

FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1955

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 1¾ per cent to 2¼ per cent, and the other Banks having increased their rates from 1¾ 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 2¼ 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.

This meeting was for the purpose of discussing the potential economic effects of the President's illness over the preceding week-end and what, if any, change should be made at this time in credit policy. The Committee concluded that since there had been no change in the fundamental economic situation it should aim at maintaining about the same degree of credit pressure that had existed, with the understanding, however, that doubts need not be resolved on the side of greater restraint. This change was made for the purpose of providing flexibility in order to counter adverse psychological developments that might appear.

October 4, 1955

1. Authority to Effect Transactions in System Account.

The Committee again renewed without change the directive to the Federal Reserve Bank of New York in the form approved at meetings held on August 2, August 23, and September 14, 1955, including the instruction that transactions for the System account be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth." In addition, the Committee restored the understanding that had been reached at the meeting on September 14, 1955, and which was suspended at the special meeting on September 26, 1955, that in carrying out open market operations, doubts should be resolved on the side of greater restraint rather than of ease.

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

At the time of this meeting the economic situation had advanced to a point where financial developments had become a more critical factor in the shaping of business trends. Consumer credit had been rising rapidly to new heights and so also had mortgage credit, supporting very active markets for automobiles and housing. It was at this stage of economic developments that announcement of the President's illness on September 24 had come as a shock to confidence and, while it was too early at the time of this meeting to assess the economic significance of that announcement, the immediate response had been a sharp setback in stock prices accompanied by a sharp rise in trading. It was suggested that there was at least the possibility of some postponement in business and consumer spending. Despite the psychological shock to the business community, the current and prospective momentum of economic activity was such that the Committee concluded the situation called for continuing the present policy of restraint without allowing the restraint to become so severe as to accentuate any tendency toward a downturn in the economy that might develop. While

there were various shades of opinion as to the effect of the President's illness on the economy, the apparent leveling off at a high level of production still seemed to be accompanied by increasing upward pressure on prices. The Committee approved the same general instruction with respect to open market operations that had been adopted at the meeting on September 14—restraint on credit expansion, with the understanding that doubts should be resolved on the side of increased restraint.

October 25, 1955

1. Authority to Effect Transactions in System Account.

The Committee renewed at this meeting the directive to the Federal Reserve Bank of New York that had been approved at the meeting of the Committee on August 2, 1955 and at each meeting since and which included the specific instruction that, among other things, operations for the System account be with a view "to restraining inflationary developments in the interest of sustainable economic growth." In addition, it was understood that while the Committee wished to maintain a restraining influence on the credit situation, it did not wish to increase pressure drastically.

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

The economic situation was still one of advance but with the pace of advance, in terms of physical output, necessarily slowing down as capacity operations were reached in basic industries. Most economic indicators were showing moderate fluctuations at advanced levels. Industrial prices had risen 3 per cent since midyear and consumer prices had risen slightly in September. Mortgage credit had become tight and was getting tighter, and residential building was falling off somewhat more than seasonally; but business and industrial construction was rising. It was still difficult to judge the economic effect of the President's illness, the Committee felt, and how that factor might have altered plans of businessmen and consumers. Inflationary pressures did not seem to be carrying through to speculative excesses in the accumulation of inventories or in rapidly spiraling prices. With the over-all business and credit outlook remaining exceedingly strong, however, it was not evident that the present policy of restraint had been too restrictive, and the Committee's judgment was that the situation did not call for action to ease credit policy. Monetary policy could not be expected to correct the disparity between industrial and agricultural prices, nor could general policy be expected to correct the imperfections that had been evident in the mortgage credit and consumer credit fields without causing difficulty in other