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, November 12, 1957, at 10:00 a.m.

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

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

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

Mr. Riefler, Secretary
Mr. Thurston, Assistant Secretary
Mr. Sherman, Assistant Secretary
Mr. Solomon, Assistant General Counsel
Mr. Thomas, Economist
Messrs. Atkinson, Bopp, Roelse, Tow and Young, Associate Economists
Mr. Rouse, Manager, System Open Market Account
Mr. Carpenter, Secretary, Board of Governors
Mr. Koch, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Gaines, Manager, Securities Department, Federal Reserve Bank of New York

Messrs. Hostetler, Storrs, and Wheeler, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, and San Francisco, respectively; Mr. Holland, Assistant Vice President, Federal Reserve Bank of Chicago; Mr. Parsons, Director of Research, Federal

Reserve Bank of Minneapolis; Messrs. Willis and Walker, Economic Advisers, Federal Reserve Banks of Boston and Dallas, respectively; and Mr. Hastings, Financial Economist, Federal Reserve Bank of St. Louis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 22, 1957 were approved.

Before this meeting there had been distributed to the members of the Committee a report prepared at the Federal Reserve Bank of New York covering open market operations during the period October 22 through November 4, 1957, and a supplementary report covering commitments executed November 5 through November 8, 1957. Copies of both reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse reported that open market operations had supplied reserves during the three weeks since the last meeting. Principal reliance was placed on repurchase agreements in view of projections showing net borrowed reserves falling to levels in the neighborhood of $100 to $200 million in the weeks of November 20 and November 27. By using repurchase agreements, Mr. Rouse said it was hoped that the run-off of these arrangements at the middle of the month would make it possible to avoid outright selling from the System Account while the Treasury was in the market. It was anticipated that the Treasury financing would be announced the latter part of this week and that

the books would be open early next week. Mr. Rouse went on to say that there were problems and uncertainties in the period ahead. The increase in required reserves resulting from the Treasury cash financing, in combination with the usual float decline and other seasonal influences, would call for about $500 million of reserves in the week ending December 4 and an additional $300 million would be needed in the week of December 11. It was difficult to draw detailed plans as to how these funds would be supplied in view of the Treasury's cash problem and the prospect that the Treasury in early December might draw down its Stabilization Fund balance and its operating balance with the Reserve Banks, and, in addition, might sell some of the free gold. To the extent that any of these actions supplied reserves, the need for System purchases of Treasury bills would be reduced.

Reviewing current market conditions, Mr. Rouse pointed out that expectations with respect to the business situation were an important influence in the Government securities market. Prices of Treasury bonds had been improving, and there was some feeling in the market that the Treasury could select almost any maturities it wished in its financing this month, with excellent prospects of success. The improved tone in the Government securities market had not extended to the corporate and municipal markets, however, where the large volume of new issues had tended to keep the market under pressure. The Desk was successful in buying large amounts of Treasury bills for foreign and international accounts two weeks ago, at a time when bills came

easily. More recently, large buying by industrial corporations and the reinvestment of the proceeds of a recent utility financing had sharply reduced the market's supply of short-term issues and driven rates lower. The Treasury bills sold on Friday went at an average rate of 3.47 per cent, and it was not unlikely that the Treasury bill rate would move still further away from the discount rate on the down side.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period October 22 through November 8, 1957, were approved, ratified, and confirmed.

Mr. Hayes referred to the visit to the Federal Reserve Bank of New York in October of members of the staff of Congressman Wright Patman, and he read the following letter that he had received from Mr. Patman under date of October 25:

"Thank you for your October 18th letter.

"Both Mr. William Johnson and Dr. Clifford Clark have reported to me on their visit to observe open market operations, and they commented especially on how helpful and gracious you and your staff were.

"I deeply appreciate your courtesies to them and hope that I shall have opportunity to visit with you too when I am in New York."

Mr. Hayes also stated that, as arranged by Chairman Martin, Senator Wallace Bennett visited the New York Bank on October 23, 1957 for the purpose of observing operations and asking questions concerning transactions for the System open market account, and he read a

letter dated November 6 that he had received from the Senator:

> "I want to acknowledge gratefully the receipt of the material which you sent me including the chart of the organization of the New York Bank and a number of speeches you and Mr. Sproul have made.
>
> "I have been in Utah since I was in New York and have just come back to my desk in Washington. I haven't had time yet to read the material but I will do so at the earliest opportunity.
>
> "Mr. Golembe and I enjoyed our visit to New York very much. We got about all we could absorb that one day but both of us hope we can come back again."

A memorandum from the staff on "Recent Economic and Financial Developments in the United States and Abroad" had been sent to each member of the Committee on November 8, 1957. That memorandum, a copy of which has been placed in the Committee's files, stated that the economic climate domestically was in process of change, that expansive forces had eased, and that contractive forces had become more prominent. Industrial production declined further in October as did employment and department store sales, and unemployment claims had been running sharply above a year earlier. These changes followed significant weakening in business sentiment as evidenced by sharp declines in stock market prices, in prices of sensitive commodities, and in new orders. There also had been a sizable number of professional forecasts of business decline. The spreading view that business outlays for fixed capital are heading downward had been given recent support by the McGraw-Hill survey of plans for capital spending in 1958. The staff memorandum also pointed out that private demands for bank credit eased considerably in October,

while demands for long-term funds continued strong. Yields on Government securities had declined steadily although moderately in recent weeks. Stock prices had fluctuated within a fairly narrow range around a level about a sixth below the July peak. Despite the appearance of these recent signs of slackening, the memorandum called attention to the fact that the domestic economy still was operating at very high levels.

Chairman Martin now requested that Mr. Young point up the current economic data, and Mr. Young made a statement as follows:

> In our presentation at the last meeting of the Committee, we reported that, more than at any time in recent months, the pattern of economic indicators pointed to possible decline in over-all economic activity, and we intimated further that actual decline might be in process. The most recently available data confirm that moderate downward adjustment has, in fact, been occurring. Indeed, the composite showing that cyclical downturn has now set in is fairly impressive:
>
> After five months of little change, output at factories and mines is expected to show a drop of as much as 2 index points from September to October. Declines in activity were widespread, although most conspicuous in durable goods lines.
>
> Both freight car loadings and electric power generation in October were off moderately further. The decline in car loadings extends a decline that began in April, and that for power generation a decline that commenced in August.
>
> While total new construction holds at a high level, industrial construction continued the decline which set in in May.
>
> Business inventory accumulation has slowed markedly in recent months. In manufacturing, with declines occurring in new orders and sales, the inventory-sales ratio in September was at levels considerably above the average of the past two years.

Business capital spending plans for the year ahead are off significantly, with a decline in expenditures of a tenth or more from current levels indicated over the next four quarters.

Nonfarm employment receded further in October from the August peak. Reductions in both manufacturing and nonmanufacturing lines, though small, were widespread. Only State and local government employment registered an increase, although service and trade employment held about even.

Unemployment in October, after allowance for seasonal factors, rose to 4.6 per cent of the labor force, after holding at 4.2 per cent for three months, and initial claims for unemployment insurance averaged 45 per cent higher than in October of last year. The average length of the work week in manufacturing, after stability over recent months, declined half an hour to 39.5 hours; reductions in hours, though accentuated by the flu epidemic, were widespread, and operated to reduce weekly earnings, the average for which fell one dollar.

Total retail sales, which declined nearly 1 per cent in September, fell further in October, possibly by 2 per cent. Personal income was apparently also down in October for the second consecutive month, with the decline concentrated in wages and salaries.

U. S. exports fell sharply in September to about 10 per cent under the average of the preceding three months.

Prices of sensitive or basic industrial materials declined somewhat further in recent weeks and are now not much above the 1954 recession low.

Since July, business loans at city banks have been stable, compared with substantial growth in all other recent years except 1954. The decline in such loans during October, which was sizable, was the first October decline of the postwar period.

In Canada, recession tendencies have become fairly clear. In Europe, industrial activity by late spring had ceased expanding and through September had tapered off moderately. With the exchange position of many inflationary development economies tight, world trade impulses stemming from these economies seem more likely to be contractive than sustaining or expansive.

It should be emphasized that downward adjustment in the domestic economy thus far has been very moderate and that average wholesale and consumer prices have held relatively stable. But with industrial and other capacity substantially enlarged and with aggregate demand no longer expanding, the price structure would appear to confront supply pressure.

