TESTIMONY OF CHAIRMAN MARTIN BEFORE THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
February 7, 1956

On behalf of the Board of Governors, I should like to express appreciation of this opportunity to report to you on the nation's credit and monetary developments during 1955. The President's Economic Report describes in detail the generally gratifying performance of the nation's economy, except for agriculture, over the past year and you have already had testimony dealing with important phases of the subject. The only supplement I will offer for your background information is a small chart book of key statistical information on domestic and international economic developments over the past year. My prepared statement will relate mainly to adaptations in Federal Reserve operations in response to the changing economic situation.

In 1955 Federal Reserve policy shifted from maintenance of ease in the money market to restraint of inflationary developments. During January, System policy continued to be directed toward fostering recovery, while maintaining conditions in credit markets that would avoid unsustainable expansion. Beginning in February, however, and for the remainder of the year, as over-all demands mounted, as industrial output approached capacity and inflationary pressures appeared, measures were adopted to moderate the pace of credit expansion. Federal Reserve action sought to keep growth in bank credit consistent with growth in employment and production. Increased credit demands exerted increasing pressure on bank reserve positions; borrowed funds became less readily available to marginal users, and interest rates rose.

In pursuance of this policy of restraint on bank credit expansion, the Reserve System reduced slightly over the year its portfolio of United States Government securities. Commercial banks, in order to meet growing loan demands from their customers, had to sell a large amount of Government securities to nonbank holders. These banks also increased both the frequency and magnitude of their borrowing from the Reserve Banks. The fact that the banks found it necessary to borrow did, in itself, impose some restraint on their lending activity. This restraint was reinforced by successive increases in the discount rates charged by Federal Reserve Banks on member bank borrowing.

For the year 1955 as a whole, the rise in total loans and investments of commercial banks amounted to approximately $5 billion or about 3 per cent--a smaller expansion than in 1954. Loans and investments, excluding United States Government securities, rose by $12 billion or 15 per cent--the largest growth of any year since 1950. Through sales and run-offs at maturity, bank holdings of Government securities were reduced by $7 billion, mainly in short-term issues. This shift from Government securities to business and consumer loans caused bank liquidity to decline, which in turn worked to restrain bank lending.

Like the increase in total bank credit, the rise in the active money supply, namely, the demand deposit and currency holdings of consumers and businesses, was moderate. For the year, the money supply rose about $3.5 billion or less than 3 per cent. The turnover of demand deposits outside leading financial centers, however, rose from 19.2 times a year in 1954 to 20.4 times, or by 6 per cent reflecting more active use of existing money. Deposit turnover in financial centers was also faster than in 1954. As compared with 1954, the increase in time deposits in 1955 was much less at commercial banks and about the same at mutual savings banks. Growth in savings and loan shares was somewhat greater than in the preceding year.

Nonbank sectors of the community, particularly business corporations, State and local governments, pension and trust funds, and individuals, added substantially to their holdings of United States Government securities, including the short-term issues sold by banks. This shift in ownership of Government securities represented a reversal of developments in 1954 when commercial banks added appreciably to their holdings of Government securities by market purchases from nonbank holders while increasing loans only slightly. Nonbank lenders also extended more credit to private borrowers in 1955 than in previous years. Especially sharp was the rise in mortgage and consumer credit.

Although policy actions of the Federal Reserve in 1955 tended to produce a gradually increasing degree of restraint over much of the year, most of the System's open market operations, including repurchase agreements with dealers in Government securities, sought to moderate the impact of seasonal factors on the money market. In January and February the System sold, or allowed to mature without replacement, $1.3 billion of United States Government securities. This was mainly for the purpose of absorbing reserves made available by the seasonal return of currency from circulation and the reduction in required reserves associated with the seasonal deposit decline. Since the declines both in currency demands and required reserves were less than usual for the season, some additional member bank borrowing from the Reserve Banks resulted. Borrowings, which averaged about $300 million in December 1954 and January 1955, increased to $500 million in March and April 1955. This change marked a shift in the emphasis of Federal Reserve operations from ease toward moderate restraint.

During the second quarter of the year Federal Reserve operations in the Government securities market were small, and there was little net change in commercial bank reserve positions. In recognition of the rise in market rates of interest that had been occurring since the summer of 1954, the Federal Reserve Banks raised their discount rates in April from 1-1/2 to 1-3/4 per cent.

The Board of Governors raised margin requirements for purchasing and carrying listed securities from 50 to 60 per cent in early January and again to 70 per cent in late April. The volume of stock market credit, which had risen sharply from early 1954 through the spring of 1955, thereafter expanded but little.

In the early part of July, the System purchased Government securities to supply banks with reserves to meet temporary seasonal needs, including Treasury borrowing in the market. From mid-July to late September, the System's holdings of securities declined and member bank borrowing from the Reserve Banks rose in September to a daily average level of about $850 million, as compared with an average of $400 million in June. Interbank borrowing also increased during this period. In early August, discount rates were raised from 1-3/4 to 2 per cent at 11 Reserve Banks and to 2-1/4 per cent at the Federal Reserve Bank of Cleveland. The 2-1/4 per cent rate was established at all Reserve Banks by early September. Thus in this period, restraint on bank credit expansion was firmed.

