FORTY-THIRD

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1956

Digest of Principal Federal Reserve Policy Actions, 1956

Period	Action	Purpose of action
January	Reduced System holdings of U. S. Government securities by over $1.4 billion through sales in the market, redemption of maturing bills, and termination of repurchase agreements. Member bank borrowings increased to weekly averages of $900 million in late January.	To offset seasonal return flow of currency and reduction in reserve needs and restore degree of restraint prevailing before December action to moderate restraint temporarily.
February and March	Bought small amounts of Government securities at times. Member bank borrowings declined somewhat in February but increased substantially in March as result of sharp increase in required reserves.	To meet changing reserve needs and avoid an increasing degree of credit restraint in view of growing tone of uncertainty as to economic prospects.
April and May	Discount rates raised from 2½ per cent to 2¾ per cent at 10 Reserve Banks and to 3 per cent at 2 Banks around middle of April; System holdings of U. S. Government securities reduced by $350 million. Member bank borrowings at Reserve Banks rose to over $1 billion.	To increase restraint on credit expansion, in view of sharp increase in bank credit in March and indications of broad increase in spending, growing demands for credit, and upward pressures on prices and costs.
Late May–early August	Increased System holdings of U. S. Government securities around end of May and end of June and maintained holdings at higher level than in previous period.	To meet currency needs around holidays, to cover added demands for reserves around tax payment and midyear settlement periods, and to avoid increasing the degree of restraint in view of uncertainties in economic situation.
August–November	Discount rates raised late in August to 3 per cent at the 10 Reserve Banks with rates of 2¾ per cent. System holdings of U. S. Government securities increased by nearly $1 billion; member bank borrowings at Reserve Banks rose to average of $900 million in August and averaged between $700 and $800 million in other months.	Discount rates increased in conformity with rise in market rates resulting from vigorous credit demands. Policies designed to increase and maintain restraint on undue credit expansion while covering seasonal and other temporary variations in reserve needs, including effects of frequent Treasury financing operations.
December	System holdings of U. S. Government securities and bankers' acceptances increased by over $550 million, including substantial repurchase agreements with dealers. Member bank borrowings declined to weekly averages of around $600 million, except in last week of year, and at times were less than excess reserves.	To supply reserve funds in recognition of additional pressures in money, credit, and capital markets resulting from seasonal factors and international conditions, at a time when lower liquidity ratios of banks were themselves exerting restraint on bank lending.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

At the beginning of the year 1956, the policy directive of the Federal Open Market Committee, issued to the Federal Reserve Bank of New York as Agent selected by the Committee to execute transactions for the System open market account, was the one that had been approved at the meeting on December 13, 1955, reading as follows:

To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System open market account in the open market, or in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to restraining inflationary developments in the interest of sustainable economic growth, 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;

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;

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.

The policy actions listed on the following pages were taken by the votes indicated at the nineteen meetings of the Federal Open Market Committee held during 1956.

the light of the evidences that the current year had begun with activity and employment sharply above a year ago and, in many countries, close to capacity. It was recognized that further increases in over-all output in the United States could be achieved only slowly and that in such circumstances relatively small increases in demand might bring heavy upward pressure on prices. At the same time the Committee noted the currently reduced levels of farm prices and uncertainties in the housing and automobile markets; and it gave consideration to the view that the domestic economy after a year and a half of expansion might be nearing a cyclical peak and that a reaction might be in prospect before long. It observed likewise that some seasonal contraction in the volume of credit was then taking place and, although a rise during February and March might be anticipated, some of the rise would be to meet seasonal needs.

The net of the Committee's review was that there had been a slight—perhaps almost imperceptible—change in the state of the economy in recent weeks, which might make some relaxation of restraint appropriate in the near future. It concluded that the situation at the moment did not call for a policy directive which gave sole emphasis to restraining inflationary forces. This did not mean that a reversal of the existing policy was called for, but a shift in emphasis seemed desirable as a means of indicating the intent to make credit available to permit the economy to work, to produce, and to consume at near-capacity levels. Thus, for the purpose of emphasizing flexibility, the Committee added the instruction to take into account any deflationary tendencies in the economy while carrying out operations directed toward restraining inflationary developments.

February 15, 1956

Authority to effect transactions in System account.

The Committee renewed its directive to the Federal Reserve Bank of New York with no change in the wording approved at the meeting on January 24, 1956.

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

In its review of the economic situation at this time the Committee observed some continued diversity in tendencies with necessary realignment taking place in a number of important activities. However, industries generally were operating at very advanced levels and, even where this was not the case, evidence was not available to indicate an economic downturn. Some easing in the labor market had appeared, particularly in automobile manufacturing centers where reductions in both employment and working hours had been greater than had been previously expected. Markets for consumer durable goods were showing a mixed picture, but over-all retail trade continued at high levels. The rise in industrial prices persisted.

The leveling off in economic activity noted at this time had been reflected in the credit situation with bank credit and the money supply having shown about the customary seasonal declines, compared with less than the usual seasonal reductions in early 1955. However, this did not indicate a general slackening in the demand for credit. Business plans for capital expenditures were still impressively strong. Member bank borrowing had increased somewhat in late January and member bank reserve positions had been relatively tight. On balance, the Committee concluded that the signs of economic strength continued to outweigh signs of weakness and that a relaxation of pressure on bank reserves was not indicated, although no increase in restraint appeared to be called for at the moment.

