ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

High levels of output and employment, with demands pressing on resources, characterized the year 1955. At the beginning of the year, industrial capacity and manpower in the United States were ample for further expansion, and during the year resources and productivity grew further. By the year-end, however, many important industries were operating at or close to capacity, employment and weekly hours of work were at advanced levels, while a number of key materials were in short supply. Economic resources were being intensively utilized both here and abroad.

As the year progressed, growth in demand arising from consumption and investment pressed against available supplies in almost all areas except agriculture. These pressures were reflected in wage advances and in rising prices for industrial materials and products. At the same time, there were price weaknesses in agriculture. Growing over-all demands for goods and services generated expansion of credit here and abroad. Accordingly, additional measures of restraint were adopted by the monetary and fiscal authorities of many countries. These measures were designed to keep demands within the limits of capacity to produce, to restrain price advances and, in some countries, to prevent or moderate drains on monetary reserves.

In conformance with the broad objective of fostering growth and stability in the economy, Federal Reserve policy during 1955 responded to changes in the economic climate. As recovery turned into vigorous expansion, emphasis shifted gradually from facilitating recovery to restraining inflationary developments. The additional reserves needed to support monetary expansion during the year were obtained by member banks through borrowing at the Federal Reserve Banks. Federal Reserve open market operations were used in the main to adjust the supply of bank reserves to the ebb and flow of seasonal requirements. This had the effect of restraining the over-all growth of bank credit and induced banks to sell Govern-

ment securities from their portfolios to nonbank buyers in order to provide themselves with the funds to meet the exceptionally heavy loan demands. Federal Reserve Bank discount rates were advanced four times during the year, from 1½ per cent to 2½ per cent. Margin requirements on stock market credit were raised twice in the first half of the year, from 50 per cent to 70 per cent.

CREDIT AND ECONOMIC REVIEW

Total growth in private debt and equity financing was larger in 1955 than in any previous year, with strong demands in nearly all sectors of the financial markets. The bulk of the funds came from nonbank sources through direct investment or indirectly through the purchase of Government securities sold by banks. The impact of increased demand was particularly marked in the short-term area, not only in business borrowing for working capital and in consumer credit but also in temporary financing of long-term needs, as exemplified by borrowing at banks by mortgage lenders and utilities.

Notwithstanding unprecedented expansion in bank loans, growth in the total of loans and investments at banks was less than half as large as in 1954. The active money supply, measured by the volume of demand deposits and currency held by individuals and businesses, increased slightly less than in 1954. Turnover of demand deposits was at a more rapid rate.

With credit demands strong, interest rates rose during the year, particularly in the short-term area. Short-term rates rose above 1953 peaks to the highest levels since 1933. Long-term rates increased, but more moderately, and remained below the peaks reached in the spring of 1953. The interplay of various forces in the credit markets reduced the spread between short- and long-term interest rates to the narrowest margin since 1930.

Gross national product in the United States totaled $387 billion in 1955, a rise of $27 billion or 7 per cent from 1954. By the fourth quarter of 1955 total product, at an annual rate of $397 billion, was up 11 per cent from the low second quarter of 1954 and 8 per cent from the peak of mid-1953. For the most part these increases represented gains in physical output, although after mid-1955 price advances became a factor.

The initial impulse to economic recovery in 1954 came largely from expansion in consumer demands for automobiles, household

durable equipment, and new houses, together with a shift from liquidation to accumulation of business inventories. Beginning early in 1955 outlays for business capital expansion became an influence of growing importance, as did consumer outlays for nondurable goods and services. Federal Government outlays changed little during 1955 while State and local spending continued to rise.

Levels of output in the United States were at new highs during 1955 in all major sectors of the economy. Industrial production in December, at 144 per cent of the 1947-49 average, was 11 per cent above the level of a year earlier and 5 per cent above the earlier high of mid-1953. Increases were most striking for durable goods, but output of nondurables and minerals also rose to record levels. Output of electric power expanded at a rapid pace. Construction activity, although showing some decline in the residential sector from the exceedingly high level reached in the spring and summer of 1955, was at a record total for the year. Despite acreage restrictions, crop production almost equaled the 1948 peak and output of livestock products was in record volume.

Expansion in demand and output was accompanied by increases in prices of industrial materials and finished products, particularly in the second half of the year. Meanwhile, with increased output of farm products and lower Federal support levels for some crops, there were further declines in prices of many of these commodities. The general indexes of wholesale and consumer prices were slightly higher at the end of 1955 than at the beginning of the year. Under the influence of active business and consumer demands in the United States and abroad, industrial prices were strong as the year closed.

The growing volume of private spending in 1955 was financed from rising incomes and increased use of credit. In the fourth quarter, personal disposable income was at an annual rate of $277 billion, 7 per cent higher than a year earlier. This increase reflected sharp advances in wage rates, as well as a larger volume of employment and more hours of work in some industries. There were also increases in other major income components, except income from farming. Consumer spending for goods and services rose even more rapidly than personal income for the year as a whole. A major factor in the increase of consumer spending relative to income was a growing use of credit on easy terms. Outstanding

consumer instalment credit and home mortgage credit increased by record amounts.

Corporate profits after taxes rose about $4.5 billion and dividends $1.2 billion. Total internal funds of corporations, including both retained earnings and depreciation allowances, were higher by almost $5 billion and at a new peak level. This large volume of corporate internal funds helped to finance increased business outlays for both fixed and working capital. In addition, businesses had temporary use of large amounts set aside for future tax payments, and borrowed heavily from banks and in the long-term capital markets.

The aggregate volume of security issues for new capital by corporations during 1955 was about one-fifth larger than in 1954, reflecting in part a sharp increase in flotations by sales finance companies. The volume of new common stock issues showed a substantial increase during the year both in dollar amount and as a percentage of total corporate issues, as a continued rise in stock market prices made the market more favorable for raising equity capital. The volume of new securities issued by State and local governments was about one-eighth below the 1954 total, reflecting a substantial reduction in toll-road financing.

Abroad, activity continued to increase, and new records of production were achieved. In Western Europe, industrial production in the fourth quarter showed increases from a year earlier ranging from 3 per cent in the United Kingdom to 14 per cent in West Germany. Levels of national income and of imports and exports exceeded previous records. Western Europe's pace of advance—which had exerted a pervasive influence on the world economy in 1954—slowed after the spring of 1955 as domestic resources became more fully utilized.

In order to prevent or limit drains on reserves of gold and foreign exchange and to maintain stability in their general price levels, credit policies directed toward restraint were pursued in many European countries—in Great Britain throughout the year and later in Germany also—and in a number of countries outside Europe. In some countries fiscal and other governmental measures were also employed to exert a stabilizing influence. British reserves of gold and dollars declined during most of the year. Germany, France, and Italy gained reserves on a considerable scale.

In consequence of the continuing growth in foreign demand and rapid rise in United States purchases abroad, world trade reached a record level. By the fourth quarter, United States imports were more than a fifth larger than a year earlier. The expansion of imports was especially great for finished manufactures and for certain materials, particularly metals. Further enlargement of United States exports accompanied the expansion in imports.

FEDERAL RESERVE CREDIT POLICY

In 1955 Federal Reserve policy shifted from maintaining 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, and interest rates rose.

In pursuance of this policy of restraint on bank credit expansion, the Reserve System reduced its portfolio of United States Government securities slightly over the year. 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 to meet loan demands in itself imposed 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 $4.5 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 in 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 a decline in bank liquidity, 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 $3.2 billion or 2.5 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 slightly less 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, Federal 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 moderately. 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 occasional 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. Because of the strong credit demand, 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 reflected 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 had little net effect on reserves, 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 1½ to 1¾ per cent.

In late March the Federal Reserve Bank of New York began to purchase bankers' acceptances on a small scale for its portfolio. These purchases, the first since 1951 for Federal Reserve account, were made in recognition of the increasing use of bankers' acceptances by banks and businesses and their potential importance to financing international trade.

The Board of Governors raised margin requirements for purchasing and carrying listed securities from 50 to 60 per cent in early January and 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 late 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. In the first half of August, discount rates were raised from 1¾ to 2 per cent at 11 Reserve Banks and to 2¼ per cent at the Federal Reserve Bank of Cleveland. The 2¼ per cent rate was established at all the Reserve Banks by mid-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 $400 million were securities acquired under repurchase agreements. These operations offset seasonal drains on bank re-

serves 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 2½ 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 Treasury 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 at a time of stringent money market conditions not foreseen when the terms of the Treasury refunding were decided upon. Another unforeseen circumstance was the need of many holders of the maturing issues for 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—that is, through 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. Thus, the System's policy of restraint remained in effect.

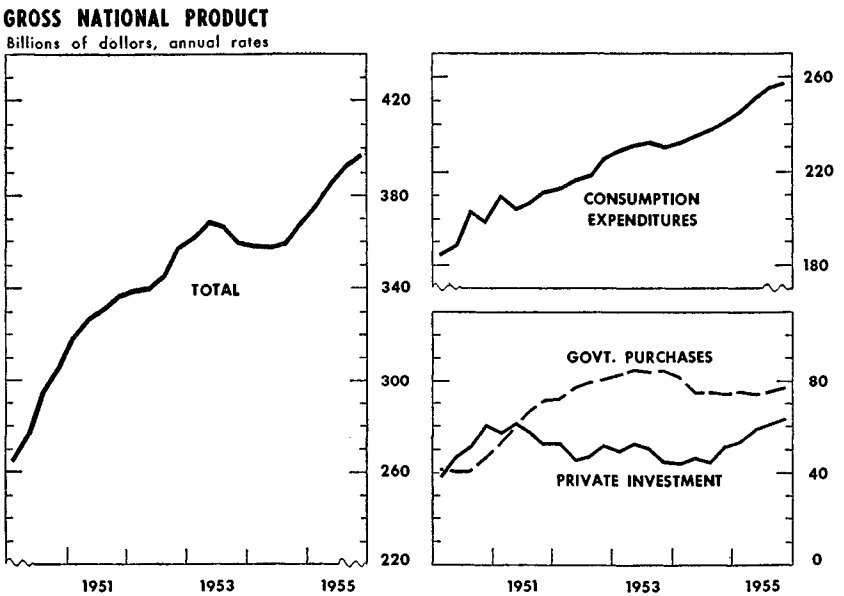
ECONOMIC CONDITIONS

The expansion in economic activity that got under way after mid-1954 continued throughout 1955. At the year-end, output and employment were at new record levels. Operations in some key industries were up against capacity limitations and some materials were in short supply. Strong demands in the United States, and also abroad, led to increased prices of industrial materials and finished products, particularly after midyear. Prices of farm products,

however, declined further under the pressure of record supplies. Average consumer prices at the year-end were only slightly higher than a year earlier.

Demand and production. The value of total output of goods and services in the United States was $387 billion in 1955 as compared with $360 billion in 1954 and a previous high of $365 billion in 1953. Most of the increase represented a gain in physical volume.

In the fourth quarter of 1955 the gross national product was at an annual rate of $397 billion, $30 billion or 8 per cent larger than a year earlier and $40 billion or 11 per cent larger than in mid-1954. The advance mainly reflected expansion in consumer and business demands as total government spending changed little.



NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation. Private investment includes expenditures for residential and other construction, producers' durable equipment, inventory change, and net foreign investment. Government purchases include Federal and State and local purchases of goods and services, but exclude government interest and transfer payments.

Initially, the major stimuli to recovery after mid-1954 were sharp expansion in consumer outlays for automobiles and other durable goods, continued advances in purchases of new homes, and a shift from liquidation to moderate accumulation in business inventories.

These accounted for $13 billion of a total rise of $16 billion in gross national product from the third quarter of 1954 to the first quarter of 1955.

After early 1955 the upward impetus came principally from a turnaround in business spending for fixed capital and from a rise in consumer spending for nondurable goods and services. State and local outlays for goods and services continued to rise. Inventory accumulation increased. Spending for consumer durable goods and new houses continued to rise through the third quarter and then declined. On the whole, the types of spending that were responsible for most of the initial expansion in gross national product accounted for only a small part of the subsequent gains.

For the year, consumer expenditures were up 7 per cent from 1954, with outlays for durable goods, nondurable goods, and services all at record levels. Population increased by 2.8 million persons or 1.7 per cent, about the same rapid rate as in most postwar years. With average consumer prices little changed, growth in per capita real takings of goods and services in 1955 was large. Dramatic features of the year's developments were the increase in outlays for consumer durable goods, particularly automobiles, and the associated record expansion in outstanding consumer instalment credit.

Markets for residential real estate were active throughout 1955. The number of private nonfarm dwelling units started was slightly in excess of 1.3 million, as compared with 1.2 million in 1954 and a record 1.4 million in 1950. After allowance for seasonal influences, the number of units started fell off after midyear, and at the year-end was at an annual rate of 1.2 million. The value of residential construction activity, after rising by almost 50 per cent from early 1954 to the summer of 1955, subsequently declined. With residential and other construction activity in record volume and important materials in short supply, prices of building materials rose further in 1955.

The rapid expansion in home building that began early in 1954 was stimulated in part by relaxation in mortgage terms. After the spring of 1955, the availability and terms of mortgage credit, particularly for new commitments, became somewhat less easy. Also, permissible terms on Federally underwritten loans were made less easy in the spring and summer and shortly thereafter some limita-

tion was placed on borrowing by savings and loan associations from Federal home loan banks. Although the rate of mortgage extensions leveled off late in the year, mortgage lending on new and old homes was in unprecedented volume for the year as a whole. Outstanding mortgage debt on 1- to 4-family housing units increased by $13 billion as against $9.6 billion in 1954.

Accumulation of nonfarm business inventories amounted to about $3 billion in 1955, after a liquidation of like amount in 1954. A greater rise in book value of inventories represented in large part the effects of rising prices. The bulk of both the expansion and the earlier contraction was in durable goods lines. Business sales advanced more rapidly than book value of inventories, and ratios of inventories to sales during most of the year were around the lowest levels since early 1951. In the fourth quarter, accumulation of inventories increased to a seasonally adjusted annual rate of $5 billion, partly reflecting a more than seasonal build-up in dealers' stocks of 1956 model automobiles. New orders received by manufacturers in the closing months of 1955 were maintained on an unusually high plateau and unfilled orders continued to increase.

Business expenditures for fixed investment were an important expansive factor after early 1955. For the year, such outlays were 8 per cent larger than in the preceding year and 2 per cent larger than the record amount of 1953. All major nonfarm industry groups spent more on plant and equipment in 1955 than in 1954, with outlays by commercial enterprises showing an exceptionally great increase. Late in the year, expanded investment programs were announced in a number of important industries.

In contrast with private expenditures, Federal purchases of goods and services were relatively stable in 1955. Federal outlays for national security programs were close to an annual rate of $41 billion as compared with a peak rate of $53 billion in mid-1953. At the end of 1955, the proportion of total output taken by national security programs was about 10 per cent as compared with 14.5 per cent in mid-1953. State and local outlays continued their steady postwar growth, with increases in both construction expenditures and compensation of employees.

Industrial production. Output at factories and mines for the year 1955 exceeded the earlier high of 1953. By spring industrial output had recovered to the mid-1953 high of 137 per cent of the

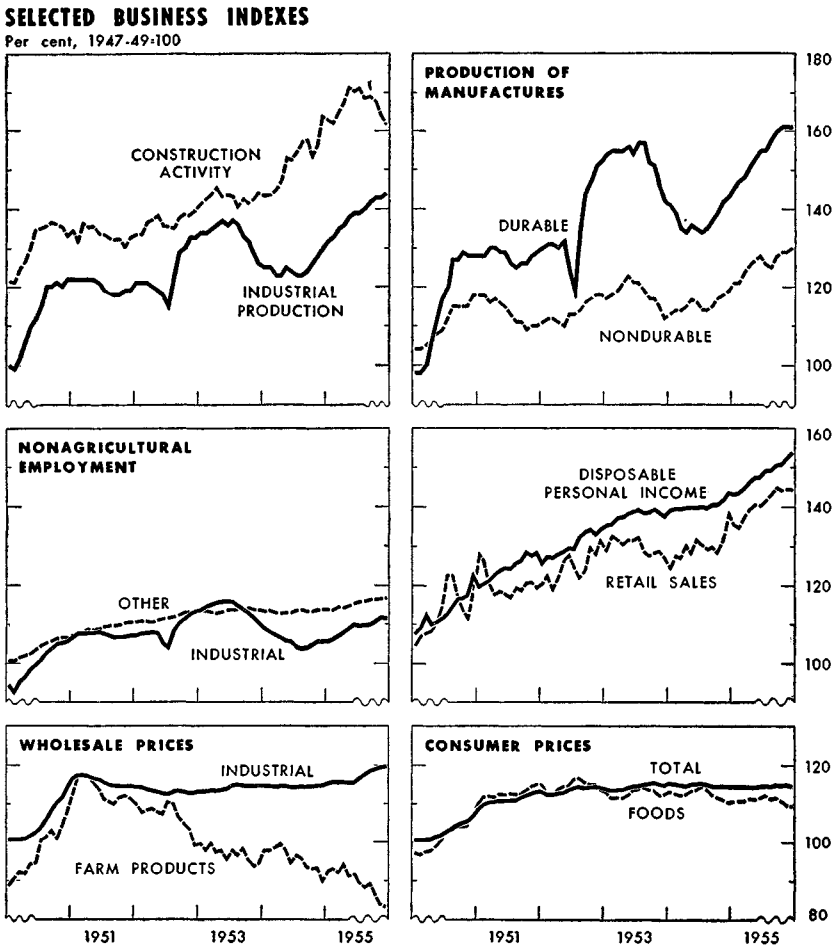
1947-49 average—a rise of 11 per cent from the mid-1954 recession low. With output in a number of lines approaching capacity and with some materials in short supply, expansion in industrial production after the spring was more moderate. In December the Board's seasonally adjusted production index, at 144, was at a record high.

Expanding production of autos and household appliances in late 1954 and early 1955 was a major factor in the rise in total output. Following the fall changeover to 1956 models, auto output recovered to earlier record rates, and dealers' stocks were built up rapidly. After mid-December, curtailment of auto assemblies brought output somewhat below the level at the beginning of the year. Auto output for the year totaled almost 8 million—1.2 million above the previous high in 1950—and domestic sales amounted to 7.4 million units. Production of household durable goods advanced to a peak in September and subsequently declined. Altogether, seasonally adjusted production of consumer durable goods in December was 147 per cent of the 1947-49 average as compared with an autumn high of 154 and a 1954 monthly low of 110.

Pressure on supplies of metals and some other materials developed when business outlays for new plant and equipment turned up sharply in the spring of 1955, after a period of decline, and production of building materials reached capacity levels. Output of steel and some nonferrous metals was limited in the summer by work stoppages and other factors. It rose to new highs in the autumn, and steel ingot output for the year totaled 117 million tons, 5 per cent above the previous record of 1953.

Activity in producers' equipment industries was generally rising through the summer and autumn. At the year-end, despite marked recovery in output, order backlogs were substantial for freight cars, machine tools, generating equipment, and other business equipment. Total durable goods production was at a new high of 161 per cent of the 1947-49 average toward the end of 1955. Despite sharply reduced defense production, this was somewhat above the mid-1953 level.

Strength in consumer markets and rising business demands led to further expansion in nondurable goods production in 1955. Increases were sharp for paper, chemicals, and rubber products until capacity limitations were approached. Increases in textiles, apparel,



NOTE.—Monthly series, seasonally adjusted except for prices. Indexes for retail sales and disposable personal income based on Department of Commerce data. Indexes for prices and employment based on Bureau of Labor Statistics data. Index for construction activity in constant prices based on Commerce and Labor data. Index for industrial production is Federal Reserve series.

and leather products were more moderate. At year-end, over-all output of nondurable goods was at a new high of 130 per cent of the 1947-49 average.

Output of minerals also reached a new peak, partly in response to strong demands from manufacturers of metal products and building materials. Fuels were also in strong demand during the year, with severe weather at the year-end further heightening demands and stimulating output of coal and petroleum.

Agriculture. Agricultural developments in 1955 continued to be dominated by large supplies and downward pressures on prices and income. Prices of farm products declined 7 per cent from December 1954 to December 1955 and, with farm costs at advanced levels, net income from farming for the year was off 10 per cent from 1954. Farm land values, however, rose somewhat to a new high. Commodity Credit Corporation holdings of commodities under the price-support program increased further in 1955. Agricultural exports were a little larger than in 1954.

Total farm output was in record volume in 1955. Production of livestock products was 3 per cent larger than in 1954 and crop output was up 4 per cent, notwithstanding acreage limitations and large carryovers of major crops. Increases in marketings were pronounced for meat animals, feed crops (where acreages were expanded), and cotton (where further restrictions in acreage were more than offset by sharply higher yields). Production of wheat and rice was reduced somewhat. Price-support levels for a number of crops were reduced in 1955.

In the last quarter of the year, meat production was about 10 per cent above the corresponding quarter of 1954. Output of dairy products and eggs increased little during the year, although prices were up somewhat and feed costs much lower.

A moderate increase in farm land values, reflecting in part purchases by established farmers to enlarge their operations, was accompanied by a 10 per cent rise in farm mortgage debt. Production loans to farmers also rose by about 10 per cent. Price-support loans declined.

Labor market. The labor market strengthened during 1955. Nonfarm employment rose to a new high, unemployment was reduced, and overtime work was widespread in manufacturing industries. Growth in the labor force was large.

Nonfarm employment rose sharply in the first half of the year and less rapidly thereafter. It exceeded 50 million in December, a new high and 1.8 million more than a year earlier. In most nonmanufacturing activities employment was at record levels, but manufacturing employment had not reattained its mid-1953 peak. The workweek in manufacturing tended to lengthen throughout the year and in December, at more than 41 hours, was about as long as at any time in the postwar period. Employment on farms

averaged 6.7 million in 1955, slightly more than in either of the preceding two years.

Unemployment, after allowance for seasonal influences, declined during the first half of 1955 and then remained relatively stable. The number unemployed in December, 2.4 million, was 400,000 below a year earlier. For the year, unemployment averaged 2.7 million persons or 4 per cent of the civilian labor force, and was moderately below the 1954 average. The labor force (including the armed forces), however, was 1 million larger than in 1954.

Wage rates rose throughout the year, but more rapidly after midyear following collective bargaining agreements in major industries. Gains were largest in the manufacturing industries, particularly in the metal producing sectors, but substantial wage increases also were granted to Federal Government workers, bituminous coal miners, railroad workers, and others. Average weekly earnings in manufacturing in December amounted to almost $80, a record sum and 8 per cent higher than a year earlier, while hourly earnings were up 5 per cent. In addition to wage increases, many workers gained liberalized health, welfare, and pension programs. Supplementary unemployment benefits were negotiated for the first time in the automobile and some other industries.

Prices. Reflecting strong demands and a high degree of resource utilization, upward price pressures predominated in industrial markets; in contrast, large supplies resulted in further price declines in agricultural markets. Consumer prices, reflecting both of these major influences, were slightly higher after midyear.

Average prices of industrial commodities, including finished products, changed little in the first half of 1955 and advanced considerably in the second. Industrial materials as a group rose 4 per cent in the last six months of the year. Steel mill products were raised 7 per cent at midyear and some further advance occurred toward the year-end. Prices of lumber, other building materials, paper products, and fuels increased during the year, while prices of textiles and chemicals changed little.

With the increase in prices of materials and other costs, further expansion of demands in the second half of 1955 was accompanied by a rise of 3 per cent in average wholesale prices of finished industrial products. Advances were general for business equipment, which rose 5 per cent.

Prices of farm commodities declined further after the spring and at the year-end were 7 per cent below a year earlier. With marketings of livestock, particularly hogs, considerably expanded, average farm prices of meat animals declined about one-fourth during the year.

Consumer prices were stable in the first half of 1955 and rose slightly in the second half of the year. Retail meat prices declined but other foods generally changed little. Retail prices of many other commodities tended higher after midyear, but competitive pressures remained strong and effective prices of some durable goods declined. Prices of consumer services rose further.

Income and saving. Expansion in 1955 was supported by further growth in consumers' spendable income. In the fourth quarter, disposable income was at an annual rate of $277 billion, an increase of 7 per cent from late 1954. Real disposable income per capita also rose to a new high.

Consumer spending increased even more than incomes and outstanding consumer debt expanded rapidly. Net personal saving, both in dollar amount and as a percentage of disposable income, declined further in 1955 and was lower than for any year since 1950. In the fourth quarter, however, personal saving increased.

Personal income advanced without interruption in 1955 and in the fourth quarter was at a seasonally adjusted annual rate of $312 billion, 7 per cent higher than a year earlier. All major types of income participated in the advance, except for farm proprietors' income, which declined for the fourth successive year. Total wage and salary income rose substantially, reflecting increases in employment, average weekly hours, and wage rates. Government transfer payments changed little during the year as payments under the old-age and survivors insurance program continued to rise while unemployment compensation benefits fell off.

Dividend and interest income rose considerably further in 1955. Extra dividends at the year-end were large. Rental income leveled off. Reflecting recovery in retail trade and continued growth in services, income of nonfarm proprietors advanced appreciably. Corporate profits before tax increased sharply to a new high, and after-tax profits also rose.

Debt and equity financing. Consumer and business demands for credit pressed on the supply of available funds in 1955. Record volume

of expenditures for home construction and automobiles was accompanied by sharp increases in demands for mortgages and instalment loans, while rising business activity and plant and equipment outlays resulted in greater business needs for bank credit and in a larger volume of corporate security offerings.

With the flow of new savings into major financial institutions increasing at a slower rate than in 1954, and with monetary restraint limiting the expansion of bank reserves, lenders were under pressure to allocate available funds among competing demands. Most financing institutions found it necessary to borrow or reduce liquid asset holdings in order to meet commitments to customers.

Insurance companies, heavily committed to mortgage lending throughout the year, met their obligations in part through curtailment of other lending activities and to some extent through temporary financing arrangements with commercial banks. Savings and loan associations expanded the volume of their real estate lending by more than the net inflow of new share purchases; the excess was financed through advances from Federal home loan banks and through drawing down of deposits at these banks by member associations. Mutual savings banks, with a somewhat smaller deposit increase than in 1954, reduced their holdings of other types of investments in order to increase their mortgage portfolios.

Financing of real estate activity, which absorbed such a large part of institutional funds in 1955, added $16.7 billion to private debt, as compared with an expansion of $12.5 billion in 1954. Most of the increase was in mortgages on smaller residential properties, but there was also a substantial rise in loans on commercial properties, apartment houses, and similar structures. About half of the housing units started in 1955 were financed through Federally underwritten loans, which rose more rapidly than conventional loans for most of the year. The less easy terms applied to Government guarantee of home mortgage debt were followed by some slackening in demand for Government aided financing. At year-end well over two-fifths of the home mortgage debt outstanding was guaranteed or insured by the Federal Government.

Consumer credit rose by more than $6 billion for the year, as compared with an increase of less than $1 billion in 1954 and an average of about $3 billion in earlier postwar years. Instalment loans, particularly for automobile purchases, accounted for most

of the increase. Lengthening of maturities, smaller down payments, increased size of notes, and a growth in the proportion of sales involving credit all contributed to the rise in automobile credit. Most of the rise occurred before autumn; by then repayments began to approach the volume of new credit extensions. At the same time, increased lender caution was reflected in some stabilization of credit terms and more careful screening of loan applicants.

Some $4 billion of the expansion in consumer credit came from lenders other than commercial banks, particularly sales finance companies that borrowed substantial amounts from banks as well as through capital markets.

Business requirements for short- and intermediate-term funds increased in 1955. Net borrowing from commercial banks by domestic businesses other than sales finance companies totaled $4.6 billion as compared with net repayment of $700 million in 1954.

Business needs for long-term funds to finance capital outlays also increased in 1955. Flotations of corporate securities for new capital by industrial corporations and public utilities were some 8 per cent greater than in 1954. However, retirement of securities was unusually large, and as a result the net change in outstanding corporate issues (other than those of sales finance and investment companies) was one-seventh less than in 1954.

For most industries, internal sources continued to provide the bulk of long-term funds. Corporate profits for the year were about a quarter larger than in 1954. Depreciation and related charges were at record levels in 1955. Dividend payments also rose but outlays for tax payments declined, and the amount paid out for these two purposes was about the same as in 1954. The increase in funds available from operations, together with new borrowing, exceeded the rise in outlays for fixed capital and inventories. There was a very large accumulation of corporate liquid assets, in part to provide for larger tax payments in 1956.

In some areas, private demands for credit were more moderate in 1955 than the year before. The expansion in stock market credit was limited by two Board actions early in the year raising margin requirements. Bank loans to finance the purchase or carrying of securities rose $500 million for the year as compared with an increase of $900 million in 1954. Bank loans to farmers declined in 1955. A reduction of $1.3 billion in price-support loans held by

Growth in Major Types of Debt and Equity Financing

[Net increase in amounts outstanding, in billions of dollars]

Distribution of growth by—	1955[p]	1954	1953	1952
Major types:				
Federal cash borrowing	0.2	0.9	4.6	3.4
State and local government issues (net)	5.1	5.4	3.9	3.2
Real estate mortgages	16.7	12.5	9.8	9.0
Corporate bond and stock issues (net)[1]	4.8	5.6	5.4	7.1
Bank loans to business[2]	4.6	−0.7	−0.1	1.5
Consumer credit by banks and other lenders	6.1	0.6	3.7	4.4
Bank loans not included above[2]	1.7	2.4	1.3	1.6
Selected holders:				
Federal Reserve Banks	− .3	−0.9	1.2	0.9
Commercial banks	4.6	10.1	4.0	8.9
Nonbank holders—				
Mutual savings banks	2.0	2.0	1.8	1.7
Savings and loan associations	5.8	4.3	3.8	3.0
Life insurance companies	5.5	5.1	4.5	4.4

[p] Preliminary.

[1] Excludes funds obtained by consumer finance companies and investment companies.

[2] Excludes funds obtained by sales finance companies.

Note.—Includes only selected types of loan extensions and of new equity financing. Among types not included are trade credit other than consumer credit; interbank loans; security issues by foreign agencies, international organizations, nonprofit and eleemosynary institutions; nonbank loans for purchasing securities; and claims such as shares, pass books, and policies issued by financing organizations.

The sum of the figures for major types of debt and equity financing does not equal the sum of the amounts shown for holders, since not all types of credit and holders are included. Holders exclude Federal, State, and local governments, individuals, corporations, foreign investors, nonlife insurance companies, and other investor groups not shown separately.

Owing to differences in coverage, most of which are indicated above, the figures for bank credit in this table differ from those used elsewhere in this report.

commercial banks more than offset a rise in bank holdings of farm mortgages and farm production loans.

Loan demands from Federal, State, and local governments did not add greatly to pressures in credit markets. Net borrowing by State and local governments was slightly less than in 1954. New security offerings declined, particularly for toll-road financing. Borrowing for school construction and other local needs continued in about the same large volume as in the previous year.

Treasury finance. Increasing tax revenues permitted the Federal Government to come within $1 billion of balancing the cash budget

in the calendar year. Federal cash income from the public in 1955 was $71.3 billion, and cash payments to the public $72.1 billion. By drawing down deposits at commercial and Federal Reserve banks, net Treasury cash borrowing requirements were reduced from $900 million in 1954 to only $200 million in 1955.

Reduction of the cash deficit was accomplished despite an increase in cash expenditures of nearly $3.2 billion. The higher level of expenditures resulted from substantial increases in certain nondefense expenditures over 1954, with the largest increases occurring in the farm price-support and the social security programs. These increases were partly offset by a further decline in national security outlays.

The increase in Federal tax receipts in 1955 was most pronounced in individual income taxes. There were also substantial increases in excise and social security taxes, the latter due in part to expanded coverage and a higher wage base under the 1954 law first effective in 1955. Corporate tax collections were lower, reflecting the lower level of profits the year before.

Federal receipts continued to be largely concentrated in the first half of the year, owing largely to the timing of corporate tax payments. A cash surplus of $6.1 billion during the January-June period permitted $5.0 billion of net cash debt repayment, while the second half-year cash deficit of $6.9 billion led to $5.2 billion of net cash borrowing.

During 1955 the Treasury refunded nearly $40 billion of maturing securities, a total exceeded only by the 1954 record of more than $50 billion. As in 1954, refundings were limited to one each quarter, with the two largest occurring in February and December. Total Treasury cash offerings in 1955 were $14.5 billion, including a $1.3 billion increase in Treasury bills. More than two-thirds of this new cash financing was in the form of tax-anticipation securities of which $8 billion were outstanding at the year-end.

Cash borrowing was undertaken to cover the calendar-year deficit, to repay maturing tax anticipation securities, to meet attrition on refundings, and to provide for net redemptions of nonmarketable securities. Additional funds were also obtained by drawing down the Treasury's cash balance. Net redemptions of savings bonds remained small. About $4.5 billion of savings notes matured and were redeemed in 1955; there has been no new issue of such notes

since 1953. Reflecting competing demands from other borrowers and restraint on the availability of bank reserves, the rate of attrition on total Treasury refundings increased to more than 10 per cent of maturing issues held outside the Federal Reserve System. In absolute terms attrition was more than $1 billion larger than it had been on 1954's greater volume of maturities.

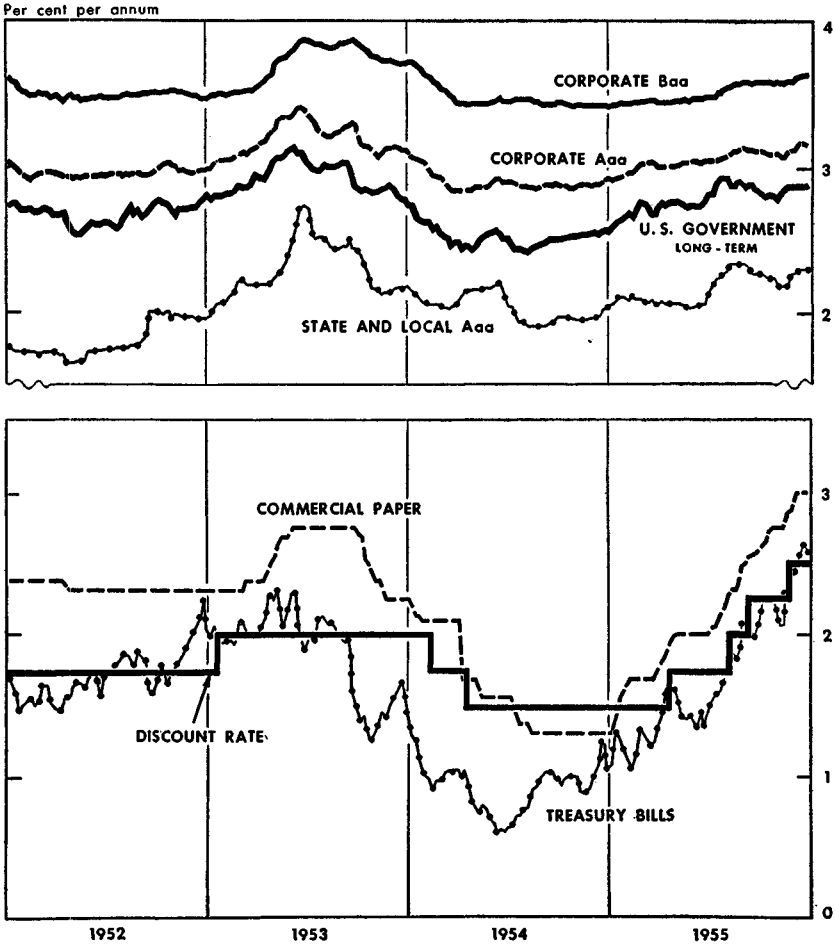
With business moving to new high levels in 1955, the Treasury again sought to extend the maturity structure of the Federal debt through the flotation of a new 40-year bond. In several refundings and cash offerings the Treasury offered securities with intermediate maturities. As a result of these actions, the volume of marketable debt maturing within one year continued to decline in 1955, reducing the proportion of such debt from 40 to 37 per cent; the share of maturities exceeding 20 years was raised from 1 to 3 per cent. In general, however, intermediate offerings were of shorter maturity than they had been in 1954. The proportion of debt in the 1- to 5-year maturity category rose, while that in the 5- to 20-year range declined.

Interest rates. Interest rates, which had risen somewhat late in 1954, continued to rise in 1955 in response to the strong demand for credit relative to the available supply of savings and the limited growth of bank reserves. The largest increase was in yields on short-term securities, which were particularly affected by the vigorous demand for short-term credit and the growing pressure on bank reserve positions. At the end of the year, most short-term rates were at the highest levels in more than 20 years. Yields on long-term securities were only slightly above short-term rates at the end of 1955, as shown by the chart on the following page.

Yields on short-term Treasury securities, after increasing about ½ percentage point in the second half of 1954, increased about 1½ percentage points during 1955. In the first half of the year the rise in the Treasury bill rate was moderated by strong demand on the part of nonbank investors, particularly nonfinancial corporations and State and local governments. The demand was intensified by maturities of nonmarketable savings notes and seasonal retirements of marketable tax anticipation securities. In the second half of the year, however, rates on Treasury bills advanced sharply, despite continued nonbank demand, as reserve pressure continued and the

INTEREST RATES

Per cent per annum



NOTE.—Discount rate is for Federal Reserve Bank of New York. Market yield data are weekly averages of daily figures. Treasury bill rates are market yields on longest bills. Long-term U. S. Government yields are on long-term 2½ per cent bonds. Commercial paper rate is on prime 4- to 6-month open market paper. Yields on corporate and State and local Aaa bonds are from Moody's Investors Service.

Treasury increased its issues of bills and tax anticipation securities.

At the end of 1955 market yields on both 3-month Treasury bills and 9- to 12-month certificates of indebtedness exceeded the Federal Reserve Bank discount rates. The average yield of 2.58 per cent on bills for the week ending December 31 compared with 1.08 per cent a year earlier and a low of 0.61 per cent in mid-1954. The peak in mid-1953 had been 2.29 per cent.

Yields on intermediate-term Treasury bonds and notes also rose sharply prior to mid-1955 in response to pressure on bank reserve positions, but after midyear they rose at a slower rate than yields on shorter term securities.

Rates on other short-term open market paper, which had remained unchanged or declined slightly in the second half of 1954, followed the increase in yields on Treasury securities closely during 1955. Rate increases totaled more than 1½ percentage points on prime commercial paper and privately placed finance company paper, and somewhat less on bankers' acceptances. At the end of the year these rates were at new highs for recent years.

Yields on long-term securities generally increased about ¼ percentage point during 1955. Those on United States Government and State and local government bonds had increased somewhat late in 1954, while those on corporate bonds had changed little. After an increase in the first quarter of 1955, long-term yields were generally stable in the second quarter. They increased further after midyear and, after declining in September and October, rose at the year-end to levels near or above their summer peaks.

At the close of 1955 yields on long-term securities were close to those prevailing in late 1953 and early 1954, but were generally ¼ to ½ percentage point below their mid-1953 highs. Over the year the differential between yields on Treasury bills and long-term United States Government bonds declined from more than 1½ per cent to less than ½ per cent, the smallest differential since 1930.

Interest rates charged customers by commercial banks and other lenders increased during 1955. The average rate charged by commercial banks on short-term business loans rose almost ½ percentage point. Rates charged by lenders on conventional mortgages also increased and discounts deepened on Federally underwritten mortgages.

BANK CREDIT AND MONEY

A declining rate of growth in total bank credit and deposits in 1955 reflected growing pressure on bank reserve positions.

Bank loans and investments. Aggregate loans and investments of commercial banks increased $4.5 billion or 3 per cent during 1955. A record loan expansion of $11.6 billion was offset in large part by a decline in bank holdings of United States Government securities,

as the accompanying table shows. The rate of growth of total loans and investments was about equal to that in 1953 but less than half as high as in 1954. In 1954 loans had increased only $3 billion but holdings of United States Government and other securities had increased more than $7 billion.

LOANS AND INVESTMENTS OF COMMERCIAL BANKS

[In billions of dollars]

Type of loan or investment	Outstanding, Dec. 31, 1955[p]	Increase, or decrease (−)		
		1955[p]	1954	1953
Loans and investments, total	160.2	4.5	10.2	4.1
U. S. Government securities	61.7	− 7.3	5.6	0.1
Other securities	16.5	0.2	1.6	0.5
Loans, total	82.0	11.6	2.9	3.4
Business	33.1	6.2	− 0.3	− 0.7
Real estate	20.8	2.4	1.7	1.0
Agricultural	4.4	− 0.8	0.2	1.0
Security	5.0	0.5	0.9	0.4
Consumer	12.7	2.0	− 0.2	1.5
Other	7.2	1.4	0.7	0.2

[p] Preliminary.

NOTE.—Data exclude interbank loans. Total loans are after, and types of loans before, deductions for valuation reserves. Consumer and "other" loans are partly estimated for all dates. Details may not add to totals because of rounding.

An expansion of more than 20 per cent or $6 billion in business loans accounted for about half of the growth in total bank loans in 1955. This expansion, the largest percentagewise since 1950, contrasted with declines in 1953 and 1954. About $1.3 billion of the growth during 1955 was in loans by city banks to sales finance companies, which were borrowing mainly to finance consumers and dealers in consumer durable goods. Banks also increased their loans to most other business groups, including the petroleum and chemical industries, public utilities, and the metal, textile, trade, and construction groups.

Business loans of commercial banks increased $2 billion in the first half of 1955, compared with declines in the corresponding period of the preceding three years. Seasonal repayments of bank loans by food processors and commodity dealers totaling $1 billion

were more than offset by increases in loans to most other groups of businesses. In the second half of the year the increase in business loans totaled about $4 billion as seasonal borrowers added their demands to the continued heavy demands of other groups.

Real estate loans of commercial banks expanded $2.4 billion during 1955. The 13 per cent rate of growth for the year was about the same as in the second half of 1954 and the highest for a full year since 1950. Expansion in 1955 reflected the purchase of mortgages on a temporary basis from insurance companies and other nonbank investors as well as substantial direct lending by banks. Late in the year real estate loans at city banks decreased somewhat, probably in part as a result of the resale of some mortgages previously acquired from nonbank investors under repurchase agreements.

In addition to lending a large amount to sales finance companies, commercial banks increased their own holdings of consumer loans $2 billion or almost 20 per cent. Such loans had changed little during 1954. A decline in agricultural loans of banks during 1955 reflected redemption of publicly issued Commodity Credit Corporation certificates of interest. Other agricultural loans increased. Security loans increased considerably less in 1955 than in the preceding year.

About two-thirds of the increase in commercial bank loans in 1955 was offset by sales of United States Government securities totaling $7.3 billion. The 10 per cent decline in holdings was the largest for a calendar year since 1946. About $5.7 billion of the reduction was in the first six months of the year, when the Treasury used a seasonal surplus to retire more than $5 billion of publicly held debt. During this period the Federal Reserve Banks were also selling securities, while nonbank investors were increasing their portfolios. Commercial banks reduced their Government security portfolios further in the second half of the year despite the seasonal increase in the public debt. Bank holdings of Government securities had changed little in the first half of 1954 and increased $5.5 billion in the second half.

Most of the reduction in bank holdings of United States Government securities was in short-term issues. Securities maturing within one year, which had been reduced from 45 to 25 per cent of bank portfolios during 1954 largely as the result of Treasury refunding

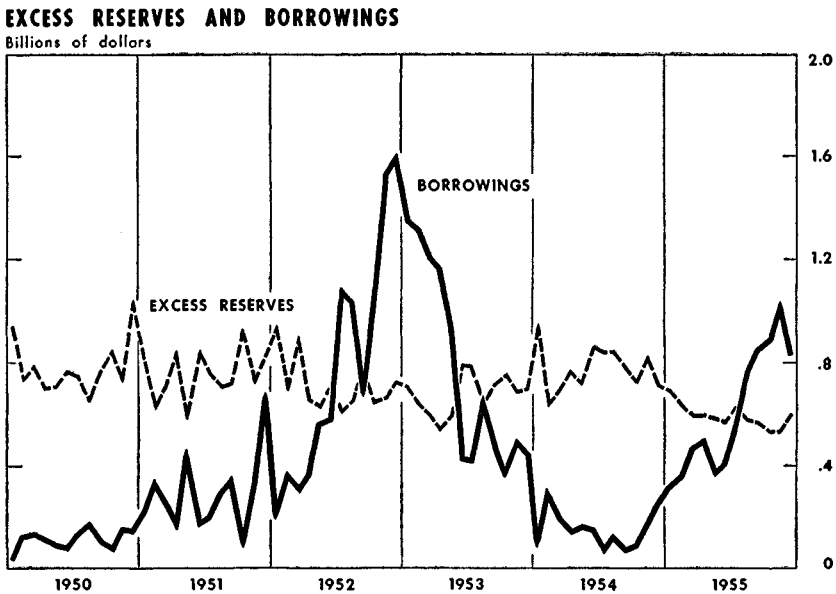
operations, had declined to about 15 per cent of their portfolios by the end of 1955. The decrease in holdings of short-term securities reduced bank liquidity and thus tended to discourage further bank sales of securities in order to expand loans.

Commercial bank holdings of corporate and State and local government securities changed little in 1955. During 1954 banks had made net purchases of tax-exempt State and local government securities totaling nearly $2 billion.

Although all classes of banks sold securities during the year, the reduction in holdings was particularly great on the part of New York City banks, which lost deposits to reserve city and country banks and also met a heavy loan demand. New York central reserve city banks reduced their holdings of United States Government securities almost 30 per cent during 1955, compared with an increase of 20 per cent in 1954. The reduction in holdings of Government securities by country banks was moderate. New York banks also reduced their holdings of securities other than United States Government securities, while country banks purchased such securities on balance.

Bank reserve positions. Sales of securities by commercial banks during 1955 were in response to the growing pressure on bank reserve positions associated with the change from ease to restraint in Federal Reserve policy. Reserve positions, which had become less easy late in 1954, were under gradually increasing pressure in the first quarter of 1955. They changed little in the second quarter. Free reserves of member banks—that is, excess reserves less indebtedness to the Federal Reserve Banks—declined from an average of $600 million in the fourth quarter of 1954 to $150 million in the second quarter of 1955. After midyear reserve positions came under further restraint, and in the fourth quarter borrowings exceeded excess reserves by about $350 million.

The growing pressure on bank reserves was reflected primarily in an increase in member bank borrowing but also in some reduction in excess reserves, as shown in the accompanying chart. Member bank indebtedness to the Federal Reserve Banks, which had averaged somewhat more than $150 million in the fourth quarter of 1954, exceeded $400 million in the second quarter of 1955. The bulk of the borrowing at this time was on the part of reserve city and country banks. In November average indebtedness to the



NOTE.—Data are monthly averages of daily figures of reserve balances held in excess of requirements and of borrowings at Federal Reserve Banks by all member banks.

Federal Reserve Banks reached a total of more than $1 billion, the largest volume since the spring of 1953. Although borrowing declined in December, the average for the fourth quarter exceeded $900 million. Increases in aggregate indebtedness after midyear reflected mainly borrowing by central reserve city banks and reserve city banks. Excess reserves declined from $750 million in the fourth quarter of 1954 to $550 million in the corresponding period of 1955.

Changes in bank reserve positions reflected the effects of Federal Reserve open market operations in United States Government securities together with other factors affecting reserves, as shown in the table on page 28. In general, open market operations offset the effects of major seasonal changes in currency in circulation and in required reserves, although reserve positions were permitted to come under increasing pressure over the year. Federal Reserve security purchases at the year-end, largely under repurchase agreements with dealers and brokers, were primarily for the purpose of relieving money market pressures at that time.

The Federal Reserve portfolio of United States Government securities declined somewhat over the year, but the increase in cur-

CHANGES IN MEMBER BANK RESERVES WITH RELATED FACTORS

[Based on monthly averages of daily figures; in billions of dollars]

Item	6 months		Year	
	June 1955—Dec. 1955	Dec. 1954—June 1955	Dec. 1954—Dec. 1955	Dec. 1953—Dec. 1954
Member bank reserves				
Total reserves	+ 0.5	− 0.6	(1)	− 0.6
Excess reserves	(1)	− 0.1	− 0.1	(1)
Required reserves	+ 0.5	− 0.4	+ 0.1	− 0.7
Effect of:				
Reduction in reserve requirement percentages	.....	.....	.....	− 1.6
Change in deposits	+ 0.5	− 0.4	+ 0.1	+ 0.9
Principal factors affecting reserves	(Signs indicate effect on reserves)			
Currency in circulation	− 1.2	+ 0.7	− 0.5	+ 0.2
Treasury operations	− 0.1	+ 0.1	+ 0.1	+ 0.2
Gold stock and foreign accounts	(1)	(1)	(1)	− 0.3
Federal Reserve float	+ 0.5	− 0.1	+ 0.4	(1)
Other factors	− 0.1	(1)	− 0.1	(1)
Federal Reserve loans and investments:				
U. S. Govt. securities, total	+ 1.0	− 1.3	− 0.3	− 0.7
Bought outright	+ 0.7	− 1.3	− 0.6	− 0.3
Held under repurchase agreements	+ 0.3	(1)	+ 0.3	− 0.4
Discounts and advances:				
To member banks	+ 0.4	+ 0.2	+ 0.6	− 0.2
To others	− 0.1	− 0.1	− 0.2	+ 0.2
Acceptances	(1)	(1)	(1)	(2)

[1] Less than $50 million.

[2] No acceptances held.

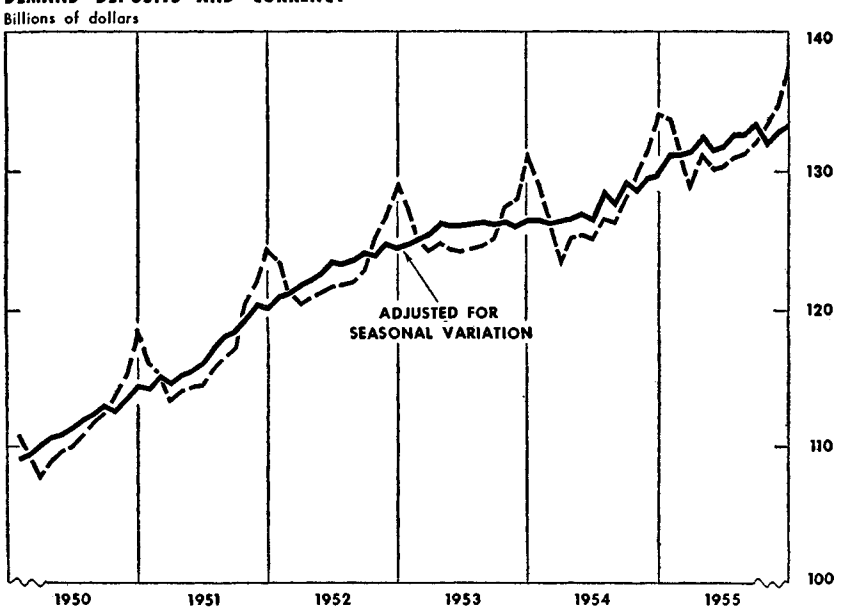
NOTE.—Details may not add to totals because of rounding.

rency in circulation was the largest drain on reserves. Required reserves increased only slightly, as the effect of an expansion of demand and time deposits held by consumers and businesses was offset in part by a decline in United States Government deposits and a shift of deposits from banks with higher reserve requirements to those with lower reserve requirements. Federal Reserve float was somewhat larger during 1955 than a year earlier, and an unusually large seasonal increase in December temporarily supplied a substantial volume of reserves near the year-end.

Deposits and currency. The growth of deposits and currency declined in 1955 from the rapid rate reached in the second half of 1954, when banks were using available reserve funds to expand holdings of securities. During 1955 demand deposits and currency held by consumers and businesses, which together constitute the active part of the money supply, increased $3.2 billion or 2.5 per cent. The expansion was somewhat less than that for 1954 as a whole, and the rate of growth was only about half the annual rate reached in the second half of that year, after allowance for usual seasonal developments. The active money supply had also increased about 2.5 per cent in the period of strong credit demand from mid-1952 to mid-1953, as shown in the chart.

DEMAND DEPOSITS AND CURRENCY

Billions of dollars



NOTE.—Figures are for last Wednesday of month and are partly estimated. Demand deposits are for all banks in the United States and exclude U. S. Government and interbank deposits and items in process of collection. Currency excludes bank vault cash. Data for second half of 1955 are preliminary.

Demand deposits held by consumers and businesses increased $2.6 billion and currency expanded $0.6 billion during 1955. In 1954 the increase in demand deposits had been greater, but currency holdings of consumers and businesses had declined.

While expansion of the active money supply was moderate, an increase in its turnover contributed to the rising level of expenditures. The annual rate of turnover of demand deposits outside New York City rose from 21.1 in the last quarter of 1954 to 22.5 in the last quarter of 1955, an increase of almost 7 per cent. Most of the increase was in the first half of the year.

Expansion of time and savings deposits in commercial and mutual savings banks and the Postal Savings System in 1955 was $3 billion,

CHANGES IN DEPOSITS AND CURRENCY WITH RELATED FACTORS

[In billions of dollars]

Item	1955	1954
Deposits and currency		
Demand deposits adjusted[1]	+ 2.6	+ 4.1
Currency outside banks[2]	+ 0.6	− 0.2
Total	+ 3.2	+ 3.9
Time deposits adjusted[3]	+ 3.0	+ 4.9
U. S. Govt. deposits	− 0.7	+ 0.3
Total	+ 5.5	+ 9.0
Factors affecting deposits and currency	(Signs indicate effect on deposits and currency)	
Bank loans and investments other than U. S. Govt. securities	+14.2	+ 7.3
Commercial	+11.8	+ 4.6
Mutual savings	+ 2.3	+ 2.5
Bank holdings of U. S. Govt. securities	− 7.9	+ 3.9
Federal Reserve	− 0.1	− 1.0
Commercial	− 7.3	+ 5.6
Mutual savings and other	− 0.6	− 0.7
Gold stock and foreign deposits at Federal Reserve Banks	+ 0.1	− 0.4
Foreign bank deposits, net, at commercial banks	(4)	− 0.6
Other factors[5]	− 0.9	− 1.2

[1] Excludes interbank and U. S. Government deposits and items in process of collection.

[2] Excludes bank vault cash.

[3] Commercial and mutual savings banks and the Postal Savings System. Excludes interbank and U. S. Government deposits.

[4] Less than $50 million.

[5] Includes bank capital, miscellaneous bank assets and liabilities, and differences between deposits due to and from banks.

NOTE.—Changes are based on data for Dec. 31, 1953 and 1954, and on preliminary data for Dec. 31, 1955. Figures may not add to totals because of rounding.

only about three-fifths as much as a year earlier. Reduction in the rate of growth was associated in part with less personal saving and more security purchases by individuals. The reduction was concentrated at commercial banks, where savings deposits increased less than half as much as in 1954. Deposit growth at mutual savings banks was almost as large as in the preceding year, probably in part because of increases in interest rates paid by savings banks in some areas.

United States Government deposits declined $700 million during 1955, compared with a small increase in 1954. These deposits fluctuated sharply over the year in accordance with the pattern of Treasury receipts and expenditures.

ECONOMIC AND FINANCIAL DEVELOPMENTS ABROAD

Worldwide increases in economic activity in 1955 brought world production to record levels. In the industrial countries heavy demands were made on manpower resources, and in many lines of manufacturing and mining the rate of output required virtually full use of existing plant capacity. Credit restraints were needed to keep the growth of demand within the limits of productive capacity, to restrain the rise of prices, and to protect monetary reserves.

Steady advances since 1953 in European employment and productivity, and in consumer income and demand, had led to rising expenditures for enlargement of European industrial capacity. Such expenditures were apparently still increasing in the second half of 1955, when capital expenditure plans and outlays in the United States were rapidly mounting. In response to enlarged investment demands, European production of steel and of capital goods continued to grow throughout 1955, within the limits set by the available productive resources.

Most European countries experienced an exceptional spillover of domestic demand into buying of imports for several months at the end of 1954 and the beginning of 1955. United States exports responded vigorously to this rise in trade activity, with especially large increases in sales of steel, steel scrap, and coal. Subsequently, world trade remained at a record level, but expanded little through the summer. By the autumn of 1955, broadened pressure of world demand led to a further expansion of United States exports and at the same time United States imports rose very strongly.

European prices of scrap steel, copper, and rubber reacted somewhat by April or May from earlier peaks. In June and July, however, and also toward the end of the year, world prices of various industrial materials increased sharply again.

Prices of industrial products as well as materials tended to rise in 1955, but further advances in prices of industrial products after midyear were smaller on the average in Europe than in the United States. On both sides of the Atlantic consumer prices tended to rise, though only slowly in most countries. Wage rates, however, continued to rise rapidly in many European countries, and in some countries appeared to be outrunning the gains in manhour productivity. In other parts of the world domestic price levels rose a little in many countries, but increases of more than a few per cent were uncommon.

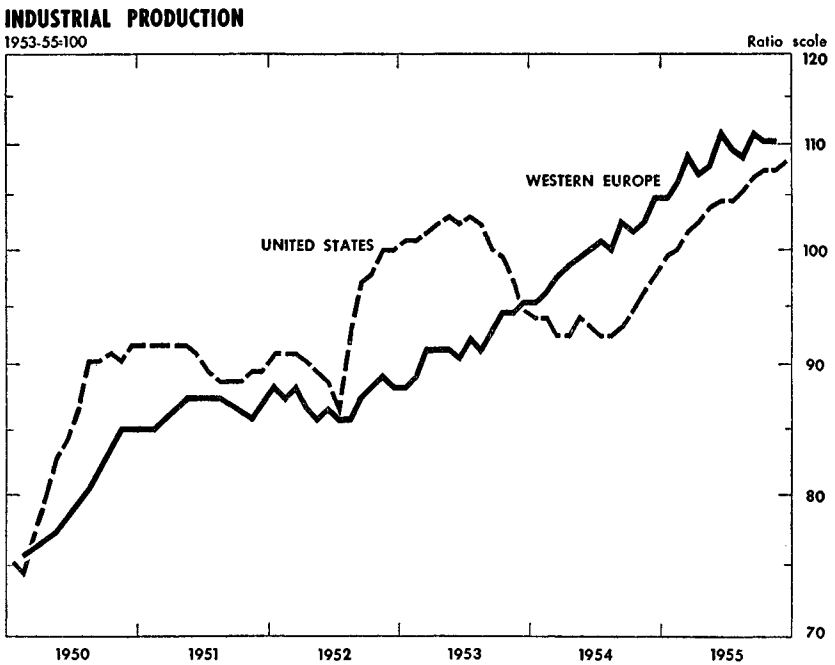
Moderation in the expansion of business and consumer credit, especially of credit provided through bank loans and investments, was the object of central bank and government action in many countries. Strong restraints were being enforced in several leading countries in Europe and elsewhere by autumn.

Despite the difficulties that Great Britain and some other countries experienced with their external payment balances in 1955, the degree of freedom of international trade from direct controls was generally greater at the end of the year than at the beginning. In the course of the year a number of important steps toward convertibility of currencies were taken by the Organization for European Economic Cooperation and by individual countries in Western Europe. At the same time, the expansion of United States imports, which percentagewise was even more marked for manufactured goods than for most materials, demonstrated anew that the structure of international payments has remained favorable for further advances toward convertibility.

Western Europe. Total industrial production advanced continuously through the year, but as the margin of unutilized manpower and industrial capacity diminished, the rate of increase in output slowed. The year-to-year increase narrowed from 10 per cent in the first quarter of 1955 to 7 per cent in the fourth quarter. Seasonally adjusted indexes show that from May to the end of the year no significant enlargement of total industrial production occurred

in Great Britain, while Continental output advanced at a reduced average rate under 5 per cent per annum.

The most rapid gains in output, both of capital goods and of consumer goods, were those of West Germany. Production increased rapidly also in France and Italy.



NOTE.—Seasonally adjusted figures for physical volume of production. Federal Reserve data for United States, monthly. Organization for European Economic Co-operation index for Western Europe, covering member countries, quarterly through 1951 and monthly thereafter, shifted to 1953-55 base; October and November 1955 partly estimated by Federal Reserve.

Consumer prices increased 2 per cent over the year in Germany, 1 per cent in France, and 6 per cent in Britain. These increases were due less to advances in prices of nonfood manufactured goods than to rising prices of services and of domestically produced foods; in Britain upward adjustments of fuel prices were also significant.

An effective brake on internal price advances was provided by the relatively liberal exchange control policies of all leading European countries in 1955. Belgium, the Netherlands, Switzerland, and Greece had few direct restrictions on imports. Restrictions in other countries on imports from the dollar area and other sources were

further relaxed in a number of cases, including cuts in German restrictions on dollar imports and in British restrictions on imports from the rest of Europe.

Positive measures to resist inflationary pressures, and to obtain relief from balance-of-payments difficulties by restraining the growth of demand, were taken in a number of countries.

The Bank of England's discount rate was raised in January and February from 3 per cent to 4½ per cent. Loans of British commercial banks continued to rise until midyear. In July credit restrictions were intensified and banks were asked to reduce their loans. An extraordinary budget was adopted in the autumn; certain taxes were increased, more than offsetting the tax reductions made in the spring, and actions were taken to reduce Government subsidies for public housing and Government loans to local authorities. By the year-end, although industrial prices had risen about 5 per cent, bank loans including nonindustrial credit were reduced to about the end-of-1954 level.

In May the German central bank was enabled to undertake restrictive open market operations by obtaining a large issue of marketable Government securities in exchange for previously nonnegotiable obligations. In August the discount rate was raised, and reserve requirements for commercial banks were increased as of the first of September. German tax revenues continued greatly to exceed governmental expenditures in 1955, despite tax reductions at the beginning of the year. In Austria, the discount rate was raised in May and again in November.

In Sweden and Norway, discount rates were raised early in the year and new Government bond issues at higher interest rates absorbed liquid funds of banks and other lenders; subsequently, the banks agreed to limit their loans. Taxes on investment were increased. In Denmark, where measures to reduce consumer demand and credit expansion had already been taken in 1954, consumption taxes were further increased in 1955 and the rediscount rate was raised again in May. Besides these financial measures, in each Scandinavian country the licensing of building was made more restrictive.

In France, Italy, and the Netherlands, it was not considered necessary to take formal measures to restrain credit expansion. The Netherlands, like Germany, reduced consumption taxes to hold

down the cost of living. In these countries, as in most other countries on the Continent, general stability of prices was maintained.

Important steps toward currency convertibility in 1955 included simplification of Belgian and Italian exchange controls affecting accounts of nonresidents. The Organization for European Economic Cooperation reached agreement on a European Fund to be brought into being when formal convertibility is established, meanwhile extending the European Payments Union for another year with a larger gold-payment requirement for monthly settlements.

Other areas. Canadian manufacturing activity, which had turned up near the end of 1954 after a mild recession in 1953-54 like that in the United States, increased 10 per cent in the course of the year. Canadian output of minerals continued its rapid growth, uninterrupted since 1949. In Japan, where a brief recession in 1954 had been reversed by rising exports before the end of that year, industrial production rose more than 10 per cent further during 1955. Japanese food prices were reduced toward the end of the year, after a harvest of exceptionally large crops. In both countries exports rose during 1955.

Central bank and budgetary policies in Canada were expansionary in the first half of the year, but shifted thereafter to restraint. Bank loans expanded rapidly and banks had to sell Government securities to nonbank holders. In Japan, on the other hand, commercial bank liquidity increased as a result of a large balance-of-payments surplus.

Developments in India followed a significantly different pattern from those in Canada and Japan. Following bumper crops in 1953, heavy Government importation of rice in 1954, and large gains in the 1954 crops of nonfood agricultural products, Indian wholesale prices of foods and raw materials fell sharply throughout 1954 and the first half of 1955. Industrial output, which had risen 14 per cent in the course of 1954, leveled off for several months in the first half of the year, when textile inventories were reduced. In consequence of growing Government expenditures for economic development and an increase in the budgetary deficit, the central bank enlarged its holdings of Government securities. Business activity and prices turned up again in the second half of the year.

In countries producing raw materials and foodstuffs for export,

developments depended partly on the degree of strength of world demand for the commodities produced.

Large increases in metal prices in 1955, reflecting strength in demand from many sources, stimulated plans for further enlargement of output in later years. Prices of natural rubber nearly doubled. On the other hand, coffee and tea prices declined in the first part of the year, and cocoa throughout the year. Export prices for wheat and sugar continued relatively stable, despite large world supplies. Export prices for rice in Southeast Asia, after declining sharply throughout 1954, tended to level off in the first half of 1955.

Cotton prices declined in some countries. While demand for United States price-supported cotton was depressed by anticipations of export sales at lower prices in 1956, there were increases in the cotton exports of some producers. For wool and for fats and oils, both supply and demand grew moderately and prices weakened partly in consequence of the competition of synthetic substitutes.

Internal inflationary pressures were present in many countries, even where export prices declined, but in many cases such pressures were successfully resisted. To help maintain price stability and check a rise in imports, New Zealand, for example, increased reserve requirements for commercial banks and raised the discount rate sharply in three steps from 4 to 7 per cent. Australia, however, faced with similar problems in its balance of payments, relied mainly on regulation of imports by quotas; despite some slackening in the expansion of bank credit, Australian prices rose several per cent.

In Latin America, increases in Governmental development expenditures occurred in many countries, including Mexico, Venezuela, Cuba, Colombia, and Peru. In the first two of these surplus revenues were anticipated, but many countries had Government deficits financed through the banking system. The extensive rise in Mexican prices following the 1954 devaluation of the peso appeared to be somewhat slower in 1955. In most other countries with convertible currencies a fair degree of price stability was maintained.

On the other hand, efforts to check inflation in Brazil, which had some degree of success in the first part of the year, later appeared to have been relaxed. Depreciation of the Argentine peso was recognized in an official adjustment of exchange rates. In Chile and Bolivia, virtually the only countries in the world experiencing

continuous rapid inflation over the past few years, internal and external depreciation in currency values continued.

International trade and the balance of payments. In world trade, as in production, expansion was most rapid in the latter part of 1954 and the first months of 1955, and more gradual thereafter. This change reflected mainly a tendency toward stabilization of European purchases of imports at a high level, while imports of the United States and Canada continued to rise rapidly. Similar mixed tendencies appeared in other areas. After a two-year rise, imports of Australia and New Zealand leveled off in 1955. In a number of other countries producing and exporting raw materials, imports turned gradually up after earlier declines.

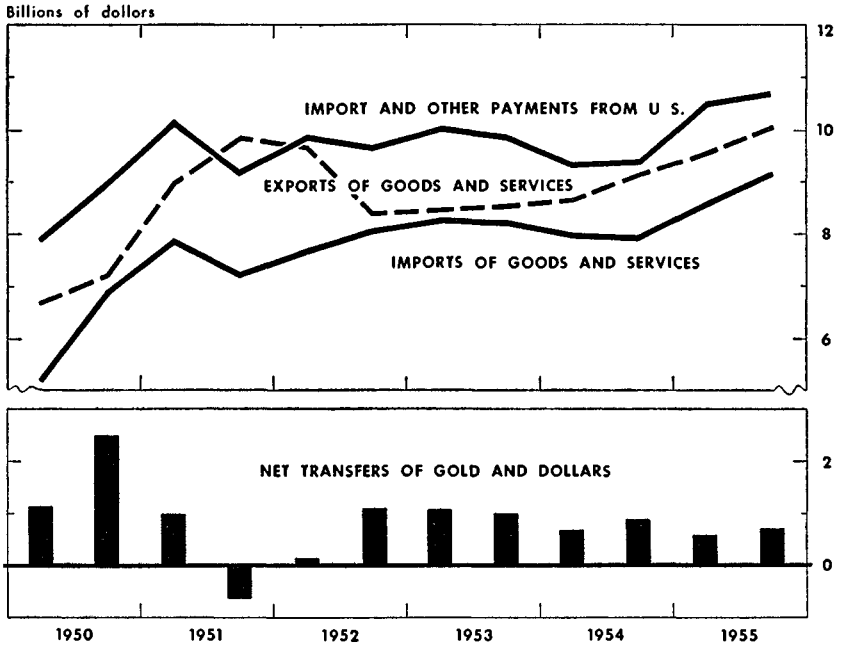
In Europe several countries experienced steady gains in exports, and, after the summer, trade deficits shrank in Scandinavia while Germany's export surplus widened again. France's trade balance improved in 1955. Great Britain's trade deficit was larger throughout the year than in 1954; although exports increased, imports remained relatively high, except for a brief period in the spring.

United States balance of payments. United States imports and exports both showed great strength in 1955. The current account surplus on transactions in goods and services was relatively steady. In the second half of the year, exports of goods and services (excluding military-aid transfers) were at a seasonally adjusted annual rate of about $20 billion, while imports of goods and services exceeded a rate of $18 billion.

For the whole year 1955, exports of goods and services totaled about $19.5 billion and imports more than $17.5 billion. The current account surplus, after deduction of $600 million in payments for remittances and pensions, was about equal to the 1954 surplus of $1.3 billion. Exports and imports each exceeded the 1954 totals by more than $1.5 billion.

Payments for goods and services in 1955 included military expenditures abroad a little larger than the $2.6 billion spent in 1954. Most types of United States military expenditures abroad continued roughly proportional to the strength of United States forces abroad. Expenditures in Europe for offshore procurement of military equipment for transfer to other countries under aid programs increased, and constituted about one-fourth of the total in 1955. At the year-

U. S. BALANCE OF PAYMENTS



NOTE.—Semi-annual aggregates; Department of Commerce data; second half 1955 partly estimated by Federal Reserve. Payments shown include civilian and military payments for goods and services, plus the net outflow of remittances, Government nonmilitary grants and loans, and private U. S. direct investment. Other capital movements are not included. Exports exclude military transfers under aid programs. Net transfers cover gold sales or purchases by United States and changes in foreign short-term assets in United States and in holdings of U. S. Government securities; positive figures represent transfers to foreigners.

end outstanding contracts for offshore procurement in Europe were due to be entirely fulfilled in about two more years.

United States Government grants and credits to other countries, other than aid given in the form of military supplies and services, exceeded $2 billion in 1955, compared with $1.5 billion in 1954. This outflow included moderate increases in the Government's holdings of foreign currencies arising from sales of surplus agricultural commodities. Payments on grants to Europe declined after the first quarter of the year.

The outflow of private American direct investment capital continued at close to the 1948-54 average rate of $700 million. The net outward movement of private American portfolio and short-term capital was much smaller than in 1954. Interest rate differen-

tials until near the end of the year continued to encourage Canadian repayment of indebtedness in the United States.

Foreign reserves. Foreign holdings of United States Government securities and of short-term dollar balances again increased substantially. The rise, together with small purchases of gold from the United States, was approximately $1.3 billion, compared with $1.6 billion in 1954. Including gold from new production and from other sources, total gold reserves and dollar holdings of foreign countries (other than the U.S.S.R.) and of international institutions increased about $1.9 billion in 1955.

Increases in gold reserves and foreign exchange holdings were especially large in France, Germany, Italy, Mexico, and Venezuela. In many countries changes either upward or downward were relatively small. A few South American countries, however, experienced heavy drains on their reserves, and large declines in holdings of sterling reserves occurred in Australia, South Africa, and New Zealand. In Europe the only large fall in gold and dollar holdings was that of Great Britain. This drain resulted partly from the deficit in British trade transactions and partly from adverse capital movements, which were halted in the autumn.

LOAN GUARANTEES FOR DEFENSE PRODUCTION

Under the provisions of the Defense Production Act of 1950 as amended and the implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private financing institutions to finance and expedite production for national defense, also to finance contractors and subcontractors in connection with or in contemplation of termination of their defense contracts. The guaranteeing agencies are the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, the General Services Administration, and the Atomic Energy Commission.

The present program is a reactivation of the V-loan program utilized during World War II. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies in receiving applications and in the making of such contracts of guarantee.

During 1955 the guaranteeing agencies authorized the issuance of 44 guarantee agreements amounting to $75 million. On December 31, 1955, guarantee agreements outstanding covered credits

totaling $464 million, of which amount $294 million represented loans actually outstanding and $170 million was available to borrowers under guarantee agreements in force. During the year more than $931 million was advanced on V-loans, most of which are revolving credits.

Of the total number of loans authorized more than 56 per cent were for amounts under $500,000 and more than 72 per cent were for amounts under $1 million. More than 72 per cent of the number of guarantees authorized are to concerns employing under 500 persons.

From the beginning of the program in September 1950 through December 31, 1955, 1,411 loans totaling $2,575 million were authorized by the guaranteeing agencies.

The net income received by the guaranteeing agencies to the end of 1955 represented by guarantee fees, commitment fees, and interest on purchased loans amounted to approximately $23 million after deducting the expenses of the Federal Reserve Banks as fiscal agents and providing reserves to cover estimated losses.

BANKING OPERATIONS AND STRUCTURE

Bank earnings and profits.[1] For the year 1955 member banks reported $2,075 million of net current earnings before income taxes, $247 million more than in 1954. Net profits after taxes, however, were $112 million lower than in the previous year because of a substantial decline in profits on sales of securities. The ratio of net profits to average total capital accounts decreased from 9.3 to 7.9 per cent.

Gross current earnings were $509 million larger than in 1954, and expenses were up $262 million. Earnings on loans rose $364 million and on United States Government securities $51 million. The average rate of return on loans advanced from 4.71 to 4.76 per cent and on United States Government securities from 1.96 to 2.09 per cent. Average total holdings of loans increased $7 billion, holdings of obligations of States and political subdivisions increased $1 billion, and holdings of United States Government obligations declined about $1 billion. Taxes on net income declined $113 million. The accompanying table gives a summary of earnings, expenses, and profits of member banks for 1955 and 1954.

[1] Figures for 1955 are based on preliminary tabulations.

EARNINGS, EXPENSES, PROFITS, AND DIVIDENDS OF ALL MEMBER BANKS, 1955 AND 1954

[In millions of dollars]

Item	1955[p]	1954
Earnings	5,335	4,826
On U. S. Govt. securities	1,117	1,066
On loans	3,075	2,711
All other	1,143	1,048
Expenses	3,261	2,999
Net current earnings before income taxes	2,075	1,828
Net losses, charge-offs, and transfers to valuation reserves	400	+73
Profits before income taxes	1,165	1,900
Taxes on net income	691	804
Net profits	984	1,096
Cash dividends declared	501	456

[p] Preliminary; final figures will appear in the *Federal Reserve Bulletin*, probably in the May issue.