At a time like the present, perspective is highly important. A good deal of adjustment in the economy has taken place during the past two years, first, in autos and housing, second, in materials-producing industries, and, most recently, in selected defense industries, especially military aircraft. It is possible that auto and housing markets, reflecting increased credit availability as that develops with demands slackening elsewhere, will show special strength, and that resumption of military ordering will soon set in--indeed, as an aftermath of Sputnik, will increase. These developments, should they occur, could have a considerable effect on an economic situation that has already absorbed various important rolling adjustments, particularly in turning around the general business climate. On the other hand, turn abouts in the economic climate do take time, and the most likely prospect for the immediate future would seem to be for further moderate downdrift of activity.

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

Recent financial developments have reflected the indications of slackening in economic activity discussed by Mr. Young. They help to corroborate the likelihood of abatement in inflationary pressures. The details of these developments have been described in the memorandum prepared for the Committee. Significant aspects have been the sharp decline in business loans by banks, the recent firming of the market for Treasury securities, the reduced level of share prices, and the less than seasonal growth in the money supply this fall. At the same time, new securities issued by corporations and by State and local governments continue in large volume, and Treasury borrowing has been larger than in other recent years. The continued growth in time deposits at commercial banks has provided banks with funds for credit expansion. This raises questions as to the interpretation to be placed on the slackening in the money supply growth.

The decline in commercial loans at banks in leading cities during the five weeks ending October 30, amounting to over $600 million, was the first decline shown for that

month in the postwar period. Although $400 million of the decrease represents repayments by finance companies, which is usual in that month, the remaining decline of over $200 million compares with increases of about $500 million, after excluding finance companies, in each of the two preceding Octobers.

For the period since the end of July, eliminating from consideration the decline in July after the large tax borrowing in June, there have been declines or less than seasonal increases in loans to nearly all groups of borrowers. In recent years business loans have generally increased considerably during November and December, particularly in the latter month. Some increase should occur this year, especially since corporate tax payments in December will be larger than in the two previous years.

Corporate borrowing in capital markets has continued at the same high level that has been maintained for the past 12 months but is showing no further increase. No doubt some of these receipts have recently been used to reduce bank loans. In view of the reduced borrowing from banks and the indicated curtailment in business capital expenditures, some reduction in corporate offerings of new securities might be expected during the months ahead. State and local government borrowing, however, is likely to continue in large volume.

Treasury borrowing in the market, including that by Government agencies to raise cash for the Treasury, has been larger since mid-year than in the same period of other recent years. Much of this borrowing has been effected initially through the banks, and bank holdings of such securities have increased moderately in contrast to declines in the same period of other recent years. Yet a substantial amount of Government securities has been absorbed by nonbank holders.

Home mortgage credit has continued to increase at a rate of over 8 per cent a year for the total outstanding--a rate which, though less than in previous years, can hardly be called small. It appears that demands for housing are such that mortgages might increase even faster if funds were available at rates at which FHA loans could be marketed. Consumer instalment credit has also increased this year at a pace which may be above rather than below that which could be indefinitely sustainable, although the increase in September was somewhat slower.

Total loans and investments of commercial banks have shown little change since midsummer, as the increase in holdings of securities has approximately offset the unseasonal loan decline. In the aggregate, bank credit has been supplied since midsummer in a somewhat smaller amount than in the same period of other recent years.

Demands for bank reserves have been notably lighter this fall than in the same period of the two previous years. To a small extent this has reflected reserves made available by gold and foreign transactions and by advance payments by the Reserve Banks to the Treasury, but principally it has been due to less than seasonal increases in currency and in required reserves.

Until the past week there has been no easing in the money market from this development, because a reduction in Federal Reserve holdings of securities at a time when increases are usual kept member bank borrowing at a fairly high level. Until two or three weeks ago net borrowed reserves averaged close to $500 million. This, together with the higher discount rate, the generally low liquidity position of banks, and the frequent Treasury borrowing operations, served to keep the money market under pressure.

System policy has thus been quite restrictive in a period when credit demands have been slackening. To a degree slackening in credit growth was the aim of the restrictive policy. System operations, however, have absorbed not only additional reserves made available by the so-called operating factors, but they also have offset the effect of reduced monetary demands, thus keeping banks heavily in debt at the higher discount rate established in August.

Estimates based on the projected seasonal pattern for the remainder of this year, shown in the chart, indicate that after the next two weeks, during which reserves will be made available by the mid-month float increase, reserve needs will mount rapidly. Approximately $700 million of additional reserve funds would be needed to keep net borrowed reserves around the current level of about $350 million. To the extent that the Treasury makes use of its free gold, the need for System purchases would be reduced.

It will be recalled that in November and December of last year and also in December 1955 reserves were made freely available and net borrowed reserves were negligible. Even so interest rates rose sharply, reflecting the pressures of strong credit demands. In fact the weakness in the Government securities markets, together with international tensions, provided the basis for relaxing restraint on reserves. Because of large temporary liquidity requirements of business and banks in December, rates on Treasury bills generally rise in that month even in periods of relatively easy money. Funds are needed at the time to meet urgent temporary needs.

The current decline in yields on Government securities, both short and long, notwithstanding the higher level of net borrowed reserves than a year ago, probably reflects the

slackening of credit demands in contrast to the vigorous demands of last year. The pressure of usual seasonal needs, however, together with Treasury borrowing demands, may soon reverse the current decline, at least temporarily, unless reserves are made readily available.

The Treasury will need to borrow at least $1.5 billion of cash in December, in addition to a refunding operation, and some more in January. The timing of this borrowing is complicated by debt-limit considerations. The nature of these immediate borrowing operations, and of other debt management in the near future, will need to take into consideration the current change in the tone of the Government securities market and also the possibility of increased Government expenditures later. Prompt advantage should be taken of any opportunity to issue long-term securities.

Evidences of abatement of inflationary pressures present an occasion for a reconsideration of the general direction of System policy. To some degree the slackening may reflect the intended and desirable consequences of the restrictive credit policy in limiting the use of bank credit to meet investment demands not covered by savings. To a large extent, however, the slowing down may be viewed as an inevitable reaction to unsustainable elements in the previous expansion. For example, one of the main reasons for the prospective decline in business capital expenditures is that productive capacity in so many lines is now in excess of sales. In addition, consumer resistance to higher prices may be an influence in retarding expansion of sales.

Monetary policy could have prevented these developments only by exerting more restraint on expansion. An easier policy would have stimulated overexpansion, speculation, and rising prices, and thus made the inevitable reaction more severe than it might otherwise be.

Monetary policies need not be changed with a view to bolstering those sectors that are reacting from overexpansion or in an attempt to validate the higher prices which consumers are resisting. Nevertheless, if these corrective forces have reduced the pressure of demands for excessive bank credit expansion, there is less need for restraint on bank credit. When there appears to be a slackening in over-all demands for bank credit, the long-run objective of fostering sustainable economic growth does not call for forcing contraction by keeping member banks heavily in debt at a relatively high discount rate.

It is possible that demand pressure from accelerated expansion in State and local government borrowing, in home

> mortgages, in consumer credit, and even in Federal Government expenditures, might more than offset lessened borrowing by business. Because of the continuing strong demands in many sectors, the situation evidently does not call for flooding the banks with excess reserves or removing the need for all borrowing. Yet, if sustainable growth is to be fostered, any slackening in total credit demands should be permitted to bring about some relaxation of credit restraints.

Chairman Martin said that the vacation from which he returned last week had been better than any he had had in five years and that he felt his perspective had been refreshed. He had picked a good time to be away, he added, stating that he had not seen the article that appeared in the New York Times on October 24 by Edward Dale until after he returned. He could see how this article justifiably had caused concern to members of the Committee. Chairman Martin went on to say that he did not think the Committee could let newspaper articles and newspaper irritations, which were going to be with us always, blunt the Committee's perspective in either direction. An article such as the one that appeared in the New York Times calls attention to the great responsibility of each of us with respect to what goes on in open market meetings, he said, and this applies to the members of the staff as well as to the members of the Board and the Reserve Bank Presidents. In reading the Dale article, it was not difficult to think that someone may have said something that gave an inkling of what transpired in one of these meetings. Articles of this type could not be prevented, and it would be most unfortunate if the Committee permitted this clearing house for System policy discussions in any way

to be lessened in scope and purpose. It was necessary to get all the views and thoughts possible, the Chairman said, and this was the only clearing house in a large System that provided an opportunity for such exchanges. As he had commented before, no one should feel bound by the views he initially expressed in open market meetings, and we should recognize that these were a step in the process of policy decision.

