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.

two weeks earlier. There was general strength in expansive forces throughout the economy, with demands pressing against supplies in many sectors and with some further rise in wholesale prices.

The rebound in economic activity since the end of the steel strike early in August had been even more rapid than was expected earlier. To a large extent the great strength of the business picture reflected a record level of capital formation, but consumer spending also had been well maintained. While residential building was at levels moderately below those of a year earlier, actual developments did not indicate that a substantial further decline was likely to be precipitated by lack of adequate mortgage credit. Continued expansion in employment and production to the extent permitted by capacity limits and further upward pressures on prices seemed likely during the immediate future. Wholesale prices had risen almost without interruption since the end of June, and the vigor of the current economic expansion pointed to some danger of renewed speculative building of inventories although there was not much evidence that this had actually taken place.

Heavy demands had continued in capital markets and bank loans had risen considerably in the six weeks preceding this meeting, with business loans accounting for all of the increase. It seemed clear that credit restraints had not resulted in undue curtailment of either business or consumer spending, although they had no doubt kept banks from supplying some of the demands for credit, which continued strong.

One of the factors given particular attention by the Committee at this meeting was the prospective borrowing by the United States Treasury of a substantial volume of new funds. The money market had been consistently tight recently and it appeared that the Treasury might have some difficulty in coming to the market at this time. The Committee considered on the one hand its responsibility for contributing to economic stability and minimizing inflationary pressures, and on the other hand the responsibility that it had in connection with the Treasury's financing problem. It directed its discussion toward how the System might take appropriate account of that situation while pursuing a policy that would restrain undue credit expansion in the economy as a whole. Its conclusion was that the general policy directive should not be changed, that operations for the System account should limit additions to reserves to meet seasonal needs so as to maintain pressures of about the same degree that had existed recently, but that in case of doubt operations should be resolved on the side of ease rather than restraint during the period immediately ahead.

October 16, 1956

Authority to effect transactions in System account.

Again the Committee renewed without change its directive stating a policy to restrain inflationary developments in the interest of sustainable economic growth.

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

Domestically, the over-all economic picture at the time of this meeting continued to be one of general expansion of activity, rising average prices for industrial commodities, and high confidence in both near-term and longer term business prospects. Consumer demand was well sustained while unemployment had reached the lowest levels since 1953. There were, however, some indications that the inflationary pressures in the economy had become a little less intense than they were in the weeks immediately following the steel strike settlement. Sentiment while still buoyant seemed to be a little more cautious. Many price increases were still being reported, especially among finished and semi-finished goods, but there had been recent easing of several important raw material prices. Consumers appeared to be increasingly concerned over the price outlook.

Growth in total bank loans during the third quarter of the year had been substantial but slower than in the first half of 1956 or the third quarter of 1955. Business loans had increased more over the past three months than total loans; real estate loans also had increased, while loans on securities had declined and all other loans (including consumer loans) had shown little change. The Treasury had successfully raised approximately $1.6 billion in new money. Notwithstanding a large volume of new corporate offerings, the bond market had had a better tone and yields on outstanding issues had been relatively stable in recent weeks. The calendar of prospective new capital issues continued large. Short-term money rates had tended to rise further, despite a somewhat easier bank reserve position than had existed a few weeks earlier.

The consensus of the Committee was that no change should be made at this time in the policy of restraint on inflationary developments. This did not imply a greater degree of restraint, for the Committee wished to avoid a tightening that might seriously unsettle the capital markets and intensify the demand for short-term credit. It observed that seasonal demands for credit could be expected automatically to cause some tightening during the next several weeks, besides which additional Treasury financings for cash and refunding would exert further pressure. The Committee also observed that banks could use the Federal Reserve discount facilities as pressure increased. In addition, it contemplated that, if undue tightening developed, reserves should be supplied through the open market with a view to maintaining substantially the present degree of restraint.

November 13, 1956

Authority to effect transactions in System account.

No change was made at this meeting in the wording of the Committee's directive that System operations in the open market be 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, Balderston, Erickson, Fulton, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, and Vardaman. Votes against this action: none.

The over-all economic situation still appeared to be inflationary. Since the preceding meeting the Middle East war crisis had caused major uncertainties, however, and cumulative pressures from restrictive monetary and fiscal policies were showing up at the same time that there were indications that the upward momentum of the boom might be losing some of its force.

Industrial output during October had increased slightly further from the September level and during the current month appeared to be at least equal to the October rate. Employment continued at a high level and upward drift in industrial prices persisted. On the other hand, information on industrial construction showed some decrease in recent weeks and residential construction, although still

high, continued below the record 1955 levels. Department store sales in October were only 1 per cent higher than a year earlier despite higher retail prices.

Bank credit growth had slackened perceptibly during recent weeks. This slowing reflected in part restraint on bank lending because of the continued tight reserve position as well as the lowered liquidity position of the banks; it appeared that demand for funds was still strong. Capital markets continued under pressure from the large volume of new issues offered and awaiting offering, and bond yields had risen to postwar highs. Corporate profits were showing signs of leveling off or declining.

The prospect for further seasonal expansion in demand for credit and for additional Treasury financing before the end of the year, with their possible effects on the money market, led the Committee to the conclusion that the degree of restraint should not be intensified at this time. Also, while there was no real indication that the boom had leveled off, there were a number of uncertainties growing out of the international situation, the profit squeeze that had been in evidence for almost a year, the somewhat reduced level of total construction, and the lack of factors pointing definitely to higher levels of economic activity in the future.

Accordingly, in continuing its policy of credit restraint, the Committee did so with the thought that another meeting should be held within two weeks, that in the meantime the degree of pressure in the money market should remain substantially unchanged, and that the members of the Committee should be alert to the possible need for a modification of policy that might develop as a result of the divergent influences noted at this time.

November 27, 1956

Authority to effect transactions in System account.

The Committee continued its directive calling for a policy of restraining inflationary developments in the interest of sustainable economic growth, but it added a qualifying instruction to clause (b) that in carrying on such a program recognition should be given to additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions.

> Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Erickson, Fulton, Johns, Mills, Powell,