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.

and the heavy loan demand both in capital markets and at banks. The interest rate structure had risen sharply during this three-week period. In considering policy for the period ahead, it was necessary for the Committee to judge the reactions of lenders and borrowers to the current restrictive policy: whether the actions taken thus far would effectively limit credit growth without serious disruption of the credit markets, or whether credit demands remained so strong as to cause further rises in interest rates and a weakening in securities markets that might threaten a money market crisis.

As to economic developments, the Committee found activity continuing to move sidewise on the high plateau that had been maintained since late fall of 1955. The over-all picture was still somewhat mixed, but indications were that pressures growing out of expanding private investment were beginning to tilt activity upward. The automobile and housing markets appeared to have stabilized over the past few weeks, and other consumer markets had been on the firm to rising side. Business and investor psychology continued optimistic, and the picture was generally one of continuing business investment boom, not only in the United States but in other industrial countries as well. The Committee therefore agreed that there should be no relaxation of pressures. However, the restrictive policy should not be pressed too strongly pending more opportunity to observe reactions to the mid-April increase in discount rates, increased pressure on bank reserve positions, and clarification of the economic outlook.

May 9, 1956

Authority to effect transactions in System account.

The Committee renewed without change the directive issued to the Federal Reserve Bank of New York on March 27 and April 17, 1956 for effecting transactions in the System open market account.

> 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 meeting on April 17, 1956 no important change had become apparent in the state of the economy. Output of goods had continued at the high level that had prevailed for several

months. Upward pressures on prices of industrial commodities had continued and new increases in steel prices were anticipated following negotiations of a new wage contract later in the spring or summer. Business demands for goods and services had risen over the months and aggregate consumer demand, including demand for automobiles and housing, had about held its own. Money markets at the time of this meeting were not under quite as much pressure as they had been at the time of the meeting on April 17, which had followed by only a few days the increase in discount rates at the Federal Reserve Banks at a time when the credit markets were still adjusting to the unusual pressures of March.

The Committee saw no evidence of a change in the economy that called for lessening restraint on credit expansion at this time. Demand for credit including demand in the capital markets suggested a further bulge, although there was some feeling that the actions already taken by the Federal Reserve System to restrain undue credit expansion might have a cumulative effect that would hold down the expansionary tendencies. Furthermore, there had been a decline in the liquidity position of business and of banks over a period of months which could have important effects. The Committee's decision to make no change in the existing policy reflected its belief that credit restraint continued suitable to the situation and that no change either toward increased pressure or toward relaxation would be justified at this time.

May 23, 1956

Authority to effect transactions in System account.

At this meeting the Committee restored to clause (b) of its directive to the Federal Reserve Bank of New York an instruction to take into account deflationary tendencies in the economy while pursuing a general policy of restraining inflationary developments. With this change, the clause read as it had from January 24, 1956 to March 27, 1956, that transactions 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, Balderston, Erickson, Johns, Mills, Powell, Shepardson, Szymczak, Fulton, and Treiber. Votes against this action: none.

The Committee found less exuberance in the economic situation at the time of this meeting than had been observed at either of the two preceding meetings. Although a sidewise movement on a high plateau still seemed to be continuing, divergent tendencies had been noteworthy during the past few weeks. In particular, sales of new automobiles had been weak at the consumer level and dealer inventories of new cars had risen to around 900,000 units with the result that output was being cut back sharply. Use of consumer instalment credit had slowed down further. The Committee recognized the possibility that future developments could be affected by weaknesses in some parts of the economy and by a pessimistic business and investor psychology. Another factor was the less ready reception accorded new capital issues as large offerings came to the market seeking funds to carry out the large business spending programs. Stock prices had declined sharply. Bank reserves had been under greater pressure during the past three weeks than had been anticipated by the Committee, and member bank borrowing at the Federal Reserve Banks had risen to the highest level since early 1953 and held there for several weeks. Bankers and businessmen were expressing fears, at least privately, as to whether credit for needed purposes would be available even at higher interest rates during the months ahead.

The Committee still believed that the basic economic factors were expansionary. Under the circumstances, however, it determined to restore to its directive the qualifying clause that would require the Management of the System Open Market Account, in carrying out transactions in pursuit of a generally restrictive credit policy, to take into account any deflationary tendencies that might be appearing in the economy. To implement this policy, the Committee agreed that during the immediate future additional reserves should be supplied to take care of seasonal and growth needs; it did not wish to permit a further tightening to develop as pressures for increased credit bore against the existing supply of reserves.

June 5, 1956

Authority to effect transactions in System account.

The Committee made no change in the directive to the Federal Reserve Bank of New York that had been approved at the preceding meeting held on May 23, 1956, stating a policy of restraining

inflationary developments while taking into account any deflationary tendencies in the economy.

Votes for this action: Messrs. Martin, Chairman, Balderston, Erickson, Johns, Mills, Shepardson, Szymczak, Vardaman, Fulton, Leedy, and Treiber. Votes against this action: none.

Economic data presented at this meeting confirmed that a sidewise movement in activity was continuing. May automobile sales had proved generally disappointing but sharp cutbacks in production had started to reduce the heavy dealer stocks of new cars. Some reduction in output of household appliances had been reported and production of textiles, particularly synthetics, had been reduced. Common stock prices had declined further during this period.

In contrast to these indications of weakening in parts of the economy, little change in total employment and over-all output was evident and credit demand continued vigorous. A particularly significant development was indicated by the latest figures of business plans for plant expansion which showed a still further rise in such programs. It appeared that the continuation of the boom in business investments would largely offset the readjustment currently taking place in the automobile industry. On the financial side, a somewhat better tone had appeared in markets for new capital issues and additional offerings had been reported. Interest rates had steadied after the decline in long-term rates earlier in May. Bank reserve positions had been eased as a result of the System's action in putting nearly $300 million of reserves into the market during the preceding two weeks, in addition to making repurchase agreements available. Estimates indicated that additional reserves would have to be supplied in order to take care of seasonal and other temporary needs for credit and currency during the June tax payment and midyear settlement period and over the July 4 holiday.

In view of the atmosphere of uncertainty that still existed in some quarters, it appeared desirable for the Committee to continue a program that would dispel any doubts as to its readiness to meet seasonal and other temporary reserve needs. It was recognized that the past momentum that had been evident in the economy did not necessarily indicate prospective economic conditions. The Committee did not wish policy to become more restrictive at this