Chairman Martin went on to say that he thought it perfectly obvious that there had been a major change in psychology. He could see it clearly while he was away; he did not see it quite as clearly now that he had gotten back. Last Friday the members of the Board had had an economic go-around which made it clear that there was no longer a question of forecasting a change in the economy; it was a question of recognizing what was on us. In the Chairman's opinion, the Committee would be blind if it ignored these developments. There were a number of ways in which the Committee could recognize the changed situation. It could put in reserves through the open market. The discount rates of the Federal Reserve Banks could be changed. The Committee's directive could be modified. One of the advantages of the System was that it had a top staff that should express views freely, whether the Committee agreed or disagreed with those views. As a prelude to this meeting, Chairman Martin said he would ask Mr. Riefler who worked with him closely on these matters and who also had just returned from vacation to give his thoughts on the situation. This would be done as a means of getting all the cards on the table.

The final conclusions of the Committee would, of course, result from decisions made after members of the staff and members of the Committee and other Reserve Bank Presidents had expressed their thoughts.

Mr. Riefler said that he was quite surprised when he came back from vacation to find how definitely the psychology had changed. It seemed to him that this presented for the System a problem of posture and policy. This had been a long capital boom with strong inflationary tendencies going on all over the world. It had gradually and finally built up excess capacity to a point where that was now taking over. Mr. Riefler did not know how long that sort of thing would go on, but his own feeling was that the tendencies the other way had a very good chance of being persistent since it would take time to absorb over-capacity. This time, however, there was the great ace of rapid population growth to help. On the other hand, the expansion in capacity had been world wide.

At this time the correct policy seemed obscure, Mr. Riefler said. For example, there was the suggestion of Business Week for reducing reserve requirements of central reserve city banks. That, it seemed to him, in the climate of the bond market would have the effect of shoving banks into speculation in bonds. There was considerable expectation that when the Federal Reserve shifted policy there would be a boom market in bonds and, even though there was something to that view, he felt there was a speculative danger. Personally, Mr. Riefler did not feel much inclined toward a decrease

in reserve requirements or for a policy of flooding banks with reserves at this time. He did not think this a period at all like 1953 when there was a genuine knot and when putting excess reserves into the market in quantity had delayed effects in relieving the knot. On the other hand, the System had the problem of posture. It needed to take a correct posture in terms of the changed outlook if it hoped to retain the understanding and support of the people.

The present posture of the System, Mr. Riefler said, is one of having gone up a full one-half per cent in discount rates in August at a time when the business situation was level and at a time when the System's policy was under quite heavy criticism in Congress. That was a posture that made it clear to the world without any doubt that the Federal Reserve was not going to finance inflation. The action had done its job. Usually, the System feels its way in the open market before it moves on the discount rate, Mr. Riefler noted. It would seem to him in this particular situation, however, that the most appropriate thing to do would be to reduce the discount rate to 3 per cent very shortly. That would be an unmistakable sign to everybody of a changed posture and of a recognition of a generally changed situation. Accompanying that move, Mr. Riefler said, he would go towards somewhat easier bank reserves but he certainly would not flood the market with reserves and would not go into any reserve requirements reduction at this time. He felt the investment market should work out of its situation in an orderly manner.

The most serious financial problem looming up was in the area of the structure of the Federal debt, Mr. Riefler suggested. It seemed to him as though the debt ceiling was gone in any event, with the existing public attitude toward Sputnik and the strong demand that money must be spent for defense purposes. Thus, the debt ceiling was gone on two counts: (1) a decline in revenues, and (2) a prospective increase in expenditures for defense. So far as the availability of resources was concerned, this defense spending program would come on at a time when there was a decline in spending from private capital sources. This was manageable, Mr. Riefler said. In fact, he could not think of a better time for diversion of resources to defense than on a declining picture. However, on the financial side, the prospect looked somewhat disastrous. At present the structure of the large floating Federal debt was as unbalanced as it ever had been. An increase in total debt under the circumstances could present an appalling problem. On the other hand, there was, of course, a rather general expectation in the market that there would be a boom market in bonds. Advantage should be taken of this. On the financial front, he felt that the best procedure would be to use the next four months for as rapid a program of reducing the floating debt as was practicable. Perhaps there should be an exchange of unmaturing issues for longer debt instruments.

Mr. Hayes then presented his views on business activity and credit policy, his comments being substantially as follows:

There is no longer much doubt that at least a mild downturn in business activity is under way, and there is widespread belief that it will probably continue well into 1958. Evidence pointing in this direction is available in many segments of the economy and in virtually all sections of the country. I have in mind particularly the further decline in industrial production and retail sales in October; the significant rise in unemployment to nearly 5 per cent of the labor force; the prospect of some reduction in inventories which, at the manufacturers' level, have become rather high in relation to sales and new orders; the development of excess capacity in a growing number of industries; the confirmation of somewhat reduced capital spending plans for 1958 as compared with this year; the depressing effect of recent Defense Department economy moves on business activity and sentiment; and the probable reduced demand of foreign countries for American goods. On the favorable side, residential building seems to have stabilized and has shown some signs of renewed strength, while public construction continues to expand. With respect to unemployment, it seems likely that further increases will occur in coming months even if the level of output should remain unchanged, both because the labor force is growing and because of the prospect of more pronounced gains in productivity than in the last year.

Price developments in the last few weeks have been in keeping with the general slowing down in the economy already outlined. The decline in wholesale prices noted in September appears to have carried somewhat further in October. While the October consumer price index is not yet available, there is some hope that it will show little if any gain over September and that seasonal declines in food prices may hold the index pretty steady for the rest of the year.

Although the sharp deterioration in business sentiment of recent weeks may be viewed as in part a psychological phenomenon, receiving considerable stimulus from the persistent weakness of the stock market, it is now clear that it rests in part on a definite weakening of underlying business statistics. The major question now seems to be not whether a further business decline will occur, but for how long and in what degree. The views of most business economists are reassuring, involving projections of a mild downturn, with gross national product, in dollar terms, remaining about unchanged and with a continued though slight advance in consumer prices, but with a moderate drop in production and some significant increase in unemployment. On the other hand, a few economists argue that the economy is "ripe" for a much more severe jolt than most observers believe possible. In this view, attention is centered on the extended loan position of the banks, reduced corporate liquidity and high consumer

indebtedness, and also on the possibility that recent surveys of business capital spending, while correctly indicating the direction of future outlays, may seriously understate the magnitude of the declines involved. Such understatement could result from future modifications in spending plans in the light of the recent deterioration in business psychology or because of further downward revisions in expectations as to consumer spending.

I am inclined to take the more optimistic of these two views, first because many of the capital spending programs covered in recent surveys seem reasonably firm, and second because news with respect to defense spending will on balance probably have a stimulating effect on business sentiment in coming months. The already announced relaxation in previous military expenditure ceilings, together with public pressure for quick action to intensify missile development, may soon lead to markedly higher rates of orders, even though actual defense outlays may not expand materially for some time to come.

Statistics on bank credit changes in the past four weeks clearly confirm a pronounced slackening in pressure as compared with 1956. This is true of business loans, and particularly of short-term seasonal borrowings. It is also true of total loans, and of loans and investments. We have made very rough estimates suggesting that the money supply at the end of 1957 may be about 1 per cent lower than a year earlier. The tendency toward reduced pressure is scarcely visible as yet in the corporate bond markets, because of a still heavy calendar of new offerings-- but the recent action of the Government security market points clearly to widespread expectations of diminished pressure in coming months, even though the Treasury will be faced with sizable refunding and cash-financing problems. We must, of course, take account of the prospect that the Treasury will probably be borrowing something like $1.5 billion for payment partly in late November and partly in early December, in addition to the substantial December 1 refunding.

Coming to the question of credit policy, I feel that it is not necessary for us to attempt to judge at this point whether the prospective business decline will be mild or severe, and of short or long duration. The important point is that the evidence now available clearly suggests that we can safely go further than we have in relaxing credit restraint without adding significantly to the threat of inflation. Prompt action in this direction seems desirable in view of the possibility, however remote, that the business adjustment may be more than a mild dip. But I see no reason why we cannot move gradually and cautiously

in the first instance, being prepared to reverse our actions if the business news improves substantially, or to adopt a more aggressive program if the outlook deteriorates further.

I agree with Mr. Thomas' view as expressed in his recent memorandum that we should allow the lessened demand for bank credit to be reflected in an easier tone in the money market; and to my mind, this easier tone might well produce a somewhat lower level of market interest rates. While I like to think of our instructions to the Manager as being expressed in rather general terms, i.e., to pursue a somewhat easier policy than that of recent weeks, if we are to use some kind of benchmark in terms of net borrowed reserves, I would propose a figure of roughly a quarter of a billion dollars, perhaps with fluctuations of plus or minus 100 million dollars, around that figure--all subject to the usual proviso that the Manager should have ample leeway to adjust for the "feel of the market" and to the further proviso that doubts should be resolved on the side of ease, especially in view of the Treasury financing expected in the next few weeks. Some sales might be required in the coming week; but I would hesitate to be very definite on this score, preferring to leave the Manager ample leeway. Incidentally, it would seem appropriate to increase the System's holdings of bankers' acceptances in conjunction with any open market purchases of Government securities required in the next few weeks.

I think the Board of Governors might appropriately continue to give serious consideration to a reduction in reserve requirements at the central reserve city banks. This would be one way of meeting the seasonal reserve needs of the banking system. Perhaps the economic statistics do not yet support the need for this action, which probably would be interpreted as an overt move toward easier credit policy, but new evidence during the next few weeks might provide appropriate occasion for the action. If such a move is to be made, the first week in December might be a suitable time, when reserves so released would obviate the need for open market purchases which will otherwise probably be required. The Board may also wish to review within the next few weeks the matter of a possible reduction in margin requirements under Regulations T and U.

The time has not come, in my opinion, to reduce discount rates. The directors of the New York Bank concur in this view, although they are at the same time emphatically of the opinion that we should be making a start at this time toward diminished restraint, through open market operations. It may well be that the lessened demand for bank credit--and the easier tone in the money market that should be allowed to develop as a result--

might lead to somewhat lower interest rates on Treasury bills and other short-term instruments. This in turn might provide the setting for a subsequent reduction in discount rates.

The directive should be amended, if the Committee agrees that some such policy as that outlined above should be adopted. To the extent that policy in the period ahead will be guided by a willingness to provide for prospective seasonal credit expansion, the directive might well reflect this intention. I would suggest the following wording for clause (b) in the directive:

> "to foster sustainable economic growth by supplying reserves to provide for prospective seasonal needs while remaining alert to continued though lessened inflationary pressures."

Mr. Erickson said that conditions in the First District followed pretty much the national picture. Business sentiment appeared to be weaker and this weakness appeared to be outrunning the weakness in business performance. As in the national picture, there were plusses and minuses. Employment was still good, especially in the service producing industries, but manufacturing employment was continuing its downward trend. Shoe production for the country as a whole may match the 1956 total. For the first nine months last year New England had 34 per cent of that production. This year it was 33 per cent. Textile performance was still very disappointing. Mill margins were down as were inventories. Some mill managers believe there is only one way the industry can go and that is up. Readjustment in paper industries was continuing, due to increased productive capacity. The electronics industry presented a mixed picture. TV inventories were in better position and prospects were good for some types of computors. The

Government contract picture was said to be very confused. Machine tool orders continued a downward trend. Ordinarily at this time of year the machine tool people would be getting orders in connection with the 1959 cars. No orders have appeared as yet, and they are of the opinion that there will be no radical changes in the 1959 automobile. Electric power distribution was showing a declining rate of expansion. Construction contract awards for the first nine months of this year were 5 per cent better than last year and residential building was up 4 per cent. Department store sales for the first nine and a half months were one per cent behind last year.

Mr. Erickson then reported on a follow-up survey of capital expenditures of some 150 companies made last month. Those companies now estimate that in 1957 they will spend almost 4 per cent more than they did last year. This, however, would not be as high as estimated earlier in the year. These companies also were asked what their expectations for 1958 expenditures might be. Only 95 replied, 48 stating they would spend less than in 1957, while 27 planned to spend more and 20 no change.

As to credit policy, Mr. Erickson said he thought a change should be made in the directive. He would make no change in the discount rate at this time, preferring to wait until the next meeting or next month. As far as open market operations were concerned, he felt that the restraint should be lessened to the extent that net borrowed

reserves might fluctuate between $200 and $300 million, and if errors were made they should be on the lower side.

Mr. Irons said that the economic factors in the national picture were turning moderately downward. On the whole, the weakening had been quite slight with the possibility of offsetting factors coming into the picture. In the Eleventh District, there had not been much change in recent weeks. The confidence quotient was one of caution, recognizing that there had been less than seasonal growth in some areas and some actual declines. The petroleum industry had not changed much since the preceding meeting and Mr. Irons thought that it would take some time for correction of the situation in that industry. The aircraft industry had been affected by defense moves and there had been some layoffs of workers. There had been a little damage to the cotton crop in the last couple of weeks because of an early frost. Evidences of strength in the Eleventh District included an increase in total employment, construction contract awards running a little above last year, and recently quite strong demand for bank loans in contrast with the decline in the country as a whole. Some leading bankers reported a shift of borrowings by national corporations out of New York and Chicago to Dallas, perhaps a temporary move. On balance, Mr. Irons felt that activity in the Eleventh District was at a high level.

On credit policy, thinking only in terms of a three-week period, Mr. Irons thought the Committee must take into consideration the developing deflationary forces that were beginning to appear in

the past month or two. However, he would not shift as much toward ease as he understood Messrs. Hayes and Erickson to have suggested, but would attempt to maintain approximately the degree of restraint achieved during the past few weeks.

With respect to basic policy, Mr. Irons did not think this was the time to change discount rates or reserve requirements, or to take away other basic steps of that nature, although he recognized it was certainly not a time for further restraint. Assuming that discount rates were not to be reduced, he would hope that market rates, including the bill rate, would conform fairly closely to the discount rate. He doubted that policy should contribute to an easing that would bring about a reduction in rates at this time. Member bank borrowing might be in the $600-$700 million range during this period and, while he did not have much regard for the net borrowed reserve figure as a guide, something in the neighborhood of $300-$400 million would be sufficient. Pressure during the past four weeks had been appropriate in Mr. Irons' opinion and he did not think the System had accentuated the slight declining tendency that had appeared. In another three to six weeks the desirability of a more definite step might become apparent, Mr. Irons said, adding that he was not ignoring recent factors but he did not think that a need for change was yet crystal clear. The System should not act to maintain a preconceived level of net borrowed reserves but should meet requirements as they develop, while giving consideration to the movement of market rates

relative to the discount rate.

The Committee's directive might be changed, Mr. Irons said, but he would hesitate to put into it what he understood Mr. Hayes suggested in the way of a statement that the Committee intended to supply seasonal needs. The Committee would always be expected to meet seasonal needs. If the directive were lacking anything--and Mr. Irons did not think the present wording was bad--it might be lacking the thought of a mixture of factors, some inflationary and some developing deflationary factors. If a change in clause (b) of the first paragraph of the directive were to be made, Mr. Irons would think of something along lines that would call for "sustainable economic growth under conditions characterized by both inflationary and deflationary forces".

Mr. Mangels said that not much new statistical material had become available on Twelfth District conditions since the preceding meeting but such figures as had been reported confirmed the recent pessimism in business sentiment. The production trend was slightly down and employment in manufacturing, mining, transportation, public utilities, and Government had dropped. In the aircraft industry employment in September declined 2 per cent for the second month and related defense industries were being affected by cutbacks. Insured unemployment was 63 per cent higher than a year ago, the largest increase appearing in the Pacific Northwest because of the lumber situation. All types of construction--residential, nonresidential,

public works, utilities--declined 18 per cent in September from a year ago but for the first nine months of 1957 totalled slightly more than in 1956. Department store sales during the last four weeks were down 2 per cent but for the first ten months of this year showed a 1 per cent increase over a year ago. September automobile registrations in California were 8 per cent above August and 30 per cent ahead of September last year. Bank loans during the past three weeks showed a decline compared with a year ago. Demand deposits were about the same as a year ago. Twelfth District banks recently had become net buyers of Federal funds and in the week ending November 6 a larger number of banks were borrowing at the Federal Reserve than in the recent past although the aggregate amount of borrowings remained nominal.