Approximately $501 million or 51 per cent of 1955 net profits was paid out as dividends to stockholders; this amounted to a return on average total capital accounts of 4.0 per cent compared with 3.9 per cent in 1954. Earnings retained in capital accounts were $483 million, in contrast with $640 million in 1954 when unusually large profits on sales of securities contributed heavily to net profits.

Bank earning assets.[2] Earning assets of member banks at the year-end were $135 billion, $4 billion larger than the year before. An increase of $11 billion in loans was partly offset by a decline of $7 billion in holdings of United States Government securities; obligations of States and political subdivisions continued to increase but by a lesser amount than in 1954.[3]

Commercial and industrial loans, after declining for two consecutive years, increased $6 billion and accounted for over half the total increase in loans by member banks. The next largest increase, $2 billion, was in loans to individuals for household, family, and other personal expenditures, which had changed relatively little

[2] Figures for 1955 are partly estimated.

[3] These year-end comparisons of holdings of earning assets differ considerably from the changes in average holdings during the year given under bank earnings and profits.

during 1954. According to sample data by industry groups, the large increase in commercial and industrial loans resulted from increased borrowing by all major classifications of business, but sales finance companies accounted for about one-quarter of the increase.

Capital accounts.[3] Capital accounts of member banks amounted to $12,700 million, an increase of $500 million during the year. Retained earnings accounted for approximately $483 million of the increased capital and proceeds from sales of common stock accounted for most of the balance; lesser factors were mergers and changes in Federal Reserve membership.

The ratio of average total capital accounts to average total assets for all member banks was 7.3 per cent, a slight increase from 1954.

The ratio of average total capital accounts to average total assets less cash assets and United States Government securities was 15.4 per cent as compared with 16.1 per cent for 1954; this decline reflected the increased holdings of loans and substantial decreases in holdings of United States Government securities during the year.

Number of banking offices. For the twelfth consecutive year the number of banking offices increased. The number of banks (head offices) continued the decline of recent years, reflecting bank consolidations and absorptions. The number of branches continued to increase, both by conversion of merged banks into branches and by establishment of de novo branches.

There was a net decline of 124 banks during the year. New banks opened for business numbered 117, but this increase was more than offset by consolidations or absorptions of 232 banks, 205 of which were converted into branches. Table 18 on page 79 gives a statistical analysis of the changes in the number of banks and branches.

The number of branches and additional banking offices increased by a net of 624; this was 105 more than the record increase reported in 1954. As in other recent years, most of the increase was in de novo branches, of which 462 were established in 1955. Approximately 70 per cent of the increase in branches occurred in places outside the cities in which the parent banks are located. California and Pennsylvania had the largest branch increases, with

[3] Figures for 1955 are partly estimated.

89 and 78, respectively. (The figures for branches exclude 213 banking facilities at military and other Government establishments, an increase of 15 during the year.)

Federal Reserve membership. The 6,543 banks that were members of the Federal Reserve System at the end of 1955 accounted for 48 per cent of the number and held 85 per cent of the deposits of all commercial banks in the United States. State member banks accounted for 21 per cent of the number of all State commercial banks and held 68 per cent of the deposits of these banks.

The membership of 4,692 national banks and 1,851 State member banks reflected net declines for the year of 97 and 20, respectively. The continued decline in the number of member banks was largely the result of consolidations and absorptions; branch offices were opened in the former locations of most of these banks. Other declines included two State members that withdrew from membership and three national banks that converted into nonmember banks.

Newly established banks included 28 national and 4 State members. Sixteen nonmember banks were admitted to membership and 6 banks became members by conversion from nonmember to national banks.

Par and nonpar banks.[4] During 1955, 124 banks were added to the Federal Reserve Par List, 3 withdrew from the Par List, and 219 par banks were consolidated with or absorbed by other par banks. Of the additions, 19 were formerly nonpar banks that chose to remit at par, 101 were newly organized banks, and 2 were formerly nonpar banks admitted to membership in the Federal Reserve System. The number of par-remitting and nonpar offices at the end of 1955 is shown below:

	On Par List	Not on Par List
Banks (head offices)	11,855	1,770
Branches	6,375	325
Banking facilities at military and other Government establishments	212	1
Total	18,442	2,096

[4] This section refers only to banks on which checks are drawn and their branches and offices, including "banking facilities" at military and other Government establishments. The Federal Reserve Par List comprises all member banks, which are required under the law to remit at par for checks forwarded to them by the Federal Reserve Banks for payment, and such nonmember banks as have agreed to do so.

The par-remitting banks, representing 87 per cent of the banks on which checks are drawn, held about 98 per cent of the deposits of all commercial banks in the United States. All banks in 29 States and the District of Columbia were on the Federal Reserve Par List at the end of the year, and in each of 5 other States the number of nonpar banks was less than 10. Table 19 on page 80 shows the number of par and nonpar banking offices by States and Federal Reserve Districts.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the 12 Federal Reserve Banks and their 24 branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1955 program for the examination of State member banks was practically completed.

Bank holding companies. During 1955 the Board authorized the issuance of five voting permits for general purposes and eight permits for limited purposes to holding company affiliates of member banks.

To provide information with respect to such organizations, regular annual reports were obtained from holding company affiliates to which voting permits have been granted. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to 14 organizations.

Trust powers of national banks. During 1955, 46 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to 28 banks which previously had been granted certain trust powers. One additional national bank acquired trust powers as a result of consolidation. Trust powers of 51 national banks were terminated by voluntary liquidation, consolidation, or merger. At the end of 1955, there were 1,727 national banks holding permits to exercise trust powers.

Foreign branches and banking corporations. Under the provisions of Section 25 of the Federal Reserve Act, the Board approved during 1955 seven applications made by member banks for permission to establish branches in foreign countries. One member bank opened a branch in Beirut, Lebanon; another opened branches in Beirut, Lebanon; Jeddah, Saudi Arabia; Cairo, Egypt; and Caracas, Venezuela. The latter two branches had been authorized by the Board in 1954.

At the end of 1955, seven member banks had in active operation a total of 111 branches in 26 foreign countries and overseas areas of the United States. Of the 111 branches, three national banks were operating 85 and four State member banks were operating 26. The foreign branches were distributed geographically as follows:

Latin America	**56**
Argentina	10
Brazil	10
Chile	2
Colombia	4
Cuba	20
Mexico	2
Panama	4
Peru	1
Uruguay	1
Venezuela	2
Continental Europe	**6**
Belgium	1
France	3
Germany	2
England	**11**
Near East	**4**
Egypt	1
Lebanon	2
Saudi Arabia	1

Far East	**20**	**United States areas**	**14**
Hong Kong	1	Canal Zone	4
India	2	Guam	1
Japan	10	Puerto Rico	9
Philippines	5		
Singapore	1		
Thailand	1	**Total**	**111**

There was no change in 1955 in the list of corporations organized under State laws which operate under agreements with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. Of the four corporations in operation, one has no subsidiaries or foreign branches; one operates a branch in France; one has an English fiduciary affiliate; and one operates an agency at the New York International Airport, has a branch in England, and during 1955, pursuant to authorization by the Board, acquired the stock of a bank which was organized under the laws of Liberia.

During 1955 one corporation was chartered by the Board, under the provisions of Section 25(a) of the Federal Reserve Act, to engage in international or foreign banking, making a total of three such corporations in active operation at the end of the year. The head offices of these corporations are located in New York City; two of them were examined during the year by the Board's Division of Examinations. One such institution has no subsidiaries or foreign branches; one has a branch in France and an English fiduciary affiliate; and one operates branches in Germany, France (authorized by the Board and opened in 1955), and Singapore (authorized by the Board in 1953 and opened in 1955). The Board approved during 1955 an application by one of the institutions for permission to establish a branch in Lebanon.

In 1955, examiners for the Board of Governors examined the two European branches of the foreign banking corporations operating under agreement with the Board of Governors pursuant to the provisions of Section 25, the two European branches of the foreign banking corporations organized and operating under the provisions of Section 25(a), and seven European branches of three State member banks.

Inter-Agency Bank Examination School. During 1955, three five-week sessions of the School for Assistant Examiners and one

four-week session of the School for Examiners were held. The Inter-Agency Bank Examination School is conducted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. Since the Inter-Agency School was established in 1952, the various sessions have been attended by 465 men, representing the three Federal bank supervisory agencies, the State Banking Departments of Connecticut, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, New Hampshire, North Dakota, Ohio, Oklahoma, Oregon, and Virginia, the Treasury Department of the Commonwealth of Puerto Rico, and one foreign country.

CHANGES IN REGULATIONS OF THE BOARD OF GOVERNORS

Advances and discounts by Federal Reserve Banks. The Board's Regulation A, relating to advances and discounts by Federal Reserve Banks, was revised effective February 15, 1955. Although the revision made certain changes in the language of the Regulation itself, the most important change was a revision of the foreword to the Regulation, entitled "General Principles," so as to restate and clarify certain guiding principles which are observed by Federal Reserve Banks in making advances and discounts. The Board stated that the revision was not intended further to restrict or restrain access by member banks to the credit facilities of the Federal Reserve Banks.

Savings deposits. The Board's Regulation D, relating to reserves of member banks, and Regulation Q, relating to payment of interest on deposits, were amended effective May 16, 1955 so as to permit deposits to be classified as "savings deposits" in certain circumstances even though not evidenced by a passbook. A passbook continues to be necessary for all savings deposits except those covered by the amendments.

Collective investment of trust funds. Section 10(*c*) of the Board's Regulation F, relating to trust powers of national banks, was amended effective June 13, 1955 so as to permit the collective investment of funds of trusts which are established under employers' pension, profit-sharing, or stock bonus plans, without compliance with the provisions of Section 17 of the Regulation, provided each such trust is exempt from Federal income taxes and collective investment is specifically authorized by the trust instru-

ment or by court order. The funds of pensions and similar trusts may, as previously, be invested in participations in common trust funds operated pursuant to Section 17.

Margin requirements for purchasing securities. The Supplement to the Board's Regulation T, entitled "Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges," and the Supplement to Regulation U, entitled "Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange," were amended effective January 4, 1955 so as to increase margin requirements from 50 per cent to 60 per cent for credit extended by brokers and by banks to finance purchases of stock exchange securities. Effective April 23, 1955 the two Supplements were again amended so as to increase the margin requirements from 60 per cent to 70 per cent. The increased margins applied also to short sales.

CHANGES IN REGULATION OF THE FEDERAL OPEN MARKET COMMITTEE

Executive committee discontinued. The Federal Open Market Committee, comprising the seven members of the Board of Governors and five of the presidents of the Federal Reserve Banks, amended its regulation relating to open market operations of Federal Reserve Banks, effective June 22, 1955, so as to discontinue its executive committee, which was a standing committee consisting of three members of the Board and two Reserve Bank presidents. The executive committee, which was established following the Banking Act of 1935, was discontinued in view of the availability of more swift and certain travel facilities that facilitate the attendance of the members of the Federal Open Market Committee at regular meetings and make it possible to gather members for special meetings on short notice when necessary.

LEGISLATION

Defense Production Act of 1950. The Defense Production Act of 1950, which would have expired June 30, 1955, was extended one month by Joint Resolution, and was amended and continued in force until the close of June 30, 1956, by the Act of August 9, 1955. Section 301 of the Act is the basis for guarantees of loans for defense production.

Real estate loans by national banks. Section 24 of the Federal Reserve Act was amended by the Act of August 11, 1955 so as to permit national banks to make "conventional" real estate loans (not insured or guaranteed by the Federal Government) for periods up to a maximum of 20 years (instead of 10 years as previously) and so as to permit loans up to 66⅔ per cent of the value of the real estate instead of 60 per cent as previously. The new law requires loans with maturities in excess of 10 years to be amortized at a rate which would be sufficient to pay off the entire loan in 20 years.

The new law also increased from six months to nine months the permissible maturity of "construction loans" by national banks (that is, loans to finance the construction of residential and farm buildings which are not subject to the limitations applicable to real estate loans).

RESERVE BANK OPERATIONS

Volume of operations. Table 5 on page 65 gives the volume of operations in the principal departments of the Federal Reserve Banks for the years 1951-55. Checks handled continued their upward trend, exceeding the all-time high reached the previous year; discounts and advances were also substantially greater than last year. On the other hand, the volume of currency received and counted was slightly smaller than in 1954.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of each Federal Reserve Bank during 1955 are shown in detail in Table 6 on pages 66-67, and a condensed historical statement is shown in Table 7 on pages 68-69. The table on page 50 summarizes the earnings and expenses and the distribution of net earnings for 1955 and 1954.

Current earnings of $412 million in 1955 were 6 per cent less than in 1954, largely because of a lower average rate of interest and a smaller volume of holdings of United States Government securities. Earnings from discounts and advances were greater in 1955 than the year before, reflecting increases in the discount rate and a rise in the volume of discounts and advances. Current expenses of $110 million were about the same as in 1954. Current net earnings amounted to $302 million, a decrease of 8 per cent compared with 1954.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1955 AND 1954

[In thousands of dollars]

Item	1955	1954
Current earnings	412,488	438,486
Current expenses	110,060	109,733
Current net earnings	302,428	328,753
Additions to current net earnings	178	[1]527
Deductions from current net earnings	[1]443	661
Net deductions	265	134
Net earnings before payments to U. S. Treasury	302,163	328,619
Paid U. S. Treasury (interest on F. R. notes)	251,741	276,289
Dividends	17,712	16,442
Transferred to surplus (Sec. 7)	32,710	35,888

[1] Includes $482,000 of net profits in 1954 and $506 of net losses in 1955 on sales of U. S. Government securities.

Profit and loss additions and deductions were relatively small, leaving net earnings before payments to the United States Treasury at $302 million.

Statutory dividends to member banks amounted to $18 million, a rise of about $1 million over 1954 that reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital of the Federal Reserve Banks.

Payments to the United States Treasury as interest on Federal Reserve notes amounted to $251 million in 1955. This was 90 per cent of net earnings after dividends and allowances for building up surplus to 100 per cent of subscribed capital of those Banks whose Section 7 surplus was below that amount. These allowances are consistent with the provisions of the franchise tax when it was in effect; for 1955 allowances for bringing surplus up to subscribed capital were $4,739,000 for two Banks, and for 1954 they were $5,187,000 for three Banks. Total payments to the Treasury as interest on Federal Reserve notes since the policy of making such payments was begun in 1947 have amounted to $2,049 million.

The $33 million of net earnings remaining after dividends and payments to the United States Treasury were added to surplus account.

Holdings of loans and securities. Average holdings of United States Government securities during 1955 amounted to $23,891 million, $758 million less than during 1954. The average rate of interest on these holdings decreased slightly from 1.76 to 1.67 per cent. Average holdings of discounts and advances during 1955 were $666 million and approached the 1953 level; this was a reversal of the sharp decline in 1954. The average rate of interest on discounts and advances rose from 1.61 to 1.96 per cent, reflecting four increases in the discount rate to 2½ per cent. As mentioned elsewhere in this report, a change in System open market policy resulted in holdings of acceptances beginning March 31, 1955; these were the first acceptances purchased since 1951. The table below shows a comparison of average daily holdings and average interest rates on loans and securities held by the Federal Reserve Banks during the past three years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1953-55

[Dollar amounts in thousands]

Item and year	Total[1]	Discounts and advances	Industrial loans	Acceptances	U. S. Government securities
Average daily holdings:[1]					
1953	$25,438,684	$777,595	$3,185	.....	$24,657,904
1954	24,866,567	216,697	1,179	.....	24,648,691
1955	24,570,401	666,152	607	$12,422	23,891,220
Earnings:					
1953	r512,852	r15,276	121	.....	497,455
1954	438,359	3,479	43	.....	434,837
1955	412,303	13,085	24	216	398,978
Average rate of interest (per cent):					
1953	2.02	1.96	3.80	.....	2.02
1954	1.76	1.61	3.65	.....	1.76
1955	1.68	1.96	3.95	1.74	1.67

r Revised.

[1] Based on holdings at opening of business.

Foreign and international accounts. A further rise of $666 million occurred during the year in the Federal Reserve Banks' holdings of gold and dollar assets for foreign account. The rising tendency of recent years began early in 1952 and has continued since that time, with little interruption. Year-end holdings of $9.8

billion consisted of $5.7 billion of earmarked gold, $3.5 billion of United States Government securities, largely Treasury bills, approximately $400 million in dollar deposits, and about $125 million of miscellaneous securities.

The gold and dollar assets of the International Monetary Fund and the International Bank for Reconstruction and Development, held at the Federal Reserve Bank of New York, registered a comparatively slight gain, $66 million, to reach a total of $3.8 billion.

Accounts were opened by the central banks of two of the new independent Indochinese states.

New advances against gold were of relatively minor importance, this type of accommodation having declined substantially in recent years. One loan of $133 million outstanding at the beginning of the year was liquidated by October and new credit arrangements involved only a total of $28 million, of which $1 million was outstanding at the year-end. Loans on gold and commitments for such loans are ordinarily made to foreign monetary authorities to assist them in meeting seasonal dollar shortages or other shortages of a clearly temporary nature.

The Federal Reserve Bank of New York continued, in its capacity of depositary and fiscal agent, to extend various services to the International Bank for Reconstruction and Development and the International Monetary Fund. Also, as fiscal agent of the United States, it operated the United States Stabilization Fund pursuant to authorization and instructions of the Treasury Department. On behalf of the Treasury Department it continued the administration of the foreign assets control regulations pertaining to assets in the United States of Communist China and North Korea and their nationals, including transactions with those countries.

Bank premises. During the year the Board authorized the construction of new buildings for the Buffalo and Louisville Branches; the construction of additions to the Bank buildings at Baltimore, Charlotte, Minneapolis, Pittsburgh, and San Francisco; and the construction of a parking garage and security court adjacent to the Bank building at Atlanta.

FEDERAL RESERVE MEETINGS

The Federal Open Market Committee met on January 11, March 2, May 10, June 22, July 12, August 2, August 23, September 14,

September 26, October 4, October 25, November 16, November 30, December 8, and December 13, 1955, and the executive committee of the full Committee met frequently until it was abolished by action of the full Committee on June 22, 1955. Under the provisions of Section 12A of the Federal Reserve Act, the Federal Open Market Committee, which has responsibility for determining the policies under which the open market operations of the Federal Reserve Banks will be carried out, is required to meet in Washington at least four times each year. A record of the actions taken by the Committee on questions of policy will be found on pages 89-111 of this report.

A meeting of the Conference of Chairmen of the Federal Reserve Banks was held on December 1-2, 1955, and was attended by members of the Board of Governors.

The Conference of Presidents of the Federal Reserve Banks held meetings on February 28-March 1, June 20-21, and October 3, 1955, and the Board of Governors met with the Presidents on March 3, June 22, and October 4, 1955.

Meetings of the Federal Advisory Council were held on February 13-15, May 15-17, September 18-20, and November 13-15, 1955. The Board of Governors met with the Council on February 15, May 17, September 20, and November 15, 1955. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The accounts of the Board for the year 1955 were audited by the public accounting firm of Arthur Andersen & Co., whose certificate follows:

To the Board of Governors
of the Federal Reserve System:

We have examined the balance sheet of the Board of Governors of the Federal Reserve System as of December 31, 1955, and the related statement of income and expenses for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statement of income and expenses present fairly the financial position of the Board of Governors of the Federal Reserve System as of December 31, 1955, and the results of its operations for the year then ended, and were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Andersen & Co.

Washington, D. C.,
January 30, 1956.

Balance Sheet—December 31, 1955

Assets

Cash in Federal Reserve Bank of Richmond			$ 529,189.69
Petty cash			800.00
Miscellaneous receivables and travel advances			13,878.87
Stockroom and cafeteria inventories, at cost			18,255.15
Property and equipment:	At cost	Reserve for depreciation	
Land and improvements	$ 792,852.42	$ —	
Building	3,770,175.61	—	
Furniture and equipment	458,120.16	276,276.94	
Automobiles	15,388.36	15,220.59	
	$5,036,536.55	$291,497.53	4,745,039.02
			$5,307,162.73

Liabilities and Fund Balances

Accounts payable		$ 175,531.18
Employee Federal income taxes withheld		110,270.87
Accrued payroll		134,942.12
Fund Balances:		
Balance, December 31, 1954	$5,156,607.86	
Excess of expenses over income, per accompanying statement	(268,641.85)	
Fixed assets purchased, etc. (net)	(1,547.45)	
Balance, December 31, 1955	$4,886,418.56	
Represented by—		
Property and Equipment Fund		4,745,039.02
Operating Fund		141,379.54
		$5,307,162.73

Note—The Board provides for depreciation of furniture and equipment and automobiles, but depreciation of the building has not been recognized in the accounts inasmuch as the Board deems a provision for such depreciation as unnecessary since funds for replacement of the building will be obtained, when required, from outside sources.

Statement of Income and Expenses
For the Year Ended December 31, 1955

Income:	
Assessments against Federal Reserve Banks	$4,194,100.00
Bulletin sales	18,296.91
Other publications sales	16,368.34
Miscellaneous income	2,802.92
	$4,231,568.17
Expenses:	
Salaries	$3,192,745.93
Retirement and insurance contributions	330,234.46
Traveling expenses	233,088.05
Postage and expressage	53,437.06
Telephone and telegraph, including leased wire operations (net)	64,749.90
Printing and binding	183,629.36
Stationery and supplies	31,511.68
Equipment rental	22,888.95
Provision for depreciation	26,394.92
Books and subscriptions	13,239.92
Heat, light, and power	38,956.25
Repairs, maintenance, and alterations	15,529.32
Insurance	6,283.15
Consumer Finances Surveys	135,560.78
Talle Subcommittee project	52,374.30
Other survey and research projects	15,132.00
Legal and consultant fees and expenses	14,710.17
Security clearance investigations for Board employees	5,374.40
Audit expenses applicable to Board's accounts	2,500.00
Loss from operation of cafeteria (net)	46,829.88
Other	15,039.54
	$4,500,210.02
Excess of expenses over income	$ 268,641.85

Note—Salaries, and retirement and insurance contributions exclude approximately $71,600 and $7,600, respectively, which were charged direct to cafeteria operations.

In the foregoing statement of income and expenses, as reported on by Arthur Andersen & Co., "Other" expenses of $15,039.54 include an expenditure of $66.50 by the Board of Governors for cost of a luncheon at a meeting in connection with the Treasury Department's savings bond program.

The Board received the following reimbursements in 1955 for expenditures which it makes on a reimbursable basis:

Printing Federal Reserve notes	$4,224,898.88
Currency Redemption Division (Office of the Treasurer of the United States)	384,759.00
Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)	150,940.86
Leased wire service (telegraph)	276,786.44
Leased telephone lines	9,684.00
Miscellaneous	17,331.31

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In 1956 economic activity in the United States and abroad continued to expand and to generate upward pressures on prices as growing demands pressed against productive capacity in key industries. In this country consumer outlays for automobiles and homes gave way to business spending for plant and equipment as the principal expansive force in the economy. With output near capacity in industries producing basic materials and aggregate demands for goods and services mounting, prices at wholesale and retail rose throughout the year.

In view of these output limitations, rising prices, and the strength of demands, there was need for a close rein on the pace of credit and monetary expansion. Federal Reserve policy, therefore, continued to exert restraint while providing for seasonal bank credit requirements and for some increase in the monetary base. The degree of restraint was altered from time to time during the year in response to changes in the economic climate. Reserve Bank discount rates were raised in April and in August, advancing from 2½ to 3 per cent, and member bank borrowing from Reserve Banks showed a declining tendency during the year. The growth of the money supply amounted to $1.5 billion, or about 1 per cent. Deposit turnover rose sharply further.

Total debt increased less than in 1955, but demands for credit continued to be large relative to the supply of loanable funds and relative to demands in most earlier years. As a result, interest rates advanced considerably—to the highest levels, in fact, since the early 1930's. Business demands for funds were especially heavy. The increase in debt of consumers was less than in the previous year, and Federal Government debt was reduced.

In the latter part of the year there was some slackening in the growth of bank loans except for a temporary spurt in business loans toward the year-end. In securities and mortgage markets, however, demands for funds remained strong.

ECONOMIC BACKGROUND OF FEDERAL RESERVE POLICY

Growth in output and expenditures. The year began with resources of labor and materials intensively utilized and a limited potential for additional economic growth over the near term. Hence, expansion in total output of goods and services was not so great as in 1955, and pressure on prices continued.

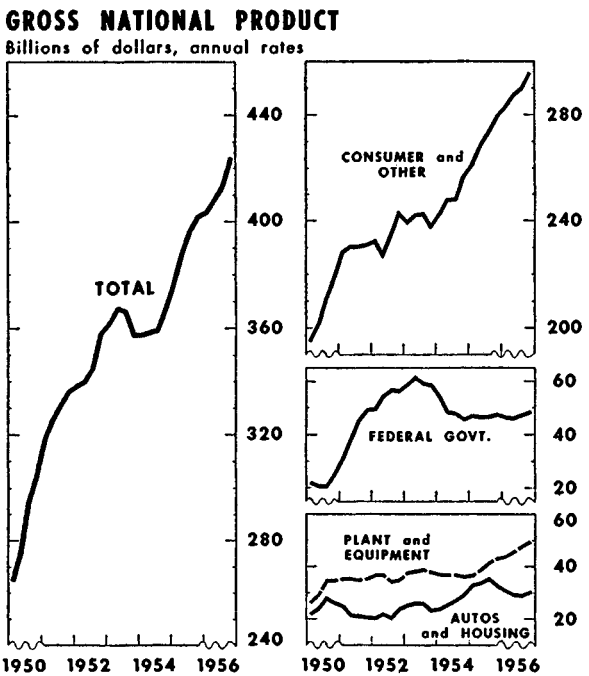
Gross national product in 1956, at $412 billion, was 5.5 per cent above 1955. Higher prices accounted for about half of the increase. The physical volume of agricultural output was up about 1 per cent and other output, including services, about 3 per cent. Employment rose further and unemployment remained at low levels. The average working week at factories exceeded 40 hours throughout the year.

The moderate expansion in total output and expenditures reflected offsetting changes in major components. Outlays for new housing and automobiles, which together had accounted for one-fourth of the 1955 growth of gross national product, fell $4 billion in 1956. This decline was more than offset by an increase in business plant and equipment expenditures of $6.5 billion, or one-fifth, which provided the major expansive force in the economy in 1956. Business inventories were accumulated at about the same rate as in 1955. Expenditures by consumers for services and nondurable goods and by State and local governments continued to expand.

Demands from abroad also contributed to domestic expansion in 1956. Exports of goods and services (excluding military grants) rose by one-sixth, and exceeded $23 billion. Rising exports reflected not only higher economic activity abroad but also larger foreign investments by United States business and Government programs to stimulate agricultural exports. Imports, which leveled off after the first quarter, were one-tenth greater than in 1955.

Although there were important shifts in the composition of total output, basic materials industries operated near capacity throughout the year and employment remained at high levels. In the case of steel, for example, output was at capacity levels during the entire year (except for strike interruptions) despite a decline of more than one-fourth in automobile production, which usually absorbs about one-fifth of steel output. In construction, employment rose further in 1956, despite a reduced level of home building, as other

forms of construction increased sharply. While productive capacity was not fully utilized in some areas, the intensive employment of materials and labor meant that still greater growth of total output, to the extent possible, could have been achieved only with larger increases in prices and costs than were actually experienced.

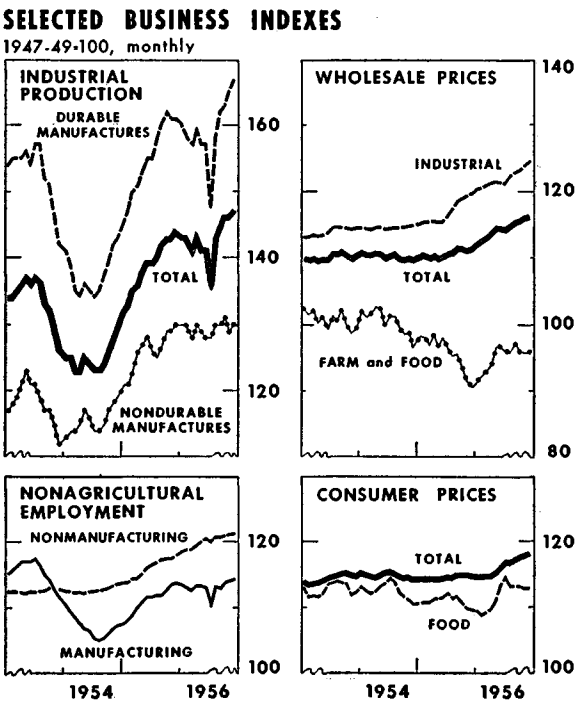


NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation. Consumer and other includes consumer purchases of goods and services other than autos and parts; State and local government purchases of goods and services; net foreign investment; and business inventory change. Plant and equipment includes producers' durable equipment and private nonresidential construction. Autos relate only to consumer expenditures for automobiles and parts.

Price and wage movements. The upward movement in prices that began in mid-1955 accelerated in 1956. Industrial commodity prices, which had increased 4 per cent in 1955, rose 4 per cent further. Agricultural prices, which had declined in 1955 as industrial prices advanced, rose in the first half of 1956 and in December were about 7 per cent above the level of a year earlier. Consumer prices,

which had shown little change until the spring of 1956, increased almost 3 per cent in the last nine months of the year.

The sharp expansion in demands for producers' equipment and nonresidential construction resulted in large increases in wholesale prices of metal products. Metals and metal products advanced 6 per cent and machinery and equipment prices increased 8 per



NOTE.—Seasonally adjusted series, except for prices. Bureau of Labor Statistics data for employment and prices, and Federal Reserve data for production. Industrial prices include those other than farm products and foods.

cent in the course of the year. Prices of steel mill products, which had been raised sharply in mid-1955, were increased again in mid-1956. At the end of the year they were nearly one-fifth higher than in the first half of 1955. Copper prices, however, turned down around midyear, after rising more than 50 per cent from early 1955.

The upward movement in prices reflected the immediate strength

of demands for finished goods and for services, which in turn was translated into active demands for manpower and other resources that enter into production costs. In these circumstances, wage increases were widespread. An increasing number of wage agreements covered periods of more than one year and incorporated cost-of-living escalator clauses and automatic annual wage increases. The increase in average hourly earnings in manufacturing, amounting to 6 per cent in 1956, exceeded the rise in output per man hour. About half of the gain in hourly earnings was matched by the rise in consumer prices.

Credit demands. Developments in financial markets in 1956 reflected the shifts noted above in expansive forces in the economy. Nonfinancial businesses absorbed considerably more funds from credit markets than in 1955. Consumers and State and local governments borrowed somewhat less. The Federal Government became a net supplier of funds, as a cash surplus permitted reduction in Treasury debt held by the public.

Business finance. Business demands for external financing were strong throughout the year as investment outlays increased sharply. Corporate profits rose little. With dividend payments higher, retained earnings declined, offsetting a major part of the increase in depreciation allowances. The gap between capital outlays and funds from current operations widened, and businesses drew heavily on internal cash resources, bank credit, and the securities markets.

In the first half of 1956 corporate income tax payments, due in March and June, enlarged demands for funds that were already heavy. Loans to metal fabricating companies accounted for a substantial portion of business loan growth at banks in this period, when new orders for machinery and equipment were rising rapidly and steel stocks were being accumulated in anticipation of a midyear strike in the steel industry. The expansion of business loans at banks appeared to reflect not only enlarged short-term needs for funds but also some temporary financing of longer term outlays that ordinarily would be financed through security issues.

Corporate security issues outstanding increased substantially in the first half of 1956. In addition, nonfinancial corporations obtained $6 billion of funds by liquidating United States Government securities. This was in contrast to the first half of 1955 when there was a reduction of only $500 million in such holdings.

In the second half of 1956, the growth of bank loans to businesses other than sales finance companies slackened somewhat, but net corporate security issues were even larger than in the preceding six months. Although tax liabilities were accumulating in this period, corporations added only $1.2 billion to their holdings of Government securities, whereas in the second half of 1955 such holdings had been increased $4.7 billion. Over the entire year 1956 the liquidity position of nonfinancial corporations declined considerably. The ratio of cash and Government security holdings to total current liabilities fell from 54 per cent at the end of 1955 to 47 per cent at the end of 1956, the lowest level since before World War II.

Sales finance companies were the only major group that appreciably reduced indebtedness to banks in 1956. At the same time, however, they continued to borrow on long-term securities and on short-term paper placed directly with investors. Credit extended by these companies to consumers and businesses increased only about one-sixth as much as in 1955, reflecting primarily developments in automobile sales and inventories.

Consumer finance. The increase in indebtedness of consumers fell short of the record amounts of the previous year. Residential mortgage debt outstanding on 1- to 4-family houses rose $11.1 billion in 1956, compared with $12.4 billion in 1955. Nevertheless, the increase in 1956 was the second largest on record. The slowdown in rate of expansion of residential mortgage debt was accounted for entirely by the FHA and VA components. These Government-underwritten mortgages, with interest rate ceilings, became less attractive to investors as the general level of interest rates rose. Conventional mortgage debt outstanding on 1- to 4-family properties increased more than in 1955.

Consumer short- and intermediate-term debt expanded $3.2 billion, about half as much as in 1955. Repayments on previously incurred instalment debt rose about one-tenth, and a decline in extensions of automobile credit offset most of the increase in extensions of other types of instalment credit.

Treasury finance. Total outlays of the Federal Government rose in 1956 by about the same amount as in the previous year. Receipts increased considerably more than expenditures and the resulting

surplus in the cash budget for the calendar year amounted to $5.5 billion, compared with a deficit of $700 million in 1955.

Individual and corporate income taxes accounted for more than nine-tenths of the increase in Federal revenues. Most of the increase in Government spending was for national security outlays, which moved up in the second half of the year.

The emergence of a surplus in the cash budget contributed to the restraint of inflationary pressures. The surplus enabled the Treasury to return $6 billion to the private economy through reduction in Federal debt held by the public. This represented Government savings that helped to finance the increase in private investment outlays, moderating upward pressures on interest rates. As Treasury debt was reduced, nonfinancial corporations and the banking system together liquidated more than $8 billion of Government securities in 1956, compared with about $3 billion in the previous year. All other investors taken together acquired about $2 billion of additional Government securities, compared with more than $3 billion in the previous year.

State and local governments. Total outlays for goods and services by State and local governments rose about 9 per cent in 1956. Long-term security issues amounted to $5.4 billion, about one-tenth less than in 1955. Most of the reduction was accounted for by issues to finance toll highway construction. The amount of securities issued for school construction was about the same as in 1955, while expenditures for this purpose increased about 10 per cent.

Supplies of credit. Cash balances that could be loaned in credit markets were less readily forthcoming in 1956 than a year earlier, while demands for loanable funds remained strong. As a result, interest rates rose more in 1956 than in 1955, even though total indebtedness in the economy rose less. In part, this reflected a cumulative decline in liquidity accompanying sustained economic expansion under conditions of credit restraint. Furthermore, in the case of businesses, funds that accrued in the course of 1956 were used more extensively to finance physical investment than to acquire financial assets. Savings institutions and commercial banks supplied a smaller volume of loan funds, but individuals added somewhat more to their security holdings than in 1955.

Personal saving. Net personal saving, including the saving of unincorporated business, rose to 7.3 per cent of disposable personal

income in 1956, from 6.1 per cent in 1955. An important feature of this increase in the rate of personal saving was increased debt repayment along with a reduction in new borrowing by consumers. Another feature was a rise in holdings of financial assets by individuals.

Institutional lenders. There was little change in 1956 in the aggregate flow of savings to life insurance companies, savings and loan associations, and mutual savings banks. However, supplementary sources of loanable funds that had been used by these institutions in 1955 were not drawn upon in 1956.

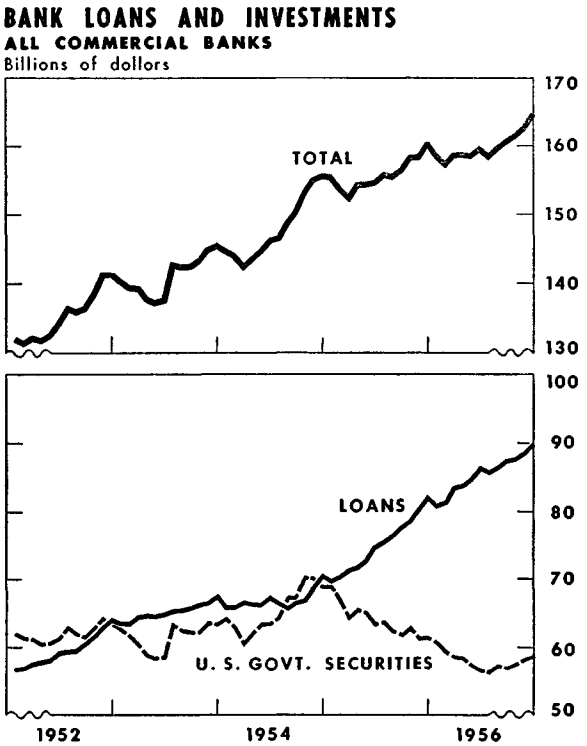
The inflow of savings to savings and loan associations was about 5 per cent greater in 1956 than in the previous year, but these institutions repaid about $200 million of debt to the Federal home loan banks, whereas they had increased such debt by more than $500 million in 1955. Life insurance companies, whose assets rose less than in 1955, also reduced dependence on other sources of funds; in the previous year they had temporarily lodged mortgages with commercial banks in meeting heavy commitments to acquire new mortgages. The deposits and loans and investments of mutual savings banks increased about as much as in 1955.

The growth of loan and investment portfolios of commercial and mutual savings banks, life insurance companies, and savings and loan associations, taken together, was less than in 1955. Nevertheless, the proportion of total public and private financing accounted for by these institutions increased in 1956, as the absorption of securities by other investor groups declined from the high levels of 1955. With liquidity drawn down as a result of developments in 1955, loanable funds were less readily available in 1956, and some sources reduced the amounts they supplied.

Bank credit. Total loans and investments of commercial banks increased $4.2 billion in 1956, slightly less than in 1955. The growth of loans, amounting to $7.6 billion, was about one-third less than in 1955, but larger than in most other years. As in the previous year, commercial banks reduced United States Government security portfolios in order to expand loans.

While total bank loans expanded at a slower pace in 1956, bank loans to businesses other than consumer and mortgage lenders increased more than in 1955. The expansion was strongest in the first half of the year.

Bank loans outstanding to consumers increased about one-third less than in 1955, reflecting the general slowdown in total consumer credit expansion. The slower growth of real estate loans at commercial banks in 1956 was a reflection partly of the reversal in bank



NOTE.—Figures are partly estimated. Data exclude interbank loans, and are for last Wednesday of month except for June and December call dates.

lending to other financial institutions. In 1955, as mortgage lenders experienced difficulty in meeting commitments to acquire mortgages, banks had purchased from them a substantial amount of such mortgages under resale agreements. Banks had also extended loans to mortgage lenders and total bank credit to these lenders had increased about $1 billion in 1955. In 1956 the indebtedness of mortgage lenders to banks was reduced more than $100 million.

Reflecting strong loan demands and Treasury debt retirement, banks reduced their Government security holdings $5 billion in the

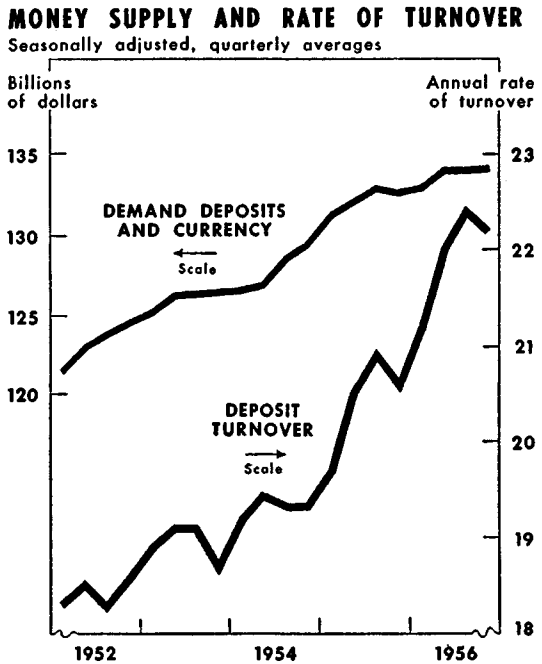
first half of the year. In the second half, as loan growth slackened somewhat and the Treasury offered new issues of bills and certificates, commercial banks added $1.9 billion to holdings of Government securities, reversing an almost steady decline that had begun in late 1954. A substantial part of the net increase in bank holdings of Government securities was at country member and nonmember banks, which also experienced much of the slowdown in loan growth in the second half of the year.

While bank portfolios of Government securities declined $3 billion in 1956, their holdings of Government securities maturing in one year or less increased nearly $5 billion, as a result of acquisitions of newly issued bills and certificates and of the approach of maturities due to the passage of time. Consequently, the ratio of short-term Government securities to deposits rose during the year, and this tended to offset part of the decline in liquidity that commercial banks have experienced since late 1954.

Monetary growth. Demand deposits adjusted and currency outside banks—the active money supply—rose $1.5 billion in 1956 compared with $3.8 billion in the previous year. The growth of time and savings deposits at commercial banks, at $2.2 billion, was the source of funds for one-half of the increase in bank loans and investments in 1956 as compared with only one-third in 1955.

The $1.5 billion growth in the money supply during the year ending December 1956 represents an increase of about 1 per cent. From the fourth quarter of 1955 to the fourth quarter of 1956, gross national product increased 5.5 per cent, of which about half was accounted for by rising prices. The velocity of circulation of money thus increased considerably. This is evidenced by the growth in the rate of turnover of demand deposits; that is, the ratio of debits against deposit accounts to the amount of deposits. In reporting centers outside New York City, the rate of turnover rose 8 per cent in the year ending with the fourth quarter of 1956, after increasing 7 per cent in the previous year.

A rising velocity of circulation of money—or a more active use of cash balances—is typical of periods of increasing economic activity. At such times incentives to economize the holding of cash balances become greater as interest rates rise and investment opportunities become more attractive. An increase in velocity is also likely to

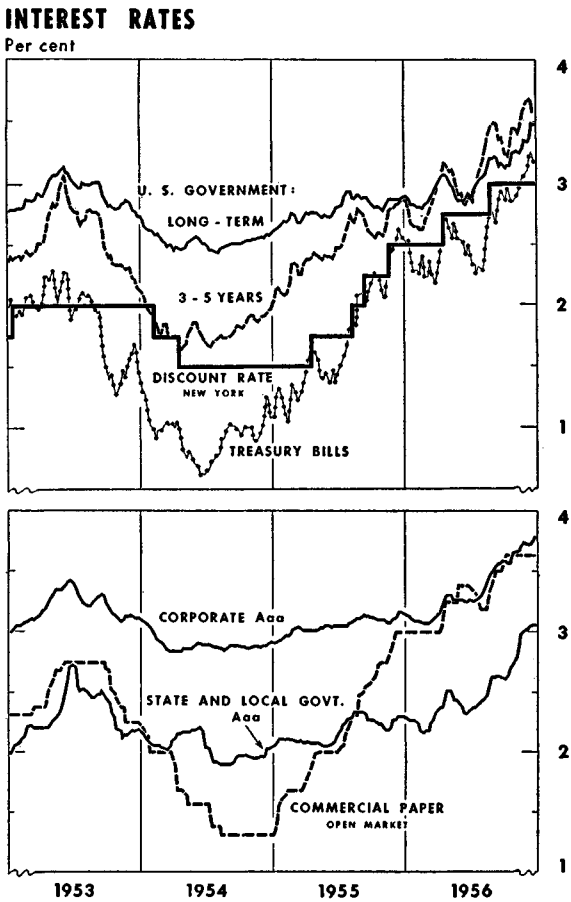


NOTE.—Figures for deposits and currency are quarterly averages of seasonally adjusted data for last Wednesday of month and are partly estimated. Demand deposits are for all banks in the U. S. and exclude U. S. Govt. and interbank deposits and items in process of collection. Currency excludes bank vault cash. Figures for turnover of demand deposits are quarterly averages of seasonally adjusted monthly data for 337 leading centers outside New York and 6 other financial centers.

occur in an inflationary period when expectations of rising prices provide an additional incentive to minimize the holding of cash balances.

Interest rates. With over-all demands for credit strong and the supply of loanable funds limited, interest rates continued to rise in 1956, reaching the highest levels since the early 1930's. The increase was especially marked in the long-term area where private debt expansion remained almost as large as in 1955. Differentials among yields on obligations of different maturities were smaller than in most other recent years.

Market rates on corporate and State and local government bonds rose more than twice as much as in 1955. Yields on long-term Treasury issues rose less than those on corporate and municipal



NOTE.—Market yield data are weekly averages of daily figures. Treasury bill rates are market yields on longest bills. Long-term U. S. Govt. yields are on 2½ per cent bonds. Commercial paper rate is on prime 4- to 6-month open market paper. Yields on corporate and State and local Aaa bonds are from Moody's Investors Service.

bonds, while those on intermediate-term Government securities remained above long-term Treasury yields during most of the year.

Treasury bill yields fluctuated with pressures on bank reserves but rose sharply in the second half of the year as credit market pressures increased. A special factor in the fourth quarter was the sale by the Treasury of three new issues of bills in addition to the

regular weekly offerings, increasing Treasury bills outstanding from $20.8 to $25.2 billion. Other short-term market rates moved in general with yields on Treasury bills.

FEDERAL RESERVE POLICIES AND BANK RESERVES

While maintaining a general condition of restraint on credit expansion in 1956, Federal Reserve operations were adjusted from time to time in accordance with changes in the climate of economic activity as well as with seasonal variations in the demand for bank credit. Furthermore, in recognition of the cumulative effects of a sustained period of credit restraint and of some reduction in bank liquidity positions, a moderate decline in member bank indebtedness to the Reserve Banks was not resisted.

On balance, the reserves of member banks increased about $300 million in 1956. Required reserves increased about $240 million, and member bank indebtedness to Federal Reserve Banks declined about $150 million. About $500 million of reserves were supplied by an increase in the gold stock and by declines in foreign and other deposits at Federal Reserve Banks, while a corresponding amount of reserves was absorbed by an expansion of currency in circulation. Federal Reserve holdings of United States Government securities

Changes in Member Bank Reserves

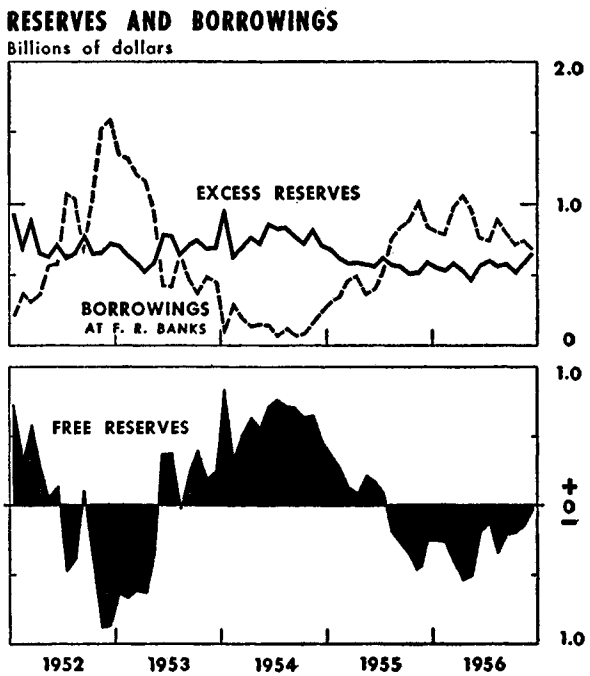
[Based on averages of daily figures for December; in millions of dollars]

Item	1956	1955
Member bank reserves		
Total reserves	+295	−39
Required reserves	+237	+70
Excess reserves	+58	−109
Principal factors affecting reserves	(sign indicates effect on reserves)	
Federal Reserve credit:		
Discounts and advances to member banks	−151	+593
Federal Reserve holdings of U. S. Govt. securities and acceptances	+194	−296
Float	+244	+397
Currency in circulation	−510	−516
Gold stock and foreign accounts	+340	−42
Other factors	+181	−180

NOTE.—Figures may not add to totals because of rounding.

and bankers' acceptances expanded over the year by about $200 million, and an increase in Federal Reserve float—or checks awaiting collection—also supplied reserves.

Member bank borrowing at the Reserve Banks, which had increased rapidly in 1955 to $900 million in the fourth quarter of that year, reached $1.1 billion in April 1956 as bank loans expanded and Federal Reserve holdings of Government securities were reduced.



NOTE.—Monthly averages of daily figures for member banks. Free reserves are excess reserves less borowings.

In April borrowings exceeded excess reserves by $500 million. Member bank indebtedness declined after April, except for a temporary rise in August, as bank loan expansion moderated and conformed more closely to the usual seasonal pattern. In the fourth quarter of 1956 member bank borrowing at the Reserve Banks averaged $700 million, compared with excess reserves of $550 million.

The cost of member bank borrowing at Reserve Banks was raised in April—by ¼ percentage point to 2¾ per cent at 10 Reserve Banks and by ½ percentage point to 3 per cent at the Minneapolis and San Francisco Banks. In August the other 10 Banks advanced discount rates to 3 per cent.

Although the reserve position of member banks was somewhat easier at the end of 1956 than a year earlier, the cost to banks of acquiring additional reserves was higher. Reserve Bank discount rates at 3 per cent were up ½ percentage point and the prices at which Government securities could be sold were lower. Furthermore, with reduced Government security portfolios, banks had become less willing to dispose of such securities in order to expand loans further. Banks also showed a tendency in the latter part of the year to repay borrowings at Reserve Banks more quickly. Thus, banks had become more sensitive to Federal Reserve policies and a given level of member bank borrowings represented a greater degree of restraint.

As the year ended, Federal Reserve policies were continuing to limit bank credit expansion. Over the second half of the year the wholesale prices of industrial commodities had risen at an annual rate of nearly 6 per cent and consumer prices at a rate of 3 per cent a year. Average hourly earnings in manufacturing had risen at an annual rate of 8 per cent. In these circumstances and in the light of developments since mid-1955, the threat of an inflationary spiral, with price and wage increases feeding upon each other, was a matter of concern in the formation of Federal Reserve policy in the latter months of the year.

The principal changes in Federal Reserve policy during the year are summarized on the following page.

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.

January 10, 1956

Authority to effect transactions in System account.

The Federal Open Market Committee renewed without change the directive that was in effect at the beginning of 1956, set forth above, which called for a policy of restraint on credit expansion.

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

This action continued the policy of restraint on credit expansion in the same terms that had been used in each directive issued by the Committee since August 1955; that is, transactions in the System open market account were to be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth." During the first four months of 1955, the directive had been in terms of "fostering growth and stability in the economy by maintaining conditions in the money market that would encourage recovery and avoid the development of unsustainable expansion;" and from May to August of 1955, the directive had likewise been in terms of fostering growth and stability, although the instruction to "encourage recovery" had been deleted in May. Restraints on credit expansion had been exercised by making it necessary for member banks to borrow to obtain additional reserves needed and by raising discount rates, and these restraints had become increasingly restrictive as banks reduced their liquidity in order to expand loans.

In reviewing the domestic situation at the beginning of 1956, the Committee found that economic activity was still advancing with industrial output and industrial prices penetrating new high ground, and with many industries operating near existing capacities. Aggregate domestic demands were continuing to expand and pressing upward on prices. Data for other industrial countries similarly showed further advances in activity with manpower and productive facilities being utilized intensively and with prices tending to advance. At the same time, the Committee noted signs of slowing in the rate of expansion in key domestic areas such as automobile production and residential building, and it also took note of an apparent leveling off in consumer demand and of views expressed by

some observers that a downturn in activity might occur during 1956. These factors were weighed against the indications that plant and equipment expenditures by business would establish new records during the year and that, if credit were too readily available at this stage, there could be an upward spiraling of prices based on increasing costs and shortages of some materials. The Committee reached the conclusion that the over-all situation was still inflationary in character, at least on the industrial side, and that a continuation of restraint on credit expansion was required. Until the economic outlook and the demand for credit had become clearer, however, and in view of the increased severity of restraints on banks, the Committee did not feel that the general level of restraint should be increased beyond that which had existed in the autumn of 1955.

In considering the implementation of this general policy of restraint, the Committee observed that the usual year-end strains in the money market had been moderated by certain unusual factors as well as by System operations that had permitted some easing of member bank reserve positions in the last two weeks of 1955. The Committee believed it desirable to absorb some of the reserves that had been supplied at that period and thus to move toward recapturing the degree of restraint that had existed in November and early December.

January 24, 1956

Authority to effect transactions in System account.

The Committee modified its directive to the Federal Reserve Bank of New York at this meeting by adding to clause (b) an instruction that transactions for the System account, in addition "to restraining inflationary developments in the interest of sustainable economic growth," should take "into account any deflationary tendencies in the economy."

> 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.

The decision at this meeting to continue the directive calling basically for restraint on inflationary developments was made in

the light of the evidences that the current year had begun with activity and employment sharply above a year ago and, in many countries, close to capacity. It was recognized that further increases in over-all output in the United States could be achieved only slowly and that in such circumstances relatively small increases in demand might bring heavy upward pressure on prices. At the same time the Committee noted the currently reduced levels of farm prices and uncertainties in the housing and automobile markets; and it gave consideration to the view that the domestic economy after a year and a half of expansion might be nearing a cyclical peak and that a reaction might be in prospect before long. It observed likewise that some seasonal contraction in the volume of credit was then taking place and, although a rise during February and March might be anticipated, some of the rise would be to meet seasonal needs.

The net of the Committee's review was that there had been a slight—perhaps almost imperceptible—change in the state of the economy in recent weeks, which might make some relaxation of restraint appropriate in the near future. It concluded that the situation at the moment did not call for a policy directive which gave sole emphasis to restraining inflationary forces. This did not mean that a reversal of the existing policy was called for, but a shift in emphasis seemed desirable as a means of indicating the intent to make credit available to permit the economy to work, to produce, and to consume at near-capacity levels. Thus, for the purpose of emphasizing flexibility, the Committee added the instruction to take into account any deflationary tendencies in the economy while carrying out operations directed toward restraining inflationary developments.

February 15, 1956

Authority to effect transactions in System account.

The Committee renewed its directive to the Federal Reserve Bank of New York with no change in the wording approved at the meeting on January 24, 1956.

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

In its review of the economic situation at this time the Committee observed some continued diversity in tendencies with necessary realignment taking place in a number of important activities. However, industries generally were operating at very advanced levels and, even where this was not the case, evidence was not available to indicate an economic downturn. Some easing in the labor market had appeared, particularly in automobile manufacturing centers where reductions in both employment and working hours had been greater than had been previously expected. Markets for consumer durable goods were showing a mixed picture, but over-all retail trade continued at high levels. The rise in industrial prices persisted.

The leveling off in economic activity noted at this time had been reflected in the credit situation with bank credit and the money supply having shown about the customary seasonal declines, compared with less than the usual seasonal reductions in early 1955. However, this did not indicate a general slackening in the demand for credit. Business plans for capital expenditures were still impressively strong. Member bank borrowing had increased somewhat in late January and member bank reserve positions had been relatively tight. On balance, the Committee concluded that the signs of economic strength continued to outweigh signs of weakness and that a relaxation of pressure on bank reserves was not indicated, although no increase in restraint appeared to be called for at the moment.

March 6, 1956

This was the first meeting of the Federal Open Market Committee after the new members elected by the Federal Reserve Banks for the year beginning March 1, 1956 assumed their duties.

1. Authority to effect transactions in System account.

The Committee again renewed its directive to the Federal Reserve Bank of New York in the same form that had been adopted at the meeting on January 24, 1956 calling for transactions in the System open market account to be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while taking into account any deflationary tendencies in the economy."

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

Domestic industrial production and gross national product had shown little change over the three months preceding this meeting, following uninterrupted and marked advances from mid-1954 to late 1955. Some selective reductions in demand had appeared recently, however, and at this meeting the Committee gave thorough consideration to their possible significance for economic prospects and credit policy. There were indications of diminishing expansionary forces in the consumer credit field, and mortgage lending and housing starts had declined somewhat from the high levels that had prevailed a few months earlier. Pressures on productive capacity seemed to be less than they had been three months earlier, and it appeared that the tremendous upsurge in over-all economic activity over the preceding year and a half was slowing down.

Notwithstanding the foregoing elements, output of steel continued at capacity with reduced demand from the automobile industry being offset by takings of other industries. Evidence of still further rise in plans for capital expenditures by business had appeared, accompanied by widespread expressions of optimism regarding the future. Wholesale prices of industrial commodities and finished goods were continuing to advance, and some recovery in prices of farm products seemed to be getting under way.

Judging from the current high level of activity in most parts of the economy, the Committee saw no evidence that the policy of credit restraint that had been followed for some months had been too restrictive. Even though some divergent tendencies were apparent at the time, a continuation of that policy appeared to be called for and there were indications that increased restraint might become necessary shortly. However, at the time of this meeting a Treasury financing was under way and the Committee desired to avoid action that might disturb the stability in the money market during the period of that financing. It also felt that the adjustments taking place in the automobile and residential building industries and some other areas might slow the growth of credit and help reduce rising price pressures. Its conclusion, therefore, was to continue the existing policy without any overt action toward

either increasing or lessening the degree of restraint that then existed.

2. Authorization to acquire bankers' acceptances and to enter into repurchase agreements.

The Committee renewed the authorization that had been approved in March 1955 under which the Federal Reserve Bank of New York was authorized (a) to purchase or sell, at market rates of discount, prime bankers' acceptances of the kinds designated in the regulation of the Federal Open Market Committee, at such times and in such amounts as may be advisable and consistent with the general credit policy and instructions of the Federal Open Market Committee; and (b) to enter into repurchase agreements with nonbank dealers in bankers' acceptances covering prime bankers' acceptances, subject to certain conditions.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Erickson, Johns, Mills, Powell, Shepardson, Szymczak, Vardaman, and Fulton. Vote against this action: Mr. Roberston.

The Committee voted to continue the authority for purchases of bankers' acceptances and repurchase agreements covering such instruments in substantially the form approved at the meeting in March 1955. This was on the grounds that the System should assist in the further development of an acceptance market in the United States with a view to improving this country's means of financing foreign trade and the functioning of an international money market, and with the understanding that purchases of bankers' acceptances would be effected only at such times and in such amounts as might be advisable and consistent with the general credit policy and instructions of the Federal Open Market Committee.

Mr. Robertson voted against the renewal of this authority because he felt that the Federal Reserve System should withdraw from active participation in the acceptance market unless it was clear that such participation would yield specific benefits. He did not believe that this had been the case since the authorization was granted in 1955. Further, he believed that if the Federal Reserve System desired to support and encourage the acceptance market,

it could accomplish that objective more effectively by standing ready to purchase acceptances at published rates that ordinarily would represent a fractionally higher rate of discount than market rates.

3. Review of continuing authorities or statements of policy.

The Committee reviewed and reaffirmed all continuing statements of operating policy and specific authorities for operations (including authority for repurchase agreements with nonbank dealers in United States Government securities) which were in effect immediately prior to this meeting. Among these were the following statements:

A. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

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

B. Operations for the System account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

> Votes for this action: Messrs. Martin, Chairman, Balderston, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Vote against this action: Mr. Sproul, Vice Chairman.

C. Transactions for the System account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Balderston, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Vote against this action: Mr. Sproul, Vice Chairman.

Renewal of these three continuing authorities or statements of policy was in the same form as that approved in March of 1954 and 1955.

In voting against the continuation of statements B and C set forth above, Mr. Sproul, who had voted against their renewal a year earlier, stated that he was still opposed in principle and in practice to these operating rules. The other members of the Committee believed the continuation of the rules to be desirable.

March 27, 1956

Authority to effect transactions in System account.

The Committee modified its directive to the Federal Reserve Bank of New York by deleting from clause (b) of the first paragraph the instruction to take "into account any deflationary tendencies in the economy" while effecting transactions in pursuit of the general policy of "restraining inflationary developments in the interest of sustainable growth."

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

The economic review at this time confirmed the Committee's observations at the past few meetings that economic activity had ceased to advance toward the end of 1955 and had moved on a plateau during the first quarter of 1956. Industrial production had shown little change from the high level reached in the fall months of 1955, nonfarm employment had been steady, and gross national product was estimated to have been only slightly higher during the first quarter of 1956 than in the last quarter of 1955, although it continued at a record high, well above year-ago levels.

The slight increase in total product during the quarter under review reflected mainly further growth in business fixed capital and inventory outlays, in State and local government purchases, and

in consumer expenditures for services. Consumer goods purchases at retail had been about stable. Construction activity had been only moderately below the record rate of mid-1955, the decrease reflecting solely reduced residential building. Prices, which had shown signs of weakening early in 1956, had strengthened in March, and key prices were firm to rising, with agricultural prices displaying more than seasonal strength. In other industrial countries, consumer and business demands were continuing to grow, although at a slower pace.

The question before the Committee was whether the economy would resume its advance, remain on the recent plateau, or decline; and the Committee's judgment was that available information pointed toward a further advance. Among the general factors leading to this conclusion were the much greater than expected plans of business concerns in all major lines for plant and equipment expenditures, the widespread optimism of consumers as to the economic outlook and their own financial position and income prospects, and evidence of an exceptionally heavy demand for bank credit in the current month. The Committee also noted that common stock prices had risen sharply further. Growing pressures for increases in prices and wages were evident, and there was danger that if supported by further credit expansion pressures would engender an inflationary spiral.

The Committee discussed the extent to which monetary policy might be used to combat an inflationary cost-price spiral and the risk of incurring temporary unemployment on the one hand, as against the risk of undermining the basis of sustained employment on the other. It was suggested that while monetary policy could not be expected to achieve all of the task of combating inflationary pressures, the System would be derelict in its duty if it did not exercise additional restraint in this situation. In the circumstances, the Committee concluded that its instruction to take into account deflationary tendencies in the economy in effecting transactions for the System account was not consistent with the existing situation or the prospective renewal of growth in the economy. Accordingly, it deleted the qualification as to deflationary tendencies that had been added to clause (b) of the directive at the meeting on January 24, 1956, leaving an instruction to effect transactions for the System account with a view, among other things, "to re-

straining inflationary developments in the interest of sustainable economic growth."

In reviewing credit measures at this meeting, the Committee also discussed the relation to open market policy of possible action by the directors of the Federal Reserve Banks to increase discount rates from the 2½ per cent level that had been in effect at all Reserve Banks since November 1955. It was noted that there was some feeling in the System that an increase might be necessary at an early date to prevent undue credit expansion for financing capital outlays through the banking system. On the other hand, there was some feeling that, with increasing credit demand, additional restraint would result from the Committee's policy of limiting additions to the supply of reserves to such amounts as were needed for sustainable growth in the economy.

April 17, 1956

Authority to effect transactions in System account.

The Federal Open Market Committee renewed without change the directive that had been approved at the meeting on March 27, 1956, which called for transactions in the System account 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, Erickson, Johns, Mills, Powell, Robertson, Shepardson, Szymczak, Vardaman, and Fulton. Votes against this action: none.

Since the preceding meeting eleven of the Federal Reserve Banks had increased their rates of discount effective April 13, 1956. Nine of the increases were from 2½ to 2¾ per cent and two were from 2½ to 3 per cent. (The remaining Reserve Bank increased its rate to 2¾ per cent effective April 20.)

At the time of this meeting, credit markets were in process of adjusting to the increase in discount rates that had just been announced. This added factor followed a period of several weeks during which the markets had been adjusting to the impact of corporate income tax payments in March, the Treasury refunding operation that had come at the same time as the tax payments,

and the heavy loan demand both in capital markets and at banks. The interest rate structure had risen sharply during this three-week period. In considering policy for the period ahead, it was necessary for the Committee to judge the reactions of lenders and borrowers to the current restrictive policy: whether the actions taken thus far would effectively limit credit growth without serious disruption of the credit markets, or whether credit demands remained so strong as to cause further rises in interest rates and a weakening in securities markets that might threaten a money market crisis.

As to economic developments, the Committee found activity continuing to move sidewise on the high plateau that had been maintained since late fall of 1955. The over-all picture was still somewhat mixed, but indications were that pressures growing out of expanding private investment were beginning to tilt activity upward. The automobile and housing markets appeared to have stabilized over the past few weeks, and other consumer markets had been on the firm to rising side. Business and investor psychology continued optimistic, and the picture was generally one of continuing business investment boom, not only in the United States but in other industrial countries as well. The Committee therefore agreed that there should be no relaxation of pressures. However, the restrictive policy should not be pressed too strongly pending more opportunity to observe reactions to the mid-April increase in discount rates, increased pressure on bank reserve positions, and clarification of the economic outlook.

May 9, 1956

Authority to effect transactions in System account.

The Committee renewed without change the directive issued to the Federal Reserve Bank of New York on March 27 and April 17, 1956 for effecting transactions in the System open market account.

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

Since the meeting on April 17, 1956 no important change had become apparent in the state of the economy. Output of goods had continued at the high level that had prevailed for several

months. Upward pressures on prices of industrial commodities had continued and new increases in steel prices were anticipated following negotiations of a new wage contract later in the spring or summer. Business demands for goods and services had risen over the months and aggregate consumer demand, including demand for automobiles and housing, had about held its own. Money markets at the time of this meeting were not under quite as much pressure as they had been at the time of the meeting on April 17, which had followed by only a few days the increase in discount rates at the Federal Reserve Banks at a time when the credit markets were still adjusting to the unusual pressures of March.

The Committee saw no evidence of a change in the economy that called for lessening restraint on credit expansion at this time. Demand for credit including demand in the capital markets suggested a further bulge, although there was some feeling that the actions already taken by the Federal Reserve System to restrain undue credit expansion might have a cumulative effect that would hold down the expansionary tendencies. Furthermore, there had been a decline in the liquidity position of business and of banks over a period of months which could have important effects. The Committee's decision to make no change in the existing policy reflected its belief that credit restraint continued suitable to the situation and that no change either toward increased pressure or toward relaxation would be justified at this time.

May 23, 1956

Authority to effect transactions in System account.

At this meeting the Committee restored to clause (b) of its directive to the Federal Reserve Bank of New York an instruction to take into account deflationary tendencies in the economy while pursuing a general policy of restraining inflationary developments. With this change, the clause read as it had from January 24, 1956 to March 27, 1956, that transactions be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while taking into account any deflationary tendencies in the economy."

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

The Committee found less exuberance in the economic situation at the time of this meeting than had been observed at either of the two preceding meetings. Although a sidewise movement on a high plateau still seemed to be continuing, divergent tendencies had been noteworthy during the past few weeks. In particular, sales of new automobiles had been weak at the consumer level and dealer inventories of new cars had risen to around 900,000 units with the result that output was being cut back sharply. Use of consumer instalment credit had slowed down further. The Committee recognized the possibility that future developments could be affected by weaknesses in some parts of the economy and by a pessimistic business and investor psychology. Another factor was the less ready reception accorded new capital issues as large offerings came to the market seeking funds to carry out the large business spending programs. Stock prices had declined sharply. Bank reserves had been under greater pressure during the past three weeks than had been anticipated by the Committee, and member bank borrowing at the Federal Reserve Banks had risen to the highest level since early 1953 and held there for several weeks. Bankers and businessmen were expressing fears, at least privately, as to whether credit for needed purposes would be available even at higher interest rates during the months ahead.

The Committee still believed that the basic economic factors were expansionary. Under the circumstances, however, it determined to restore to its directive the qualifying clause that would require the Management of the System Open Market Account, in carrying out transactions in pursuit of a generally restrictive credit policy, to take into account any deflationary tendencies that might be appearing in the economy. To implement this policy, the Committee agreed that during the immediate future additional reserves should be supplied to take care of seasonal and growth needs; it did not wish to permit a further tightening to develop as pressures for increased credit bore against the existing supply of reserves.

June 5, 1956

Authority to effect transactions in System account.

The Committee made no change in the directive to the Federal Reserve Bank of New York that had been approved at the preceding meeting held on May 23, 1956, stating a policy of restraining

inflationary developments while taking into account any deflationary tendencies in the economy.

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

Economic data presented at this meeting confirmed that a sidewise movement in activity was continuing. May automobile sales had proved generally disappointing but sharp cutbacks in production had started to reduce the heavy dealer stocks of new cars. Some reduction in output of household appliances had been reported and production of textiles, particularly synthetics, had been reduced. Common stock prices had declined further during this period.

In contrast to these indications of weakening in parts of the economy, little change in total employment and over-all output was evident and credit demand continued vigorous. A particularly significant development was indicated by the latest figures of business plans for plant expansion which showed a still further rise in such programs. It appeared that the continuation of the boom in business investments would largely offset the readjustment currently taking place in the automobile industry. On the financial side, a somewhat better tone had appeared in markets for new capital issues and additional offerings had been reported. Interest rates had steadied after the decline in long-term rates earlier in May. Bank reserve positions had been eased as a result of the System's action in putting nearly $300 million of reserves into the market during the preceding two weeks, in addition to making repurchase agreements available. Estimates indicated that additional reserves would have to be supplied in order to take care of seasonal and other temporary needs for credit and currency during the June tax payment and midyear settlement period and over the July 4 holiday.

In view of the atmosphere of uncertainty that still existed in some quarters, it appeared desirable for the Committee to continue a program that would dispel any doubts as to its readiness to meet seasonal and other temporary reserve needs. It was recognized that the past momentum that had been evident in the economy did not necessarily indicate prospective economic conditions. The Committee did not wish policy to become more restrictive at this

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.

The Committee gave especial attention to the rate at which economic resources of the country were being used and to the tendencies of prices to rise in numerous markets. These price tendencies appeared to result from the competitive spending, investing, and borrowing propensities of a highly optimistic business and consumer public, rather than from fiscal and monetary policies, which had been anti-inflationary. It appeared that there was danger in misdirected use of resources, unwise judgment as to business and investment opportunity, over-optimism as to management's ability to pass along higher wages and other costs into higher prices, over-commitment of credit based on a discounting of the future, and a cumulative deterioration in the quality of credit. The Committee felt that at this stage monetary policy should minimize the dangers referred to by fostering as efficient an allocation of scarce resources, including savings, as could reasonably be effected by market processes. The Committee believed it should do what it could toward discouraging the financing of plant and equipment expenditures out of bank credit when such demands should be satisfied in the long-term capital market. At the same time, it wished to take care of normal growth and reasonable credit needs of the economy as such needs arose.

In concluding that it was no longer appropriate to retain in the directive the instruction to take into account deflationary factors, the Committee also discussed other measures that might be taken to strengthen credit restraint, including the possible desirability of action by the Federal Reserve Banks to increase discount rates. It was felt that operations should not be modified materially until the current Treasury financing had been completed, but it was suggested that additional actions toward restraining credit expansion would more than likely be needed shortly.

August 21, 1956

Authority to effect transactions in System account.

The Committee made no change at this meeting in the directive to the Federal Reserve Bank of New York calling for continuation of operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth."

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

Most of the measures of production, consumption, and prices presented at this meeting seemed to confirm that the economy was still definitely in an expanding phase. During the two weeks since the preceding meeting, there had been numerous and sizable price advances in industrial commodities, especially in metals and metal products. Industrial output had rebounded sharply from the July steel strike. In the central money markets, interest rates had risen appreciably.

The tendency toward price increases was spreading in both raw materials and finished goods in response to recent wage increases. Heavy demand for capital funds, with business and personal savings insufficient to match the demand, was putting pressure on banks. This tendency was being accentuated by the reluctance of borrowers to accept sharply higher long-term interest rates, as indicated by the fact that several long-term capital issues had been deferred or withdrawn from the market recently. Bank loans had shown moderate seasonal increases for several weeks preceding this meeting, but banks appeared to be increasingly reluctant to reduce their liquidity ratios further by selling Government securities to procure funds for loan expansion. System operations had been directed toward supplying reserve funds to meet seasonal needs but the reserve position of banks had tightened since June and July.

The Committee felt that credit policy should be made somewhat more restrictive, but in view of the fact that individual Federal Reserve Banks were known to be considering discount rate increases at a time when the market for Government securities was showing strain, the directive was renewed with no change in the general open market policy of restraint on credit expansion.

September 11, 1956

Authority to effect transactions in System account.

The directive of the Federal Open Market Committee was renewed without change at this meeting, providing for continuation of a policy having as its objective the restraint of inflationary developments in the interest of sustainable economic growth.

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

Reports at this meeting showed that aggregate demand and supply were continuing to rise, that there was sustained vigor in the demands for credit and capital, and that business and financial psychology was confident. Prices of a number of raw materials had leveled off in recent weeks, but the general tendency of prices for fabricated industrial products continued upward as did prices of consumer goods. Capital expenditure programs were still pressing on supplies of materials, on manpower, and on the capital goods industries, and late information regarding business plans for plant and equipment expenditures during the fourth quarter of 1956 indicated a further rise to an annual rate of about $38 billion, compared with an expected total for the year of $35.5 billion, an amount about 25 per cent higher than for the year 1955.

Industrial output for August had recovered sharply and in September appeared to be running at a rate in excess of the level before the steel strike in July. Employment for August showed a record high and unemployment showed more than the usual seasonal decline. Retail markets except for automobiles had been showing considerable strength. Construction activity in August had been at about the July record rate, a decline from the preceding year of about 12 per cent in residential construction having been offset by higher levels of industrial and commercial construction. Farm price developments, combined with larger marketings and soil bank payments, indicated that net income of farm operators in 1956 probably would exceed that of the preceding year.

Increases in discount rates during the latter part of August to a uniform level of 3 per cent at all Federal Reserve Banks had produced little reaction in money markets. Total loans and investments of banks had increased during August. The money supply, which was barely 1 per cent higher than a year earlier, had shown relatively little change in recent months, but turnover had been at a faster rate. It did not appear that credit restraints thus far adopted had been too severe; additional reserves had been supplied in substantial amounts during the past three weeks to help meet seasonal

needs, and credit demands were generally being met although there were indications that expansion of credit was being limited.

Figures presented to the Committee at this meeting suggested prospective growth in bank credit during the autumn at least equal to normal seasonal expectations. In addition, there was some tendency for long-term borrowers to shift from capital markets to the commercial banks even though bankers were reported to be resisting the trend toward use of bank credit for capital purposes. Another factor was the prospect that the Treasury would have to borrow substantial additional amounts of new funds in October aside from refunding maturing certificates later in the year. Still another influence on the Treasury's need for funds was the high rate of redemption of savings bonds.

