no important changes in the general situation had taken place since the preceding meeting. He cited a special report of automobile sales in the district, stating that all but 4 of 48 counties for which data were available showed an increase in sales during April as compared with a year ago. Nothing in the Philadelphia District business picture would warrant a change in policy at this time, Mr. Williams said, although real questions may arise in July and August. For the present, he favored maintaining existing discount rates, continuing the Committee's existing directive, and giving whatever assistance was necessary through supplying reserves in the open market. He thought free reserves should be held around the negative $200 million level.

Mr. Bryan said that in the Sixth District, there appeared to be a little softening in economic activity but not much, and that such softening as could be observed was attributable almost entirely to textile shut downs and to the strikebound Birmingham steel situation. Nationally, he felt the situation confusing. The problem, he said, was to judge whether the massive readjustments taking place were of the "rolling adjustment" type that precede an economy getting into balance for another upsurge, or whether they indicated some sort of cyclical down turn. He did not think the evidence conclusive one way or the other at present and any judgment must be tentative. His view was that we must for the time being confine ourselves to the conclusion that the economy is moving sidewise and that the previous massive upsurge has been at least momentarily checked. When the economy is moving sidewise in this way, credit policy should not become more restrictive. The System should meet the seasonal demand for funds. At the same time the System should do nothing dramatic toward softening policy, such as reducing discount rates or reducing reserve requirements until evidence of an actual or impending downward trend in the economy is clearer. Mr. Bryan said he had a further question in his mind whether the System should supply reserves sufficient not merely to meet the seasonal needs but also to restore some growth factor in the total reserve supply. His present inclination was that the Committee should go somewhat further than merely supplying réserves for seasonal and tax date requirements: it would be justified for a temporary period in supplying reserves in a quantity that would restore some growth. If this resulted in a move in the Treasury bill rate to a point where it was out of touch with the discount rate, he would be disposed to reduce the discount rate. Mr. Bryan added the comment that he had not been greatly concerned about the volume of borrowings at the Reserve Banks, that these had "put the grease on the wheels that needed the grease at the time they needed it."

Mr. Szymczak entered the meeting during Mr. Bryan's statement.

Mr. Johns said that department store sales in the Eighth District were running stronger than in the nation as a whole but other than that he had nothing to report that differed from the staff review. He recalled that two weeks ago he had complained mildly that the reserve position of banks had been somewhat tighter since the preceding meeting than the Committee had wanted it to be. He now wished to say that he had been very much pleased by the performance of the desk during the past two weeks. Mr. Johns said that there appeared to be a little uncertainty regarding the economy at the present time although he was unable to place his finger exactly on signs of weakness. An opinion had been expressed to him within the past few hours by an informed and careful observer that the System's operations during the past two weeks had reassured bankers as to the availability of reserves and credit but that such assurance had not yet been divined by the business community other than banks. This observer suggested the desirability of the System communicating such assurance to the business community and indicated he would welcome a reduction in discount rate or perhaps a reduction in margin requirements. Mr. Johns said that he was not sure that he agreed with this observer but that he hoped the Committee would exercise care between now and its next meeting not to permit the reserve situation to tighten. He would prefer that negative borrowed reserves drift slowly downward rather than that they rise. For the moment he did not contemplate recommending a reduction in the discount rate of the St. Louis Bank, although as Mr. Bryan had suggested he would watch short-term interest rates carefully, Treasury bill rates particularly, and if they declined much he would begin thinking about recommending a reduction in the discount rate. Once past the June tax date, Mr. Johns said, if the bill rate continued to drift downward he would begin to think quickly about reducing the discount rate.

Mr. Szymczak said that he thought the policy the Committee had been pursuing during the past two weeks had been about right. The dramatic thing industry seemed to expect was a reduction in the discount rate, he said, but he did not think the System was ready to take that action. He did feel, however, that the Committee should supply reserves to the market to meet seasonal needs and that it should watch the situation carefully. If the bill rate declined to a level out of relation to the discount rate, he would be disposed to act on the discount rate.

Mr. Balderston said that developments since the previous meeting confirmed the soundness of the Committee's action in changing the directive two weeks ago to make the supply of credit more available. He noted that the bill rate had declined but is still in an appropriate relation to the discount rate and that the discount total had dropped below $1 billion for the first time in many weeks. While net borrowed reserve figures could not be used with precision, Mr. Balderston said that he felt these figures should be brought down at least to $250 million, with a target range of zero to $200 million. He commented on evidence of readjustments taking place in economic activity and of deterioration in business confidence, which led to his belief that the Committee's operations for the near-term should be designed to offset fears and uncertainties that might result this summer from necessary readjustments in the auto, steel, and other industries. In the longer-run, Mr. Balderston said, the need to encourage expansion of productive capacity and continuing improvements in plant efficiency made it desirable for the System to give attention to increasing the money supply to the extent needed to provide for jobs and a constantly rising standard of living. Such increase should take place when it can be accomplished without the risk of inducing inflationary price advances.

Chairman Martin stated that the views expressed at this meeting were much closer together than those at the meeting two weeks ago. His view, he stated, was much the same as that expressed by Mr. Mills this morning. The Chairman said that he felt the Committee had made substantial progress in what may be a valley and what easily could become a triple top movement. There had been a valley in February, he said, and we probably are going to have a little valley this summer. He was not the slightest alarmed about anything in the economy today--he wished he were more alarmed perhaps. The Chairman said that he agreed with Mr. Bryan that prudence is desirable but that he believed developments had taken a natural course. If the Committee applied itself, recognizing that money and credit is only one element in this situation no matter how much its importance may be put out of focus by commentators or others, the Committee could handle the situation surprisingly well.