On the over-all picture, Mr. Mangels said that it looked as though plant and equipment expansion had reached a crest. With the completion of many projects, expanded capacity could produce sufficiently to put consumer goods on a competitive basis. There had been enough restraint to hold back further upward pressures. Mr. Mangels did not think the System should put on so much restraint as to force activity down too far too fast. He noted that September wholesale prices had declined slightly and that a further slight decline in October might be expected. Bank loans were down although public issues of corporate and other securities were still high. The Treasury would require new cash and the System should consider

those needs seriously. Mr. Mangels thought that perhaps serious inflation was no longer a threat and that the economy may have reached a turning point with greater weight beginning to shift to the deflationary side, although when this would occur was uncertain. Until there was more positive evidence in the form of more serious unemployment, for example, or more serious price declines, Mr. Mangels thought that policy should continue a moderate degree of restraint. He had in mind net borrowed reserves in the $200-$400 million range, perhaps more in the lower area. The Manager of the System Account should have full leeway in operations. Mr. Mangels did not think the discount rate should be changed now although this might be necessary in the near future. At a meeting of the directors of the San Francisco Bank tomorrow this question would undoubtedly be discussed, some directors having indicated their feeling that the rate might well be reduced. As to the directive, Mr. Mangels thought that clause (b) might well be changed to shift the emphasis along the lines suggested by Mr. Balderston at the preceding meeting so that the clause would read "to fostering sustainable economic growth, restraining inflationary developments, recognizing uncertainties in the business outlook, the financial markets, and in the international situation."

Mr. Deming said that in the Ninth District the situation seemed to be a little stronger than in the nation as a whole, although there were signs of less strength or more weakness than had been anticipated. The more favorable situation in the district reflected

the position of farmers and some strength in residential building. Employment was still higher than last year although unemployment had crept up. Taking out Montana, there had not been much change in the district as a whole in recent weeks. Hours worked had declined slightly. For what it was worth, Mr. Deming stated that forecasts by the unemployment agency for Minnesota indicated that the number of unemployed by next Friday would be about 4,000 higher than last February in the State of Minnesota, reflecting the situation in mining. Without question, Mr. Deming stated, business sentiment in the Ninth District had deteriorated over the past three weeks. Even such developments as would ordinarily be regarded favorably were being looked upon unfavorably in some quarters. For example, the clean-up of 1957 model automobiles which had been very good was now being interpreted by some dealers as borrowing sales from 1958.

As to policy, Mr. Deming said he would associate himself pretty much with the views expressed by Mr. Hayes excepting his feeling on reserve requirements. Mr. Deming thought this was not the time for any dramatic move to signal a change in Federal Reserve policy. He would go along with some easing that would be reflected in net borrowed reserves around the $250 million level.

Mr. Allen referred to two meetings of Seventh District business economists that had been held during the past ten days, stating that for the first time in four years a considerable majority of opinion now pointed to a continuing decline in business activity. The Ann Arbor

business outlook conference held on November 4 and 5 reflected similar sentiments. With about 100 economists in attendance representing firms in finance and industry in the East and Midwest, most expected the industrial production index to be lower next year. The majority opinion was that price inflation had ended or at least had slowed markedly. The expected drop in capital expenditures of business was emphasized at both these meetings, Mr. Allen said. Many of the economists in the Seventh District area believed that the decline in capital outlays in 1958 would be 10 per cent rather than the 7 per cent indicated by the McGraw-Hill survey of business plans. This would be especially important in the Seventh District, Mr. Allen noted, since that district accounts for approximately one-third the nation's production of machinery of all types. On the other hand, some of the district's capital goods industries look to improvement in output and sales, namely farm equipment, road building equipment, office equipment, and electric generating apparatus. Mr. Allen said that as far as he was concerned the prospective decline in capital expenditures was a welcome event. After all, it would be a decline from an excessive level and the lower level would still be large by historical standards. He referred to a report that had appeared in a Chicago paper that next year over-all construction would exceed this year's total by about 5 per cent, and that increased home and public building would more than offset the estimated 7 per cent decline in capital expenditures reported by the McGraw-Hill survey.

The strong trend in retail trade noted earlier this fall had not been maintained, Mr. Allen said. General merchandise stores were operating at about the same level as a year ago despite price increases. Sales of these stores were considered disappointing in each of the past two years but the Christmas upturn made the fourth quarter appear favorable.

Mr. Allen then commented on the automobile industry, stating that the report in last Friday's Wall Street Journal covered the situation well although there was an error in the figure for unsold new cars in dealers' hands on November 1, that is, the Journal reported a 500,000 figure whereas the correct figure was 580,000 of which 250,000 were 1957 models. The industry seemed to be well satisfied with the clean-up of those models. As usual, production was expected to continue at a high rate until early 1958 when dealers' show rooms should be stocked and sales would become a factor bearing on production. In Detroit it was felt that wage contract negotiations in the coming spring would influence manufacturers to push for high production and sizable inventories in the intervening months, whereas labor stoppages would be a counteracting influence in the opposite direction. The labor difficulties have already begun, Mr. Allen noted, referring to a strike in a General Motors transmission plant.

As for monetary policy, Mr. Allen said that he thought the statements by the Chairman and the Vice Chairman of the Board of Governors in their speeches last week were very good. The changes

in the business situation, such as they are, seemed to him necessary adjustments. He referred to the expression Mr. Thomas had used describing the effects of monetary policy thus far as "intended and desirable" results of what the Committee had been trying to bring about. Mr. Allen felt his views were closer to those expressed by Mr. Irons than others who had spoken thus far. If the Committee were concerned about the situation and felt that there should be some easing, he doubted that the level of net borrowed reserves would matter very much, and he would keep this figure around $350 million, about where it now is. Mr. Allen said he was interested in Mr. Riefler's comments, and when the Committee felt that the time for a change was desirable his view was that the discount rate would be the place where a move should be made. He was not ready to make that move now. Mr. Hayes had commented that the directors of the New York Bank were unanimously against a move in discount rate right now, Mr. Allen noted, and he expressed the view that some of the directors of the Chicago Bank would be opposed to a change, although he believed they would favor a change in the discount rate as the first move when action in that direction was taken. On the directive, Mr. Allen said that Mr. Hayes' suggestion seemed satisfactory although he would leave out the words "though lessened" in referring to inflationary pressures, believing that with the wage settlements coming up next year the time had not yet come to recognize lessened inflationary pressures.

Mr. Leedy said that views expressed at a meeting of the directors of the Kansas City Bank last week, with respect both to conditions

in the Tenth District and to sentiment generally, were anything but bearish. Member bank borrowings had increased sharply since the meeting three weeks ago, apparently a result of a lower level of interbank balances at city correspondents and of lower Treasury balances. In addition, the annual tax assessment made in Oklahoma, under which intangibles held as of November 30 were taxable, was causing some shifting of bank balances out of the district temporarily.

It seemed to Mr. Leedy that the signs were so clear with respect to the decline in economic activity that the Committee could not fail to heed them and do something about them. However, any precipitate action might contribute to further deterioration in market and business sentiment. His view was that such action was not yet required, Mr. Leedy said, but for the immediate future he thought the Committee should be operating with a considerably lower level of net borrowed reserves, perhaps in the $100-$250 million area. On the discount rate, the latest move in August had been to bring that rate into conformity with the level of market rates. He did not think a downward adjustment in the rate could be made on that basis. He felt that a lower level of net borrowed reserves should first be signaled. Perhaps the discount rate should then lead the market. Mr. Leedy would make no change in reserve requirements of central reserve city banks for much the same reasons that he did not think a precipitate move in the discount rate should be taken at this time. He would favor some change in wording of clause (b) of the Committee's directive to the effect that policy

should be with the view to "maintaining restraint on the expansion of credit in the interest of sustainable growth, while taking account of contractive elements in the economy," and continuing the phraseology with respect to uncertainties now in the directive. He felt it important that the directive set out that the Committee was taking account of contractive elements.

Mr. Leach said there was evidence that the areas of weakness in the Fifth District economy had spread somewhat during the past few weeks. However, there were no indications of an appreciable acceleration in the slide-off in the principal industries. There had been a small decrease in hours worked in the textile industry, and a number of the larger cotton mills were planning longer-than-usual shutdowns at Thanksgiving and Christmas. Declining sales recently had been reported by department stores, furniture stores, and household appliance stores, and by a majority of reporting automobile dealers. The increase in aggregate nonagricultural employment in September was less than is usually experienced.