The Committee's broad objective continued to be to restrain inflationary developments but, as always, it recognized that monetary and credit policy alone could not be successful in halting inflationary pressures. It believed it necessary to assist in meeting seasonal and growth demands for credit as well as the needs of the Treasury in its financing operations, even though the buoyant state of the economy clearly required a continuation of at least the existing degree of restraint. In renewing its directive without change, the Committee did so with an instruction to the Management of the System Account to maintain substantially the existing degree of stability in the market, with doubts being resolved on the side of tightness rather than of ease, but with the understanding that the Account Management would not initiate action toward more tightness.

September 25, 1956

Authority to effect transactions in System account.

At this meeting, the Committee again renewed without change its directive calling for a policy of restraining inflationary developments in the interest of sustainable economic growth.

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

Economic reports to the Committee at this meeting showed essentially a continuation of the trends reported at the meeting held

two weeks earlier. There was general strength in expansive forces throughout the economy, with demands pressing against supplies in many sectors and with some further rise in wholesale prices.

The rebound in economic activity since the end of the steel strike early in August had been even more rapid than was expected earlier. To a large extent the great strength of the business picture reflected a record level of capital formation, but consumer spending also had been well maintained. While residential building was at levels moderately below those of a year earlier, actual developments did not indicate that a substantial further decline was likely to be precipitated by lack of adequate mortgage credit. Continued expansion in employment and production to the extent permitted by capacity limits and further upward pressures on prices seemed likely during the immediate future. Wholesale prices had risen almost without interruption since the end of June, and the vigor of the current economic expansion pointed to some danger of renewed speculative building of inventories although there was not much evidence that this had actually taken place.

Heavy demands had continued in capital markets and bank loans had risen considerably in the six weeks preceding this meeting, with business loans accounting for all of the increase. It seemed clear that credit restraints had not resulted in undue curtailment of either business or consumer spending, although they had no doubt kept banks from supplying some of the demands for credit, which continued strong.

One of the factors given particular attention by the Committee at this meeting was the prospective borrowing by the United States Treasury of a substantial volume of new funds. The money market had been consistently tight recently and it appeared that the Treasury might have some difficulty in coming to the market at this time. The Committee considered on the one hand its responsibility for contributing to economic stability and minimizing inflationary pressures, and on the other hand the responsibility that it had in connection with the Treasury's financing problem. It directed its discussion toward how the System might take appropriate account of that situation while pursuing a policy that would restrain undue credit expansion in the economy as a whole. Its conclusion was that the general policy directive should not be changed, that operations for the System account should limit addi-

tions to reserves to meet seasonal needs so as to maintain pressures of about the same degree that had existed recently, but that in case of doubt operations should be resolved on the side of ease rather than restraint during the period immediately ahead.

October 16, 1956

Authority to effect transactions in System account.

Again the Committee renewed without change its directive stating a policy to restrain inflationary developments in the interest of sustainable economic growth.

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

Domestically, the over-all economic picture at the time of this meeting continued to be one of general expansion of activity, rising average prices for industrial commodities, and high confidence in both near-term and longer term business prospects. Consumer demand was well sustained while unemployment had reached the lowest levels since 1953. There were, however, some indications that the inflationary pressures in the economy had become a little less intense than they were in the weeks immediately following the steel strike settlement. Sentiment while still buoyant seemed to be a little more cautious. Many price increases were still being reported, especially among finished and semi-finished goods, but there had been recent easing of several important raw material prices. Consumers appeared to be increasingly concerned over the price outlook.

Growth in total bank loans during the third quarter of the year had been substantial but slower than in the first half of 1956 or the third quarter of 1955. Business loans had increased more over the past three months than total loans; real estate loans also had increased, while loans on securities had declined and all other loans (including consumer loans) had shown little change. The Treasury had successfully raised approximately $1.6 billion in new money. Notwithstanding a large volume of new corporate offerings, the bond market had had a better tone and yields on outstanding issues had been relatively stable in recent weeks. The calendar of prospective new capital issues continued large. Short-

term money rates had tended to rise further, despite a somewhat easier bank reserve position than had existed a few weeks earlier.

The consensus of the Committee was that no change should be made at this time in the policy of restraint on inflationary developments. This did not imply a greater degree of restraint, for the Committee wished to avoid a tightening that might seriously unsettle the capital markets and intensify the demand for short-term credit. It observed that seasonal demands for credit could be expected automatically to cause some tightening during the next several weeks, besides which additional Treasury financings for cash and refunding would exert further pressure. The Committee also observed that banks could use the Federal Reserve discount facilities as pressure increased. In addition, it contemplated that, if undue tightening developed, reserves should be supplied through the open market with a view to maintaining substantially the present degree of restraint.

November 13, 1956

Authority to effect transactions in System account.

No change was made at this meeting in the wording of the Committee's directive that System operations in the open market be with a view, among other things, to restraining inflationary developments in the interest of sustainable economic growth.

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

The over-all economic situation still appeared to be inflationary. Since the preceding meeting the Middle East war crisis had caused major uncertainties, however, and cumulative pressures from restrictive monetary and fiscal policies were showing up at the same time that there were indications that the upward momentum of the boom might be losing some of its force.

Industrial output during October had increased slightly further from the September level and during the current month appeared to be at least equal to the October rate. Employment continued at a high level and upward drift in industrial prices persisted. On the other hand, information on industrial construction showed some decrease in recent weeks and residential construction, although still

high, continued below the record 1955 levels. Department store sales in October were only 1 per cent higher than a year earlier despite higher retail prices.

Bank credit growth had slackened perceptibly during recent weeks. This slowing reflected in part restraint on bank lending because of the continued tight reserve position as well as the lowered liquidity position of the banks; it appeared that demand for funds was still strong. Capital markets continued under pressure from the large volume of new issues offered and awaiting offering, and bond yields had risen to postwar highs. Corporate profits were showing signs of leveling off or declining.

The prospect for further seasonal expansion in demand for credit and for additional Treasury financing before the end of the year, with their possible effects on the money market, led the Committee to the conclusion that the degree of restraint should not be intensified at this time. Also, while there was no real indication that the boom had leveled off, there were a number of uncertainties growing out of the international situation, the profit squeeze that had been in evidence for almost a year, the somewhat reduced level of total construction, and the lack of factors pointing definitely to higher levels of economic activity in the future.

Accordingly, in continuing its policy of credit restraint, the Committee did so with the thought that another meeting should be held within two weeks, that in the meantime the degree of pressure in the money market should remain substantially unchanged, and that the members of the Committee should be alert to the possible need for a modification of policy that might develop as a result of the divergent influences noted at this time.

November 27, 1956

Authority to effect transactions in System account.

The Committee continued its directive calling for a policy of restraining inflationary developments in the interest of sustainable economic growth, but it added a qualifying instruction to clause (b) that in carrying on such a program recognition should be given to 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,

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.

* * *

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.

RECORD OF POLICY ACTIONS

BOARD OF GOVERNORS

April 12, 1956

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective April 13, 1956, the Board approved actions by the boards of directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, St. Louis, Kansas City, and Dallas establishing a rate of 2¾ per cent (an increase from 2½ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act; and actions by the Federal Reserve Banks of Minneapolis and San Francisco establishing a rate of 3 per cent (an increase from 2½ per cent) on such discounts and advances.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, Robertson, and Shepardson. Votes against this action: none.

Pursuant to the policy established by this action, the Board also approved, effective April 20, 1956, a rate of 2¾ per cent (an increase from 2½ per cent) for the Federal Reserve Bank of Chicago.

Effective the same dates, the Board approved for the respective Federal Reserve Banks rates on advances to member banks under Section 10(b) of the Federal Reserve Act, which, as required by that section, were ½ of 1 per cent per annum higher than the new rates in effect at the Banks on discounts and advances under Sections 13 and 13a. In addition, the Board approved changes at some of the Federal Reserve Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

(In accordance with the provisions of the Federal Reserve Act, the Federal Reserve Banks establish, subject to review and determination of the Board of Governors, rates on discounts and advances to member banks at least every 14 days and submit such rates to the Board for consideration. No changes involving new policy had been made in these rates since those referred to on page 88 of the Board's Annual Report for 1955.)

Economic activity in the early part of 1956 continued at approximately the level attained during the latter half of 1955, with principal indices substantially higher than for the comparable period of the preceding year. As the first quarter progressed, increasing optimism regarding the business outlook was reflected in surveys

which showed a marked upward revision in plans for plant and equipment expenditures during the remainder of the year. The market for producers' durable goods was particularly strong, there was a tendency toward inventory accumulation, and price pressures became more evident as output in some lines of production approached capacity limitations. Interest rates rose in March and April in response to increasingly heavy credit demands and the resulting pressure on commercial bank reserves. In the latter part of March, yields on Government securities advanced rapidly under the stimulus of these credit pressures and the large prospective volume of new corporate and municipal financing.

The increase in the discount rates again brought these rates into better alignment with short-term market rates and represented a further step to strengthen the degree of credit restraint being exerted by Federal Reserve policy in the interest of preventing inflationary developments. It also served as a signal to those businesses planning to finance plant and equipment expansion through the capital markets that higher borrowing costs might be anticipated if the supply of savings was taxed further by demands for capital.

April 23, 1956

Amendment to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges.

Effective May 1, 1956, the Board amended Regulation T (1) by striking out the words "three full business days" in subsection (b) of section 3 and substituting therefor the words "four full business days"; (2) by striking out the words "three-day period" wherever they appeared in subsections (e) and (f) of section 3 and substituting therefor the words "four-day period"; and (3) by striking out the words "or 'three-day riding'" in the footnote to subsection (e) of section 3.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, and Robertson. Votes against this action: none.

This technical amendment changed from three full business days to four full business days the maximum period allowed for a broker to obtain margin in a margin account. It recognized mechanical operating problems of brokers in the light of reduced daily

deliveries of mail and brokers' machine bookkeeping methods. Regulation T continued to require that the broker in all cases obtain the necessary deposit of margin "as promptly as possible" and the new maximum period merely stated an outside limit to be used by the broker only to the extent that it is not possible for him to obtain the margin in less time.

July 19, 1956

Adoption of Regulation Y, Bank Holding Companies.

Effective September 1, 1956, the Board issued Regulation Y pursuant to the provisions of the Bank Holding Company Act of 1956.

> Votes for this action: Messrs. Martin, Balderston, Vardaman, Mills, and Shepardson. Votes against this action: none. Messrs. Szymczak and Robertson, who were not present when this action was taken, stated previously that they concurred in it.

The Bank Holding Company Act of 1956, "To define bank holding companies, control their future expansion, and require divestment of their nonbanking interests", was approved May 9, 1956. A draft of Regulation Y, prepared pursuant to the provisions of that Act, was published in the Federal Register on May 29, 1956, and the Regulation was adopted by the Board of Governors following consideration of views and comments received from interested parties upon such publication. It was the decision of the Board that a Regulation in the form approved would best carry out the purposes of the Bank Holding Company Act and the responsibilities placed on the Board by that Act.

The Bank Holding Company Act and the Board's Regulation Y were in addition to, and did not take the place of, provisions of other laws such as Section 5144 of the Revised Statutes, and the Board's Regulation P thereunder, which relate to "holding company affiliates" as distinguished from "bank holding companies".

August 23, 1956

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective August 24, 1956, the Board approved actions by the boards of directors of the Federal Reserve Banks of New York, Philadelphia, Richmond, and Chicago establishing a rate of 3 per cent (an increase from 2¾

per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

> Votes for this action: Messrs. Martin, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: none. Governor Vardaman, who was not present when this action was taken, stated previously that he concurred in it.

Pursuant to the policy established by this action, the Board also approved the same rate for the following Federal Reserve Banks, effective on the dates indicated:

Cleveland	August 27, 1956
Boston	August 28, 1956
Atlanta	August 28, 1956
St. Louis	August 28, 1956
Dallas	August 28, 1956
Kansas City	August 31, 1956

Effective the same dates, the Board approved for the respective 10 Federal Reserve Banks a rate of 3½ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act, and on industrial loans and commitments under Section 13b.

During the period since April, when the discount rates of the Federal Reserve Banks were previously increased, there was continued heavy demand for goods, services, and credit. With output in many lines of production pressing against capacity, the price structure continued to be subject to persistent upward pressures. The strongest expansive force in the economy was provided by business expenditures for plant and equipment, which ran at a record high, considerably above the 1955 level. Since external funds were needed to finance a large part of the investment outlays by businesses and the demand for long-term funds strained the capacity of the capital markets, businesses were resorting in some measure to commercial bank loans to meet their financing requirements for these purposes. The resulting expansion in bank credit, together with increased use of existing funds, added to the demand for goods faster than output could be increased and thus contributed to upward pressures on prices.

The current discount rate increases, which brought the rates at all Federal Reserve Banks to the level prevailing at the Minneapolis and San Francisco Banks since April, recognized the con-

tinued upward trend in money market rates and served to indicate to the financial and business community, and the public generally, the need for credit restraint and for resistance to inflationary developments.

December 3, 1956

Amendment to Regulation Q, Payment of Interest on Deposits.

Effective January 1, 1957, the Board made changes as follows in the maximum permissible rates of interest payable by member banks of the Federal Reserve System on savings deposits and time deposits pursuant to the provisions of Regulation Q:

	From (per cent)	*To (per cent)*
Any savings deposit	2½	3
Any time deposit having a maturity date six months or more after the date of deposit or payable upon written notice of six months or more; and any postal savings deposit which constitutes a time deposit	2½	3
Any time deposit having a maturity date less than six months and not less than 90 days after the date of deposit or payable upon written notice of less than six months and not less than 90 days	2	2½

No change was made in the maximum permissible rate of one per cent on any time deposit having a maturity date less than 90 days after the date of deposit or payable upon written notice of less than 90 days.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, and Shepardson. Votes against this action: Mr. Robertson. Mr. Vardaman, who was not present when this action was taken, stated previously that he concurred in it.

Section 19 of the Federal Reserve Act, as amended by the Banking Act of 1933 and the Banking Act of 1935, requires the Board of Governors to limit by regulation the rates of interest which may be paid by member banks of the Federal Reserve System, while the Federal Deposit Insurance Act requires that the Federal Deposit Insurance Corporation prescribe limitations on the maximum rates payable on such deposits by insured nonmember banks. The legislative history suggests that a primary purpose of these pro-

visions was to prevent unsound practices in competition for time and savings deposits.

Prior to the above action, the maximum permissible rates of interest prescribed by the Board on time and savings deposits had remained unchanged for more than 20 years. During nearly all of that period, however, the maxima were well above the rates actually paid, and only recently did the pressure of demand for credit begin to bring rates up to the ceilings.

After extended consideration of this matter, during which the views of the Federal Reserve Banks and the Federal Advisory Council were obtained, the Board concluded that in a period of heavy demands for funds and a relatively high structure of interest rates generally, it would be desirable to permit individual member banks greater flexibility to encourage the accumulation of savings than was available under the existing maximum permissible rates. It also appeared to the Board that there was insufficient reason to prevent banks, in the exercise of management discretion, from competing actively for time and savings balances by offering rates more nearly in line with other market rates. By increasing the rate limitations only on savings deposits and on time deposits with maturities longer than 90 days, the Board continued to recognize the special thrift character of savings accounts and to preserve a differential between longer term time deposits and short-term time deposits representing essentially liquid balances.[1]

Effective the same date, the Federal Deposit Insurance Corporation made similar changes in its regulation prescribing the maximum interest rates permitted to be paid on time and savings deposits by insured nonmember banks.

Governor Robertson voted against this action for the reasons set forth in the statement beginning on the following page.

[1] Under the Supplement to the Board's Regulation Q, Payment of Interest on Deposits, a member bank may pay interest on time and savings deposits at the maximum rate prescribed by the Supplement regardless of the basis upon which interest is computed, provided the aggregate amount of interest paid does not exceed the amount which would be paid at the maximum rate when compounded quarterly. In view of a suggestion which had been made, the Board published in the Federal Register for February 25, 1956, a notice inviting comments with respect to a proposed amendment to Regulation Q which would have permitted member banks to compute interest at the maximum rate, provided the aggregate amount of interest paid did not exceed the amount which would be paid at the maximum rate when compounded monthly. However, in the light of comments received and after further consideration of the matter, the Board decided not to adopt the amendment.

A. An increase to 3 per cent in the maximum interest rates that member banks may pay on (1) savings deposits and (2) time deposits not payable within six months would make it possible, it is alleged, for commercial banks to compete more effectively against other savings institutions for time deposits. Payment of such higher rates of interest might have these undesirable results:

1. It would increase bank operating costs and make it more difficult for banks to raise additional capital that they need. Since any bank offering higher rates would have to pay them on existing as well as new deposits, net profits after taxes of some member banks could be reduced by as much as 25 per cent—or more in the case of country banks—and this would lower net profits to below 6 per cent of capital accounts, compared with an average of around 8 per cent for many years.
2. To offset such additional costs, banks would be under pressure to seek higher yielding assets, which would probably be less liquid and more risky, and thus impair the liquidity and solvency of the commercial banking system. Probably the principal purpose of the legislation authorizing regulation of interest rates on time deposits was to prevent such a development, which was to some extent responsible for the banking difficulties of the 1930's.

Furthermore, I have some doubts as to the effectiveness of such a raising of the interest ceiling in attracting savings to banks, because competing institutions could always pay higher rates. Their ability to pay more is due not to this limitation on banks but to other advantages with respect to such matters as taxation and restrictions as to the nature of assets that can be acquired. In addition, it is questionable whether generally higher rates on savings deposits would bring about a material increase in aggregate savings or would merely influence the form in which savings are held. It is plausibly argued that banks should be permitted to distribute to their customers as much of their earnings as they think they can afford, and that, since bank earnings are higher than they have been at times in the past, banks should be permitted to pay higher rates of interest on savings deposits. My answer is that Congress imposed on the Board the duty of preventing that very thing to the extent that it might jeopardize the soundness of the whole banking system. If the ceiling should be raised whenever a few banks feel they can afford to pay higher rates, there is no point in having a ceiling.

In view of these possible undesirable consequences to the commercial banking system, and my doubts concerning the effectiveness of such an increase, I would question the wisdom of raising the ceiling at this time and would vote to retain the present maximum rates. The number of banks which are now paying ceiling rates is small and only a fractional percentage of these banks actively seeks the privilege of paying higher rates. I would not

accede to the wishes of those few banks and thereby, perhaps, adversely affect the whole banking system.

B. An increase in the maximum rate which can be paid by banks on time deposits payable in less than six months is questionable for a number of reasons:

1. Many of the funds thus held are not genuine savings but are liquid balances subject to withdrawal either to meet cash needs or to invest in other liquid assets whenever a rise in short-term market rates of interest makes such a shift profitable.
2. Banks would tend to treat such deposits the same as savings and determine their asset structure accordingly. This tendency is illustrated by the present situation in New York City banks which have substantial time deposits consisting of foreign central banks' balances and other liquid funds, such as trust department deposits, but have permitted their holdings of liquid assets to fall to exceptionally low levels. They now want to raise interest rates payable on such deposits to keep from losing them because they are so ill-prepared to meet the withdrawals.
3. Payment of high rates of interest on short-term time deposits would encourage evasion of the prohibition against the payment of interest on demand deposits.
4. Any resulting tendency to shift from demand to time deposits would reduce required reserves and thus release reserves for lending. This would not be in harmony with existing Federal Reserve credit restraint policies.
5. Liquid funds of this nature should be invested in open market paper, so that holders would have to bear the burden and risks of fluctuating rates and not shift that risk to the banking system.

Finally, it should be noted that if the ceilings are raised sufficiently to be effective, they will enable commercial banks to attract funds now invested in Government securities—short-term and long-term. This may have a detrimental effect on the Government securities market and even lead to higher levels of interest rates generally, as applied to the borrowing public. I doubt the need for, and prospective benefits of, a present change in the ceiling rates on time and savings deposits are such as to warrant risking this possible consequence.

December 4, 1956

Revision of Regulation K, Corporations Doing Foreign Banking or Other Foreign Financing under the Federal Reserve Act.

Effective January 15, 1957, the Board revised Regulation K, which relates to corporations doing foreign banking or other foreign financing under Section 25 or 25(a) of the Federal Reserve Act, in order to clarify and make more

specific the rules applicable to such corporations, particularly the rules relating to their activities in the United States. (Prior to this revision, Regulation K was issued under the title "Banking Corporations Authorized to do Foreign Banking Business under the Terms of Section 25(a) of the Federal Reserve Act.")

Votes for this action: Messrs. Martin, Balderston, Szymczak, and Shepardson. Votes against this action: Messrs. Mills and Robertson.

Adoption of the revised Regulation K followed a lengthy review, prompted by numerous questions arising under the Board's supervisory responsibility, as to what activities were appropriate and inappropriate for an Edge Act corporation, particularly in the United States, in the light of the provisions of Section 25(a) of the Federal Reserve Act. A primary objective of the study was to enable the Board to determine what changes should be made in existing regulations, agreements, and policies in order to deal with such questions on a general basis rather than on an *ad hoc* basis.

For purposes of the study a special committee was set up, composed of personnel from the Board's staff and the Federal Reserve Banks, which functioned under relatively broad terms of reference, being requested among other things to consider the activities of various types of institutions engaged in international or foreign banking and to appraise the operations of United States financial institutions in the financing of foreign trade and commerce. Following receipt of the special committee's report, the Board created a legal committee, composed of counsel from the Board's staff and the Federal Reserve Banks, and directed such committee to prepare a draft revision of Regulation K reflecting the special committee's conclusions. When the draft revision was available, the Board gave extended consideration to it, received the views of affected corporations, published a proposed regulation in the Federal Register, and considered comments received from interested parties as the result of such publication.

Regulation K, in the revised form adopted by the Board, applies both to Federal corporations organized under Section 25(a) of the Federal Reserve Act for the purpose of engaging in international or foreign banking or other international or foreign financing operations and, to the extent specified in Section 11 of the Regulation, to State-chartered corporations having agreements or undertakings with the Board under Section 25 of the Act.

The chief purposes of the revision were to bring the Regulation up to date, to reaffirm and clarify the separation of deposit banking and other foreign financing functions, as carried on by corporations subject to the Regulation, and to prescribe the activities that may and may not be carried on by such corporations in the United States incidental to their international or foreign business.

A corporation engaged in foreign *banking* under the Regulation may conduct deposit business, accept drafts or bills of exchange, make loans related to foreign business, and, subject to the permission of the Board, invest in stock of other corporations engaged in foreign banking activities. It may not issue, underwrite, sell, or distribute securities or issue its own obligations, except within certain narrow limitations. On the other hand, a corporation engaged in foreign *financing* under the Regulation may finance itself by the issuance of debentures, bonds, and similar obligations and, with the advance permission of the Board, may make certain kinds of investments in other foreign corporations not engaged in banking business. Like the foreign banking corporation, a foreign financing corporation may make loans related to foreign business, but it may not receive deposits or accept drafts or bills of exchange.

Governors Mills and Robertson voted against this action because in their opinion the revised Regulation K contained provisions relating to banking and financing activities of affected corporations which were unduly liberal, were inconsistent with the intent of the controlling statutes, and could tend to encourage undesirable practices.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the 12 Federal Reserve Banks and their 24 branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable.

In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1956 program for the examination of State member banks was practically completed.

Bank holding companies. The Bank Holding Company Act of 1956 became effective on May 9, 1956. During the remainder of the year the Board approved the acquisition of voting shares of one bank by a bank holding company pursuant to Section 3(a)(2) of the Act, and issued one tax certification in accordance with the tax provisions of the Act.

During 1956, pursuant to the Banking Act of 1933, as amended, the Board authorized the issuance of four voting permits for general purposes and 10 permits for limited purposes to holding company affiliates of member banks.

To provide information with respect to such organizations, regular annual reports were obtained from holding company affiliates to which voting permits have been granted. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to six organizations and rescinded one determination previously made.

Trust powers of national banks. During 1956, 31 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to 8 banks which previously had been granted certain trust powers. Trust powers of 28 national banks were terminated, 26 by voluntary liquidation, consolidation, or merger, and 2 by voluntary surrender.

At the end of 1956, there were 1,722 national banks holding permits to exercise trust powers.

Foreign branches and banking corporations. Under the provisions of Section 25 of the Federal Reserve Act, the Board approved during 1956 five applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States. One member bank opened a branch in Rio Piedras (San Juan), Puerto Rico. Another opened branches in Hato Rey (San Juan), Puerto Rico; Mayaguez, Puerto Rico; Panama, Republic of Panama; and Maracaibo, Venezuela. The latter two branches had been authorized by the Board in 1955. One office in Germany, heretofore shown as a branch, was removed from the list of foreign branches of member banks and is now regarded as a military banking facility.

At the end of 1956, seven member banks had in active operation a total of 115 branches in 26 foreign countries and overseas areas of the United States. Of the 115 branches, three national banks were operating 89 and four State member banks were operating 26. The foreign branches were distributed geographically as follows:

Latin America	**58**
Argentina	10
Brazil	10
Chile	2
Colombia	4
Cuba	20
Mexico	2
Panama	5
Peru	1
Uruguay	1
Venezuela	3
Continental Europe	**5**
Belgium	1
France	3
Germany	1
England	**11**
Near East	**4**
Egypt	1
Lebanon	2
Saudi Arabia	1
Far East	**20**
Hong Kong	1
India	2
Japan	10
Philippines	5
Singapore	1
Thailand	1
United States Overseas Areas	**17**
Canal Zone	4
Guam	1
Puerto Rico	12
Total	**115**

There was no change in 1956 in the list of corporations organized under State laws which operate under agreements with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. One of these "agreement" corporations was examined in 1956 by an examiner for the

Board of Governors. Of the four corporations in operation, one has no subsidiaries or foreign branches; one operates a branch in France; one has an English fiduciary affiliate; and one operates an agency at the New York International Airport, has a branch in England, and owns all the stock of a bank organized under the laws of, and operating in, Liberia.

At the end of 1956 there were in operation three banking corporations organized under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. The home offices of these corporations are located in New York City and all were examined during the year by examiners for the Board of Governors. One such institution has no subsidiaries or foreign branches; one has a branch in France and an English fiduciary affiliate; and one operates branches in Germany, France, Singapore, and Lebanon (authorized by the Board in 1955 and opened in 1956). The Board approved during 1956 an application by one of the institutions for permission to establish a branch in Guatemala.

In 1956, examiners for the Board of Governors, jointly and in cooperation with examiners for the Banking Department of the State of New York, examined the 12 Caribbean area branches of a State member bank.

Inter-Agency Bank Examination School. During 1956, four sessions of the School for Assistant Examiners and one session of the School for Examiners were held. The Inter-Agency Bank Examination School is conducted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. Since the Inter-Agency School was established in 1952, the various sessions have been attended by 626 men, representing the three Federal bank supervisory agencies, the State Banking Departments of Connecticut, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, New Hampshire, New Jersey, North Dakota, Ohio, Oklahoma, Oregon, and Virginia, the Treasury Department of the Commonwealth of Puerto Rico, and one foreign country.

Federal Reserve membership. The 6,462 banks that were members of the Federal Reserve System at the end of 1956 accounted for 47 per cent of the number and held 85 per cent of the deposits of all commercial banks in the United States. State member banks

accounted for 20 per cent of the number of all State commercial banks and held 70 per cent of the deposits of these banks.

The membership of 4,651 national banks and 1,811 State member banks reflected net declines for the year of 41 and 40 respectively. The continued decline in the number of member banks was largely the result of consolidations and absorptions; branch offices were opened in the former locations of most of these banks. Other declines included 14 State member banks that withdrew from membership and 3 national banks that converted into nonmember banks.

Newly established banks included 30 national and 6 State members. Ten nonmember banks were admitted to membership and seven banks became members by conversion from nonmember to national banks.

LEGISLATION

Bank Holding Company Act of 1956. The Bank Holding Company Act of 1956, approved May 9, 1956, makes it unlawful for any bank holding company, as defined in that Act, to acquire bank stocks or take certain other actions without the prior approval of the Board of Governors of the Federal Reserve System. It further requires every bank holding company to divest itself of its interests in nonbanking organizations, with certain enumerated exceptions, by May 9, 1958. The Act also prohibits loans by subsidiary banks of a bank holding company to that bank holding company or to other subsidiaries of that company. Amendments to the Internal Revenue Code provide certain tax benefits with respect to distributions by bank holding companies of their interests in either banking or nonbanking organizations as required by the new Act.

Purchase of Government obligations by Federal Reserve Banks. The authority of the Federal Reserve Banks under Section 14(b) of the Federal Reserve Act to purchase and sell direct or fully guaranteed obligations of the United States directly from or to the United States, which would have expired on June 30, 1956, was extended until June 30, 1958, by Act of June 25, 1956.

Defense Production Act of 1950. The Defense Production Act of 1950, Section 301 of which is the basis for guarantees of loans for defense production, which would have expired on June 30, 1956, was amended and continued in force until the close of June 30, 1958, by Act of June 29, 1956.

Salary of Federal Reserve Board members. By Act of July 31, 1956, adjusting the compensation of certain officials of the Federal Government, the rate of basic compensation of the Chairman of the Board of Governors of the Federal Reserve System was increased from $16,000 to $20,500 per annum, and the rate of basic compensation for other members of the Board was increased from $16,000 to $20,000 per annum. This Act, in effect, amended Section 10 of the Federal Reserve Act.

RESERVE BANK OPERATIONS

Loan guarantees for defense production. Under the provisions of the Defense Production Act of 1950 as amended and the implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private financing institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with or in contemplation of termination of their defense contracts. The guaranteeing agencies are the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, the General Services Administration, and the Atomic Energy Commission.

The present program is a reactivation of the V-loan program utilized during World War II. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies in receiving applications and in the making of such contracts of guarantee.

During 1956, the guaranteeing agencies authorized the issuance of 57 guarantee agreements amounting to $186 million.[2] During 1955, there were 44 guarantee agreements authorized amounting to $75 million. On December 31, 1956, guarantee agreements outstanding covered credits totaling $514 million, of which $389 million represented actual loans outstanding and $125 million was

[2] Regulation V, Loan Guarantees for Defense Production, provides that rates of interest, guarantee fees, commitment fees, and other charges which may be made with respect to guaranteed loans and guarantees executed through the agency of any Federal Reserve Bank under the Regulation will from time to time be prescribed, either specifically or by maximum limits or otherwise, by the Board of Governors after consultation with the guaranteeing agencies designated in the Defense Production Act of 1950, as amended, and pertinent Executive Orders. In view of the higher prevailing structure of interest rates generally, the Board during 1956 gave consideration to increasing the existing 5 per cent maximum rate of interest which lending institutions are permitted to charge on loans made pursuant to Regulation V, but no action was taken in the year.

available to borrowers under guarantee agreements in force. Of the actual loans outstanding, 74 per cent on the average was guaranteed. This compares with total guarantee agreements outstanding December 31, 1955, of $464 million. During the year, approximately $1,122 million was advanced on V-loans, most of which are revolving credits. This compares with total advances of about $931 million made during 1955.

From the beginning of the program in September 1950 through December 31, 1956, 1,468 V-loans totaling $2,761 million were authorized by the procurement agencies which may guarantee such loans under the Defense Production Act of 1950. Of the total number of loans authorized, 56 per cent of the number and 7 per cent of the amount were loans under $500,000 and 72 per cent of the number and 13 per cent of the amount were loans under $1 million.

Of the total number of loans authorized 42 per cent of the number and 8 per cent of the amount were to borrowers having assets of under $500,000; 58 per cent of the number and 13 per cent of the amount were to borrowers having assets of under $1 million. Seventy-three per cent of the number and 19 per cent of the amount of loans authorized were to borrowers having less than 500 employees.

Under the law as amended by the Defense Production Act amendments of 1956, authority for the V-loan program, unless further extended, will terminate on June 30, 1958.

Volume of operations. Table 5 on page 79 gives the volume of operations in the principal departments of the Federal Reserve Banks for the years 1952-56. Checks handled continued their upward trend, exceeding the all-time high reached the previous year. Discounts and advances and the volume of currency received and counted also showed increases over 1955; on the other hand, coin received and counted declined slightly.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of each Federal Reserve Bank during 1956 are shown in detail in Table 6 on pages 80-81, and a condensed historical statement is shown in Table 7 on pages 82-83. The table on page 64 summarizes the earnings and expenses and the distribution of net earnings for 1956 and 1955.

Current earnings of $595 million in 1956 were 44 per cent more than in 1955, reflecting a considerably higher average rate of interest

on holdings of United States Government securities. Earnings from discounts and advances also were greater than in the year before, reflecting increases in the discount rate and a rise in the volume of discounts and advances. Current expenses of $121 million were about 10 per cent above 1955. Current net earnings amounted to $474 million, an increase of 57 per cent from 1955.

Profit and loss additions and deductions were relatively small, leaving net earnings before payments to the United States Treasury at $474 million.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1956 AND 1955

[In thousands of dollars]

Item	1956	1955
Current earnings	595,649	412,488
Current expenses	121,182	110,060
Current net earnings	474,467	302,428
Additions to current net earnings	[1] 359	178
Deductions from current net earnings	383	[1] 443
Net deductions	24	265
Net earnings before payments to U. S. Treasury	474,443	302,163
Paid U. S. Treasury (interest on F. R. notes)	401,555	251,741
Dividends paid	18,905	17,712
Transferred to surplus (Sec. 7)	53,983	32,710

[1] Includes $268,000 of net profits in 1956 and $506 of net losses in 1955 on sales of U. S. Government securities.

Statutory dividends to member banks amounted to $19 million, a rise of about $1 million over 1955 that reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital of the Federal Reserve Banks.

Payments to the United States Treasury as interest on Federal Reserve notes amounted to $401 million in 1956. This was 90 per cent of net earnings after dividends and allowances for building up surplus to 100 per cent of subscribed capital of those Banks whose Section 7 surplus was below that amount. These allowances are consistent with the provisions of the franchise tax when it was in effect; for 1956 allowances for bringing surplus up to subscribed

capital were $9,366,000 for four Banks, and for 1955 they were $4,739,000 for two Banks. Total payments to the Treasury as interest on Federal Reserve notes since the policy of making such payments was begun in 1947 have amounted to $2,451 million.

The $54 million of net earnings remaining after dividends and payments to the United States Treasury were added to surplus account.

Holdings of loans and securities. Average daily holdings of loans and securities during 1956 were about the same as during 1955; holdings of discounts and advances increased $167 million and holdings of United States Government securities decreased $183 million. The average rate of interest earned on discounts and advances rose from 1.96 to 2.76 per cent, reflecting increases in the discount rate to 3 per cent; and the average rate on Government securities rose from 1.67 to 2.41 per cent. Total earnings on loans and securities amounted to $595 million, an increase of $183 million over 1955. The accompanying table shows holdings, earnings, and interest rates on loans and securities held by the Federal Reserve Banks during the past three years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1954–56

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Industrial loans	Acceptances	U. S. Government securities
Average daily holdings:[1]					
1954	$24,866,567	$216,697	$1,179	.....	$24,648,691
1955	24,570,401	666,152	607	$12,422	23,891,220
1956	24,563,390	833,297	837	20,662	23,708,594
Earnings:					
1954	438,359	3,479	43	.....	434,837
1955	412,303	13,085	24	216	398,978
1956	595,396	23,025	36	547	571,788
Average rate of interest (per cent):					
1954	1.76	1.61	r3.64	.....	1.76
1955	1.68	1.96	r3.99	1.74	1.67
1956	2.42	2.76	4.26	2.65	2.41

r Revised.
[1] Based on holdings at opening of business.

Foreign and international accounts. Gold and dollar assets held for foreign account at the Federal Reserve Banks increased by $68 million in 1956, substantially less than the rise for the previous year. At the end of the year holdings amounted to $9.9 billion, representing $5.5 billion of earmarked gold, $3.9 billion of United States Government securities, largely Treasury bills, $322 million in dollar deposits, and $139 million of miscellaneous securities.

An account was opened for the newly established International Finance Corporation. The gold and dollar assets of the International Monetary Fund, the International Bank for Reconstruction and Development, and the International Finance Corporation held at the Federal Reserve Bank of New York declined by $471 million. Total holdings of these international institutions amounted to $3.3 billion at the year-end.

Accounts were opened also for two central banks, one in Asia and the other in Africa.

As in 1955 loans secured by gold collateral were of relatively minor importance. A loan of $1 million outstanding at the beginning of the year was liquidated in January. New credit arrangements amounted to a total of $36.5 million, of which $25 million was outstanding at the year-end. Loans on gold are ordinarily made to foreign monetary authorities to assist them in meeting seasonal dollar shortages.

The Federal Reserve Bank of New York, as depositary and fiscal agent, continued to perform various services for the International Bank for Reconstruction and Development and the International Monetary Fund, and it also extended such services to the International Finance Corporation. As fiscal agent of the United States, the Bank operated the United States Exchange Stabilization Fund pursuant to authorization and instructions of the Treasury Department. On behalf of the Treasury Department it continued to administer the foreign assets control regulations pertaining to assets in the United States of, and transactions with, Communist China and North Korea and their nationals. Since the end of July 1956 it also has administered such regulations involving certain assets of the Egyptian Government and the Suez Canal Company.

Bank premises. During the year the Board authorized the construction of new buildings for the Nashville, El Paso, and Houston Branches, and the construction of an addition to the Branch building at Birmingham.

With the approval of the Board, the Federal Reserve Bank of Chicago completed the program for acquiring property adjacent to the head-office building for future expansion. The Federal Reserve Bank of Atlanta consummated the purchase of property adjacent to its head-office building which had been occupied for the last five years under a lease-purchase agreement previously approved by the Board.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The accounts of the Board for the year 1956 were audited by the public accounting firm of Arthur Andersen & Co., whose certificate follows:

To the Board of Governors
of the Federal Reserve System:

We have examined the balance sheet of the Board of Governors of the Federal Reserve System as of December 31, 1956, and the related statement of income and expenses for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statement of income and expenses present fairly the financial position of the Board of Governors of the Federal Reserve System as of December 31, 1956, and the results of its operations for the year then ended, and were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Andersen & Co.

Washington, D. C.,
February 5, 1957.

Balance Sheet—December 31, 1956

Assets

Cash in Federal Reserve Bank of Richmond			$ 776,998.74
Petty cash			800.00
Due from Federal Reserve Banks and Treasury Department			84,497.17
Travel advances and miscellaneous receivables			7,907.60
Stockroom and cafeteria inventories, at cost			18,172.47
Property and equipment:	At cost	Reserve for depreciation	
Land and improvements	$ 792,852.42	$ —	
Building	3,832,774.61	—	
Furniture and equipment	486,519.36	297,711.97	
Automobiles	10,368.22	10,368.22	
	$5,122,514.61	$308,080.19	4,814,434.42
			$5,702,810.40

Liabilities and Fund Balances

Accounts payable		$ 298,682.95
Employee income taxes withheld		127,885.52
Accrued payroll		162,229.47
Fund Balances:		
Balance, December 31, 1955	$4,886,418.56	
Excess of income over expenses, per accompanying statement	225,447.17	
Property and equipment adjustments	2,146.73	
Balance, December 31, 1956	$5,114,012.46	
Represented by—		
Property and Equipment Fund		4,814,434.42
Operating Fund		299,578.04
		$5,702,810.40

Note—The Board provides for depreciation of furniture and equipment and automobiles, but depreciation of the building has not been recognized in the accounts inasmuch as the Board deems a provision for such depreciation as unnecessary since funds for replacement of the building will be obtained, when required, from outside sources.

Statement of Income and Expenses
For the Year Ended December 31, 1956

Income:	
Assessments against Federal Reserve Banks	$5,339,800.00
Bulletin sales	35,903.14
Other publications sales	18,114.96
Miscellaneous income	2,239.74
	$5,396,057.84
Expenses:	
Salaries	$3,379,468.32
Retirement and insurance contributions	270,300.40
Traveling expenses	284,605.09
Postage and expressage	53,210.13
Telephone and telegraph, including leased wire operations (net)	80,623.25
Printing and binding	191,392.28
Stationery and supplies	36,277.16
Equipment and other rentals	26,050.59
Provision for depreciation	24,137.12
Books and subscriptions	13,985.60
Heat, light, and power	41,784.28
Repairs, maintenance, and alterations	34,881.55
Insurance	5,707.55
Consumer Finances Surveys	158,723.31
Consumer Instalment Credit Surveys	308,522.73
Business Loan Survey	28,667.14
Retail Trade Survey	25,000.00
Legal, consultant, and audit fees and expenses	70,499.94
Security clearance investigations	60,095.00
Loss from operation of cafeteria (net)	47,090.46
Other	29,588.77
	$5,170,610.67
Excess of income over expenses	$ 225,447.17

Notes—In 1956, the Civil Service Retirement Act was amended to increase retirement benefits. The Board approved amending its Plan to incorporate such increased benefits. The additional costs for 1956 and for past service have not been determined and will not be paid until 1957. The amount is expected to be substantial.

Salaries, and retirement and insurance contributions exclude approximately $70,500 and $7,400, respectively, which were charged direct to cafeteria operations.

The Board's expenses in 1956, as shown in the statement above, include $323,001 for Consumer Instalment Credit Surveys and other costs incurred during the year for a study of consumer instalment

credit undertaken by the Board of Governors at the request of the President through the Chairman of the Council of Economic Advisers. Also included are costs of $61,411 for emergency planning programs under Defense Mobilization Order 1-20.

The Board received the following reimbursements in 1956 for expenditures which it makes on a reimbursable basis:

Printing Federal Reserve notes	$4,893,506.24
Currency Redemption Division (Office of the Treasurer of the United States)	406,708.00
Federal Reserve Issue and Redemption Division (Office of the Comptroller of the Currency)	186,894.63
Leased wire service (telegraph)	438,750.80
Leased telephone lines	8,728.00
Miscellaneous	22,097.81

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Output, employment, consumption, and business investment in fixed capital established new records in 1957 in the United States and in other industrial countries. During much of the year, striking cross currents and mixed tendencies influenced economic conditions. At the year-end, economic activity was declining in the United States and Canada, but it was continuing at advanced levels in the industrial countries of Western Europe.

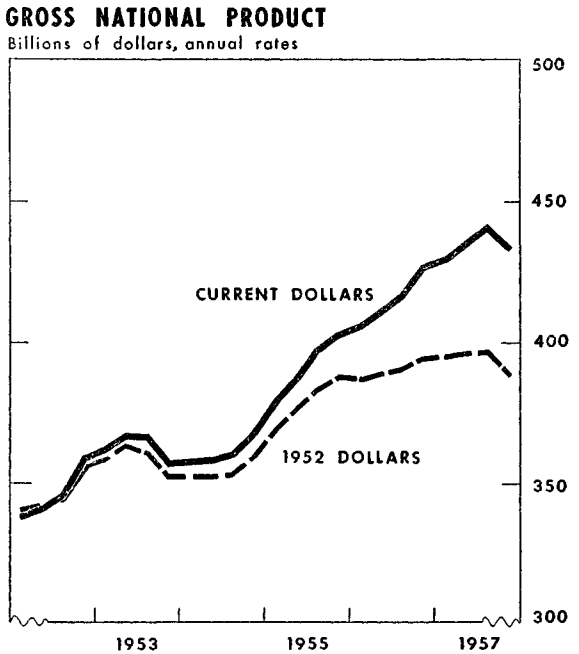
During the first three quarters of the year inflationary forces continued to push prices of goods and equities upward. The pressure of capital and credit demands on the supply of new savings and other loan funds, in the face of restrictive financial policies of governments and monetary authorities, led to the highest levels of interest rates in more than two decades.

In late summer and early autumn, financial tensions and uncertainties, domestic and international, became dominant forces. By mid-autumn, inflationary pressures were abating and there were indications, both in this country and abroad, of less intensive resource utilization.

Inflationary Pressures

In the United States, the year opened with output and activity close to capacity in key industries, with margins of unemployed manpower relatively low, foreign demands for American exports very active, and prices of goods and services generally under upward pressure. Uncertainties in late winter suggested the possibility of slackening in aggregate demand. These uncertainties were partly seasonal and partly associated with reductions in inventory demands, in new orders for durable goods, and in housing construction, as well as with declines in prices of basic materials as supplies became more ample.

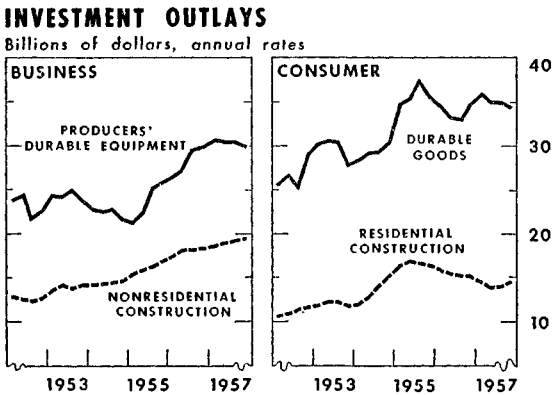
In the spring, however, consumer buying, particularly of nondurable goods and of services, showed renewed strength and imparted



NOTE.—Department of Commerce seasonally adjusted quarterly estimates, deflated by Federal Reserve on basis of Commerce annual data.

fresh impetus to over-all economic activity, encouraging expectations of further intensification of resource use and upward price pressure. Business spending for inventories rose and expenditures for plant and equipment advanced, although at a reduced rate and with some additional slowing of forward orders. Also, housing starts were rising again.

Until autumn, defense spending increased faster than had been expected. Beginning around midyear new procurement orders were sharply curtailed and expenditures began to taper off. Spending by State and local governments maintained a steady increase. United States exports remained strong, although petroleum exports, which had risen sharply during the Suez crisis, fell off after April. While total industrial production edged off in the second quarter from the high level reached late in 1956 and early 1957, it strengthened during the summer months.



NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation.

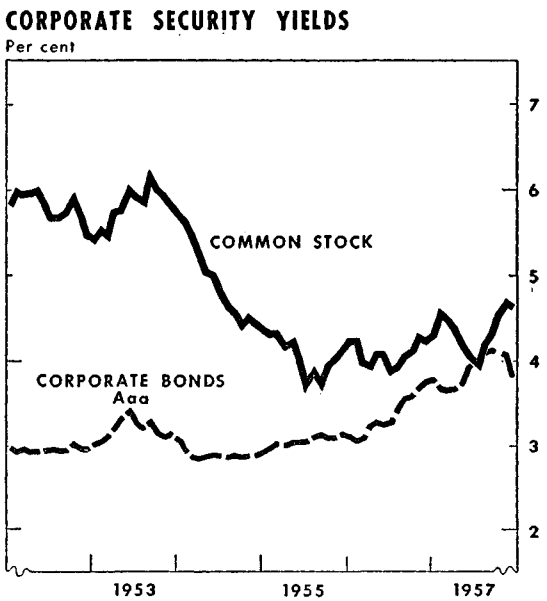
Total employment continued to expand into the third quarter of the year in spite of moderate decline in manufacturing employment. Industrial production was thus not the expanding demand force in labor markets that it had been in the preceding two years. The additional expansion in employment that occurred was primarily in service lines, trade, and State and local government activities.

Economic activity generally continued to rise into the third quarter with inflationary pressures dominant. In that quarter gross national product reached a peak 5½ per cent above a year earlier, reflecting higher prices as well as further expansion in the volume of output.

During the first three quarters of the year demand for bank credit remained strong and bank loans and investments continued to grow. This growth was paralleled by an increase in time deposits. The increase in demand deposits and currency was small and there was a marked lowering of these forms of money holdings in relation to gross national product. With an associated rise in the turnover of demand deposits, the liquidity position of business enterprises and of financial institutions declined further.

A disturbing feature of the economic climate in this country as well as abroad in 1957 was the notion that creeping inflation was an unavoidable and inevitable condition of modern economic life. Partly reflecting this view, common stocks, the most popular hedge against

inflation, rose sharply in price while bond prices were falling. Similarly, farm and urban land values extended their rise. In July, for the first time in two decades, the average dividend yield on stocks fell below the average yield on high-grade corporate bonds.



NOTE.—Yields on common stocks are Standard and Poor's Corporation monthly averages of Wednesday data for 90 stocks: 50 industrials, 20 rails, and 20 utilities. Bond yields are from Moody's Investors Service: monthly averages of daily data on 20 bonds with average maturity of about 25 years.

Until autumn, total credit demands remained vigorous and pressed against the supply of available savings, and market interest rates rose to a postwar peak. In early August, in view of heavy current and prospective demands for bank credit, city banks raised their lending rate to prime business customers from 4 to 4½ per cent. Federal Reserve discount rates, which had remained below market rates for some months, were raised from 3 to 3½ per cent. This increase served to realign them with market rates and to restore their effectiveness as a cost deterrent to member bank borrowing.

Cyclical Turning Point

In late summer and early autumn, mixed trends and uncertainties in the United States and abroad began to dampen business and financial spending plans. In European financial markets, widespread expectations of changes in exchange rates fostered large speculative movements of funds between European centers and particularly toward Germany. These expectations in part reflected fears that inflationary developments would not be arrested in affected key countries, despite restraining actions taken during the summer. The crisis was not resolved until late September, after the Bank of England raised its discount rate from 5 to 7 per cent and the German Bundesbank, almost simultaneously, lowered its discount rate from 5 to 4½ per cent, thereby lessening the incentive for short-term funds to move from sterling into deutsche marks. It then became clear that inflationary trends would be strongly resisted and that key foreign currency values would be maintained.

Unexpected curtailment in defense payments and changes in procurement policies, inaugurated in the United States during the summer to avoid exceeding budget estimates and the debt ceiling, had an unsettling effect on business in early autumn. Also, retail trade, which had been at record levels in July and August, showed signs of sluggishness in September. Partly as a result of these developments, common stock prices, which had already reacted from the high points reached in July, broke further in late September and passed through the lower edge of the trading range that had prevailed during the past two years.

In this context, there was a change in attitudes of businessmen, investors, and the public generally toward spending and investing. Downward adjustments that had been occurring for some months in various individual lines of activity, including capital goods and ordnance lines, became a more widespread influence on spending plans. This change was reinforced by the realization that growth in industrial capacity had been large relative to current and prospective demands. In contrast to earlier indications of strong bank credit demands, bank loans to business during early autumn decreased contrary to usual seasonal tendencies.

Thus the business cycle upswing that began in the third quarter of 1954, nourished at first by outlays for consumer capital goods and

later by a surge of business capital investment, culminated in a turning point in economic activity during the third quarter of 1957.

Decline in Activity

During the fourth quarter, economic recession set in. It was dominated by a sharp liquidation in business inventories and cutbacks in new orders for machinery and equipment. Industrial output declined rapidly, particularly in durable goods lines. Industrial employment as well as the length of the workweek was reduced substantially. Gross national product declined to an annual rate of $433 billion from the record $440 billion in the preceding quarter. Personal income also declined but at a slower rate, in part because increased unemployment benefits offset some of the loss in wage and salary incomes.

These reductions in incomes and expenditures were not reflected in price developments. The average for consumer prices rose further, while that for wholesale prices remained relatively steady at its advanced level.

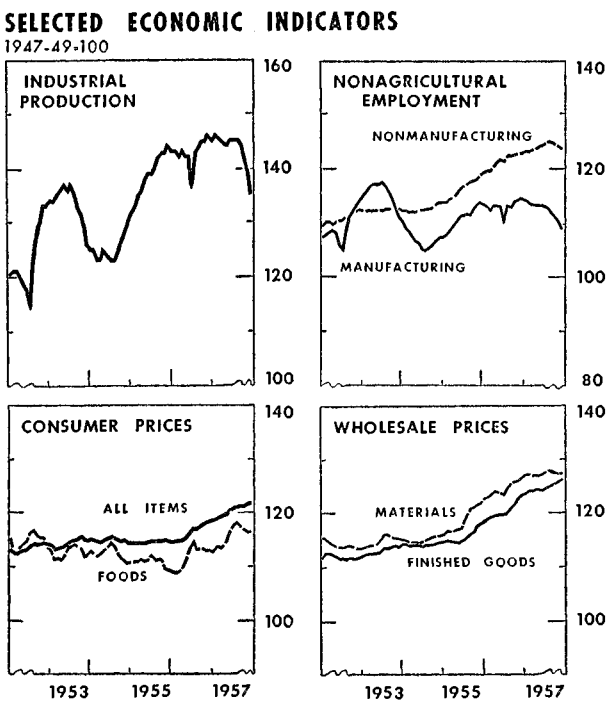
The fourth quarter also witnessed rapid readjustment in financial markets. Credit demands, particularly for carrying business inventories, moderated. Business profits declined sharply. Monetary expansion slowed, and turnover of demand deposits fell.

In view of the indications of changing economic and financial trends, Federal Reserve open market operations in mid-October began to ease restraint on bank credit expansion. In mid-November as the various shifts in the business and financial climate gave evidence of general economic recession, the Federal Reserve Banks reduced their discount rates from 3½ to 3 per cent.

Following this discount rate action, market rates of interest fell abruptly as funds in the credit and capital markets also became more readily available. As the quarter drew to its close, a progressive easing of commercial bank reserve positions was fostered by open market operations. In these circumstances, bank loans and investments began to increase vigorously.

At the year-end, the nation's immediate economic objective was that of cushioning and moderating recession tendencies. The basic problem confronting monetary and fiscal policy was to promote resumed growth of aggregate demand and at the same time en-

courage those essential adjustments and shifts in resource utilization, prices, and costs that would contribute to sustainable economic expansion.

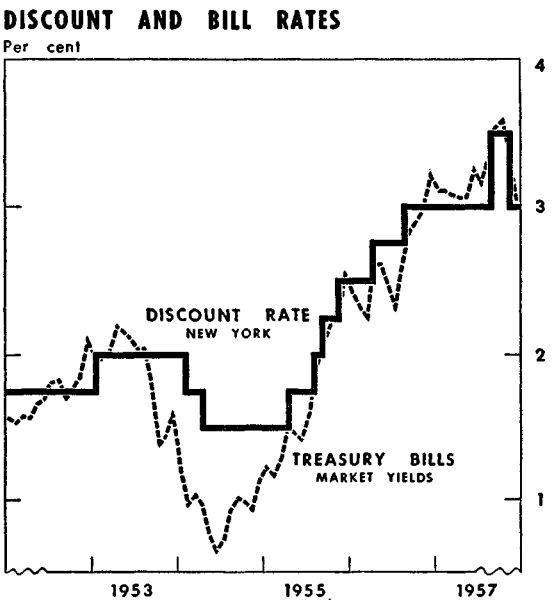


NOTE.—Seasonally adjusted series, except for prices. Bureau of Labor Statistics data for employment and prices, and Federal Reserve data for production.

FUNCTIONING OF THE DISCOUNT MECHANISM

The restraints on bank credit expansion in force from 1955 until the latter part of 1957 featured a considerably more active use of the discount rate than in the previous restrictive period of 1952-53. In the earlier period, discount rates were raised only once—in January 1953, by ¼ percentage point to 2 per cent. During the 1955-57 period in contrast, the Reserve Banks advanced their discount rates four times in 1955, twice in 1956, and once in 1957—altogether from 1½ per cent to 3½ per cent. In November 1957, they were lowered to 3 per cent, reversing the August increase.

The more frequent use of the discount rate is a further step in an evolving process, which began seven years ago when the Treasury-Federal Reserve Accord reactivated the flexibility of monetary policy. It is the purpose of this section of the Annual Report to outline the role of the discount function as an instrument of monetary policy under present-day conditions.



NOTE.—Treasury bill rates are monthly averages of daily market yields on 90-day bills. Discount rate is that charged by the Federal Reserve Bank of New York.

Federal Reserve Bank lending to member banks has taken the form chiefly of advances secured by United States Government securities rather than discounts of commercial paper as envisaged in the original Federal Reserve Act. Following active utilization of the discount mechanism in the early years of the System, this facility was little used from 1934 through 1952. During most of the 1930's, when member banks had large excess reserves, the discount mechanism had mainly a standby significance. During the war and until early 1951, member banks generally found it advantageous to re-

plenish their reserves by disposing of United States Government securities rather than by borrowing at the Federal Reserve Banks. They held large amounts of such securities, the prices of which were supported by the Federal Reserve.

After the spring of 1951, however, when the support policy was discontinued, market prices of Government securities became responsive to supply and demand forces. Thenceforth, when banks, in order to replenish their reserves, sold Government securities, yields were free to rise. When yields on short-term Government securities rose above the discount rate, the discount window at the Federal Reserve Banks became in terms of cost an attractive alternative to security sales as a means of making reserve adjustments.

In 1952-53, as credit demands expanded and Federal Reserve policy limited the amount of reserves made available through open market operations, pressure on bank reserves increased, and member bank borrowing from the Reserve Banks rose rapidly. During this initial revival of the discount mechanism after a generation of disuse numerous problems arose, including uncertainty among many member banks about what was an appropriate use of the discount privilege. A special circumstance was that the then-existing excess profits tax made borrowing from the Reserve Banks profitable to banks subject to the tax. Nevertheless, revival of member bank borrowing demands served to refamiliarize member banks and the Federal Reserve System with the discount mechanism and its role in credit and monetary management.

As one result of these developments, the System re-examined historical experience, notably in the 1920's, with member bank borrowing under prevailing provisions of the law. In the light of practices shown by experience to be appropriate and sound and also in the light of statutory provisions now governing Reserve Bank discounts and advances to member banks, the Board of Governors revised its Regulation A. The revised regulation, effective in February 1955, set forth the following general guiding principles applicable to both the extension of advances and discounts by the Reserve Banks and the use by member banks of the discount privilege:

Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal

requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. Under ordinary conditions, the continuous use of Federal Reserve credit by a member bank over a considerable period of time is not regarded as appropriate.

In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. It keeps informed of and takes into account the general character and amount of the loans and investments of the member bank. It considers whether the bank is borrowing principally for the purpose of obtaining a tax advantage or profiting from rate differentials and whether the bank is extending an undue amount of credit for the speculative carrying of or trading in securities, real estate, or commodities, or otherwise.

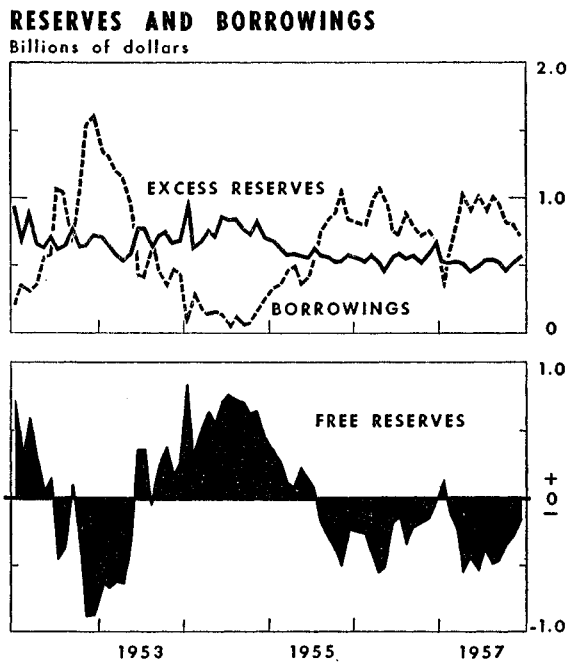
Thus, when monetary restraint once again became appropriate in 1955, the stage was set for a more effective and more readily understood use of the discount mechanism as one element in the process of limiting monetary and credit expansion.

Nature of Discount Instrument

Monetary policy in the United States operates largely by regulating the volume of member bank reserves, which constitute the base for bank credit and the money supply. Apart from infrequent changes in reserve requirements, the reserve base is regulated from week to week and from month to month by open market operations at the initiative of the Federal Reserve System. In a period of monetary restraint, such as prevailed in the past three years, open market policy tends to provide a smaller amount of bank reserves than is called for by the demands for bank credit.

Limited provision of bank reserves on the System's initiative does not mean that additions to reserve funds are prevented, but rather that such further accretions as occur will reflect in part initiative taken by member banks in discounting with the Reserve Banks. Thus, in a period of monetary restraint, reserves for monetary expansion while continuously available, must be obtained to a greater extent through the discount window at Federal Reserve Banks than

in other periods. The provision of the reserves thus supplied is subject to the principles of prudent discounting set forth in Regulation A and to an interest cost—the discount rate established by Federal Reserve action.



NOTE.—Monthly averages of daily figures for member banks. Free reserves are excess reserves less borrowings from Reserve Banks.

In view of the general reluctance of member banks to operate on reserves obtained through continued borrowing, the discount mechanism acts as a brake on bank credit and monetary expansion. Although individual banks may continue to expand their loans from the proceeds of security sales, this gradually reduces their liquidity positions and in time works as a check on their loan expansion. While such sales of securities provide additional reserves to individual banks, they do not add to over-all bank reserves unless they are purchased for Federal Reserve account. In other words, each bank's gain

of reserves is another bank's loss. As a result, restrictive open market operations, by causing more frequent and widespread reserve drains among member banks, leads them to discount temporarily at the Federal Reserve Banks in order to maintain their legal reserve positions.

At times of a relatively large volume of member bank borrowing, many banks are in debt to their Federal Reserve Banks. For each bank, however, borrowing is temporary and the repayment by one bank tends to draw reserves from other banks, which in turn may have need to borrow. Consequently, a progressively larger number of member banks become subject to the restrictive functioning of the discount mechanism over time as the volume of discounts rises.

In a purely accounting sense, an increase in borrowing by member banks, by providing them with additional reserves, offsets, at least in part, the effect of open market operations designed to limit reserve availability. This observation calls for further comment on the role of discounting.

The discount mechanism acts as a safety valve, providing a temporary means of adjustment to the more frequent reserve deficiencies that occur at times of pressure on reserves. Use of the safety valve, however, does not provide an escape from monetary restraint. In the first place, a higher discount rate makes member bank borrowing more expensive. Secondly, indebted banks tend to restrict credit expansion at such times and to use reserve accretions that come into their possession to repay their debts to the Reserve Banks rather than to make additional loans and investments.

The attitude of member banks toward operating with borrowed resources varies from bank to bank. Many banks never borrow from the Federal Reserve Banks, preferring to make reserve adjustments by varying their holdings of liquid assets or by borrowing from other commercial banks. Many of the banks that do avail themselves of the discount privilege are reluctant to incur frequent indebtedness at the Federal Reserve Banks. This attitude is based on a long-standing tradition among commercial banks against assuming liabilities that take precedence over those to depositors. It is also based on Federal Reserve practice in administering the discount window, which ordinarily discourages reliance on discounting for extended periods. The function of the discount rate at times of re-

straint is to reinforce both the commercial banks' reluctance to borrow or remain in debt and the Reserve Banks' administration of the discount window.

In summary, open market policy and discount policy are complementary instruments of day-to-day monetary policy. In a period of monetary restriction, open market policy limits the availability of bank reserves at the System's initiative. In effect this action places initiative in obtaining additional reserves with the member banks, many of which are reluctant to operate for extended periods on the basis of borrowed reserves. As restrictive monetary policy continues or becomes more intense, there are increases in the frequency, average duration, and volume of discounts, as well as in the number of member banks engaging in such borrowing. At such times, the cost of borrowing reserves—that is, the discount rate—may also be raised. Commercial bank lending and investing policies thus come under increasing restraint.

At a time when a reversal of monetary restraint is called for by economic circumstances, open market and discount policy also operate in association. As reserves are supplied at the System's initiative, one result is that member banks are enabled to repay their indebtedness at Reserve Banks. As this happens and excess reserves accrue, banks seek active uses for them in loan and investment expansion.

Role of the Discount Rate

Because of the restraining effect of borrowing and the stimulating effect of excess reserves on member banks' extension of credit, there is a broad relationship between the amount of borrowings and excess reserves—or the net of these figures—and the level of short-term open market interest rates. When member bank borrowing is at a relatively high level, short-term market interest rates tend to remain close to and at times above the Reserve Bank discount rate.

The effectiveness of the discount rate as an influence on member banks' attitudes toward indebtedness depends upon a number of factors, including the relationship of the discount rate to market rates of interest, especially rates on the market instruments that banks use as secondary reserves. The margin of preference as between one form of reserve adjustment and another is in part affected by the relative cost of the alternative methods.

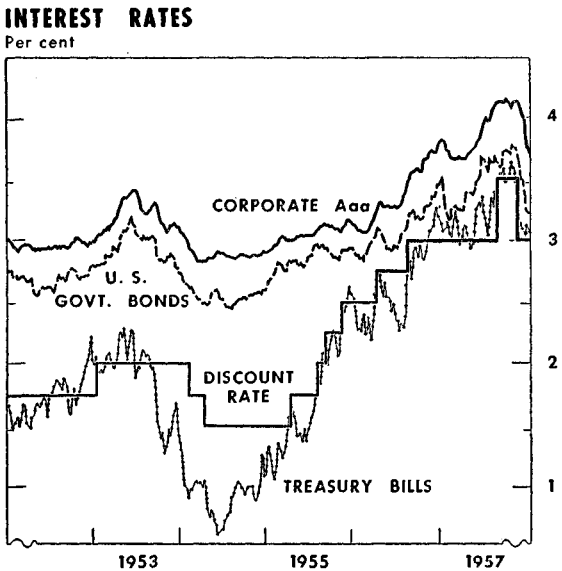
As pressure on bank reserve positions leads to increasingly frequent reserve deficiencies, banks dispose of Treasury bills and other short-term securities, particularly if the market yield on bills is appreciably below the discount rate. Their actions, in view of the active credit demands that are likely to feature a period when credit restraint is in force, increase the market supply of short-term securities and this tends to raise their market yields. As these rise above the discount rate, there is some shift in the margin of preference of member banks as between borrowing and sale of short-term securities to meet reserve drains. If, from the point of view of the Federal Reserve, it is desirable to maintain or increase the pressure on banks to restrict loan expansion, an increase in discount rates may become appropriate.

Although effective discount policy requires that the discount rate remain in touch with market rates, there are no simple rules governing either the magnitude or timing of changes in discount rates. A given change in discount rates may in some circumstances express a shift in direction or intensity of policy. In other circumstances, however, a change may merely represent a technical adjustment designed to maintain the existing degree of restraint or ease, when variations in the strength of credit demands have caused market rates to move substantially above or below the prevailing discount rate.

The relationship between market rates and discount rates is one of interdependence. When market rates rise in periods of monetary restraint, it is desirable that discount rates rise concurrently in order to reinforce the influence of a relatively high level of indebtedness on member bank willingness to extend credit. On the other hand, however, discount rates in such periods are also focal rates in the credit market, and short-term rates tend to become closely related to them. For example, if discount rates are raised above yields on short-term securities, the margin of preference of many banks as between sales of securities and borrowing at Reserve Banks will shift toward sales of securities. This, in turn, will work to raise short-term market yields toward or above the discount rate.

It is evident, therefore, that discount policy can be used more or less actively depending upon the economic and financial situation with which monetary policy is attempting to cope. Discount rates

can be raised fairly aggressively, leading the market to some extent, at times when it is desirable to impose a distinct increase in monetary restraint. In those circumstances member banks would find it desirable to sell securities in order to avoid or reduce indebtedness at the Reserve Banks. At the other extreme, even when there is no



NOTE.—Weekly averages. Corporate series is from Moody's Investors Service; U. S. Government bonds, old series through April 1953, then consolidated series based on bonds due or callable in 10 or more years; discount rate is that charged by Federal Reserve Bank of New York; and Treasury bill series represents market yield on 90-day issues. All Government yields are averages of daily closing bid quotations compiled by the Federal Reserve Bank of New York.

desire to increase the degree of restraint, a significant advance in market rates may require that discount rates be raised in order to avoid a diminished effectiveness of existing restraint.

The discount rate also plays a role at a time of recession, when monetary policy is endeavoring to increase the availability of bank credit to finance expenditures. In the first place, a reduction in discount rates at such times, like an increase in periods of monetary restraint, tends to be reflected in many market rates of interest. Secondly, it makes the direction of Federal Reserve policy perfectly clear

to financial markets and to the public generally, as is true also of increases in discount rates in times of expansion. In addition, as open market operations provide reserves that enable member banks to reduce indebtedness at the Reserve Banks, a lowering of discount rates assures the banks that any temporary reserve drains can be offset by temporary borrowing without severe penalty. In these circumstances, individual banks will tend to be more willing to utilize such increments in reserves as they may experience in expanding their loans and investments. This role of the discount rate in relaxing restraint or in easing credit conditions, while psychological in its impact, may at times justify reductions in rates that lead the market.

Initiative in changing discount rates under the Federal Reserve Act rests with the individual Reserve Banks. The law requires that the Reserve Banks shall establish discount rates every 14 days, and recommend them to the Board for review and determination. Each Reserve Bank has an economic intelligence staff which keeps economic and credit conditions in its District under continuous observation in relation to developments in national markets as well as in relation to international developments. Officials of individual Reserve Banks are also in constant communication with officials of other Reserve Banks and with the Board of Governors, facilitating the exchange of information within the System. Thus, a continuous flow of information about regional, national, and international influences in the economic and credit situation is available to the Reserve Bank directors, who also are actively engaged in banking, business, or other pursuits and who, through these pursuits, have close knowledge of commerce, industry, and agriculture. Coordination of discount rate action among the Reserve Banks is ordinarily effected through this flow and exchange of economic information, although all Banks do not act at the same time or by the same amount.

Discount Policy 1955-57

As rapid recovery from the 1953-54 recession turned into vigorous economic expansion in 1955, Federal Reserve policy gradually changed from ease to restraint. The restrictive policy was designed mainly to limit the rate of bank credit and monetary expansion to a

pace that would foster sustainable economic growth but also dampen inflationary pressures. The policy of restraint—which continued with varying intensity until the autumn of 1957—was implemented by a combination of open market operations and discount rate changes.

Open market policy during the period of restraint limited the growth of bank reserves in the face of rapid expansion in loan demands. This led, among other consequences, to a substantial reduction of bank holdings of United States Government securities and, at the same time, to a decline in excess reserves and an increase in member bank borrowing at the Federal Reserve Banks. Member bank indebtedness rose above $500 million in mid-1955, and, with few exceptions, fluctuated between this amount and $1 billion until late in 1957.

In the course of the entire period, strong demand for loanable funds in credit markets maintained upward pressure on interest rates. As market yields on short-term securities—notably Treasury bills—rose to or above the prevailing discount rates, these rates were increased in order to maintain pressure on member banks to repay their borrowings and thus to restrain their lending activity.

In most instances, the advance in discount rates represented an adjustment to changes that had occurred in market rates rather than an attempt to lead market rates. In contrast with 1952-53, however, such adjustments in discount rates were made quickly and readily. There were few occasions until late 1956 when the yield on Treasury bills remained above the discount rate for an appreciable period.

Discount rates were raised in April, August, September, and November 1955, for a total of one percentage point. In April 1956, 10 Reserve Banks raised discount rates one-fourth percentage point to 2¾ per cent and the Minneapolis and San Francisco Banks advanced rates to 3 per cent. In August 1956, the other 10 Banks went up to 3 per cent.

From August 1956 until August 1957, discount rates remained unchanged at 3 per cent. During most of this 12-month period, Treasury bill yields were above the discount rate. A factor delaying a further increase in discount rates in 1957 was the frequency of Treasury financing operations for both new borrowing and refunding purposes. Also, variation in economic developments was a factor,

as appraisals of economic prospects shifted from exuberance to uncertainty and back to exuberance again.

In August 1957, following several months of rise in market rates of interest, with Treasury bill yields above 3¼ per cent, and with leading banks raising their rate on loans to prime customers to 4½ per cent, discount rates were raised to 3½ per cent after the completion of a large financing by the Treasury. This action represented an effort to maintain the effectiveness of the discount mechanism as a component of restrictive policy in the face of the sharp increases in rates on loans and in market yields on securities.

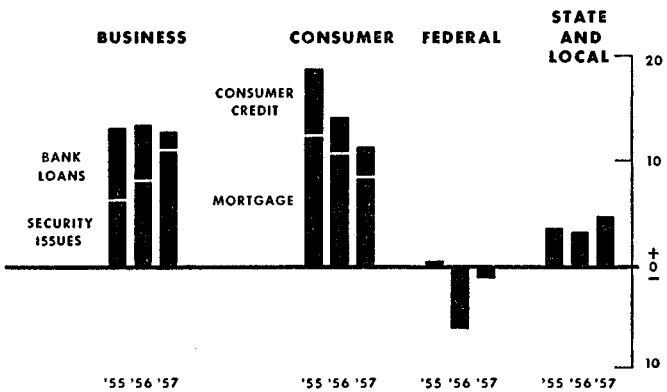
By October, bank loans were being reduced contrary to usual seasonal trends and economic information becoming available suggested that inflationary pressures were abating. In these circumstances, open market operations were modified to lessen restraint on bank credit and monetary expansion. In mid-November, information indicated that general downward readjustment was setting in and Federal Reserve Bank discount rates were reduced from 3½ to 3 per cent. While short-term money rates had shown a declining tendency before this action, this discount rate reduction was intended not as an adjustment to the movement of market rates but rather as a clear signal to the business community and the public generally that Federal Reserve policy was being directed toward moderating pressures on bank reserves.

Postwar experience with flexible monetary policy embraces a relatively short period—in fact, less than a decade. While a pattern of complementary use of the discount and other policy instruments has emerged in this brief period, it would be premature to regard this pattern as established. The Federal Reserve System has had to proceed experimentally, evaluating the relative strength of forces in each developing situation and keeping constantly mindful of the lessons learned from experience and of the public interest as expressed in the Federal Reserve Act and in the Employment Act of 1946. Further development of the complementary use of policy instruments will necessarily have to evolve in this way.

DEMAND AND SUPPLY OF FUNDS IN 1957

Total public and private debt increased somewhat less in 1957 than in the preceding year. After rising by a record peacetime amount in 1955, total debt in the economy grew at a declining rate

in the two subsequent years. With supplies of loanable funds from all sources less readily forthcoming as the capital goods boom extended itself, and with credit demands remaining strong, interest rates rose further until the autumn of 1957. When economic activity turned down in the latter part of the year, total demands for borrowed funds declined. With monetary policy also easing, interest rates fell sharply in the fourth quarter.



NOTE.—Calendar-year totals. *Business:* (1) Security issues—net change in outstanding corporate securities as estimated by Securities and Exchange Commission; (2) bank loans—net change in business loans at all commercial banks with figure for 1957 preliminary. *Consumer:* (1) Net change in mortgage debt outstanding on 1- to 4-family houses with figure for 1957 preliminary, and (2) net change in short- and intermediate-term consumer credit outstanding. *Federal:* Net cash borrowing as reported by the United States Treasury Department. *State and local government:* Net change in outstanding State and local government debt as estimated by Federal Reserve.

