

FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1955

only upon the affirmative vote of a majority of the executive committee after the existence of a situation seeming to require correction had come to its attention through notice from the Manager of the System Open Market Account or otherwise. Since an authorization for intervention in the future would require the affirmative vote of a majority of the Federal Open Market Committee, no similar provision was included in this directive to the Agent Bank.

No change of substance was made in the directive at this meeting in so far as it stated the policy of the Federal Open Market Committee with respect to current credit needs of the economy, and the clause which from time to time had been modified to reflect changes in policy or emphasis by the full Committee remained the same as that included in the directive issued at the meeting on May 10, 1955, that is, that operations for the System account should be with a view "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

In its review of the economic situation at this meeting, the Committee noted that activity was continuing to rise to new record levels, with expansion activated by private spending. Industrial production in May had reached a new high and some further increase appeared to be occurring in June. Broad averages of commodity prices had been stable despite sharp expansion in output. Industrial capacity and manpower resources were being used fairly intensively and some materials were in tight supply. Use of the country's resources was not so intensive as in the spring of 1953, however, partly because the labor force, productivity, and capacity had grown since then. Some unemployment still existed and conditions in agriculture and coal mining were not satisfactory, but the general level of economic activity and prosperity was high. This feeling of satisfaction with over-all economic progress was tempered by the fact that the high levels of productivity and employment had been supported by rapid expansion in consumer and mortgage credit on easy terms, and by the likelihood that prices, after two years of stability, might break out on the up-side because of pressure from costs and anticipation of price rises by businessmen and consumers. There appeared to be little leeway for further increases in production, and it was doubtful that productivity could be increased rapidly enough to counteract cost-price influences.

While the Committee recognized that monetary policy was only one of the factors influencing the level of demand for goods and services, it felt that restraint from the credit side could be helpful at this time in preventing unsound developments. On the other hand, it noted that a period was approaching when, in addition to supplying funds for growth in the economy, substantial amounts of reserves would be required to meet normal seasonal needs. The Committee also took cognizance of Treasury financing require-

ments during the third quarter of the year which would add to the demand for reserves at least temporarily because of necessary bank participation in the initial absorption of the new issues. After considering all factors, the Committee concluded that for the immediate future it should not alter the course it had been following recently which had had a restraining influence on credit expansion, that reserves should be supplied to the market on the basis of current needs, and that operations for the System account should be directed toward maintaining about the existing degree of pressure on the reserve position of banks.

The directive included a paragraph authorizing the sale to the Treasury from the System account, against payment in gold certificates, of Treasury securities maturing within one year in an amount not to exceed \$500 million. The purpose of this authorization, as had been the case when a similar transaction was consummated in November 1953, was to enable the System account to make it possible for the Treasury to use some of its gold in repaying some Federal Reserve-held debt without affecting the reserve position of member banks, should the Treasury find it necessary to do so in order to avoid exceeding the statutory debt limit. A similar continuing authorization previously had been given by the executive committee to the Federal Reserve Bank of New York but, with the abolishment of the executive committee at this meeting, the Committee concluded that it would be desirable to include this authorization within its directive to the New York Bank.

July 12, 1955

1. Authority to Effect Transactions in System Account.

The Federal Open Market Committee renewed its directive to the Federal Reserve Bank of New York in the same form as the directive issued at the meeting on June 22, 1955, including the instruction that operations for the System open market account were to be with a view, among other things, "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Fulton, Irons, Leach, Robertson, Shephardson, Vardaman, and Powell. Votes against this action: none.

The Committee's review of the over-all economic situation revealed underlying strength and further advance, domestically and abroad. Business and financial expectations as to sales and profits were decidedly optimistic. Industrial production continued at high levels. Manufacturers' orders were running ahead of sales, and unfilled orders were rising further largely because

of private as distinct from Government buying. Business inventories had risen sharply at both manufacturer and distributor levels in the spring months although they were substantially below peak 1953 levels. Unemployment had declined further. Credit demand continued active with business loans showing further substantial expansion and consumer credit and mortgage debt rising rapidly. Expansion in total bank credit was more moderate because banks were meeting a large part of the increased loan demand through sales of United States Government securities.

This situation suggested the need for increased restraint in order to avoid stimulating demands to the point of straining available productive capacity. However, general price indexes had continued stable, and as output had approached nearer to capacity the rate of expansion had slowed. The Committee was clear that there should be no easing of the situation, but it did not feel that a more restrictive credit policy was immediately necessary. Furthermore, such a policy might complicate Treasury financing operations later in July, which would add to the demand for bank reserves that would arise from seasonal factors and prospective growth in the economy.

In these circumstances, the Committee agreed that it should maintain substantially the degree of restraint that had existed and that during the period of the forthcoming Treasury financing open market operations should be so conducted as to maintain stability in the money market.

2. Repurchase Agreements Covering United States Government Securities.

The Federal Open Market Committee rejected a proposal that would have discontinued the procedure that had been followed previously under which Federal Reserve Banks were authorized to enter into repurchase agreements with nonbank dealers in United States Government securities covering such securities, and which would have substituted therefor a procedure under which there would have been established at the Federal Reserve Banks an open window for use in financing dealers at rates preferably above, but not lower than, the discount rate.

Votes against the proposal: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Fulton, Irons, Leach, Shepardson, Vardaman, and Powell. Vote for the proposal: Mr. Robertson.

Mr. Robertson made this proposal because he felt that the continuation of the existing procedure was likely to encourage unnecessarily frequent and extensive use of repurchase agreements in order to affect the level of short-term rates in the money market. Furthermore, at times when short-term rates in the money market were below the discount rate, dealers might be given access to Federal Reserve credit at rates lower than those available to member banks, which he believed to be undesirable. If Federal Reserve credit were

to be supplied at such times, he believed it preferable that this be done directly through purchases of bills by the Federal Reserve System. While he would prefer that the use of repurchase agreements be discontinued entirely, Mr. Robertson felt that if they were to be continued they should be used not as a supplementary technique in providing or absorbing reserves, but for the purpose of enabling dealers in Government securities to maintain broad and ready markets. He felt that this could be done through a procedure similar to rediscount operations by establishing an open window at the Reserve Banks for carrying dealers at rates preferably above but in no event below the discount rate. Under this arrangement, he suggested that dealers should feel assurance that the facility was always available to them within reasonable limits, in the same manner as the discount window is open to member banks.

Those who voted against Mr. Robertson's proposal did so in the belief that repurchase agreements had been useful as a supplementary means of making open market policy effective at the initiative of the Committee. They did not believe that repurchase agreements should be available at the initiative of Government securities dealers.

Following rejection by the Committee of the proposal stated above, the Committee authorized the Reserve Banks to continue to use repurchase agreements covering United States Government securities, pending further study by the Committee, with the understanding that the authority would be used sparingly in entering into agreements at rates below the discount rate.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Fulton, Irons, Leach, Robertson, Shepardson, Vardaman, and Powell. Votes against this action: none.

August 2, 1955

1. Authority to Effect Transactions in System Account.

At this meeting, the Federal Open Market Committee changed clause (b) of its directive to the Federal Reserve Bank of New York to provide that transactions for the System open market account be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth." This replaced the clause in the directive issued at the meetings in May, June, and July, which provided that operations be with a view, among other things, "to fostering growth and stability in the economy by maintaining conditions in the money market that would avoid the development of unsustainable expansion."

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Mills, Robertson, Shepardson, Szymczak, and Erickson. Votes against this action: none.