With respect to policy, Mr. Leach said he thought the Committee should attempt to maintain enough tightness to prevent the resurgence of inflationary pressures but not enough tightness to accelerate the over-all downturn in the economy. This would presumably permit adjustments now under way to continue. In view of the downward trend in virtually all economic indicators, including the contraseasonal movement of business loans, he thought the degree

of restraint maintained in recent weeks could be modified without running much risk as to the resurgence of inflationary pressures. He was not thinking of a shift so substantial as to be interpreted as a shift from restraint to ease, or one that would require abrupt action if renewed evidences of inflation should appear. In terms of net borrowed reserves perhaps $200 million would be a suitable benchmark. Mr. Leach added the comment that the discussion this morning made him feel more strongly than before that the net borrowed reserves figure had some use as a benchmark but not as a goal. That is, the figures do serve as indicators of the degree of tightness, and if the Committee were going to make any change in the degree of tightness these figures would have to get down around $150 or $200 million in order to indicate a change from the present.

Mr. Leach went on to say that he was inclined to feel that such dramatic action as lowering of the discount rate would be a mistake at this time, although he had a strong feeling that the Committee's directive must be changed. The record should not show that the Committee failed to recognize a change in the economic outlook from what it was some months ago when the present wording of the directive was adopted. For some time the Committee had been endeavoring to restrain inflationary developments, and Mr. Leach said he thought it had succeeded. However, he thought the Committee

would not wish to continue saying in its directive that it was trying to restrain: rather, it would now seem better to say in substance that it wished to prevent the resurgence of inflationary developments. A change in the directive clearly was needed, Mr. Leach said, and he felt it should provide for less restraint but not for ease. He would not care particularly to put in a reference to meeting seasonal needs. His suggested wording of clause (b) of the first paragraph of the directive would read "to preventing the resurgence of inflationary pressures in the interest of sustainable economic growth, while recognizing increasing uncertainties in the business outlook, the financial markets, and the international situation." We should proceed gradually rather than abruptly, he said, because we could not be sure at this time that it might not become necessary to reverse what we were doing.

Referring again to the discount rate, Mr. Leach said he would not be particularly happy to see a lowering of the rate now and an increase a little later, although he would like to use the discount rate some time as a lead action, rather than always as a catch-up action. Nevertheless, he hesitated to use the discount rate as a lead action at this time since such a change might indicate that the Federal Reserve was anticipating more of a downturn than was actually the case.

Mr. Robertson said that none of the statements and none of the facts presented today left him with a feeling of pessimism. Public

psychology, which he felt should be weighed more heavily than any other factor, was at a low point in the East but seemed to be quite high in the western three-quarters of the country. Consequently, he would align himself completely with the views of Messrs. Irons and Allen. The Committee should not close its eyes to the fact that there has been a downturn, but it should not be panicked by it; it merely indicated to Mr. Robertson that the policy the Committee had been following was actually working. The policy should not be pressed harder, Mr. Robertson said, but he would not change the discount rate at the present time and would not reduce the volume of net borrowed reserves. He would be flexible and prepared to move whenever that was called for. Although he did not think a sharp move was called for at this time, Mr. Robertson said he agreed with the suggestion that the directive should be changed to get away from the idea that the Committee was directing policy completely toward fighting inflation. If the directive recognized that there were signs of developing deflationary trends, that would be a sufficient indication of a flexible policy, Mr. Robertson said. If, three weeks hence, conditions indicated a further downward trend in economic activity, it might be time to consider a reduction in reserve requirements as well as in discount rates. For the present, the Committee should move sidewise, holding its place and always remaining as flexible as possible, but he emphasized that flexibility does not involve jumping back and forth just for the sake of jumping. In sum, Mr. Robertson would not

change the policy of restraint at the present time, would not change the discount rate, would not change the level of net borrowed reserves, but would modify the directive.

Mr. Shepardson said that his feelings were much the same as those expressed by Mr. Robertson. All of us recognized that there had been some changes in the situation. Mr. Shepardson felt these changes had been desirable and in the direction that the Committee had been aiming for some time past in trying to bring the inflationary forces under control. There was still a strong possibility of a resurgence of upward pressures from expansion to come in defense expenditures and other factors, and any overt move toward ease, any positive change in direction of policy, would seem to him to be a mistake at this time. Under present conditions, there was an opportunity to bring about some material gains in efficiency. If the current restraint continued for a time, many persons might do some pruning of inefficiencies that had come into the economy. This would be all to the good. The Committee should have in mind the possibility of the coming wage negotiations and should maintain as far as possible the kind of climate that would hold some restraint against wage moves such as had been witnessed in the past. At the same time, the Committee should recognize the slackening of inflationary pressures, and restraint should not be increased in any way. Mr. Shepardson's preference would be to hold just about the degree of restraint of the past three weeks, not taking positive steps to ease but being

careful not to increase pressure. He agreed that there should be a change in the wording of the directive and he liked the suggestion Mr. Leach had made.

Mr. Fulton aligned himself completely with the views Mr. Shepardson had expressed. There are evidences of greater than adequate capacity in the heavy goods industries that resulted from the considerable expansion of plants and this added capacity is just not being fully used. Businessmen and consumers are going through a psychological reversal from conditions prevailing over the past year. There has been a jolt because of the earth satellites launched by the Russians. Business does not now feel there is a chance of an upturn this year and, after a sidewise movement, there might be a moderate downward movement next year. Mr. Fulton thought this would be of benefit to industry in that some of the "fluff" would be taken out. Inventories were believed to be in such shape that an upturn in consumer demand would come back promptly to basic manufacturers. The whole economic system could open up very rapidly. Mr. Fulton commented on a meeting in Cleveland a few days ago attended by 23 economists from industry, stating that their projections of the industrial production index indicated a slight decline in the first quarter of 1958, some further let-down in the second quarter, but a rise in the third quarter of the year. Their conclusions were that unemployment would not be excessive.

Mr. Fulton said he felt the Federal Reserve should not reduce the discount rate at this time. This would be too sharp a change in

posture and in direction. Perhaps net borrowed reserves should be reduced to the $250-$300 million area, but nothing dramatic should be done at this time. Any dramatic move could easily upset the economy. The Committee's directive might well be modified to recognize the change that had taken place in the economy, but nothing should be done that would be abrupt in the direction of ease.

Mr. Williams said that in the past several months there had been indications that sentiment on the pessimistic side had been outrunning statistics. Now the statistics were beginning to confirm the sentiment. This could be observed in loans of large city banks. In the past six weeks loans for business purposes had fallen off persistently in the Philadelphia District. Without exception, the lowest point in those loans was in the latest figures. Final figures on capital expenditures in the Philadelphia District showed that plans for 1958 were almost universally on the pessimistic side, with all manufacturing showing a decline of 13 per cent, durables a decline of 10.5 per cent, and nondurables a decline of 15.5 per cent.

The directors of the Philadelphia Reserve Bank had become vocal on the question of the business outlook and credit policy, Mr. Williams said, referring to a discussion on the matter at last week's meeting of the directors at the conclusion of which the Chairman of the Board was directed to send a letter to the Board of Governors calling for a change in policy through open market operations. After

reading the letter that the Chairman of the Philadelphia Bank had sent to the Board of Governors, Mr. Williams stated that he felt the objective for net borrowed reserves should be lowered to the $100-$250 million range. The Committee's directive should be changed, but Mr. Williams would turn the job of detailed wording over to someone else. He felt it evident that we were beyond a position of uncertainty and that the Federal Reserve could assume a posture not by changing the discount rate, but by easing operations through the System Open Market Account.

