FORTY-SIXTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1959

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS, 1959

Period	Action	Purpose of action
January–February	Reduced holdings of U.S. Government securities in January by about $1 billion. Member bank borrowings at the Federal Reserve Banks continued at an average of $500 million or more.	To offset the seasonal inflow of reserve funds resulting mainly from the post-holiday return flow of currency from circulation and thus maintain restraint on credit expansion.
March–Mid-July	Increased System holdings of U.S. Government securities by about $1.1 billion. Member bank borrowings rose further to an average of $1.0 billion in mid-July.	To offset partially the absorption of reserves due mainly to a decline of $780 million in gold stock and an increase of about $1 billion in currency in circulation and to keep credit expansion under restraint.
March	Raised discount rates from 2½ to 3 per cent at all Reserve Banks.	To keep discount rates in an appropriate relationship with the rise in market rates resulting from vigorous credit demands and to restrain undue credit expansion.
May–June	Raised discount rates from 3 to 3½ per cent at all Reserve Banks.	
Mid-July–October	Bought and subsequently sold small amounts of U.S. Government securities around periods of Treasury financing and the 3rd quarter tax date. Member bank borrowings averaged about $900 million with temporary increases above $1 billion around Treasury financing and tax payment dates.	To supply special reserve needs for only limited periods in recognition of pressures in money, credit, and capital markets resulting from vigorous public and private demand for credit.
September	Raised discount rates from 3½ to 4 per cent at all Reserve Banks.	To keep discount rates in an appropriate relationship with the rise in market rates resulting from vigorous credit demands and to restrain undue credit expansion.
November–December	Increased System holdings of U.S. Government securities by about $800 million through mid-December and then reduced holdings somewhat. Authorized member banks to count about $300 million of their vault cash as required reserves through amendment to Regulation D, effective December 1, under new legislation. Average borrowings rose to about $1 billion in the last half of December.	To meet part of the temporary end-of-year needs of banks for reserve funds but at the same time to keep bank reserve positions under pressure.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

The record of policy actions of the Federal Open Market Committee is presented in the Annual Report of the Board of Governors pursuant to the requirements of Section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying the actions of the Board and the Committee in each instance, and that it shall include in its Annual Report to the Congress a full account of such actions.

In the pages that follow, there is an entry with respect to the policy approved by the Committee at each of the 18 meetings held during the calendar year 1959, which record includes the votes on the policy decisions as well as a resume of the basis for the decisions, as reflected by the minutes of the Committee's meetings. In some cases policy decisions were by unanimous vote, while in others a dissent was recorded. As this record shows, the fact that a decision for a general policy was by large majority or even by unanimous vote does not necessarily indicate that all members of the Committee were equally agreed as to the reasons for a particular decision or as to the precise operations in the open market that were called for to implement the general policy. These shades of opinion, fully expressed at meetings, serve to provide the Manager of the System Open Market Account (who attends the meetings of the Committee) with guides to be used in the conduct of open market operations within the framework of the policy directive adopted.

Set forth below is the policy directive of the Federal Open Market Committee that was in effect at the beginning of 1959, the directive having been approved in this form at the meeting on December 16, 1958. This directive was issued to the Federal Reserve Bank of New York as the Bank selected by the

May 26, 1959

Authority to effect transactions in System Account.

Clause (b) of the first paragraph of the Committee's policy directive was revised at this meeting so as to provide for increased restraint on credit expansion. This was indicated by adoption of wording specifying that open market operations should be conducted with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities." This replaced the clause of the directive that had been in effect since December 16, 1958 calling for operations with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability."

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, King, Robertson, Shepardson, Szymczak, and Bryan. Vote against this action: Mr. Mills.

Productive activity was spurting ahead and the economic climate had become distinctly more inflationary, according to reports at this meeting. Industrial production in April, which carried the Board's index up two points in a month for the third consecutive month, reflected principally gains in output of durable goods industries, including both producer and consumer lines. Data available for May suggested another two-point advance in the index for that month. Personal income had been climbing for several months at an annual rate of more than $3 billion a month, principally because of higher wage and salary payments. Reflecting this improvement in personal income, retail sales (seasonally adjusted) in April carried beyond the large March volume and were about 12 per cent higher than the cyclical low point of March 1958. A robust expansion of consumer instalment credit, which had been in process since late 1958, supported rising sales of automobiles and household durables.

