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.

Robertson, Szymczak, and Vardaman. Votes against this action: none.

Since the meeting held two weeks previously, information becoming available had made it clearer that the economic effects of the Middle East crisis were serious and would not soon be overcome. Domestically, business advance was general, although housing was an important exception. At the same time, there were some "straws in the wind" suggesting possible slackening of activity later on.

Industrial prices had continued upward because of advances in fabricated items and industrial materials, some of which reflected the Middle East situation. Wholesale prices had remained stable on the average reflecting the offsetting effects of lower farm products prices, mainly seasonal reductions in livestock prices. Consumer prices had continued to rise. Industrial output had increased somewhat further in November, and department store sales had rebounded from the reduced October level.

The straws in the wind included October declines in the principal segments of construction—residential, industrial, and public utility. Preliminary data suggested that plant and equipment expenditures for 1957 would rise only slightly from the current rate. Inventories of most goods seemed abundant relative to sales, considerably higher than a year earlier. Business failures had risen to a new postwar high in October. Third quarter corporate earnings data showed that the cost-profit squeeze was continuing to increase with more than two-fifths of the large firms for which data were available showing earnings below the third quarter totals of 1955.

Among financial developments, there had been a sharp decline in Treasury bond prices just before this meeting, accompanied by a rise in the Treasury bill rate to a new high level even though the reserve position of banks outside New York and Chicago had been relatively easy. Expansion in bank loans during the past four weeks had been smaller than in the comparable period of 1955 and banks had made further reductions in their investments. All in all, credit restraint seemed to have taken hold more effectively in the autumn of 1956 than at any time in the past two years.

While the immediate situation impressed the Committee as continuing to be inflationary, it took cognizance of the suggestion

that a fundamental change in the foreign and domestic outlook could be in the making. It did not wish the disturbed conditions in the securities market to become worse and bring on a disorderly situation which might require that more reserves be put into the market than would be necessary to meet the seasonal and growth demands. However, in adding to the directive the qualifying instruction to recognize "additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions" the Committee did not intend an overt change away from a policy of restraint; it desired to indicate that the Committee was alert to the kind of pressures that developed toward each year-end as well as to the uncertainties implicit in the international situation and in financial markets.

December 10, 1956

Authority to effect transactions in System account.

The Committee made no change in credit policy at this meeting, and the directive to the Federal Reserve Bank of New York was renewed in the same form as at the meeting held two weeks earlier. This directive called for continued restraint on inflationary developments in the interest of sustainable economic growth, while recognizing additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions.

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

Recent international developments had had important economic effects abroad including a substantial drain on British monetary reserves, curtailment of the flow of petroleum to Western Europe, and sharp increases in shipping rates. One result of the Middle East developments and the current British sterling crisis had been the announcement by the United States Treasury of an additional financing for cash in the amount of $1 billion. This announcement, which came just prior to this meeting, surprised the money market because it had been generally assumed that the Treasury's financing needs had been taken care of for the remainder of the calendar year.

The review of the domestic business and financial situation indicated need for continued restraint on credit expansion in the near future, although it did not appear that additional restraining measures were necessary. Industrial production and industrial prices had continued to advance over recent months, reaching new high levels. Increases in both production and prices had been widespread. Unemployment was low, gross national product had continued to rise, and expansion in capital equipment expenditures had been greater than anticipated early in the year.

Along with these indications of sustained or expanded activity, there were some evidences that the upward pressure of the boom might be diminishing. The previously noted reduction in housing construction persisted although volume was still at a high level; production of automobiles had not been up to 1955 volume; and outputs of lumber, synthetic fibers, and some paper items were well below capacity. Surveys of private capital expenditures for the coming year were indicating a flattening out of the current high level rather than any new sharp gains.

Open market purchases had been fairly heavy during the past several weeks and had been designed to alleviate potential strains attributable to seasonal factors, Treasury financings, and the international situation. However, the market had continued under rather severe pressure. Loan expansion during the fall months had been less rapid than had been expected three months earlier or than had taken place in 1955. It was clear that the normal year-end needs would require additional funds of a temporary nature and that these demands would exert an increased restraining effect unless reserves were made available. The Committee issued its policy directive in the belief that additional restraint should not be applied over the year-end period and that, while the existing policy should not be changed, reserves should be supplied to assist in meeting the seasonal and other temporary needs for reserves that would arise during this period.

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At the beginning of the year 1956, the policy directive of the Federal Open Market Committee was, as set forth on page 17, one which provided for "restraining inflationary developments in the interest of sustainable economic growth." During the year, five changes were made in the wording of clause (b) of the directive.

On January 24, there was added a qualifying instruction to take "into account any deflationary tendencies in the economy." On March 27, this qualifying instruction was deleted. On May 23, the Committee reinserted the instruction to take "into account any deflationary tendencies in the economy," and on August 7, the Committee again deleted the phrase. On November 27, the Committee added to the policy statement calling for restraint on inflationary developments the instruction that recognition be given to "additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions." With these changes, the directive that was in effect at the close of 1956, as approved at the last meeting of the year on December 10, read 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 while recognizing additional pressures in the money, credit, and capital markets resulting from seasonal factors and international conditions, 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.