Mr. Bryan said that, with the possible exception of Florida, the Sixth District was showing changes in a downward direction--not dramatic, but a series of small changes. He was greatly impressed with the shift in business sentiment and statistics in recent weeks. At the meeting of the directors of the Atlanta Bank last Friday, a full discussion of the situation showed a remarkable shift in the sense of ebullience and exuberance that had existed. Mr. Bryan felt that the System was confronted with a difficult problem in policy. The statistics showed deterioration in the situation, and if the System were dealing merely with the question of a short-run deterioration, he would favor a considerable easing of monetary policy at this time. However, the problem was more difficult because of a difference between the short-run and longer-run outlook. The longer run considerations, Mr. Bryan felt, might require a fairly high rate of interest in view of the need over the longer pull to encourage savings

to take care of the population growth, and because, as Mr. Riefler had mentioned, the Federal debt ceiling and budget limitation were gone as a result of missile developments. Under the circumstances, Mr. Bryan said that he leaned a little more toward easing the situation, perhaps not by immediate and overt action, than he did toward maintaining the present degree of restraint. He had reached this conclusion believing there was an inherent danger in the present situation. Just as the strength and duration of booms tends to be underestimated, so the extent of readjustments, particularly after a long-continued boom such as we have had, tends to be underestimated. The lack of liquidity in the economy could provide a terrific drag if recession got underway. At the last meeting of the Committee it seemed to him desirable that the bill rate should be kept in the neighborhood of the discount rate. He felt now that the bill rate might be moved a little below the discount rate. If the situation eased naturally and substantially by virtue of the failure of loans to go up, he would not put any brakes on that easing. He would let net borrowed reserves fall where they will since they could be influenced by many factors, and he doubted that the Committee should put on pressure because of a preconceived figure of net borrowed reserves. He would buy the long bills very freely if they had a tendency to go above the discount rate, and if they tended to move below the discount rate, he would let them go. In addition, the System might begin to consider re-establishment of some moderate growth factor in the total factor of reserves. Growth

had been so negligible recently as to be nonobservable and by the end of the year may prove to have been a negative figure. The economy was trying to grow, and unless we allowed the reserves to get out to permit growth, the Federal Reserve would eventually be a party to producing economic convulsions. Mr. Bryan said that if any overt action were to be taken, he would like to see it done at this time by reducing reserve requirements on savings deposits. He also would like to see the Committee's directive changed.

Mr. Johns said that he, too, had returned from vacation, but being under the necessity of remaining at home he had been exposed to a variety of reading, including the Dale article in the New York Times, and perhaps his perspective had not been improved during his vacation. In preparing for this meeting, he reached conclusions agreeing with the statements that had been made by Mr. Young to the effect that a moderate downward adjustment in the economy had been occurring, that the evidences of psychological change were fairly impressive, and that further moderate downward drift might be likely. The Eighth District seemed to be contributing its share at least to that kind of performance. Manufacturing activity was down, employment was not strong, department store sales were down, bank loans were behaving about as in the country generally, and bank debits in October certainly evidenced no great strength in economic activity. Eighth District agriculture tracked with the nation except for the recent

impairment of the cotton crop both as to quality and quantity. In only one factor was there evidence of strength--construction--and even that strength was because of two major public housing projects connected with Armed Forces installations. Mr. Johns' conclusions on the basis of his appraisal of the situation were that (1) a reduction of the discount rate was indicated and that should take place very soon; (2) through open market operations restrictions upon bank reserves should be moderated; and (3) the Committee's directive should be changed promptly.

Mr. Johns went on to say that perhaps there had been signs some time ago of the change that might seem to have occurred recently. He was inclined to think that the statistics were just now catching up with the evidences which perhaps were not clearly seen but which were perhaps divined as early as last August when the Federal Reserve was assuming a rather strong posture with respect to restraint of inflation. He felt that the adjustment of the discount rate in August had greater significance than bringing it into line with the market structure; he was inclined to agree with Mr. Riefler that that action was a clear indication that the Federal Reserve did not intend to finance inflation. At this time, Mr. Johns thought the System should acquire a new posture as Mr. Riefler had suggested. He doubted, however, that the System should move too quickly to reduce the discount rate by 1/2 per cent. We have had a very long and very well advertised period of tight

money, he noted, which has engendered some apprehensiveness in the minds of reasonable people. Possibly a clearly announced but moderate change in policy in the direction of less restraint would have a salutary effect on public opinion and attitude. Assurance that the tight money policy would not overstay its welcome might be a very healthy thing. Therefore, Mr. Johns would lean in the direction of a rather prompt reduction in the discount rate of 1/4 per cent. He noted that the directors of the St. Louis Bank met on Thursday of this week, adding that he would not be able to argue strongly against such a reduction.

With respect to open market operations, Mr. Johns said that he believed that there should be observable moderation of restriction on bank reserves. Also, there should be a change in the Committee's directive. He did not believe the directive should continue to proclaim as its central purpose the restraint of inflationary forces. In commenting on this point, Mr. Johns suggested the desirability of having the directive state in more specific terms than it has in the past what the Committee expected in the way of operations in the open market from the Manager of the System Open Market Account. Specifically, at this time he thought that the directive should tell the Manager quite clearly that he should moderate the restrictiveness through operations to increase the availability of bank reserves.

Chairman Martin interjected the comment that the directive was the basis for the record of open market policy actions submitted to

the Congress. It was not written only for the Manager of the System Account, but it was a public document. The directive had a heritage that had been built up over a period of many years. This heritage and the purposes served by the directive should not be confused with the more detailed comments given in the minutes of the meetings to help guide operations during the intervals between meetings. The Chairman pointed out that the nature of the directive must be considered in thinking of the relations between the Chairman and other members of the Committee and the Congress. While he did not believe there was any major disagreement between the views he was expressing and the thoughts Mr. Johns had in mind, he thought we should bear in mind not only the drafting problem but the nature of the directive that had been issued by the Committee in the past and which the Committee would be dealing with in the future.

Mr. Szymczak said that the problems of monetary policy were similar to the problems of fiscal policy in that both were very difficult. Monetary policy was much more flexible and therefore could meet its situations much more readily than fiscal policy. Even there, however, it was not always easy to adjust monetary policy to statistics that became available late. Mr. Szymczak agreed with Mr. Bryan that there was not only the present situation to consider, but there was the likelihood of another and different situation that might develop over the longer run and take us into deficit financing. At the present time, Mr. Szymczak felt that the Committee should decrease

to some extent the net borrowed reserves by supplying reserves through the open market. A move in this direction would be indicated by net borrowed reserves in the $200-$250 million area. He also felt that the wording of the Committee's directive should be changed so as to recognize the reduced inflationary pressures and the increased uncertainties in the business situation, but he would also have something in the directive to suggest that it still might be necessary to fight inflation. On the discount rate, if the Committee were to supply reserves it would become necessary to reduce the discount rate because of the effect additional reserves would have on market rates. His own view was that discount rates should be reduced as soon as possible and not by 1/4 per cent, but by 1/2 per cent.

Mr. Balderston said that, as he had remarked at the preceding meeting, the economy seemed to him to have reached and probably to have passed the peak of the boom. This appeared to be the case not only in this country but in Canada and in Western Continental Europe. In attempting to avoid confusion in his mind between the psychological and the real situation, he was basing his conclusions on indices of production in foreign countries and in the United States, the fact that electrical power consumption was dropping below its trend line, the falling off in freight car loadings, and the decline in manhours worked per week. The Department of Labor had been making some studies as to probable changes next year in unemployment, he noted, that

indicated a doubling of unemployment in 1958.

Mr. Balderston said he would differ from Mr. Hayes, not as to the diagnosis of the situation, but as to the remedy to be applied. He would not favor a change in reserve requirements or in margin requirements because he thought the interpretation that would be placed on such moves by the country would be that the System was favoring Wall Street and forgetting Main Street. Moreover, either of these moves might prove premature. To dissipate any impression that the Federal Reserve System was adamant and doctrinaire, Mr. Balderston said that he would favor an immediate reduction in the discount rate, the sooner the better, and he would make the reduction 1/2 of 1 per cent. A suitable target for net borrowed reserves would be around $250 million. He would change the directive with a simplified statement of clause (b) that would call for operations with a view "to fostering economic growth that is sustainable." If some qualification seemed necessary, this could be supplemented with a statement such as "and continuing to watch potential inflationary threats."

Chairman Martin said that he thought we had had another extremely good go-around. He certainly was not gloomy. Excellent progress had been made both in the System's public relations and in its policy. In his judgment, we had not yet licked the business cycle. Any idea that we may have had at times that the business cycle was out the picture was mistaken. How to relate that to the present situation was another question. Chairman Martin said that he was not trying to

forecast the future, but as he saw the factors shaping up, and as he tried to recognize forces as they were developing, private capital formation had slowed up. This was not the inventory problem that we had in 1953 and 1954. At this particular stage of the cycle, the slowing of private capital formation could have more dangerous repercussions over a period of time than the country faced in 1953-54.