March 6, 1956

This was the first meeting of the Federal Open Market Committee after the new members elected by the Federal Reserve Banks for the year beginning March 1, 1956 assumed their duties.

1. Authority to effect transactions in System account.

The Committee again renewed its directive to the Federal Reserve Bank of New York in the same form that had been adopted at the meeting on January 24, 1956 calling for transactions in the System open market account to be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while taking into account any deflationary tendencies in the economy."

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Votes against this action: none.

Domestic industrial production and gross national product had shown little change over the three months preceding this meeting, following uninterrupted and marked advances from mid-1954 to late 1955. Some selective reductions in demand had appeared recently, however, and at this meeting the Committee gave thorough consideration to their possible significance for economic prospects and credit policy. There were indications of diminishing expansionary forces in the consumer credit field, and mortgage lending and housing starts had declined somewhat from the high levels that had prevailed a few months earlier. Pressures on productive capacity seemed to be less than they had been three months earlier, and it appeared that the tremendous upsurge in over-all economic activity over the preceding year and a half was slowing down.

Notwithstanding the foregoing elements, output of steel continued at capacity with reduced demand from the automobile industry being offset by takings of other industries. Evidence of still further rise in plans for capital expenditures by business had appeared, accompanied by widespread expressions of optimism regarding the future. Wholesale prices of industrial commodities and finished goods were continuing to advance, and some recovery in prices of farm products seemed to be getting under way.

Judging from the current high level of activity in most parts of the economy, the Committee saw no evidence that the policy of credit restraint that had been followed for some months had been too restrictive. Even though some divergent tendencies were apparent at the time, a continuation of that policy appeared to be called for and there were indications that increased restraint might become necessary shortly. However, at the time of this meeting a Treasury financing was under way and the Committee desired to avoid action that might disturb the stability in the money market during the period of that financing. It also felt that the adjustments taking place in the automobile and residential building industries and some other areas might slow the growth of credit and help reduce rising price pressures. Its conclusion, therefore, was to continue the existing policy without any overt action toward

either increasing or lessening the degree of restraint that then existed.

2. Authorization to acquire bankers' acceptances and to enter into repurchase agreements.

The Committee renewed the authorization that had been approved in March 1955 under which the Federal Reserve Bank of New York was authorized (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 may be advisable and consistent with the general credit policy and instructions of the Federal Open Market Committee; and (b) to enter into repurchase agreements with nonbank dealers in bankers' acceptances covering prime bankers' acceptances, subject to certain conditions.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Erickson, Johns, Mills, Powell, Shepardson, Szymczak, Vardaman, and Fulton. Vote against this action: Mr. Roberston.

The Committee voted to continue the authority for purchases of bankers' acceptances and repurchase agreements covering such instruments in substantially the form approved at the meeting in March 1955. This was on the grounds that the System should assist in the further development of an acceptance market in the United States with a view to improving this country's means of financing foreign trade and the functioning of an international money market, and with the understanding that purchases of bankers' acceptances would be effected only at such times and in such amounts as might be advisable and consistent with the general credit policy and instructions of the Federal Open Market Committee.

Mr. Robertson voted against the renewal of this authority because he felt that the Federal Reserve System should withdraw from active participation in the acceptance market unless it was clear that such participation would yield specific benefits. He did not believe that this had been the case since the authorization was granted in 1955. Further, he believed that if the Federal Reserve System desired to support and encourage the acceptance market, it could accomplish that objective more effectively by standing ready to purchase acceptances at published rates that ordinarily would represent a fractionally higher rate of discount than market rates.

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 (including authority for repurchase agreements with nonbank dealers in United States Government securities) which were in effect immediately prior to this meeting. Among these were the following statements:

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, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. 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, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. 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, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Vote against this action: Mr. Sproul, Vice Chairman.

Renewal of these three continuing authorities or statements of policy was in the same form as that approved in March of 1954 and 1955.

In voting against the continuation of statements B and C set forth above, Mr. Sproul, who had voted against their renewal a year earlier, stated that he was still opposed in principle and in practice to these operating rules. The other members of the Committee believed the continuation of the rules to be desirable.

March 27, 1956

Authority to effect transactions in System account.

The Committee modified its directive to the Federal Reserve Bank of New York by deleting from clause (b) of the first paragraph the instruction to take "into account any deflationary tendencies in the economy" while effecting transactions in pursuit of the general policy of "restraining inflationary developments in the interest of sustainable growth."

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Votes against this action: none.

The economic review at this time confirmed the Committee's observations at the past few meetings that economic activity had ceased to advance toward the end of 1955 and had moved on a plateau during the first quarter of 1956. Industrial production had shown little change from the high level reached in the fall months of 1955, nonfarm employment had been steady, and gross national product was estimated to have been only slightly higher during the first quarter of 1956 than in the last quarter of 1955, although it continued at a record high, well above year-ago levels.

The slight increase in total product during the quarter under review reflected mainly further growth in business fixed capital and inventory outlays, in State and local government purchases, and