

FORTY-SECOND

# ANNUAL REPORT

*of the*

BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR  
THE YEAR

1955

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.

The shift to a policy of restraining inflationary developments resulted from the Committee's review of the economic situation and its conclusion that the supply of money and credit was a more stimulating force at the time than was desirable in the interest of sustainable economic growth. Information that had become available for June and July indicated that industrial production had increased to a new high level, with fairly general advances in durable and nondurable goods lines as well as in minerals. Unfilled orders had continued to rise. In addition, a renewed upsurge of consumer buying appeared to be developing. Buying of automobiles in July continued at record levels, and sales of appliances and other goods at department stores showed remarkable gains from the preceding month and a year ago. This upsurge in consumer demand reflected a further marked rise in consumer instalment credit and an increased willingness of consumers to draw on liquid asset accumulations. It also suggested consumer expectations of higher prices later on. Numerous industries appeared to be producing at near-capacity, and over-all productivity gains had virtually disappeared in recent months. The situation was one in which a given percentage gain in output called for about an equal percentage gain in manhours, and in which too easy access to bank credit was likely to result in increased prices rather than in increased production. There had been a substantial and contra-seasonal rise in bank loans during the first half of the year, and in July all banking reports confirmed a continuing strong demand for bank credit.

The Committee believed that, with increased costs pushing upward on industrial prices, the general price level might well move upward with accompanying speculative increases in inventories. It also took into account discussions relating to a probable increase in the discount rate at the Federal Reserve Banks early in August, based on observations of economic and financial developments in the respective Federal Reserve districts, and it agreed that the wording of its directive should be changed, as indicated above, to show that increased monetary restraint on credit expansion was now clearly appropriate.

## 2. Repurchase Agreements Covering United States Government Securities.

The Committee modified its authorization for repurchase agreements covering United States Government securities to provide that the Federal Reserve Bank of New York, rather than all Federal Reserve Banks, be authorized to enter into such agreements with nonbank dealers in Government securities, subject to the following conditions and to the understanding that the authority would be used sparingly in entering into repurchase agreements at rates below the discount rate:

### 1. Such agreements

- (a) In no event shall be at a rate below whichever is the lower of (1) the discount rate of the Federal Reserve

Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of three-month Treasury bills;

- (b) Shall be for periods of not to exceed 15 calendar days;  
 (c) Shall cover only Government securities maturing within 15 months; and  
 (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.
2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.
  3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System open market account.

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.

The change to limit the authorization for repurchase agreements to the Federal Reserve Bank of New York was in recognition of the fact that, in practice, that was the only Bank that had been entering into repurchase agreements covering Government securities, and there was little or no likelihood that the authority would be used by Federal Reserve Banks other than New York.

In voting to approve this action, Mr. Robertson stated that he did so notwithstanding his expressed doubts about the use of repurchase agreements.

At subsequent meetings during 1955, the Committee considered the use to be made of repurchase agreements and reaffirmed its authorization for the Federal Reserve Bank of New York to enter into such agreements, subject to the conditions set forth above.

August 23, 1955

### 1. Authority to Effect Transactions in System Account.

The directive to the Federal Reserve Bank of New York was renewed at this meeting in the same form as the directive approved at the meeting of the Committee on August 2, 1955, at which time it was agreed that operations for the System open market account should be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth."