FORTY-THIRD

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1956

Digest of Principal Federal Reserve Policy Actions, 1956

Period	Action	Purpose of action
January	Reduced System holdings of U. S. Government securities by over $1.4 billion through sales in the market, redemption of maturing bills, and termination of repurchase agreements. Member bank borrowings increased to weekly averages of $900 million in late January.	To offset seasonal return flow of currency and reduction in reserve needs and restore degree of restraint prevailing before December action to moderate restraint temporarily.
February and March	Bought small amounts of Government securities at times. Member bank borrowings declined somewhat in February but increased substantially in March as result of sharp increase in required reserves.	To meet changing reserve needs and avoid an increasing degree of credit restraint in view of growing tone of uncertainty as to economic prospects.
April and May	Discount rates raised from 2½ per cent to 2¾ per cent at 10 Reserve Banks and to 3 per cent at 2 Banks around middle of April; System holdings of U. S. Government securities reduced by $350 million. Member bank borrowings at Reserve Banks rose to over $1 billion.	To increase restraint on credit expansion, in view of sharp increase in bank credit in March and indications of broad increase in spending, growing demands for credit, and upward pressures on prices and costs.
Late May–early August	Increased System holdings of U. S. Government securities around end of May and end of June and maintained holdings at higher level than in previous period.	To meet currency needs around holidays, to cover added demands for reserves around tax payment and midyear settlement periods, and to avoid increasing the degree of restraint in view of uncertainties in economic situation.
August–November	Discount rates raised late in August to 3 per cent at the 10 Reserve Banks with rates of 2¾ per cent. System holdings of U. S. Government securities increased by nearly $1 billion; member bank borrowings at Reserve Banks rose to average of $900 million in August and averaged between $700 and $800 million in other months.	Discount rates increased in conformity with rise in market rates resulting from vigorous credit demands. Policies designed to increase and maintain restraint on undue credit expansion while covering seasonal and other temporary variations in reserve needs, including effects of frequent Treasury financing operations.
December	System holdings of U. S. Government securities and bankers' acceptances increased by over $550 million, including substantial repurchase agreements with dealers. Member bank borrowings declined to weekly averages of around $600 million, except in last week of year, and at times were less than excess reserves.	To supply reserve funds in recognition of additional pressures in money, credit, and capital markets resulting from seasonal factors and international conditions, at a time when lower liquidity ratios of banks were themselves exerting restraint on bank lending.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

At the beginning of the year 1956, the policy directive of the Federal Open Market Committee, issued to the Federal Reserve Bank of New York as Agent selected by the Committee to execute transactions for the System open market account, was the one that had been approved at the meeting on December 13, 1955, reading as follows:

To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System open market account in the open market, or in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to restraining inflationary developments in the interest of sustainable economic growth, and (c) to the practical administration of the account; provided that the aggregate amount of securities held in the System account (including commitments for the purchase or sale of securities for the account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million;

To sell direct to the Treasury from the System account for gold certificates such amounts of Treasury securities maturing within one year as may be necessary from time to time for the accommodation of the Treasury; provided that the total amount of such securities so sold shall not exceed in the aggregate $500 million face amount, and such sales shall be made as nearly as may be practicable at the prices currently quoted in the open market.

The policy actions listed on the following pages were taken by the votes indicated at the nineteen meetings of the Federal Open Market Committee held during 1956.

stage of the sidewise movement in the economy, although it was satisfied that no material change from the general policy of restraining inflationary developments was called for. The decision to renew its directive without change thus contemplated a continuation of operations that would limit credit expansion but which would supply additional reserves during the next few weeks as a means of avoiding an increase in pressure.

June 26, 1956

Authority to effect transactions in System account.

The Committee again renewed its directive to the Federal Reserve Bank of New York without change from the instruction approved at the meeting on May 23, 1956.

> Votes for this action: Messrs. Martin, Chairman, Balderston, Erickson, Johns, Mills, Powell, Shepardson, Szymczak, Vardaman, Fulton, and Treiber. Votes against this action: none.

The economic situation looked considerably stronger at the time of this meeting than at either of the two preceding meetings of the Federal Open Market Committee. While evidence of summer doldrums was beginning to appear and the imminent steel strike was creating uncertainties, total industrial production was holding steady within the narrow range maintained for some months. Retail sales of new automobiles had picked up noticeably during June, common stock prices had rebounded a little, business sentiment had a much more confident tone than during the second half of May, and demand for credit was showing exceptional strength. Average wholesale prices had shown little further advance in recent weeks although industrial commodities continued to rise.

In the financial picture, Treasury operations had exerted less of a drain on reserves of commercial banks than had been expected. Reserve System operations had added to bank reserves, which on the whole had been more freely available during the past month than earlier in the spring, although the money market had not eased significantly.