CREDIT DEMANDS

Over-all credit demands remained strong in 1957, increasing in some areas and declining in others. As the business investment boom leveled off, business demands for new funds subsided slightly from the advanced level of the previous year. Net borrowing by consumers to finance purchases of both homes and durable goods declined further, after the extraordinary surge of such borrowing in 1955. The Federal Government, on the other hand, reduced its cash

surplus markedly and Treasury debt repayment supplied a smaller volume of funds to financial markets. Borrowing by State and local governments continued to expand strongly. International transactions also brought increased pressures on credit markets in 1957.

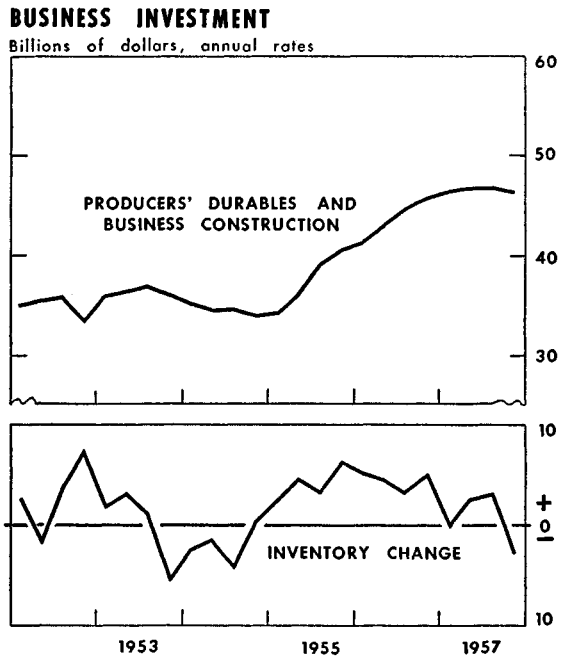
Business sector. The boom in fixed capital spending by business extended itself into the third quarter of 1957 after a record increase in 1956. These outlays were about 8 per cent larger than in the first three quarters of 1956. Business receivables continued to grow rapidly, but additions to nonfarm business inventories were much less than earlier. Consequently total investment outlays of business were about the same as in the first three quarters of 1956.

In the fourth quarter fixed investment expenditures declined while business receivables and inventories were reduced. In this quarter, too, capital commitments and plans for new expansion were being cut sharply.

In financing investment outlays, business corporations had available a somewhat greater volume of internal funds than in 1956, as the continued rise in depreciation allowances was offset only in part by a decline in retained earnings. Even so, they reduced further their holdings of cash and Government securities. The volume of external financing through securities markets and banks combined was thus slightly less than the extraordinary amounts in 1956. There was, however, a marked shift in the external sources of business financing. Security issues for new capital were one-fifth larger than in the previous year. On the other hand, business loans outstanding at commercial banks increased only one-third as much as in 1956.

In the first nine months of 1957, business loans at commercial banks expanded at a slower pace than in the previous year, as loan repayments rose more rapidly than new lending. The amount of new loans made, however, continued to exceed the 1956 volume month by month. In the fourth quarter, there was little net growth in loans outstanding as seasonal borrowings were offset by net repayments on the part of other users of bank credit. Contrary to usual seasonal trends, business loans at commercial banks were actually reduced in October and November.

The shift in business financing from banks to securities markets in 1957 was in part a reflection of the changing pattern of business



NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation.

spending. Inventories were accumulated at a reduced rate as industrial capacity increased and supplies of most materials and products became readily available on short notice. Accordingly, bank financing of inventory expansion was held down and even discouraged. Furthermore, an increasing proportion of the growing total of fixed capital outlays was accounted for by public utility firms, which typically rely more heavily than other industries on borrowing in the capital markets.

The shift by businesses from banks to securities markets also was a result of rapid growth of bank loans in 1955-56, when bank financing was frequently used in anticipation of long-term borrowings. Finally, the reduction in liquidity of businesses and banks that had already occurred tended to discourage, on both the demand and supply sides, further expansion of business loans at banks.

Among other forms of business finance, the expansion of mort-

gage credit other than on 1- to 4-family homes, part of which represents business borrowing, was about one-third less than in 1956. In addition, corporations raised a smaller volume of funds through the sale of United States Government securities. The reduction in holdings of Government securities by nonfinancial corporations was about $2.5 billion, compared with $4.7 billion in 1956.

Although smaller than in 1956, the total amount of funds absorbed by the business sector was large relative to other years. Following as it did two years of rapid debt expansion, the volume of business borrowing in the first nine months of 1957 gave rise, especially in the corporate bond market, to sharply advancing interest rates and to other loan provisions more attractive to lenders. In the last quarter of the year, these tendencies were reversed.

Consumer sector. Consumer indebtedness increased less than in 1956 but the rate of expansion, about 6 per cent, exceeded the growth in consumer incomes. The growth of debt in the form of residential mortgages and consumer credit, at $11.3 billion, was one-fifth less than in 1956 and two-fifths less than the unusual expansion of 1955.

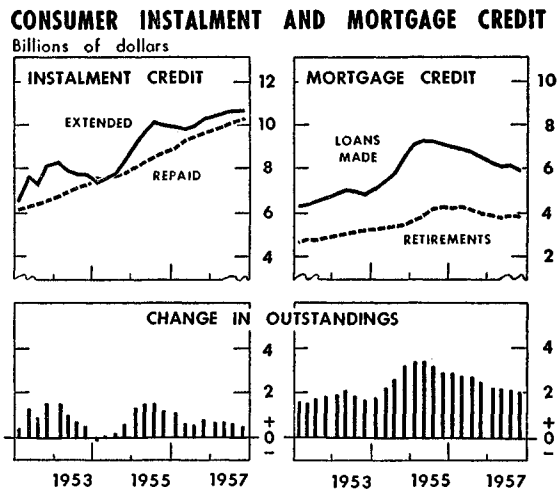
Residential construction, after a two-year decline, leveled out in the spring of 1957. For the year as a whole outlays for residential construction were less than in 1956, as was the volume of sales of existing houses. The slower expansion of residential mortgage debt was related to these developments as both cause and effect.

The slower growth of home mortgage debt in 1957 was reflected mainly in continued sharp reduction of Federally underwritten loans, as market interest yields rose relative to the fixed rates on FHA and VA mortgages. Rates on conventional mortgages rose more than one-half percentage point.

In the course of the year, terms on Federal Housing Administration mortgages were adjusted to improve their competitive position. Maximum permissible interest rates on FHA mortgages, which had been raised one-half percentage point to 5 per cent in December 1956, were increased to 5¼ per cent in August 1957. Although maximum discount schedules were also established, FHA mortgages apparently became more attractive instruments of housing finance, and applications rose markedly in the latter months of the year. Concurrently, with the rate on Veterans Administration mortgages fixed at

4½ per cent, applications in connection with this type of financing dwindled to low levels.

Consumer purchases of automobiles and other durable goods increased in dollar terms in 1957. Extensions of consumer instalment credit also rose, particularly for automobile purchases and personal



NOTE.—*Instalment credit:* Federal Reserve seasonally adjusted quarterly estimates. Repayments include amortization and interest, and changes in outstandings are differences between credit extended and repaid. *Mortgage credit:* Quarterly data, seasonally adjusted by Federal Reserve. Loans made are Federal Home Loan Bank Board's series on mortgage recordings of $20,000 or less. Changes in outstandings are derived from Federal Reserve estimates of mortgage debt outstanding on 1- to 4-family houses. Retirements include prepayments and scheduled amortization of principal and are differences between loans made and changes in outstandings.

loans. Repayments continued to increase rapidly, however, and the expansion in outstanding credit slackened toward the end of the year. Most of the slowdown was accounted for by credit for purchasing consumer goods other than automobiles.

Government sector. The Federal Government's cash operations in the calendar year 1957 resulted in a surplus of $1.5 billion compared with a surplus of $6.3 billion in the preceding year. While tax receipts rose $4 billion, Treasury cash expenditures increased more than twice that amount. Federal spending rose sharply from mid-1956 to mid-1957, with much of the increase in the national

security category. After midyear 1957, outlays and new orders for military procurement were somewhat reduced.

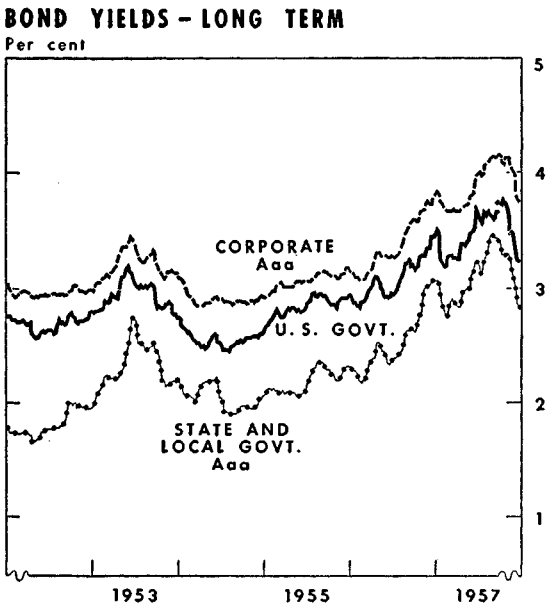
For the calendar year 1957 as a whole, Federal cash expenditures were nearly $9 billion above the level of the previous year. About one-third of the increase was accounted for by spending for goods and services and the rest by transfer payments including social security benefits, agricultural payments, and payments to the States from the highway trust fund.

As the Federal cash surplus declined, net Treasury debt repayment, which had amounted to $5.9 billion in 1956, fell to $1.5 billion in 1957. Aside from returning a smaller volume of funds to the securities markets in 1957, the Treasury found it necessary to sell securities more often and in larger amounts than in 1956. Unanticipated difficulties in managing the Treasury's balances in the early months of the year—associated with heavy redemptions of savings bonds and of maturing securities that were being refunded—led to sales of securities for new money in the amount of nearly $6 billion in the first half. Such financing is usually unnecessary during this period of the year when tax receipts are heavy. In the second half of 1957, new money borrowing also was greater than in the corresponding period of 1956.

In addition to direct Treasury borrowing, various Government agencies increased their sales of securities in the market. Some of the funds obtained financed expanding activities of these agencies; some repaid indebtedness to the Treasury, permitting it in turn to increase expenditures without increasing direct debt.

State and local government expenditures continued to grow steadily in 1957. Following the approval of a record volume of new construction projects at the November 1956 elections, the demand for long-term funds by State and local governments increased. Bonds issued for new capital amounted to $7.1 billion, about one-third more than in 1956. Issues to finance school construction were in record volume and accounted for about two-fifths of the total, compared with one-third in 1956. A large volume of authorized borrowing was still unused at the end of 1957.

Interest costs for both the United States Treasury and State and local governments rose to new high levels during the first three quarters of 1957 as the entire interest rate structure moved up. By



NOTE.—U. S. Government yields are old series through April 1953, then consolidated series based on bonds due or callable in 10 years or more. Yields on corporate and State and local government bonds are from Moody's Investors Service. U. S. Government and corporate yields are weekly averages of daily figures and State and local yields are based on Thursday data.

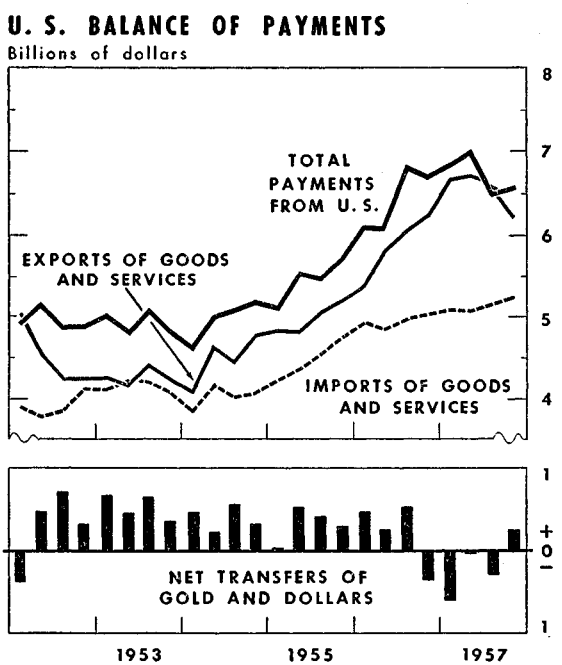
late summer, the spread between short- and long-term Treasury securities had almost disappeared, and long-term Treasury bonds were yielding nearly 3¾ per cent. Yields on the highest grade State and local obligations, which are tax-exempt, reached a peak of nearly 3½ per cent in late August and then turned down. In the last quarter of the year, all rates declined sharply in response to the downturn in economic activity and the relaxation of credit restraint.

International capital transactions. The financing of increased United States exports added to the credit demands of domestic and foreign business borrowers and of the Federal Government. Moreover, foreign holdings of money market assets such as Treasury bills increased much less than in preceding years.

Export of goods and services in the first half of 1957 were at an annual rate of about $27 billion, 20 per cent more than in the corre-

sponding period of 1956. Capital transactions provided much larger sums for the financing of exports than at any time in the preceding four years. Net foreign investment—defined in financial accounts as the increase in United States assets abroad and in gold minus the increase in foreign assets in the United States—was at an annual rate of almost $4 billion in the first half of 1957, compared with about $500 million in the same period of 1956. In the second half of 1957, foreign purchases from the United States were reduced and net foreign investment fell off to about $2.5 billion. At the end of the year it was at a still lower rate.

Financing of the $3 billion excess of foreign purchases in this



NOTE.—*Upper section:* Quarterly data, adjusted for seasonal variation by the Department of Commerce. Total payments from the United States include imports of goods and services, private remittances, Government grants and loans, and net U. S. private capital outflow. Exports of goods and services and Government grants exclude military transfers under aid programs. *Lower section:* Increases in total foreign gold and dollar holdings through transactions with the United States, quarterly, unadjusted for seasonal variation. Dollar holdings include short-term U.S. liabilities to foreigners reported by banks in the United States and U. S. Government long-term securities.

country over United States imports and Government grants was accomplished through the interplay of several types of flows, affecting various segments of United States financial markets. Net outflows of United States private capital and Government credits amounted to about $3 billion and $1 billion, respectively. On the other hand, there was a net inflow of foreign private long-term capital and unidentified net inflows which together amounted to about $1 billion.

Gold sales to the United States by the International Monetary Fund and foreign countries were about $800 million; these, however, were partly offset by an increase, though a smaller one than in earlier years, in aggregate foreign holdings of liquid dollar assets, including Treasury bills and other Government securities, bankers' acceptances, and bank deposits.

The $3 billion outflow of United States private capital had its counterpart in domestic credit markets and in flows of corporate internal funds. Net new investment abroad of $2 billion in subsidiaries of United States companies was supported in part by internal funds of the parent companies and in part by new corporate security issues and bank loans in the United States. Issues of new securities by foreign borrowers and by the International Bank for Reconstruction and Development amounted to about one-half billion dollars in the year 1957 as a whole. Other foreign borrowings net of repayments exceeded one-half billion.

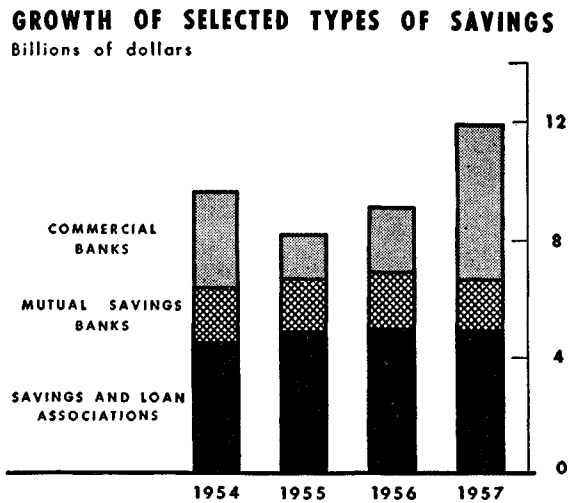
Credit Supplies

The supply of loanable funds from all sources—savings plus bank credit—declined further in 1957, as it had in 1956 after the extraordinary volume of lending that had occurred in 1955. Activation of idle cash balances continued in 1957 but at a slower pace than in the two previous years. New funds available to savings institutions other than commercial banks were somewhat smaller in the aggregate than in 1956 but direct lending by individuals in capital markets increased. Commercial bank credit, reflected particularly in growth in time deposits, expanded by nearly $5 billion—somewhat more than in the two preceding years.

Personal saving. For the year as a whole, net personal saving was little changed from 1956. It declined slightly as a percentage of dis-

posable personal income, reflecting a lower saving rate in the second half of the year.

Saving in financial form, however, increased markedly. The spurt in financial saving by individuals was the result of larger accumulation of financial assets as well as smaller incurrence of debt, and accompanied a rise in interest returns available on savings. Repayments on short- and intermediate-term consumer instalment credit rose from 13.0 per cent of disposable income in 1956 to 13.3 per cent in 1957.



NOTE.—Time deposits (excluding interbank deposits) at commercial and mutual savings banks. Share accounts for all savings and loan associations in the United States, from the Federal Savings and Loan Insurance Corporation. Figures are preliminary for 1957.

Among the financial assets acquired by individuals were exceptionally large amounts of corporate securities and savings deposits at commercial banks, the interest returns on which were rising during much of the year. Their holdings of United States Government securities rose less than in 1956 as substantial amounts of savings bonds were turned in for redemption. While a larger share of individuals' savings was invested directly in securities, a smaller share was invested through the financial intermediaries that channel these savings to capital market borrowers.

Institutional lenders. The growth in combined assets of insurance companies, savings and loan associations, and mutual savings banks was somewhat less than in 1956. While the assets of savings and loan associations increased a little more than in the previous years, those of life insurance companies and mutual savings banks expanded less. More striking than the small changes in the rate of asset growth of these institutions was the shift in the pattern of their investments. The flow of their funds into business securities increased while their new investment in mortgages declined sharply.

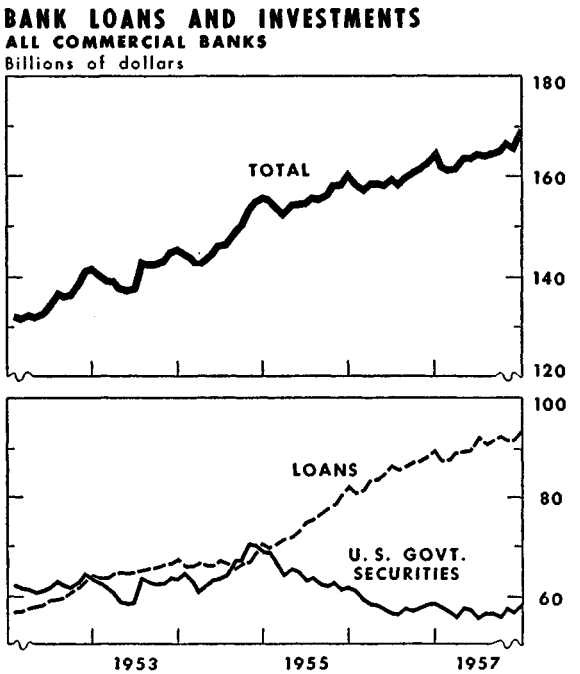
As yields on corporate securities rose more rapidly than those on residential mortgages, the allocation of investment funds by savings institutions shifted accordingly. The growth of net mortgage holdings by life insurance companies was $1.4 billion less than in 1956 while holdings of business securities rose half a billion more than in 1956. Mutual savings banks acquired $800 million of business securities in 1957, compared with $200 million in 1956; on the other hand, mortgage portfolios of these institutions rose $900 million less than in 1956. Savings and loan associations, which are more highly specialized in their lending activity, increased mortgage holdings slightly more than in 1956.

Bank credit. Loans and investments at all commercial banks increased $5 billion in 1957, or one-sixth more than in 1956. Most of the difference between the two years occurred in the fourth quarter, when monetary policy shifted and commercial bank credit expanded $500 million more than in the fourth quarter of 1956.

Bank loan expansion slowed considerably. After rising 16 per cent in 1955 and 9 per cent in 1956, loans outstanding at commercial banks grew 4 per cent in 1957. As noted earlier, business loan expansion slackened in the first nine months of the year and, contrary to seasonal expectations, practically ceased in the last quarter. Other bank loans, however, increased in the fourth quarter by as much as in the same period of 1956.

Bank holdings of securities rose in 1957 after declining substantially in 1955 and 1956. Although United States Government security holdings were reduced by a small amount, holdings of other securities, including those of Government agencies, State and local governments, and business corporations, increased $1.5 billion.

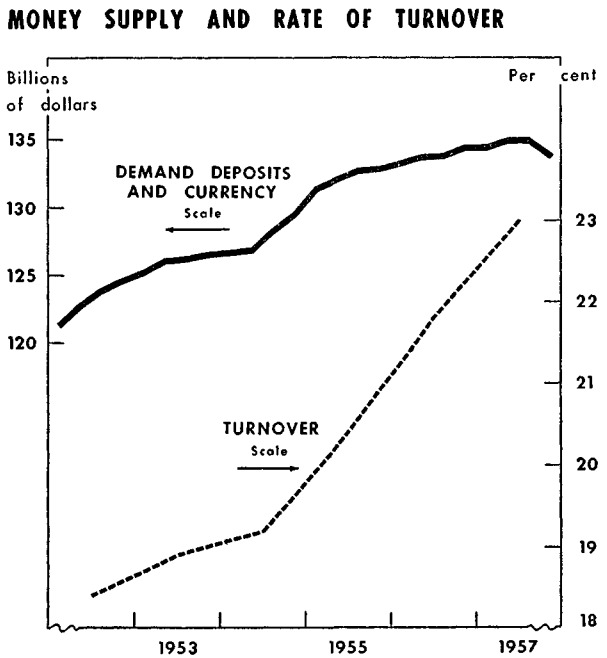
Commercial bank deposit liabilities increased more than in 1956.



NOTE.—Figures are partly estimated. Data exclude interbank loans and are for last Wednesday of month, except for June and December call dates. Figures for last half of 1957 are preliminary.

Within the total, however, demand deposits declined slightly over the year while time deposits grew by a record peacetime amount. The large growth in savings and other time deposits at commercial banks in 1957—amounting to $5.3 billion or more than twice as much as in 1956—undoubtedly represented in part a shift of relatively inactive balances from demand deposits.

Demand deposits adjusted and currency outside banks, generally considered as the active money supply, had increased 3 per cent in 1955 and one per cent in 1956. The latter rate of growth continued in the first half of 1957 but was not maintained thereafter. At the end of the year, the active money supply was slightly below the end-of-1956 level. Turnover of demand deposits rose further in the first three quarters, but not so much as in the preceding two years. In the



NOTE.—Figures for deposits and currency are quarterly averages of seasonally adjusted data for last Wednesday of month and are partly estimated. Demand deposits are for all banks in the United States and exclude U. S. Government and interbank deposits and items in process of collection. Currency excludes bank vault cash. Data for last half of 1957 are preliminary. Figures for turnover are annual averages for 337 leading centers outside New York and 6 other financial centers.

fourth quarter, with the downturn in economic activity, turnover declined.

Since bank deposit expansion during 1957 was in time deposits, which carry low reserve requirements, there was little change in required reserves of member banks during the year. Reserves were supplied early in the year from additions to the country's gold stock and at times by member bank borrowing. Federal Reserve holdings of securities declined on balance during the year.

The principal changes in Federal Reserve policy during the year are summarized on the following page.

Digest of Principal Federal Reserve Policy Actions, 1957

Period	Action	Purpose of action
January–June	Reduced holding of U. S. Government securities by about $1.8 billion. Member bank borrowings increased from an average of $400 million in January to $1 billion in June.	To offset the effect on reserves of seasonal factors and the sale of $600 million of gold to the United States Treasury by the International Monetary Fund, and to exert pressure on bank reserve positions by bringing about a higher level of member bank borrowings.
August	Raised discount rates from 3 to 3½ per cent at all Reserve Banks.	To bring discount rates into closer alignment with open market money rates and maintain the restrictive effect of member bank borrowing.
July–Mid-October	Bought and subsequently sold small amounts of U. S. Government securities at various times. Member bank borrowings remained at or near average of $1 billion.	To meet changing reserve needs and at the same time maintain continuing pressure on bank reserve positions.
Mid-October–December	System holdings of U. S. Government securities increased by $1 billion, including substantial amounts of securities held under repurchase agreement. Member bank borrowings declined to an average of less than $750 million.	To increase the availability of bank reserves and thereby cushion adjustments and mitigate recessionary tendencies in the economy.
November–December	Reduced discount rates from 3½ to 3 per cent at all Reserve Banks.	To reduce the cost of borrowing from the Reserve Banks and eliminate any undue restraint on bank borrowing in view of the decline in business activity and evidences of economic recession.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

The policy directive of the Federal Open Market Committee in effect at the beginning of 1957 was the directive that had been approved at the meetings on November 27 and December 10, 1956. This directive, which placed emphasis on restraining inflationary developments and which was issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System open market account, read as follows:

(1) 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;

(2) 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;

(3) 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 Federal Open Market Committee met 18 times during 1957, and the policy actions taken at those meetings are reported on the following pages by date of meeting, together with the record of votes on each such action. In addition to these meetings, the Committee held a telephone conference of the available members on April 24, 1957 for the purpose of discussing informally the instructions that had been issued at the preceding meeting. No policy actions were proposed or taken during that discussion.

January 8, 1957

1. Authority to effect transactions in System account.

The Committee changed clause (b) of the first paragraph of its directive to provide for open market operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation." Since November 27, 1956 this clause had read "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."

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

The domestic economic situation, as of this meeting, was summarized as strong and still on the inflationary side; while abroad it was partly slackening and partly steady in Europe and inflationary outside Europe. Commodity prices were continuing to tend upward, industrial production had risen slightly in December from the November level and a further rise appeared possible for January, construction activity had been holding close to record levels, total employment was close to the highest levels reported for this season of the year, business inventories had shown a spurt in November (the latest month for which data were available), new orders in durable manufacturing in November exceeded slightly previous record levels, and personal income in November had been 6 per

cent ahead of a year earlier. Department store sales in November and December had shown similar gains over the previous year. The full year 1956 represented close to capacity performance for the domestic economy, and this had taken place while the rate of increase in the privately held monetary stock had declined, the money supply having averaged only 1.3 per cent greater in the course of 1956 than in 1955. Although there had been a more active use of the existing money stock, the cumulative effects of the slower growth in the privately held money stock had operated to retard the further expansion of aggregate demand for goods and services in relation to output and to damp down inflationary pressures.

This business picture showed essentially no change since the December 10 meeting of the Committee, although there were intimations that the upward thrust of the economy might be losing some of its momentum. System open market operations during the closing weeks of 1956, as called for by the directive approved at the November 27 and December 10 meetings, had been designed to meet expected heavy liquidity needs of the period due to seasonal and special international factors. They had, in effect, been conducted so as to prevent any increase in restrictive pressures beyond those previously applied and had actually relaxed pressures somewhat. There had been continued pressures on the market, however, because of the very heavy credit demands, some of which reflected more than the usual business borrowing to meet end-of-year financial needs, owing in part to the reduced liquidity of business. These developments indicated that credit demands continued to be vigorous.

With the economy operating at close to capacity limits and with prices continuing to rise, the change in the policy directive to delete the reference to seasonal factors that brought additional pressures and which had called for some adjustment of policy in the last few weeks of 1956 seemed appropriate. At the same time, the revised wording registered an awareness by the Committee of the possibility of unduly severe restraint inherent in the current low level of corporate liquidity and in the financing program ahead. In other words, the directive issued at this first meeting of 1957 continued the policy of restraint upon credit expansion that had been in effect for approximately two years, but it represented an adjustment from the program followed in the last few weeks of 1956 when funds had

been put into the market to help meet added seasonal pressures within the limits of the policy of restraint.

2. Resolution concerning International Monetary Fund transactions.

The Committee approved the following resolution: "Resolved, that the Federal Open Market Committee express no views with respect to the form in which the International Monetary Fund chooses to draw upon its dollar resources."

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

This resolution was a response to an inquiry by the United States Executive Director of the International Monetary Fund who had inquired whether the Federal Reserve System would see objection to use by the Fund of some of its gold holdings in meeting prospective drawings against the Fund. In concluding that it would express no views as to the form in which the Fund might choose to draw upon its dollar resources, the Committee sought to preserve the utmost freedom to the Fund in meeting its problems. It was not felt that the Federal Reserve System should tell the Fund or any other agency how it should carry out its responsibilities. The Committee wanted, however, to be kept informed by the Fund in advance of its operations in the American market and appreciated having had an opportunity to know of and consider the current proposal. In keeping with this approach, the Committee felt that the System should follow monetary policy that fitted the circumstances whenever external factors occurred. Thus, in approving the resolution it was understood that the Committee's operations would be used to offset the influence of the operations of the Fund in accordance with whatever the Committee's policy might be.

January 28, 1957

1. Authority to effect transactions in System account.

The Committee made no change at this meeting in the wording of its directive to the Federal Reserve Bank of New York, thus con-

tinuing in effect the policy decision that operations for the System open market account should be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation."

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

At the time of this meeting the economic situation domestically remained one of intensive utilization of manpower and other resources and of demand pressure on price levels. Abroad, output and employment generally continued at high levels with price trends most typically on the upside. Domestic industrial production for January was turning out to be at about the same level as in December.

There were at the same time developments that suggested that the economy might be losing some of its upward momentum. While these data were not sufficient to support a forecast of a downward turn as a clear, nearby prospect, they suggested that the economy might be entering a period of sidewise movement. For example, a tendency for total capital expeditures to level off was evidenced by recent figures for factory construction contracts, new machine tool orders, and freight car orders, together with scattered announcements of postponements of plant construction projects. There were cross currents in the area of prices with higher costs showing up in increased prices for finished goods, both at wholesale and at retail, in contrast with a softening trend in prices of a number of primary products. Business loans at all reporting member banks after a fourth quarter rise of $1.6 billion declined by more than $700 million in the three weeks to mid-January, a postwar record decline for the period that compared with a drop of $355 million a year earlier. A rapid decline in security loans had also occurred and about three-fourths of the total rise in loans during the fourth quarter of 1956 had been wiped out. December's sharp rise in interest rates had been followed by an equally sharp decline, the tight tone of the money market by a feeling of ease. The contraction in bank loans that had occurred since the latter part of December had taken place

notwithstanding a continued state of relatively less restraint on bank reserve positions, reflected in a decrease in member bank borrowing to the lowest level since early 1955. This liquidation of bank loans since the Christmas season indicated that most of the unprecedented credit demands in December had been to cover temporary needs for cash.

These mixed developments suggested on balance that, while the situation still seemed to be one of pressures on the expansionary side requiring continued restraint on credit growth, care was needed to avoid becoming too restrictive. In reviewing operations during recent weeks, the Committee recognized that the furnishing of reserves in the latter part of 1956 to meet seasonal and other requirements had actually resulted in some reduction in the degree of restraint on credit expansion that had existed in mid-November. It also recognized that the current relative ease was unintended, since it reflected a larger than expected decline in loans and return flow of currency, as well as the relative immobility imposed on the System by the Treasury financing operation. It was believed that operations now should be designed toward restoring approximately the degree of restraint of the late November-early December period, but it was not believed that an increase in that level of restraint was called for at this particular time.

2. Increase in authority to effect transactions in System account.

The Committee ratified the action taken by the individual members of the Committee as of the close of business January 22, 1957 in increasing by $300 million the authorization to the Federal Reserve Bank of New York to make sales of securities from the System open market account under paragraph (1) of the directive approved January 8, 1957.

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

The directive approved at the meeting on January 8, 1957, provided a limitation of $1 billion on the aggregate amount of securities that might be purchased or sold for the System open market account in carrying out the policy approved at that meeting. By

January 22, the larger than expected contraction in bank loans, along with various other factors adding to the availability of reserves, made it desirable that the System account have greater leeway to makes sales of securities than had been authorized at the January 8 meeting in order to absorb more of the reserves coming into the market and thus to maintain the policy of restraint on inflationary developments. This January 22 increase of $300 million in the limitation was no longer believed necessary at the time of the meeting on January 28 and, in issuing the directive at that time, the Committee fixed the limitation at $1 billion, the same as that approved on January 8.

February 18, 1957

Authority to effect transactions in System account.

No change was made in the policy directive issued by the Committee, which again directed that open market operations be with a view to restraining inflationary developments in the interest of sustainable economic growth, while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation.

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

There was no clear evidence of serious weakness in the economy, although business and financial observers had been reappraising, with some doubts, their year-end expectations that 1957 would bring further advances in business activity and further creeping inflation. Industrial production had hesitated in January and slipped back one index point, but it remained close to record levels. While the general level of wholesale commodity prices had continued to rise from mid-December to mid-January and probably further to mid-February, advances in industrial commodities had slackened since late autumn. For some months industrial construction had been below a year ago and, since the spring of 1956, residential contract awards in millions of square feet had been falling. Nonresidential construction awards for business purposes also had been declining, and avail-

able evidence suggested that plant and equipment expenditures by manufacturing industries were in the process of leveling off. Unfilled orders in durable goods industries had changed little since August, in contrast to the earlier situation of a mounting order backlog. Business inventories had risen through 1956 at about the same rate as in 1955. This increase in inventories had been greater than the rise in sales, so that inventory-sales ratios in manufacturing were currently higher than a year earlier. The labor market was still strong. Government spending for goods and services had been rising steadily, and further steady rise seemed to be in prospect. Consumer incomes had risen further and spending at retail in January had been at about the record level relative to the season of December. Business optimism was running higher than in the third quarter of 1956—a feeling that appeared to be shared by most manufacturing and retail groups. Demand for long-term business funds continued very strong.

From the survey of economic data available, there was evidence of some slackening in the momentum of inflationary tendencies, but as yet there was no clear-cut evidence of a combination of forces that would halt the advance in the foreseeable future. The financial problem of the economy continued to be that of aggregate demand pressing against aggregate supply. Credit developments in recent weeks had continued to indicate a relaxation of pressures, with rapid bank loan liquidation, less strain on bank reserve positions, a sharp decline in money rates, and an improved tone in the bond market which had permitted sale of a large volume of new issues of securities at declining yields. This easing of inflationary pressures was the goal toward which monetary forces had been directed. It was too early to tell, however, whether this was but a temporary lull, the beginning of a downturn, or the attainment of high-level stability. While it seemed clear that it would be unnecessary and inappropriate to have more stringent restraint at this time, there appeared to be confidence in the vitality of the economy, and this suggested that credit policy should not help to promote a new bulge in activity. The Committee's conclusion was that this was a time calling for continuation of the status quo, and on that basis no change in the policy directive was deemed necessary or desirable.

March 5, 1957

1. Review of continuing authorities or statements of policy.

At this, the first meeting of the Federal open Market Committee after the new members elected by the Federal Reserve Banks for the year beginning March 1, 1957 had assumed their duties, the Committee reviewed and reaffirmed all continuing statements of operating policy and specific authorities for operations which were in effect immediately prior to this meeting. Among the continuing statements of policy that were renewed were the following:

a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

b. Operations for the System account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

c. Transactions for the System account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

The action renewing these three statements was taken by unanimous vote, pending further study of these and related matters.

Votes for these actions: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against these actions: None.

2. Authority to effect transactions in System account.

The policy directive of the Federal Open Market Committee was changed at this meeting for the first time since the meeting on Janu-

ary 8, 1957 by adopting wording for clause (b) of paragraph (1) to provide that, among other things, open market transactions would be with a view "to restraining inflationary developments in the interest of sustainable economic growth while recognizing uncertainties in the business outlook, the financial markets, and the international situation." This wording superseded that in effect since January 8, which had called for operations with a view "to restraining inflationary developments in the interest of sustainable economic growth, while recognizing unsettled conditions in the money, credit, and capital markets and in the international situation."

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against this action: None.

This change in wording of clause (b) of the Committee's directive was not an indication of a shift in direction of policy but was designed to emphasize the factor of uncertainty in the current business outlook. The general direction of policy continued to be one of restraining inflationary developments.

In its review of conditions, the Committee found evidence of the slowing down of expansionary forces in many sectors of the private economy but no indication that a pronounced downturn had begun. Rather, there were many underlying forces tending to hold activity at a high level. In contrast to the indications of balance in the private economy, the governmental sectors were showing some signs of strain. State and local government expenditures continued to increase and those of the Federal Government also were rising. It was apparent that the Federal budget surplus would be considerably less during the current year than last, and in addition large cash drains on the Treasury were to be expected for non-budgetary payments such as savings bond redemptions, aid to the mortgage market, drawings by international agencies, and attrition on refundings of marketable securities. There had been some easing in credit markets during January, partly because of funds made available by the Treasury and because bank loans had declined as increased funds had become available for new capital issues. Increased financing strains had developed for the Treasury, and it had had to go to the short-term market for new funds at a time when a reduction in

Treasury debt had been expected. The apparent slackening in demand for private credit, if accompanied by increased Government borrowing, might not present an appropriate occasion for relaxation of restraints on credit in general, since it seemed essential that the Treasury borrow as much as possible from savings or that any Treasury borrowing from banks be largely offset by curtailment in bank credit supplied to private borrowing. It was suggested that the only way in which the economy would continue to have growth without inflation under existing conditions was by reducing spending and increasing saving.

While it was apparent that a sidewise movement was taking place in the economy, there was uncertainty as to which way the economy would go. In any event, however, since the economy's upward momentum had definitely slackened and since the rise in finished goods prices seemed likely to level off in the near future, it was not believed appropriate that overt action be taken toward increasing credit restraint, although maintenance of about the degree of restraint that had existed for some time seemed to be called for. Thus, the Committee sought to continue about the same pressure on credit expansion that had been intended by the actions taken at the last several meetings, and in modifying the wording of the policy clause of the directive it was simply bringing into the picture a specific reference to the business outlook which had not been mentioned in the previous wording.

March 26, 1957

Authority to effect transactions in System account.

The policy directive calling for a continuation of restraint on inflationary developments was renewed without change at this meeting of the Federal Open Market Committee.

> Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: None.

The Committee's review of the economic situation did not indicate a material change since the preceding meeting but rather showed a sidewise movement of activity at inflated price levels.

There had been evidence of slackened momentum in the cyclical advance after some 30 months of sustained rising activity, and the question was how monetary policy should react in this situation after a depreciation in the purchasing power of the wholesale dollar over these months of about 6 per cent and of the consumer dollar of over 3 per cent.

This cyclical rise in activity had gotten its first stimulus from consumer outlays for houses and durables purchased heavily on credit. This had been in direct response to the exceptionally easy credit conditions prevailing in 1954. The size of this stimulus had resulted in a large acceleration in business plant and equipment expenditures but there were other factors bringing about these capital expenditures, such as high wage costs and much technological obsolescence of plant and equipment. The large capital investment had meant a heavy total demand for credit and also that savings would have to increase substantially if monetary expansion were not to get out of control. It also had meant that interest rates would rise to higher levels. In addition, since supplies had to be diverted so largely to producers' goods, thus generating additional income without enlarging short-run supplies of products for current use, the rising investment had meant that commodity and service markets were under heavy demand pressures tending to advance prices. Against this background, the Open Market Committee had directed policy for more than a year before this meeting to resisting inflationary pressures as they intensified.

Although it appeared at this time that the boom had lost much of its buoyancy, it was not possible to tell whether the present sidewise movement would continue for some months, perhaps with a renewed upward movement, or whether the economy would decline. Consumer demand, industrial production, and employment remained at or near record levels, although they were no longer rising appreciably.

The Committee's conclusion that the policy directive should be continued with emphasis on restraint included the understanding that, in adjusting amounts of reserves supplied to the market by the Federal Reserve System, doubts should be resolved on the side of greater rather than less restraint than had existed in recent months.

April 16, 1957

Authority to effect transactions in System account.

The directive of the Committee was renewed without change, continuing the policy of restraint on inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: None.

Economic activity continued on a high plateau with divers surface irregularity. Wholesale prices appeared to be generally stable with consumer prices continuing to tend up. In the credit field, private loan demands were somewhat more moderate than they had been a year earlier, but they were still large and in addition the Government was becoming a new source of borrowing demand on banks. Additional reserves sought by member banks recently had been supplied largely through an increase in member bank borrowing, and the money market had become tighter than at the time of the preceding meeting.

The Committee considered that the increased degree of pressure that had resulted since the preceding meeting had been appropriate. In deciding to renew its policy directive without change, it felt that a stable situation should be maintained for the next few weeks.

May 7, 1957

Authority to effect transactions in System account.

Again the Committee's directive was renewed without change, providing for restraint on inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Vardaman, Williams, and Treiber. Votes against this action: None.

The economy continued to move sidewise but with a slight upward tilt for both gross national product and prices. Credit markets had continued under pressure of large borrowing demands. New securities issues by corporations, though at a slower rate than in the first quarter of the year, had continued relatively heavy. Pressure of credit demand had resulted in a sharp run-up in bond yields although rates on Treasury bills had declined, reflecting an easing of

member bank reserve positions as a result of funds supplied when the Treasury drew down its balances that had been built up during March. Business sentiment appeared to have become more optimistic. There were fewer products in short supply. At the same time, there was a shortage of savings, the country was operating at an inflated price level, and, although monetary policy could not appropriately be used to restore the price level that had been lost through the inflationary process, it was believed that it should be set to counter further inflationary developments. Renewal of the directive without change was on the basis that current developments made a continuation of substantially the existing degree of restraint appropriate and that no overt action to ease or to tighten the situation was called for.

May 28, 1957

Authority to effect transactions in System account.

The policy directive of the Committee calling for restraint on inflationary developments was renewed without change at this meeting.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against this action: None.

The economic situation continued fundamentally strong and essentially unchanged since the preceding meeting. Business sentiment seemed to have improved perceptibly even though current indexes of production and distribution indicated a sidewise movement, at best, or perhaps a slight downward tilt. Wholesale prices had shown little change and retail prices had advanced somewhat further.

The degree of pressure in the money market had continued about unchanged for several weeks, and in renewing its directive without change the Committee sought to have the same situation continue for future weeks. The Committee also observed that the Federal Reserve System would be called upon to supply additional reserves to meet seasonal needs in the second half of the year and discussed whether the directors of the Federal Reserve Banks might consider an increase in the discount rate appropriate as a means of maintaining restraint under these circumstances.

June 18, 1957

Authority to effect transactions in System account.

Renewal of the directive without change at this meeting continued the policy of firm restraint on inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against this action: None.

Over-all economic activity appeared to be showing great strength. The general level of wholesale prices had advanced slightly since mid-May. Consumer prices had been continuing their steady rise and were estimated to be about 4 per cent higher than a year earlier. Expansion of bank loans had unmistakably slowed down this year, but the turnover of demand deposits had risen substantially. Thus, while monetary growth had been moderate during the preceding 12 months, it appeared to have been adequate for the economic activity that could be had on the basis of existing resources. The tighter condition of the money market during the past three months, which had been brought about within the present wording of the Committee's directive, did not appear to have been too restrictive, and the Committee's conclusion was that a firm policy of restraint should be continued for the present.

July 9, 1957

Authority to effect transactions in System account.

Another renewal without change of the directive providing for restraint on inflationary developments resulted from the deliberations of the Federal Open Market Committee at this meeting.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against this action: None.

At midyear, over-all economic activity was being maintained at about the high level of the past winter. Downward adjustments had been going on in a number of lines but the areas of weakness had not widened significantly and upward adjustments had been taking place in other areas. The general sidewise movement during

the first half of 1957 had been similar to that of the first half of 1956. In the earlier year, easing tendencies through July had been followed by strong expansion later in the year. A like course of events was widely anticipated in business and financial circles at the time of this meeting. One of the strong factors at this time was in construction where outlays for residential building had increased in June—the first rise in seven months—following a sharp rise in total construction contracts in May. A disturbing element, however, was the renewed rise in construction costs after six months of relative stability. There also had been a rise in new orders of durable goods manufacturers in May, the first since November of 1956. Average hours worked in manufacturing had increased slightly in June, following several months of decline. Economic activity abroad remained buoyant and a number of countries recently had adopted additional measures to restrain the strong inflationary pressures. It seemed clear that the economy was in a period of prosperity as well as inflation.

Considerable feeling was expressed at this meeting of the Open Market Committee that an increase in the degree of pressure was called for, particularly since the Federal Reserve System would have to supply reserves during the remainder of 1957 to take care of seasonal borrowings and Treasury needs. One of the possibilities discussed was that of putting additional reserves into the market through the System account and at the same time increasing the discount rates of the Federal Reserve Banks as a signal that the System felt that credit policy should be tighter than it had been. It was concluded, however, that under present conditions it would not be wise simultaneously to increase the flow of reserves and to raise discount rates. The Treasury was about to make an offering of securities for which payment would be made when seasonal demand for reserves was increasing. The Committee's decision, therefore, was to renew the directive without change and to maintain but not to increase the existing degree of restraint for the immediate future.

July 30, 1957

Authority to effect transactions in System account.

This meeting of the Committee also resulted in a decision to continue without change the policy directive providing for restraint on inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Shepardson, Vardaman, and Williams. Votes against this action: None.

Data presented at this meeting showed little change in the picture of the economy that had been developed in recent meetings of the Committee. Such new data as had become available, while indicative of divergent trends in various areas, did not alter the over-all impression of the sidewise movement, and they provided no clue as to the direction and intensity of the next major change in economic activity. Prices were up at both wholesale and retail, however, apparently to new highs. During July there had been some moderation of the degree of tightness in money and securities markets. A large Treasury refunding operation was completed and a substantial reduction in bank loans and investments occurred following a sharp increase in June.

The Committee took cognizance at this meeting of a further rise in interest rates, including a sharp rise in bond yields. Although recent credit expansion had been moderate, the world-wide atmosphere of ebullience and the tendency to accept inflation as inevitable seemed to call for continued restraint through monetary and fiscal measures. Four of the European central banks had increased discount rates during the month, and the reports indicated that inflationary pressures existed in Asia, South America, and other parts of the world as well. Commodity prices had shown a disturbing degree of imperviousness to monetary restraint for more than a year.

The Committee's decision that there should be no change in its policy directive at this time but that efforts should be made to regain the degree of pressure that existed before the Treasury refunding operation in July reflected the view that it was appropriate to keep the banking system under substantial pressure. However, it was observed during the Committee discussion that the discount rates of the Federal Reserve Banks at 3 per cent were already lagging behind the rate structure generally and that if other rates continued to rise the directors of some of the Reserve Banks could be expected to give consideration to raising their discount rates.

August 20, 1957

Authority to effect transactions in System account.

No change was made at this meeting in the Committee's directive that policy should be with a view to restraining inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Vardaman, Williams, and Treiber. Votes against this action: None.

In the period between the Open Market meeting on July 30 and that on August 20, the directors of nine Federal Reserve Banks acted to increase the discount rates of those banks from 3 per cent to 3½ per cent. These actions followed an increase from 4 per cent to 4½ per cent early in August in the rate charged by commercial banks on loans to prime borrowers, as well as further increases in other market rates. The increase of one-half percentage point in discount rates generally was regarded as primarily a technical move made at a time when market interest rates were considerably above discount rates. It was recognized that business activity was continuing to move sidewise and that the business outlook seemed to be a little less buoyant than a few weeks earlier. Money markets had tightened somewhat in August. Although a heavy repayment of business loans occurred in July and early August following record tax borrowings in June, demand for credit and capital continued strong.

No change in the directive of the Committee calling for restraint on credit expansion was made at this meeting, but in renewing the directive the Committee did so with the understanding that the System account would have latitude for flexibility in providing reserves during the next few weeks.

September 10, 1957

Authority to effect transactions in System account.

The Federal Open Market Committee's policy directive was again renewed at this meeting without change in the wording calling for restraint on inflationary developments.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Leedy, Mills, Robertson, Szymczak, Vardaman, Williams, and Irons. Votes against this action: None.

When the Committee met on September 10, it again found no material change in over-all business activity since the preceding meeting or, for that matter, for the past several months. Data were presented showing that bank credit had expanded somewhat less rapidly in the past five weeks than in the corresponding period of other recent years. It was also pointed out that banks continued to feel heavy pressure for loans and that the substantial reduction in bank liquidity since a year earlier had intensified that pressure. Monetary expansion had been virtually absent since spring, some slackening in the rise in money turnover had appeared, and normal seasonal pressures could be expected to reinforce the Committee's policy of restraint. Also, it was reported that banks currently were cautious and that since the increase of one-half percentage point in the Reserve Bank discount rates in August, there was recognition throughout the country of the Federal Reserve's policy of firm restraint. Thus, although the Committee made no change in the policy directive, it was renewed with the understanding that in carrying out the broad policy of restraint in the immediate future doubts would be resolved on the side of less rather than greater restraint.

October 1, 1957

Authority to effect transactions in System account.

The directive of the Federal Open Market Committee was renewed without change at this meeting and the policy of restraint on inflationary pressures was thus continued.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, Vardaman, and Williams. Votes against this action: None.

At the time of the October 1 Open Market Committee meeting, an increasing number of business observers were suggesting that the major expansive forces had been spent, that pressure of inflationary forces was in process of lessening and even of dispersing, and that the prospective movement in activity was a decline. Business senti-

ment, which had shown pronounced gyrations over the past two years, being at times more optimistic than the figures and portents, at other times less optimistic, appeared to be developing into a psychology of gloom in some places and was much more cautious about prospects than for some months. That was reflected in inventory policy which, after permitting some rise in the spring months, later was designed to hold inventories in close relationship with sales. On the other hand, the reports to the Committee at this meeting did not present a picture of a settling or declining economy. There was considerable feeling that while inflationary clouds might be breaking up, it would be premature to conclude that they had been scattered.

The most significant financial development reported to the Committee was that there had been a leveling out of interest rates at the advanced level of early August. This leveling out had occurred notwithstanding the increase in Reserve Bank discount rates, the unprecedented two-point rise in the rate of the Bank of England, continued large offerings of new security issues by corporations and State and local governments, and relatively heavy borrowing by the United States Treasury. A smaller than seasonal increase in business loans in the first half of September had been followed by an unusually large decline in the latest week. Required reserves of banks had increased less than anticipated, reflecting the smaller increase in credit and deposits. For the third quarter as a whole, growth in bank loans had fallen further behind the preceding year than had been the case in the second quarter, but bank investments had increased somewhat more than in the previous year. The money supply was less than one per cent higher than a year earlier. This picture suggested that banking developments had kept within the limits envisioned by recent policies of credit restraint and that capital market rates might have reached the level appropriate to the maintenance of equilibrium.

The views of the Open Market Committee at this meeting were that there should be no change in policy or in the Committee's directive at this time. In reaching this conclusion, the Committee did so with the understanding that, in carrying on transactions for the System open market account, an effort would be made to continue the same degree of restrictive pressure that had been sought during the preceding three weeks.

October 22, 1957

Authority to effect transactions in System account.

The Committee renewed its policy directive with the same wording that had been adopted at the meeting on March 5 and at each meeting since, namely, that open market operations were to be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while recognizing uncertainties in the business outlook, the financial markets, and the international situation."

Votes for this action: Messrs. Hayes, Vice Chairman (presiding), Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: None.

The over-all situation at the time of the October 22 meeting was such as to suggest that the Committee should be especially alert to any sign of breakout from the sidewise movement that had been characteristic of business for some months. In a searching reexamination of the economic situation, the Committee found that the latest quarterly and monthly figures showed continuation through the third quarter of 1957 of many features prevailing earlier in the year, with production steady at a high level, price movements in wholesale markets mixed with the average up, and consumer prices generally continuing upward. September industrial production was at 144, down a point from August but within the narrow 143 to 146 range prevailing so far this year. The economy as a whole showed basic strength, but there was uncertainty as to what combination of demands would prevent recession in activity, or, on the other hand, make for an advance in total output and employment from present levels.

In analyzing the implications of recent business and credit developments for monetary and fiscal policy, it appeared that there had been short-run abatement in inflationary pressures, and questions were raised about potential declines in important sectors of activity. Business sentiment had turned more pessimistic than the current indicator picture, and attitudes of common stock investors appeared to reflect a growing disbelief in the extension of inflationary trends. Business loan expansion was continuing to run behind the preceding year. As a result of the increasing uncertainty as to the business

situation, resulting particularly from psychological factors and from international developments including the Russian earth satellite launching, the environment for monetary policy was beginning to look quite different from the boom conditions that initially justified the current restrictive policy. It was suggested that the Federal Reserve System should meet seasonal reserve requirements freely and that, if readjustments then taking place were to gather momentum, some easing of member bank reserve positions and even a decrease in Reserve Bank discount rates might be appropriate. In sum, the economic data presented indicated that developments in business and economic conditions would have to be watched particularly closely in coming weeks in order to make policy adjustments that might be suitable.

The Committee concluded, after reviewing the data, that there was no immediate occasion to reverse its policy of restraint on credit expansion or to make a change in the policy directive. While it was clear that the Committee at this juncture did not wish to make any move which would signal a change in policy, it wished to supply seasonal needs reasonably freely. It did not wish to increase restraint from what it had been. There was some feeling that the Committee should actually diminish restraint a little, but more of the members believed that the Committee should resolve doubts on the side of ease. Thus, in renewing the directive without change, the Committee agreed that although general policy was not to be changed appreciably, it should tend on the easier side from where it had been in recent weeks.

November 12, 1957

Authority to effect transactions in System account.

The directive of the Federal Open Market Committee was changed at this meeting by deleting the clause that had been in effect since March 5, 1957 calling for operations with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth while recognizing uncertainties in the business outlook, the financial markets, and the international situation," and by replacing that clause with wording that called for operations with a view, among other things, "to fostering sustainable growth in the

economy without inflation, by moderating the pressures on bank reserves."

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Shepardson, Szymczak, and Williams. Vote against this action: Mr. Robertson.

Data presented to the Committee at this meeting showed that the economic climate domestically was in process of change, that expansive forces had eased, and that contractive forces had become more prominent. Declines were indicated by data for October covering industrial production, employment, and department store sales, and unemployment claims were running sharply above a year earlier. These changes had followed significant weakening in business sentiment as evidenced by sharp declines in stock market prices, in prices of sensitive commodities, and in new orders. There also had been a sizable number of professional forecasts of business decline. The spreading view that business outlays for fixed capital were heading downward had been given recent support by a survey of plans for capital spending in 1958, which showed a decline of a tenth or more. Private demands for bank credit had eased considerably in October, with business loans at city banks showing a substantial decrease in contrast to a marked increase customary during that month. Demands for long-term funds, however, continued strong. Yields on Government securities had declined steadily although moderately in recent weeks. Bank reserve positions had eased somewhat since early October, reflecting in part a decline in required reserves and in part Federal Reserve open market operations.

Among the latest specific data presented at this meeting, the Committee noted that after five months of little change, domestic output at factories and mines was expected to show a drop of as much as two index points from September to October. Declines in output were widespread although most conspicuous in durable goods lines. Both freight carloadings and electric power generation in October were off moderately, the decline in carloadings extending a decline that had begun in April and that for power generation a decline that commenced in August. While total new construction was holding at a high level, industrial construction had continued the decline that had set in in May of this year. Business inventory accumulation had slowed markedly in recent months. Nonfarm

employment in October had receded further from the peak reached in August. Not only were the signs of domestic decline fairly general, but in Canada recession tendencies had become clear, and in Europe industrial activity which had ceased expanding in late spring of 1957 had tapered off moderately through the summer months.

Although the Committee's analysis showed that the domestic economy still was operating at high levels and that the downward adjustment thus far had been moderate, there no longer was much doubt that at least a mild downturn in business activity was under way, and there was widespread belief that it would probably continue well into 1958. The major question seemed to be not whether a further business decline would occur, but for how long and in what degree. In terms of credit policy, the question presented was how far the Committee should go at this time in recognizing the change in the economic situation and outlook, and by what means.

The Committee's decision at this meeting was that action should now be taken to recognize the change in the general economic situation away from the sidewise movement that had prevailed during most of 1957. This did not signify a shift that would entirely eliminate restraint on credit expansion, but it did reflect a decision that there should be a moderate relaxation of the degree of restrictive pressure. It was on the basis of this general view that the directive was changed to eliminate the previous clause (b) which had called for restraining inflationary pressures and to replace that clause with wording that provided for open market operations with a view, among other things, "to fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves."

Mr. Robertson dissented from the foregoing action with respect to the insertion in clause (b) of the words "by moderating the pressures on bank reserves." His action was based on the belief that the prevailing condition of the economy was not such as to call for a lessening of restraint, that inflationary potentials were still strong, and that continued restraint was essential to their containment.

There was also a discussion at this Open Market Committee meeting, at which all of the Federal Reserve Bank Presidents were in attendance, of the relationship of open market policy to the discount rates of the Federal Reserve Banks and the appropriateness of those rates in view of the changed economic situation and the change in open market policy.

December 3, 1957

1. Authority to effect transactions in System account.

The Committee renewed its directive in the same form that had been adopted at the meeting on November 12, 1957, at which time the wording of clause (b) of the first paragraph had been changed so that it called for operations in the open market with a view, among other things, "to fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves."

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Shepardson, Vardaman, and Williams. Vote against this action: Mr. Robertson.

The economic report at this meeting was consistent with that presented at the meeting on November 12 showing a moderate downsettling of the economy. Industrial production had continued to sag, especially in the areas of steel and other metals, equipment and ordnance, household durables, apparel and textiles, and mining, but higher automobile output had tended in the direction of maintaining the level of the index of industrial production. On the other hand, new construction was being well maintained, with residential and public utility construction up, industrial construction down, and commercial and public construction about even.

The further sag in equipment production and industrial construction was closely related to cutbacks in spending decisions for business, plant, and equipment. Information that had just become available on third quarter capital appropriations of large manufacturing companies showed a decline of almost a third from a year earlier. This was the second successive quarter showing a substantial decline. Labor market data showed a further rise in unemployment claims, with increases fairly widespread geographically. The mid-November unemployment survey showed substantially more than the usual seasonal rise in number of unemployed to a seasonally adjusted level of about 5.2 per cent of the labor force. Gross national product for the fourth quarter of the year according to preliminary estimates would probably show little change or moderate decline from the third quarter of the year. Personal income in October had declined for the second successive month due to reduced wage and salary

disbursements. The general average of wholesale prices had shown little change in November, while the consumer price index which was unchanged in October was expected to show a rise in November, reflecting higher new automobile prices and additional advances in rents and service costs.

In the credit field, cross currents in economic forces in recent weeks had precipitated sharp and often paradoxical developments in financial markets. Through action reducing the discount rates of the Federal Reserve Banks from a 3½ per cent level to a 3 per cent level in mid-November, there had been public recognition by the Federal Reserve System that economic adjustment had lessened and perhaps removed the threat of inflation for the time being. Prices of securities in the stock market had increased sharply in this period, and prices of bonds had risen substantially with corresponding decreases in yields. Bank credit had continued to decline, contrary to the usual seasonal tendency at this time of year.

As a result of the slackened growth in bank credit and deposits, required reserves of member banks had failed to show the customary seasonal increase in November. In addition, reserves had been supplied by a reduction in Treasury balances at the Federal Reserve Banks and by substantial System purchases of bills. The cumulative results of these measures were being reflected in member bank reserve positions at the time of this meeting, and it was expected that if the Treasury continued to keep its balances in the Federal Reserve Banks at a low level, no strain on member bank positions would occur during December despite customary seasonal demands for additional funds.

In the Committee's review of the economic situation, the view was advanced that while it had become more evident than at earlier meetings that business was declining, there were basic uncertainties that made it difficult to assume either a prompt resumption of the upward movement in business or much further continuation of the decline. In these circumstances, the general view of the Committee was that there should be further moderating of the restrictive pressures on credit expansion and, for this reason, the directive was renewed with the same terms that had been approved at the meeting on November 12 calling for "fostering sustainable growth in the

economy without inflation, by moderating the pressures on bank reserves."

Mr. Robertson dissented from this action for the same reasons as those stated previously for dissenting from the wording adopted at the meeting on November 12.

2. Rate of interest on special certificates.

The Committee authorized that the rate to be charged on special short-term certificates of indebtedness purchased direct from the Treasury pursuant to paragraph (2) of the Committee's directive to the Federal Reserve Bank of New York be fixed at one-fourth of one per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchase.

> Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Shepardson, and Vardaman. Votes against this action: Messrs. Robertson and Williams.

Section 14(b) of the Federal Reserve Act authorizes purchases or sales of securities by the Federal Reserve Banks direct from the United States Treasury under certain conditions and with a proviso that the aggregate amount held by the Reserve Banks at one time shall not exceed $5 billion. Paragraph (2) of the Committee's directive, which authorized purchases for the account of the Federal Reserve Bank of New York of such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury, had been used infrequently over the years and had not been used at any time since March 1954. The rate charged for the facility when it had been used had been one-fourth of one per cent, a rate that had prevailed since the early 1940's when the discount rates at the Federal Reserve Banks were at the one-half per cent level.

The purpose of the Committee in taking the action was to adopt a procedure which would provide for a rate that was flexible and closer to the current market.

In voting against this action, Messrs. Robertson and Williams indicated that they felt the matter was of little importance and that on the whole it would be preferable to let the existing rate of one-fourth of one per cent stand.

December 17, 1957

Authority to effect transactions in System account.

The policy directive of the Federal Open Market Committee was changed at this meeting to provide that transactions for the System open market account were to be with a view, among other things, "to cushioning adjustments and mitigating recessionary tendencies in the economy." This wording replaced that adopted at the meeting on November 12 and reaffirmed at the meeting on December 3 calling for transactions that would foster sustainable growth in the economy without inflation, by moderating the pressures on bank reserves.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: None.

General economic recession appeared to be the most appropriate description for the drift in over-all activity that had characterized developments for some weeks prior to this meeting. The industrial production index for October had been placed at 141 and a preliminary estimate of the index for November was 139, or 5 index points below the September level of 144. The decline, which had been greater than was indicated previously, had been widespread despite the strong factor of new automobile assemblies during November. December production schedules for the automobile industry had been reduced because of a resistant sales market in November, steel output had slipped further, and it appeared that average hours worked might decline further in December. The latest data on business plant and equipment expenditures also justified the characterization of general recession in that these figures pointed to a faster and a greater downward adjustment than had been indicated earlier. Another item was the liquidation of business inventories at a rate of $4.5 billion annually during the month of October—a movement which appeared to have continued during November, with the contraction concentrated in durable goods lines. The labor market also pointed to general recession, with unemployment at the highest rate, on a seasonally adjusted basis, since late 1954. Accompanying these changes, personal income was down during November and this had been reflected in slower retail trade in recent weeks.

The average of wholesale prices had shown little change during the past two months.

In the financial area, a significant development in November had been a decline in the seasonally adjusted annual rate of turnover of demand deposits at banks outside New York City, along with a less than seasonal increase in the volume of demand deposits. With turnover about the same as a year earlier, it could no longer be said that increased turnover had offset the effect of a decrease in the supply of money. Federal Reserve operations in late November and early December had supplied a substantial volume of reserves to meet seasonal needs, but even so considerable tightness in the money market had developed in mid-December, partly reflecting the usual seasonal increase in currency needs along with a sharp expansion in credit demands to meet heavy liquidity requirements of the public usual at that time of the year. In addition, the Treasury was raising new money in the market at that time.

The economic and financial data presented at this meeting confirmed rather clearly the developing recession that had been indicated by reports at earlier meetings at which the Committee acted to moderate the pressures on bank reserves. The recession was still of moderate intensity, and inasmuch as the Committee actions taken since mid-November to lessen pressures on reserves, together with the reduction in Reserve Bank discount rates, had signaled an effective change in policy toward less severe credit restraint, it did not appear to the Committee that additional major actions were necessary at the moment. The change at this meeting in wording of the Committee's policy directive was adopted with the understanding that reserves would continue to be made somewhat more available, but the particular reason for this change was to recognize that the economy had encountered a recession and that the Federal Open Market Committee's policies were being molded accordingly.

* * *

Four changes in the wording of the directive of the Open Market Committee were made during 1957, the changes being those reported in this record for the meetings held on January 8, March 5, November 12, and December 17. The January 8 and March 5 changes continued policy within the framework of that in effect at the beginning

of the year which placed emphasis on restraint of inflationary developments. The change made on November 12 represented a significant shift in policy away from the emphasis on restraint of inflationary developments, to a program for fostering sustainable growth in the economy without inflation, by moderating the pressures on bank reserves. This shift in policy was further emphasized at the meeting on December 17 with the inclusion in the directive of words that gave frank recognition to recessionary tendencies that were present and to the need for mitigating such tendencies and for cushioning adjustments in the economy. The directive in effect at the conclusion of 1957 read as follows:

(1) 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 cushioning adjustments and mitigating recessionary tendencies in the economy, 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;

(2) 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;

(3) 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.

RECORD OF POLICY ACTIONS

BOARD OF GOVERNORS

May 15, 1957

Amendment to rule for classification of central reserve and reserve cities.

Effective March 1, 1957, the Board amended its rule adopted on December 19, 1947, for the classification of central reserve and reserve cities, so as to provide that the designation of a city as an additional reserve city, because that city qualifies for designation as such under the average-aggregate-deposit standard set forth in paragraph (2) of subsection (b) of the rule, shall not become effective until after one year, or such longer period as the Board may determine, from the date as of which such designation would be effective under paragraph (4) of subsection (b) of the rule in the absence of this amendment.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, Robertson, and Shepardson. Votes against this action: None.

Provisions of the Federal Reserve Act, including particularly Section 11(e), confer upon the Board authority to classify and designate central reserve and reserve cities and to terminate the designation of cities as such. In 1947, after careful consideration of all relevant information, the Board concluded that a logical, fair, and appropriate standard for determining the designation and termination of reserve cities would be one determined by the ratio of interbank demand deposits held by member banks in each city to the aggregate amount of interbank demand deposits held by all member banks of the Federal Reserve System, or by such a ratio considered in connection with the ratio of interbank demand deposits held by member banks in each city to the aggregate amount of all demand deposits held by the member banks in such city. The Board also concluded that such a standard for the designation and termination of reserve cities should be reapplied at three-year intervals. Accordingly, a rule based on these conclusions was adopted effective March 1, 1948.

Pursuant to this rule, the Board gave consideration in December 1956 to the classification of central reserve and reserve cities effective March 1, 1957. It then appeared, among other things, that the city of Miami, Florida, qualified for designation as a reserve city under

the prescribed standard, and the Federal Reserve Bank of Atlanta was requested to so advise all member banks located in Miami. At the request of such banks, and in order that full consideration might be given to the Miami situation, the Board on January 22, 1957, decided to defer until not later than June 1, 1957, a decision on the designation of that city as a reserve city.

The Board thereafter gave thorough study to all relevant data and views, including views presented in writing and orally by the member banks in Miami. As the result of this study, the Board on May 15, 1957, concluded that there was justification for giving the member banks in Miami, and in any other city that might be similarly affected in the future, an adequate period in which to make the adjustments required by designation of the city as a reserve city. Accordingly, the Board adopted, effective March 1, 1957, and published in the Federal Register, the amendment to its 1947 rule which is described above. At the same time, pursuant to the amended rule, the city of Miami was designated as a reserve city effective May 15, 1958.[1]

May 15, 1957

Increase in maximum permissible interest rate on loans made pursuant to Regulation V, Loan Guarantees for Defense Production.

Effective immediately, the Board raised from 5 per cent to 6 per cent the maximum permissible rate of interest on V-loans, with no change in the existing maximum commitment fee of ½ of one per cent or in the existing schedule of guarantee fees.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, Robertson, and Shepardson. Votes against this action: None.

Under the provisions of the Defense Production Act of 1950 and the implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private financing institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with, or in contempla-

[1] Acting pursuant to the 1947 rule, the Board took action, effective March 1, 1957, for the continuance of the classification of all existing reserve cities except Cedar Rapids and Sioux City, Iowa, which ceased to be reserve cities on that date. A full statement on the Board's action is set forth in the March 1957 issue of the *Federal Reserve Bulletin*, p. 276.

tion of, the termination of their defense contracts. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies in receiving applications and in the making of such contracts of guarantee. The Board's Regulation V, issued pursuant to the aforementioned statutory authority, provides that rates of interest, guarantee fees, commitment fees, and other charges which may be made with respect to guaranteed loans and guarantees executed through the agency of any Federal Reserve Bank pursuant to the Regulation, will from time to time be prescribed, either specifically or by maximum limits or otherwise, by the Board of Governors after consultation with the guaranteeing agencies.

In view of the higher prevailing structure of interest rates generally, and indications that under the existing 5 per cent maximum rate of interest the net yield to lending institutions on guaranteed loans was not sufficiently high in some cases to make such loans attractive in preference to alternative uses of available funds, thus hampering the effectiveness of the program, the Board and the guaranteeing agencies gave consideration, beginning in 1956, to the possibility of an increase in the maximum permissible rate of interest. The Board had received advice from the Department of Defense that the Secretary of that Department agreed with and concurred in the view that the maximum rate should be increased to 6 per cent, with no change in the schedule of guarantee fees. Advice likewise had been received from the guaranteeing agencies outside the Defense Department that they would regard such an increase favorably. In these circumstances, and in the interest of maintaining the effectiveness of the V-loan program, the Board decided to increase the maximum permissible rate of interest to 6 per cent, effective immediately.

May 20, 1957

Amendment of Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges.

Effective May 27, 1957, the Board amended Section 4(f)(2) of Regulation T to exempt certain additional types of loans for capital purposes, particularly certain such loans between a member firm or member corporation of a national securities exchange and its corporate affiliate.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: None.

Section 4(f)(2) of Regulation T has the effect of exempting from the usual margin requirements certain loans made for capital purposes to a member or member firm of a national securities exchange. The principal effect of the minor technical amendment adopted by the Board at this time was to give recognition to the fact that corporations are now permitted to be members of a securities exchange.

May 24, 1957

Increase in maximum rate on advances under Section 13b of the Federal Reserve Act.

Effective May 27, 1957, the Board approved establishment by the Board of Directors of the Federal Reserve Bank of Philadelphia of a maximum rate of 6 per cent (an increase from 5 per cent) on advances direct to industrial or commercial businesses, including advances made in participation with other financing institutions, under Section 13b of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, Robertson, and Shepardson. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently approved the same maximum rate for the Federal Reserve Bank of Boston, effective June 5, 1957, and for the Federal Reserve Banks of Cleveland and Kansas City, effective June 17, 1957, the increase being from 5½ per cent in each instance. For the Kansas City Bank the Board also approved a minimum rate of 4 per cent, rather than 3½ per cent.

(In accordance with the provisions of the Federal Reserve Act, the Federal Reserve Banks establish, subject to review and determination of the Board of Governors, rates on discounts and advances to member banks at least every 14 days and submit such rates to the Board for consideration. No changes involving new policy had been made in these rates since those referred to on pages 50-52 of the Board's Annual Report for 1956.)

Section 13b of the Federal Reserve Act provides that in exceptional circumstances, when it appears to the satisfaction of a Federal Reserve Bank that an established industrial or commercial business located in its district is unable to obtain requisite financial assistance on a reasonable basis from the usual sources, the Federal Reserve

Bank, pursuant to authority granted by the Board of Governors of the Federal Reserve System, may make loans to or purchase obligations of such business, or may make commitments with respect thereto, on a reasonable and sound basis, for the purpose of providing it with working capital. No obligation may be acquired or commitment made under this authority with a maturity exceeding five years.

The increase to 6 per cent in the maximum rate for the Reserve Banks named above was approved by the Board of Governors in recognition of the increased prevailing structure of rates generally, including the increased maximum permissible rate of interest on V-loans which was approved by the Board effective May 15, 1957.

August 8, 1957

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective August 9, 1957, the Board approved actions by the boards of directors of the Federal Reserve Banks of Philadelphia, Chicago, Minneapolis, and Kansas City establishing a rate of 3½ per cent (an increase from 3 per cent) on discounts and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Vardaman, Mills, and Shepardson. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	August 13, 1957
Atlanta	August 13, 1957
Dallas	August 13, 1957
San Francisco	August 15, 1957
Richmond	August 19, 1957
St. Louis	August 21, 1957
New York	August 23, 1957
Cleveland	August 23, 1957

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 4 per cent on advances to member banks under Section 10(b) of the Federal Reserve Act, together with increased rates on advances to individuals, partnerships, and corporations under the last paragraph of Sec-

tion 13 of the Act. In addition, the Board approved, for most of the Banks, increased rates on industrial loans and commitments under Section 13b.

For a period of several months the economy had exhibited in general a sidewise movement at a high level of activity. The index of industrial production, seasonally adjusted, moved within a narrow range just under the peak reached in December 1956, employment had been growing further and was at a very high level, and there was almost full utilization of resources. Prices of goods and services, after showing some tendency to stabilize during the spring of the year, resumed an upward trend during the summer which carried them to new peak levels, an important factor being the persistent increase in wages and other costs of production.

Demands for credit, stimulated by the need for financing a large volume of business plant and equipment expansion, continued to be vigorous, while the rate of bank credit expansion slackened somewhat after midyear due to Federal Reserve policies limiting the availability of reserves and also to a reduction of liquidity resulting from the steady growth of loans relative to deposits. With the upward movement of interest rates, the discount rate of the Federal Reserve Banks, which had stood at 3 per cent since the fall of 1956, fell further behind the rate structure generally. The disparity became even more pronounced in early August when the commercial banks increased from 4 to 4½ per cent the rate charged on loans to prime business borrowers.

The increase in the Federal Reserve Bank discount rates, which brought them into better alignment with money market rates, raised the cost to member banks of operating on borrowed reserves and thus diminished incentive on the part of the member banks to borrow from the Reserve Banks.

November 14, 1957

Reduction in rates on discounts and advances by Federal Reserve Banks.

Effective November 15, 1957, the Board approved actions by the boards of directors of the Federal Reserve Banks of New York, Richmond, Atlanta, and St. Louis establishing a rate of 3 per cent (a reduction from 3½ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Szymczak, and Vardaman. Vote against this action: Mr. Robertson.

(While the Board was in session on November 14 advice was received from the Federal Reserve Bank of New York that the directors of the Bank had fixed a discount rate of 3¼ per cent. The Board voted unanimously to take no action on this rate and the Federal Reserve Bank of New York was so informed. Shortly thereafter the Board was advised that the directors of the New York Bank had fixed a rate of 3 per cent. This rate was approved by the Board with the votes as stated above.)

