

FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1955

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."

Votes for this action: Messrs. Martin, Chairman, Earhart, Irons, Mills, Leach, Shepardson, Szymczak, Vardaman, Treiber, and Young. Votes against this action: none.

Since the meeting on August 2, at which the Committee adopted a clear-cut policy of restraining inflationary developments, the reserve position of banks had changed markedly. During August, banks had been in the position of borrowing net amounts of reserves, whereas in July and most earlier months of the year the banking system had had a moderate to substantial volume of free reserves available for lending. Discount rates at all of the Federal Reserve Banks had been increased during the first half of August, one Bank having increased the rate from $1\frac{3}{4}$ per cent to $2\frac{1}{4}$ per cent, and the other Banks having increased their rates from $1\frac{3}{4}$ to 2 per cent. Other interest rates had also resumed an upward tendency after an interruption early in August. Bank credit had continued to rise, however, reflecting expansion in most types of loans in a period of usual seasonal slack. It appeared that the rate of growth in the money supply had increased.

The economic situation continued to be one of demand pressure in the industrial sector and supply pressure in the agricultural sector of the economy; there was apparent over-all price stability because price declines in the agricultural sector were offsetting price increases in the industrial sector. The wage-cost pressures toward higher prices appeared to be increasing, and the feeling of optimism on the part of business and the public did not appear to have lessened. Inventory accumulation seemed to be increasing. The Committee felt that a restrictive credit policy was called for in this situation and that one of the questions was how to conduct open market operations so as to make the increase that had taken place in discount rates at the Reserve Banks effective as a restraining force.

There was agreement that the Committee's policy should be one of gradually increasing pressure and that such a condition would result if the System continued its existing policy of not supplying reserves through open market operations except to relieve temporary stringencies in the money market. It was also thought that a further increase in discount rates at the Federal Reserve Banks might be needed as a part of a program of continuing restraint on credit expansion. The Committee's existing directive calling for operations for the System account that would restrain inflationary developments in the interest of sustainable economic growth seemed appropriate to the program agreed upon, and it was therefore renewed without change.

September 14, 1955

1. Authority to Effect Transactions in System Account.

The Committee renewed without change the directive to the Federal Reserve Bank of New York that had been approved at its meetings on August 2

and 23, 1955, providing that, among other things, transactions for the System open market account be with a view "to restraining inflationary developments in the interest of sustainable economic growth."

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

Review of the available data suggested that the economy had entered a phase of decelerating advance. Manufacturing employment in durable goods lines had been maintained on an overtime basis for several months; output in several important industries was close to capacity; the labor market had reached a state of tightness in many localities; and restrictive monetary developments with higher interest rates had been operating with mounting pressure to brake credit expansion. Since the preceding meeting, discount rates at the 11 Federal Reserve Banks that had fixed such rates at 2 per cent in August had been brought up to the $2\frac{1}{4}$ per cent level, to which the rate had been increased by one Reserve Bank early in August. Demand was still pressing the markets for industrial products, however, despite the prevailing high level of supply. Price advances were occurring in considerable numbers, with further widespread increases in prospect. Business, consumer, and mortgage loans at banks had continued to expand, a particularly sharp advance having appeared in business loans. It was the judgment of the Committee that this situation called at least for the maintenance of, and preferably for some slight increase in, the restraining pressure it had been exerting through open market operations. To carry this out, it renewed the directive calling for restraint on inflationary developments through maintaining pressure on the reserve position of banks, but with the additional understanding that doubts should be resolved on the side of increased pressure.

September 26, 1955

1. Authority to Effect Transactions in System Account.

At this meeting, which was held through telephone conference arrangement, the Committee agreed that no change be made in the existing general program of restraint on credit expansion, excepting the elimination of the understanding reached at the meeting on September 14, 1955, that, in conducting operations for the System open market account in pursuit of the policy of restraint, doubts should be resolved on the side of greater restraint.

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