The Committee's decision to continue without change the existing directive calling for restraint on inflationary developments was taken on the basis that the composite picture at midyear, as judged

from data on production, trade, employment, and prices, was one of a basically strong and expanding economy. It believed, however, that in carrying forward its policy, it should for the present continue to take into account any deflationary tendencies and maintain as nearly as possible stability in the money market. It noted that immediate seasonal demands would require several hundreds of millions of reserves over the July 4 holiday period, and it also gave consideration to the prospective needs of the economy for perhaps $1.5 billion of additional reserves during the second half of 1956 in order to meet seasonal and growth needs, including needs connected with Treasury financing operations to be announced shortly. The Committee agreed that, within the framework of the restrictive policy it had been following, doubts should be resolved on the side of ease during the next few weeks, rather than on the side of actions that might be construed as additional restraint, even though there was the possibility that the System would find it desirable to move toward substantially greater restraint in the fall.

July 17, 1956

Authority to effect transactions in System account.

The Committee continued without change the directive to the Federal Reserve Bank of New York that had been approved on May 23, 1956 and at each meeting since. The policy stated in that directive was one of restraining inflationary developments while taking into account any deflationary tendencies in the economy.

> Votes for this action: Messrs. Martin, Chairman, Balderston, Johns, Mills, Powell, Shepardson, Treiber, Vardaman, Fulton, and Williams. Votes against this action: none.

Economic data presented at this meeting showed continued broad strength in the economy with a further upward tilt to activity. Wholesale prices had been fairly steady for several weeks, but consumer prices had been rising. Credit demand continued active and business and financial sentiment optimistic. The impact of the steel strike had been limited mainly to that industry and closely related activities; it did not appear to have had a marked effect generally in the economy, partly because of the large inventories of steel that had been built up prior to the beginning of the strike. Gross national product had risen further during the second quarter of the year, and personal income also was above any previous level. Although farm income was still lower than a year ago, some recovery in prices of farm products appeared to be taking place. Retail trade had been at a near-record level during June despite reduced sales of automobiles. Industrial construction had increased sharply further during June and the number of housing starts, though reduced, was still running at a high annual rate.

The strength indicated in the domestic and foreign economies was reflected in recent credit developments. Total bank credit had shown a net increase during the past six weeks. Banks were continuing to liquidate holdings of Government securities as their loans increased. New corporate issues for plant expansion and improvement continued in large volume and, reflecting the active demand for such financing, yields on the securities offered were relatively high. Even so, some accumulation of unsold securities had been reported in dealers' inventories. All evidence indicated that businesses were using available funds more actively than they had been earlier in the year.

The increase in discount rates in April had been followed by a period of severe pressure in the money market, which the Committee had relieved somewhat by open market operations in late May and June. At the moment, continuation of firm restraint seemed necessary not only because most current indicators were tending upward but also because it was felt that whatever settlement of the steel strike was arrived at would create additional inflationary pressures. The Committee did not believe, however, that this was the time for clearly increased restraint. It recognized that if a settlement of the steel strike was delayed for a considerable period, action of an easing nature might become necessary. Another reason for the conclusion that no significant change in credit policy should be made at this time was the fact that the meeting was held in the midst of a Treasury refunding operation and at a time when it was expected that the Treasury very shortly would announce a substantial offering of securities for cash. In these circumstances, the Committee decided that continuation of firm restraint was appropriate for the time being. Such a program would permit it to move either toward greater restraint or toward easing, depending upon developments during the next few weeks.

August 7, 1956

Authority to effect transactions in System account.

At this meeting, the Committee deleted from its directive the qualification that had been inserted on May 23 to take into account any deflationary tendencies in the economy, leaving the policy as one of "restraining inflationary developments in the interest of sustainable economic growth." With this change, the instruction returned to the wording that had been used from March 27 to May 23 of this year.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Vardaman, and Fulton. Votes against this action: none.

Aggregate industrial output had dropped fairly sharply during July as a result of the work stoppages in the steel and related industries and some reduction in such nondurable goods industries as textiles and paperboard. Nevertheless, the composite of information confirmed the view presented at the preceding meeting that economic activity had resumed an upward slant. Wage and other costs were tending upward. Demand pressures continued strong. With settlement of the steel strike, business psychology was clearly on the buoyant side and prices of commodities were generally firm to rising. Some prices had reflected the Suez Canal crisis, but increases in numerous commodities were not directly related to that situation. In contrast to the general tendencies, prices of lumber and textile fibers continued on the soft side.

Credit developments since the preceding meeting had not been particularly striking. Commercial loans had declined moderately during July, and loans on securities and holdings of securities also declined. Demands on the capital markets continued large, and a further rise in corporate bond yields on both outstanding securities and new issues had been recorded. Yields on long-term bonds, which had declined in May and June, had again risen to or above the previous highs for this year as well as the highs for 1953. All indications pointed to continued strong credit demands, although it was believed that credit growth during the remainder of the year might not be so strong as in the second half of 1955.