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	November 19, 1957
Philadelphia	November 22, 1957
Minneapolis	November 22, 1957
Kansas City	November 22, 1957
Cleveland	November 29, 1957
Chicago	November 29, 1957
San Francisco	November 29, 1957
Dallas	December 2, 1957

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 3½ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

By the middle of November available economic information suggested an abatement of inflationary pressures, some change in the economic environment, and a deterioration in the tone of business psychology. While the economy continued to operate at a high level, it seemed clear that the sidewise movement evident during earlier months of 1957 was no longer continuing and that a rather widespread downward adjustment had begun. From a level of 145 for August, the index of industrial production slipped a point in September and in mid-November it appeared from preliminary estimates that the index for October had dropped further. Declines in output were quite general, the rate of business inventory accumulation had slowed down markedly in recent months, and employment had receded from the August peak.

While the demand for long-term funds continued strong, the demand for bank credit eased considerably and bank loans to business decreased during the autumn contrary to the usual seasonal pattern. The greater ease in the money market was reflected in a moderate but steady decline in the yields on Government securities.

The reduction of the discount rate reflected a judgment that the prevailing economic situation, and in particular its financial aspects, indicated a downward trend was developing. The action constituted a public signal of that judgment and, as a stabilizing step, provided a relaxation of the restraint of credit that had prevailed.

Governor Robertson voted against approving the discount rate reduction because in his opinion the prevailing economic situation did not call for an overt act that could be interpreted as a drastic move toward monetary ease. It appeared to him that the downtrends noticeable in the economy might be generally in the nature of readjustments from unsustainable upward movements and that the dangers of continuing inflation remained as great as the dangers of deflation. In such a situation, he felt that an indication of changed monetary policy might encourage the belief that the System would validate all price and wage increases by supplying enough credit base to support the higher levels; he was concerned about the possible effect of such a belief on people administering prices and negotiating wages. He was also apprehensive that a discount rate reduction would create the erroneous impression that the System saw greater danger in current economic movements than it actually considered to exist. This might cause unjustified fears to feed upon themselves and become exaggerated, with unfortunate results. On balance, therefore, he felt that prevailing conditions did not justify the risks involved in reducing the rate at this time.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the 12 Federal Reserve Banks and their 24 branches during the year as required by law.

Examination of State member banks. State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to

conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. In order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1957 program for the examination of State member banks was practically completed, since only 10 out of 1,773 banks were not examined during the calendar year.

Bank holding companies. Pursuant to the provisions of Section 5 of the Bank Holding Company Act of 1956, the Board extended to January 15, 1957, the time within which bank holding companies were required to register. During 1956 and 1957, 69 bank holding companies registered with the Board; 19 of those organizations have since ceased to be bank holding companies. During 1957, pursuant to Section 3(a)(2) of the Act, the Board approved the acquisition by six bank holding companies of voting shares of seven banks and denied two applications for such acquisitions with respect to two banks. Under Section 4(c)(6) of the Act, the Board, after a hearing, denied a request for a determination that an insurance subsidiary of a bank holding company was so closely related to the banking activities of the holding company system as to be a proper incident thereto and as to make it unnecessary for the prohibitions of Section 4 to apply in order to carry out the purposes of the Act. During the year the Board issued three certifications in accordance with the tax provisions of the Act (Internal Revenue Code, Sections 1101 and 1103). To provide necessary current information, annual reports for the year 1956 were obtained from registered bank holding companies.

During 1957, pursuant to the Banking Act of 1933, the Board authorized the issuance of four voting permits for general purposes and 13 permits for limited purposes to holding company affiliates of member banks. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term

"holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to six organizations and denied one application for such a determination.

Trust powers of national banks. During 1957, 30 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to 7 banks which previously had been granted certain trust powers. Trust powers of 30 national banks were terminated by voluntary liquidation, consolidation, merger, or conversion. At the end of 1957, there were 1,715 national banks holding permits to exercise trust powers.

Foreign branches and banking corporations. Under the provisions of Section 25 of the Federal Reserve Act, the Board approved during 1957 two applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States. One member bank closed one branch and contemporaneously opened another in London, England, and opened an additional branch in Havana, Cuba (the latter two authorized by the Board in 1956); and also opened an additional branch in Mexico City, Mexico (authorized by the Board in 1955).

At the end of 1957, seven member banks had in active operation a total of 117 branches in 26 foreign countries and overseas areas of the United States. Of the 117 branches, three national banks were operating 91 and four State member banks were operating 26. The branches were distributed geographically as follows:

Latin America	**60**
Argentina	10
Brazil	10
Chile	2
Colombia	4
Cuba	21
Mexico	3
Panama	5
Peru	1
Uruguay	1
Venezuela	3
Continental Europe	**5**
Belgium	1
France	3
Germany	1

England	**11**
Near East	**4**
Egypt	1
Lebanon	2
Saudi Arabia	1
Far East	**20**
Hong Kong	1
India	2
Japan	10
Philippines	5
Singapore	1
Thailand	1
United States Overseas Areas	**17**
Canal Zone	4
Guam	1
Puerto Rico	12
Total	**117**

There were in operation at the beginning of 1957 four banking corporations organized under State laws which operate under agreements with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. Three of these "agreement" corporations were examined in 1957 by examiners for the Board of Governors. During the year, one of these corporations converted into a foreign banking corporation organized and operating under the provisions of Section 25(a) of the Federal Reserve Act. Of the three corporations now in operation, one operates a branch in France; one has an English fiduciary affiliate; and one has a branch in England, owns all the stock of a bank organized under the laws of, and operating in, Liberia, and operates two agencies at the New York International Airport (the second agency having been authorized by the Board and opened in 1957).

At the end of 1956, there were in operation three banking corporations organized under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. Of these corporations, during 1957 the Board granted permission to one to be a Financing Corporation subject to the provisions of Regulation K as revised effective January 15, 1957 and approved the organization of a new Section 25(a) corporation for the purpose of acquiring substantially all the assets and substantially all the liabilities of another such corporation which was placed in liquidation. As indicated above, in December 1957, one State chartered corporation operating under agreement with the Board converted into a new Section 25(a) corporation with the permission of the Board of Governors. The home offices of these four corporations, two of which are regarded as "Banking Corporations" and two as "Financ-

ing Corporations," are located in New York City. Three were examined during the year by examiners for the Board of Governors. Two such institutions have no subsidiaries or foreign branches; one has a branch in France and an English fiduciary affiliate; and one operates branches in Germany, France, Singapore, Lebanon, and Guatemala (authorized by the Board in 1956 and opened in 1957) and owns substantially all of the stock of a bank organized under the laws of, and operating in, Italy.

Inter-Agency Bank Examination School. During 1957, four sessions of the School for Assistant Examiners and two sessions of the School for Examiners were held. The Inter-Agency Bank Examination School is conducted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. Since the Inter-Agency School was established in 1952, the various sessions have been attended by 839 men, representing the three Federal bank supervisory agencies, the State Banking Departments of California, Connecticut, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, and Virginia, the Treasury Department of the Commonwealth of Puerto Rico, and one foreign country.

Federal Reserve membership. Member banks account for 47 per cent of the number, and hold approximately 85 per cent of the deposits of all commercial banks in the United States. The 6,393 member banks of the Federal Reserve System at the end of 1957 included 4,620 national and 1,773 State member banks, reflecting net declines of 31 and 38, respectively, from the previous year-end.

The total number of member bank offices increased, however, as a result of both the conversion of merged banks into branches and the establishment of de novo branches. At the end of the year member banks were operating 6,166 branches, 484 more than at the close of 1956.

The continued decline in the number of member banks was largely due to consolidations and mergers. Other reductions included 13 State member banks that withdrew from membership and 3 national banks that converted into nonmember banks. The decrease was partly offset by 20 newly established national banks, 3

newly established State members, the admission of 7 nonmember banks to membership, and the conversion of two nonmember banks into national banks.

State member banks accounted for 20 per cent of the number, 30 per cent of the banking offices, and about 67 per cent of the deposits of all State commercial banks.

Detailed figures on banking structure changes for the year 1957 are shown in Table 18 on page 105.

RESERVE BANK OPERATIONS

Loan guarantees for defense production. Under the provisions of the Defense Production Act of 1950 as amended and the implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private financing institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with or in contemplation of termination of their defense contracts. The guaranteeing agencies are the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, the General Services Administration, and the Atomic Energy Commission.

The present program is a reactivation of the V-loan program utilized during World War II. In the making of guarantees, the Federal Reserve Banks are authorized to act, on behalf of the guaranteeing agencies, as fiscal agents of the United States, subject to the supervision of the Board of Governors of the Federal Reserve System; and the Board is authorized, after consultation with the guaranteeing agencies, to prescribe rates and fees and forms and procedures.

During 1957, the guaranteeing agencies authorized the issuance of 35 guarantee agreements amounting to $151 million. On December 31, 1957, guarantee agreements outstanding covered credits totaling $530 million of which amount $395 million represented actual loans outstanding and $135 million was available to borrowers under guarantee agreements in force. Of the actual loans outstanding, 76 per cent on the average was guaranteed. This compares with total guarantee agreements outstanding December 31, 1956 of $514

million. During the year, approximately $1,085 million was advanced on V-loans, most of which are revolving credits.

From the beginning of the program in September 1950 through December 31, 1957, 1,503 V-loans totaling $2,912 million were authorized by the procurement agencies which may guarantee such loans under the Defense Production Act of 1950. Of the total loans authorized, 56 per cent of the number and 6 per cent of the amount were under $500,000 and 72 per cent of the number and 13 per cent of the amount were loans under $1 million.

Of the total loans authorized 42 per cent of the number and 8 per cent of the amount were to borrowers having assets of less than $500,000; 58 per cent of the number and 12 per cent of the amount were to borrowers having assets of less than $1 million.

Seventy-two per cent of the number and 19 per cent of the amount of loans authorized were to borrowers having less than 500 employees.

Under the law as amended by the Defense Production Act amendments of 1956, authority for the V-loan program, unless further extended, will terminate on June 30, 1958.

In May 1957, the Board of Governors, after consultation with the guaranteeing agencies, authorized an increase from 5 per cent to 6 per cent in the maximum permissible rate of interest a lending bank may charge a borrower.

Volume of operations. Table 5 on page 91 shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1953-57. In general, activities were somewhat greater in 1957 than in 1956. All-time peaks were reached in the number and amount of currency and coin received and counted, checks handled, and transfers of funds.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of each Federal Reserve Bank during 1957 are shown in detail in Table 6 on pages 92-93, and a condensed historical statement is shown in Table 7 on pages 94-95. The table on page 77 summarizes the earnings and expenses and the distribution of net earnings for 1957 and 1956.

Current earnings of $763 million in 1957 were 28 per cent more than in 1956, reflecting mainly a higher average rate of interest on United States Government securities which more than offset a slight

decline in average holdings. Earnings of $27 million from discounts and advances also were somewhat greater than in the year before, reflecting increases in the discount rate and a rise in the volume of discounts and advances. Current expenses of $131 million were about 9 per cent above 1956. Current net earnings amounted to $632 million, an increase of 33 per cent from 1956.

After allowing for profit and loss additions and deductions from current net earnings, net earnings before payments to the United States Treasury amounted to $624 million, an increase of 32 per cent over 1956.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1957 AND 1956

[In thousands of dollars]

Item	1957	1956
Current earnings	763,348	595,649
Current expenses	131,814	121,182
Current net earnings	631,534	474,467
Additions to current net earnings[1]	1,580	359
Deductions from current net earnings	[2] 8,721	383
Net deductions	7,141	24
Net earnings before payments to U. S. Treasury	624,393	474,443
Paid U. S. Treasury (interest on F. R. notes)	542,708	401,555
Dividends paid	20,081	18,905
Transferred to surplus (Sec. 7)	61,604	53,983

[1] Includes net profits of $167,000 in 1957 and $268,000 in 1956 on sales of U. S. Government securities.

[2] Includes a payment of $8,335,000 to Federal Reserve retirement system representing adjustment for revised benefits.

Statutory dividends to member banks amounted to $20 million, a rise of about $1 million over 1956 that reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital of the Federal Reserve Banks.

Payments to the United States Treasury as interest on Federal Reserve notes amounted to $543 million in 1957. This was 90 per cent of net earnings after dividends and allowance for building up surplus to 100 per cent of subscribed capital where Section 7 surplus was

below that amount. This allowance is consistent with the provisions of the franchise tax when it was in effect; for 1957 the allowance for bringing surplus up to subscribed capital was $1,303,000 for one Bank, and for 1956 the total was $9,366,000 for four Banks. Total payments to the Treasury as interest on Federal Reserve notes since the policy of making such payments was begun in 1947 have amounted to $2,993 million.

Net earnings of $61 million remaining after dividends and payments to the United States Treasury were added to surplus account.

Holdings of loans and securities. Average daily holdings of loans and securities during 1957 amounted to $24,222 million, $341 million less than during 1956; holdings of discounts and advances increased $17 million and holdings of United States Government securities decreased $362 million. The average rate of interest earned on discounts and advances rose from 2.76 to 3.15 per cent, reflecting an increase in the discount rate to 3½ per cent for a portion of the year; and the average rate on Government securities rose from 2.41 to 3.15 per cent. The accompanying table shows holdings, earnings, and interest rates on loans and securities held by the Federal Reserve Banks during the past three years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1955–57

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Industrial loans	Acceptances	U. S. Government securities
Average daily holdings:[1]					
1955	$24,570,401	$666,152	$607	$12,422	$23,891,220
1956	24,563,390	833,297	837	20,662	23,708,594
1957	24,222,331	850,097	686	25,142	23,346,406
Earnings:					
1955	412,303	13,085	24	216	398,978
1956	595,396	23,025	36	547	571,788
1957	763,041	26,792	30	848	735,371
Average rate of interest (per cent):					
1955	1.68	1.96	3.99	1.74	1.67
1956	2.42	2.76	4.26	2.65	2.41
1957	3.15	3.15	4.37	3.37	3.15

[1] Based on holdings at opening of business.

Foreign and international accounts. Gold and dollar assets held for foreign account at the Federal Reserve Banks rose $65 million in 1957, almost the same as the increase for 1956. At the end of the year holdings amounted to $9,926 million, consisting of $5,488 million of earmarked gold, $3,729 million of United States Government securities (largely Treasury bills), $356 million in dollar deposits, $76 million of bankers' acceptances purchased through Federal Reserve Banks, and $277 million of miscellaneous assets. The latter item includes mainly dollar bonds issued by foreign countries and international institutions.

The aggregate gold and dollar assets held for the International Bank for Reconstruction and Development, the International Finance Corporation, and the International Monetary Fund declined $670 million in 1957, reflecting principally drawings on the Fund by member countries.

Accounts were opened for three central banks, two in Asia and one in Latin America.

Loans on gold were again of relatively minor importance. A loan of $25 million outstanding at the beginning of 1957 was repaid by June. New credit arrangements amounted to a total of $16.5 million, of which $5 million was outstanding at the end of the year. Loans on gold are ordinarily made to foreign monetary authorities to assist them in meeting their dollar requirements for temporary needs.

The Federal Reserve Bank of New York, as depositary and fiscal agent, continued to perform various services for the international institutions mentioned above. As fiscal agent of the United States, the Bank continued to operate the United States Exchange Stabilization Fund pursuant to authorization and instructions of the Treasury Department. Also on behalf of the Treasury Department it continued the administration of foreign assets control regulations pertaining to assets in the United States of, and transactions with, Communist China and North Korea and their nationals, and regulations involving certain assets of the Egyptian Government and the Suez Canal Company.

Retirement System. During the year a number of important changes were made in the Retirement System of the Federal Reserve Banks. The provisions of the Retirement System had been under study for many months. Initially Industrial Relations Coun-

selors Service, Inc., of New York was engaged by the Federal Reserve System to examine and evaluate the Retirement System in the light of other retirement programs in the cities where Federal Reserve Banks and Branches are located. On the basis of this study and a review by a special subcommittee of the Conference of Presidents, recommendations of this latter group were put into effect, after approval by the Board, on September 1, 1957.

The principal changes resulted in an over-all increase in total retirement benefit allowances of about 25 per cent and provided a somewhat more liberal disability pension. The accrued liability for these benefits resulted in an 8.3 million dollar expenditure by the Federal Reserve Banks.

Bank premises. During the year the Board authorized the construction of a new building for the Salt Lake City Branch, and the construction of an addition to and alteration of the Federal Reserve Bank building in Chicago. The Chicago construction program is planned to extend over several years.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The accounts of the Board for the year 1957 were audited by the public accounting firm of Price Waterhouse & Co., whose certificate follows:

To the Board of Governors
of the Federal Reserve System

In our opinion the accompanying financial statements present fairly the assets, liabilities and fund balances of the operating fund and the property and equipment fund of the Board of Governors of the Federal Reserve System as at December 31, 1957, and the related assessments and expenditures for the year then ended, in conformity with generally accepted accounting principles. Our examination of the financial statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary.

Price Waterhouse & Co.

Washington, D. C.,
February 12, 1958.

Assets, Liabilities and Fund Balances
December 31, 1957

Assets

Cash, exclusive of $149,399 representing withheld taxes		$ 456,975
Miscellaneous receivables and travel advances		91,898
Stockroom and cafeteria inventories, at cost		21,192
Total assets of operating fund		570,065
Property and equipment, at cost:		
Land and improvements		792,852
Building		3,831,976
Furniture and equipment		524,747
Total assets of property and equipment fund		5,149,575
Total assets		$5,719,640

Liabilities and Fund Balances

Accounts payable and accrued expenses		$ 240,562
Fund balances:		
Operating fund—December 31, 1956	$299,578	
Excess of assessments over expenditures for the year	29,925	
Operating fund—December 31, 1957		329,503
Property and equipment fund, including 1957 additions of $29,603 (Note)		5,149,575
Total liabilities and fund balances		$5,719,640

Note—During 1957 the Board concluded that it was not necessary or meaningful to account for depreciation of furniture and equipment in its case and it therefore decided to discontinue the practice. The accumulated allowance for depreciation of $331,453 was restored to the property and equipment fund.

Assessments and Expenditures
For the Year Ended December 31, 1957

Assessments Levied on Federal Reserve Banks:		
For Board expenses and purchases of property and equipment		$ 7,507,900
For expenditures made on behalf of the Federal Reserve Banks		5,363,711
Total assessments		$12,871,611
Expenditures:		
Printing, issue and redemption of Federal Reserve Notes paid on behalf of the Federal Reserve Banks		$ 5,363,711
Expenses of the Board:		
Salaries	$3,541,885	
Retirement and insurance contributions:		
Special payment for increased benefits—prior years	2,233,178	
Contributions for current year	356,506	
Traveling expenses	310,966	
Postage and expressage	55,901	
Telephone and telegraph	81,976	
Printing and binding, net	210,305	
Stationery and supplies	38,181	
Equipment and other rentals	29,319	
Books and subscriptions	15,382	
Heat, light and power	46,678	
Repairs, maintenance and alterations	16,075	
Insurance	5,631	
Operation of cafeteria, net	44,222	
Miscellaneous, net	16,790	
Professional and contractual services:		
Legal, consultant and audit fees and expenses	204,252	
Consumer Finances Surveys	160,724	
Small Business Financing Study	30,200	
Retail Trade Survey	25,000	
Other	25,201	7,448,372
Furniture and equipment purchases		29,603
Total expenditures		$12,841,686
Excess of assessments over expenditures for the year		$ 29,925

The Board's expenses in 1957 include survey costs of $30,200 and other costs of $3,331, a total of $33,531, incurred on the Small Business Financing Study, which was undertaken during the year by the Federal Reserve System to provide information for the use of Congress in its 1958 session, and also to initiate a longer run survey of the financial structure and experience of small business as viewed by the businessmen themselves. Also included are expenditures of $2,369.25 contributed by the Board of Governors for three luncheons at meetings of Treasury Department Savings Bond Program voluntary workers and costs of $20,521 for emergency planning programs under Defense Mobilization Order No. 1-20.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

The year 1958 brought vigorous recovery from a brief but sharp recession in economic activity in the United States. From a low point in early spring, output of goods and services rose rapidly and, by year-end, gross national product in current dollars exceeded and in real terms was close to earlier peaks. As is characteristic of early phases of recovery movements, employment rose less rapidly than output, and unemployment remained relatively high. Abroad, economic expansion was resumed at the end of 1958 after temporary interruptions in many countries.

The Federal Reserve adapted its policies to the changing economic environment by fostering bank credit expansion during the recession early in the year and by moderating the availability of funds in the last five months as economic activity gained momentum. Demands for credit remained slack early in 1958 and interest rates continued to decline. In the last half of the year, when private and public demands for credit were rising, particularly those of the Federal Government to finance the large current deficit, interest rates rose sharply.

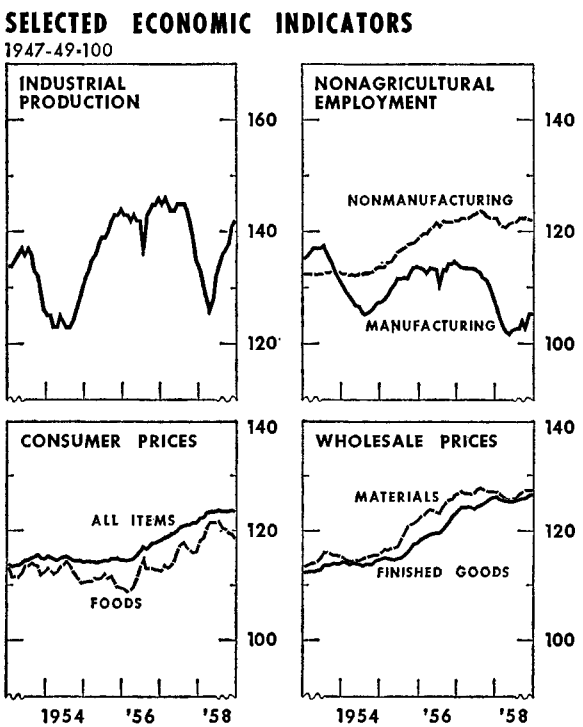
Consumer and wholesale prices, after rising somewhat early in the year, were fairly stable during most of 1958. Stock prices, however, rose rapidly throughout the year.

RECESSION AND RECOVERY

At the beginning of 1958, economic activity in this country was receding. Contraction in output and employment was general, and unemployment was rising at a disturbing pace. No one could be sure how far the downward adjustment would go, or how long it would last.

Even at that time, however, some were beginning to view the outlook more optimistically. In January, corporations, taking advantage of easier conditions and lower interest costs in financial

markets, were offering an appreciable volume of new issues in anticipation of future needs for funds, and to refund shorter term debt. State and local governments were bringing to market bond issues that had been deferred earlier, and were stepping up the pace of bond offerings to provide for public works.



NOTE.—Seasonally adjusted series, except for prices. Bureau of Labor Statistics data for employment and prices and Federal Reserve data for production.

Farmers continued to foresee favorable output and price conditions in agriculture and were bidding up further the prices of farm land. Bankers, with slackened customer demand for credit and strengthened reserve positions, were bidding more aggressively for investments. By February, bankers were accelerating expansion of the

assets and deposits of their institutions, thus increasing more rapidly the economy's stock of cash balances and raising its over-all liquidity.

By the early part of the second quarter, personal income and consumer spending had ceased to decline and, in fact, were rising slightly. Production and employment turned upward soon after. Whether these developments, though encouraging, foreshadowed wide revival in activity was not known at the time; not until summer did the current flow of information and reports provide substantial confirmation that general economic recovery was under way.

From that stage on, currently available data reflecting market trends, production, and employment showed that recovery was both broadly based and vigorous. At year-end, eight months after recovery had set in, total output approximated the peak of 1957 and it was growing with increasing momentum.

Federal Reserve Action to Combat Recession

Federal Reserve policy began to move in a counter-recession direction in late October of 1957. At that time, the System began to shift its open market operations toward supplying reserves more liberally to the banking system. In November, it reduced the discount rates on member bank borrowings from the Reserve Banks. As the stream of factual information verified the emergence of recessionary trends, Federal Reserve actions and policies became more aggressive, and discount rate, open market, and reserve requirement instruments were actively applied in complementary fashion to foster ease in credit markets and encourage bank credit and monetary expansion.

From late fall 1957 through April 1958, there were four reductions in Federal Reserve Bank discount rates, from 3½ per cent to 1¾ per cent. Through continuing open market operations from late fall of 1957 to early summer of 1958, the Reserve System supplied the commercial banks with some $2 billion of reserve funds. Through three successive reserve requirement reductions in late winter and early spring of 1958, the System released for the use of member banks about $1.5 billion of their required reserves.

The total amount of reserve funds supplied by the Federal Reserve System over the nine months November 1957-July 1958 was enough to enable member banks to reduce their discounts at the Reserve Banks from $800 million to about $100 million, to offset sales of

gold to foreign countries amounting to about $1.5 billion, and to finance a commercial bank credit expansion of almost $8 billion. Monetary expansion from February through July stimulated by this Federal Reserve action was at an exceptionally rapid rate—at an annual rate of 13 per cent for all deposits, including time and demand deposits. For the active money supply, that is, demand deposits and currency, the rise was at an annual rate of 8 per cent. After the shift in Federal Reserve policy in the summer, expansion in the active money supply slackened, and for the year as a whole it amounted to about 4 per cent.

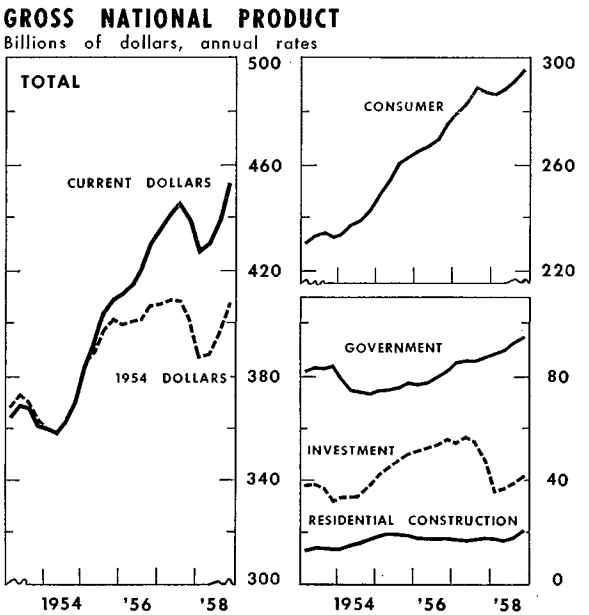
Broader Effects of Monetary Action

Although the immediate impact of Federal Reserve policy was on commercial banks, it clearly had broader effects upon the economy generally. For one thing, since commercial banks are direct participants in some degree in all important credit markets, expansion in bank lending and investing activities intensified competition among all lenders for the acquisition of the available supply of credit-worthy loans and securities. This widened access of all potential borrowers to credit funds. It also worked to reduce the cost of financing to borrowers generally—businesses, farmers, consumers and home buyers, and all levels of government.

Another effect of the credit ease was a greater willingness on the part of banks and other lenders to make new loans to business customers and to renew outstanding credits. This permitted the orderly run-off of excess business inventories accumulated in the preceding boom. It also facilitated the completion of business programs of plant and equipment expansion begun in that period. With a $6 billion reduction in business inventory holdings and a significant cutback in fixed investment programs during the recession, business loans outstanding declined only $1.5 billion in the year ending September 1958. The ability of businesses to maintain their bank borrowing and also to borrow more readily in capital markets not only cushioned downward pressures on investment spending but helped many companies to minimize cutbacks in their working force and payrolls, to maintain dividends, and to strengthen liquidity positions.

In housing markets, the easier conditions broadened the avail-

ability of mortgage funds. Discounts were reduced on FHA and VA mortgages subject to ceiling interest rates, and interest rates on new conventional mortgages fell. As bank credit expansion gained in momentum, banks participated in mortgage investment more actively than at any time since the boom housing year of 1955. The increased availability of mortgage funds at lower cost, together with the maintenance of personal income, was promptly reflected in a step-up of builder activity in constructing new houses.



NOTE.—Department of Commerce quarterly estimates, adjusted for seasonal variation. "Investment" includes producers' durable equipment, private construction other than nonfarm residential, change in business inventories, and net exports of goods and services.

In the consumer instalment credit area, the increased availability of funds made it possible for lenders to meet sound demands for credit more readily, thus bolstering lagging demand for consumer durable goods. On some transactions, terms were eased and, in addition, new credit plans were developed and extended. Easier

credit conditions permitted lenders to be more liberal in granting renewals and extensions of time for repayment of outstanding credit. Thus, the volume of repossessions and credit losses was less than would otherwise have been the case, with benefits to both borrowers and lenders.

Increased availability of funds also had an impact on State and local government financing. In some cases, the lower cost of financing encouraged States and municipalities to borrow in order to finance capital projects. Lower market rates also enabled certain State and local governments that had a ceiling on interest rates to return to the market. The increase in annual rate of spending by State and local governments from the summer of 1957 to the summer of 1958 was a billion dollars more than in the preceding year.

These observable effects of easier monetary conditions which developed from efforts to combat recession were, of course, important and salutary. They are not to be overly stressed, however, for monetary action is always only one element in Government counter-recession policy. In turn, Government policy is always only one element in the total economic scene. Businesses, individuals, and State and local governments, in the light of their own circumstances, were taking actions to adjust and adapt their situations and to redirect their energies. Their actions undoubtedly shaped the recovery and gave it momentum. Restraint of inflationary pressures during the preceding boom undoubtedly contributed to an underlying economic situation favorable to recovery and made the economy responsive to these monetary and other anti-recession actions.

Changing Expectations

Achievement of monetary ease to combat recession so promptly and amply was not without its problems. One of the most acute was the build-up of prices in the bond market as speculators counted on continuing business recession, credit ease, and still higher bond prices. Psychological reactions and expectations always play a role in swings in economic and financial developments, but they were of particular importance in financial markets in the summer of 1958 as the economic outlook rapidly changed from one of a continuing recession to one of early, vigorous recovery.

At that time, the improved economic outlook led to a sharp

change in expectations in regard to renewed inflationary pressures and a turnabout in the trend of interest rates. A much larger Federal deficit loomed up than had been estimated, as well as the crisis and threat of military action in the Middle East. Concern about the drain of gold from the nation's monetary reserves through sales of gold to the industrial nations of Europe was a further cause of uncertainty. The fact that the Canadian Government announced a major refunding operation at sharply higher interest rates was also a complicating factor.

In these circumstances, heavy market sales by holders of United States Government securities in anticipation of higher interest rates sharply depressed bond prices. Initially, this selling stemmed from temporary holders who had bought in anticipation of a continued rise in Government securities prices. Some of these holdings had been acquired with funds borrowed on thin margins in connection with the Treasury's June financing operations. In this financing, investors had exchanged the major portion of maturing issues for 6⅔-year bonds rather than for the 11-month certificates also included in the exchange offering. In many cases, selling was forced because the margins vanished as securities prices declined.

Prices of Government securities continued to decline under pressure of steady liquidation and the reluctance of investors to purchase market offerings in view of changed prospects for credit demands and inflationary threats. During the period from June 19 through July 9, the Treasury purchased nearly $600 million of the bonds previously taken in the exchange, retiring about three-fourths of these and placing the remainder in Treasury investment funds. On July 18, the Federal Open Market Committee concluded that the market situation had become disorderly and decided to intervene temporarily in the medium- and long-term sectors of the Government securities market. This action was within the framework of the Committee's established operating rules. From July 18 to July 23 the System purchased $1.2 billion of securities involved in a Treasury refinancing, largely "when issued" securities, and a small amount of other notes and bonds.

Thereafter, as market conditions became more orderly, no further Federal Reserve open market transactions were effected outside the usual area of short-term Government securities. During late July

and early August, sales of Treasury bills by the System together with other factors affecting reserves more than absorbed the redundancy of reserves that threatened to result from Federal Reserve intervention in the Government bond market.

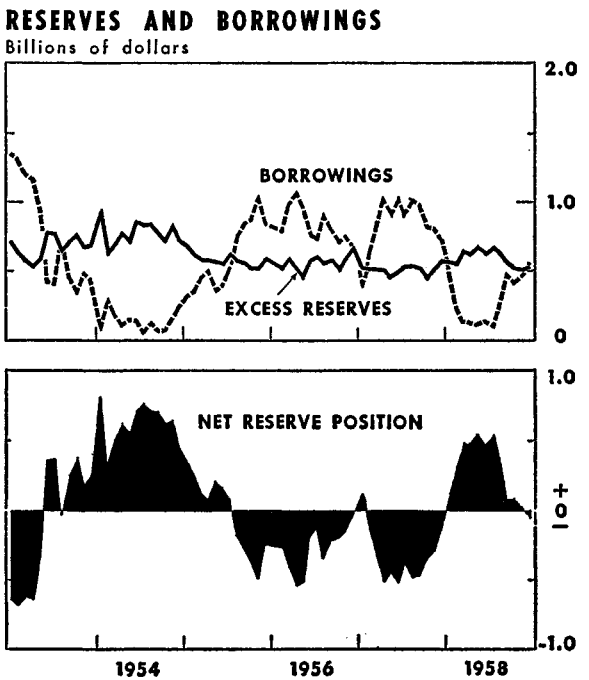
Moderation of Federal Reserve Policy

By August, there was clear evidence in current statistics that recovery in economic activity and production had gained considerable momentum and was likely to go forward without serious setback. Moreover, in view of the strength of consumer demand, appreciable further decline in business inventory holdings and capital outlays was no longer likely.

About this time, inflationary expectations began to spread. The abrupt upward shift of interest rate levels in central money markets, while precipitated by liquidation of speculative positions in Government securities, reflected in part investor demand for an interest premium to cover the risk of a depreciating purchasing power of invested funds. There was a large shift by investors, including institutional investors such as pension funds, in the allocation of newly available funds to common stocks instead of fixed interest obligations, with hedging against inflation a frequent explanation of the change in investor policy. Large current and prospective demands for credit by the Federal Government, State and local governments, and home purchasers also influenced the rising cost of borrowed funds. In the stock market, the volume of trading was expanding rapidly and the rise in stock prices reduced the yields on common stocks below the yields on high-grade corporate bonds.

In the light of the rapidly changing economic situation, in most respects highly encouraging but with inflationary and speculative psychology spreading, the Federal Reserve, during the summer, began to move away from its anti-recession policy of low discount rates, high excess reserves, and reductions in reserve requirements.

System open market operations after midsummer supplied only a portion of the reserves needed to meet rising credit demands and to offset the reserve drain of a continued gold outflow. As a result, member banks drew down their excess reserves somewhat and at the same time increased their borrowings from the Federal Reserve Banks. Such borrowing was made much more costly when Reserve



NOTE.—Monthly averages of daily figures for member banks. Net reserve position indicates excess reserves minus borrowings.

Bank discount rates were raised in the late summer from 1¾ per cent to 2 per cent, and in midautumn to a level of 2½ per cent.

From late summer through the end of the year, bank credit and the money supply continued to expand but at a rate much reduced from earlier in the year. Some seasonal expansion in business loans was supplemented by a rapid growth of real estate loans. On the other hand, bank holdings of short-term United States Government securities rose only moderately despite a substantial increase in the supply of such securities to finance the Treasury's deficit. With business sales and liquidity showing rapid rise, the higher interest rates that developed in the market helped to attract a substantial volume of funds of nonbank investors, especially business corporations, into the purchase of the new short-term Treasury issues. As a consequence, the Treasury was able to finance most of its deficit

outside the banking system, and at the same time banks were able to meet private credit demands accompanying economic recovery, with only a moderate further growth in total bank credit and money.

Regulation of Margin Requirements

In addition to its broader monetary responsibilities, the Federal Reserve is directed by law to prescribe margin requirements to guard against excessive use of credit for purchasing or carrying stock market securities. By providing a means of dealing directly with this volatile type of credit, margin requirements serve as a special-purpose supplement to the general instruments of Federal Reserve action. Since the flow of credit into the stock market tends to fluctuate with general business conditions, changes in margin requirements are usually correlated with policy actions that affect general credit availability.

Following the stock market decline in the early fall of 1957, total credit to customers for purchasing and carrying stock market securities declined by about 5 per cent and was back to about the level outstanding in mid-1955. With this indication of abatement of credit use in the stock market, the Board of Governors, early in January 1958, reduced the required margin from 70 to 50 per cent.

With the increasing activity and rise in stock prices accompanying economic recovery, stock market credit rose sharply, reaching by July a level about 20 per cent above the volume at the beginning of the year. In view of the rapid rise in credit to finance trading in or temporary ownership of stocks, and the emerging investment psychology favoring purchase of stocks as an inflation hedge, the Board, early in August, restored the required margin to 70 per cent. As outstanding stock market credit continued to rise following this action, the Board, in mid-October, raised the required margin to 90 per cent.

Situation at Close of 1958

Monetary policy during the autumn aligned monetary conditions more closely with developments in the economy. Consumer spending on durable goods and housing continued to expand and was reflected in high levels of output of household durable goods, in a more than

seasonal pickup in auto production, and in a rise in housing starts to the highest level in recent years. Business inventory policies were switching from liquidation toward accumulation, and there was a widespread, though small, upturn in capital expenditures. At the same time, Federal, as well as State and local government spending, was expanding rapidly in accordance with budgetary authorizations adopted earlier.

In financial markets moderate curtailment of credit availability and higher interest rates helped to dampen speculative excesses then developing, to restrain and spread out the volume of new corporate and municipal securities financing, and to facilitate the financing of the large Federal deficit outside the banking system. The reduction of corporate and municipal securities financing followed some anticipatory borrowing by these issuers earlier in the year when long-term interest rates were lower. At the turn of the year, there was a large calendar of authorized but unissued State and local government securities.

Total economic activity, measured in real terms, had nearly regained its earlier peak. The active money supply had risen about 3½ per cent above its pre-recession level, and holdings of other liquid assets, including time deposits, were up sharply. The financial basis for further growth was established.

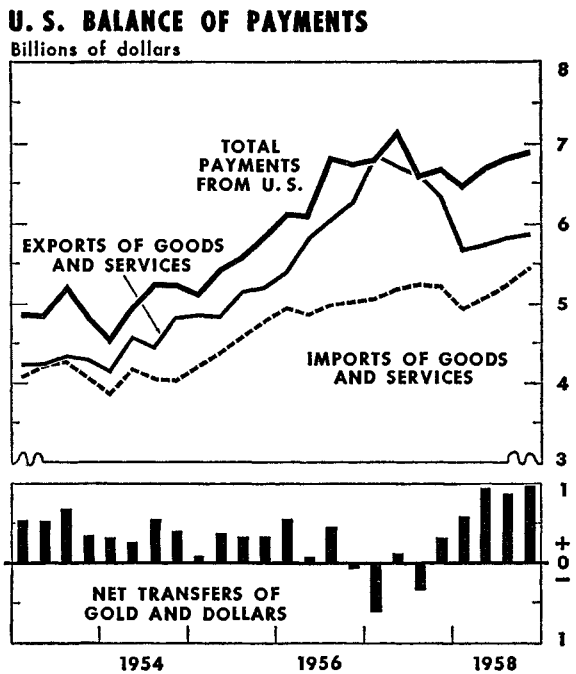
CHANGES IN GOLD RESERVES

Developments in international trade and finance in 1958, and especially the decline in United States gold reserves, brought to public attention the interdependence of events in free market economies here and abroad. At the end of the year, announcement by a dozen European countries of the restoration of external convertibility for their currencies testified to the postwar renewal of Europe's economic and financial strength.

Unlike most components of domestic demand, external demand for United States exports failed to turn up during 1958. Exports of goods and services, which in the previous cyclical expansion had increased from $18 billion in 1954 to an annual rate of $27 billion in the first half of 1957, remained throughout 1958 at the level of $23 billion to which they had fallen early in the year.

The position of the United States in world trade is unique, in that

it is the leading exporter of manufactured products and at the same time the most important exporter of crude and semi-finished materials and fuels. Like other exporters of primary products, the United States was affected by worldwide recessions in steel and textile industries, which checked its previously swollen exports of coal, scrap metal, steel, and raw cotton. Like other exporters of manufactures, this country was affected by cyclical adjustments of demand, not only in other industrial countries, but also in the less industrialized countries whose international earnings had fallen.



NOTE.—Department of Commerce seasonally adjusted quarterly data. Total payments from the United States include imports of goods and services, remittances, Government nonmilitary grants and loans, and net U. S. private capital outflow. Exports of goods and services exclude military transfers under aid programs. Net transfers of gold and dollars include gold purchases from the United States and net increases in foreign holdings of short-term assets in the United States and of U. S. Government long-term securities. Exports in first quarter of 1954 adjusted to include, and exports in second quarter to exclude, shipments delayed by port strike in March 1954.

Moreover, United States export trade in manufactures became subject to increasingly effective competition from Europe and Japan, areas whose capacity for exporting had greatly increased. And while United States demand for imported raw materials was relatively low in 1958, demand for imported consumer goods continued to increase.

One consequence of developments such as these was that the surplus of exports over imports of goods and services was much smaller than in 1957, and fell far short of matching the large continuing outflow of private loans and investments and of Government loans and grants. The export surplus was only moderately larger than in the years immediately preceding the 1956-57 upsurge, but the capital outflow was much larger. In its total balance of international payments—on current and capital account—the United States thus had an unusually large deficit in 1958. It is the purpose of this section of the Annual Report to indicate how gold movements were related, on the one hand, to this deficit, and, on the other hand, to the functioning of the United States monetary system.

Gold and the Balance of International Payments

A deficit in a country's balance of international payments (an excess of payments to foreigners over receipts from foreigners) involves the transfer of international means of payment from domestic to foreign holders. In relations between the United States and foreign countries or international institutions, two kinds of international means of payments are used: gold and liquid dollar assets. The United States Treasury sells gold to, and purchases gold from, foreign monetary authorities for the settlement of international transactions at the fixed price of $35 an ounce, plus or minus a commission charge of one-fourth of one per cent. Dollar assets are freely transferred between United States holders and foreign monetary authorities or (as far as foreign countries' exchange regulations permit) private persons. Liquid dollar assets held by foreigners include deposits with the Federal Reserve Banks and other banking institutions, holdings of Treasury bills and other United States Government securities, and, to a smaller extent, holdings of bankers' acceptances and other short-term dollar claims.

In 1958, a major part of the $3.4 billion deficit in the United

States balance of international payments was settled in the form of gold. The amount of net gold sales to foreigners during the year, $2.3 billion, was larger than in any other 12-month period with the exception of the period immediately following the outbreak of the Korean war in 1950.

Some of the factors accounting for the large deficit in the United States balance of international payments have already been discussed. The reason why a large fraction of that deficit was settled in gold lies primarily in the regional distribution of the balance-of-payments surpluses of foreign countries.

The practices of foreign monetary authorities vary widely in regard to the proportion of their reserves held in the form of gold on the one hand, or dollars or other foreign exchange on the other. Some countries, such as the United Kingdom, Belgium, the Netherlands, and Switzerland, have for many years held most of their official reserves in the form of gold, and have held liquid dollar assets only insofar as they were needed for working balances. Most other European nations also have held a substantial part of their reserves in gold.

In 1958 the countries that experienced the greatest gain in reserves were highly industrialized countries, including many European countries. This development was the consequence of the slowdown in economic expansion throughout most of the free world and of the relatively greater decline in export earnings for raw-material producing countries than for industrial countries other than the United States.

Sales of gold to the four countries that generally take practically all of their reserve gains in the form of gold (the United Kingdom, Belgium, the Netherlands, and Switzerland) accounted for three-fourths of United States net gold sales in 1958; sales to three other industrial countries (Austria, Italy, and Japan) accounted for virtually all the rest.

Within the year 1958, net gold sales were largest in the second quarter, and gradually declined during the third and fourth quarters. This decline in the gold component of balance-of-payments settlements did not reflect a decline in the balance-of-payments deficit itself.

Gold and the United States Monetary System

A balance-of-payments deficit for the United States means, in the first instance, a transfer of liquid assets from domestic to foreign residents or monetary authorities. This transfer need not affect total bank assets or liabilities in the United States as long as the deficit is settled exclusively by transfers of dollar assets. For example, if a United States deficit is settled by the transfer of dollar deposits to residents of foreign countries and then to their monetary authorities, no change in total deposits with United States banks occurs. If foreign monetary authorities receiving dollars then invest in money market paper, such as United States Treasury bills, unless the bills are purchased from banks the effect generally will be simply a decrease in domestic nonbank holdings of bills accompanying the increase in foreign holdings, with the volume of bank deposits remaining unchanged.

If transfers of dollar assets to foreign monetary authorities are followed by sales of gold to them, further monetary effects of a somewhat more complicated kind occur. Under the monetary system of the United States, gold is both a means of international payments and the ultimate reserve basis of the United States money supply. Movements of gold directly affect the money supply, the reserves of commercial banks, and the reserves of the Federal Reserve Banks.

The great bulk of the gold holdings of the United States (at the end of 1958, $20.0 billion out of a total of $20.6 billion) is held in the Treasury as security against a corresponding amount of gold certificates issued to the Federal Reserve Banks. These gold certificates owned by the Reserve Banks, together with their holdings of United States Government securities, advances to member banks, and other assets, serve as backing for Reserve Bank liabilities. Under the Federal Reserve Act, holdings of gold certificates must be not less than 25 per cent of Federal Reserve note and deposit liabilities; actually the amounts held greatly exceed this minimum. Federal Reserve deposit liabilities represent primarily reserves that the member banks are required to hold against their own deposits. Member bank deposits in turn are a major component of the country's money supply.

The way in which the money supply, member bank reserves, and

Federal Reserve Bank reserves are affected by international transfers of gold may be explained by describing the consequences of a gold sale by the United States to a foreign monetary authority. (A sale of gold by a foreign monetary authority to the United States Treasury would have exactly the opposite effects on bank deposits, member bank reserves, and gold certificate holdings of the Federal Reserve Banks.) In preparing to buy gold, the foreign authority usually accumulates funds in its account with the Federal Reserve Bank of New York, either by selling money market paper or by transferring funds from deposits with commercial banks. In either case, the immediate effect is a reduction in commercial bank deposits, generally those of member banks, and along with this a reduction in member bank reserves.

When the foreign authority purchases gold from the Treasury, it transfers funds from its foreign account with the Federal Reserve Bank of New York to the Treasury's account with the Federal Reserve Bank. (This is usually done through the intermediation of the Stabilization Fund of the Treasury, which handles these transactions through its fiscal agent, the Federal Reserve Bank of New York.) The Treasury in turn uses the proceeds in most cases to redeem a corresponding amount of gold certificates owned by the Reserve Banks. The effects of the transaction thus include, first, a reduction in money in the form of bank deposits; second, a drain on member bank reserves; and, third, a reduction in the gold certificate reserves of the Federal Reserve Banks.

Gold and Federal Reserve Policy

Gold movements and the underlying developments in international trade and payments are among the elements of the economic situation constantly under review in the determination of monetary policy.

In the administration of policy, the effects of gold movements upon member bank reserves are of immediate importance, since changes in member bank reserves usually have further multiple effects upon the money supply through bank credit contraction or expansion. The Federal Reserve takes into account the impact upon member bank reserves of gold transactions and of all other factors that affect those reserves, including changes in currency in circulation, movements in Treasury deposits at the Reserve Banks, and fluctuations

in Federal Reserve float. When, as in early 1958, the combined effect of such factors on member bank reserves would be in a direction contrary to policy objectives, the Federal Reserve takes offsetting action.

In the first seven months of the year, Federal Reserve policy was aimed at adding substantially to member bank reserves. Gold sales, however, were draining about $1.5 billion of reserves, and this drain was offset only in small part by other factors affecting reserves. In order to complete the offset, and in addition to ease reserve positions and provide for monetary expansion, member bank reserve requirement percentages were lowered, releasing $1.5 billion of reserves, and additional reserve funds were supplied through open market operations.

In the latter part of the year, continued although reduced sales of gold further drained bank reserves. Also, the rise in currency in circulation drained more reserves than were supplied by the rise in Federal Reserve float. Since in this period the Federal Reserve was moderating the availability of reserves, only part of the contractive impact of these and other factors upon the reserves of member banks was offset through open market operations. Member banks provided the rest of the reserves needed for deposit expansion through borrowing from the Federal Reserve Banks.

Over the year as a whole, the ratio of gold certificate reserves of the Federal Reserve Banks to their note and deposit liabilities dropped from 46.3 per cent to 42.1 per cent, but it remained well above the statutory minimum of 25 per cent. There was a moderate increase in liabilities for Federal Reserve notes in circulation. Deposit liabilities of the Reserve Banks declined; the increase in required reserves of member banks brought about by growth in their deposits was more than offset by the lowering of member bank reserve requirement percentages.

DEMAND AND SUPPLY OF FUNDS IN 1958

Total public and private debt rose more in 1958 than in 1957, although much less than the record postwar growth in 1955. Record postwar expansion of commercial bank credit provided a large part of the funds to absorb this rise in debt, but funds available for investment from nonbank sources also rose.

Availability of funds in relation to demand changed considerably over the year, mainly in response to shifts in the business outlook and in Federal Reserve policy. In the first half of 1958, when business and consumer demands for credit were slack and the availability of bank reserves increased, funds seeking outlets pressed against demand and interest rates declined. Total bank credit rose contraseasonally as banks increased their holdings of securities. In the last half, when the availability of bank reserves was more restricted, vigorous economic recovery, together with a large Federal Government deficit, generated additions to demands for financing and interest rates rose sharply. Expectations of still more active credit demands and of possible creeping inflation tended to make lenders reluctant to invest in fixed interest obligations, especially on longer term, and accentuated the rise in interest rates. The channeling of an increased volume of available funds into stocks, also in response to expectations of inflation, was a further factor of upward pressure on interest rates.

Credit Demands

Credit growth in 1958 reflected mainly increased borrowing by all levels of government. Rising Federal expenditures and reduced tax revenues resulted in a large cash deficit, in contrast with a small surplus in the previous year. State and local governments increased their outstanding debt more than in 1957.

Private debt expanded further, but the annual rate of growth continued the downtrend that had prevailed since 1955. Business borrowing fell off substantially, reflecting reduced plant and equipment outlays and heavy inventory liquidation. Consumer indebtedness for the purchase of goods and services declined during the year, reflecting principally a decrease in automobile purchases. Mortgage financing of residential properties, however, showed an accelerated increase. Outstanding farm mortgage debt also continued to rise and other loans to farmers by banks went up nearly one-fourth.

Government. The Federal Government had a cash deficit of $7.3 billion in calendar year 1958, a sharp change from the surplus of $1.2 billion in 1957 and of $5.5 billion in the preceding year. Federal expenditures were about $6 billion higher in 1958 than in 1957 and cash receipts nearly $3 billion lower. The decline in revenue, mainly

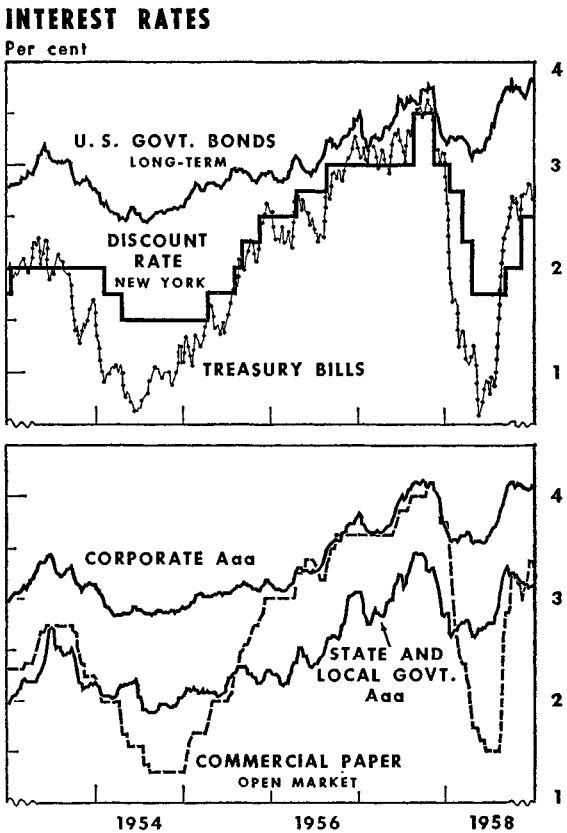
in corporate and individual income taxes, reflected the impact of recession on corporate profits and personal incomes.

Increased Federal spending was concentrated in the second half of the year when outlays rose substantially. About $4 billion of the 1958 increase was in unemployment benefits and other social security payments, but military, highway, and agricultural expenditures also rose.

As a result of Treasury borrowing to cover the deficit, outstanding public debt rose $8 billion in 1958, the largest calendar year increase since World War II. A small part of this increase occurred in the first half of 1958, when the Treasury used the proceeds of this borrowing, together with its seasonal cash surplus, to build up its cash balance in anticipation of a larger than seasonal deficit later in the year. In the last half of 1958, the Treasury financed its $12.6 billion cash deficit through net cash borrowing of $7.7 billion and a reduction in the Treasury balance of $4.9 billion.

Marketable debt rose $11.4 billion, or $3.4 billion more than total public debt, offsetting a decline of that amount in nonmarketable issues. About two-thirds of the marketable debt increase was in issues maturing in five years or more. A $14.5 billion increase in these issues in the first half of the year, mainly in connection with refunding operations, was offset in part by a $7.2 billion decline in the last half as the passage of time carried some issues into shorter maturity ranges. Net redemptions of savings bonds continued, but were in much smaller volume than in 1957. The volume of special issues to Government funds and other nonmarketable debt also declined in large part because of payments in excess of receipts in the old-age and survivors insurance and unemployment trust funds.

State and local governments continued to increase their expenditures, as in previous years. Their needs for long-term funds, primarily to finance schools, highways, and other public works, were increasing, and these governments sold a record volume of bonds to obtain new capital. The volume of financing was heaviest during the first half of the year when State and local governments responded to the lower level of interest rates by accelerating the financing of construction programs, funding shorter term debts, and undertaking some financing deferred in 1957. Despite a record volume of bond sales, amounting to $7.7 billion, the backlog of authorized but unsold bond issues increased during the year.



NOTE.—Market yields, weekly averages of daily figures. Treasury bills, market yields on 90-day bills. Long-term U. S. Government, yields on bonds maturing or callable in 10 years or more. Commercial paper, rate on prime 4- to 6-month open market paper. Yields on corporate and State and local government bonds, from Moody's Investors Service.

Market rates of interest on United States Government and State and local securities declined further in the early months of 1958 following a sharp drop in the fall of 1957. Rates on Treasury bills and intermediate-term issues fell much more than rates on bonds, and the spread between short- and long-term Treasury issues reached a postwar record around midyear. The smaller drop in long-term rates resulted in part from the continuation of a substantial volume

of bond issues by corporations and State and local governments, as well as by the Federal Government.

During the summer, rates rose sharply from their spring lows, reflecting the rapid economic turnaround and the growing realization that the Federal cash deficit would be large, together with a mounting fear of inflation. After early October, rates on Treasury issues were relatively stable despite substantial Federal net cash borrowing. Rates on State and local securities fell off somewhat in late 1958, owing in large part to the small volume of new issues, and at year-end were about one-third of a percentage point below their 1957 peaks.

Business. The decline in business investment that began late in 1957 continued through the first three quarters of 1958. Outlays for new plant and equipment fell one-fifth over this period and inventory liquidation was substantial. In the fourth quarter of the year, spending for fixed capital edged upward and liquidation of business inventories ceased. For 1958 as a whole, total business investment was one-fourth smaller than in 1957.

Funds available to business corporations from current operations took a sharp drop in the first half of 1958. While depreciation allowances continued to rise, retained earnings fell almost two-thirds. In the last half of the year, corporate profits rose sharply and in the fourth quarter the volume of funds available from retained earnings and depreciation allowances reached a new peak. For the year as a whole, these internal funds were only 7 per cent smaller than in 1957.

The volume of external financing by business was considerably smaller in 1958 than in any of the previous three years of business expansion although much larger than in the recession year 1954. Growth in outstanding securities of corporations was one-tenth less than in 1957 but more than in any previous year. Business loans at commercial banks, however, declined slightly in contrast with increases of roughly $2 billion in the previous year and $6 billion in 1956 and 1955.

The pronounced shift in external financing from banks to securities markets evident in 1957 continued in 1958, induced in part by the somewhat reduced level of long-term interest rates that prevailed in the first half of the year. In the last quarter, following

the onset of vigorous recovery and a sharp rise in interest rates, securities market financing fell off and demands for bank loans strengthened.

Most of the decline in new securities financing was in issues of manufacturing and sales finance companies. Capital outlays of manufacturing corporations were at greatly reduced levels, and sales finance companies had less need for new funds in view of the decline in borrowing on automobiles by consumers and dealers. Public utility and communication companies reduced their expenditures for plant and equipment and their securities financing only moderately. A sizable increase in new issues by investment companies reflected in part the establishment of new investment companies.

Business loans at commercial banks fell off more than usual during the first seven months of the year, mainly in response to inventory liquidation and the funding of some short-term loans through sale of long-term securities in the capital market. Business loans rose over the remainder of the year, mainly because of seasonal borrowing and renewed borrowing by public utilities, which had reduced bank indebtedness over most of the first three quarters.

Outstanding mortgage debt on multi-family and commercial construction, part of which represents borrowing for business purposes, rose more in 1958 than in any other recent year. A large part of this increase, however, was for construction of apartment buildings.

With funds from current operations and external financing reduced less than total spending for fixed capital and inventories in 1958, corporations added to their holdings of cash and United States Government securities. Most of the additions were in the last quarter, when a sharp rise in corporate profits brought them close to pre-recession highs. At year-end, corporate liquidity, as measured by the ratio of these liquid assets to total current liabilities, was higher than at any time since the end of 1955.

Consumers. The pace of growth in consumer indebtedness slackened in 1958. The increase for the year in residential mortgage and consumer credit totaled $10.7 billion, about the same as in 1954 but much below the $18.9 billion rise in 1955. Almost all the 1958 increase was in residential mortgages, which expanded one-fifth more than in 1957. Outstanding consumer credit for the purchase of goods

and services changed little in 1958, as liquidation of debt early in the year was about offset by later expansion.

Housing starts, which were at a reduced level in the first quarter of 1958, rose at a rapid rate over the remainder of the year, reaching a seasonally adjusted annual rate of 1.4 million in the last quarter. Of the 1.2 million starts for the year, privately financed units totaled more than 1.1 million, 15 per cent more than in 1957 and the largest number since 1955. Apartment units accounted for a larger proportion of the starts in 1958 than in other recent years.

Reflecting the large number of sales of existing houses as well as of new houses, mortgage debt outstanding on nonfarm 1- to 4-family houses rose about $10.2 billion to almost $118 billion in 1958 compared with an increase of $8.6 billion in 1957. Nearly three-fourths of the increase was in conventional mortgages and the remainder in FHA-insured mortgages; both types rose much more than in any previous year. VA-guaranteed mortgage debt declined for the first time on record, reflecting for the most part a further drop in volume of new loans to the lowest level since 1949.

Yields on home mortgages declined along with other market rates of interest in the first half of 1958. In late 1957, when yields on competitive capital market investments were declining sharply, mortgage yields had shown little change. These mortgages continued to be attractive to investors. The emergency housing legislation enacted in the spring of 1958 provided additional stimulus to home mortgage financing by authorizing the Federal National Mortgage Association to buy $1 billion of FHA-insured and VA-guaranteed mortgages on new low-cost housing, by eliminating discount controls on Government underwritten mortgages, and by raising the interest rate ceiling on VA-guaranteed mortgages from 4½ to 4¾ per cent. After mid-year, when other market rates of interest rose sharply, mortgage yields rose only moderately.

Reflecting these and other developments, seasonally adjusted applications for FHA insurance and requests for VA appraisals on new homes began to mount in April, reached a peak in September, and then fell off. FHA applications for the year were the highest since 1950, and VA appraisal requests were up nearly 50 per cent from the low level of 1957.

Outstanding short- and intermediate-term consumer debt changed

little in 1958, after increasing in every earlier postwar year. A marked decline in instalment debt on automobiles in 1958 was offset by increases in other types of instalment debt and in non-instalment debt. Extensions of credit on sales of new cars were far below the levels of other recent years. Extensions of personal loans and other consumer goods credit, after a downturn early in the year, increased gradually to levels above those prevailing at the end of 1957. Extensions of automobile credit also rose in the last quarter of 1958 but remained below 1957 levels. Repayments of instalment debt were stable throughout the year. Instalment credit terms on some transactions were eased and new credit plans were developed and extended.

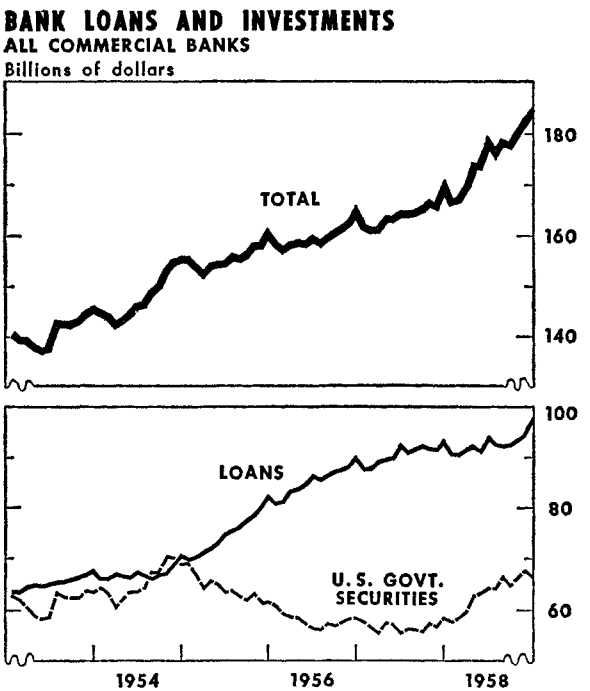
International capital transactions. The net outflow of United States private capital in all forms was about $300 million less in 1958 than in 1957, but this moderate decline was accompanied by substantial shifts in composition of the flows of investments and loans. The outflow for direct investment in affiliates abroad was about half the 1957 amount, a decline of more than $900 million, reflecting in part the completion of certain large capital expenditure programs. Net new security issues in the United States by foreign and international borrowers, however, reached a postwar record level of $900 million in 1958, twice as much as in 1957. Offerings by Canadian corporations and local governments and by the International Bank for Reconstruction and Development were unusually large, particularly in the first half of the year when interest rates in the United States were relatively low, and the volume of other foreign issues also was at a record level. The net outflow of bank loans and commercial credits was little changed; persistence of foreign credit demands was associated in part with balance-of-payments difficulties in some of the less industrialized countries.

These and other capital transactions, together with current transactions between the United States and the rest of the world, enabled foreign monetary authorities to acquire $2.3 billion of gold from the United States while foreign holdings of liquid dollar assets increased by $1 billion. Most of this increase was in time deposits of foreign banks at United States commercial banks. Foreign holdings of Treasury securities showed no net change. They declined during the first half of the year, when bill yields fell below the

time deposit interest rate, but rose in the last half when the trend of interest rates was reversed.

Credit Supplies

The flow of loanable funds rose in 1958 following declines in 1956 and 1957. The bulk of the increase was in commercial bank credit, which expanded in response to increased availability of bank reserves by the postwar record amount of $15 billion. A major component of the growth in loanable funds was a postwar record rise in commercial bank time deposits. Individuals also continued to accumulate savings in other financial forms at a high rate. Activation of idle cash balances, which had occurred in other recent years, when interest rates were rising, apparently did not continue in 1958.



Note.—Figures are partly estimated. Data exclude interbank loans and are for last Wednesday of month, except for June and December call dates.

Consumer saving. Saving by consumers in financial form—the increase in their financial assets less the increase in their indebtedness—continued at a high level during 1958 after rising substantially in the previous two years. Consumer accumulation of funds through savings institutions and banks was at record rates, while saving through the acquisition of marketable securities was at a much lower rate than in 1957. Indebtedness of individuals to purchase securities, however, rose sharply in 1958, while that for the purchase of residential real estate and goods and services, discussed earlier in this report, rose by a moderate amount.

Deposits in mutual savings banks and shares in savings and loan associations, which had been increasing by relatively stable amounts in the past few years, grew at a more rapid pace in 1958. The total of savings and time deposits at commercial banks also rose more than in other recent years, although growth in the last half of the year was much below the rapid rate of the first half. This change in rate of growth was due in large part to a shift of business and State and local government funds out of Treasury bills and other liquid assets into time deposits in the first half and a reversal of that flow in the second half in response to movements in market rates of interest on these alternative investments.

Growth in savings deposits at commercial banks is estimated to have remained above the high 1957 rate over most of the year, though dropping off toward the year-end. Individuals supplied funds to other financial intermediaries, such as life insurance companies and pension funds, at a somewhat higher rate in 1958 than in the previous year.

Individuals accumulated securities at a much lower rate in 1958 than in the previous two years. They made smaller net purchases of State and local government securities and corporate bonds, and they also reduced their holdings of United States Government securities. Net redemptions of United States savings bonds were at a much slower pace than in the previous year, but the decline in holdings of other Treasury issues offset the previous year's rise.

Consumer net borrowing to purchase securities showed a marked rise of about $1 billion in 1958 in contrast with a decline of about $500 million in the previous year. Most of the increase was in customer debit balances with New York Stock Exchange member

firms covering the purchase of corporate stocks. There was also considerable borrowing for speculative purchases of United States Government securities in connection with the June Treasury financing, but these loans were rapidly liquidated following the sharp decline in bond prices in midsummer.

Institutional lenders. The flow of funds to institutional lenders increased in 1958. Growth in assets of life insurance companies was nearly one-sixth more than in 1957, but savings capital of savings and loan associations rose one-fourth more and deposits at mutual savings banks two-fifths more than in 1957.

Reflecting the increased demand for mortgage loans and the relatively high yield on mortgages in relation to other investments over much of 1958, institutions increased their holdings of mortgages substantially more in 1958 than in 1957, while their holdings of business securities rose less. The growth in mortgage holdings of mutual savings banks in 1958 was $670 million larger than in 1957, while the rise in business securities was $200 million less. Savings and loan associations, which invest primarily in mortgages, increased their holdings over $1.3 billion more in 1958 than in 1957. Life insurance companies, whose new investments largely reflect previous forward commitments, increased their commitments for mortgages sharply during the year, but their acquisitions of mortgages did not rise until late in the year. Mortgage portfolios of these companies expanded $400 million less than in 1957. Their holdings of business securities rose about as much as a year earlier, and, for the first time since 1946, their holdings of United States Government securities rose, contrasting with substantial reductions in other recent years.

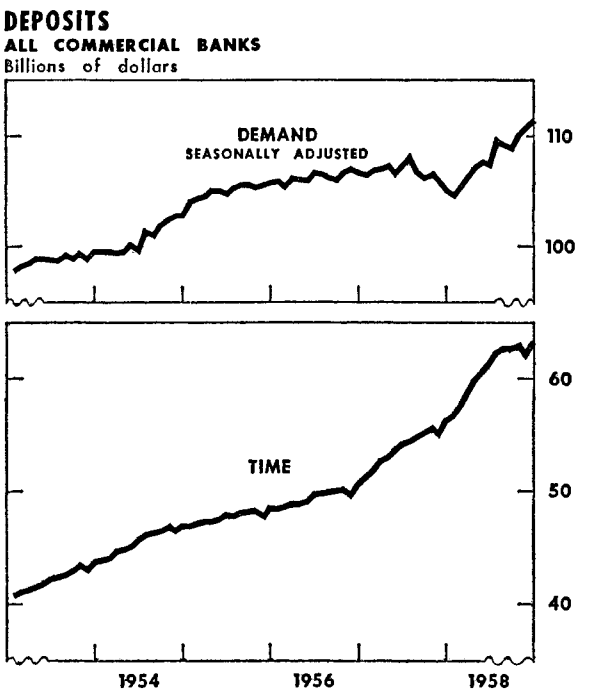
Bank credit. Loans and investments at commercial banks rose $15 billion in 1958, about half again as much as the previous postwar record growth in 1954. In response to a continued policy of credit ease, almost three-fifths of the increase occurred during the first half of the year, a period when bank credit usually declines. About $1.5 billion of the increase in this period was a direct offset to reductions in reserve requirements. In the latter part of the year, as economic recovery gained momentum and reserve availability was restricted, bank credit expanded at little more than the usual seasonal rate.

With loan demands generally slack throughout the year, most of

the credit growth was in holdings of United States Government securities, which rose by a postwar record amount of $8 billion. Investments in other securities, mainly State and local government issues, also rose by a record $2.5 billion.

Loan growth in 1958 totaled only $4.3 billion, slightly more than in 1957 but much less than in most other postwar years. Real estate loans, which rose in record volume in the last half of the year, accounted for about half of the total loan growth. Agricultural loans also showed a large increase. As already indicated, business loans declined a little over the year, although growth in the last quarter was about in line with seasonal expectations.

Deposits at commercial banks rose by a postwar record amount



NOTE.—Last-Wednesday-of-month figures partly estimated by Federal Reserve, except for time deposits in June and December, which are call report data. Demand deposits exclude collection items, and both series exclude interbank and U. S. Government deposits. Demand deposits are for all banks in the United States.

of $12.6 billion, more than twice as much as in 1957. Time deposits accounted for almost three-fifths of this total, with a record growth of $7.0 billion. Demand deposits adjusted, which went down by a small amount in the previous year, also rose substantially. Treasury deposits, however, rose only slightly.

The active money supply—demand deposits and currency held by the public—rose about 4 per cent in 1958, the largest increase since 1951. On a seasonally adjusted basis, most of the increase occurred between the end of January and the end of July, when bank credit was expanding at a rapid rate. Turnover of demand deposits declined in the first half of 1958 and rose in the last half to a level approaching the postwar peak reached in the third quarter of 1957.

Reserve positions of member banks over the year reflected the course of Federal Reserve policy, easing in the first half and tightening in the last half, but changed little on balance. There were, however, substantial changes in several major factors affecting reserves. Required reserves declined about $500 million, as deposit growth absorbed about $1 billion of the $1.5 billion of funds released through reductions in reserve requirements early in the year. System acquisitions of United States Government securities also supplied about $2.1 billion of reserves. Reserves were absorbed over the year mainly by a $2.2 billion gold outflow and a $500 million increase in currency in circulation.

The principal Federal Reserve policy actions during the year are summarized on the following pages, and are described more fully in the records of policy actions of the Board of Governors and of the Federal Open Market Committee appearing elsewhere in this report.

Digest of Principal Federal Reserve Policy Actions, 1958

Period	Action	Purpose of action
January	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.	To ease reserve positions by absorbing only part of the reserves made available by seasonal factors affecting bank reserve positions.
January	Reduced margin requirements on loans for purchasing or carrying listed securities from 70 to 50 per cent of market value of securities.	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.
January–February	Reduced discount rates from 3 to 2¾ per cent at 11 Reserve Banks.	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.
February	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.	
March	Reduced discount rates from 2¾ to 2¼ per cent at 11 Reserve Banks and from 3 to 2¼ per cent at one Reserve Bank.	
March	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.	
February–Mid-April	Purchased about $450 million of U. S. Government securities. Member bank borrowings declined further to an average of about $180 million.	To supplement reserve requirement actions in further increasing the availability of bank reserves.
April	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.	To supplement previous actions to encourage bank credit and monetary expansion and resumed growth in economic activity and to offset current gold outflow.
April–May	Reduced discount rates from 2¼ to 1¾ per cent at all Reserve Banks.	
Mid-April–June	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.	

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.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

The record of policy actions of the Federal Open Market Committee is presented in this report pursuant to the requirements of Section 10 of the Federal Reserve Act. That section provides that the Board of Governors of the Federal Reserve System shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open market operations and shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying the actions of the Board and the Committee in each instance. Section 10 also provides that the Board shall include in its Annual Report to the Congress a full account of the actions taken during the preceding year, both by the Board and by the Federal Open Market Committee, with respect to open market policies and operations and with respect to the policies determined by the Board.

The record of policy actions of the Federal Open Market Committee is prepared on the basis of the minutes of the meetings of that Committee, as approved by the Committee, and sets forth the policy decisions reached together with a résumé of the reasons therefor. Many policy decisions are by unanimous vote of the Committee members, but the emphasis on specific reasons for preferring a particular line of policy may vary from individual to individual. There are times when individual members of the Committee may concur in a concept of policy action formed by a majority because it moves generally in the direction that they believe to be called for, even though their views may differ considerably from those of other members of the Committee as to the degree of movement that is desirable. When a member records a dissent from an action of the majority of the Committee, the dissent may reflect a variety of factors, such as a fundamental disagreement with the direction of policy action as indicated in the directive, or a fundamental disagreement with the emphasis attached to a particular objective as indicated in the directive.

It should be noted that the policy directive adopted at a meeting of the Federal Open Market Committee is usually in general terms

and that, without changing the wording of the directive, the Committee may from time to time modify considerably the emphasis to be placed on operations designed to implement the general policy. The shadings of opinion that enter into the formation of a policy decision provide the Manager of the System Open Market Account (who attends the meetings of the Committee) with a guide to be used in the conduct of open market operations within the framework of the policy directive adopted at that meeting.

* * *

The policy directive of the Federal Open Market Committee that was in effect at the beginning of 1958 was the one that had been approved at the meeting on December 17, 1957. This directive called for open market operations with a view, among other things, to cushioning adjustments and mitigating recessionary tendencies in the economy. It was issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account and directed that Bank:

(1) 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 cushioning adjustments and mitigating recessionary tendencies in the economy, 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;

(2) 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.

(3) 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 Federal Open Market Committee met 31 times during 1958. Of these meetings, 19 were held in Washington and 12 were held by means of telephone conference arrangements in which some members were located outside Washington. In five of the meetings held by telephone conference, policy decisions were reached, while the other seven telephone conference meetings did not involve proposals for new policy actions but were for the purpose of discussing operations being conducted within the limits of policy actions previously taken. The policy actions taken by the Committee during the year are set forth in the following pages by date of meeting.

January 7, 1958

Authority to effect transactions in System Account.

No change was made in the Committee's policy directive that specified that operations should be with a view, among other things, "to cushioning adjustments and mitigating recessionary tendencies in the economy."

> Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: none.