Chairman Martin said that his feeling had not changed since the meeting two weeks ago and that he felt we should be moving toward zero free reserves. He recognized the qualifications that should be put on any figures of free reserves and he wished that the Committee had never gotten into using these figures. However, they had come into use, and at this time he would favor negative free reserves in the $250-million-zero range, rather than a higher figure. All aspects of the market must be taken into consideration, however, not only the figures of free reserves. The Committee must not be misled by talk of "holding the line" or by misinterpretations that might appear in the press or in letters as to actions the Committee might take. Chairman Martin emphasized that this is a moving picture and that there have been substantial changes in the situation since discount rates were increased eight weeks ago. There has been a real advantage in the split rate, with two banks at 3 per cent and the rest at 2-3/4, he said. This advantage may have given the System an opportunity to have one foot on third base and the other on home plate. However, in any change of the rate, if there were to be a change, it would be preferable if action came first from the banks now having the 3 per cent rate rather than from those having the 2-3/4 per cent rate. He noted that the Board would have a responsibility to try to coordinate a change in rates, and he expressed the hope that we would not get into a position where one bank was holding at the 3 per cent level while other banks were moving to a 2-1/2 per cent level. He made this comment, he said, because of the possible implications of the comments on the discount rates in the discussion this morning.

Chairman Martin reiterated that the views expressed at this meeting by Mr. Mills were very close to those he (Chairman Martin) held. There is a momentum in the economy. If the situation today were to be measured against that in 1954, the economy now is roaring. However, two years have elapsed since 1954, and the Committee should not ignore the ebb and flow of the economy. There are indications at present of some decline in economic activity. We may have summer doldrums. The Chairman said he hoped the System could adjust monetary policy so that it would not be too far out in front in either direction. The Committee should not feel bad about rolling a little with the picture during the next three weeks. If operations moved in the direction of negative free reserves of $250 million or less, he did not think this would be construed as an overt sign of ease in view of the tax period coming up and the general economic background.

Rather, the Committee would be in sound position for whatever later action might develop on discount rates. It is too early for such a move, but when discount rates are changed the movement ought to be orderly.

Chairman Martin said that unless a different view was expressed, he would interpret the consensus of this meeting to be that no change should be made in the directive to be issued to the New York Bank. As to the level of free reserves, net borrowed reserves, or whatever you want to call them, Chairman Martin said that no purpose would be served by voting on whether they should be in the $200-250 million range. He suggested that emphasis be placed on a trend downward from the present position. This, he thought, would be doing about what the majority of the Committee favored, although he noted that Mr. Irons had indicated he would favor a somewhat higher level of borrowed reserves than others indicated. To this, Mr. Irons responded that there was no magic figure.

Chairman Martin then asked Mr. Rouse to comment on the situation.

Mr. Rouse said that he agreed with the consensus of the Committee that there should be a continuation of the decline represented by the negative borrowed reserve figures. The volume of payments to be effected during the next three weeks would require that there be additional reserves available.

Mr. Rouse then commented on probable Treasury expenditures and estimates of Treasury cash position and of the Treasury balance during the next several weeks. He said he planned to meet that afternoon with Treasury representatives to discuss the use of the anticipated Treasury surplus, adding that he would be glad to have any suggestions that those present cared to offer.

In response to a question from Chairman Martin as to whether he was reasonably clear on the policy to be followed during the next three weeks, Mr. Rouse stated that he was. However, he referred to the comments made during this meeting on the bill rate and the discount rate to the effect that if the bill rate moved down perhaps the discount rate should be reduced. Mr. Rouse said that he did not believe this conclusion followed. The bill rate is not the guiding rate in this respect, he said, but rather the Federal funds rate. He was not concerned about the bill rate getting out of hand immediately, since corporation selling of Treasury bills in connection with the June tax date would exert upward pressure on bill rates for the next two weeks. If, however, the System account purchased several hundred million of Treasury bills toward the end of June to offset reserve losses at that time, there might then be a marked decline in the bill rate. This would be a result of the open market policy being followed, Mr. Rouse noted, and he said he did not think that the results of action taken in carrying out the Committee's policy should be looked upon as something to force the Reserve Banks to lower their discount rates.

Chairman Martin commented that this was a very pertinent point. He inquired of Mr. Rouse whether he had any changes to suggest in the directive to be issued to the New York Bank, and Mr. Rouse responded that he had none.

Chairman Martin then stated that in renewing the directive it would be understood that operations would be carried on as indicated earlier in the discussion, that is, with a downward trend in negative free reserves.

Thereupon, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System open market account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to restraining inflationary developments in the interest of sustainable economic growth while taking into account any deflationary tendencies in the economy, and (c) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of

special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million;

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

Chairman Martin suggested that the proposal to authorize swaps in Treasury bills, listed as Topic 3.c. on the agenda for this meeting, be carried over to the next meeting, which he suggested be held on June 26. He also suggested that the question whether to make available to the Treasury the memorandum prepared at the New York Bank under date of September 29, 1955, "Notes on Debt Management," be carried over to the next meeting with the understanding that there would be a full discussion of both of these matters at that meeting. There was agreement with these suggestions of Chairman Martin, including his suggestion that the next meeting of the Committee be held on Tuesday, June 26, 1956.

Thereupon the meeting adjourned.

Winfield W. Riefler
Secretary