FORTY-FIFTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR
THE YEAR

1958

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS, 1958

<table>
<tr><th>Period</th><th>Action</th><th>Purpose of action</th></tr>
<tr><td>January</td><td>Limited net reduction in holdings of U. S. Government securities to $900 million, more than half of which represented securities held under repurchase agreement at end of year. Member bank borrowings declined to an average of $450 million.</td><td>To ease reserve positions by absorbing only part of the reserves made available by seasonal factors affecting bank reserve positions.</td></tr>
<tr><td>January</td><td>Reduced margin requirements on loans for purchasing or carrying listed securities from 70 to 50 per cent of market value of securities.</td><td>To recognize that dangers of excessive use of credit for stock market speculation had subsided, since stock prices and the volume of credit in the stock market had declined to levels near or below those prevailing at the time of the previous increase in requirements.</td></tr>
<tr><td>January–February</td><td>Reduced discount rates from 3 to 2¾ per cent at 11 Reserve Banks.</td><td rowspan="4">To reduce further the cost of borrowing from the Reserve Banks and increase further the availability of bank reserves in order to encourage bank credit and monetary expansion conducive to resumed growth in economic activity.</td></tr>
<tr><td>February</td><td>Reduced reserve requirements on demand deposits from 20 to 19½ per cent at central reserve city banks; from 18 to 17½ per cent at reserve city banks; and from 12 to 11½ per cent at country banks, thus freeing an estimated $500 million of reserves.</td></tr>
<tr><td>March</td><td>Reduced discount rates from 2¾ to 2¼ per cent at 11 Reserve Banks and from 3 to 2¼ per cent at one Reserve Bank.</td></tr>
<tr><td>March</td><td>Reduced reserve requirements on demand deposits from 19½ to 19 per cent at central reserve city banks; from 17½ to 17 per cent at reserve city banks; and from 11½ to 11 per cent at country banks, thus freeing an additional $500 million of reserves.</td></tr>
<tr><td>February–Mid-April</td><td>Purchased about $450 million of U. S. Government securities. Member bank borrowings declined further to an average of about $180 million.</td><td>To supplement reserve requirement actions in further increasing the availability of bank reserves.</td></tr>
<tr><td>April</td><td>Reduced reserve requirements on demand deposits from 19 to 18 per cent (in two stages) at central reserve city banks and from 17 to 16½ per cent at reserve city banks, thus freeing a total of about $450 million of reserves.</td><td rowspan="3">To supplement previous actions to encourage bank credit and monetary expansion and resumed growth in economic activity and to offset current gold outflow.</td></tr>
<tr><td>April–May</td><td>Reduced discount rates from 2¼ to 1¾ per cent at all Reserve Banks.</td></tr>
<tr><td>Mid-April–June</td><td>Purchased outright about $1.7 billion net of U. S. Government securities. Member bank borrowings declined further to an average of $100 million at the end of June.</td></tr>
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Period	Action	Purpose of action
July–early August	Bought a small volume of U. S. Government securities other than short-term issues and a large amount of securities involved in a Treasury refinancing. Promptly thereafter reduced Treasury bill holdings substantially.	To correct disorderly conditions in the Government securities market, to facilitate the Treasury refinancing, and then to recapture the bank reserves created by the earlier securities purchases.
August	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 70 per cent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities. The volume of credit in the stock market and stock prices were advancing sharply and were at or near the highest levels since World War II.
August–early September	Made little change in holdings of U. S. Government securities. Member bank borrowings increased to an average of more than $400 million in early September.	Open market action not taken to offset drains on reserve funds reflecting bank credit and monetary expansion resulting from seasonal factors and the sharp upturn in economic activity.
August–September	Raised discount rates from 1¾ to 2 per cent at all Reserve Banks.	To keep discount rates in an appropriate relationship with market rates and to increase the cost of borrowing by individual banks from the Reserve Banks in case of increasing demands for bank credit.
October	Raised margin requirements on loans for purchasing or carrying listed securities from 70 to 90 per cent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities.
Late October–early November	Raised discount rates from 2 to 2½ per cent at all Reserve Banks.	To bring discount rates into closer alignment with open market rates.
Mid-November–December	Increased system holdings of U. S. Government securities about $900 million, including securities held under repurchase agreement. Member bank borrowings rose to average of $560 million in December.	To meet part of reserve needs associated with seasonal factors and a further moderate outflow of gold.

per cent to 70 per cent, effective August 5, 1958); and by a flow of banking, monetary, and Treasury deficit data pointing to a sharp increase in the cash balance position of the economy.

In considering policy, the Committee was faced with the fact that the large Federal Government deficit would have to be financed during a period characterized by broadly spread revival of productive activity and incomes and an abnormal expansion in privately held cash balances, and by the emergence of an inflationary psychology in the stock market and other financial markets that could easily spill over into commodity and real estate markets. Notwithstanding the substantial numbers of unemployed persons, the data presented indicated that the rate of expansion in the money supply in the immediate future should be tempered and that operations for the System Open Market Account should move in the direction of lower free reserves without seriously disrupting the Government securities market. The fact that seasonal influences would be working in this direction through the Labor Day week end suggested that, without too much pressure, the System Account might be able to move in the direction of the elimination of free reserves by the time of the next meeting.