Domestic economic activity continued to be characterized by general cyclical recession, with contraction in output at a pace comparable to that experienced in the 1948-49 and 1953-54 recessions. Gross national product in the fourth quarter of 1957 had decreased about $6 billion, annual rate, largely associated with inventory liquidation, while industrial production for December was estimated at 137, seasonally adjusted, compared with 147 a year earlier and with the narrow range of 143-146 that prevailed during the period from January through September 1957. The market for new automobiles had been disappointing to producers, with sales off sig-

nificantly from a year earlier, while repossessions on instalment sales had reached high ground and still seemed to be edging upward. However, other sales at retail picked up sharply in the latter half of December, after having started the month slowly, and department store sales, seasonally adjusted, reached a new high in that month. Construction activity in December continued at record levels, with increases in residential construction again offsetting declines in the industrial area, but unemployment rose further in that month to around 5 per cent of the total labor force. Wholesale prices showed little change in December, remaining at about the average that had prevailed since midyear, while consumer prices were reflecting advances in services and meat prices.

In the financial area, two developments had occurred since the reduction in Federal Reserve Bank discount rates in November. One of these was a sharp decline in interest rates and the other was some seasonal increase in bank loans and investments, which represented a turnaround from the contra-seasonal decreases shown for October and November. The Federal Reserve System had supplied over $1 billion of reserves to the banking system during the six weeks prior to the end of the calendar year, and those reserves had contributed to credit expansion as well as currency expansion a little in excess of seasonal estimates. In brief, recent policies designed to cushion adjustments and mitigate recessionary tendencies in the economy had established the basis for maintaining the privately owned money supply.

Analysis of the data on economic activity indicated that the current recession was attributable largely to a decline in business plant and equipment expenditures, aggravated by an inventory cycle. It was not apparent, however, whether those influences were likely to spread to consumer spending and thus produce a cumulative recession. There was uncertainty as to the probable speed of inventory adjustment, particularly by manufacturers, and there was also uncertainty as to the amount and timing of the expected increase in defense spending, although it did not seem probable that this would be a significant factor for several months. In view of the wide range of possible ways in which the recession might develop, it seemed prudent to assume that the next upturn might be a fairly long way off, to be preceded either by a continuing gradual

decline or perhaps by a sideways movement after the current decline had run its course. The shift in System credit policy in the fall of 1957 had made it clear that open market operations were being directed toward assuring an adequate volume of credit for all potential borrowers with economically sound credit needs, but on the other hand System policy had not gone to the point of trying to bring about an excessive volume of free reserves.

In concluding that no change should be made in the policy directive, the Committee agreed that a slight easing in the reserve positions of banks would be desirable and that operations in the System Open Market Account should be conducted with sufficient latitude to permit this development to take place within the limits of the directive.

January 28, 1958

Authority to effect transactions in System Account.

The Committee made no change at this meeting in the wording of the directive to the Federal Reserve Bank of New York, which called for operations in the System Open Market Account directed toward cushioning adjustments and mitigating recessionary tendencies in the economy.

> Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: none.

Economic decline had acquired a definite momentum at the time of this meeting, and further decreases in production, employment, and other measures of activity were in prospect. It appeared that the industrial production index for January would show a decline of 2 or 3 percentage points from December, which would put it about 8 per cent below the early 1957 level, and unemployment claims were continuing to increase.

The declines in activity during recent months had been traceable primarily to adjustments in the capital goods area, and it was pointed out that readjustments in this particular area might take

considerable time. Installation of much new capacity during the past few years had eased the supply situation enough so that for some time there had been less incentive for buyers to maintain inventories and, at this time, they were being reduced. While inventory adjustments could occur fairly quickly, the rapidity of adjustment in both the inventory and capital goods areas would partly depend on changes in other demands, including consumer demands, State and local government demands, defense demands, and foreign demands.

The free reserve position attained thus far by member banks had been of moderate size, and monetary expansion, which had paused in the latter part of 1957, had not yet been resumed. Demand for bank loans now appeared to be showing a slackening drift, reflecting a larger than seasonal decline in business loans and also liquidation of dealers' positions in Government securities financed with bank credit in December. A large Treasury financing operation was expected shortly, and, although there were prospects that reserve availability would expand in coming weeks owing to further seasonal decline in deposits and to a reduction in Treasury cash balances, it was suggested that it would be desirable to continue through open market operations at least the present degree of reserve availability until indications of monetary expansion appeared. Some members suggested a more aggressive easing immediately, believing that could be done without disturbance to the forthcoming Treasury financing. Such a policy would be consistent with the reduction in discount rates to the 2¾ per cent level that had been made at several of the Federal Reserve Banks just prior to this meeting.

In all the circumstances, the Committee concluded that, even though the level of economic activity was continuing to decline, there should be no change at this meeting in the policy of supplying reserve funds in a manner that would cushion adjustments and mitigate recessionary tendencies in the economy and that, in view of the desirability of having an "even keel" during the period of the Treasury financing, open market operations should be directed toward maintaining approximately the same condition in the money market that had existed immediately prior to this meeting.

February 11, 1958

Authority to effect transactions in System Account.

The Committee again renewed without change the policy directive that placed emphasis upon operations in the System Account with a view to cushioning adjustments and mitigating recessionary tendencies in the economy.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Bryan, Leedy, Mills, Robertson, Shepardson, Szymczak, and Williams. Votes against this action: none.

Recession in general activity had continued during the month of January and signs of leveling out were not yet at hand. The declines were again general, but they were greatest in durable goods and related industries. The length of the work week had fallen to the lowest level of the postwar period, and by mid-January unemployment had risen close to the postwar peak of 4.7 million that prevailed in February 1950. Manufacturers' new orders for December showed a 2 per cent drop from November and were down 7½ per cent over the year, with new orders for durable goods running a fifth below the previous year. Business inventory liquidation had continued in December, mainly concentrated in durable goods manufacturing, but despite such liquidation the stock-sales ratio rose further to the highest level in a decade. January retail deliveries of new automobiles were some 20 per cent lower than deliveries in the previous month or in January 1957. Preliminary estimates suggested a further decline in gross national product for the first quarter of 1958 of from $4 to $5 billion, annual rate, putting total product back to the level of the first quarter of 1957. Exports in December were down sharply after two months of stability. Favorable factors included total construction activity, which continued at close to record levels in January, and total retail sales including those at department stores.

While business loans at city banks were liquidated in a record-breaking amount during January, the banks had increased their holdings of securities since the end of November. As a result, total loans and investments rose more in December and decreased less after the turn of the year than they did in 1957 or 1956. Time de-

posits at city banks advanced even more sharply in January 1958 than in the same month of the previous year. New security issues by State and local governments were proceeding in record-breaking volume, with some issues which were deferred in 1957 now being brought to the market. Short-term interest rates had declined to the lowest levels since early 1955, while long-term rates had been somewhat firmer during the past two or three weeks. Reserves to cover credit demands had been abundantly supplied through market factors and System operations. Additions to System holdings of Government securities had been much larger in December than usual, while the January decline was smaller than usual. The result was that the reserve position of member banks had shifted from net borrowed reserves of over $300 million during the last week of November to free reserves of over $200 million in the past two weeks. Projections indicated that free reserves might fluctuate around this level during February and increase sharply, though temporarily, in the first half of March unless offset by System operations.

It was the view of the Committee that the policy that it had been following had resulted in placing the System in a quite appropriate posture. If later on there were clear indications that the recession was spiraling, more drastic action might be required. Accordingly, for the present it was felt that the Committee should continue to follow an "even keel policy tipped on the side of ease." In these circumstances, no change was made in the existing policy directive.

March 4, 1958

1. Review of continuing authorities or statements of policy.

This being the first meeting of the Federal Open Market Committee after the new members elected by the Federal Reserve Banks for the year beginning March 1, 1958 had assumed their duties, the Committee reviewed and reaffirmed all continuing statements of policy and authorities for operations. These included the following:

a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

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

b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Balderston, Fulton, Irons, Leach, Mangels, Mills, Shepardson, Szymczak, and Vardaman. Vote against this action: Mr. Hayes, Vice Chairman.

Mr. Hayes stated that he would vote to approve the statement if the qualifying phrase, "as a general rule," were inserted after "shall" in the second and fourth lines.

c. Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Balderston, Fulton, Irons, Leach, Mangels, Mills, Shepardson, Szymczak, and Vardaman. Vote against this action: Mr. Hayes, Vice Chairman.

Mr. Hayes stated that he would vote to approve the action if the word "solely" were deleted from the second line and "primarily" substituted therefor, and if the phrase "as a general rule" were inserted after "shall" in line three.

2. Authority to effect transactions in System Account.

Clause (b) of paragraph (1) of the directive was changed at this

meeting to provide that, among other things, open market transactions would be with a view "to contributing further by monetary ease to resumption of stable growth of the economy." The Committee also deleted from the directive the paragraph authorizing the sale direct to the Treasury from the System Open Market Account for gold certificates of such amounts of Treasury securities maturing within one year as might be necessary from time to time for the accommodation of the Treasury up to an aggregate amount of $500 million face amount.

Votes for these actions: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Fulton, Irons, Leach, Mangels, Mills, Shepardson, Szymczak, and Vardaman. Votes against these actions: none.

During recent weeks, business activity had shown indications of deepening recession. A further decline during February indicated that the Board's index of industrial production for that month would be about 10 per cent under the mid-1957 high. Employment had continued to decline and unemployment to rise. Preliminary data from a survey of plans for plant and equipment expenditures during 1958 pointed to a decrease for the year of 10 per cent, whereas a similar survey made in the fall of 1957 indicated a decline of 7 per cent. Although the housing market appeared to be holding fairly strong, the over-all summary of economic conditions at the time of this meeting was described as one of little cheer.

The volume of free reserves had increased during late February, reflecting among other factors a reduction in reserve requirements ordered by the Board of Governors of the Federal Reserve System. At the same time the Committee authorized by telegram the maintenance of a somewhat higher level of free reserves than had been contemplated at the February 11 meeting.

In the market, an expansion in the total volume of bank credit had taken place during February. Business borrowing had been sharply reduced in the past 90 days, but the banks, supplied with ample reserves, had expanded holdings of securities and loans on securities, particularly in February, in contrast with the customary seasonal reduction at that time.

The Committee's discussion of the situation disclosed considerable

feeling that the policy directive should reflect a more positive approach to recovery than was embodied in the wording calling for "cushioning adjustments and mitigating recessionary tendencies in the economy." Agreement was reached on the change indicated, namely, that during the period following this meeting open market operations should be with a view to "contributing further by monetary ease to resumption of stable growth of the economy."

The Committee also discussed whether the discount rates at the Federal Reserve Banks should be reduced further from the prevailing level of 2¾ per cent, concluding that the matter should take its course at the respective Federal Reserve Banks.

Elimination from the directive of the third paragraph authorizing the sale direct to the Treasury from the System Open Market Account for gold certificates of Treasury securities up to an aggregate of $500 million resulted from the belief that under current circumstances, including the action taken by the Congress to increase the national debt limit from $275 to $280 billion, such an authorization was not likely to be used.

March 25, 1958

Authority to effect transactions in System Account.

The Committee renewed without change the directive approved at the meeting on March 4, 1958, which called for transactions in the System Open Market Account with a view, among other things, to contributing further by monetary ease to resumption of stable growth of the economy.

> 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.

Economic information presented to the Committee indicated a likelihood that industrial production during March would fall below the rate for February, which was 130 per cent of the 1947-49 average. The February figure represented a decline from 135 in December 1957 and 145 last August, which meant that in the six months from August to February industrial production had declined a little more rapidly than in the corresponding periods of early recession in 1948-

49 and 1953-54. Employment had continued to decline in both manufacturing and nonmanufacturing lines, with the decrease particularly marked in durable goods industries. Unemployment had risen sharply to 5.2 million in February, the number of workers on part time had increased further, and the number working overtime had continued to decline. Meanwhile, however, both consumer and wholesale prices were appreciably higher in February than in December, reflecting principally higher prices of food products and higher charges for services. Inventory liquidation was proceeding at a rather rapid pace, while business outlays for plant and equipment were continuing downward, with no turning point yet in sight. Although consumer buying had been well sustained, the February figures on retail sales were below the same month last year and it appeared that this trend might be continuing in March.

In the securities markets, stock prices had moved up irregularly and high-grade corporate bond prices had declined slightly since late January. A more than seasonal reduction in bank loans to business had accompanied declines in economic activity and business inventories, but the banks had been increasing their investments since late in the fall of 1957 and total bank credit outstanding had increased at a season when a decrease is usual. Corporations had obtained large amounts of new capital, and borrowing by the Treasury and other Government entities had been large.

There had been a fair degree of stability in activity abroad. Although the leveling off in activity overseas had had a disproportionate impact on exports from this country, the major part of the downward adjustment in exports appeared to have been completed. Thus far, the recession in the United States had had only a limited impact on the industrialized European countries.

The record of free reserves and short-term interest rates since the last Committee meeting suggested that the degree of ease desired by the Committee had been achieved. However, there was at the same time an occasional tendency for a feeling of relative tightness to develop temporarily in the money centers. The commercial banks, generally speaking, seemed to have adequate reserves at their disposal for the expansion of credit, but it appeared that the reduced level of liquidity which came about in the late stages of the 1955-57 boom might still be exerting some dulling effect on their attitudes toward

lending. Accordingly, it was regarded by some as questionable whether the commercial banking system would be an active instrument in fostering recovery until it had attained substantially greater liquidity.

In the last 130 days the System had moved on a broad front to establish a condition of credit ease. Aside from open market operations making reserves more readily available, the discount rates of the Federal Reserve Banks had been reduced in several steps from 3½ per cent to 2¼ per cent, the latest reduction having been effected in the period since the last meeting of the Committee. In addition, there had been two reductions totaling one percentage point in member bank reserve requirements against demand deposits, the more recent of which became effective for central reserve and reserve city banks on March 20, 1958, and would become effective for other member banks on April 1, 1958. The present posture of Federal Reserve policy was one of ease and it was the view of the Committee that it should continue to be such. Discussion brought out the comment that, although further discount rate reductions might possibly seem logical in view of the level of the Treasury bill and other money market rates, a change on the eve of a Treasury financing might incite undesirable speculation in the Government securities market.

While making no change in the existing policy directive, the Committee concluded that operations in the System Account should be directed toward maintaining a slightly larger volume of free reserves and money market conditions slightly easier than had been achieved since the last meeting of the Committee.

April 15, 1958

Authority to effect transactions in System Account.

This meeting of the Committee resulted in a decision to continue without change the policy directive calling for operations designed to contribute further by monetary ease to resumption of stable growth of the economy.

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

Data available to the Committee indicated some slowing down in

the pace of decline for total output and employment, some leveling out in trade, and maintenance of construction activity at close to record levels in value terms. In contrast, there were some developments of an expansive character in finance. While the picture domestically therefore appeared as one of more diversity or crosscurrents than earlier in the year, the over-all drift of the economy nevertheless was still plainly downward. Current statistics offered only slight basis for the hope that the saucering-out phase of the recession was at hand. After allowances for seasonal influences, the labor market continued to show further weakening, while surveys of business plans for plant and equipment expenditures reflected a further substantial projected cutback for 1958 as compared with 1957. The industrial production index for March was estimated to have declined two points further to 128, and preliminary April information indicated further output curtailment, much along the lines of the March pattern but with the possibility of some slowing. Retail trade, seasonally adjusted, was estimated to have been off another one per cent in March, manufacturers' sales and orders continued to show declines, with the fall-off much sharper in durable goods than in nondurable goods lines, and business inventory liquidation was believed to have continued in March at quite a sharp rate. At the same time, prices at wholesale and in consumer markets had risen further to late March, putting the indices a full one per cent above the December 1957 level.

In the financial area, total credit extended by commercial banks had apparently continued to expand during recent weeks, mostly in the form of short-term liquid assets. Savings of consumers held in financial form seemed to be increasing, while consumer debt had been decreasing. Business loans at banks had increased less than at this time in other recent years but corporate issues for new capital continued at a high level, as did new issues of State and local governments, and the Federal Government had become a net borrower. Deposits at banks had increased, on a seasonally adjusted basis. Short- and medium-term interest rates had shown further declines with wide variations, reflecting changes in liquidity, while long-term rates, under the influence of continued heavy borrowing in capital markets, remained firm.

Nearly $1 billion of reserves had been released by reductions in

reserve requirements of member banks since February 26 and an additional $250 million had been supplied by System open market operations through April 9. Reserves had been absorbed by an increase in required reserves of about $200 million resulting from growth in deposits, a rise in currency in circulation, foreign operations, consisting principally of gold withdrawals amounting to about $400 million, and changes in float and other factors. Free reserves in the aggregate had averaged somewhat in excess of $500 million. Although country banks appeared to be well supplied with reserves, banks in New York and Chicago, and probably in some other cities, had experienced wide fluctuations in their reserve positions and had borrowed heavily in the Federal funds market. It appeared that a substantial amount of additional reserves might need to be supplied by the Federal Reserve System in the next few weeks in order to maintain a condition of ease conducive to further credit and monetary expansion.

Reports at this meeting indicated that the directors of some of the Federal Reserve Banks had been giving serious consideration to the establishment of a discount rate lower than the existing 2¼ per cent rate. With the recent Treasury financing now completed, it appeared that those Reserve Banks might act to establish a lower rate rather quickly. A further reduction in the reserve requirements of member banks was seen as a possible means of providing the additional reserves that would otherwise have to be supplied by open market operations during the next few weeks in order to maintain the present level of free reserves. If the reduction were concentrated at central reserve and reserve city banks, it would also have a tendency to relieve pressure that occasionally developed in the money centers. Taken together, it was suggested that such actions on the discount rate and reserve requirements would clearly confirm the current easing posture of monetary policy and reinforce the policy objective of assisting the recovery of the economy.

The Committee was of the view that there was no reason to change its policy directive at this time. Free reserves had averaged slightly higher during the period since the last meeting of the Committee than during the preceding three-week period, and it was agreed that this general level should be maintained. It was noted, however, that if action should be taken in the near future on both the discount

rate and reserve requirements, the level of free reserves would tend to become relatively incidental, as long as the free reserve position did not decrease to an extent that might make it appear as though the System was reversing policy.

May 6, 1958

Authority to effect transactions in System Account.

The policy directive calling for operations to contribute further by monetary ease to resumption of stable growth of the economy was again renewed at this meeting.

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

Although some statistical evidence suggestive of a slowing of economic decline had been accumulating, most of the information available to the Committee at the time of this meeting indicated that the recession was still deepening and that a bottom was yet to be established. Among other things, the index of industrial production was estimated to have dropped another two points to 126 in April, manufacturers' sales and new orders were off again in March to about the same extent as in February, business inventory liquidation in March was found to have amounted to a further $700 or $800 million, seasonally adjusted, and estimates of new construction outlays had recently been revised downward due to lower private expenditures. Unemployment in April decreased less than seasonally, initial claims for unemployment insurance were still running at quite high levels, and the number of continued claims of those unemployed for 15 weeks or more was double that recorded in earlier postwar recessions. At the same time, the average of wholesale prices was holding stable and the average of consumer prices was still rising.

Since the preceding meeting of the Committee, there had been a further reduction to 1¾ per cent in the discount rates of most of the Federal Reserve Banks along with a further reduction of one-half percentage point in reserve requirements against demand deposits at central reserve and reserve city banks, while open market operations had been such as to maintain free reserves generally exceeding $500

million. Financial developments during this period were influenced by the additional availability of bank reserves and by the activities of banks in endeavoring to put their available funds to use. Demands on capital markets continued heavy. In the five weeks ended April 30, banks in leading cities showed a further increase of over $2.5 billion in total loans and investments, and it appeared that during the five months since the end of November, a period in which bank credit usually declines, total loans and investments of all commercial banks may have increased by $7 billion or more. The increase in April reflected almost wholly additions to holdings of United States Government securities, particularly the new Treasury five-year notes. Demand deposits adjusted at city banks increased during the five weeks prior to April 30 by about $1,200 million, compared with a growth of $750 million in the same period of 1957, while time deposits continued to increase at a much faster pace than the previous year.

The pattern of economic and financial developments caused the Committee to conclude that the prevailing policy of ease should be continued and that no change should be made in the outstanding policy directive.

May 27, 1958

Authority to effect transactions in System Account.

The Committee again continued without change the policy directive providing for operations in the System Account with a view to contributing further by monetary ease to resumption of stable growth of the economy.

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

The composite of current economic indicators reported at this meeting suggested that the recession in economic activity had been leveling off and that a bottom to the decline might be in the making. The decline in industrial production, over all, seemed to have been checked in May, and a number of other indicators, including retail sales, personal income, residential building, and new orders received by durable goods manufacturers, likewise appeared to have stopped

receding or to have risen slightly. While inventory liquidation had probably been continuing in the aggregate, some key material markets suggested a lessening in such liquidation. Also, although initial and continued unemployment compensation claims were still very high, the trend was indicative of a little firmer labor market. March figures for exports had risen from February, while imports continued to be well maintained at the moderately reduced level of the first two months of the year. In agriculture, the income outlook was quite favorable. Capital market activity had been well sustained and banking developments were in the direction of a strengthening of business and individual liquidity positions. As to prices, a degree of flexibility in the area of industrial commodities seemed to be emerging gradually, especially at the wholesale level.

The Committee recognized that each of the favorable factors needed qualification and that a number of other factors in the current situation raised questions about the imminence of recovery. Furthermore, there were reports of a substantial speculative interest in the Treasury issues maturing in June, a factor that suggested the need for close attention in view of the forthcoming Treasury refunding operation. On balance, therefore, it seemed prudent to view the forthcoming period as one of gradual testing, with the realization that on the basis of past cyclical patterns the period of testing might last for some time.

Short-term interest rates recently had declined to new low levels while long-term rates, after declining somewhat in April, rose slightly in early May. New security financing by corporations and by State and local governments continued in large volume. Recent figures showed that total loans and investments of all commercial banks increased by about $4 billion in April—a larger growth than had previously been estimated—thus bringing the total increase since the end of November 1957 to above $8 billion. Marked increases occurred during April in both loans and investments at country banks and in holdings of investments by city banks, where declines in business loans were offset by increases in loans on securities. In May, the decline in total loans and investments at city banks had been smaller than usual at that time. Demand deposits adjusted and currency outside banks showed a seasonally adjusted increase of $900 million in April following similar increases in February and March,

with the result that the total at the end of April was the largest since July 1957 and was equal to the total at the end of April 1957. Time deposits, other than interbank, were about $7 billion larger than at the same time in 1957, while interbank and United States Government deposits had also risen to higher levels than a year earlier. In addition to the growth in the volume of deposits, the rate of turnover of demand deposits had increased in April, contrary to the usual seasonal trend, and was about the same as in April 1957. Free reserves held close to $500 million during May, substantial drains on reserves attributable to the continued gold outflow and to a larger than seasonal increase in currency in circulation having been largely offset by additional reserves supplied through open market operations and other factors.

Estimates presented to the Committee indicated that reserve needs would be rather large in June and the first half of July, arising in part from seasonal factors and from a larger than usual increase in Treasury deposits at banks. Therefore, in the absence of System action free reserves might generally average much less than the levels that had prevailed recently.

In the light of these estimates and related factors, including the imminent and sizable Treasury financing operation, the Committee considered how best to implement and maintain the current posture of monetary ease without further depressing Treasury bill rates. It was the consensus that no change should be made in the language of the policy directive and that operations in the System Account should be directed toward maintaining an even keel over the ensuing period. In terms of approach, this contemplated that the Account Management would place emphasis on the tone and action of the market and the course of credit developments.

June 17, 1958

Authority to effect transactions in System Account.

The directive was renewed without change, continuing the policy of contributing further by monetary ease to resumption of stable growth of the economy.

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

Economic information available for this meeting was generally on the encouraging side and was confirmatory of the report at the May 27 meeting that bottoming out of recession was in fact occurring. However, analysis of the data suggested that the haze obscuring the outlook had not suddenly lifted, and that it was the better part of wisdom not to conclude as yet that a recovery pattern had definitely taken form. On the other hand, it could not be denied that there was a possibility that an accelerating recovery movement was now shaping up.

High levels of consumer and Government demands seemed to be roughly offsetting recessionary forces generated in the investment area of the economy. Heavy demands on capital markets, including a Treasury bond offering for cash, had been met in part by substantial expansion in bank holdings of securities and loans on securities. Additional reserves had been supplied by System purchases of securities, but on balance free reserves had been somewhat lower than in May. The money market had continued relatively easy until the week of this meeting, but with the mid-June needs for funds for taxes, dividends, and other payments, and with settlement for the recent Treasury offering of securities, it seemed clear that substantial financing needs would have to be met by the banking system during the next two or three weeks which would include the July 4 holiday demand for currency.

Despite the encouragement expressed by most Committee members regarding the business outlook, it did not appear that the time had arrived for backing away from the Committee policy of outright monetary ease or for creating a public impression that the Committee might be backing away from it. There was general agreement that over-all Federal Reserve credit policy should not be changed at this time and that, during the next three weeks, the System should stay about where it was. However, a minority suggested that, apart from open market operations, it might be desirable for some of the need for additional reserves during the immediate future to be met by a further reduction in reserve requirements for member banks. Another and contrasting variation from the general view was that reserves had been supplied in over-generous amounts during the past two months and that further injections to maintain the recent level of around

$500 million of free reserves would abet speculation in the Government securities market and create excessive liquidity.

Consideration of the foregoing factors resulted in a decision that at this meeting the Committee should make no change in Federal Reserve credit policy and that for the next three weeks no action should be taken to cause the tone of the market to get materially easier or tighter.

July 8, 1958

Authority to effect transactions in System Account.

No change was made at this meeting in the Committee's directive calling for open market operations with a view, among other things, to contributing further by monetary ease to resumption of stable growth of the economy.

> 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.

A summary of the economic data presented at this meeting was that performance of the economy in May and June had been better than had been anticipated. The index of industrial production over those two months had risen two points, and final data might show the rise to be three points. Gross national product for the second quarter was currently estimated to be at least moderately higher than in the first quarter. Whether an abrupt turnabout of activity was taking place or whether the extended improvement merely reflected a temporary rebound of production that had been far below consumption was yet to be determined. However, the odds seemed to favor more than a rebound improvement.

An important feature of the recent strengthening was that it represented a composite of small improvements over a wide range of activities, rather than dominant activity in one or two areas. One big uncertainty in the situation was the possibility of cyclical downturn in European business activity and of a new surge in inflationary forces in the Latin American and Far Eastern countries. However, the evidence at this time did not warrant the inference that European recession was likely to become a force affecting adversely United

States and world trade developments, although it was apparent that developments in those markets would require close observation in the months ahead.

On the financial side, the most striking development since the June 17 meeting had been severe pressure on the Treasury bond market. The underlying feature had been the large commitments in Treasury bonds made by temporary holders, many for pure speculation, induced by expectations of further declines in interest rates, and the attempt to close out those commitments at a time when the money market was under adverse pressure because of exceptionally heavy seasonal liquidity demands. This had called for exceptional amounts of Federal Reserve credit, and the increase in required reserves in the five weeks ending July 2 had been one of the largest on record for a period of that length. System open market operations had supplied $1.4 billion of additional reserve funds, and purchases of Government securities for Treasury investment accounts had been made, notwithstanding which interest rates rose. The Treasury bond market had been notably weak under the influence of the closing out of speculative commitments, and yields on such securities had risen sharply. In addition to the present disturbed atmosphere of the Government bond market, it was noted that important Treasury financing operations were in prospect between this and the next meeting of the Committee.

While some members of the Committee felt that the likelihood of a rapid upturn in economic activity argued for less ease, the Committee reached the conclusion that, on balance, there should be no change in policy at this time and that the directive should be renewed in its existing form calling for continued monetary ease.

July 18, 1958

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 this afternoon $50 million or less of Government securities at the discretion of the Manager of the System Open Market Account on scale wherever the Manager deemed it appropriate in order to steady the market.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Fulton, Irons, Leach, Shepardson, and Szymczak. Mr. Vardaman, who was not present at the meeting, when informed of the action stated that he concurred. Votes against this action: Messrs. Mills and Robertson.

Authority was granted to the Federal Reserve Bank of New York to purchase for the System Open Market Account in the open market, without limitation, Government securities in addition to short-term Government securities.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Fulton, Irons, Leach, Mills, Robertson, Shepardson and Szymczak. Mr. Vardaman, who was not present at the meeting, when informed of the action stated that he concurred. Votes against this action: none.

The action set forth in the first paragraph of this entry was taken at a meeting of the Federal Open Market Committee, held by telephone conference in the early afternoon of July 18, and was based on a report by the Manager of the System Open Market Account that a condition was developing in the Government securities market which, in his judgment, was close to a disorderly condition although it had not yet actually reached that point. His recommendation was that purchases of securities during the afternoon of $50 million or less be authorized for the purpose of steadying the market. After considering the recommendation in the light of the existing conditions in the market and of the Committee's continuing operating policy providing that open market operations shall be "solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets)," the Committee authorized the purchase of Government securities as indicated.

Messrs. Mills and Robertson voted against this authorization on the ground that at this time no one contended the market was disorderly and therefore there was no basis for intervention. In addition, they felt that the proposal to enter the market on a limited basis (as distinguished from action sufficiently massive to do the job) was unwise and would do very little to restore confidence in the market. Furthermore, they felt that if later there should be a disorderly market, the correction of it would have been seriously handicapped by

temporizing and fluttering around the edges of the market with minor purchases at this time.

As the System Account was starting to put this authorization into effect, further developments in the market caused the Manager of the Account to report (again by telephone conference) that he would now have to call the market disorderly. After consideration of the Manager's detailed report covering these developments, the Committee approved by unanimous vote the action set forth in the second paragraph of this entry, which authorized the purchase of Government securities in the open market, without limitation. It was understood that the authorization was made for the purpose of correcting a disorderly market and included the purchase of "rights" and when-issued securities, purchase of which was precluded during a period of Treasury financing under one of the Committee's continuing policies, last renewed at the meeting on March 4, 1958. In taking this action, the Committee also authorized the immediate release of an announcement reading as follows:

> In view of conditions in the United States Government securities market, the Federal Open Market Committee has instructed the Manager of the Open Market Account to purchase Government securities in addition to short-term Government securities.

July 23, 1958

Authority to effect transactions in System Account.

The Committee authorized the Federal Reserve Bank of New York to engage in a transaction that would include an offsetting purchase and sale of securities in the amount of $30 million for the purpose of altering the maturity pattern of the System's portfolio.

> 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.

The purpose of this action, taken during a telephone conference meeting, was to permit the System Account to complete a specific transaction for a foreign account in a manner that would result in adding to the amount of System Account holdings of Treasury bills that would mature on July 31, 1959. Thus, the Committee would be

in position to let these bills run off at that time and to help absorb the large volume of reserves that would be released to the market on August 1 because of purchases for System Account on a when-issued basis of new Treasury certificates due to be issued on that date. These purchases had been made under authorization by the Committee on July 18 of purchases for the purpose of correcting a disorderly market.

The foregoing action was recognized as a departure from the Committee rule, in effect since December 1953, prohibiting "swap" transactions. It was authorized only because of the unusual circumstances of the past few days and because it was deemed desirable to have as large a runoff of bills as possible within the next few days when large amounts of reserves would be released to the market.

July 24, 1958

Authority to effect transactions in System Account.

The Committee terminated the authority given to the Federal Reserve Bank of New York on July 18, 1958 to purchase for the System Open Market Account in the open market, without limitation, Government securities in addition to short-term Government securities.

> 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.

The Government securities market had steadied in the period since July 18, when, because of disorderly conditions then existing in the market, the Committee had authorized the purchase of Government securities in addition to short-term securities. Accordingly, at this telephone conference meeting, the July 18 authorization was terminated with the understanding that, if conditions in the market should seem to require it, another meeting of the Federal Open Market Committee would be called to consider what, if any, further action should be taken.

July 29, 1958

Authority to effect transactions in System Account.

The wording of the Committee's directive was changed at this meeting to delete the clause that had been in effect since March 4, 1958, and which called for operations that would contribute further by monetary ease to resumption of stable growth of the economy, and to replace that clause with an instruction to the Federal Reserve Bank of New York that operations for the System Account were to be with a view, among other things, to recapturing redundant reserves.

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

At this meeting reports of economic developments made it reasonably clear that April had marked the recession trough and May the first month of revival in economic activity. Evidences accumulating for June and July confirmed the broad range of increased industrial output that had been reported at the July 8 meeting of the Committee. In addition to the statistical data, indications of improvement in business sentiment suggested that an uptrend in economic activity might now be under way. The growing evidences of business improvement, together with the possibility that the degree of monetary ease prevailing in recent months might produce a very rapid expansion in bank credit and the money supply, raised the question whether the Committee should consider some modification of the degree of ease that had developed in recent months.

During the two weeks preceding this meeting, System operations had been largely concerned with correcting disorderly developments in the Government securities market, rather than with current economic and credit needs. This was in accordance with the authorization given by the Committee at a special meeting on July 18 to purchase Government securities without limitation for the purpose of correcting a disorderly market.

In the five-day period from July 18 to July 23, the System Account had purchased $1.2 billion of securities, largely when-issued securities involved in the Treasury financing, but also a small volume of other notes and bonds. These purchases had been made under the

specific authorization given on July 18 and within the general framework of the Committee's continuing operating policies that had been in effect since 1953, and which were last reaffirmed on March 4, 1958. Payment for the securities involved in the Treasury financing would result in a substantial rise in the volume of member bank reserves on August 1, over and above the level that had been maintained during the past seven or eight months, and the Committee gave consideration to what would be the effect of such a substantial increase in the availability of reserves. In light of the evidence of improvement in the economic situation, which suggested that the directive that had been in effect since March 4 was no longer appropriate, and in view of the decision of July 24 that the need for action to correct a disorderly condition in the Government securities market had passed, the conclusion was reached that for the next three weeks the problem for the Committee would be one of absorbing the redundant reserves that would be entering the market, in so far as that could be done consistently with an orderly market in Government securities. Thus, the Committee modified its directive in the manner indicated to require that operations be conducted with a view to recapturing redundant reserves that were expected to be released to the market on August 1.

August 4, 1959

Authority to effect transactions in System Account.

The Committee agreed that for the present, having recaptured redundant reserves, the policy to be followed with respect to operations for the System Open Market Account should be one of keeping from having redundant reserves.

Votes for this action: Messrs. Martin, Chairman, Balderston, Irons, Leach, Mangels, Mills, Shepardson, Vardaman, Allen, and Treiber. Votes against this action: none.

The recapture of redundant reserves having been effected, pursuant to the policy directive issued at the meeting on July 29, 1958, this action (taken in a meeting held by telephone conference) was for the purpose of giving the Federal Reserve Bank of New York and the Manager of the System Open Market Account an indication as

to general policy to be followed until the next meeting of the Committee.

August 19, 1958

Authority to effect transactions in System Account.

The policy directive of the Federal Open Market Committee was changed at this meeting by adopting wording for clause (b) of paragraph (1) to provide that, among other things, transactions be with a view "to fostering conditions in the money market conducive to balanced economic recovery." This wording superseded that adopted at the meeting on July 29, which called for operations with a view "to recapturing redundant reserves" and which was supplemented by the action taken on August 4 designed to keep from having redundant reserves return.

Votes for this action: Messrs. Martin, Chairman, Balderston, Fulton, Irons, Leach, Mangels, Shepardson, Vardaman, and Treiber. Votes against this action: none.

Information presented at this meeting showed that vigorous revival in domestic economic activity was taking place. Similarly, in Canada revival appeared to be under way. In Europe, production trends had been mixed, with contractions, where occurring, apparently associated with inventory adjustment.

In the United States the Board's index of industrial production through July had risen at least seven points or 6 per cent, from April, and it seemed possible that late data might raise the amount of advance. Regional reports bore out the national trend, although some important areas of the country were still not experiencing much recovery and the total number of unemployed persons nationally remained disturbingly large.

Domestic financial developments since late July included further expansion in bank credit, which had risen by $7 billion in the first seven months of the year. Financial markets had been influenced by the stream of economic data and corporation reports indicating that vigorous recovery was under way; by indications and rumors that Federal Reserve policy might be shifting away from ease (the Board of Governors of the Federal Reserve System had increased margin requirements for purchasing and carrying listed securities from 50

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

industrial countries with, however, activity still fairly high in most such areas.

Bank credit expansion in recent weeks had been larger than in the corresponding period of 1957 but less than in some other years. In capital markets, a shift from fixed return assets to equities seemed to be continuing. Margin requirements on listed securities had been increased effective October 16, 1958. Slackened monetary expansion along with Treasury deficit financing and general economic recovery had been possible because of previously accumulated liquidity. Further monetary expansion other than seasonal had not been needed to finance economic recovery. However, the total of economic events and the prospective borrowing needs of the Federal Government indicated a likelihood of growing credit demands in the near future. In addition, an outflow of gold was persisting. It was estimated on the basis of customary seasonal currency and deposit growth, and with some allowance for a further gold outflow, that from the time of this meeting to the end of 1958 there would be a need for additional bank reserves totaling about $1.3 billion, a need that could be met mainly through open market operations without varying the degree of restraint on credit expansion.

At this meeting, the Committee reviewed in detail the level and structure of interest rates and considered the credit actions that would help keep investment and saving in balance. The discount rates of the Federal Reserve Banks currently were out of line with market rates, and the suggestion was made that an increase in discount rates would be desirable in order to remove the incentive for member banks to obtain reserves by borrowing at the Reserve Banks instead of by selling securities in the market.

The conclusion of the Committee was that in present circumstances it would be undesirable to aim toward a greater degree of restraint on reserve availability through open market operations, especially if an increase in discount rates at the Federal Reserve Banks were to be made at the same time. The directive was, accordingly, again renewed with its provision for open market operations that would foster conditions in the money market conducive to balanced economic recovery.

November 10, 1958

Authority to effect transactions in System Account.

The Committee again reaffirmed its 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, and Szymczak. Votes against this action: none.

During the three weeks preceding this meeting, in which seasonal demands for credit were present, the System Open Market Account had been fairly active in supplying reserve funds to the market with a view to achieving the objectives agreed upon by the Committee at the meeting on October 21, namely, the maintenance of about the same degree of restrictive pressure in the market that had existed at the time of that meeting. Free reserves had averaged somewhat less than $100 million, and the money market atmosphere had been generally firm. During this period, the discount rates of all Federal Reserve Banks had been increased from the 2 per cent level to 2½ per cent—a rise that conformed to the prevailing money market rate structure and appeared to have caused no further adjustment in the market.

Economic indicators at the time of this meeting were still rising, although there was more diversity than had been shown in late summer and early autumn and the over-all rate of rise seemed to have slowed somewhat. The October industrial production index was estimated to have risen one index point, a smaller rise than had been projected earlier. On the other hand, construction activity had gone up in October to an all-time high, with advances shown in all major categories of private construction as well as public construction. Data for United States exports during September had shown a sharp fall, but imports had risen. Stability to modest recession in activity in Europe was reported, along with a leveling out in Canadian recovery. The unevenness shown by economic indicators in recent weeks was occasioning in various quarters re-appraisals of the outlook, with some toning down of optimistic projections because of inability to foresee forces that would convert recovery into a period of expansionary boom. However, the more moderate rate of rise was believed by

some to provide a better basis for expansion than if the rapid autumn rise had continued.

Sharp increases that had occurred in productivity during the past three months were being reflected in corporate profits and not in lowered industrial prices, and they thus provided support to demands for wage increases. There appeared to be little prospect for abatement of the persistent upward pressures on industrial prices notwithstanding the existence of unused resources, including considerable plant capacity not being utilized and substantial numbers of unemployed persons. Under these circumstances, a monetary policy on the side of restraint appeared to be appropriate and it did not appear that such restraint would retard sound recovery and growth in the economy.

The conclusion of the Committee was that the System Account should seek during the period immediately ahead to maintain conditions in the market about as they were at present, believing that the moderate degree of restraint that had existed for the past several weeks was appropriate under the circumstances and that it could be applied within the terms of the directive to the Federal Reserve Bank of New York that had been in effect since August 19.

December 2, 1958

Authority to effect transactions in System Account.

The Committee made no change at this meeting in the directive that had been in effect since August 19, 1958, which contemplated a policy directed toward fostering conditions in the money market conducive to balanced economic recovery.

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

During the three weeks preceding this meeting, the System Account had provided additional reserves to the market and member bank borrowing from the Federal Reserve Banks had risen on some days in the past week to more than $1 billion. These supplies of reserve funds had been sufficient to meet seasonal growth in currency and an increase in required reserves, although free reserves had declined to a nominal level.

Recovery in domestic economic activity was continuing on a broad basis although, as indicated at the November 10 meeting, there recently had been indication of a slowing in the rate of expansion. The weight of statistical evidence continued on the side of fairly well sustained momentum upward. More recently, some indication of improvement in the unemployment situation had been evident, and the number of labor market areas classified as substantial surplus areas had been reduced during November. Over all, it was apparent that the domestic recovery that had shown up during the summer months had now gone far enough to be on the verge of a new expansion period, with the possibility that the rise in activity would carry major indexes of activity into new high ground.

Developments in the financial area had shown no particularly striking features during the past month, although gyrations in the stock market had continued. Bond yields had declined somewhat in November, while short-term money rates had continued to rise. Although expansionary forces in the credit area had not been vigorous during recent weeks, the basis for renewed expansion continued to exist in the broadening economic recovery and the continuing Government deficit.

The policy discussion by the Committee pointed to some increase in the degree of restraint that should be exerted, with the proviso that due consideration must be given to the financing problems of the Treasury. It was suggested that there was enough flexibility within the Committee's general policy to allow seasonal forces to exert an influence in the direction of some further reduction in reserve availability, perhaps moving in the direction of net borrowed reserves. The Committee's conclusion contemplated letting market developments tend to increase restraint within limits consistent with the policy directive which, as renewed at this meeting, continued to provide for open market operations "fostering conditions in the money market conducive to balanced economic recovery."

December 16, 1958

Authority to effect transactions in System Account.

The Federal Open Market Committee changed its policy directive at this meeting by adopting wording for clause (b) of paragraph

(1) to provide that, among other things, transactions be with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability." It was the Committee's view that at this time the emphasis should be on preventing expansion at an unsustainable rate.

Votes for this action: Messrs. Martin, Chairman, Fulton, Irons, Leach, Mangels, Mills, Robertson, Shepardson, and Szymczak. Votes against this action: Mr. Hayes, Vice Chairman.

Since the recession's low in April 1958, recovery in economic activity had been remarkably good. Gross national product, personal income, retail trade, residential construction activity, manufacturers' new orders, industrial production, freight carloadings, and various other economic indicators had increased about as much in that seven-month period as in the corresponding seven-month periods of cyclical recoveries following earlier postwar contractions. The decline had been somewhat deeper during the recent recession than in the preceding two recessions, but it had been briefer and the subsequent recovery more rapid than in other postwar and prewar cycles. Even though peak activity levels had not been re-attained at the time of this meeting, they were sufficiently close at hand to direct attention to the problems to be considered in a period of renewed economic expansion.

Money and credit markets had been calm during the month preceding this meeting in the face of the vigorous economic recovery, the rather heavy financing operations of the Treasury, the liquidity demands customary at this season of the year, and a moderate tightening of bank reserve positions. Interest rates had fluctuated moderately, close to the increased levels reached earlier in the autumn. Firming of rates during the two weeks immediately preceding this meeting had not been as great as customary in December. In the first half of 1958, when reserves were freely available, total loans and investments of member banks had expanded sharply. Since midyear, a period in which availability of reserves had been reduced, loans and investments of New York City banks had declined, those of reserve city banks had increased only slightly, and those of country banks had expanded by much larger amounts than in the corresponding period of either of the two preceding years. In total, bank credit

since midyear had shown further expansion and by a greater than seasonal amount. Reserves to provide the basis for this credit had been largely supplied through System open market operations since August, when the volume of free reserves had been reduced sharply.

The discussion at this meeting of economic and financial developments indicated a consensus favoring a move in open market operations towards somewhat greater restraint, but a very moderate move in that direction. A majority of the Committee also felt that the policy directive that had been adopted at the meeting on August 19, and which had continued in effect since that time without modification, should be changed to delete the word "recovery" and to put emphasis on preventing expansion at an unsustainable rate. Specifically, it was felt by a majority of the Committee that the instruction to conduct System Account operations "conducive to balanced economic recovery" was somewhat out of date, and there was agreement on a modification in clause (b) of the first paragraph of the directive to provide for operations with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability." Within this wording, it was believed that a move toward somewhat greater restraint on the availability of reserves would be appropriate.

In voting against the change in wording of the directive, Mr. Hayes expressed himself as feeling that a move toward further restraint was premature at this stage of the recovery and might suggest to the public a policy of progressive tightening and set off an exaggerated market reaction. Apart from questioning the desirability of further restraint at this time, Mr. Hayes suggested that, if the Committee believed that policy should be more concerned with a developing threat of inflation than with recovery and that it should make a major effort to prevent such inflation by credit restraint, the directive should be made clear on that particular point.

* * *

The Open Market Committee's directive in effect at the beginning of 1958 called for operations with a view to cushioning adjustments and mitigating recessionary tendencies in the economy. This was changed at the March 4 meeting to provide that transactions should be with a view to contributing further by monetary ease to resump-

tion of stable growth of the economy. The next change in the directive was made on July 29, but during the period July 18 to July 24 the terms of the instruction adopted March 4 were temporarily superseded when the Committee gave a special authorization for the System Account to purchase Government securities, without limitation as to amount or maturity, for the purpose of correcting a disorderly condition in the Government securities market. That special authority having been terminated on July 24, the directive was modified at the meeting on July 29 to specify that operations should be with a view to recapturing redundant reserves that were expected to be released to the market August 1. A further instruction adopted on August 4, by which time the redundant reserves had been recaptured, called for keeping from having redundant reserves return. At the August 19 meeting, the directive was changed to provide for operations fostering conditions in the money market conducive to balanced economic recovery. This wording remained unchanged until the meeting on December 16, when it was modified to an instruction that operations be with a view to fostering conditions in the money market conducive to sustainable economic growth and stability. The form in which the directive was in effect at the end of 1958 provided an instruction to the Federal Reserve Bank of New York, until otherwise directed by the Committee;

(1) 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 fostering conditions in the money market conducive to sustainable economic growth and stability, 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;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems de-

sirable, 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.

RECORD OF POLICY ACTIONS
BOARD OF GOVERNORS

January 15, 1958

Reduction in margin requirements.

Effective January 16, 1958, the supplements to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange, were amended to reduce the margin requirements from 70 per cent to 50 per cent, these requirements to be applicable both to purchases of securities and to short sales.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: none.

For several months prior to this date common stock prices had been moving within a narrow range at a level approximately one-sixth below the peak reached in July 1957, and at this lower range the yields on stocks were restored to a point below those available on high-grade corporate bonds. The price movement was accompanied by a substantial reduction in stock market credit outstanding which, at the end of 1957, was estimated at about $3.6 billion, 10 per cent less than in mid-1957 and 5 per cent less than in April 1955 when the margin requirements were raised to 70 per cent. With the downward trend of general economic developments resulting in a series of rather discouraging business and financial reports, stock market behavior reflected a psychology of caution.

Although the historical record suggested the probability of some increase in customer debit balances following a margin reduction, it did not appear that such action at this time would be any great stimulant to stock market activity. Instead, the reaction of investors seemed likely to depend largely on their appraisal of the over-all economic situation.

In these circumstances, a 70 per cent margin requirement could no longer be justified on the grounds given when that level was placed in effect, namely, potential excessive speculative activity and potential undue use of credit to finance such activity.

January 21, 1958

Reduction in rates on discounts and advances by Federal Reserve Banks.

Effective January 22, 1958, the Board approved action by the Board of Directors of the Federal Reserve Bank of Philadelphia establishing a rate of 2¾ per cent (a reduction from 3 per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Mills, and Shepardson. Votes against this action: Messrs. Szymczak and Robertson.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

New York	January 24, 1958
Cleveland	January 24, 1958
Richmond	January 24, 1958
Chicago	January 24, 1958
St. Louis	January 24, 1958
Kansas City	January 24, 1958
Boston	January 28, 1958
Atlanta	January 28, 1958
Minneapolis	February 7, 1958
Dallas	February 14, 1958

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 3¼ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

(In accordance with the provisions of the Federal Reserve Act, the Federal Reserve Banks establish, subject to review and determination of the Board of Governors, rates on discounts and advances to member banks at least every 14 days and submit such rates to the Board for consideration. Prior to this date, no changes involving new policy had been made in these rates since those referred to on pages 68-70 of the Board's Annual Report for 1957.)

Factual information available to the System by mid-January verified the emergence and progression of recessionary trends. Industrial production and employment continued to decline, while unem-

ployment was rising at a disturbing pace. Declining gross national product was associated closely with a reduction in business plant and equipment expenditures aggravated by inventory liquidation, despite which manufacturers' stock-sales ratios were rising significantly.

Federal Reserve policy had started to shift in a counter-recessionary direction in late October and early November 1957 when open market operations began to supply reserves more liberally to the banking system. In mid-November the discount rate was reduced from 3½ to 3 per cent. The response of the financial area to the shift in policy was reflected in a sharp decline in interest rates and a substantial increase in bank credit. The interest rate decline, which extended to yields on securities and open market paper but was not yet pronounced in bank loan or mortgage rates, occurred most markedly in yields on securities issues that previously had risen most, particularly medium-term Treasury issues and State and local government issues.

With the accumulating evidence of recessionary tendencies, a further decrease in the discount rate was deemed an appropriate step in the execution of System policy designed to encourage credit and monetary expansion. In addition to placing the rate in closer alignment with rates on short-term market instruments, including the Treasury bill, the move had the effect of encouraging member banks to make any temporary reserve adjustments through borrowing rather than through credit liquidation.

Governor Szymczak's negative vote reflected administrative rather than economic or financial considerations. With the discount rate reduction in November 1957 having been announced just before the announcement of a Treasury refunding operation, he was apprehensive that a second such occurrence might create the impression of a pattern likely to be followed. Accordingly, he would have preferred to relax through the medium of open market operations for the time being and to defer a discount rate change until after completion of the forthcoming Treasury financing operation.

Governor Robertson's negative vote reflected his view that, with the country having passed only recently through a period of strong inflationary pressures which resulted in a substantial increase in wholesale and consumer prices from which there had as yet been

no general downward readjustment, a move to ease too rapidly might place a floor under existing price levels. As he saw it, a reduction of the discount rate at this time would have no advantage by way of creating more employment or a higher volume of production through the utilization of more bank credit. Instead, it might tend to accentuate fears of a serious recession, or even depression, and thereby actually contribute to bringing about such a situation. While the lower discount rate would affect interest rates, he noted that it would not necessarily make additional reserves available.

February 19, 1958

Reduction in reserve requirements of member banks.

The supplement to Regulation D, Reserves of Member Banks, was amended to reduce reserve requirements with respect to net demand deposits of member banks of the Federal Reserve System as follows:

Effective	*For*	*Per cent*
February 27, 1958	Central reserve city banks	From 20 to 19½
February 27, 1958	Reserve city banks	From 18 to 17½
March 1, 1958	Banks not in central reserve or reserve cities	From 12 to 11½

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, and Shepardson. Votes against this action: none.

This action released to member banks about $500 million from required reserves. For central reserve city banks, about $125 million of reserves were released, while for reserve city and country banks the amounts were in the neighborhood of $195 million and $180 million, respectively.

At the time this action was under consideration, industrial production, employment, income, and retail sales were continuing on a downward trend, while unemployment, on a seasonally adjusted basis, had risen further. Although total bank loans and investments had increased, this reflected principally larger holdings of Government securities. Business loans had continued to decline.

The reduction of reserve requirements was complementary to steps being taken actively by the Federal Reserve System through

the use of other policy instruments to foster conditions of credit ease during a period of deepening recession and thus to increase the willingness and ability of the banking system to expand credit. The freeing of reserves tended in the direction of reducing the cost of financing to borrowers and widened the access of potential borrowers to credit funds.

March 6, 1958

Reduction in rates on discounts and advances by Federal Reserve Banks.

Effective March 7, 1958, the Board approved action by the Boards of Directors of the Federal Reserve Banks of New York, Philadelphia, and Chicago establishing a rate of 2¼ per cent (a reduction from 2¾ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Vardaman, Mills, and Shepardson. Votes against this action: none.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Atlanta	March 10, 1958
Boston	March 11, 1958
San Francisco	March 13, 1958[1]
Cleveland	March 14, 1958
Richmond	March 14, 1958
St. Louis	March 14, 1958
Kansas City	March 14, 1958
Dallas	March 14, 1958
Minneapolis	March 21, 1958

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 2¾ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

[1]Reduction from 3 per cent.

In early March economic activity was continuing to recede. The decline in industrial production had by this time carried to a point 10 per cent below the peak reached in the summer of 1957, inventory liquidation continued to be substantial, particularly in durable goods lines, and retail trade had worsened perceptibly. With substantial cancellations of previously approved appropriations reported, the prospective level of business plant and equipment expenditures for 1958 was around 10 per cent lower than expenditures during 1957. Unemployment on a seasonally adjusted basis was estimated to be running at about 6.7 per cent of the labor force, a rate comparable to that reached in 1949. The composite of available economic information suggested the possibility that the current recession might develop to be less moderate in extent or duration than either the 1948-49 or the 1953-54 recessions.

Reflecting to a large extent Federal Reserve policy of providing a generous supply of reserves, member banks had been able not only to get substantially out of debt at the Reserve Banks but also to expand credit contrary to usual seasonal trends. In the face of a net liquidation of business loans, this expansion was being accomplished by placement of funds in securities and in loans on securities. Bank purchases of securities were providing funds directly or indirectly to the United States Treasury to meet the growing deficit incidental to the recession, as well as to State and local governments and corporations borrowing in capital markets and to borrowers on home mortgages. Due to the easier reserve position of banks and the resulting increase in the availability of lendable funds relative to current demands, there was a sharp further decline in short-term interest rates and the rate on Treasury bills had fallen to around 1¼ per cent.

In these circumstances, the action to reduce the discount rate to 2¼ per cent was not of particular immediate significance from the standpoint of member bank borrowing. However, it brought the discount rate into better alignment with short-term interest rates, reflected the general attitude of System policy at this stage of the recession, and tended toward a position that would afford the System greater flexibility of adjustment to future developments.

March 18, 1958

Reduction in reserve requirements of member banks.

The supplement to Regulation D, Reserves of Member Banks, was amended to reduce reserve requirements with respect to net demand deposits of member banks of the Federal Reserve System as follows:

Effective	*For*	*Per cent*
March 20, 1958	Central reserve city banks	From 19½ to 19
March 20, 1958	Reserve city banks	From 17½ to 17
April 1, 1958	Banks not in central reserve or reserve cities	From 11½ to 11

Votes for this action: Messrs. Martin, Balderston, Vardaman, Mills, Robertson, and Shepardson. Votes against this action: none.

This action released about $490 million from required reserves, with the pattern of distribution approximately as follows: central reserve city banks $125 million; reserve city banks $190 million; and country banks $175 million.

This second reduction of reserve requirements, viewed in association with earlier discount rate changes and the provision of reserves through open market operations, reflected furtherance of a System policy designed in its over-all aspects to foster ease in credit markets as the course of recession carried major business indices to lower levels. Taken together, the succeeding steps of Federal Reserve policy enabled member banks further to reduce their discounts at the Reserve Banks, served to offset the reserve drain involved in a continuing outflow of gold from the United States, and offered the means of financing a substantial commercial bank credit expansion. With the release of required reserves, member banks were able not only to meet seasonal loan demands but at the same time to continue adding to their holdings of United States Government securities.

April 17, 1958

Reduction in reserve requirements of member banks.

The supplement to Regulation D, Reserves of Member Banks, was amended to reduce reserve requirements with respect to net demand deposits of member banks of the Federal Reserve System as follows:

Effective	*For*	*Per cent*
April 17, 1958	Central reserve city banks	From 19 to 18½
April 24, 1958	Central reserve city banks	From 18½ to 18
April 24, 1958	Reserve city banks	From 17 to 16½

Votes for this action: Messrs. Martin, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: none.

The effect of this action, the third in a series of reductions in reserve requirements, was to release about $450 million from required reserves. For central reserve city banks the reduction which became effective April 17 released about $130 million of reserves, and the reduction effective April 24 released approximately the same amount. For reserve city banks, the effect was to free about $190 million of required reserves.

Nearly $1 billion of reserves had been released by the two preceding reductions in reserve requirements, and additional reserves had been supplied by System open market operations during the past several weeks. However, a substantial part of the reserves thus provided had been absorbed by increased requirements resulting from a contra-seasonal growth in bank deposits, a larger than seasonal increase in currency in circulation, foreign operations (principally gold withdrawals), and float and other factors. In addition, free reserves of member banks had increased to a level deemed consistent with Federal Reserve policy objectives at this particular stage and depth of the recession. In view of the likelihood of a further gold drain, a prospective increase in required reserves resulting from payment by banks for a new Treasury issue, and an indicated increase in demand deposits of at least seasonal magnitude, it was estimated that some $300 million additional reserves would have to be supplied within the near future to maintain a condition of ease conducive to further credit and monetary expansion.

This action was taken in recognition of the prospective need for additional reserves and to relieve pressures that were appearing on the reserve positions of central reserve and, to a somewhat lesser extent, reserve city banks. Some members felt that the existing situation afforded an opportunity to reduce the level of reserve requirements at a time when such action was consistent with credit policy

and at the same time further to enlarge the area of flexibility for System action should it become necessary at some future date to institute a policy of credit restraint in the light of changed economic conditions.

April 17, 1958

Reduction in rates on discounts and advances by Federal Reserve Banks.

Effective April 18, 1958, the Board approved actions by the Boards of Directors of the Federal Reserve Banks of New York, Philadelphia, Chicago, St. Louis, and Minneapolis establishing a rate of 1¾ per cent (a reduction from 2¼ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: none.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	April 22, 1958
Atlanta	April 22, 1958
Cleveland	April 25, 1958
Richmond	April 25, 1958
Kansas City	April 25, 1958
San Francisco	May 1, 1958
Dallas	May 9, 1958

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 2¼ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

By mid-April, data becoming available to the System suggested some slowing in the pace of decline of output and employment. There were, in fact, developments in certain segments of the economy such as to create the impression of more diversity of trends than had been the case earlier. Nevertheless, the sum of statistical evidence indicated that the general movement continued to be one

of downward drift. In reflection of a System policy of ease, there had been a rapid expansion of bank credit while short- and medium-term interest rates had declined further and reached their lowest levels since early 1955.

This further action served to narrow the discrepancy between the discount rate and money market rates, including the Treasury bill rate, and provided assurance to member banks of a ready availability of funds at the lower rate in the event of need. The concurrent actions on the discount rate and on reserve requirements placed monetary policy clearly in the posture of doing everything possible to assist in the turnaround and recovery of the economy.

August 4, 1958

Increase in margin requirements.

Effective August 5, 1958, the supplements to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange, were amended to increase the margin requirements from 50 per cent to 70 per cent, these requirements to be applicable both to purchases of securities and to short sales.

Votes for this action: Messrs. Martin, Balderston, Vardaman, Mills, and Shepardson. Votes against this action: none.

By this date there was clear statistical evidence that recovery in economic activity and production had gained considerable momentum and was likely to go forward. The recovery was accompanied by a rise in stock prices sufficient to carry common stock yields below yields on bonds of the same companies, and by a sharp increase in the volume of stock market credit which by July had reached a level some 20 per cent higher than at the beginning of the year. In view of this rapid rise in credit and the re-emergence of an investment psychology favoring the purchase of stocks as a hedge against potential inflation, which would be a particular inducement to borrowing for the purpose, the margin requirements were restored to the 70 per cent level that had prevailed prior to the middle of January.

August 14, 1958

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective August 15, 1958, the Board approved action by the Board of Directors of the Federal Reserve Bank of San Francisco establishing a rate of 2 per cent (an increase from 1¾ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Vardaman, and Shepardson. Votes against this action: none.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Dallas	August	22, 1958
Atlanta	August	26, 1958
Kansas City	August	29, 1958
Chicago	September	5, 1958
Minneapolis	September	5, 1958
New York	September	12, 1958
Cleveland	September	12, 1958
Richmond	September	12, 1958
St. Louis	September	12, 1958
Philadelphia	September	19, 1958
Boston	September	23, 1958

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 2½ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

Increasing evidence of vigorous economic recovery on a broad front was visible by the early part of August. By July, the seasonally adjusted index of industrial production had risen six points from the low of 128 reached in April, with the improvement in output diffused through durable and nondurable goods industries. Construction activity, already quite strong, increased further in July as private housing starts rose for the fifth successive month and attained a seasonally adjusted rate close to 1.2 million units, almost 15 per cent higher than the rate a year earlier. Personal income in June was back

nearly to the level of August 1957, and it was estimated to have reached further ahead in July. In the first six months of the year, farm income had attained its highest level since 1953, and on the basis of crop and marketing prospects it seemed likely to rise further in the months ahead. Wholesale prices, advancing since mid-June, had by August exceeded the peak reached in March 1958, and consumer demand was strong.

The improved economic outlook and the prospect of a large Federal deficit for the current fiscal year led to a sharpening of expectations with regard to a renewal of inflationary pressures and to a reversal in the trend of interest rates. The yield on Treasury bills rebounded strongly from the low point reached in June and by the first part of August was in the neighborhood of 1½ per cent.

In view of these developments, System open market operations had been modified so as to supply only a portion of the reserves needed to meet rising credit demands and offset the reserve drain of a continued gold outflow. As a result, member banks were obliged to draw down their excess reserves and to begin to increase their borrowings at the Federal Reserve Banks. The discount rate adjustment made such borrowings more costly.

October 15, 1958

Increase in margin requirements.

Effective October 16, 1958, the supplements to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange, were amended to increase the margin requirements from 70 per cent to 90 per cent, these requirements to be applicable to both purchases and short sales.

Votes for this action: Messrs. Balderston, Szymczak, Mills, and Shepardson. Votes against this action: Mr. Robertson.

Following the increase in margin requirements from 50 per cent to 70 per cent early in August, common stock prices continued their upward climb in a heavy volume of trading activity and had now registered a further advance of about 8 per cent. By October this price movement had carried common stock yields to a level more than half a percentage point below the average yield on high-grade

corporate bonds. After a pause in August, stock market credit likewise resumed its upward thrust and latest estimates placed the volume of total customer credit at above $4.3 billion. In addition, the number of open margin accounts was reported to have increased considerably from June to September.

Prevalent psychology, favoring equities, including those of a speculative character, as a medium of investment in preference to fixed-income obligations, appeared to reflect not only growing public confidence in continued business improvement but apprehension as to an intensification of inflationary pressures. In light of the developments in the market, the margin requirements were increased to 90 per cent at this time pursuant to the Board's statutory responsibility for administering those requirements with a view to preventing the excessive use of credit for purchasing or carrying registered stocks.

Governor Robertson voted against this action for the following reasons:

(1) Under withdrawal and substitution rules in effect at that time, a customer selling securities in a margin account was free to purchase an equal market value of securities or to withdraw the margin *currently* required on such a purchase. Thus, if he sold $1,000 of securities, he could replace them with a $1,000 purchase of securities, or he could withdraw $700 in cash under a 70 per cent margin requirement or $900 under a 90 per cent margin requirement. Consequently, Governor Robertson felt, the increased margin requirements would apply in practice only to new extensions of credit and not to the turnover of credit already in the market. It would fail, he believed, to reach the most important aspect at that time of the "excessive *use* of credit" and would therefore be a relatively futile and ineffective action, the psychological effect of which might be the reverse of that intended.

(2) Also because of the then existing withdrawal and substitution rules, the increased margin requirements would unjustifiably enlarge the inequity as between customers who could continue to trade on lower margins and new customers subject to higher margins.

(3) The higher margin requirements, coupled with the existing withdrawal and substitution rules, would tend to encourage a weakening of margin accounts and create dangers of cumulative forced selling in undermargined accounts if stock prices should fall.

October 23, 1958

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective October 24, 1958, the Board approved action by the Boards of Directors of the Federal Reserve Banks of Philadelphia, Richmond, St. Louis, Minneapolis, and Dallas establishing a rate of 2½ per cent (an increase from 2 per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Balderston, Szymczak, Robertson, and Shepardson. Votes against this action: none.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Atlanta	October 28, 1958
Cleveland	October 30, 1958
Chicago	October 31, 1958
Boston	November 4, 1958
Kansas City	November 4, 1958
San Francisco	November 6, 1958
New York	November 7, 1958

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 3 per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

During the period since the previous discount rate increase in August, the economy had continued its trend toward recovery, with further advances in industrial production, construction activity, retail sales, and personal income. Although average wholesale prices showed stability, prices of basic industrial materials were moving upward. Currency in circulation, bank credit, and deposits each reflected a seasonal rise. Short-term interest rates, which began to advance rapidly after midyear, continued that trend, reflecting in part substantial cash borrowing on the part of the Treasury in the form of short-term securities and also anticipation of further growth in credit demands. By the middle of October, the yield on three-month

Treasury bills had risen to a level around 2⅝ per cent. Seasonal monetary needs were estimated to require a further growth of over $4 billion in total bank credit by the end of the calendar year, while the Treasury was scheduled to undertake shortly a series of financing operations that would involve, through the end of the year, borrowing additional cash of around $4 billion and refunding some $12 billion of outstanding securities. Other pressures also tending to influence the trend toward a higher structure of interest rates included growing apprehension concerning potential inflationary developments and a continued tendency to shift from fixed-return assets to equities.

With the discount rate having fallen substantially out of line with short-term money market rates, and with influences present such as to suggest the probability of a further distortion of the normal relationship, the increase in the rate served to produce a better alignment and at the same time recognized existing trends in the money market and the economy generally.

November 12, 1958

Amendment to Regulation K, Corporations Doing Foreign Banking or Other Foreign Financing under the Federal Reserve Act.

Effective November 12, 1958, Regulation K was amended by deleting Section 10(c)(2) and the reference thereto contained in Section 3(b).

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: none.

Section 10(c) of Regulation K, as revised January 15, 1957, contained a provision that "no Financing Corporation hereafter organized shall have a name which is similar to the name of, or identifies the Corporation with, any bank in the United States with which such Financing Corporation is affiliated." Section 3(b), relating to names of corporations organized under Section 25(a) of the Federal Reserve Act, contained a reference to the aforementioned provision of Section 10(c).

In the light of experience with the administration of the revised Regulation K, the Board concluded that the provision in question was unduly restrictive and unnecessary in the public interest. Pursuant to Section 3(b), the name of any corporation organized under Section

25(a) continued to be subject to the approval of the Board of Governors. Further, the same section also provides that in no case shall the name of such a corporation resemble the name of any other corporation to an extent that might result in misleading or deceiving the public as to the corporation's identity, purpose, connections, or affiliations. In addition, the name of any corporation organized under Section 25(a) shall, so far as practicable, indicate the nature of the business contemplated and shall include the word "international," "foreign," "overseas," or some similar word. No financing corporation is permitted to have the word "bank" or "banking," or any similar word, as part of its name.

December 18, 1958

Actions incident to admission of Alaska to Statehood.

Effective upon issuance by the President of the United States of a proclamation admitting Alaska to Statehood, which proclamation subsequently was issued on January 3, 1959, the Board readjusted the Federal Reserve districts so as to include the State of Alaska in the Twelfth District, and within that District included Alaska in the Territory of the Seattle Branch of the Federal Reserve Bank of San Francisco. Effective the same date, certain amendments were made to several regulations of the Board to correct language rendered inappropriate by the admission of Alaska to Statehood.

Votes for this action: Messrs. Martin, Szymczak, Mills, and Robertson. Votes against this action: none.

Section 2 of the Federal Reserve Act provides that the Federal Reserve districts, as created originally by the Reserve Bank Organization Committee, may be readjusted from time to time by the Board of Governors of the Federal Reserve System, not to exceed 12 in all. Section 19 of the Alaska Statehood Act amended the aforesaid Section 2 to provide that "when the State of Alaska is hereafter admitted to the Union the Federal Reserve districts shall be readjusted by the Board of Governors of the Federal Reserve System in such manner as to include such State." In anticipation of a Presidential proclamation admitting Alaska to Statehood, the Board therefore took action to include Alaska in the Twelfth Federal Reserve District coincident with the date of the proclamation.

Regulations relating to branches of Federal Reserve Banks, which are prescribed under the authority of Section 3 of the Federal Reserve Act, provide that no change shall be made by any Federal Reserve Bank in the territory included within the district served by any of its branches except with the prior approval or upon the direction of the Board of Governors. Pursuant to these regulations, the Board provided that the State of Alaska, upon admission to the Union, be included in the territory of the Seattle Branch of the Federal Reserve Bank of San Francisco.

Certain technical changes in a number of Board regulations were made, effective the same date, because the admission of Alaska to Statehood rendered the existing language inappropriate. The regulations affected included G, Collection of Noncash Items; H, Membership of State Banking Institutions in the Federal Reserve System; J, Check Clearing and Collection; and U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined each of the 12 Federal Reserve Banks and their 24 branches during the year as required by law. In conjunction with their annual examination of the Federal Reserve Bank of New York, the Board's examiners also made a detailed audit of the accounts and holdings of the System Open Market Account maintained at that Bank, and rendered a report thereon to the Federal Open Market Committee. The techniques and procedures employed by the Board's examiners were surveyed and appraised by a private firm of certified public accountants during the course of the examination of a Federal Reserve Bank of its selection.

Examination of member banks. Although authorized to examine all member banks, both State and national, as a matter of practice neither the Federal Reserve Banks nor the Board of Governors examines national banks since the Comptroller of the Currency is directly charged with that responsibility by law. Reports of examinations made by the Comptroller are furnished the respective Federal Reserve Banks and made available to the Board of Governors. Likewise, because all member banks are insured, the Federal Deposit Insurance Corporation is empowered to make special examinations of national banks and State member banks. However, such examinations have been rare and have been made only in anticipation of financial assistance by the Corporation in a rehabilitation program or where a member bank desired to continue as an insured bank after withdrawal from membership in the System. Reports of examination of both national banks and State member banks are made available to the Federal Deposit Insurance Corporation.

State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. Here again, in order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking au-

thorities or alternate examinations are made by agreement with State authorities. The 1958 program for the examination of State member banks was practically completed, since only 9 of the 1,734 banks were not examined during the calendar year.

Federal Reserve membership. The 6,312 banks that were members of the Federal Reserve System at the end of 1958 accounted for 47 per cent of the number and held 85 per cent of the deposits of all commercial banks in the United States. State member banks accounted for 20 per cent of the number of all State commercial banks and held 66 per cent of the deposits of these banks.

The 4,578 national and 1,734 State member banks comprising Federal Reserve membership reflected declines of 42 and 39, respectively, from the previous year-end. This continuing decline was largely due to consolidations and mergers; other reductions include 15 State member banks that withdrew from membership, and one national bank that became a nonmember bank. The decrease was partly offset by 19 newly established national and two newly established State member banks, the admission of seven nonmember banks to membership, and the conversion of three nonmember banks into national banks.

The total number of member bank offices increased as a result of both the conversion of merged banks into branches and the establishment of de novo branches. At the end of the year member banks were operating 6,700 branches, 535 more than at the close of 1957.

Detailed figures on changes in the banking structure for the year 1958 are shown in Table 18 on page 127.

Bank holding companies. During 1958, pursuant to Section 3(a)(1) of the Bank Holding Company Act of 1956, the Board approved one application for prior approval of action to become a bank holding company, and denied three such applications, the latter three being involved in a proposal that would have resulted in one continuing bank holding company. Pursuant to Section 3(a)(2) of the Act, the Board approved the acquisition by three bank holding companies of voting shares of four banks and denied one application for such acquisition with respect to one bank. Under Section 4(c)(6) of the Act, the Board, after a hearing, denied a request for a determination that certain subsidiaries of a bank holding company were so closely related to the banking activities of the

holding company system as to be a proper incident thereto and as to make it unnecessary for the prohibitions of Section 4 to apply in order to carry out the purposes of the Act; one such request was approved. During the year the Board issued four certifications in accordance with the tax provisions of the Act (Internal Revenue Code, Sections 1101 and 1103). To provide necessary current information, annual reports for the year 1957 were obtained from registered bank holding companies.

During 1958, pursuant to the Banking Act of 1933, the Board authorized the issuance of five voting permits for general purposes and 13 permits for limited purposes to holding company affiliates of member banks. In accordance with established practice, a number of holding company affiliates were examined during the year by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to seven organizations.

Trust powers of national banks. During 1958, 42 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to five banks which previously had been granted certain trust powers. One additional national bank acquired trust powers as a result of consolidation. Trust powers of 31 national banks were terminated by voluntary liquidation, consolidation, merger, or conversion. At the end of 1958, there were 1,722 national banks holding permits to exercise trust powers.

Acceptance powers of member banks. During the year the Board approved applications of two member banks, pursuant to the provisions of Section 13 of the Federal Reserve Act, for increased acceptance powers. One member bank was granted permission to accept commercial drafts or bills of exchange to an amount not

exceeding at any time, in the aggregate, 100 per cent of its paid-up and unimpaired capital stock and surplus, and the application of one member bank was approved for limited permission to accept drafts or bills of exchange drawn for the purpose of furnishing dollar exchange as required by the usages of trade in Brazil.

Foreign branches and foreign banking and financing corporations. Under the provisions of Section 25 of the Federal Reserve Act, the Board approved during 1958 seven applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States. One member bank opened a branch in Bayamon, Puerto Rico; and another opened branches in Asuncion, Paraguay, and Valencia, Venezuela. The Valencia branch had been authorized by the Board in 1957. One member bank closed one of its branches in London.

At the end of 1958, seven member banks had in active operation a total of 119 branches in 27 foreign countries and overseas areas of the United States. Of the 119 branches, three national banks were operating 93 and four State member banks were operating 26. The branches were distributed geographically as follows:

Latin America	**62**
Argentina	10
Brazil	10
Chile	2
Colombia	4
Cuba	21
Mexico	3
Panama	5
Paraguay	1
Peru	1
Uruguay	1
Venezuela	4
Continental Europe	**5**
Belgium	1
France	3
Germany	1
England	**10**
Near East	**4**
Egypt	1
Lebanon	2
Saudi Arabia	1
Far East	**20**
Hong Kong	1
India	2
Japan	10
Philippines	5
Singapore	1
Thailand	1
United States Overseas Areas	**18**
Canal Zone	4
Guam	1
Puerto Rico	13
Total	**119**

There was no change in 1958 in the list of corporations organized under State laws which operate under agreements with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged

principally in international or foreign banking. The head offices in New York of the three "agreement" corporations were examined in 1958 by examiners for the Board of Governors. One corporation operates a branch in France; one has an English fiduciary affiliate; and one operates two agencies at the New York International Airport, has a branch in England, owns all the stock of a bank organized under the laws of, and operating in, Liberia, and owns all the stock of a bank organized under the laws of, and operating in, the Union of South Africa. The investment in the latter bank was authorized by the Board and the bank opened in Johannesburg in 1958.

