FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR
THE YEAR

1955

Williams, and Young. Votes against this action: none. Not voting: Mr. Bryan.

Clause (b) of the directive was changed at this meeting to provide that transactions for the System open market account should be with a view, among other things, "to fostering growth and stability in the economy by maintaining conditions in the money market that would encourage recovery and avoid the development of unsustainable expansion." This superseded the clause in the directive that had been adopted by the Committee at its meeting on December 7, 1954 which read "to promoting growth and stability in the economy by maintaining a condition of ease in the money market."

The change to eliminate the word "ease" from the Committee's directive and to adopt the wording set forth above reflected the view of the Committee that, while the economic situation was developing satisfactorily, easy credit was no longer needed to foster recovery. There had been a rapid advance in most indicators of over-all economic activity since mid-1954 to levels only moderately below earlier peaks and, at the same time, there were some indications that further ease might contribute to the germination of unhealthy speculative activity which might endanger stability. The volume of credit used in security trading had been increasing rapidly, and the Board of Governors had increased margin requirements from 50 per cent to 60 per cent, effective January 4, 1955. The Committee's conclusion that, in order to avoid the development of unsound conditions, it should not continue to promote "ease" in credit availability, was a shift in emphasis, a further step away from the policy of "active ease" that had been pursued during the latter part of 1953 and most of 1954 and which had been modified in December of that year by elimination of the word "active" from the instruction to pursue a policy of ease. While the Committee did not believe that it was yet fighting inflation, it took the position that this shift in emphasis was desirable to avoid credit conditions that might encourage the development of an inflationary situation. This would contemplate a gradual contraction in the volume of free reserve funds of banks from the level that had prevailed, and some increase in the cost and decrease in the ready availability of credit. On the other hand, the change in directive at this meeting did not call for pursuit at this stage of a program of credit restraint or of firmness in the money market.

March 2, 1955

1. Authority to Effect Transactions in System Account.

The Federal Open Market Committee approved a renewal without change of the directive issued at its meeting on January 11, 1955 with respect to effecting transactions for the System open market account. Among other things, this directive provided that transactions for the System open market

account be conducted with a view "to fostering growth and stability in the economy by maintaining conditions in the money market that would encourage recovery and avoid the development of unsustainable expansion."

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Szymczak, and Vardaman. Votes against this action: none.

The Committee's review of the economic situation indicated that expansive forces had continued generally strong, both domestically and abroad, during the opening months of 1955. Recovery was well advanced from the recession low of mid-1954 but industrial activity was still slightly below the previous peak reached in mid-1953. While there had been scattered increases in prices of raw materials, there had been no spreading of such increases to the general price structure. Speculative inventory accumulation was not apparent. Unemployment was still relatively high, notwithstanding the degree of recovery that the country had experienced. Concern was indicated with respect to the relaxation of terms for and the volume of expansion in mortgage and consumer credit, and there were some fears that in a few industries, including building, activity was reaching levels that could not be sustained.

This situation did not appear to call for a generally restrictive credit policy but for a program that would continue to encourage sound economic growth and high employment, while discouraging speculative developments and financial over-commitments by business and consumers. Monetary policy had been taking some of the slack out of the money market since the turn of the year and money rates had risen. Thus, while policy had not become restrictive, it had recently resulted in some restraint on the rate of credit expansion. The Committee concluded that this policy was appropriate to the current needs of the economy, and it agreed that, although increased ease should be avoided, further measures toward restraint should be deferred until the effects of the shift in operations that had taken place since the beginning of the year were more apparent.

2. Authorization to Acquire Bankers' Acceptances When Consistent with the General Credit Policy of the Federal Open Market Committee.

The Committee authorized the Federal Reserve Banks (a) to purchase or sell, at market rates of discount, prime bankers' acceptances of the kinds designated in the regulation of the Federal Open Market Committee, at such times and in such amounts as the executive committee might deem advisable and consistent with the general credit policies and instructions of the Federal Open Market Committee; and (b) to enter into repurchase agreements with nonbank dealers in bankers' acceptances at such times, in such amounts, and at such rates or rate ranges as the executive committee should prescribe. Incident to this change in the procedure it had been following with respect to acquisition of bankers' acceptances, the Committee discontinued the procedure approved on June 19, 1952 under which a minimum buying rate on prime bankers' acceptances was established by the Committee with authority for the Manager of the System Open Market Account to specify currently effective buying rates at which such purchases would be made.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Szymczak, and Vardaman. Vote against this action: Mr. Robertson.

The purpose of this action was to authorize modest participation by the Federal Reserve in the market for bankers' acceptances as a means of showing the interest of the central banking organization in this market, which was expanding and which it was felt might become, in time, a more important means for financing international trade transactions. It was understood that transactions in bankers' acceptances would be entered into only when consistent with the general credit policies of the Federal Open Market Committee, within limits to be determined by the executive committee. Approval of this procedure by the full Committee was with the understanding that the executive committee would prepare a specific authorization to carry out the intent of the full Committee, and such authorization was issued by the executive committee to the Federal Reserve Bank of New York, effective March 29, 1955.

