

**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.

national product had risen further during the second quarter of the year, and personal income also was above any previous level. Although farm income was still lower than a year ago, some recovery in prices of farm products appeared to be taking place. Retail trade had been at a near-record level during June despite reduced sales of automobiles. Industrial construction had increased sharply further during June and the number of housing starts, though reduced, was still running at a high annual rate.

The strength indicated in the domestic and foreign economies was reflected in recent credit developments. Total bank credit had shown a net increase during the past six weeks. Banks were continuing to liquidate holdings of Government securities as their loans increased. New corporate issues for plant expansion and improvement continued in large volume and, reflecting the active demand for such financing, yields on the securities offered were relatively high. Even so, some accumulation of unsold securities had been reported in dealers' inventories. All evidence indicated that businesses were using available funds more actively than they had been earlier in the year.

The increase in discount rates in April had been followed by a period of severe pressure in the money market, which the Committee had relieved somewhat by open market operations in late May and June. At the moment, continuation of firm restraint seemed necessary not only because most current indicators were tending upward but also because it was felt that whatever settlement of the steel strike was arrived at would create additional inflationary pressures. The Committee did not believe, however, that this was the time for clearly increased restraint. It recognized that if a settlement of the steel strike was delayed for a considerable period, action of an easing nature might become necessary. Another reason for the conclusion that no significant change in credit policy should be made at this time was the fact that the meeting was held in the midst of a Treasury refunding operation and at a time when it was expected that the Treasury very shortly would announce a substantial offering of securities for cash. In these circumstances, the Committee decided that continuation of firm restraint was appropriate for the time being. Such a program would permit it to move either toward greater restraint or toward easing, depending upon developments during the next few weeks.

August 7, 1956

**Authority to effect transactions in System account.**

At this meeting, the Committee deleted from its directive the qualification that had been inserted on May 23 to take into account any deflationary tendencies in the economy, leaving the policy as one of "restraining inflationary developments in the interest of sustainable economic growth." With this change, the instruction returned to the wording that had been used from March 27 to May 23 of this year.

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

Aggregate industrial output had dropped fairly sharply during July as a result of the work stoppages in the steel and related industries and some reduction in such nondurable goods industries as textiles and paperboard. Nevertheless, the composite of information confirmed the view presented at the preceding meeting that economic activity had resumed an upward slant. Wage and other costs were tending upward. Demand pressures continued strong. With settlement of the steel strike, business psychology was clearly on the buoyant side and prices of commodities were generally firm to rising. Some prices had reflected the Suez Canal crisis, but increases in numerous commodities were not directly related to that situation. In contrast to the general tendencies, prices of lumber and textile fibers continued on the soft side.

Credit developments since the preceding meeting had not been particularly striking. Commercial loans had declined moderately during July, and loans on securities and holdings of securities also declined. Demands on the capital markets continued large, and a further rise in corporate bond yields on both outstanding securities and new issues had been recorded. Yields on long-term bonds, which had declined in May and June, had again risen to or above the previous highs for this year as well as the highs for 1953. All indications pointed to continued strong credit demands, although it was believed that credit growth during the remainder of the year might not be so strong as in the second half of 1955.

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, Sheardson, 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.