During 1958 one corporation was chartered by the Board under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign financing, making a total of five corporations engaged in international or foreign banking or financing in active operation at the end of the year, two of which are regarded as "Banking Corporations" and three as "Financing Corporations." The home offices of these five corporations are located in New York City, and four were examined during the year by examiners for the Board of Governors. Three corporations have no subsidiaries or foreign branches; one has a branch in France and an English fiduciary affiliate which has a branch in Canada; and one operates branches in France, Germany, Guatemala, Lebanon, and Singapore (with branches in Hong Kong and the Federation of Malaya authorized by the Board in 1958 but not opened by the end of the year), and owns substantially all of the stock of a bank organized under the laws of, and operating in, Italy.

In 1958, examiners for the Board of Governors examined the Singapore, Colony of Singapore, and Beirut, Lebanon, branches of a foreign banking corporation, and the Japanese and Beirut, Lebanon, branches of a State member bank. The London branches of another State member bank were surveyed at the head office of the bank in New York by examiners for the Board of Governors.

Inter-Agency Bank Examination School. During 1958, two sessions of the School for Examiners and four sessions of the School for Assistant Examiners were held. The Inter-Agency Bank Examination School is conducted in Washington by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

Since the Inter-Agency School was established in 1952, the various sessions have been attended by 1,064 men, representing the three Federal bank supervisory agencies, the State Banking Departments of California, Connecticut, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, and Virginia, the Treasury Department of the Commonwealth of Puerto Rico, and one foreign country.

LEGISLATION

Defense Production Act. The Defense Production Act of 1950, Section 301 of which is the basis for guarantees of loans for defense production, which would have expired June 30, 1958, was amended and continued in force until the close of June 30, 1960, by the Act of June 28, 1958.

Purchase of Government obligations by Federal Reserve Banks. The authority of the Federal Reserve Banks under Section 14(b) of the Federal Reserve Act to purchase and sell direct or fully guaranteed obligations of the United States directly from or to the United States, which would have expired on June 30, 1958, was extended until June 30, 1960, by the Act of June 30, 1958.

Alaskan Statehood. The Alaskan Statehood Act of July 7, 1958 amended Section 2 of the Federal Reserve Act to provide that upon admission of Alaska to Statehood the Federal Reserve districts should be readjusted so as to include such State, and to require national banks in any new State to become members of the Federal Reserve System within 90 days after admission of such State into the Union. Pursuant to the requirements of this amendment, the Board subsequently readjusted the Federal Reserve districts so as to include the State of Alaska in the Twelfth Federal Reserve District effective January 3, 1959.

Real estate loans by national banks. Section 24 of the Federal Reserve Act was amended by the Act of July 18, 1958 so as to make the limitations and restrictions of that section on real estate loans by national banks inapplicable to loans made to established industrial or commercial businesses in which the Small Business Administration cooperates through agreements to participate on an immediate or deferred basis.

Small Business Investment Act. Section 13b of the Federal Reserve Act, authorizing working capital loans and commitments by the Federal Reserve Banks for industrial or commercial businesses, was repealed by the Small Business Investment Act of 1958, approved August 21, 1958, to become effective one year after the date of enactment of that Act. The same Act provided for payment by the Federal Reserve Banks to the United States within 60 days after the date of its enactment of amounts previously paid by the Secretary of the Treasury to the Federal Reserve Banks under the provisions of Section 13b of the Federal Reserve Act. In addition, the Act of August 21, 1958 made stock of small business investment companies organized under that Act eligible for purchase by national banks and by other member banks and nonmember insured banks to the extent permitted by State law, subject to certain limitations.

Bank Holding Company Act. The Board is required by Section 5(d) of the Bank Holding Company Act of 1956 to include in its annual report to Congress any recommendations for changes in that Act which, in the opinion of the Board, would be desirable. In a special report submitted to Congress on May 7, 1958 the Board recommended a number of amendments to the Bank Holding Company Act which would tend to clarify ambiguities in the law and facilitate its administration. The Board continues to urge favorable consideration of those amendments.

RESERVE BANK OPERATIONS

Loan guarantees for defense production. Under the provisions of the Defense Production Act of 1950 as amended and the implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private financing institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with or in contemplation of termination of their defense contracts. The guaranteeing agencies are the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, the General Services Administration, and the Atomic Energy Commission.

The present program is a reactivation of the V-loan program

utilized during World War II. In the making of guarantees, the Federal Reserve Banks are authorized to act, on behalf of the guaranteeing agencies, as fiscal agents of the United States, subject to the supervision of the Board of Governors of the Federal Reserve System; and the Board is authorized, after consultation with the guaranteeing agencies, to prescribe rates and fees and forms and procedures. The schedule of rates and fees was reviewed from time to time by the Board and guaranteeing agencies but developments during 1958 did not indicate the need for any changes.

During 1958, the guaranteeing agencies authorized the issuance of 40 guarantee agreements amounting to $193 million. On December 31, 1958, guarantee agreements outstanding covered credits totaling $478 million, of which amount $310 million represented actual loans outstanding and $168 million was available to borrowers under guarantee agreements in force. Of the total credit available to borrowers, including loans outstanding, 74 per cent on the average was guaranteed. During the year, approximately $728 million was advanced on V-loans, most of which are revolving credits.

From the beginning of the program in September 1950 through December 31, 1958, 1,543 V-loans totaling $3,105 million were authorized by the procurement agencies which may guarantee such loans under the Defense Production Act of 1950. Of the total loans authorized, 56 per cent of the number and 6 per cent of the amount were less than $500,000 and 72 per cent of the number and 12 per cent of the amount were less than $1 million.

Forty-two per cent of the number and 7 per cent of the amount of loans authorized were to borrowers having assets of less than $500,000; 57 per cent of the number and 12 per cent of the amount were to borrowers having assets of less than $1 million.

Seventy-three per cent of the number and 19 per cent of the amount of loans authorized were to borrowers having less than 500 employees.

Under the law as amended by the Defense Production Act amendments of 1958, authority for the V-loan program, unless further extended, will terminate on June 30, 1960.

Volume of operations. Table 5 on page 113 shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1954-58. Changes from 1957 were mixed, with

some activities decreasing and others increasing. Discounts and advances and currency received and counted declined. On the other hand, checks (other than Government checks and Postal money orders), coin, and transfers of funds increased and reached new peaks; checks handled, however, increased less than in recent years.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of each Federal Reserve Bank during 1958 are shown in detail in Table 6 on pages 114-15, and a condensed historical statement is shown in Table 7 on pages 116-17. The table below summarizes the earnings and expenses and the distribution of net earnings for 1958 and 1957.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1958 AND 1957

[In thousands of dollars]

Item	1958	1957
Current earnings	742,068	763,348
Current expenses	137,722	131,814
Current net earnings	604,346	631,534
Additions to current net earnings[1]	454	1,580
Deductions from current net earnings	330	[2] 8,721
Net additions or deductions (−)	124	−7,141
Net earnings before payments to U. S. Treasury	604,470	624,393
Paid U. S. Treasury (interest on F. R. notes)	524,059	542,708
Dividends paid	21,197	20,081
Transferred to surplus	59,214	61,604

[1] Includes net profits of $157,000 in 1958 and $167,000 in 1957 on sales of U. S. Government securities.

[2] Includes a payment of $8,335,000 to Federal Reserve retirement system representing adjustment for revised benefits.

Current earnings of $742 million in 1958 were 3 per cent less than in 1957, largely because lower discount rates coupled with fewer borrowings resulted in a $20 million decrease in earnings from this source. Earnings from United States Government securities were $1 million less than in the year before, reflecting a lower average yield offset in part by a slight increase in average holdings. Current expenses of $138 million were about 4 per cent above 1957.

Current net earnings amounted to $604 million, a decrease of 4 per cent from 1957.

The effect of profit and loss additions and deductions was minor, leaving net earnings before payments to the United States Treasury at about $604 million, a decrease of 3 per cent from 1957.

Statutory dividends to member banks amounted to $21 million, or a rise of about $1 million over 1957, reflecting increases in capital and surplus of member banks with attendant increases in the paid-in capital of the Federal Reserve Banks.

Payments to the United States Treasury as interest on Federal Reserve notes amounted to $524 million in 1958. This was 90 per cent of net earnings after dividends and allowance for building up surplus to 100 per cent of subscribed capital where surplus was below that amount. This allowance is consistent with the provisions of the franchise tax when it was in effect; for 1958 the allowance for bringing surplus up to subscribed capital was $986,000 for two Banks and for 1957 the total was $1,303,000 for one Bank. Total payments to the Treasury as interest on Federal Reserve notes since the policy of making such payments was begun in 1947 have amounted to $3,517 million.

Net earnings of $59 million remaining after dividends and payments to the United States Treasury were added to surplus account.

On September 2, 1958, the Federal Reserve Banks repaid to the Secretary of the Treasury the aggregate of $27,546,310.97 pursuant to the provisions of Section 602(a) of the Small Business Investment Act of 1958. This resulted in the elimination of Section 13b surplus in the amount of $27,542,653.50; the net difference of $3,657.47 was charged to Section 7 surplus. The amounts repaid had been advanced by the Secretary of the Treasury under the provisions of Section 13b of the Federal Reserve Act.

Holdings of loans and securities. Average daily holdings of loans and securities during 1958 amounted to $24,983 million, $761 million more than during 1957; holdings of discounts and advances decreased $555 million and holdings of United States Government securities increased $1,302 million. The average rate of interest earned on discounts and advances declined from 3.15 to 2.28 per cent, reflecting the net effect of three reductions in the discount rate in the first half of the year to a low of 1¾ per cent, and two subse-

quent increases resulting in a rate of 2½ per cent for the last two months of the year. The average rate on Government securities declined from 3.15 to 2.98 per cent. The accompanying table shows holdings, earnings, and average interest rates on loans and securities held by the Federal Reserve Banks during the past three years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1956–58

[Dollar amounts in thousands]

Item and year	Total	Discounts and advances	Industrial loans	Acceptances	U. S. Government securities
Average daily holdings:[1]					
1956	$24,563,390	$833,297	$837	$20,662	$23,708,594
1957	24,222,331	850,097	686	25,142	23,346,406
1958	24,983,185	295,250	415	38,904	24,648,616
Earnings:					
1956	595,396	23,025	36	547	571,788
1957	763,041	26,792	30	848	735,371
1958	741,781	6,745	18	806	734,212
Average rate of interest (per cent):					
1956	2.42	2.76	4.26	2.65	2.41
1957	3.15	3.15	4.37	3.37	3.15
1958	2.97	2.28	4.45	2.07	2.98

[1] Based on holdings at opening of business

Foreign and international accounts. Gold and dollar assets held for foreign account at the Federal Reserve Banks increased $2,189 million in 1958, reflecting almost entirely net purchases of gold from the United States by foreign monetary authorities. At the end of the year holdings amounted to $12,115 million, representing $7,668 million of earmarked gold, $3,695 million of United States Government securities (largely Treasury bills), $272 million in dollar deposits, $68 million of bankers' acceptances purchased through Federal Reserve Banks, and $412 million of miscellaneous assets. The latter item includes mainly dollar bonds issued by foreign countries and international institutions.

The aggregate gold and dollar assets held for the International Bank for Reconstruction and Development, the International Finance

Corporation, and the International Monetary Fund increased $508 million in 1958.

Accounts were opened for two central banks in Africa.

As in 1957, loans secured by gold collateral were of relatively minor importance. A loan of $5 million outstanding at the beginning of 1958 was repaid in January. New arrangements amounted to a total of $43.3 million, of which $17.9 million was outstanding at the end of the year. Loans on gold are ordinarily made to foreign monetary authorities to assist them in meeting their dollar requirements for temporary needs.

The Federal Reserve Bank of New York, as depositary and fiscal agent, continued to perform various services for the international institutions mentioned above. As fiscal agent of the United States, the Bank continued to operate the United States Exchange Stabilization Fund pursuant to authorization and instructions of the Treasury Department. Also on behalf of the Treasury Department it continued the administration of foreign assets control regulations pertaining to assets in the United States of, and transactions with, Communist China and North Korea and their nationals, and, until revocation on May 1, of regulations involving certain assets of the Egyptian Government and the Suez Canal Company.

Bank premises. During the year the Board authorized the construction of an addition to and alteration of the Federal Reserve Bank building in Dallas. This program is planned to extend over several years.

With the approval of the Board, properties adjacent to the present locations of the Federal Reserve Bank of Kansas City and the Oklahoma City Branch were acquired for future expansion; an annex building was purchased by the Federal Reserve Bank of San Francisco; and a site for a new building was acquired for the New Orleans Branch. The Board also authorized the acquisition of property adjacent to the Little Rock Branch for future expansion.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The accounts of the Board for the year 1958 were audited by the public accounting firm of Price Waterhouse & Co., whose certificate follows:

To the Board of Governors of the
Federal Reserve System

In our opinion, the accompanying financial statements present fairly the assets, liabilities and fund balances of the operating fund and the property and equipment fund of the Board of Governors of the Federal Reserve System as of December 31, 1958, and the related assessments and expenditures for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of the financial statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary.

Price Waterhouse & Co.

Washington 5, D. C.,
February 6, 1959.

Assets, Liabilities and Fund Balances
December 31, 1958

Assets

Cash, exclusive of $173,898 representing withheld taxes	$ 630,571
Miscellaneous receivables and travel advances	15,790
Stockroom and cafeteria inventories, at cost	18,623
Total assets of operating fund	664,984
Property and equipment, at cost:	
Land and improvements	792,852
Building	3,878,710
Furniture and equipment	561,758
Total assets of property and equipment fund	5,233,320
Total assets	$5,898,304

Liabilities and Fund Balances

Accounts payable and accrued expense		$ 336,628
Fund balances:		
Operating fund—		
Balance December 31, 1957	$ 329,503	
Excess of expenditures over assessments for the year	1,147	328,356
Property and equipment fund—		
Balance December 31, 1957	5,149,575	
Expenditures for additions	87,961	
Excess of cost of assets disposed of over trade-in allowances	(4,216)	5,233,320
Total liabilities and fund balances		$5,898,304

Assessments and Expenditures
Year Ended December 31, 1958

Assessments Levied on Federal Reserve Banks:		
For Board expenses and additions to property and equipment		$ 5,917,200
For expenditures made on behalf of the Federal Reserve Banks		4,769,500
Total assessments		$10,686,700
Expenditures:		
For printing, issue and redemption of Federal Reserve Notes, paid on behalf of the Federal Reserve Banks		$ 4,769,500
For expenses of the Board:		
Salaries	$3,937,185	
Retirement and insurance contributions	512,961	
Traveling expenses	305,691	
Professional and contractual services:		
Economic surveys	294,140	
Legal, consultant and audit fees	125,313	
Other	17,631	
Printing and binding	175,450	
Telephone and telegraph	86,319	
Postage and expressage	66,191	
Equipment and other rentals	66,062	
Operation of cafeteria, net	51,119	
Heat, light and power	49,776	
Stationery and office and other supplies	48,927	
Repairs, maintenance and alterations	45,908	
Books and subscriptions	16,940	
Insurance	7,833	
Miscellaneous, net	22,940	5,830,386
For property and equipment		87,961
Total expenditures		$10,687,847
Excess of expenditures over assessments for the year		$ 1,147

The Board's expenses for 1958 include (1) an expenditure of $107,946 incurred in connection with the continuation of the Small Business Financing Study which was undertaken in 1957 for the information of the Federal Reserve System, the interested committees of the Congress, and the public generally; (2) an expenditure of $15,255 for Consumer Buying Intentions surveys requested by the Bureau of the Budget and the Council of Economic Advisers on November 21, 1957, and (3) an expenditure of $45,122 as a result of the assignment to the Board of certain responsibilities under The National Plan for Civil and Defense Mobilization and Defense Mobilization Order 1-20.

ANNUAL REPORT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

During 1959 total credit in the economy expanded by about $60 billion in all—one-third more than the previous peacetime record. Mortgage debt, most of it for housing, increased by a peak $19 billion. Consumer credit outstanding rose about $6.5 billion, equaling the previous high of 1955. New borrowing by State and local governments continued in near-record volume, and new Federal borrowing exceeded that in all earlier peacetime years.

The increase in commercial bank loan portfolios over the year was large and equaled the previous peak of 1955. The banks financed a substantial part of this lending activity by selling U. S. Government securities to nonbank investors through the market. As a result, total loans and investments of banks increased only moderately.

A main service performed by the commercial banks for the economy last year was acting as an intermediary between borrowers and savers. Banks, in effect, drew out of the market funds provided through security purchases by individuals and corporations to meet the specialized credit demands of various types of borrowers, including many whose credit demands could not be met as readily by nonbank sources. This flow of funds from savers to banks to borrowers enabled a large credit demand to be accommodated with little increase in the money supply.

Over the year, consumers and businesses increased their spending of existing cash balances as well as their spending of newly borrowed funds. This contributed to a more active use of money, reflected in an increase in the turnover or rate of use of the money supply. Cash balances were also used to invest in securities, particularly those of the Federal Government and of State and local governments.

Consumer spending was a prime generative force in the

economic expansion last year as it had been in 1955. State and local government expenditures were large, and prior to the steel strike business outlays to build up inventories were substantial. Partly as an aftermath of the 1957-58 recession, Federal Government expenditures exceeded revenues by a substantial amount.

Employment rose more slowly than output, and so output per worker increased somewhat. Consumer prices rose, but the general level of wholesale prices changed little. Prices of industrial materials and products increased, however, while agricultural prices declined. Wage rates continued to increase, although at a slower average rate than in other recent years. Abroad, rapid expansion of industrial activity was resumed early in 1959 and continued during the year.

The flow of saving into financial assets increased markedly during the year but was inadequate to meet all demands for credit at prevailing levels of interest rates. As a result, money market rates and bond yields rose further, and by the end of the year were above their previous peaks in late 1957.

Stock prices, which had advanced sharply in 1958, continued to rise into early August 1959. For a period thereafter they declined, but later in the year they rose again. Although dividends increased, yields on stocks declined to new postwar lows during the year. Yields on high-grade corporate bonds exceeded stock yields by more than a percentage point over much of the year.

FEDERAL RESERVE ACTION

The credit and monetary policies pursued by the Federal Reserve System have the broad purpose of providing a financial climate favorable to sustainable growth of the economy without inflation. With demands for financing in 1959 continuously strong, higher interest rates were needed to equate these demands with the available supply of saving and bank credit. Higher rates also induced a more economical use of cash balances and a larger flow of current financial saving. The money supply, which increased substantially in 1958 and early 1959, was limited to little further growth after

last spring. The public's holdings of other liquid assets, however, expanded sharply throughout the year.

The principal Federal Reserve policy actions during the year are summarized in the sections that follow. Later in this report they are listed in tabular form and are described more fully in the records of specific policy actions of the Board of Governors and of the Federal Open Market Committee.

Open Market Operations and the Gold Outflow

Federal Reserve purchases or sales of U. S. Government securities in the market are commonly known as open market operations. Such operations are used to provide reserves to the commercial banking system that enable it to meet the economy's growing needs for financing and also to offset the possible disturbing effects of a variety of seasonal and other market factors that recurringly create or absorb bank reserves. Over the year 1959, the most important market factor absorbing bank reserves was the further outflow of gold from the country.

Foreign operations drained $800 million from bank reserves in 1959 as net gold acquisitions from the United States by foreign monetary authorities and international institutions totaling $1.1 billion were offset in part by Treasury transactions. Other factors tending to reduce the reserves available to banks included an increase of about $400 million in the amount of currency in circulation. Unless replenished, the reduction in bank reserves due to these developments would have led to an undesirable degree of credit stringency. The largest single source of reserves to offset this was the net open market purchases of the Federal Reserve System.

The over-all deficit in this country's international payments was somewhat less than $4 billion, exclusive of a subscription to the International Monetary Fund. In the second half of the year, however, exports rose in response to increasing foreign demand, imports leveled off, and the balance-of-payments deficit tended to diminish, although continuing large. Apart from the gold transfers, settlement

CHANGES IN MEMBER BANK RESERVES

[Based on averages of daily figures for December; in billions of dollars]

Item	1959	1958
Member bank reserves		
Total reserves	(1)	−0.5
Reserves held with Federal Reserve Banks	−0.3	−0.5
Reserves allowable in cash	+0.3	.....
Required reserves	+0.1	−0.5
Effect of:		
Reduction in reserve requirement percentages	.....	−1.5
Change in deposits	+0.1	+1.0
Excess reserves	(1)	−0.1
Principal factors affecting reserves	(sign indicates effect on reserves)	
Federal Reserve credit:		
Discounts and advances to member banks	+0.3	−0.2
Federal Reserve holdings of U.S. Govt. securities and acceptances	+0.7	+2.3
Float	−0.1	+0.1
Currency in circulation	−0.4	−0.4
Gold stock and foreign accounts	[2]−1.2	−2.1
Other factors	[2]+0.3	−0.2

[1] Less than $50 million.

[2] Changes in gold stock and Treasury cash (included in other factors) include the effect of a payment of $344 million in gold from Treasury cash holdings to the International Monetary Fund in connection with the increase in the U.S. subscription to the Fund; these changes were offsetting and had no effect on total reserves.

NOTE.—Figures may not add to totals because of rounding.

of the deficit involved large foreign acquisitions of Treasury bills and other U. S. Government securities.

DISCOUNT OPERATIONS

A part of the reserve funds to support growth of bank credit and money last year was obtained by member banks borrowing at the discount windows of their respective Federal Reserve Banks. Reserve Bank advances to or discounts for member banks, which had increased in the latter part of 1958, averaged around $700 million over the first half of 1959, although by June they reached a level exceeding $900 million. Throughout the remainder of the year, borrowings fluctuated

around this higher level. Member banks obtaining Reserve Bank advances typically did so to meet drains of reserve funds to other banks as checks were cleared; such individual borrowings were soon repaid. The number of member banks accommodated by the Reserve Banks during the year was fairly large, 1,967, or almost one-third of all member banks.

To discourage bank borrowing of reserves in a situation of vigorous demand for bank credit and rising market interest rates, discount rates at the various Reserve Banks were increased three times in 1959. These changes occurred in early March, in late May and early June, and in early September. Rate increases occurred after market rates had risen to levels above prevailing discount rates. Each set of increases amounted to one-half of one per cent, and together they raised the level of rates at all Federal Reserve Banks from 2½ per cent at the beginning of the year to 4 per cent at the end.

Reserve Requirements

In early December 1959 the Board of Governors modified its reserve requirement regulation. This modification permitted member banks to count their vault cash in excess of specified percentages of their deposits as part of their required reserves. The action was taken under the authority of legislation enacted by the Congress in July 1959 and was designed in part to remedy inequities that had arisen because many banks, particularly smaller country banks, had found it necessary to hold relatively larger amounts of vault cash than other banks did for operating purposes.

No change in the over-all credit and monetary policy of the Federal Reserve was involved in this action. It had the effect of supplying some $300 million of reserves to the banking system at a time of the year when the Federal Reserve usually makes available to the banks a sizable volume of reserves for seasonal purposes. It correspondingly reduced the need for open market operations to meet these temporary demands.

Margin Requirements

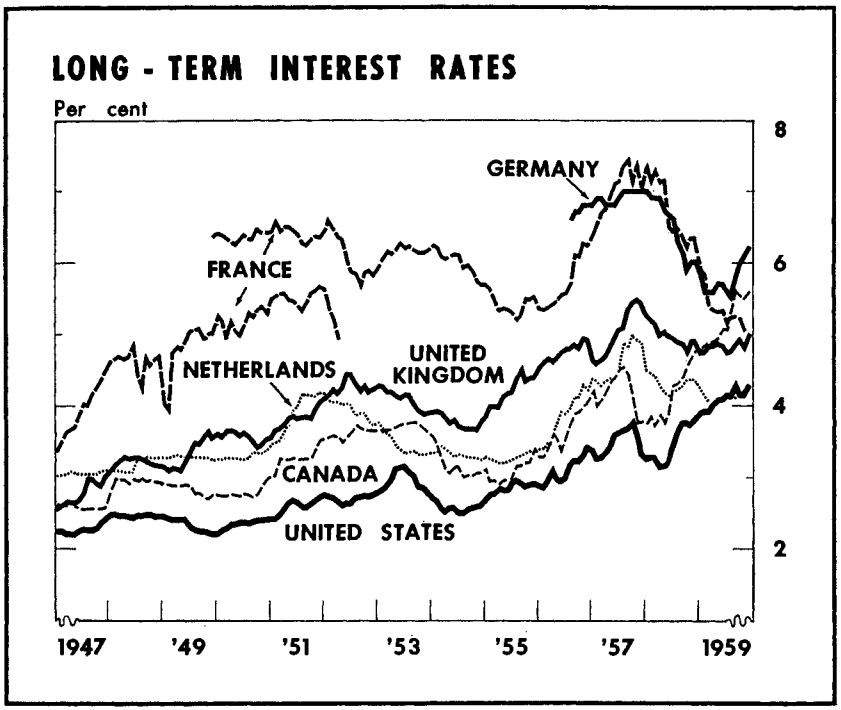
The Federal Reserve at midyear strengthened somewhat its restraints over the amount of credit used for the purchasing or carrying of stock market securities by adopting certain technical amendments to its margin regulations. Margin requirements for this type of credit, which had been raised to 90 per cent by the Board of Governors in mid-October 1958, were continued at this level throughout 1959.

The most important of the amendments had the effect of reducing the amount of cash which can be withdrawn from the proceeds of sales of securities held on margins below those currently required. The substitution of one security for another in such a situation can still be made without providing additional margin if it is done during the same day. Another amendment had the effect of limiting the number of cases in which bank loans secured by stock exchange collateral can be regarded as loans for purposes other than buying or carrying stocks and hence not subject to margin requirements.

INTEREST RATES, ECONOMIC ACTIVITY, AND SAVING

Recent years have witnessed increasing discussion and public awareness of long-debated questions about interest rates—their function in the economic system, their relation to inflationary pressures and to economic growth, and their suitability or limitation as a focus for governmental economic policy. In this country, much of the discussion has been prompted by the upward trend as well as the fluctuations in interest rates during the 1950's. In each successive period of expansion in activity, yields on private and government obligations rose to new postwar peaks; in the second half of 1959 short- and long-term rates generally reached new highs. A specific problem in 1959 was the inability of the Federal Government, in meeting its large financing needs, to issue new long-term bonds in view of the statutory ceiling of 4¼ per cent on the coupon rate for such bonds.

In foreign countries whose financial markets had been substantially restored to flexible functioning by the early



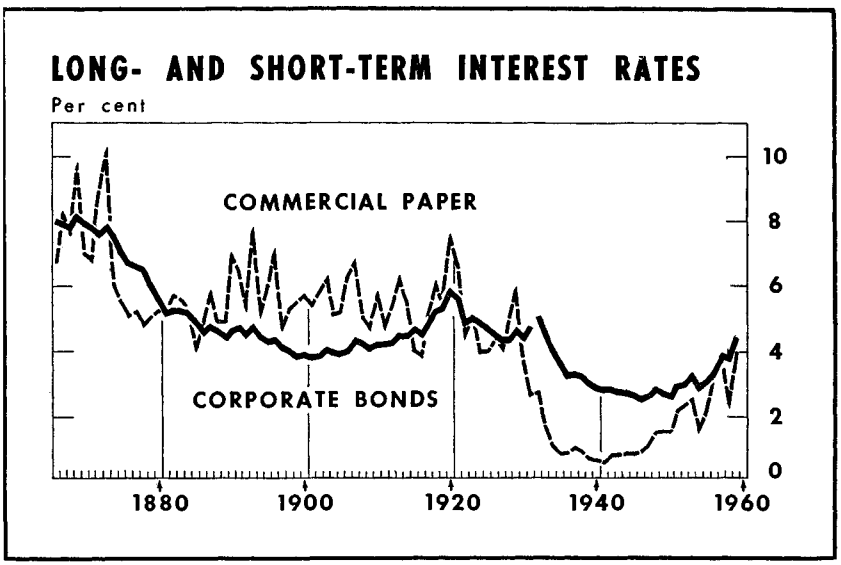
NOTE.—Average monthly yields on long-term government bonds for all countries except Germany. For Germany, yield on issues of public authorities; monthly series not available prior to August 1956.

1950's—for example, Canada, Germany, and the United Kingdom—interest rates likewise fluctuated in response to variations in economic activity. Continued improvement in world trade and the strengthening of foreign balance-of-payments positions fostered progress towards a more general currency convertibility. As a consequence, loanable funds during recent years have moved with increasing freedom among markets in different countries in response to emerging interest rate differentials; and interest rates, both short- and long-term, have become more reflective of world-wide developments than at any time during the past 30 years.

HISTORICAL PERSPECTIVE

After small advances early in the postwar period, interest rates in the United States showed an upward sweep through

the 1950's. Over the preceding 20 years, the general level of rates had been exceptionally low. The low level prevailing under depression conditions of the 1930's was maintained in the ensuing decade by policies of war and postwar finance. These policies, which were justified at the time by conditions of, or transition from, national emergency, placed major emphasis upon low, stable interest rates, even though such

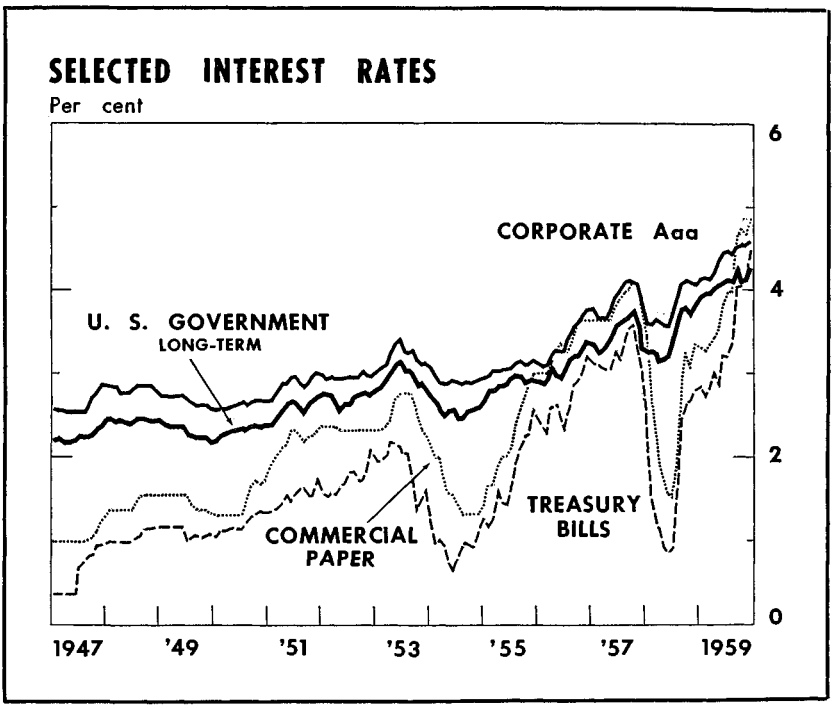


NOTE.—Corporate bond yield is average of high-grade railroad bonds until 1932 and of corporate Aaa bonds thereafter. Commercial paper is rate on 4- to 6-month open market paper.

emphasis contributed to an unregulated and very large wartime expansion of the money supply, and a postwar situation in which the money supply was without effective regulation. Price advances were held down during the war by direct controls over spending and prices, but were very sharp in early postwar years when controls were removed.

Against this background, the outbreak of hostilities in Korea in 1950 and the accompanying inflationary pressures prompted public discussion of monetary policy aimed at stability of interest rates at low levels, because such a policy in effect was leaving the money supply unregulated. En-

deavors to meet this problem and to allay public anxiety about the future value of the dollar led to the Treasury-Federal Reserve accord in March 1951, which, after a transition period, discontinued further official pegging of interest rates. Monetary policy thus became free to resume regulation of bank credit and money in order to combat not only deflationary but also inflationary tendencies in the



economy, and market rates of interest again reflected the influence of underlying supply and demand forces.

Changes in interest rates have both responded to and reflected cyclical movements of the economy. The upward trend of interest rates during the 1950's was interrupted by declines during the recessions of 1953-54 and 1957-58. The most recent cyclical rise began around mid-1958, as recovery in economic activity from the 1957-58 recession quickened. As is usual, the largest increases occurred in yields on short-term instruments, such as Treasury bills, commercial pa-

per, and bankers' acceptances, which are generally more volatile and which had fallen sharply following the onset of recession and the easing of credit conditions that began in the fall of 1957. Yields on corporate and State and local government bonds and on U.S. Government long-term securities also rose substantially after mid-1958 to levels above their previous postwar peaks. During 1959, corporate yields moved to levels well in excess of yields on common stocks, thus reversing the historical relationship between bond and stock yields.

Even at recent advanced levels, interest rates were generally low relative to earlier periods, although some rates were near their averages in the 1920's, which was also a period of intensive utilization of economic resources and strong credit demands. Moreover, since the 1920's the level of market interest rates on U. S. Government securities has risen relative to those on other obligations, reflecting in part the much larger volume of Federal debt relative to other debt and the elimination of tax exemption on Treasury bonds.

Historical comparisons of interest rates encounter various problems. Limited statistical records are one handicap. Also, broad economic and social changes—for example, the development of financial institutions, changes in the tax structure, and the enlarged role of governments—affect the interpretation of differing interest rate levels over time.

Saving-Investment Process

There are a number of theories of interest rate determination. Some emphasize the saving-investment process; others look mainly to the cash and liquidity demands of the public; and still others stress the supply and demand for loanable funds. The different theories center on different, though not necessarily mutually exclusive, aspects of the process through which interest rates are set. No one theory, however, comprehends the full complexity of this process. Observed interest rate movements reflect elements of all theories in varying degree, depending on circumstances of time and place as well as on institutional characteristics of the economy.

From the point of view of the economy's use of its resources, the rate of interest is a price that translates present saving into future command over resources. For example, at a 5 per cent interest rate, $1.00 of present income saved will exchange for $1.05 to be received after a year. In the meanwhile, since the saver has refrained from current consumption, his saving permits resources to be used to an equivalent amount in the nation's investment in plant and equipment, durable goods, and housing, or in net foreign investment. This investment increases the economy's capacity to produce future income in terms of goods and services, and thus provides the additional real income that makes it possible for the borrower to pay the interest earned by the saver.

Since interest is both an earning of savers and a cost of investment, movements of interest rates can be said to reflect the balancing of saving and investment tendencies at given levels of income and of prices. Imbalances between the willingness to save and investment demand, however, affect real income (that is, income in terms of constant prices) and market prices as well as interest rates. The extent of influence on each depends on the economic and institutional structure, the phase of the economic cycle, and general economic conditions.

At times when productive capacity is underutilized, for example, greater investment demand is likely to lead to the financing of a larger volume of real investment, and thus to increased output and rising incomes. The rise in real income will tend to be accompanied by an increase in saving, and the balancing of saving and investment may be achieved with little advance in interest rates and prices. At times when investment demand exceeds available saving under conditions of high capacity utilization, there will be greater pressure on interest rates and prices since the extent to which saving might be increased by a rise in real income is limited; pressures on interest rates and prices will be intensified when inflationary expectations are widely prevalent. It is under such circumstances that excessive expansion of bank credit and money results mainly in rising prices and merely enlarges the monetary value of both saving and investment,

without relieving a shortage of real resources and even without checking, except perhaps temporarily, a pronounced tendency for interest rates to rise.

Supply and Demand for Lendable Saving

The saving-investment process in financial markets is reflected in the balancing of supplies and demands for loanable funds, as funds move into and out of financial assets of varying types in response to borrowing demands. The composition of flows in financial markets represents the combination of supplies and demands originating in the various sectors of the economy.

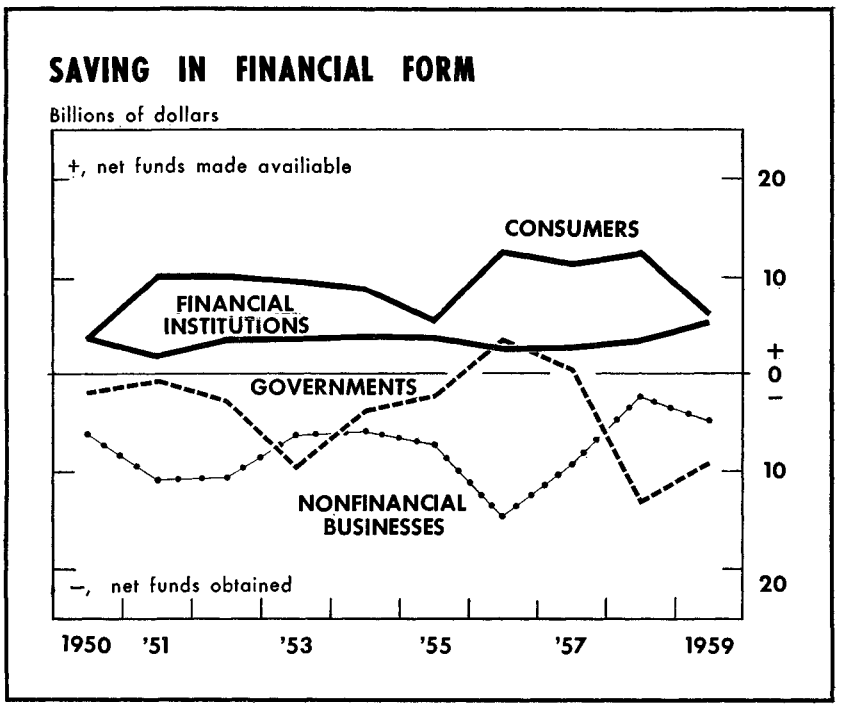
The saving of an individual sector—consumer, business, or government—represents the extent to which its current receipts (after taxes) are not spent on current consumption. This saving flows into investments, and on the investment side is equal to purchases of capital goods plus a financial component which is the sector's net saving in financial form. More specifically, a sector's saving in financial form is equal to its net acquisitions of financial assets less net incurrence of debt. Within a sector, however, some individual units or groups may be predominantly savers and acquire financial or tangible assets without incurring much debt, while others may be mainly borrowers.

The nation's saving, in contrast with the saving of any sector, is equal only to the value of investment in tangible assets plus net foreign investment. The nation's saving does not include, in measurement, investment in financial claims other than net claims on foreigners. What anyone owes within the economy is owned by another; thus, in aggregating the wealth of the nation, assets representing financial claims cancel out against liabilities. Nevertheless, the flow of saving by individuals or sectors into financial claims is a significant element in the determination of the nation's investment. The forms in which people save and the state of financial markets through which these savings flow both reflect and affect decisions to purchase capital goods.

Consumers as a group provide enough saving—either directly or through financial intermediaries, such as savings

institutions, life insurance companies, and pension funds—to cover the aggregate borrowing of the consumer sector and also to help finance demand for loanable funds from other sectors. While businesses finance themselves to a large extent out of internal saving, as a group they are usually net borrowers from the rest of the economy, as shown in the accompanying chart. In recent years governments as a group have generally been heavy net borrowers of the nation's saving; a governmental net surplus, of course, is a net addition to the nation's saving.

The supply and demand for financial saving, as well as shifting portfolio preferences of individuals, businesses, and financial institutions, come together and are balanced in financial markets, as is illustrated in the table on page 14.



NOTE.—Federal Reserve flow-of-funds data. Consumers include nonprofit organizations. Saving in financial form of a sector is equal to the net increase in its financial assets less the net increase in its liabilities. When positive, it represents the net amount of saving made available to other sectors; when negative the net amount obtained. Rest-of-world sector not shown.

In financial or monetary terms, changes in interest rates reflect this market process. Changes in the supply of money in the economy, effected through the market for bank credit, are an important marginal element affecting interest rates.

FINANCIAL QUANTITIES REFLECTIVE OF SUPPLY AND DEMAND FOR SAVING

[In billions of dollars]

	1958	1959[p]
Supply quantities		
Flows into financial assets, total	76.7	84.0
Credit market instruments, total[1]	*45.4*	*60.2*
Purchased by:		
Consumers	3.6	14.2
Nonfinancial businesses	1.4	7.6
Financial institutions	36.8	28.9
Governments	3.6	6.4
Claims on financial institutions, total[2]	*30.4*	*17.1*
Acquired by:		
Consumers	24.1	16.8
Others	6.3	.4
Other assets[3]	1.0	6.7
Demand quantities		
Increase in liabilities, total	76.7	85.1
Credit market instruments, total[1]	*45.2*	*60.4*
Borrowed by:		
Consumers	12.0	20.7
Nonfinancial businesses	14.1	18.5
Financial institutions	1.5	4.7
Governments	15.2	15.8
Liabilities of financial institutions[2]	29.9	16.9
Other liabilities[3]	1.6	7.7

[p] Preliminary estimates.

[1] Consists of marketable Federal, State, and local government securities, corporate bonds and stocks, mortgages, consumer credit, security credit, and bank and other loans. Rest of world included in total but not shown separately.

[2] Consists of currency and demand deposits, savings deposits and shares, and saving through private life insurance and pension funds. Excludes claims on financial institutions through purchase of credit market instruments.

[3] Consists of consumer-held U.S. savings bonds, trade credit, proprietors' net investment in noncorporate business, saving through government life insurance and pension funds, and miscellaneous other types of financial flows.

NOTE.—Based on Federal Reserve flow-of-funds data. Flows into financial assets and increase in liabilities are on a net basis. Differences between total financial assets and liabilities and between paired subtotals of financial assets and liabilities reflect statistical discrepancies. Details may not add to totals because of rounding.

Interest rate movements not only reflect a changing supply and demand situation but also in turn have some effect on the flow of loanable funds through financial markets. Flows into savings institutions or commercial banks in the form of time and savings deposits, into U.S. savings bonds, and into instruments bought and sold in credit markets respond to differential interest rate movements. Moreover, when interest rates are very low—generally periods of reduced economic activity and business uncertainty—savers are likely to hold more of their funds in cash, that is, demand deposits in commercial banks and currency. On the other hand, when the economy is expanding and interest rates are at higher levels, there is a tendency for the public to economize on cash balances and invest in other financial assets.

Some flows into financial institutions—especially the bulk of those going into life insurance companies and pension funds—are contractual in nature and vary only gradually, if at all, with interest rate changes. Similarly, some inflows of funds into credit markets to repay debt are fixed by previous commitments and in general do not vary with interest rate movements in a current period. On the other hand, some debts of businesses and others contain contract provisions that permit accelerated repayment, and interest rate changes may affect the timing of such repayments.

On the demand side, changes in interest rates—for example, a rise—have varying effects, depending on the relation of interest cost to total cost of the project being financed and on expectations as to the future course of interest rates. For many outlays, the relative interest cost may be small, although in individual cases it may be of sufficient size to encourage efforts to economize as rates rise. For longer lived investments, such as housing, public service facilities, and many types of commercial and industrial construction, the relative interest cost is higher and is an important consideration in making long-term commitments. Business decisions as to inventory holdings also have to take account of interest rate variations. Thus, in many areas of the economy the incurrence of debt is influenced by changes in the level of interest rates.

The restrictive impact of rising rates on borrowers may be temporarily moderated if further advances are expected; indeed, as in the case of other costs that are expected to rise, expectations may temporarily accelerate the demand for funds. This transitory effect on demand is reversed when rates reach a level that the market believes will not be sustained. Under these conditions, restrictive monetary action has a role to play in changing market expectations.

Role of Credit Availability

When credit demands are strong, limitations on credit availability together with higher interest rates restrict the extent to which borrowers can obtain needed funds. And, conversely, when credit demands are slack, increased availability of lendable funds reinforces incentives given by lower interest rates, and facilitates satisfaction of credit demands.

The direct impact of credit availability on the ability of borrowers to satisfy their demands is readily observable in market segments where changes in interest charges and in lenders' returns are not commensurate with changes in the level of market interest rates. Whatever the source of this rate inflexibility—whether unique features of lender competition, of borrower demand, or of some program of governmental underwriting of borrower default risk—lenders in such market segments experience a relative decline in interest yields when market interest rates rise elsewhere; or, if some of their funds are in turn borrowed from the market, lenders experience an actual decline in their net returns. Willingness to lend in these specialized markets is thus reduced.

When credit demand presses actively against the supply of lendable saving and interest rates rise, lenders generally tend to screen the creditworthiness of loan applicants more carefully. Under such conditions, lenders tend to adhere to stricter lending standards, to set more stringent borrowing terms, and to allocate their lendable funds on a nonprice basis as between borrowers. Where this situation develops, many borrowers are obliged to shop more intensively in order to find lenders whose loan standards and terms they can meet, and some borrowers fail to find accommodation

at current interest rates. Successful borrowers are likely to include customers of long standing or with established credit lines, borrowers offering debt instruments not subject to statutory interest rate limitations, borrowers prepared to adjust to more stringent prepayment conditions, and those offering types of loans or instruments with relatively low servicing costs.

Federal Reserve actions initially influence only the availability of loan and investment funds at banks, but changes in the availability of bank credit are reflected in the general availability of loan funds in other credit markets. Banks can to a degree avoid restriction of credit availability to their own customers by selling securities. Their sales of securities, however, tend to absorb funds of other investors and lenders. This process limits the availability of credit from these other sources except to the extent that saving increases or the public tends to substitute other financial assets for cash.

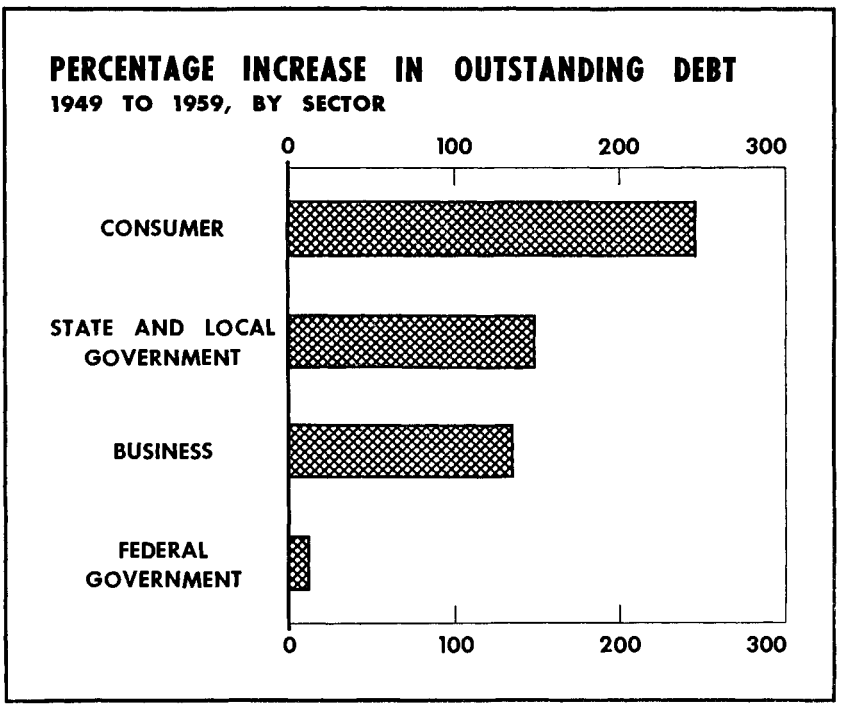
Many observers of financial processes assign great importance to changes in credit availability in restricting or accelerating the volume of current borrowing; indeed, some assign a more decisive role to availability than to changes in interest cost. The Federal Reserve, in discussing and evaluating the market impact of its policy actions, has continuously stressed the importance of changes in the availability of funds in affecting satisfaction of demands.

Factors in Interest Rate Trends of the 1950's

During the past decade, private and governmental demands for credit, together with factors affecting the supply of saving, exerted strong upward pressures on interest rates in financial markets. The economy was generally characterized by rapid population growth and, apart from two brief recessionary periods, by well sustained utilization of plant and equipment and widespread demand pressures on prices. Attempts on the part of the Federal Reserve to keep interest rates from rising in recent periods of economic buoyancy would have had effects adverse to the public interest. Expansion of bank credit and money to hold down interest rates would have run the danger of stimulating speculative de-

mands for resources and credit, would have restrained interest rate rises only temporarily, and would have led to sharply adverse repercussions later.

Credit demands. All major sectors of the economy increased their demands for credit in the 1950's. Growth of business credit demand was accompanied by continuously expanding credit demands from consumers and governments. In fact, the indebtedness of consumers and of State and local governments increased at a more rapid rate than business indebtedness.



NOTE.—Based on end-of-year data from Federal Reserve flow-of-funds accounts. Debt consists of credit market instruments other than corporate stocks (i.e., Federal, State, and local obligations, corporate bonds, mortgages, consumer credit, security credit, and bank and other loans) together with trade credit.

Consumer demands on credit markets rose along with expanding incomes and wants, and with the development and broadening of credit facilities to finance purchases of homes, durable goods, and other goods and services. Low

down-payments and the lengthening of maturities on home mortgage financing—in part in response to Federal aids—together with ready availability of short- and intermediate-term consumer credit brought increasing proportions of the population into the credit market. A large share of expenditures on homes and durable goods was financed on credit terms, and both mortgage debt and consumer credit expanded greatly.

Growth of the population and its spread to the suburbs during the past decade enlarged demands for education, transport, sewage, and other services of State and local governments, and required expansion of existing facilities to provide them. Many of these services are provided with long-lived physical facilities which are financed mainly through long-term borrowing.

Increased credit demand of businesses in the 1950's reflected the expected high profitability of business investment and innovation during a period when, for much of the time, demand for goods and services pressed against the capacity of existing plant, and when rapidly changing wants and needs of the population, as well as striking improvements in technology, tended to accelerate obsolescence of the existing facilities. Another important factor, particularly in recent years, was the rapid advance in industrial wages and the incentive this gave to labor-saving investment.

At times Federal budget deficits contributed to expanded over-all credit demand. In six years of the period beginning with 1950, when defense outlays were stepped up following hostilities in Korea, the Federal Government's receipts fell short of its spending. In these deficit years, the Federal Government competed with other sectors for part of the nation's supply of private saving, and its absorption of saving tended to reduce the availability of credit to other sectors.

Expansion of credit demands would not entail rising interest rates if it were accompanied by a commensurate increase in the public's willingness to make saving available in lendable form. The tendency for lendable saving to fall behind borrowing demand, notwithstanding a substantial growth in national income, may be attributed to many

factors. No explanation, however, can ignore the widespread belief during the latter part of the 1950's that prices would continue upward indefinitely.

Financial saving of consumers. Consumers provide the bulk—about three-fifths—of the economy's gross saving, as shown in the accompanying table. Fluctuation in the consumer share during the past decade was relatively limited. The amount that consumers were willing to make available at pre-existing rates, however, usually fell short of the demand for saving. The lag in lendable saving from this major source contributed to the upward pressure on interest rates.

GROSS NATIONAL SAVING, BY SECTOR

[In billions of dollars]

Sector	1958	1959p
Consumer[1]	67.2	73.2
Nonfinancial business	36.1	46.9
Financial institution	3.4	5.0
Gross private saving	*106.6*	*125.0*
Government saving[2]	−12.8	−9.6
Gross national saving	93.8	115.4

p Preliminary estimates.
1 Includes nonprofit organizations.
2 Coverage of Government saving is not comparable with that of private saving. Because of conceptual and statistical problems, governmental outlays on capital goods are treated as current expenditures.

Saving and spending for current consumption are, of course, alternative uses of income, and the flow of saving depends on the many factors that affect the desire to spend out of current income. A part of consumer gross saving goes directly into purchases of durable goods and homes. Another part—that is, consumer net saving in financial form—is available to meet the financing needs of the rest of the economy.

Changes in the flow of consumer financial saving influence interest rate variations, and in turn are influenced to an extent by such variations. At times during the past decade, relatively large amounts of consumer net saving in financial

form were associated with comparatively high interest rates. During 1951-53, consumer saving in financial form was markedly higher than in 1948-50, and interest rates were also higher. Also, after falling in 1955 in reflection of the boom in spending on consumer durable goods during that year, financial saving rose in 1956-57, when interest rates were relatively high.

At other times, such as in 1959, an advance in interest rates was accompanied by greater consumer acquisitions of financial assets, but these greater acquisitions were offset, for the sector as a whole, by even greater expansion of consumer debts; as a consequence, net saving in financial form of the sector declined. The rise in interest rates last year brought forth greater consumer acquisitions of securities, particularly U. S. Government obligations, and this helped to finance credit demands of the Government. By buying securities from banks offering them, consumers also indirectly helped to finance increased borrowing by other consumers. A somewhat similar pattern of consumer response occurred in the 1954-55 cyclical upswing of economic activity, as can be observed in data available in the Board's new quarterly flow-of-funds and saving accounts.

Inflationary expectations. The willingness of savers to supply funds to meet credit demands has been adversely affected when rising average prices for goods and services engendered expectations of continued advances. Such conditions were evident from early 1956 to late summer 1957, and also for a time after mid-1958.

Under the influence of inflationary expectations, savers became less willing to make funds available under fixed-interest contracts and tended to prefer assets, such as equities and land, which appeared to provide a hedge against possible erosion of the real value of saving through future price rises. Funds that might otherwise have financed new credit demands were committed to speculation in the stock market or in real estate—and eventually may have leaked into consumption expenditures based on capital gains. Both the resultant rise in interest rates and the decline in yields on equities were in part manifestations of moves by lenders

intended to maintain the real value of their funds in the face of expected price rises.

Inflationary anticipations work to increase borrowing demands even in the face of rising interest rates. Inflationary expectations make it appear to be less expensive to borrow in the present than in the future. Moreover, the cost of borrowing may seem small relative to possible speculative profits. These financial incentives tend to accelerate investment, especially in inventories or in plant and equipment, whose value may be expected to rise or which may help to produce goods and services which will rise in price.

Inflationary expectations, reflected in rising stock market activity and stock prices, may also lead to some substitution of equity for debt financing by corporate borrowers. As yields on bonds rise relative to yields on equities, it may become possible to satisfy current business demands for funds at relatively low cost by shifting to equities, and thus to strengthen the corporation's equity position for future borrowing, including that undertaken in response to inflation incentives. Such shifts apparently occurred to some extent in 1959. Corporate issues of stocks were larger than the year before, while sales of bonds were smaller.

Monetary Policy and Interest Rates

Monetary policy in the public interest seeks to facilitate sustained high levels of employment, relative stability of average prices, and balanced economic growth. Over the long run, these objectives are likely to be best served by moderate expansion of the quantity of cash balances held by the public. In the short run, monetary policy focuses on the volume and availability of bank reserves in relation to the credit demands being generated by current economic forces, and assesses whether the volume of such demands, given the share being satisfied by bank credit and monetary expansion, is making for inflationary or deflationary tendencies. On the average, the share that is satisfied by bank credit growth is relatively small.

Monetary actions affect market interest rates in a variety of ways. The main impact comes from the increase or decrease in the supply of funds in the market resulting from

forces of multiple expansion or contraction of bank credit based on fractional reserve requirements. With present reserve requirements, the member banks may expand or must contract demand deposits in a multiple of about $7 to $1 of reserves supplied or withdrawn.

The Federal Reserve can initiate a change in bank reserves through its open market operations or, when appropriate and feasible, it can vary the reserve requirement percentages. Federal Reserve purchases and sales of Government securities in the open market have some immediate, direct impact on interest rates, but this impact is least when System open market operations are conducted in short-term securities. In any event the initial, direct effect of any particular Federal Reserve operation is minor relative to the secondary multiple effects that develop out of the resulting changes in bank reserves.

A relationship between monetary action and market interest rates sometimes emphasized in public discussions is that associated with changes in the discount rates of the Federal Reserve Banks. The discount rate is not a market rate, but a rate charged by a Federal Reserve Bank on loans to member banks, the only institutions having regular access to Reserve Bank credit. When the Reserve Banks change their discount rates, their purpose is to influence the willingness or unwillingness of member banks to borrow from them, and thus to affect the over-all availability of bank reserves and bank credit. Borrowing is most advantageous to member banks, in adjusting their reserve positions, when market yields of secondary reserve assets exceed the Reserve Bank discount rates.

For a combination of reasons—traditional, operational, and regulatory—member bank borrowing from the Reserve Banks is typically very short-term and hence is resorted to mainly in financing temporary adjustments in member bank reserve positions. By keeping the discount rate in close alignment with market rates on short-term liquid paper, the Reserve Banks regulate the amount of member bank borrowing. While the Federal Reserve discount rate is related to and interacts with short-term market rates, the composite of supply and demand forces in the various sectors of the market is

more fundamental than the discount rate in determining the level and structure of interest rates.

Because of expectational or other psychological factors in the market, Federal Reserve actions may have some effects on interest rates in addition to, and even prior to, those resulting from changes in bank reserve positions. Such effects, however, are not likely to be long sustained unless accompanied by changes in basic supply and demand conditions. While market professionals strive to assess the effects of possible System actions on bank reserves, and through their own market transactions try to anticipate changes in interest rates, their judgments are likely to be based primarily on underlying economic developments that shape the demand for and supply of saving—that is, on many of the same developments that influence Federal Reserve policy decisions and actions.

In summary, while the course of interest rates is necessarily influenced by monetary actions, the monetary policy decisions themselves are based primarily on judgments as to the appropriate flow of bank credit and money, and not on judgments as to an appropriate level or pattern of interest rates. To the greatest degree possible, the determination of interest rates is left to freely functioning markets.

Economic Growth, Interest Rates, and Saving

The rate of growth of the economy depends in large part on the extent to which resources are devoted to the production of capital goods that will increase output or services in the future, rather than to the production of goods and services for current consumption. In our free society, choice in the use of resources is partly made through public decisions as to governmental taxation and spending, but it more largely depends on decisions of a multitude of individuals and businesses effected through competitive bidding in the market. The nation's willingness to save represents the degree to which it is willing to refrain from current consumption, and its willingness to invest represents the extent to which it desires to use available resources to increase future output. Monetary policy aids society in its choice as to use

of economic resources by exerting an influence toward minimizing cyclical fluctuations that interrupt the growth process and by encouraging relative stability in average prices.

Under long-run conditions of generally high capacity utilization and high investment demand, growth and stability are consistent with relatively low interest rates as long as the economy's willingness to save is great. In a society with high and rising consumption standards, however, rapid rates of economic growth generate tendencies toward price inflation and high interest rates. The encouragement of saving under such conditions helps to release resources to meet investment demand, to lessen upward pressures on prices and interest rates, and to facilitate the growth process.

RESERVES AND RESERVE REQUIREMENTS

In July 1959, the Congress amended the Federal Reserve Act in several respects concerning reserve requirements of member banks and the powers of the Board of Governors in this field. The amendments relate primarily to assets that can be counted as reserves and to the classification of banks for reserve purposes. They do not alter in any fundamental way the established mechanism of reserve requirements or their use for effectuating monetary policies, although they do change some important features of the mechanism.

When the Federal Reserve System was founded in 1913, many students of banking considered that the main purpose of reserve requirements was to assure liquidity of bank deposits. They regarded limitation on the banking system's capability for expanding credit and money as an incidental result of such requirements.

Banking experience under the Federal Reserve Act has made it clear that required bank reserves in themselves do not assure liquidity of bank deposits. For such liquidity, banks must place main reliance on the liquid market assets that they hold, often called "secondary reserves," with supplementary and ultimate reliance on the discount facilities of the Reserve Banks. Experience has also demonstrated

that the principal function of the reserve requirement is to serve, along with control over the volume of reserves, as a base for regulating the volume of bank credit and money.

It can be said, accordingly, that the present-day monetary function of a required reserve percentage is to provide the fulcrum for the quantitative regulation of bank credit and money. How large a volume of bank deposits may be generated by a given amount of reserves, in other words, will be determined by the expansion multiple derived from the reserve requirements.

Given a percentage of deposits that commercial banks are required to hold as reserves, the supply of reserve funds available to the banking system sets an over-all limit to bank credit and monetary expansion. If reserve funds available to the banking system exceed the required reserves by more than a customary margin, expansion in bank loans and investments may occur. On the other hand, if the reserve funds available fall short of required reserves, expansion in bank loan and investment assets must come to a halt, and contraction of such assets may occur. Because of these effects, monetary administration in the present-day setting must constantly pay close attention to the relation between the volume and sources of bank reserves and the amount of reserves that banks are required to hold, and to the balance of forces working to change these relationships.

Amendment of Board Authority

The legislation approved July 28, 1959 changed Section 19 of the Federal Reserve Act, which contains the provisions on reserve requirements, in the following separate but related respects:

(1) The Board was authorized to permit member banks to count their holdings of currency and coin as part of the reserves that they are required to hold under the Federal Reserve Act. Previously, only balances on deposit at a Federal Reserve Bank could be counted for this purpose. The scope and timing of any permission for the banks to count such cash in their vaults was left to the Board's discretion.

(2) By no later than July 28, 1962, the category of "central reserve city banks" is to be abolished. For reserve computation purposes thereafter, member banks will be divided into only two classes, reserve city banks and other banks (usually referred to as "country banks"), instead of three.

(3) Effective immediately, the statutory range within which the Board can set the reserve requirements on demand deposits is changed to 10-22 per cent for both central reserve city and reserve city banks. The range for country banks is kept at 7-14 per cent, and that for time deposits for all member banks at 3-6 per cent.

(4) The Board's power to permit individual banks in reserve or central reserve cities to carry lower reserves than the full requirements for those cities, which had been limited to banks situated in outlying districts of cities, was broadened to allow such exceptions to be based on the character of business of banks, wherever the bank may be located.

At the end of 1959, central reserve city banks consisted of 30 member banks in New York and Chicago, including the principal money market banks in those cities, which held altogether about $38 billion of deposits. The reserve cities were those cities having Federal Reserve Banks or branches and 15 other cities which had been so designated, mainly on the basis of their importance as places where interbank deposits were held. The 265 banks designated as reserve city banks, which included some banks in outlying districts of central reserve cities, had about $72 billion of deposits. The remaining 5,938 country banks had about $71 billion of deposits.

In addition to reserve requirements, member banks by practice or necessity hold in their vaults varying amounts of currency and coin, which serve the same function as reserves in limiting the ability to expand credit. Thus the average differentials between classes are not those indicated by the reserve requirement percentages alone. Since cash holdings vary somewhat among individual banks, the effective combined reserve and cash needs differ for banks within the same class.

MEMBER BANK RESERVE REQUIREMENTS

[Per cent of deposits]

Type of deposit and class of bank	Statutory range of requirements		Requirements in effect during 1959
	Before 1959 legislation	1959 legislation[1]	
Against net demand deposits:			
Central reserve city banks	13 to 26	10 to 22	18
Reserve city banks	10 to 20	10 to 22	16½
Country banks	7 to 14	7 to 14	11
Against time deposits:			
All member banks	3 to 6	3 to 6	5

[1] Act approved July 28, 1959.

CHANGE IN BOARD REGULATION

The Board of Governors amended Regulation D to permit country banks, effective December 1, 1959, to count any vault cash that they hold in excess of 4 per cent of their net demand deposits, along with balances at a Federal Reserve Bank, toward meeting their reserve requirements; and effective December 3, 1959, to permit reserve city and central reserve city banks similarly to count any vault cash, in excess of 2 per cent.

In amending its regulation to permit this counting of vault cash, the main purpose of the Board, in keeping with a principal purpose of the 1959 legislation, was to reduce the inequity that had existed because some banks found it necessary for operating purposes to hold much larger amounts of vault cash, relative to deposits, than were held by other banks in the same reserve classification.

With permission to count as reserves holdings of vault cash in excess of 4 per cent of net demand deposits, the maximum combined reserve and cash needs for a country bank are fixed at 15 per cent of such deposits. Similarly, with permission to count as reserves any cash holdings in excess of 2 per cent of net demand deposits, the maximum needs of a reserve city bank are fixed at 18.5 per cent and

those of a central reserve city bank at 20 per cent. The new provision has the effect of limiting potential variation in combined reserve and cash needs between banks in the same class to less than 4 percentage points for country banks and 2 points for reserve city and central reserve city banks.

The differential between the requirement against net demand deposits for a country bank and that for a reserve city bank, in effect during 1959, was 5½ percentage points, and between a country bank and a central reserve city bank, 7 points. These figures, however, overstate the differences between country banks and others in their total needs for cash and reserve balances, because country banks typically keep in their vaults proportionately larger amounts of currency and coin. Their total holdings of vault cash have recently averaged around 3.5 per cent of their net demand deposits, compared with 1.7 per cent at reserve city banks and 0.6 per cent at central reserve city banks.

The average effective requirement for banks in each class continues to depend in part on the amounts of vault cash actually held. Since for country banks cash holdings up to 4 per cent of net demand deposits are not counted as reserves and since about half of the country banks hold varying amounts less than 4 per cent, the total cash not counted equals about 3 per cent of net demand deposits of all country banks. Added to 11 per cent for required reserves, this makes the average effective requirement for all country banks about 14 per cent. The average amount of cash not counted at reserve city banks is about 1.5 per cent, making the average effective requirement for these banks 18 per cent. That for central reserve city banks, few of which reach the maximum, is about 18.6 per cent.

Computed on the basis of the average effective requirements, the differential between country banks and reserve city banks is about 4 percentage points, or about the same as before the authorization to count some cash as reserves. If a country bank and a reserve city bank hold enough cash to bring them up to the maximum combined requirement percentages of 15 and 18.5 per cent, respectively, the differential between them would be 3.5 percentage points.

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS, 1959

Period	Action	Purpose of action
January–February	Reduced holdings of U.S. Government securities in January by about $1 billion. Member bank borrowings at the Federal Reserve Banks continued at an average of $500 million or more.	To offset the seasonal inflow of reserve funds resulting mainly from the post-holiday return flow of currency from circulation and thus maintain restraint on credit expansion.
March–Mid-July	Increased System holdings of U.S. Government securities by about $1.1 billion. Member bank borrowings rose further to an average of $1.0 billion in mid-July.	To offset partially the absorption of reserves due mainly to a decline of $780 million in gold stock and an increase of about $1 billion in currency in circulation and to keep credit expansion under restraint.
March	Raised discount rates from 2½ to 3 per cent at all Reserve Banks.	To keep discount rates in an appropriate relationship with the rise in market rates resulting from vigorous credit demands and to restrain undue credit expansion.
May–June	Raised discount rates from 3 to 3½ per cent at all Reserve Banks.	
Mid-July–October	Bought and subsequently sold small amounts of U.S. Government securities around periods of Treasury financing and the 3rd quarter tax date. Member bank borrowings averaged about $900 million with temporary increases above $1 billion around Treasury financing and tax payment dates.	To supply special reserve needs for only limited periods in recognition of pressures in money, credit, and capital markets resulting from vigorous public and private demand for credit.
September	Raised discount rates from 3½ to 4 per cent at all Reserve Banks.	To keep discount rates in an appropriate relationship with the rise in market rates resulting from vigorous credit demands and to restrain undue credit expansion.
November–December	Increased System holdings of U.S. Government securities by about $800 million through mid-December and then reduced holdings somewhat. Authorized member banks to count about $300 million of their vault cash as required reserves through amendment to Regulation D, effective December 1, under new legislation. Average borrowings rose to about $1 billion in the last half of December.	To meet part of the temporary end-of-year needs of banks for reserve funds but at the same time to keep bank reserve positions under pressure.

RECORD OF POLICY ACTIONS

FEDERAL OPEN MARKET COMMITTEE

The record of policy actions of the Federal Open Market Committee is presented in the Annual Report of the Board of Governors pursuant to the requirements of Section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying the actions of the Board and the Committee in each instance, and that it shall include in its Annual Report to the Congress a full account of such actions.

In the pages that follow, there is an entry with respect to the policy approved by the Committee at each of the 18 meetings held during the calendar year 1959, which record includes the votes on the policy decisions as well as a resume of the basis for the decisions, as reflected by the minutes of the Committee's meetings. In some cases policy decisions were by unanimous vote, while in others a dissent was recorded. As this record shows, the fact that a decision for a general policy was by large majority or even by unanimous vote does not necessarily indicate that all members of the Committee were equally agreed as to the reasons for a particular decision or as to the precise operations in the open market that were called for to implement the general policy. These shades of opinion, fully expressed at meetings, serve to provide the Manager of the System Open Market Account (who attends the meetings of the Committee) with guides to be used in the conduct of open market operations within the framework of the policy directive adopted.

Set forth below is the policy directive of the Federal Open Market Committee that was in effect at the beginning of 1959, the directive having been approved in this form at the meeting on December 16, 1958. This directive was issued to the Federal Reserve Bank of New York as the Bank selected by the

Committee to execute transactions for the System Open Market Account. It directed that Bank:

(1) 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 fostering conditions in the money market conducive to sustainable economic growth and stability, 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;

(2) 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.

January 6, 1959

Authority to effect transactions in System Account.

The Federal Open Market Committee's directive was approved in the same form that had been adopted at the last meeting of the Committee in 1958 (December 16), calling for a policy of fostering conditions in the money market conducive to sustainable economic growth and stability.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Balderston, Fulton, Irons, Leach, Mills, Robertson, Szymczak, and Deming. Votes against this action: None.

Presentation and consideration of a detailed review of the

regional and national economic and financial situation preceded the Committee's decision to renew the existing policy directive. There was general agreement that the Committee should attempt to maintain about the same degree of restraint on credit expansion during the immediate future that had applied in the recent past. However, there was a considerable body of sentiment that favored resolving doubts in the operation of the System Open Market Account on the side of restricting, rather than easing, the reserve positions of banks.

This policy decision was made against an economic backdrop of maturing recovery with output back or nearly back to prerecession levels, meaning that problems of sustainable growth had now replaced problems of recession. The failure of commodity prices to decline significantly during the recession, the speed and generality of the economic recovery, the persistent rise in common stock prices, the pace of monetary expansion early in 1958, and the size of the current Federal deficit suggested the likelihood of the development of speculative or otherwise unsustainable elements in the further expansion of activity. This posed a key question for Federal Reserve policy as to what rate of monetary expansion would contribute best to the sustainability, without inflation, of prospective economic expansion.

It was noted that the money market had functioned more smoothly in the closing weeks of 1958 than in other year-end periods. Treasury bill rates had reached a peak on December 16 but since then had moved downward. As for bank credit, recent statistics had shown greater expansion than had been apparent a month or two earlier. This was true particularly with respect to a larger than expected growth in loans and investments at country banks, bringing the increase in loans and investments of all commercial banks to around $13 billion for the first eleven months of 1958.

Other factors to which the Committee paid close attention in reaching its decision as to the policy directive included the forthcoming cash and refunding operations of the Treasury, the need for the System to absorb the seasonal return flow of currency into the banking system to prevent the expansion in

the reserve base that otherwise would occur, and the continued evidence of speculative fever in the stock market. At the same time, concern was expressed over the persistence of relatively large unemployment.

The conclusion of the Committee that the degree of restraint on credit expansion in the near future should be about the same as in the immediate past, but that any deviation should be on the side of restraint, reflected the foregoing considerations.

January 27, 1959

Authority to effect transactions in System Account.

No change was made at this meeting in the Open Market Committee's directive, thus continuing the policy of conducting operations in the System Open Market Account with a view, among other things, to fostering conditions in the money market conducive to sustainable economic growth and stability.

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

In reaching its decision as to policy, the Committee gave particular attention to the fact that the monetary basis for continued economic expansion had already largely been established and that forces mostly outside the area of bank credit were likely to determine whether demands for consumption and investment would be of such magnitude and nature as to reduce the volume of unemployment, whether there would be sustainable growth, whether persistent pressures on prices would produce creeping inflation, or whether speculative commitments would create a bubble on a boom that would burst at an early stage.

Analysis of current economic trends led to the conclusion that further recovery to reasonably full utilization of resources and then continued growth at a sustainable rate would depend

upon individual decisions with respect to pricing and buying and investment and saving. It appeared that additional stimulants through fiscal or credit policies were not now needed. In fact, the forces already at work might induce commitments of a speculative nature, or lead to pricing policies that would first contribute to inflation but ultimately discourage buying. Consequently, it was the view of the Committee that the current degree of restraint on bank reserves was appropriate under existing circumstances and should be continued, especially in the light of the forthcoming Treasury refunding which indicated the desirability of no change in the general state of the money market until a reasonable time following completion of this Treasury financing.

The Committee members and the other Reserve Bank presidents in attendance at this meeting also discussed the level of the discount rate at the Reserve Banks, then 2½ per cent. Although they recognized that that rate was fixed by the directors of the Federal Reserve Banks subject to review and determination by the Board of Governors, there was a fairly unanimous opinion that no action to change the rate would be desirable prior to completion of the Treasury's February refunding.

February 10, 1959

Authority to effect transactions in System Account.

The Committee again renewed without change its directive that set forth a policy of fostering conditions in the money market conducive to sustainable economic growth and stability.

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

Careful consideration by the Committee of business and financial developments preceded its decision to renew its existing policy directive. Widespread but small further increases in industrial production were reported, and prices for some stra-

tegic industrial materials had risen further. On the whole, business recovery appeared to be continuing at a moderate pace, although unemployment had risen about seasonally during January.

In reaching its decision to make no change in policy and to maintain the same degree of pressure on bank reserve positions that had been exerted recently, the Committee took particular account of the fact that the large and almost continuous schedule of Treasury borrowings, together with potentially large private credit demands, showed every likelihood of bringing the capital markets increasingly under pressure, thus tightening credit conditions even without any aggressive System effort at restraint. The Committee also considered the prospect that the upward trend of interest rates caused by such borrowing might be sharper than would be appropriate for the general state of business activity. Nevertheless, the view was expressed by a few members that any doubts in arranging transactions for the Open Market Account, pursuant to the terms of the directive issued at this meeting, should be resolved on the side of restraint rather than of ease.

There was further discussion at this meeting of the Reserve Bank discount rate level in relation to the open market policy being followed and to prevailing market rates. Several of those present expressed the opinion that action by the Reserve Bank directors to increase the discount rate level soon after the Treasury's large February refunding operation had been completed would be appropriate and consistent with current open market policy.

March 3, 1959

1. Review of continuing authorities or statements of policy.

This being the first meeting of the Federal Open Market Committee following election of new members by the Federal Reserve Banks for the year beginning March 1, 1959, and assumption by them of their duties, the Committee reviewed and reaffirmed all continuing statements of policy and authorities for operations. These included the following:

a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, and Bryan. Votes against this action: None.

b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, and Bryan. Vote against this action: Mr. Hayes, Vice Chairman.