In voting against this action, Mr. Robertson expressed the view that there appeared to be no adequate reason for the Reserve Banks' seeking actively to buy acceptances for their own accounts. He felt that the objective of supporting and encouraging the acceptance market could be achieved more effectively through a policy of standing ready to purchase all seasoned prime acceptances offered to Reserve Banks at published rates, the practice that he understood was followed by the Reserve Banks in the 1920's, the period of their most active participation in the acceptance market.

3. Review of Continuing Authorities or Statements of Policy.

The Committee reviewed and reaffirmed all continuing statements of operating policy and specific authorities for operations which were in effect immediately prior to this meeting. This included reaffirmation of the following statements, by the votes indicated below:

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

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Szymczak, and Vardaman. Votes against this action: none.

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

Votes for this action: Messrs. Martin, Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Szymczak, and Vardaman. Vote against this action: Mr. Sproul, Vice Chairman.

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

Votes for this action: Messrs. Martin, Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Szymczak, and Vardaman. Vote against this action: Mr. Sproul, Vice Chairman.

The only change made at this meeting in the wording of any of these statements was in the second, in which the words "other than repurchase agreements" were inserted. The purpose of this insertion was to make clear that the Committee did not intend to preclude repurchase agreements with nonbank dealers in Government securities covering Treasury securities that might have a maturity outside the short-term category, or that might be involved in a Treasury financing.[1] Because pricing of securities in such agree-

[1] The repurchase agreement is a means of putting funds into the market at the initiative of the System during periods of undue money market tightness or strain attributable to temporary factors, under a procedure whereby such funds automatically come out of the market within a very short time when the elements of excessive tightness or strain have subsided. Such agreements are made to meet purely temporary needs for reserves when the impact of these needs has in some measure been shifted

ments entails no element of price support, and because of the special nature of such agreements, the Committee felt that they ordinarily could appropriately cover Treasury securities which otherwise would not be bought or sold under the Committee's general policy of effecting transactions only in short-term securities and avoiding purchases of securities involved in a Treasury financing.

Mr. Sproul voted against the statements under "B" and "C" because he continued to be opposed to the assertion by the Committee that it has a responsibility solely with respect to the volume of bank reserves; because he continued to oppose the Committee's renunciation of all or any transactions directly related to security issues involved in Treasury financings, as he believed that such transactions might in some circumstances facilitate, rather than interfere with, the attainment of the System's policy objectives; and because he continued to be opposed to the prohibition against offsetting purchases and sales of Treasury securities for the purpose of altering the maturity pattern of the System's portfolio and the limiting of transactions to short-term securities in all circumstances. In voting against these actions, Mr. Sproul said that he had been encouraged by the public statement contained in Chairman Martin's replies to questions submitted by the Subcommittee on Economic Stabilization of the Joint Committee on the Economic Report in connection with subcommittee hearings on December 7, 1954, that these operating policies are experimental, and by the warning this should convey to the market that there is no promise, expressed or implied, that these policies will always be followed.

May 10, 1955

1. Authority to Effect Transactions in System Account.

The following directive by the Federal Open Market Committee was approved:

> The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), 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 growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion, (c) to correcting a disorderly situation in the Government securities market, and (d) 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 $2 billion.
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> The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (which Bank shall have discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) of 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 $2 billion.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Shepardson, Szymczak, and Vardaman. Votes against this action: none.

This directive was modified from that approved at the meetings on January 11 and March 2, 1955 by changing clause (b) to delete the words "encourage recovery" and to make the clause read "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

The Committee noted that during the current or second quarter gross national product was estimated at an annual rate of $375 billion, nearly $20 billion above the low of last year and $5 billion above the mid-1953 peak; that strong expansion in activity was generally continuing abroad; and that in the United States a number of industries were operating at or close to capacity. Supply shortages had appeared in some industrial materials and prices of metals had advanced, although price averages were still generally steady. Business, financial, and consumer confidence was extraordinarily

to the Government securities dealers, through sales to them of additional securities or withholding by banks or other lenders of funds needed by the dealers to carry their positions. The technical arrangements consist of a purchase by the System at an agreed price, subject to a dealer's undertaking to repurchase the same securities at the same price, plus a stipulated rate of interest, on or before a maturity date set by the System. In general, the interest rate has been equivalent to the discount rate of the Federal Reserve Bank of New York, although at times there may be a temporary deviation above or below this rate; the maturity has in practice been limited to 15 days or less; and the price set in the contract is determined by the System in each instance at a nominal margin below the latest-prevailing price in the market for the securities involved.