FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1955

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 parts of the economy. Continuation of the policy of restraint on credit expansion seemed to be called for, with the understanding that doubts should be resolved on the side of dispelling any idea of an easing of System policy at this time. In renewing the existing directive to restrain inflationary developments in the interest of sustainable economic growth, the Committee did so with the understanding that pressure on the money market should not be increased drastically.

November 16, 1955

1. Authority to Effect Transactions in System Account.

The Committee approved another renewal of its directive to the Federal Reserve Bank of New York in the form that had been approved at several recent meetings providing that transactions for the System open market account be conducted with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth."

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

Analysis of the situation at the time of this meeting in mid-November showed that businessmen and consumers had thrown off doubts about economic prospects that had been created by the President's illness. Consumer spending and borrowing continued extremely high. Plans for business spending for plant and equipment during 1956 were being announced in substantially higher volumes than for 1955. Production was approaching or had reached capacity levels in more and more industries, and the labor market was showing further tightening. Markets for industrial commodities were very strong, manufacturers' unfilled orders were continuing to rise, and industrial price rises were spreading.

These factors suggested the need for additional restraint but, at the same time, the Committee noted that normal seasonal developments would require additional reserves to assist banks in supplying essential credit needs between mid-November and the year-end. The Committee was also aware that the Treasury would be in the market to refund $12 billion of maturing securities toward the end of November or early in December and that it probably would have to borrow around a billion dollars of new money by the middle of December. In addition, the Committee noted that consideration was currently being given to a further increase to 2½ per cent in the discount rates of the Federal Reserve Banks, which had been increased to 2¼ per cent in August and September. In considering these several factors, the Committee agreed that, while the Federal Reserve should operate to restrain

excesses, it should avoid undue pressure on the supply of reserves through more restrictive open market operations at a time when the Treasury was getting ready to announce its financing and during a period in which the money market and banks might be adjusting to an increase in the discount rate. Under these circumstances, the Committee renewed the existing directive with the understanding that, while it was trying to move in the direction of maintaining tightness, it should not be concerned if operations in the open market during the immediate future did not achieve as great a degree of tightness as had existed recently.

November 30, 1955

1. Authority to Effect Transactions in System Account.

The Federal Open Market Committee authorized the Federal Reserve Bank of New York to purchase for the System open market account in the open market, on a when-issued basis, up to $400 million of 2⅝ per cent Treasury certificates of indebtedness to be dated December 1, 1955, maturing December 1, 1956.

> Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Shepardson, and Szymczak. Votes against this action: Messrs. Mills, Robertson, and Vardaman.

This meeting, which was held through telephone conference arrangement, was called for the purpose of considering what, if any, action the Committee should take in view of developments in the market which suggested that the current Treasury offering of approximately $12 billion of refunding securities might be subject to unusually large requests for cash redemption. The Treasury offering had been announced on November 25 and books were open on Monday, Tuesday, and Wednesday, November 28, 29, and 30, 1955. The response to the announcement of the terms of the offering indicated that the market regarded the new issue as being properly priced. Shortly after the opening of the books, however, it became apparent that a large proportion of holders of the maturing issue had earmarked the proceeds of this maturity for other uses. This indicated that the volume of cash redemptions would be considerably larger than had been generally anticipated. Moreover, unexpectedly stringent money market conditions had developed during the latter part of November. Apparently this was in part a delayed response to an increase in mid-November to 2½ per cent in the discount rates of all Federal Reserve Banks.

In considering this situation, the Committee noted that on the basis of earlier projections of reserve needs to meet seasonal and other demands, it would probably find it necessary in any event to put into the market upwards of $400 million of reserves within the next week. Further, addi-