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 Committee gave especial attention to the rate at which economic resources of the country were being used and to the tendencies of prices to rise in numerous markets. These price tendencies appeared to result from the competitive spending, investing, and borrowing propensities of a highly optimistic business and consumer public, rather than from fiscal and monetary policies, which had been anti-inflationary. It appeared that there was danger in misdirected use of resources, unwise judgment as to business and investment opportunity, over-optimism as to management's ability to pass along higher wages and other costs into higher prices, over-commitment of credit based on a discounting of the future, and a cumulative deterioration in the quality of credit. The Committee felt that at this stage monetary policy should minimize the dangers referred to by fostering as efficient an allocation of scarce resources, including savings, as could reasonably be effected by market processes. The Committee believed it should do what it could toward discouraging the financing of plant and equipment expenditures out of bank credit when such demands should be satisfied in the long-term capital market. At the same time, it wished to take care of normal growth and reasonable credit needs of the economy as such needs arose.

In concluding that it was no longer appropriate to retain in the directive the instruction to take into account deflationary factors, the Committee also discussed other measures that might be taken to strengthen credit restraint, including the possible desirability of action by the Federal Reserve Banks to increase discount rates. It was felt that operations should not be modified materially until the current Treasury financing had been completed, but it was suggested that additional actions toward restraining credit expansion would more than likely be needed shortly.

August 21, 1956

Authority to effect transactions in System account.

The Committee made no change at this meeting in the directive to the Federal Reserve Bank of New York calling for continuation of operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth."

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

Most of the measures of production, consumption, and prices presented at this meeting seemed to confirm that the economy was still definitely in an expanding phase. During the two weeks since the preceding meeting, there had been numerous and sizable price advances in industrial commodities, especially in metals and metal products. Industrial output had rebounded sharply from the July steel strike. In the central money markets, interest rates had risen appreciably.

The tendency toward price increases was spreading in both raw materials and finished goods in response to recent wage increases. Heavy demand for capital funds, with business and personal savings insufficient to match the demand, was putting pressure on banks. This tendency was being accentuated by the reluctance of borrowers to accept sharply higher long-term interest rates, as indicated by the fact that several long-term capital issues had been deferred or withdrawn from the market recently. Bank loans had shown moderate seasonal increases for several weeks preceding this meeting, but banks appeared to be increasingly reluctant to reduce their liquidity ratios further by selling Government securities to procure funds for loan expansion. System operations had been directed toward supplying reserve funds to meet seasonal needs but the reserve position of banks had tightened since June and July.

The Committee felt that credit policy should be made somewhat more restrictive, but in view of the fact that individual Federal Reserve Banks were known to be considering discount rate increases at a time when the market for Government securities was showing strain, the directive was renewed with no change in the general open market policy of restraint on credit expansion.

September 11, 1956

Authority to effect transactions in System account.

The directive of the Federal Open Market Committee was renewed without change at this meeting, providing for continuation of a policy having as its objective the restraint of inflationary developments in the interest of sustainable economic growth.

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

Reports at this meeting showed that aggregate demand and supply were continuing to rise, that there was sustained vigor in the demands for credit and capital, and that business and financial psychology was confident. Prices of a number of raw materials had leveled off in recent weeks, but the general tendency of prices for fabricated industrial products continued upward as did prices of consumer goods. Capital expenditure programs were still pressing on supplies of materials, on manpower, and on the capital goods industries, and late information regarding business plans for plant and equipment expenditures during the fourth quarter of 1956 indicated a further rise to an annual rate of about $38 billion, compared with an expected total for the year of $35.5 billion, an amount about 25 per cent higher than for the year 1955.

Industrial output for August had recovered sharply and in September appeared to be running at a rate in excess of the level before the steel strike in July. Employment for August showed a record high and unemployment showed more than the usual seasonal decline. Retail markets except for automobiles had been showing considerable strength. Construction activity in August had been at about the July record rate, a decline from the preceding year of about 12 per cent in residential construction having been offset by higher levels of industrial and commercial construction. Farm price developments, combined with larger marketings and soil bank payments, indicated that net income of farm operators in 1956 probably would exceed that of the preceding year.

Increases in discount rates during the latter part of August to a uniform level of 3 per cent at all Federal Reserve Banks had produced little reaction in money markets. Total loans and investments of banks had increased during August. The money supply, which was barely 1 per cent higher than a year earlier, had shown relatively little change in recent months, but turnover had been at a faster rate. It did not appear that credit restraints thus far adopted had been too severe; additional reserves had been supplied in substantial amounts during the past three weeks to help meet seasonal

needs, and credit demands were generally being met although there were indications that expansion of credit was being limited.

Figures presented to the Committee at this meeting suggested prospective growth in bank credit during the autumn at least equal to normal seasonal expectations. In addition, there was some tendency for long-term borrowers to shift from capital markets to the commercial banks even though bankers were reported to be resisting the trend toward use of bank credit for capital purposes. Another factor was the prospect that the Treasury would have to borrow substantial additional amounts of new funds in October aside from refunding maturing certificates later in the year. Still another influence on the Treasury's need for funds was the high rate of redemption of savings bonds.

The Committee's broad objective continued to be to restrain inflationary developments but, as always, it recognized that monetary and credit policy alone could not be successful in halting inflationary pressures. It believed it necessary to assist in meeting seasonal and growth demands for credit as well as the needs of the Treasury in its financing operations, even though the buoyant state of the economy clearly required a continuation of at least the existing degree of restraint. In renewing its directive without change, the Committee did so with an instruction to the Management of the System Account to maintain substantially the existing degree of stability in the market, with doubts being resolved on the side of tightness rather than of ease, but with the understanding that the Account Management would not initiate action toward more tightness.

September 25, 1956

Authority to effect transactions in System account.

At this meeting, the Committee again renewed without change its directive calling for a policy of restraining inflationary developments in the interest of sustainable economic growth.

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

Economic reports to the Committee at this meeting showed essentially a continuation of the trends reported at the meeting held