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.

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 in consumer expenditures for services. Consumer goods purchases at retail had been about stable. Construction activity had been only moderately below the record rate of mid-1955, the decrease reflecting solely reduced residential building. Prices, which had shown signs of weakening early in 1956, had strengthened in March, and key prices were firm to rising, with agricultural prices displaying more than seasonal strength. In other industrial countries, consumer and business demands were continuing to grow, although at a slower pace.

The question before the Committee was whether the economy would resume its advance, remain on the recent plateau, or decline; and the Committee's judgment was that available information pointed toward a further advance. Among the general factors leading to this conclusion were the much greater than expected plans of business concerns in all major lines for plant and equipment expenditures, the widespread optimism of consumers as to the economic outlook and their own financial position and income prospects, and evidence of an exceptionally heavy demand for bank credit in the current month. The Committee also noted that common stock prices had risen sharply further. Growing pressures for increases in prices and wages were evident, and there was danger that if supported by further credit expansion pressures would engender an inflationary spiral.

The Committee discussed the extent to which monetary policy might be used to combat an inflationary cost-price spiral and the risk of incurring temporary unemployment on the one hand, as against the risk of undermining the basis of sustained employment on the other. It was suggested that while monetary policy could not be expected to achieve all of the task of combating inflationary pressures, the System would be derelict in its duty if it did not exercise additional restraint in this situation. In the circumstances, the Committee concluded that its instruction to take into account deflationary tendencies in the economy in effecting transactions for the System account was not consistent with the existing situation or the prospective renewal of growth in the economy. Accordingly, it deleted the qualification as to deflationary tendencies that had been added to clause (b) of the directive at the meeting on January 24, 1956, leaving an instruction to effect transactions for the System account with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth."

In reviewing credit measures at this meeting, the Committee also discussed the relation to open market policy of possible action by the directors of the Federal Reserve Banks to increase discount rates from the 2½ per cent level that had been in effect at all Reserve Banks since November 1955. It was noted that there was some feeling in the System that an increase might be necessary at an early date to prevent undue credit expansion for financing capital outlays through the banking system. On the other hand, there was some feeling that, with increasing credit demand, additional restraint would result from the Committee's policy of limiting additions to the supply of reserves to such amounts as were needed for sustainable growth in the economy.

April 17, 1956

Authority to effect transactions in System account.

The Federal Open Market Committee renewed without change the directive that had been approved at the meeting on March 27, 1956, which called for transactions in the System account with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic 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.

Since the preceding meeting eleven of the Federal Reserve Banks had increased their rates of discount effective April 13, 1956. Nine of the increases were from 2½ to 2¾ per cent and two were from 2½ to 3 per cent. (The remaining Reserve Bank increased its rate to 2¾ per cent effective April 20.)

At the time of this meeting, credit markets were in process of adjusting to the increase in discount rates that had just been announced. This added factor followed a period of several weeks during which the markets had been adjusting to the impact of corporate income tax payments in March, the Treasury refunding operation that had come at the same time as the tax payments,