In terms of the policy directive, the objectives sought by the Federal Open Market Committee were encompassed in the amended wording of clause (b) to provide that operations should be with a view, among other things, "to fostering conditions in the money market conducive to balanced economic recovery." This wording of the directive may be compared with that in effect from the March 4, 1958 meeting until July 29, which called for open market operations "contributing further by monetary ease to resumption of stable growth of the economy," and which had been temporarily inoperative from July 18 to July 24 in view of the special authority to make purchases for the purpose of correcting a disorderly condition in the Government securities market.

In its discussions of the policy directive the Committee also considered the market structure of interest rates, noting that the discount rate of the Federal Reserve Bank of San Francisco had been increased from 1¾ per cent to 2 per cent effective August 15, 1958. The reasons for this rate increase, which are presented in the section of this report dealing with policy actions of the Board of Governors of the Federal Reserve System, were reviewed at this meeting, and the

rate increase was considered to be consistent with the action taken by the Open Market Committee in deciding to move toward reduced reserve availability.

September 9, 1958

Authority to effect transactions in System Account.

The directive of the Committee was renewed without change, continuing the policy of fostering conditions in the money market conducive to balanced economic recovery.

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

Since the August 19 meeting of the Committee, reserve availability had declined steadily with a minimum of disturbances in the Government securities market. Despite the reduction in reserve availability, the market had been more calm during the past few days than at any time since June. A better tone also had developed in the market for corporate and municipal bonds.

Economic data presented showed that domestic recovery in output, income, and consumption had been vigorous and that it held promise of continuing to be vigorous over the period ahead. The August index of industrial production was estimated to have moved up two points further, with the widespread gains in output extending through durable goods and nondurable goods lines.

Financial developments of recent weeks had included those associated with an upward adjustment of interest rates—long-term, medium-term, and short-term. Several Federal Reserve Banks had brought their discount rates up to the 2 per cent level made effective at the Federal Reserve Bank of San Francisco on August 15. It was difficult to judge the extent to which the rise in interest rate levels reflected a basic shift in credit demands relative to supply of savings, and the extent to which they reflected the influence of the recent shift in System policy to less availability of reserves, but each had exerted an influence. The aggregate amount of credit supplied during the year had been large and prospects pointed to an increase in private borrowing along with the heavy Treasury deficit.

Discussion of recent developments showed differences of views as to the certainty of continued economic recovery and as to the degree to which credit policy should move toward further limitation of reserve availability over the next several weeks. There was general agreement, however, that for the immediate future, during which another Treasury financing operation would occur, operations for the System Account should aim at maintaining substantially the same tone in the money market as prevailed at the time of this meeting. This objective could be sought within the wording of the directive that had been adopted at the meeting on August 19, which called for operations fostering conditions in the money market conducive to balanced economic recovery, and the directive was thus renewed without change.

September 30, 1958

Authority to effect transactions in System Account.

At this meeting, the directive was again renewed without change, thus continuing the policy adopted on August 19, 1958, of fostering conditions in the money market conducive to balanced economic recovery.

Votes for this action: Messrs. Martin, Chairman, Balderston, Fulton, Irons, Mangels, Mills, Robertson, Shepardson, Szymczak, Erickson, and Treiber. Votes against this action: none.

Since the preceding meeting of the Committee, discount rates at additional Federal Reserve Banks had been raised to a uniform level of 2 per cent. An even situation had been maintained in the money market, which had been generally firm. At the same time, financial markets appeared to be discounting possible inflationary developments. Thus, with re-emergence of inflationary expectations, stock and bond yields developed a relationship similar to that which prevailed for a brief period in mid-1957, when a psychology of creeping inflation was also dominant in financial markets.

At this meeting, the Committee considered in detail the currently developing economic situation, with its rapid expansion in industrial production while unemployment figures remained relatively high. In the face of uncertainties as to whether the recovery would be sustainable, monetary policy was discussed in terms of the recent sharp rise

in interest rates, which some considered to be excessive in view of the basic supply and demand factors in the credit market. Considering the importance of curbing inflationary and speculative developments before they gained headway, attention was focused on the extent to which expansion of the money supply should be limited at this time as a means of carrying out the Federal Reserve's responsibility for maintaining in a growing economy reasonable stability of the value of the dollar as well as in employment. One suggestion was that the appropriate course would be to permit further expansion of credit and the money supply only on terms that would indicate the System's continuing awareness of potential inflationary risks and its determination to prevent them from stimulating speculative excesses in the use of credit. The conclusion reached by the Committee was that operations in the immediate future should try to maintain an even keel in the market and that no change in the policy directive was necessary. This was based on the view that no further increase at this time in the degree of restraint was favored, nor on the other hand was there a desire to ease the market from its present position.

October 21, 1958

Authority to effect transactions in System Account.

No change was made at this meeting in the Committee's directive that policy should be directed toward fostering conditions in the money market conducive to balanced economic recovery.

Votes for this action: Messrs. Balderston, Chairman pro tem, Fulton, Irons, Leach, Mangels, Mills, Shepardson, Szymczak, and Treiber. Votes against this action: none.

Continuing economic recovery was reported at this meeting. Gross national product for the third quarter was estimated at $440 billion, up $11 billion from the second quarter. Industrial production into October was rising further and broadly, new construction activity in September had been close to record levels, employment was rising and unemployment declining, and personal incomes were rising. Wholesale price averages had been stable for several months with easing of farm product prices offsetting strengthening tendencies in industrial materials and rises in some fabricated items. Latest news from abroad indicated some extension of recession in the principal