Housing starts in April, seasonally adjusted, were at the annual rate of 1.4 million, and the total of starts in the first four months of 1959 was the highest on record for a comparable period. Total construction contract awards in April had reached the highest level on record, 31 per cent above a year earlier. Marked improvement in the employment situation also had occurred in April, and the unemployment problem appeared to be diminishing in scope to certain pockets of structural unemployment. Industrial prices rose further in April and an additional advance was taking place in May; at mid-May, the level was up 2.5 per cent from a year earlier and stood 2 per cent above the prerecession high reached in 1957. Consumer prices advanced slightly in April, with a further modest rise indicated for May.

In financial markets, the month of May was characterized by unseasonably large credit demands and further increases in interest rates to the highest levels for some years. Nearly all interest rates rose except yields on three-month Treasury bills, which continued in the 2¾ to 3 per cent range that had prevailed generally since late February. Yields on long-term Treasury bonds and on both new and seasoned corporate issues had now risen to the highest levels since the 1920's. On May 15, large city banks announced an increase from 4 to 4½ per cent in their lending rate on prime customers' loans.

Following an exceptionally large increase in bank loans at all commercial banks in April, city banks showed a further loan expansion in the first three weeks of May. The increase had been particularly large in business loans, but real estate and consumer loans also showed marked increases. The ratio of total loans to total loans and investments of banks now stood close to the high level reached in 1957. The aggregate money supply, after adjustment for seasonal variations, showed an advance in recent months at an annual rate of 4 per cent or more, and in addition the turnover of bank deposits had been increasing in recent months.

The large May refunding and cash operations of the Treasury were now completed, and it appeared likely that no additional borrowing would be necessary until early July. Nevertheless, the expansion in credit demands during April and May had brought increased pressure on the reserve positions of banks, as indicated by the rise in borrowings at the Federal Reserve Banks and the accompanying increase in the level of net borrowed reserves.

Upon review and analysis of the over-all situation, including the continuing United States balance-of-payments deficit, the Open Market Committee reached the conclusion that the current level of restraint imposed by monetary and credit policy was not sufficiently restrictive and that an intensification of restraint was required. Reports presented by the Reserve Bank presidents at this meeting indicated the possibility that the directors of the respective Federal Reserve Banks would move soon to fix the discount rate at a level higher than the prevailing 3 per cent—probably 3½ per cent. On the assumption of a rate increase of no larger proportions, the Committee favored conducting open market operations with a view to exerting additional pressure as rapidly as that could be done without creating an untenable condition in the market for Government securities.

Although the firmer tone desired by the Committee was not expressed in terms of a specific target of net borrowed reserves (an excess of member bank borrowings at the Reserve Banks over their excess reserves), it was noted that additional restraint could be brought about in the next few weeks by letting natural factors take their course. On the basis of projections before the Committee as to factors affecting the supply of and need for reserves in the weeks ahead, it appeared that under such a procedure net borrowed reserves, which recently had been running in the neighborhood of $250 million, would move upward toward the $500 million level.

In the current circumstances, the policy directive to the Federal Reserve Bank of New York was deemed to be in need of revision. Accordingly, after consideration of several suggestions, it was decided that clause (b) of the first paragraph of the directive, which since December 1958 had provided for operations with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability," should be changed to provide for operations with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

Mr. Mills, who voted against approval of the revised policy directive, indicated that apprehensions he previously had expressed had not diminished with respect to the delayed and violent financial and economic reactions that he sensed to be in the offing when the cumulative pressures inherent in present monetary and credit policy took their full effect. He cautioned against undue alarm concerning anticipated events that had not yet come into clear perspective.

June 16, 1959

Authority to effect transactions in System Account.

Since the previous Open Market Committee meeting (May 26), the discount rate at each of the Federal Reserve Banks had been increased from 3 per cent to 3½ per cent. While prices of Treasury notes and bonds remained virtually unchanged following this increase, rates on bills of longer maturities moved up slightly and those on 91-day bills advanced fairly sharply.

As envisaged by the consensus at the May 26 Committee meeting, natural market factors had been allowed to have their effect since that time in order to bring about an increase in the degree of restraint. Net borrowed reserves, for example, rose from slightly over $300 million in the week ended May 27 to more than $500 million in the following week and continued around that level.

In addition to seasonal demands that would require additions to reserves during the latter part of June, it was noted that, within the three-week period following this meeting of the Committee, the Treasury was to conduct another cash financing operation in which it was anticipated that around $3.5 to $4.5 billion of new money would have to be raised, presumably again in the short-term area.

In considering the course of System policy, the Committee had before it reports indicating further economic expansion on a broad front to new high levels. Production, sales, in-