FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1955

high. On the other hand, manpower and industrial resources of the United States were generally ample for growth, and a substantial amount of unemployment still existed in some areas. Prices of farm products continued under pressure from surplus supplies and excess capacity. There had been no seasonal contraction of business loans, and rapid expansion of real estate and consumer loans had continued. This further expansion in the volume of credit and evidences of continued speculative pressures in the stock markets had been followed by action of the Board of Governors increasing margin requirements from 60 to 70 per cent, effective April 23, 1955.

In deleting the previous instruction to "encourage recovery" the Committee had in mind that recovery now was an accomplished fact and that credit policy need no longer be directed toward encouraging recovery. Its problem now was to conduct open market operations so as to foster stable growth in line with expanding manpower and industrial resources and at the same time to restrain financial over-commitments and dampen speculative excesses. The Committee noted that since its meeting on March 2, the Board of Governors of the Federal Reserve System had approved an increase of ¼ of 1 per cent in the discount rate at all Federal Reserve Banks, in recognition of current money market conditions and as a means of discouraging undue reliance on the discount facilities of the Reserve Banks. Like the change made in the directive of the Federal Open Market Committee in January, the change approved at this meeting was a further shift in emphasis toward a policy that would discourage undue credit expansion. It meant that the Committee was aiming at a lower level of free reserves of banks, and that consequently credit might cost more and be somewhat less readily available. The Committee was seeking to allow market forces to have their effect within some moderate limits, although it favored efforts to smooth temporary swings in money market conditions and to maintain stability in the market during a period of a Treasury financing.

June 22, 1955

1. Authority to Effect Transactions in System Account.

The following directive from the Federal Open Market Committee to the Federal Reserve Bank of New York was approved:

> 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 growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion, 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.
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> 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;
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> 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, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Mills, Robertson, Shepardson, and Vardaman. Votes against this action: none.

This directive was issued by the Committee to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System open market account because earlier during this meeting the executive committee of the Federal Open Market Committee, to which the full Committee formerly issued its directives, was abolished.

In connection with the issuance of the directive running from the Committee to the Agent Bank, there was eliminated one of the provisions that the full Committee previously had included in its instruction to the executive committee, namely, that in arranging for transactions for the System account the executive committee should do so with a view, among other things, "to correcting a disorderly situation in the Government securities market." That provision had been included in the directive to the executive committee since March of 1953 with the understanding that intervention to correct a disorderly situation in the Government securities market would be initiated only upon the affirmative vote of a majority of the executive committee after the existence of a situation seeming to require correction had come to its attention through notice from the Manager of the System Open Market Account or otherwise. Since an authorization for intervention in the future would require the affirmative vote of a majority of the Federal Open Market Committee, no similar provision was included in this directive to the Agent Bank.

No change of substance was made in the directive at this meeting in so far as it stated the policy of the Federal Open Market Committee with respect to current credit needs of the economy, and the clause which from time to time had been modified to reflect changes in policy or emphasis by the full Committee remained the same as that included in the directive issued at the meeting on May 10, 1955, that is, that operations for the System account should be with a view "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

In its review of the economic situation at this meeting, the Committee noted that activity was continuing to rise to new record levels, with expansion activated by private spending. Industrial production in May had reached a new high and some further increase appeared to be occurring in June. Broad averages of commodity prices had been stable despite sharp expansion in output. Industrial capacity and manpower resources were being used fairly intensively and some materials were in tight supply. Use of the country's resources was not so intensive as in the spring of 1953, however, partly because the labor force, productivity, and capacity had grown since then. Some unemployment still existed and conditions in agriculture and coal mining were not satisfactory, but the general level of economic activity and prosperity was high. This feeling of satisfaction with over-all economic progress was tempered by the fact that the high levels of productivity and employment had been supported by rapid expansion in consumer and mortgage credit on easy terms, and by the likelihood that prices, after two years of stability, might break out on the up-side because of pressure from costs and anticipation of price rises by businessmen and consumers. There appeared to be little leeway for further increases in production, and it was doubtful that productivity could be increased rapidly enough to counteract cost-price influences.

While the Committee recognized that monetary policy was only one of the factors influencing the level of demand for goods and services, it felt that restraint from the credit side could be helpful at this time in preventing unsound developments. On the other hand, it noted that a period was approaching when, in addition to supplying funds for growth in the economy, substantial amounts of reserves would be required to meet normal seasonal needs. The Committee also took cognizance of Treasury financing requirements during the third quarter of the year which would add to the demand for reserves at least temporarily because of necessary bank participation in the initial absorption of the new issues. After considering all factors, the Committee concluded that for the immediate future it should not alter the course it had been following recently which had had a restraining influence on credit expansion, that reserves should be supplied to the market on the basis of current needs, and that operations for the System account should be directed toward maintaining about the existing degree of pressure on the reserve position of banks.

The directive included a paragraph authorizing the sale to the Treasury from the System account, against payment in gold certificates, of Treasury securities maturing within one year in an amount not to exceed $500 million. The purpose of this authorization, as had been the case when a similar transaction was consummated in November 1953, was to enable the System account to make it possible for the Treasury to use some of its gold in repaying some Federal Reserve-held debt without affecting the reserve position of member banks, should the Treasury find it necessary to do so in order to avoid exceeding the statutory debt limit. A similar continuing authorization previously had been given by the executive committee to the Federal Reserve Bank of New York but, with the abolishment of the executive committee at this meeting, the Committee concluded that it would be desirable to include this authorization within its directive to the New York Bank.

July 12, 1955

1. Authority to Effect Transactions in System Account.

The Federal Open Market Committee renewed its directive to the Federal Reserve Bank of New York in the same form as the directive issued at the meeting on June 22, 1955, including the instruction that operations for the System open market account were to be with a view, among other things, "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

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

The Committee's review of the over-all economic situation revealed underlying strength and further advance, domestically and abroad. Business and financial expectations as to sales and profits were decidedly optimistic. Industrial production continued at high levels. Manufacturers' orders were running ahead of sales, and unfilled orders were rising further largely because