Turning to posture of the System, the Chairman recalled that he had repeatedly pointed out that the System did not want a recession. There might be differences of opinion on the emphasis to be placed on this, but when inflation gets ahead of us, the unraveling process becomes an extremely difficult one. We in the System cannot assume that our policies have been sound enough for people to take the position that we in no way contributed to the inflation by our policies. We could not say that our policies had been sound enough and accurate enough so that we had been completely on top of the situation. All of us know that the Federal Reserve cannot do more than minimize the problems that are created by distortions such as we have had. Chairman Martin told of an incident that he had observed recently where a child had gotten a bad burn, and when the doctor came, he reminded the father of the burned child that this was not the time to rebuke or be angry with the child: the immediate need was to apply all the remedies there were to heal the burn.

In relating this incident to the System, the Chairman stressed his belief that at this stage of economic developments, the important

thing was that the Federal Reserve have the correct posture. Over a period of time, he had felt that it would have been better if the System had put the discount rate up long before it did. However, when we came to last August, there was no alternative but to move the discount rate up as a recognition of a technical situation. The System should not now go off half-cocked, but even if it became necessary to reverse itself it should try to retain flexibility. It would be most unfortunate if the posture of the System at this time was one that could give any credence to the view that the System now had an "I-told-you-so" attitude. The System should not claim credit at this time for the decline that has occurred. It should not be saying that this was a result of our policy and that we were glad this had come about.

The Chairman said that he did not wish the foregoing remarks to be misunderstood. He believed that the adjustments now taking place would prove to be salutary, and if the inflationary movement had gone farther, the unraveling process would have been much more difficult. He was directing these remarks to the public posture of the System. It was important that the Committee bear in mind the System's posture in terms of the public psychology and the political undertones and overtones. Although he had felt that the discount rate should have gone up sooner than it did, he was glad that none of us could make these decisions alone. All parts of the System should pull together,

and there should be a synthesis of the various points of view until they gradually were welded into a System view. The tendency, however, was too much toward the status quo at times.

As to present policy, Chairman Martin said that he would not argue whether there should be a change immediately, but if the discount rate were to be changed, the System must recognize that the Treasury planned to make a financing announcement later this week. It was also important that within the System there not be shilly-shallying with posture. The Chairman thought the present situation could be distinguished from that of 1953-54, and he doubted that there would now be a resurgence of inflationary pressures such as we got at that time. There was a tendency for all of us to like to fight a new war in the same way as the last one, but in this case he thought the readjustments now taking place in the economy were likely to go on regardless of moves on the monetary front. There might be some speculative movements if certain actions were taken by the System, but in the Chairman's judgment we would be disappointed if we expected a repetition of the 1953-54 experience.

Noting that he had been a stock market speculator most of his life until he got out of that business, Chairman Martin said that while he did not think the stock market was an accurate reflector of business trends, he did believe it reflected the vagaries of the situation. The confidence factor had been permitted to get out of hand on the up side in the expectation of inflation, and the expectation that nothing would

be done about it had almost carried us over the dam on that side. The problem became more difficult when dealing with pessimism. Chairman Martin said that without placing any definite timing on the action, he hoped that within the next six weeks the Federal Reserve would take an overt action that would recognize the situation. He would favor action on the discount rate. As Mr. Johns had pointed out, the move in August from 3 per cent to 3-1/2 per cent came at the tail end of an upward move in business. That increase in the discount rate marked the posture of the Federal Reserve in terms of psychology. Since then, there had been some sharp changes. Business loans had declined during a five-week period by $650 million, the first decline in such loans during October in the postwar period. In each of the past two years, these loans had increased sharply in that month. This was a sharp swing in a very short time and it needed to be watched. There had been a suggestion that the Committee supply reserves to the market, but there was a problem in putting reserves into the money market when reserves were being released by a decrease in loans. Even though the psychology of the public has changed completely, the System does not want a sloppy money market at a time of Treasury financing. It should be very cautious about getting a sloppy condition in the flow of funds.

This morning's discussion had pointed up the System's problem very clearly, Chairman Martin said. He aligned himself with the comments

of those favoring a moderate easing of pressures on reserves through open market operations. He, too, hesitated to put out any specific figure of net borrowed reserves, but the figures mentioned by Mr. Hayes, $100-$250 million, seemed as good as any, remembering that the feel of the market had to be considered. The point was that a moderate easing seemed appropriate, and all of us should be considering other actions and their timing as the days go on.

Chairman Martin said that the more he thought of these problems, the clearer it became that no one of us could be certain he was right. He liked the way the System goes about reaching policy decisions of this type. Sometimes the process was a lot slower than he liked, but sometimes we find out later that we are glad that it was slow. At this particular time, he felt the System should not minimize the public relations problem or the psychological problem of the public. We should be careful not to let anyone get the idea, if the adjustments begin to snowball, that the System is proud of Federal Reserve policies having brought any such development about. Neither should we permit anyone to get the idea that the System was not going to do everything within its power--and we recognize its powers are limited--to "bind up and heal our wounds."

Chairman Martin then turned to the Committee's directive to be issued to the Federal Reserve Bank of New York, stating that it appeared that the majority view was that the directive should be changed along the lines discussed. There had been a number of suggestions for the

wording. He reiterated his comment that the directive was a heritage of the past, also stating that he did not care particularly about the precise wording, so long as it indicated the Committee's posture and was recognized as the basis for the record of policy actions.

There followed considerable discussion of the wording of clause (b) of the first paragraph of the directive, in the course of which numerous suggestions were made and considered. During this discussion, Mr. Shepardson reverted to Chairman Martin's illustration of the child with a burned hand and the need for applying all the remedies there were to heal the burn. Mr. Shepardson said he had in mind a different analogy. There had been a wave of "flu" over the country. In some of these serious epidemics, the great danger was in getting up too quickly and risking a relapse. In this case, Mr. Shepardson felt that we had reduced the fever but he questioned whether we were quite ready to let the patient get on his feet and start running again.

Chairman Martin responded that this was a very well takem comment and that this was where the element of judgment was involved.

At the conclusion of the discussion, it was agreed (Mr. Robertson dissenting) that clause (b) should be changed by deleting the provision that had been carried in the directive since the meeting on March 5, 1957, which called for open market operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while recognizing uncertainties in the business outlook, the financial markets, and the

international situation," and that this should be replaced by a clause which called for operations with a view, among other things, "to fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves."

In response to Chairman Martin's request for comments, Mr. Rouse stated that he thought the discussion had clearly indicated the desires of the Committee and what was meant by the suggested new wording of clause (b) of the directive. Mr. Rouse also commented briefly on the outlook for bank reserves during the next few weeks.

Thereupon, upon motion duly made and seconded, the Committee voted 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 fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves, 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.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Shepardson, Szymczak, and Williams. Vote against this action: Mr. Robertson.

Mr. Robertson dissented from the foregoing action with regard to the insertion in paragraph (1) (b) of the clause, "by moderating the pressures on bank reserves." His action was based on the belief that the prevailing condition of the economy was not such as to call for a lessening of restraint, that inflationary potentials were still strong, and that continued restraint was essential to its containment.

Mr. Johns stated that he was not clear as to what, if any consensus there had been regarding action on the discount rate.

Chairman Martin stated that he doubted there had been a consensus. His view was that whenever an announcement of a change in the rate was made, it must be carefully thought of in relation to the forthcoming Treasury financing. He did not think we should be in the

position of having the Treasury open its books on a new offering and, in the midst of that, having the System make a change in the discount rate. This was a problem that had to be worked out.

Mr. Hayes said that in suggesting consideration of a change in reserve requirements at central reserve cities, he did not mean to indicate that a reduction should be made immediately. He felt that it should, however, continue to have serious consideration.

Chairman Martin agreed that this was a subject that appropriately should be raised for consideration. He reiterated that each of us should feel perfectly free to present suggestions or ideas having to do with any aspect of monetary policy. This was not a matter of Board prerogative, or bank prerogative, or Committee prerogative, and these meetings should be looked upon as a clearing house for System policy discussion.

In concluding the meeting, the Chairman commented that every person in the room should remember that he had a special responsibility to see that what had transpired here was not permitted to get into the press.

It was agreed that the next meeting of the Committee should be scheduled for 10:00 a.m. on Tuesday, December 3, 1957, and attention was called to the fact that because of the holiday season it was likely that the following meeting of the Committee might be held on Tuesday, December 17, with the meeting after that to be held three weeks later,

on Tuesday, January 7, 1958.

Thereupon the meeting adjourned.

Secretary