In late September, the System resumed purchases of Government securities. Between that time and the year-end more than $1 billion had been added to the Federal Reserve portfolio of securities, of which about $350 million were securities acquired under repurchase agreements. These operations offset seasonal drains on bank reserves and did not ease the money market. In mid-November, restraint on bank credit expansion was again strengthened by a further increase in discount rates to 2-1/2 per cent at all Federal Reserve Banks.

During the year, outright purchases of Government securities by the Federal Reserve were confined almost entirely to Treasury bills. At the end of November, however, the System entered into commitments to purchase $167 million of new certificates when issued on December 8. The specific occasion for an acquisition of certificates rather than Treasury bills was to facilitate a large-scale Treasury refunding operation in the face of a more stringent money market than was foreseen when the terms of the Treasury refunding were decided upon. Another unforeseen circumstance was an unusually large volume of maturing issues held by investors desiring cash, which made them indifferent to the terms of the exchange offering.

Toward the close of the year, as is usual, additions to the System's portfolio consisted of temporary purchases of securities under repurchase agreements with dealers in Government securities. The purpose of these purchases was to moderate the effect on the money market of the exceptionally heavy volume of business and financial payments at the year-end. Reserves also became available about this time through an unusually large and sustained seasonal increase in Federal Reserve float, which reflects the volume of credits to the depositing banks' reserve accounts for checks still in process of collection through the Reserve Banks.

At the year-end, the money market continued firm in tone because of the large demands for liquidity, the temporary nature of some of the reserve funds available to the market, and the effect of higher discount rates in keeping down member bank borrowings.

In summary, the year 1955 was marked by the flexibility and adaptability that are essential in the administration of monetary policy if it is to play its proper role. Above all, timeliness is vital. In restrospect I think it fair to say that the transition of monetary policy from ease to restraint in 1955 was effected promptly as economic recovery was achieved and capacity output, accompanied by inflationary tendencies, was approached.

I did not take part a year ago in your hearings on the Economic Report but the preceding February of 1954 I emphasized in my statement to you that the objective of Federal Reserve policy and action is to make available a volume of bank reserves that will safeguard the economy from the over supply that makes for inflation or the under supply that makes for deflation. The exact amount of reserves needed for this purpose is difficult to measure with fine precision ahead of time. The goal is a growing economy and a rising standard of living for the nation.

Monetary policy, closely coordinated with debt management, can contribute to the attainment of that objective but cannot by itself maintain the steady and sustainable economic progress we all wish to have. Responsibility for continued progress rests not alone on Government, but upon the practice of prudence and self restraint on the part of leadership in business and finance, in labor, and in agriculture.

The operation of free markets may be counted upon to bring about many essential adjustments without the direct intervention of Government. The performance of the economy in the last few years justifies, I believe, renewal of faith in monetary action as an indispensable, though by no means omnipotent factor, in the orderly development of the economy under private enterprise institutions. I continue to have that cautious optimism about the future which I expressed here two years ago.

For your convenient reference, I am attaching to my statement a digest review of the Principal Federal Reserve Policy Actions, December 1954 through December 1955.

Principal Federal Reserve Policy Actions
December 1954-December 1955

Date	Action	Purpose of Action
December 1954	Made net purchases of U. S. Government securities in open market of less than $50 million, all under repurchase agreements with dealers and brokers. Member bank borrowing increased to an average of 250 million in December.	To meet part of the temporary end-of-year needs of banks for reserve funds, but in view of rising credit demands, to permit these needs to be reflected in part in slightly less easy reserve positions.
January-June 1955	Sold in the open market or redeemed U. S. Government securities totaling $1. 3 billion. Member bank borrowing increased to an average of more than 400 million in the second quarter.	To offset effects of seasonal factors affecting bank reserve positions and, in view of strong credit demands, to bring about somewhat greater member bank borrowing from Federal Reserve Banks.
January 1955	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 60 per cent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
April 1955	Raised margin requirements on loans for purcashing or carrying listed securities from 60 to 70 per cent of market value of securities.	
April 1955	Raised discount rates from 1-1/2 to 1-3/4 per cent.	To bring discount rates into closer alignment with open market money rates and make borrowing by individual banks more expensive.

Date	Action	Purpose of Action
March-December 1955	Made net purchase of bankers' acceptances in open market totaling $28 million.	To recognize increased use of bankers' acceptances by business as a means of financing international trade.
July-December 1955	Made outright purchases of Treasury bills in the open market totaling $700 million net and increased repurchase agreements with dealers and brokers by 300 million. Member bank borrowing increased to an average of about $850 million in September and more than $1.0 billion in November but declined to about $850 million in December.	To meet part of reserve needs associated with seasonal factors, thus requiring banking system to meet needs in part by further increasing indebtedness. This action was taken with a view to providing for seasonal needs while limiting undue expansion of bank credit.
November-December 1955	Purchased when-issued Treasury certificates of indebtedness totaling $167 million.	To facilitate Treasury refunding in period of money market stringency. Supply of reserves was consistent with over-all open market policy at time.
August-September 1955	Increased discount rates from 1-3/4 to 2-1/4 per cent. This increase was made in two steps at all Reserve Banks except Cleveland.	To keep discount rates in an appropriate relationship with market rates of interest and thus maintain a deterrent on excessive borrowing by individual banks at the Reserve Banks.
November 1955	Increased discount rates from 2-1/4 to 2-1/2 per cent.	