Mr. Hayes stated that he continued to have the same reservations as a year ago about the wording of this statement, which he would vote to approve if the qualifying phrase "as a general rule" were inserted after "shall" in the second and fourth lines.

c. Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, and Bryan. Vote against this action: Mr. Hayes, Vice Chairman.

Mr. Hayes said that he would vote to approve this action if the word "solely" were deleted from the second line and "primarily" substituted therefor, and if the phrase "as a general rule" were inserted after "shall" in line three.

2. Authority to effect transactions in System Account.

No change was made at this meeting in the directive of the Committee, thus continuing the policy of fostering conditions in the money market conducive to sustainable economic growth and stability.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, and Bryan. Votes against this action: None.

The state of economic activity appeared to be one of budding inflationary boom. The economy had now about attained the preceding cyclical high in industrial production, and it was exceeding the high in terms of aggregate output of goods and services. Business demands for fixed capital and for stock were expected to gain strength as expansion continued. The response of industrial prices to increasing demands had been at least as prompt and as strong thus far during 1959 as in the two preceding postwar expansions, with increases fairly widespread and encompassing finished products as well as materials.

Although this was the general picture, unemployment was still sizable at 6 per cent of the labor force. Further, the sharp rise that had taken place in the operating rate in the steel industry was believed to reflect to some extent precautionary buying against a possible strike, rather than a corresponding increase in final demands for steel products.

The financial situation suggested that there was adequate liquidity to finance further expansion and that under the circumstances further growth in the money supply might not be necessary for some time—at least not until there was evidence that unfulfilled monetary needs might be unduly retarding growth.

The foregoing considerations led the Committee to conclude that the policy directive should be continued without change, with the understanding as expressed by a majority of the Committee that about the same level of restraint should be maintained on bank reserves as at present and that any doubts on the part of the Account Management regarding transactions to be effected should be resolved on the side of restraint. However, a minority view was that any greater pressure than presently evidenced was unnecessary and might be unwise, and in fact that the occasional appearance of free reserves (excess reserves in excess of member bank borrowings from the Reserve Banks) could be psychologically desirable.

The members of the Open Market Committee and the other Federal Reserve Bank presidents who were in attendance at this meeting also discussed the level of the discount rate at the Federal Reserve Banks. A majority indicated the belief that the 2½ per cent rate was clearly out of line and that early adoption of a 3 per cent rate would be more appropriate.

March 24, 1959

Authority to effect transactions in System Account.

The Open Market Committee renewed without change its directive to the Federal Reserve Bank of New York, which specified that operations should be with a view, among other things, to fostering conditions in the money market conducive to sustainable economic growth and stability.

> Votes for this action: Messrs. Balderston, Chairman pro tem, Allen, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, Bryan, and Treiber. Votes against this action: None.

The Committee's decision to continue the policy directive in its existing form followed a review of national and regional business and credit conditions from which it appeared that economic activity was continuing its upward swing, with further gains noted in a number of the leading indices, including

the index of industrial production. Prices of industrial materials had risen somewhat further, while prices of agricultural commodities had declined, and the average of all wholesale prices was fairly stable. The most recent statistics, for February, indicated that both employment and unemployment were little changed.

Since the March 3 meeting of the Committee, financial markets had absorbed with remarkably little disturbance the effects of an increase in Federal Reserve Bank discount rates from 2½ per cent to 3 per cent earlier this month, some tightening of bank reserve positions, the demands of the corporate tax and dividend payment period, and the announcement of a Treasury cash financing operation totalling $4 billion. The explanation of this relative calmness in money markets during a period of special pressures seemed to lie partly in the moderateness of current credit demands, but more largely in the general state of liquidity of the economy.

The consensus favored maintaining about the degree of restraint that had prevailed during the preceding three weeks, with the impending Treasury financing operation one factor that suggested no change in open market policy. During the discussion, one view was expressed that doubts arising in the conduct of open market operations should be resolved on the side of ease and that near-term System policy should be directed toward maintaining only sufficient pressure on reserves to aid the redistribution of the Treasury's new security offerings out of the underwriting commercial banks into permanent hands. However, most members of the Committee concluded that recent policy had been appropriate and should be continued.

April 14, 1959

Authority to effect transactions in System Account.

The policy directive calling for operations in the System Account with a view to fostering conditions in the money market conducive to sustainable economic growth and stability was again renewed.

Votes for this action: Messrs. Hayes, Vice Chairman, Balderston, Deming, Erickson, Mills, Robertson, Shepardson, Szymczak, Bryan, and Fulton. Votes against this action: None. Mr. King did not vote on this action.

A consideration of importance to the Committee in the determination of policy at this juncture was the situation of the Treasury. From the $4 billion cash financing operation that had been completed on April 1, there remained for the banks and dealers the task of distributing a large portion of their acquisitions to the investing public. In the offing were the Treasury's large May refunding and another cash financing operation, while holders of the 4 per cent notes of August 1961 had until the end of this month the option of deciding whether to turn in those notes by August 1, 1959, in lieu of holding them to maturity. In the Government securities market, a slow but steady deterioration of atmosphere had developed since the first of April, with nonbank demand for securities off substantially and buyers for commercial bank offerings of the Treasury's latest issues more difficult to locate.

Reflecting the heavy schedule of Treasury financing ahead and continued improvement in the business situation, there appeared to be a growing belief in the market that interest rates were likely to move higher. As to the business situation, recent data provided a record of general economic advance, with available statistics for March indicating advances in industrial production, housing starts, and personal income, along with continued accumulation of business inventories. A greater than seasonal rise in employment was reported, and creeping advance in average prices of industrial commodities was noted.

The consensus at this meeting in terms of policy for the three-week period ahead called for maintenance of about the same degree of restraint as had existed during the past three weeks. However, the mixture of views contributing to the consensus covered a rather wide spectrum of opinion. There were those who felt that the Treasury problem was a reason for moving cautiously and that a certain degree of caution might in any case be warranted by the lack of definite evi-

dence of inflationary threats at the present time. There were also those who believed that the economy was reaching toward boom proportions and who concluded with only the greatest reluctance that the System should refrain from further restrictive measures because of the Treasury's financing program, while a small minority would have favored some probing in the market toward increased restraint. It was out of this mixture of views that there came agreement that the existing policy directive should be renewed without change and that operations in the immediate future should continue as nearly as practicable the existing degree of pressure against credit expansion.

May 5, 1959

Authority to effect transactions in System Account.

The decision of the Committee at this meeting was to renew without change the policy directive that called for operations with a view to fostering conditions in the money market conducive to sustainable economic growth and stability.

> Votes for this action: Messrs. Balderston, Chairman pro tem, Deming, Erickson, King, Mills, Robertson, Shepardson, Szymczak, Bryan, Fulton, and Treiber. Votes against this action: None.

The Treasury being in the midst of a large refunding and cash financing operation, with the new securities to be issued the next week, the consensus at this meeting of the Federal Open Market Committee favored continuing the existing degree of restraint for an appropriate period following the Treasury financing. However, upon review of current business and financial data, it was the majority view that it would be desirable to move toward greater restraint as soon as feasible after the Treasury financing and that revision of the policy directive might be indicated at the next meeting of the Committee.

The economic report was one of strongly expanding de-

mand, rising productive activity, advancing prices at wholesale, and strongly optimistic business and financial expectations. Labor market data pointed to further strengthening of demands for manpower, and altogether the domestic expansion in process was suggestive of developing inflationary boom. Internationally, a pick-up of activity in key industrial countries and improvement in the balance-of-payments positions of material-supplying areas indicated that a general upturn in world output and trade was under way.

Pressures on financial markets had increased during April, apparently reflecting expanding monetary and credit demands incident to the continuing advance of business activity rather than limitations on the supply of credit. Demands on long-term capital markets had been moderate, but bank loans (particularly consumer instalment credit) had increased more than seasonally and banks also had been endeavoring to distribute Government securities taken on in the April 1 financing. Mortgage demands continued large and real estate loans at banks had increased more than at any time since 1955. The stock market had risen to new high levels and stock market credit continued to increase. Interest rates had continued to rise further. Reflecting these factors, member bank borrowings from Federal Reserve Banks had risen in recent weeks to an average of around $700 million.

Although the majority of the Committee agreed that it would be desirable to move towards greater restraint on credit expansion as soon as feasible after the current Treasury financing was completed, a minority point of view cautioned against a monetary policy that might defeat and finally counteract what could prove to be only normal economic growth by touching off a spiral of contractive credit forces. A specific danger cited was that undue restraint on the growth of the money supply could result in harmful consequences to the Government securities market if commercial banks were forced to liquidate unduly large amounts of securities in order to fulfill lending obligations to their customers.

May 26, 1959

Authority to effect transactions in System Account.

Clause (b) of the first paragraph of the Committee's policy directive was revised at this meeting so as to provide for increased restraint on credit expansion. This was indicated by adoption of wording specifying that open market operations should be conducted with a view "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities." This replaced the clause of the directive that had been in effect since December 16, 1958 calling for operations with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability."

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, King, Robertson, Shepardson, Szymczak, and Bryan. Vote against this action: Mr. Mills.

Productive activity was spurting ahead and the economic climate had become distinctly more inflationary, according to reports at this meeting. Industrial production in April, which carried the Board's index up two points in a month for the third consecutive month, reflected principally gains in output of durable goods industries, including both producer and consumer lines. Data available for May suggested another two-point advance in the index for that month. Personal income had been climbing for several months at an annual rate of more than $3 billion a month, principally because of higher wage and salary payments. Reflecting this improvement in personal income, retail sales (seasonally adjusted) in April carried beyond the large March volume and were about 12 per cent higher than the cyclical low point of March 1958. A robust expansion of consumer instalment credit, which had been in process since late 1958, supported rising sales of automobiles and household durables.

Housing starts in April, seasonally adjusted, were at the annual rate of 1.4 million, and the total of starts in the first

four months of 1959 was the highest on record for a comparable period. Total construction contract awards in April had reached the highest level on record, 31 per cent above a year earlier. Marked improvement in the employment situation also had occurred in April, and the unemployment problem appeared to be diminishing in scope to certain pockets of structural unemployment. Industrial prices rose further in April and an additional advance was taking place in May; at mid-May, the level was up 2.5 per cent from a year earlier and stood 2 per cent above the prerecession high reached in 1957. Consumer prices advanced slightly in April, with a further modest rise indicated for May.

In financial markets, the month of May was characterized by unseasonably large credit demands and further increases in interest rates to the highest levels for some years. Nearly all interest rates rose except yields on three-month Treasury bills, which continued in the 2¾ to 3 per cent range that had prevailed generally since late February. Yields on long-term Treasury bonds and on both new and seasoned corporate issues had now risen to the highest levels since the 1920's. On May 15, large city banks announced an increase from 4 to 4½ per cent in their lending rate on prime customers' loans.

Following an exceptionally large increase in bank loans at all commercial banks in April, city banks showed a further loan expansion in the first three weeks of May. The increase had been particularly large in business loans, but real estate and consumer loans also showed marked increases. The ratio of total loans to total loans and investments of banks now stood close to the high level reached in 1957. The aggregate money supply, after adjustment for seasonal variations, showed an advance in recent months at an annual rate of 4 per cent or more, and in addition the turnover of bank deposits had been increasing in recent months.

The large May refunding and cash operations of the Treasury were now completed, and it appeared likely that no additional borrowing would be necessary until early July. Nevertheless, the expansion in credit demands during April and May had brought increased pressure on the reserve posi-

tions of banks, as indicated by the rise in borrowings at the Federal Reserve Banks and the accompanying increase in the level of net borrowed reserves.

Upon review and analysis of the over-all situation, including the continuing United States balance-of-payments deficit, the Open Market Committee reached the conclusion that the current level of restraint imposed by monetary and credit policy was not sufficiently restrictive and that an intensification of restraint was required. Reports presented by the Reserve Bank presidents at this meeting indicated the possibility that the directors of the respective Federal Reserve Banks would move soon to fix the discount rate at a level higher than the prevailing 3 per cent—probably 3½ per cent. On the assumption of a rate increase of no larger proportions, the Committee favored conducting open market operations with a view to exerting additional pressure as rapidly as that could be done without creating an untenable condition in the market for Government securities.

Although the firmer tone desired by the Committee was not expressed in terms of a specific target of net borrowed reserves (an excess of member bank borrowings at the Reserve Banks over their excess reserves), it was noted that additional restraint could be brought about in the next few weeks by letting natural factors take their course. On the basis of projections before the Committee as to factors affecting the supply of and need for reserves in the weeks ahead, it appeared that under such a procedure net borrowed reserves, which recently had been running in the neighborhood of $250 million, would move upward toward the $500 million level.

In the current circumstances, the policy directive to the Federal Reserve Bank of New York was deemed to be in need of revision. Accordingly, after consideration of several suggestions, it was decided that clause (b) of the first paragraph of the directive, which since December 1958 had provided for operations with a view "to fostering conditions in the money market conducive to sustainable economic growth and stability," should be changed to provide for operations with a view "to restraining inflationary credit expansion in order to

foster sustainable economic growth and expanding employment opportunities."

Mr. Mills, who voted against approval of the revised policy directive, indicated that apprehensions he previously had expressed had not diminished with respect to the delayed and violent financial and economic reactions that he sensed to be in the offing when the cumulative pressures inherent in present monetary and credit policy took their full effect. He cautioned against undue alarm concerning anticipated events that had not yet come into clear perspective.

June 16, 1959

Authority to effect transactions in System Account.

Since the previous Open Market Committee meeting (May 26), the discount rate at each of the Federal Reserve Banks had been increased from 3 per cent to 3½ per cent. While prices of Treasury notes and bonds remained virtually unchanged following this increase, rates on bills of longer maturities moved up slightly and those on 91-day bills advanced fairly sharply.

As envisaged by the consensus at the May 26 Committee meeting, natural market factors had been allowed to have their effect since that time in order to bring about an increase in the degree of restraint. Net borrowed reserves, for example, rose from slightly over $300 million in the week ended May 27 to more than $500 million in the following week and continued around that level.

In addition to seasonal demands that would require additions to reserves during the latter part of June, it was noted that, within the three-week period following this meeting of the Committee, the Treasury was to conduct another cash financing operation in which it was anticipated that around $3.5 to $4.5 billion of new money would have to be raised, presumably again in the short-term area.

In considering the course of System policy, the Committee had before it reports indicating further economic expansion on a broad front to new high levels. Production, sales, in-

come, and employment showed increases, while unemployment in May fell below 5 per cent of the labor force for the first time since the end of 1957. Businesses were adding to their inventories at an unusually high rate and had revised upward their plans for new plant and equipment expenditures. Total bank credit expansion, including that of the Federal Reserve Banks, appeared to have been adequate to meet the persistent gold outflow and provide for further expansion of the money supply. Abroad, general economic expansion seemed clearly in process, with principal foreign countries continuing to show a strong balance-of-payments situation and to accumulate gold and dollar reserves.

On the basis of business and credit conditions and in view of the forthcoming Treasury financing, the consensus favored continuance of the present open market policy of restraint on inflationary credit expansion. While a number of Committee members expressed the hope that the Account Management would be able to avoid any development of less restraint against credit expansion, others urged caution against operations that might result in excessive tightness.

With no change in policy indicated by the consensus at the meeting, the Committee continued without change the directive, adopted at the May 26 meeting, which was stated in terms of restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Hayes, Vice Chairman, Allen, Deming, Erickson, Johns, King, Robertson, Shepardson, and Szymczak. Votes against this action: None.

July 7, 1959

Authority to effect transactions in System Account.

It appeared to the Committee that a number of major expansive influences that had been operating in the economy, including residential construction, inventory accumulation, and gains in industrial productivity, might now have passed their maximum rates of growth and that some slowdown in the

rapid pace of advance could be expected during the next few months. A major industrial uncertainty was the possibility of a strike in the steel industry. However, for the period up to the time of this meeting, the data reflected continuation of a vigorous expansion in economic activity. Industrial production apparently had increased further in June, while estimates placed gross national product for the second quarter up $10 billion from the first quarter of the year in terms of both current and constant dollars. Expanding consumer demand was being supported by a rapid growth of consumer instalment credit, which increased in the April-May period at an annual rate in excess of $5 billion.

During June, money markets were under pressure from continued strong credit demands. The restricted availability of bank reserves made it necessary for banks to reduce their holdings of securities by large amounts in order to meet these demands, and a high level of borrowings at the Federal Reserve Banks also kept the banks under restraint. It now appeared that growth in the money supply during the first six months of 1959 had been at an annual rate of about 2 per cent but that only a small increase had taken place in May and none in June.

At the time of this meeting, interest in the Government securities market focused on the new Treasury financing, which involved the offering of a total of $5 billion of bills at auctions on July 1 and July 8 in addition to the regular weekly bill auctions. There had been pronounced increases in interest rates in recent weeks, and in the regular Treasury bill auction on the day preceding this meeting demand for both long- and short- bills was light, resulting in an average rate of 3.26 per cent for the 91-day bills and 3.96 for the 182-day bills. Awards to dealers had totalled $587 million, and the result of that auction indicated another upward adjustment in bill rates.

For the period immediately ahead, it was the consensus that there should be no change in open market policy. However, in view of the difficult Treasury financing situation, the instruction to the Manager of the System Open Market Account was tempered with the proviso that, in carrying on operations

for the Account, doubts should be resolved on the side of ease during the period of Treasury financing.

In view of the decision of the Committee to make no change in policy, and with the indicated understanding as to resolving doubts on the side of ease, the directive calling for restraint on inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities was again renewed without change.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Johns, King, Mills, Shepardson, Szymczak, and Bopp. Votes against this action: None.

July 28, 1959

Authority to effect transactions in System Account.

At this meeting the Open Market Committee continued without change the policy directive providing for restraint on inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Johns, Mills, Robertson, and Shepardson. Votes against this action: None.

Financial developments during July had been dominated by the massive Treasury operations, which included not only the raising of $5 billion of new cash through two bill offerings but the subsequent refunding of $14 billion of issues maturing on the first of August. Difficulties and uncertainties connected with the earlier Treasury operations resulted in a sharp rise in rates to the level of 4¾ per cent for a one-year issue, but this rate attracted funds from widespread sources. The refunding offer at 4¾ per cent on both a 12½ month issue and a 4-year, 9-month issue was successful, with unusually low attrition. As a consequence, the tone of the Government securities market had improved somewhat, and the amount of prospective new Treasury financing in mid-August was reduced.

(On July 16, 1959, the Open Market Committee, by poll of the available members, authorized exchange of as much as one-half of System Open Market Account holdings of $8,143 million of Treasury certificates of indebtedness maturing August 1, 1959, into 4¾ per cent notes maturing May 15, 1964, the remainder to go into 4¾ per cent notes maturing August 15, 1960. Only $2.6 billion of the Account's certificate holdings actually were exchanged into the 1964 notes. The purpose of this authorization was to assist the Treasury in evening out the maturity schedule.)

Almost all recent economic data continued to reflect rapid growth. Expansion in the second quarter of 1959 proved to have been more vigorous than earlier figures had indicated, with gross national product rising at an annual rate of $13 billion above the previous quarter. The increase over the quarter in physical volume amounted to about $10 billion, so that there was $3 billion of inflationary price rise, i.e., an annual rate of a billion dollars a month. Consumer spending advanced by the near-record rate of $7.5 billion during the quarter. Demand for producer durable goods was strong, reflecting both increased consumer spending and rising business investment, and construction activity continued at close to peak levels in June. Although wholesale prices of industrial commodities marked time, the consumer price index showed an abrupt rise of .4 per cent in June. A major uncertainty was introduced into the economic situation by the steel strike that began July 15 after extensive negotiations failed to produce a settlement. Another matter of concern accompanying the expansion in business was the balance-of-payments situation; it now appeared that the total accumulation of gold and dollar assets by foreign accounts in 1959 might be over $4 billion, compared with $3.4 billion in 1958.

The generally strong business picture, the strength of credit demands, the need to keep the Treasury's seasonal deficit financing in the next few months from swelling the money supply unduly, prospective wage and price developments, and the failure of the balance of payments to show improvement appeared clearly to justify continued monetary restraint. On the

other hand, the steel strike had injected a major element of uncertainty into the outlook, and the situation in the Government securities market remained delicate in spite of the successful Treasury refunding. Thus, although an opinion was expressed that such inflationary pressures as now existed would be adequately contained by a more moderate degree of restraint, the consensus favored aiming as far as practicable at the same degree of restraint on credit expansion as currently prevailed. Accordingly, the directive was renewed without change.

August 18, 1959

Authority to effect transactions in System Account.

The conclusion reached by the Open Market Committee was to aim toward maintenance of the status quo, that is, continuation of the existing degree of restraint, during the period immediately ahead, with no change at this time in the policy providing for System open market operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities. Accordingly, the directive was renewed in the form that had been in effect since May 26.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Deming, Erickson, Johns, King, Mills, Szymczak, and Treiber. Votes against this action: None.

In discussion leading to this conclusion relative to the course of open market policy, the Committee gave consideration to whether the present economic situation and prospective developments justified moving in the direction of additional restraint during the two-week period before its next meeting, scheduled for September 1, 1959, or, on the other hand, whether the tendency should be in the direction of leaning slightly on the side of ease.

The business and financial position was characterized by strong and broadly-based demands despite the month-old steel strike, and general optimism was reported to prevail with re-

spect to the business and employment outlook over the next few months. There continued to be reports of strong demand for bank credit, widely distributed among different types of borrowers. The index of industrial production dropped 2 points in July, but this was accounted for by the steel strike along with adjustments from the abnormal levels of activity in some sectors of the economy that had been attained in the past few months in anticipation of the strike. However, approximately 5 per cent of the labor force (exclusive of those on strike) was unemployed, and some excess production facilities were still available. Although the volume of commercial bank loans had expanded, this expansion was accompanied by substantial divestment of Government securities by the banks. This trend, together with the continued high level of member bank borrowing at the Federal Reserve Banks, suggested to some the possibility that monetary and credit policy may have been more restrictive than appeared from surface indications. The consensus that emerged from consideration of these and other factors favored continuing the present degree of restrictiveness at least until the next Committee meeting.

September 1, 1959

Authority to effect transactions in System Account.

The two-week period since the previous meeting of the Open Market Committee was marked by a further steep increase in Treasury bill rates. The rate on three-month bills, which was at the 3 per cent level in late July and moved up to 3.40 per cent by mid-August, had now increased to a point where the average rate in the auction on the day prior to this meeting was 3.89 per cent. In the same auction the average rate on six-month bills was 4.47 per cent, almost 75 basis points above the average rate in the auction on August 17. This rise in rates reflected continued sales of short-term securities by banks in order to meet an exceptionally strong loan demand, reduced demand for Treasury bills on the part of nonbank buyers as seasonal increases in cash needs approached,

and further additions to the supply of bills. The current rate level caused attention in the market to focus on the Reserve Bank discount rate (3½ per cent) and the commercial bank prime rate (4½ per cent); uncertainties with respect to the latter rate were resolved when an increase to 5 per cent was announced on the morning of this meeting.

Aside from the influence of work stoppages attributable directly or indirectly to the steel strike, the economic picture presented at this meeting appeared to be one of widespread strength. Construction activity, although showing moderate decline from the all-time record level of April and May, was at a rate one-third higher than a year earlier. New orders and sales figures for durable goods manufacturers reflected marked strength in most lines, retail sales continued vigorous, and consumers continued to seek and incur instalment and mortgage debt at a near-record pace. After rising in June, United States exports reached a seasonally adjusted rate in July one-fifth above the level earlier in the year. While prices of industrial commodities showed relative stability, the consumer price average rose in four consecutive months through July, with a broad range of price increases.

Discussion at this meeting revealed cross currents of thinking with respect to the appropriate posture of System policy at this juncture. Among other things, it was pointed out that the level and trend of Treasury bill and other short-term market rates, together with the increase in the commercial bank prime rate, raised a substantial question as to the practicability of indefinite continuation of the existing Reserve Bank discount rate.

With respect to the appropriateness of the current degree of credit restraint, some sentiment was expressed to the effect that it would be a mistake to await settlement of the steel strike before moving to a more restrictive position. This point of view suggested that there should be some reluctance on the part of the System in meeting seasonal reserve needs and some increase in the level of net borrowed reserves. A different point of view expressed by one member of the Committee held that recent developments indicated that current System policy

was unduly restrictive and that its continuation might not be consistent with the System's objective of fostering longer-run economic growth and stability. This opinion suggested that System policy traditionally had sought to meet seasonal credit needs and that there should be no doubt about doing so at this time.

The majority of the Committee favored maintenance of the existing degree of pressure on reserve positions of banks in the period immediately ahead, but no intensification, which would mean supplying reserves to meet the usual seasonal increase in money and credit needs during the next few weeks. Factors influencing the thinking of the majority included the uncertainties attendant upon the steel strike and the further complications that might be created in the Government securities market by the exertion of additional restraint at this time.

Some consideration also was given to the possibility of a revision of the Committee's directive to the Federal Reserve Bank of New York. However, in view of the consensus that there should be no move at this point toward either more or less restrictiveness on reserves, the Committee made no change in the existing directive, providing for open market operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Deming, Erickson, King, Mills, Robertson, Shepardson, Szymczak, Bryan, and Treiber. Votes against this action: None.

September 22, 1959

Authority to effect transactions in System Account.

The directive to the Federal Reserve Bank of New York was renewed without change, continuing the Open Market Committee's policy of restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Johns, King, Mills, Robertson, Shepardson, and Szymczak. Votes against this action: None.

The Committee's decision to renew the existing policy directive was made after presentation and consideration of a detailed review of the national and regional economic and financial situation. Although no change was made in the directive that provided for restraint on inflationary credit expansion, the Committee qualified its instruction to the New York Reserve Bank with an understanding that to whatever extent operations in the open market for the System Account might result in deviations from the existing degree of restraint on the reserve positions of banks, such deviations preferably should be on the side of reducing restraint. The large majority of Committee members favored this understanding, but the opposite view was put forward, namely, that any such deviations from the existing degree of pressure be on the side of greater restraint.

This policy decision was made against the background of information showing that, despite the spreading effects of the steel and other strikes, economic activity and credit demands were continuing at a high level. The discount rates of all Federal Reserve Banks had been increased from 3½ per cent to 4 per cent since the September 1 meeting, and rates on the longest outstanding Treasury bills had been bid at above 5 per cent. Some uncertainties were expressed as to the near-term future, depending on the settlement of the steel strike, but with demand for credit continuing strong, bank reserve positions remained under pressure. The banks continued to dispose of Government securities to help in meeting loan demands, and the Government securities market had weakened around mid-September as nonbank holders liquidated securities to meet quarterly tax and dividend payments. Investor demand was low, the market supply of Treasury securities was large, and it was noted that a new short-term Treasury financing expected in October would add further to the supply of securities on the market.

Some concern was expressed about the difficulties that the Treasury might expect in its imminent cash financing operation. The point also was made that the anti-inflationary policy that had been followed for some months was contributing to a tempering of business and investor exuberance in forward expectations and planning. Another factor noted was that the seasonal increase in demand for credit during the fall of the year would tend automatically to increase pressure on banks, even though additional amounts of reserve funds were supplied to the market by the Federal Reserve in accordance with projections of aggregate needs of the banking system.

The conclusion of the Committee that the degree of restraint to be maintained in the market during the next few weeks should be about the same as in the recent past, but that any deviations preferably should be on the side of less restraint, was a reflection of such considerations as the foregoing, even though there was recognition of factors to suggest a rapid recovery in economic activity, perhaps developing boom characteristics, after production of steel was renewed.

October 13, 1959

Authority to effect transactions in System Account.

At its preceding meeting (September 22, 1959), the Open Market Committee made no change in the existing policy directive calling for restraint on inflationary credit expansion, with the instruction to the Federal Reserve Bank of New York qualified by the understanding that, to whatever extent System Open Market Account operations might result in deviations from the existing degree of restraint, such deviations preferably should be on the side of reducing the degree of restraint.

At the time of this meeting (October 13), the business and financial outlook was obscured by the cumulative impact of the steel strike. Important economic developments since late spring suggested a possibility that the danger of inflationary boom might have been overcome, although a positive judgment in this respect awaited settlement of the steel strike and the results flowing from such a settlement. The Committee's

analysis of the domestic situation gave little reason for either increasing restraints or providing additional stimulants to the economy, and in these circumstances the consensus favored watchful waiting and marking time in the period immediately ahead.

One member of the Committee, Mr. Mills, in whose opinion a moderating of the policy of credit restraint had long been in order, dissented from the policy indicated by the consensus, although only mildly at this particular juncture. Mr. Mills felt that a gradual shift in policy toward relaxation of restraint was called for and that a cautious approach in shaping the supply of reserves and expanding the availability of credit was required in order to avoid provoking an artificial distortion in the structure of interest rates. While certain other members of the Committee also favored a mild backing away from the present degree of restraint, in those cases the shades of difference involved were not sufficient to cause them to record disagreement with the policy indicated by the consensus. Mr. Mills, although dissenting to the extent indicated from a policy of watchful waiting and marking time, joined in the unanimous vote to continue the existing directive to the Federal Reserve Bank of New York, which provided for restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Martin, Chairman, Allen, Balderston, Deming, Erickson, King, Mills, Robertson, Shepardson, Szymczak, and Treiber. Votes against this action: None.

November 4, 1959

Authority to effect transactions in System Account.

The Open Market Committee again renewed without change its directive to the Federal Reserve Bank of New York calling for operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Johns, King, Robertson, Shepardson, and Szymczak. Vote against this action: Mr. Mills.

Renewal of the directive reflected the conclusion of the Committee, after analysis of business and financial developments, that there should be no change in basic policy at this time and that in implementing the policy decision, operations for the Open Market Account should aim at maintaining a feeling of stability in monetary and credit conditions and assuring the availability of funds for seasonal credit needs.

In reaching its decision as to policy, the Committee gave careful consideration to the continuing lull in economic activity and in monetary and credit demands. This lull, which had been evident at the October 13 meeting and which led to the suggestion that current developments pointed less in the direction of inflationary boom than was earlier considered likely, was associated largely with the steel strike and its cumulative impact on various segments of the economy. Despite the strike, demand, particularly at the consumer level, remained strong, and an upward tilt was visible in prices for consumer goods and most basic industrial materials. Nevertheless, following a year of heavy pressures in the over-all demand for funds, some moderation of expansive pressures had appeared in late September and continued to characterize the financial markets. At this stage, however, it was questionable whether this moderating of pressures reflected a change in trend or simply a passing phase.

In voting against continuing the existing directive, Mr. Mills proposed revising clause (b) so that it would provide for "fostering sustainable economic growth and expanding employment opportunities while guarding against inflationary credit expansion." This suggestion reflected his judgment that uncertainties as to the future were strong enough to argue for a monetary and credit policy that would lessen the degree of restraint on credit expansion. Certain other Committee members expressed themselves as leaning toward a slight easing of restraint, but only to the extent that this might be accom-

plished within the framework of the existing policy directive. None expressed the view that there should be an intentional increase in the degree of restraint at this time.

November 24, 1959

Authority to effect transactions in System Account.

The policy directive providing for restraint on inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities was again renewed by the Open Market Committee.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Deming, Erickson, Johns, King, Robertson, Shepardson, and Szymczak. Vote against this action: Mr. Mills.

The consensus of this meeting favored maintaining the same degree of restraint. In reaching this conclusion as to the objective that should guide open market operations in the ensuing three-week period, the Committee had in mind that the period of heaviest pre-Christmas drain on reserves was now beginning and that the financial markets would be subject to the usual special pressures of the season. In addition, the $2 billion Treasury cash financing operation for which subscriptions were being received the day of this meeting suggested no change in the degree of restraint.

Activity in the steel industry had been resumed for approximately two weeks, after a four-month interruption, under a Taft-Hartley Act injunction. Steel production had climbed to about 80 per cent of capacity in the week before this meeting, and a 90 per cent rate was estimated for the current week. Nevertheless, the outlook as to the rate of economic advance remained uncertain, particularly since it was not yet known when and how the steel and other major labor disputes might ultimately be settled and what would be the continuing and indirect effects of shortages that had accumulated during the work stoppage.

Evidence of the underlying strength in the business situa-

tion that had prevailed despite the strike led to expression of the view by some members of the Committee that settlement of the steel dispute might result in a sharp upsurge marked by unsustainable elements of expansion and strong pressures for price increases. Those expressing this view urged that the trends be watched carefully, although they did not propose that the current degree of credit restraint should be intensified at this point. The view also was presented that the System should be ready to move in the direction of lessening restraint if a pattern of reduced pace of economic expansion should emerge. It was noted, among other things, that stability of the money supply and money velocity had prevailed over recent months and that the seasonal growth of bank credit this fall had been somewhat below normal, reflecting at least in part a slackening in economic activity and monetary needs related to the steel stoppage. At the same time, the public's holdings of liquid assets in the form of short-term Government securities had continued to increase. Under all these circumstances, the consensus was that the current open market position was not unduly restrictive or stimulating and should be continued.

Mr. Mills, who voted against continuing the existing policy directive, renewed the suggestion he had made at the meeting on November 4 that clause (b) be amended to provide for "fostering sustainable economic growth and expanding employment opportunities while guarding against inflationary credit expansion." This suggestion reflected his view that the availability of credit had been brought to a point where the commercial banking system was restricted in making its normal contribution creditwise to growth and stability.

December 15, 1959

Authority to effect transactions in System Account.

The Open Market Committee continued the policy directive calling for restraint on inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities.

Votes for this action: Messrs. Martin, Chairman, Hayes, Vice Chairman, Allen, Balderston, Deming, Erickson, Johns, King, Robertson, Shepardson, and Szymczak. Vote against this action: Mr. Mills.

At the time of this Committee meeting, the last held during calendar year 1959, a substantial recovery of industrial production from the setback due to the steel strike was under way. With full-scale output restored in the steel and to a large extent in the steel-dependent industries, it was anticipated that the Board's index of industrial production, placed at 147 for October and estimated at 148 for November, would advance further in December by five or more index points. Retail sales showed widespread gains in November in lines other than automobiles, and early December figures indicated some additional advance. Employment rose moderately in November, the gain being concentrated mainly in durable goods industries, while wholesale price averages were marked by relative stability and consumer prices continued to veer upward. Buying at the consumer level was supported by a further strong growth of instalment credit. Recent data confirmed that the balance-of-payments position of the United States had not deteriorated further and probably had strengthened somewhat. Abroad, the expansion of economic activity in industrial nations continued to be vigorous.

Domestically, prospects seemed weighted toward resumption of an expansionary movement. Although the trend in housing construction was downward from a very high level and a similar trend prevailed with respect to agricultural commodity prices, most general business indicators appeared likely to reach or exceed previous records in the near future. As yet, however, evidence of a general scramble for inventories was lacking, and latest estimates of plant and equipment expenditures suggested somewhat less of an upward trend than had been expected earlier. With the injunction period under the Taft-Hartley Act due to expire in January and labor-management negotiations apparently making little progress, the ultimate outcome of the wage dispute in the steel industry remained in doubt.

Largely in response to usual seasonal liquidity needs, and perhaps to some increase in credit demands as a result of the resumption of steel operations, interest rates rose in the latter part of November and early December. System open market transactions supplied nearly half a billion dollars of reserves to the market during the three-week period preceding this meeting, and in addition some reserves were released by action to permit member banks with relatively large holdings of vault cash to count part as required reserves, effective at the beginning of December. Treasury bill rates reached new record highs in the first part of December, but on the other hand there were occasions when the money market showed signs of easing. Among the cross currents in the market was an element of uncertainty concerning the trend of interest rates in early 1960. Although a decline in rates usually follows the end-of-year rise, there was some feeling that a resumption of expansion in credit demands following settlement of the steel strike might contribute to rate firmness. Also, substantial Treasury financing operations were in prospect, including the raising of possibly as much as $2½ billion of new money in January, the refunding of a $2 billion issue of special bills maturing January 15, and the refunding of a large February certificate maturity.

Analysis of business and financial developments and prospects resulted in a consensus favoring maintenance of the degree of restraint on credit expansion that had been agreed upon by the Committee at its meeting on November 24, 1959. Noting that the economy was still operating below capacity, that the growth of the quantitative money supply had been quite small during the past year, and that the liquidity of the banking system had diminished, some Committee members concluded that the cumulative effects of monetary policy may have become sufficient for a time and that a cautious approach should be followed in order to prevent undue tightness. Within this group, a few felt that the tendency of System policy might well be toward a slight relaxation of restraint, or at least that doubts arising in the conduct of open market operations should be resolved on the side of ease. However,

in view of the prospects for an advancing level of economic activity, with vigorous monetary and credit demands, in the months ahead, other members felt that the greater danger lay in too little rather than too much restraint. The prevailing opinion was that any lessening of restraint at this time would be unwise.

Mr. Mills, who voted against renewal of the existing policy directive, proposed the alternative wording for clause (b) that he had also suggested at the two previous Committee meetings. He believed that Federal Reserve monetary and credit policy should aim at moderate restraint over the expansion of bank credit, as contrasted with what he considered to be a policy of relatively severe restriction.

* * *

The policy directive of the Open Market Committee in effect at the beginning of 1959 was aimed at fostering conditions in the money market conducive to sustainable economic growth and stability. Within the framework of this directive, however, there was room for an increase in pressure on member bank reserve positions during the spring, as recovery in the economy had given way to expansion. On May 26, the directive was revised to provide that transactions should be undertaken with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities. Although this was the only change during the year in the language of the directive, there were occasions, as indicated in the entries for the individual meetings, when the directive was issued with the understanding that in the conduct of open market operations there would be a leaning on the side of restraint or of ease. The directive at the end of 1959 instructed the Federal Reserve Bank of New York, until otherwise directed by the Committee:

(1) 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 credit expansion in order to foster sustainable economic growth and expanding employment opportunities, 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;

(2) 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.

RECORD OF POLICY ACTIONS
BOARD OF GOVERNORS

January 9, 1959

Amendment to Regulation P, Holding Company Affiliates—Voting Permits.

Effective immediately, subsection (d) of Section 1 of Regulation P was amended by deleting clause (3) and appropriately renumbering clauses (4) and (5).

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, and Robertson. Votes against this action: None.

As previously in effect, the definition of "affiliated," in subsection 1(d), technically covered situations where control of one corporation was held, directly or indirectly, by shareholders of another corporation who also owned or controlled a majority of the shares of the latter corporation or more than 50 per cent of the number of shares voted at the last election of directors of that corporation. The amendment eliminated this technical coverage as being unnecessary to carry out the purposes of the law.

March 5, 1959

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective March 6, 1959, the Board approved action by the Boards of Directors of the Federal Reserve Banks of New York, Philadelphia, Chicago, and Dallas establishing a rate of 3 per cent (an increase from 2½ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, and Shepardson. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	March 10, 1959
San Francisco	March 12, 1959

Cleveland	March 13, 1959
Richmond	March 13, 1959
St. Louis	March 13, 1959
Kansas City	March 13, 1959
Atlanta	March 16, 1959
Minneapolis	March 16, 1959

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 3½ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act.

(In accordance with the provisions of the Federal Reserve Act, the Federal Reserve Banks establish, subject to review and determination of the Board of Governors, rates on discounts for and advances to member banks at least every 14 days, and submit such rates to the Board for consideration. Prior to this date, no changes had been made in these rates since those referred to on pages 85-86 of the Board's Annual Report for 1958.)

The period since October 1958, when the discount rates of the Federal Reserve Banks were increased to 2½ per cent, had been marked by further expansion of economic activity. Industrial production had reached a level only slightly below the record high of February 1957, and other measures such as gross national product, construction, and retail sales were sharply higher on a seasonally adjusted basis than in the last quarter of 1958 or in the first quarter a year ago. Industrial prices also were continuing to move upward, and the average of wholesale prices was held stable only by virtue of declining prices of farm products. Successive surveys of consumer and business expectations reflected mounting optimism.

The year 1959 thus far had been characterized by relatively light credit demands from business but large demands from governments—Federal, State, and local. Borrowing by individuals against mortgages continued large, and consumer credit, after increasing more than seasonally in late 1958, showed substantially less than the usual seasonal contraction in the early part of 1959. The total prospective demand for

credit during the next few months included large borrowing needs of the Treasury to cover the current deficit.

Despite the over-all liquidity of the economy, pressures upon money markets and the banking system appeared likely to strengthen when the public found it necessary to draw upon time deposits, to liquidate securities, or to borrow at banks in order to obtain additional funds to support further expansion. The impact of the Treasury's financing program would be an additional factor causing upward pressures on short-term interest rates during the coming months. The increase in the discount rate meant that, if contemplated pressures upon the money markets and the banks developed and if a restrictive open market policy made it necessary for member banks to borrow additional reserves, the policy of restraint upon credit expansion would be reinforced by a discount rate close enough to market rates to help to deter such borrowing.

May 1, 1959

Amendmends to Regulation T, Credit by Brokers, Dealers, and Members of National Securities Exchanges (formerly entitled Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges).

Effective June 15, 1959, Section 3(b)(2) of Regulation T and the Supplement to that Regulation were amended in order further to restrict withdrawals of cash or securities from so-called "restricted" accounts (that is, accounts in which more credit is outstanding on the securities in the account than would be permitted in a new purchase of those securities under current margin requirements).

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, Shepardson, and King. Votes against this action: None.

Regulation T is issued by the Board pursuant to the Securities Exchange Act of 1934, particularly Sections 7 and 8(a) thereof. It applies to every member of a national securities exchange and to every broker or dealer who transacts a business in securities through the medium of any such member. In announcing the amendments to the Regulation

that were made effective June 15, 1959, the Board issued the following explanatory statement:

Accounts can become "restricted" by declines in market value of the securities held in the account or by increases in margin requirements. (The margin requirement of a stock is the difference between its prescribed maximum loan value and its current market value.) Securities can be withdrawn from these "restricted" accounts through sale or otherwise, if there is a specified reduction in the debt owing in the account.

Under the previous regulation, when a security was withdrawn from a "restricted" account, the amount by which the debt in the account had to be reduced worked out to be the same as the maximum loan value of the security at the time. This percentage automatically changed with each change in margin requirements.

The amendment to Section 3(b)(2) provides for a new method of limiting withdrawals from "restricted" accounts. The amendment provides for a separate figure which represents the "retention requirement" of a registered nonexempted security (i.e., in the case of a withdrawal of securities, the percentage of market value that must be deposited in the account; or, in the case of a sale, the percentage of sale proceeds that must be left in the account). In a new paragraph (c) of the Supplement of Regulation T the "retention requirement" is set at 50 per cent of the market value of the securities involved. This "retention requirement" may be changed by the Board from time to time.

The amendment does not alter existing provisions that allow a purchase of registered nonexempted securities to be made in a "restricted" account without additional margin if the purchase is made on the same day that an equal or greater market value of such securities is sold in the account and the proceeds applied to the purchase.

The purpose of amending Regulation T in the manner described was to limit more effectively the excessive use of credit for the purpose of purchasing or carrying securities.

On May 6, 1959, the following conforming amendments to Regulation T were approved, effective June 15, 1959, with the understanding that they would be issued in conjunction with the amendments approved on May 1, 1959:

Section 3(g) was amended to make it clear that a transaction used to permit one offsetting transaction—for example, a deposit of securities used to permit a withdrawal of cash—would be to that extent unavailable to permit another offsetting transaction. Section 3(g) was also amended

to stipulate that a sale of a security held in a margin account must, for the purposes of Regulation T, be treated as a "long" rather than a "short" sale. Section 3(e) was amended to change the amount of liquidation required when a customer fails to supply the margin that Regulation T requires the broker to obtain within four days on additional purchases in margin accounts.

May 1, 1959

Amendments to Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks (formerly entitled Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange).

Effective June 15, 1959, (1) the third paragraph of Section 1 of Regulation U and the Supplement to that Regulation were amended in order further to restrict withdrawals of collateral against so-called "restricted" loans (that is, stock-collateralled loans which are larger than would be permitted in the case of a new loan to purchase registered stocks under current margin requirements); (2) Section 3(a) was amended to strengthen the provisions regarding statements accepted by a bank as to the purpose of a loan; (3) Section 3(b)(1) was amended to broaden the provision relating to "carrying"; (4) Section 3(j) was amended to provide for reports from certain nonbank lenders; (5) Section 3(n) was amended to prohibit the weakening of collateral behind a "purpose" loan which occurs when that same collateral is also used as the basis of a "nonpurpose" loan; (6) a new Section 3(q) was added to require that bank loans to borrowers importantly engaged in relending for stock market purposes shall comply with Regulation U even though the bank loans are not secured by any stock; (7) a new Section 3(r) was added to require loans originally for the purchase of convertible securities to be brought into conformity with the margin requirements within 30 days after conversion into a registered stock takes place; and (8) conforming changes were made at several places in the Regulation.

Votes for this action: Messrs. Martin, Szymczak, Mills, Robertson, and Shepardson. Mr. Balderston voted for all of the amendments except the amendment of Section 3(n), on which he voted "no". Mr. King voted for all of the amendments except the amendment of Section 3(a), on which he refrained from voting. There were no other negative votes on any parts of the action.

Regulation U is issued by the Board pursuant to the Securities Exchange Act of 1934, particularly Section 7 thereof.

In announcing the amendments that became effective June 15, 1959, the Board issued the following explanatory statement:

Withdrawals of collateral.—Loans can become "restricted" by declines in market value of the stocks securing the loan or by increases in margin requirements. (The margin requirement of a stock is the difference between its prescribed maximum loan value and its current market value.) Stock securing a "restricted" loan can be withdrawn through sale or otherwise if there is a specified reduction in the loan.

Under the former rule, if a stock securing a "restricted" loan was withdrawn, the amount by which the loan had to be reduced worked out to be the same as the maximum loan value of the stock at the time. This percentage automatically changed with each change in margin requirements.

The amendment to the third paragraph of Section 1 provides for a new method of limiting withdrawals of collateral securing "restricted" loans. The amendment provides for a separate figure which represents the "retention requirement" of a stock (i.e., in the case of a sale or other withdrawal of collateral, the amount, stated as a percentage of the market value of the collateral, by which the loan must be reduced). In a new paragraph (b) of the Supplement to the Regulation the "retention requirement" is set at 50 per cent of the market value of the stocks involved. This "retention requirement" may be changed by the Board from time to time.

Statement of purpose of loan.—The former Section 3(a) provided that a bank could rely upon a statement signed by an officer of the bank or by the borrower as to the purpose of a loan, if the statement was accepted by the bank in good faith. Under that section, a bank could accept a statement that a loan was not for the purpose of purchasing or carrying a registered stock without ascertaining affirmatively the purpose for which the loan was to be used. The amendment requires that the statement be signed by both borrower and lending officer. If the statement merely states what is not the purpose of the loan, the lending officer must provide a memorandum or notation describing the purpose of the loan. The amendment also emphasizes the alertness and diligence required of the bank before a statement can be said to be accepted in good faith.

"Carrying" of registered stocks.—The former Section 3(b)(1) excluded from loans for the purpose of "carrying" registered stocks all loans except a limited group specified in that section, principally loans to enable the borrower to reduce or retire indebtedness originally incurred to purchase such stock. The net effect was to exclude from regulation a large number of loans which were closely related to the financing of positions in stocks.

The amendment strikes this earlier, narrower approach and instead describes affirmatively certain situations in which a loan will not be deemed to be for the purpose of "carrying" registered stocks.

Reports from unregulated lenders.—The former Section 3(j) required banks to make such reports as the Board of Governors may require. The amendment expands this requirement to include, in addition, "every person engaged in the business of extending credit who, in the ordinary course of business, extends credit for the purpose of purchasing or carrying" registered stocks.

Loans relying on collateral which has served to permit a purpose loan. —Regulation U allows a bank to lend a specified portion, currently 10 per cent, of the market value of a stock used as collateral where the loan is to purchase or carry registered stocks. However, after the bank made such a loan, unless the borrower was a broker or dealer, the Regulation previously allowed the bank to lend as much more as it pleased on the same collateral for any other purpose. The former Section 3(n) forbade such double use of collateral when the borrower was a broker or dealer. The amendment expands this prohibition to forbid such double use in the case of loans to all borrowers under Regulation U, just as it is already forbidden in all cases under Regulation T. The amendment does not, however, require the bank to forego or to waive any lien, nor does it apply to loans to meet emergency expenses not reasonably foreseeable provided the circumstances are suitably documented.

Exemption discontinued for certain unsecured loans.—The Regulation previously exempted all loans that were not secured, directly or indirectly, by at least some stock. The new Section 3(q) discontinues this exemption as to loans made to companies engaged principally, or as one of the company's important activities, in making loans on an exempt basis to finance the purchase of registered stocks.

Loans to purchase convertible securities.—The Regulation previously did not apply to loans for purchasing or carrying convertible bonds. The new Section 3(r) requires the entire transaction to be brought into conformity with margin requirements prevailing at the time when conversion into a registered stock occurs, allowing, however, 30 days for this to be done.

The purpose of these amendments was to make the Regulation more effective in its objective of preventing the excessive use of credit for purchasing or carrying securities.

Governor Balderston voted against the amendment of Section 3(n), relating to prohibiting the double use of col-

lateral for both "purpose" and "nonpurpose" loans, because he felt that the amendment went beyond the proper scope of the Board's responsibility under the statutes.

May 28, 1959

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective May 29, 1959, the Board approved action by the Boards of Directors of the Federal Reserve Banks of New York, Chicago, St. Louis, Minneapolis, and Dallas establishing a rate of 3½ per cent (an increase from 3 per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Martin, Szymczak, Mills, Robertson, Shepardson, and King. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	June 2, 1959
Atlanta	June 2, 1959
Philadelphia	June 5, 1959
Kansas City	June 5, 1959
San Francisco	June 11, 1959
Cleveland	June 12, 1959
Richmond	June 12, 1959

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 4 per cent on advances to member banks under Section 10(b) of the Federal Reserve Act. In addition, the Board approved changes at some of the Banks in rates on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act and on industrial loans and commitments under Section 13b.

Since early March, when the discount rates of the Federal Reserve Banks were increased to 3 per cent, productive activity had surged ahead vigorously and expectations were now optimistic in virtually every sector of the economy. The Board's index of industrial production for April attained a level four points higher than the prerecession peak in Febru-

ary 1957, and weekly output data for May indicated the possibility (later confirmed) of a further gain in that month. Activity in durable goods industries advanced to a new high, while production of nondurable goods, which had surpassed the earlier highs of 1957 by mid-1958, continued to expand to a level one-tenth above those highs. Principally because of higher wage and salary payments, personal income continued to climb at a rate in excess of $3 billion a month, a rate of increase that equaled or surpassed the comparable months of the 1955-57 period of expansion. Retail sales for April exceeded the large March volume and in May were about 10 per cent above a year earlier. In early May, new automobile sales were running nearly 50 per cent higher than a year earlier and 15 per cent higher than in the similar period in 1957, while used car sales continued active at prices some 15 per cent higher than a year earlier. A strong expansion in consumer instalment credit, in evidence since the latter part of 1958, was supporting sales of automobiles and household durables; the first quarter increase in automobile credit was the largest since the first quarter of 1956, and the credit rise for diversified consumer durables was the largest since the last quarter of 1956. Marked improvement in the employment situation had occurred in the past several weeks, with the gains, which were widespread in the durable goods manufacturing industries, carrying total employment to around 52 million, approximately one million above a year earlier. At the same time, unemployment declined considerably more than seasonally to 5.3 per cent of the civilian labor force in April, with a further decline indicated in May. Thus, although unemployment remained somewhat higher than at a similar stage in other postwar recovery periods, the recent trend suggested that aside from certain pockets of "structural" unemployment, the problem would continue to diminish in importance. Average wholesale prices were relatively stable, but consumer prices were edging upward and increased price pressures seemed likely.

In financial markets, the period was marked by heavy credit demands. An exceptionally large increase in bank

loans in April was followed by further expansion in May, the demand extending to virtually all loan categories, including particularly business loans. In the face of this demand, the banks liquidated Government securities, resulting in a rise in the ratio of loans to loans and investments to a point close to the high level reached in 1957. Along with an increase in the aggregate money supply in recent months, the turnover of bank deposits increased, which meant that economic activity was expanding faster than the volume of money. On May 15, large city banks announced an increase from 4 to 4½ per cent in the lending rate on prime customers' loans.

Nearly all interest rates had risen except yields on three-month Treasury bills, which continued to move in the lower part of the 2¾ to 3 per cent range that had prevailed generally since late February, reflecting a desire on the part of investors to maintain liquidity positions in view of the possibility of further interest rate increases. Yields on six-month Treasury bills had risen to around the 3⅓ per cent level, and yields on longer bills had been as high as 4 per cent. Stock prices had again risen to peak levels, accompanied by a further increase in stock market credit. With the conclusion of May operations, it appeared that the Treasury might have no need for additional borrowing until early in July, but additional refunding and new cash offerings would be in process from late July until mid-August, to be followed by large borrowing needs in the fourth quarter of the year.

The over-all deficit in the United States balance of payments continued at about the same rate as in 1958, when it amounted to $3.4 billion, although a smaller proportion was taking the form of gold outflow. To bring the international accounts of the United States into balance, the problem of maintaining costs and prices on a competitive basis with those of other leading industrial countries loomed as vital.

In view of the strength of credit demands, and with System credit policy limiting additions to the open market portfolio to amounts sufficient only to offset drains from factors such as the contraseasonal rise of currency in circulation and the gold outflow, member banks were resorting to the discount

facilities of the Federal Reserve Banks in increasing volume. The added restraint of a discount rate increase seemed appropriate, particularly in view of the recent further rise in market interest rates.

July 31, 1959

Actions incident to admission of Hawaii to Statehood.

Effective upon issuance by the President of the United States of a proclamation admitting Hawaii to Statehood, which proclamation subsequently was issued on August 21, 1959, the Board readjusted the Federal Reserve districts so as to include the State of Hawaii in the Twelfth District, as a part of the territory served by the head office. Effective the same date, certain amendments were made to several regulations of the Board to correct language rendered inappropriate by the admission of Hawaii to Statehood.

Votes for this action: Messrs. Martin, Balderston, Robertson, and Shepardson. Votes against this action: None.

Section 2 of the Federal Reserve Act provides that the Federal Reserve districts, as created originally by the Reserve Bank Organization Committee, may be readjusted from time to time by the Board of Governors of the Federal Reserve System, the districts not to exceed 12 in all. Section 17 of the Hawaii Statehood Act amended the aforesaid Section 2 to provide that when the State of Hawaii "is hereafter admitted to the Union the Federal Reserve Districts shall be readjusted by the Board of Governors of the Federal Reserve System in such manner as to include such State." In anticipation of a Presidential proclamation admitting Hawaii to Statehood, the Board took action to include Hawaii in the Twelfth Federal Reserve District coincident with the date of proclamation, with the understanding that Hawaii would be a part of the territory served by the head office of the Federal Reserve Bank of San Francisco.

Certain technical changes in a number of Board regulations were made, effective the same date, because the admission of Hawaii to Statehood rendered the existing language inappropriate. The regulations affected included: E, Pur-

chase of Warrants; G, Collection of Noncash Items; H, Membership of State Banking Institutions in the Federal Reserve System; I, Increase or Decrease of Capital Stock of Federal Reserve Banks and Cancellation of Old and Issue of New Stock Certificates; J, Check Clearing and Collection; L, Interlocking Bank Directorates under the Clayton Act; and U, Loans by Banks for the Purpose of Purchasing or Carrying Registered Stocks.

August 10, 1959

Termination of Regulation S, Industrial Loans by Federal Reserve Banks.

Effective at the close of business August 21, 1959, Regulation S was terminated.

Votes for this action: Messrs. Martin, Balderston, Robertson, and King. Votes against this action: None.

Section 13b of the Federal Reserve Act was repealed, effective August 21, 1959, by the Small Business Investment Act of 1958, approved August 21, 1958. Accordingly, since the Federal Reserve Banks would no longer be authorized to make loans and commitments for commercial and industrial purposes pursuant to Section 13b, the Board of Governors terminated Regulation S as of the close of business August 21, 1959.

August 27, 1959

Amendment of Regulation Q, Payment of Interest on Deposits.

Effective October 1, 1959, Section 3(d) of Regulation Q was amended to permit member banks of the Federal Reserve System to pay interest at the maximum rate permitted under the Regulation calculated from the first day of the month on savings deposits received during the first ten calendar days of such month, in lieu of permitting interest to be paid at such rate from the first day of the month only on savings deposits received during the first ten business days of any calendar month commencing a quarterly or semiannual interest period and during the first five business days of any other calendar month.

Votes for this action: Messrs. Mills, Robertson, Shepardson, and King. Votes against this action: None.

The purpose of this amendment was to reduce misunderstandings in connection with so-called "grace periods" in computing interest on savings deposits, to make possible uniform advertising, to create better customer relationships, and to enable banks that compute interest on a cycle basis to facilitate computation of interest on savings accounts and eliminate difficulties being encountered. The amendment was the subject of a notice of proposed rule making, published in the Federal Register, and was adopted after consideration of all relevant views and arguments received from interested persons.

Also effective October 1, 1959, the Federal Deposit Insurance Corporation adopted a similar amendment to its regulations relating to insured nonmember banks.

September 10, 1959

Increase in rates on discounts and advances by Federal Reserve Banks.

Effective September 11, 1959, the Board approved action by the Boards of Directors of the Federal Reserve Banks of New York, Cleveland, Richmond, Chicago, St. Louis, Kansas City, Dallas, and San Francisco establishing a rate of 4 per cent (an increase from 3½ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act.

Votes for this action: Messrs. Balderston, Szymczak, Robertson, Shepardson, and King. Votes against this action: None.

Pursuant to the policy established by this action, the Board subsequently approved, effective on the dates indicated, the same rate for the following Federal Reserve Banks:

Boston	September 14, 1959
Atlanta	September 14, 1959
Minneapolis	September 14, 1959
Philadelphia	September 18, 1959

Effective the same dates, the Board approved for the respective Federal Reserve Banks a rate of 4½ per cent on advances to member banks under Section 10(b) of the Federal Reserve Act and a rate of 5 per cent on advances to individuals, partnerships, and corporations under the last paragraph of Section 13 of the Act.

In early September the economic picture reflected both the direct influence of the steel strike, which began in mid-July, and its spreading secondary effects. Work stoppages had developed in other basic metal industries, and new model changeovers had reduced assemblies of automobiles. The Board's index of industrial production was estimated to be eight points below the peak reached in June. However, aside from the work stoppage influence, the economy continued to show widespread strength. Retail sales in August remained close to the high levels of the previous three months and were 7 per cent above a year earlier, while the total value of construction put in place in August was close to the peak rate reached in the spring. Prices of basic materials, which had been relatively stable, began to rise after early August; the index of consumer prices had been edging upward for some time and in July was .8 per cent above a year earlier. As the result of strike effects, employment declined about one-half million to 52 million by mid-August, while unemployment decreased somewhat less than the usual seasonal amount.

Demand for credit was heavy and increasing. Bank loans expanded rapidly through July and August, with bank holdings of Government securities reduced in the latter month. Borrowings by member banks at the Federal Reserve Banks were averaging close to $1 billion.

The month preceding this action on the discount rate was marked by a sharp increase in short-term interest rates. Market yields on three-month Treasury bills, which were at a level around 3 per cent at the beginning of August, climbed sharply thereafter to approximately 4 per cent in early September. Yields on six-month bills rose in similar fashion, to a level around 4½ per cent, and the same trend was evident in rates on longer-term Treasury issues as well as corporate and municipal securities. At the beginning of September, large city banks increased their rate on prime customers' loans from 4½ to 5 per cent. These developments appeared to reflect expectations of higher interest rates in view of the general strength of the economy notwithstanding the steel

strike and other work stoppages, the vigor of present and prospective credit demands, Treasury borrowings in prospect, and the further economic expansion that seemed likely following settlement of the strike.

The increase in the discount rate brought it to a level that produced a better alignment with short-term money market rates and also recognized existing trends in the money market and underlying trends in the economy generally.

Governor Mills, who was not present on September 10, 1959, abstained from voting when the discount rates established by the directors of the Federal Reserve Banks of Boston, Philadelphia, Atlanta, and Minneapolis came before the Board for approval on subsequent dates. As he regarded the situation, technical conditions in the money market justified an increase in the discount rate to 4 per cent. However, it was his judgment that System monetary and credit policy, about which he had strong reservations, had been instrumental in creating the market conditions that stood in favor of such an increase.

October 23, 1959

Amendment to Regulation R, Relationships with Dealers in Securities under Section 32 of the Banking Act of 1933.

Effective immediately, Section 2 of Regulation R was amended by striking out the words "debentures issued by Federal Intermediate Credit Banks, bonds issued by Federal Land Banks," and substituting therefor "obligations of Federal Intermediate Credit Banks, Federal Land Banks, Central Bank for Cooperatives, Federal Home Loan Banks, and the Federal National Mortgage Association."

Votes for this action: Messrs. Balderston, Szymczak, Mills, Shepardson, and King. Vote against this action: Mr. Robertson.

Section 32 of the Banking Act of 1933, as amended by Section 307 of the Banking Act of 1935, provides that no officer, director, or employee of any corporation or unincorporated association, no partner or employer of any partnership, and no individual, primarily engaged in the issue, flotation,

underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve at the same time as an officer, director, or employee of any member bank of the Federal Reserve System except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

Prior to the amendment adopted effective October 23, 1959, Section 2 of Regulation R exempted from the general prohibition of Section 32 of the Banking Act of 1933 relationships of officers, directors, or employees of member banks with firms dealing in direct obligations of the United States, obligations fully guaranteed both as to principal and interest by the United States, debentures issued by Federal Intermediate Credit Banks, bonds issued by Federal Land Banks, and general obligations of territories, dependencies, and insular possessions of the United States.

Adoption of the amendment broadening the exceptions contained in Section 2 of the Regulation to include obligations of the Central Bank for Cooperatives, the Federal Home Loan Banks, and the Federal National Mortgage Association reflected the Board's conclusion that such action would not increase the likelihood of activities of an undesirable character such as were sought to be guarded against by the language of Section 32 of the Banking Act of 1933.

Governor Robertson voted against this amendment because in his view a sufficiently strong case had not been made for broadening the exemption further.

November 30, 1959

Amendments to Regulation D, Reserves of Member Banks.

The Supplement to Regulation D was amended to permit member banks not classified as central reserve or reserve city banks to count currency and coin in excess of 4 per cent of net demand deposits as part of their required reserves, effective December 1, 1959, and to permit central reserve and

reserve city banks similarly to count currency and coin in excess of 2 per cent of their net demand deposits, effective December 3, 1959. Also, effective December 1, 1959, Regulation D was amended to define currency and coin as including currency and coin in transit to or from a Federal Reserve Bank; to require currency and coin to be counted as of the beginning of the business day; to exclude drafts or authorizations on a member bank's reserve account from the definition of gross demand deposits; and to permit member banks at their option to include nonbusiness days at the end of a reserve computation period in the next succeeding period. Effective December 31, 1959, Regulation D was amended to change the reserve computation period for banks not classified as central reserve or reserve city banks from semimonthly to biweekly.

Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, Shepardson, and King. Votes against this action: None.

In announcing this action, which would permit many member banks to count a portion of their vault cash in meeting reserve requirements, the Board stated:

On the basis of average vault cash holdings for the past 12 months, it appears that almost half of the 6,250 member banks will be in a position to count a part of their vault cash in meeting their required reserves. As a result, total member bank reserve balances at the Federal Reserve Banks may be lower than would otherwise be required by as much as $230 million, of which $160 million would be at country banks and $70 million at reserve city banks. Total vault cash held by member banks has averaged about $2.2 billion.

This Federal Reserve action was taken under the terms of an Act of Congress in 1959 designed in part to remedy inequities that have arisen because many banks, particularly small country banks, find it necessary for operating purposes to hold relatively larger amounts of vault cash than other banks do. No change in the System's general monetary or credit policy is involved. The beginning of December is a logical time for this action inasmuch as the Federal Reserve System needs to make additional reserves available to the banking system each year at this season in order to meet the seasonal requirements for the economy.

The remaining amendments to Regulation D, as described above, were of a technical nature.

December 18, 1959

Actions with respect to capital accounts of the Federal Reserve Banks.

Effective December 31, 1959, and until further action by the Board, the Board determined that the surplus of the Federal Reserve Banks be maintained at a level equal to 100 per cent of the subscribed capital of the respective banks.

> Votes for this action: Messrs. Martin, Balderston, Szymczak, Shepardson, and King. Vote against this action: Mr. Mills. Mr. Robertson dissented from the action to the extent that he did not favor reducing the existing surplus of any Federal Reserve Bank in order to bring it down to a level of 100 per cent of subscribed capital, but he approved the principle that hereafter no additions would be made to surplus of any Bank beyond 100 per cent of subscribed capital.

The Board also directed that, by December 31, 1959, the reserves for contingencies of the respective Reserve Banks be discontinued and the amounts therein transferred to profit and loss, except that the reserve for registered mail losses would not be discontinued until after appropriate amendment of the Loss Sharing Agreeement of the Federal Reserve Banks.

> Votes for this action: Messrs. Martin, Balderston, Szymczak, Mills, Robertson, Shepardson, and King. Votes against this action: None.

Prior to 1933, the Federal Reserve Act included a provision under which each Federal Reserve Bank was required to pay a franchise tax to the Government equal to 90 per cent of its earnings, after the Bank had accumulated a surplus equal to its subscribed capital. The Banking Act of 1933 required each Federal Reserve Bank to pay an amount equal to one-half of its surplus on January 1, 1933, for capital stock of the Federal Deposit Insurance Corporation. These payments amounted to $139 million and reduced the surplus of the Federal Reserve Banks to an equivalent figure, or considerably less than one-half of their subscribed capital. Congress, therefore, eliminated the franchise tax in order to permit the Federal Reserve Banks to rebuild their surplus accounts from future earnings.

By the end of 1946, the combined surplus of the Federal

Reserve Banks totaled $440 million, as compared with subscribed capital of $374 million. In the circumstances, the Board on April 23, 1947, concluded that it would be appropriate to accomplish the same results as were accomplished earlier through payment of the franchise tax by establishing, under the authority of the fourth paragraph of Section 16 of the Federal Reserve Act, such rates of interest on outstanding Federal Reserve notes not covered by gold certificate collateral as would make it possible to transfer to the Treasury approximately 90 per cent of the earnings of each Federal Reserve Bank after payment of necessary expenses and statutory dividends, and after such provisions as might be necessary to restore surplus of each Bank to 100 per cent of subscribed capital if it fell below that figure. The procedure thus established by the Board in 1947 was followed through the year 1958.

At the end of 1959, combined subscribed capital of the Federal Reserve Banks stood at $777 million, while combined surplus amounted to $868 million. After a review of the situation, which included consultation with the Federal Reserve Banks, the Board concluded that the maintenance of surplus at a level equal to 100 per cent of subscribed capital would be sufficient to meet any foreseeable needs of the Banks. It was therefore decided to change the practice of adding approximately 10 per cent of the annual net earnings of the Federal Reserve Banks to the surplus accounts, and to pay to the Treasury the amounts by which the surplus accounts exceeded subscribed capital. Pursuant to this decision, the 1959 payments to the Treasury as interest on Federal Reserve notes, totaling $911 million, consisted of all net earnings after dividends and after provision for building up surplus to 100 per cent of subscribed capital at those Reserve Banks where surplus was below that amount. In addition, there was paid to the Treasury the amounts by which surplus at the other Banks exceeded subscribed capital (which is twice the amount of paid-in capital).

In dissenting from the decision to maintain surplus at no more than 100 per cent of subscribed capital after Decem-

ber 31, 1959, Governor Mills took the position that there were good reasons to continue to make reasonable additions to surplus and that any decision to pay over to the Treasury a larger share of Federal Reserve Bank earnings than paid under the formula in effect from 1947 through 1958 should be reached in accordance with some newly prescribed formula that had found acceptance by the Congress.

Governor Robertson agreed with the principle of paying 100 per cent of current net earnings of the respective Federal Reserve Banks to the Treasury, after carrying to surplus any amounts needed to bring surplus to a figure equal to 100 per cent of subscribed capital, but he disagreed with that part of the Board's action pursuant to which there would be paid to the Treasury the amounts by which surplus at certain Banks currently exceeded subscribed capital. He would have preferred to leave surplus accounts at their existing levels and let subscribed capital build up to them over a period of time.

The Board also acted to discontinue certain reserves for contingencies of the Federal Reserve Banks and to cause the respective Banks to transfer such reserves to profit and loss by December 31, 1959. The transfers from reserves for contingencies at all Reserve Banks pursuant to this action amounted to $98 million. Similar action was taken to discontinue the reserve for registered mail losses, effective after the boards of directors of the Federal Reserve Banks had acted to amend the Loss Sharing Agreement of the Federal Reserve Banks and the Board of Governors had approved the revised Agreement.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined the 12 Federal Reserve Banks and their 24 branches during the year as required by Section 21 of the Federal Reserve Act. In conjunction with their annual examination of the Federal Reserve Bank of New York, the Board's examiners also made a detailed audit of the accounts and holdings of the System Open Market Account maintained at that Bank, and rendered a report thereon to the Federal Open Market Committee. The techniques and procedures employed by the Board's examiners were surveyed and appraised by a private firm of certified public accountants during the course of the examination of one of the Federal Reserve Banks. The public accountants made their own choice of the examination that was the basis for their study.

As supplement to its own examinations, and continuing a longstanding practice, the Division of Examinations received and reviewed the reports of audits made periodically during the year by the internal auditing staffs of the respective Federal Reserve Banks.

Examination of member banks. Although authorized to examine all member banks, both State and national, as a matter of practice neither the Federal Reserve Banks nor the Board of Governors examines national banks since the Comptroller of the Currency is directly charged with that responsibility by law. Reports of examinations made by the Comptroller are furnished the respective Federal Reserve Banks and made available to the Board of Governors. Likewise, because all member banks are insured, the Federal Deposit Insurance Corporation is empowered to make special examinations of national banks and State member banks whenever such special examination is necessary to determine the condition of any such bank for insurance purposes. However, such examinations have been infrequent and have been made only in anticipation of financial assistance by the Corporation in a rehabilitation program or where a member bank desired to continue as an insured bank after withdrawal from membership in the System. Reports of examination of both national banks and State mem-

ber banks are made available to the Federal Deposit Insurance Corporation, and the Corporation in turn makes its reports available to the Comptroller of the Currency and the Board of Governors. At the request of the Comptroller of the Currency, the Board makes recommendations to his office concerning applications which he receives for charters of national banks.

State member banks are subject to examinations made by direction of the Board of Governors or of the Federal Reserve Banks by examiners selected or approved by the Board of Governors. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, by examiners for the Reserve Bank of the district in which the bank is situated, with additional examinations if considered desirable. Here again, in order to avoid duplication and to minimize inconvenience to the banks examined, wherever practicable joint examinations are made in cooperation with the State banking authorities or alternate examinations are made by agreement with State authorities. The 1959 program for examining State member banks was practically completed, since only four of the 1,691 banks were not examined during the calendar year.

In its supervision of State member banks, the Board passes upon applications to establish branches, including original offices and offices to be acquired through merger or consolidation, and also upon investments in bank premises that will exceed 100 per cent of the capital stock of the member bank. The Board does not pass upon mergers or consolidations involving State member banks unless the resulting institution will be a State member bank with less capital stock or surplus than the aggregate capital stock or aggregate surplus, respectively, of all the merging or consolidating banks.

Federal Reserve membership. At the end of 1959 member banks accounted for 46 per cent of the number, and held approximately 85 per cent of the deposits, of all commercial banks in the United States. State member banks accounted for 19 per cent of the number, 31 per cent of the banking offices, and

about 65 per cent of the deposits of all State commercial banks.

The 6,233 member banks of the Federal Reserve System at the end of 1959 included 4,542 national and 1,691 State member banks. There were net declines of 36 and 43, respectively, in these two categories during the year. The decline in the total, continuing the trend of recent years, was due largely to consolidations and mergers. Reductions from other causes included 15 State banks that withdrew from membership and two national banks that converted into nonmember banks. The membership losses were offset in part by newly established banks, of which 23 were national banks and four were State members, by the admission to membership of six nonmember banks in Alaska, one in Hawaii, and five in other States, and by the conversion of one nonmember bank into a national bank.

The total number of member bank offices increased, however, as a result of both the conversion of merged banks into branches and the establishment of de novo branches. At the end of the year member banks were operating 7,259 branches, 558 more than at the close of 1958.

Detailed figures on changes in banking structure during 1959 are shown in Table 18 on page 126.

Bank holding companies. During 1959, pursuant to Section 3(a)(1) of the Bank Holding Company Act of 1956, the Board approved one application for prior approval of action to become a bank holding company. Pursuant to Section 3(a)(2) of the Act, the Board approved the acquisition by nine bank holding companies of voting shares of seven banks; with respect to two of the banks, applications were filed by two related bank holding companies, one of which controlled the other. Under Section 4(c)(6) of the Act, the Board, after hearings, denied requests by two holding companies for orders determining that one subsidiary of each was so closely related to the banking activities of its respective holding company system as to be a proper incident thereto and as to make it unnecessary for the prohibitions of Section 4 to apply in order to carry out the purposes of the Act; such requests as to 15

subsidiaries, by six holding companies, were approved. During the year the Board issued 12 certifications in accordance with the tax provisions of the Act (Internal Revenue Code, Sections 1101 and 1103). To provide necessary current information, annual reports for the year 1958 were obtained from registered bank holding companies.

During 1959, pursuant to the Banking Act of 1933, the Board authorized the issuance of seven voting permits for general purposes and 13 permits for limited purposes to holding company affiliates of member banks. In accordance with established practice, examiners for the Federal Reserve Banks examined a number of affiliates of holding companies the principal offices of which are located in their districts.

Section 301 of the Banking Act of 1935 provides that the term "holding company affiliate" shall not include, except for the purposes of Section 23A of the Federal Reserve Act, any organization which is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the year the Board made such determinations with respect to nine organizations.

Trust powers of national banks. During 1959, 45 national banks were granted authority by the Board to exercise one or more trust powers under the provisions of Section 11(k) of the Federal Reserve Act. This number includes the grant of additional powers to four banks that had previously been granted certain trust powers. Trust powers of 29 national banks were terminated, 27 by consolidation or merger and two by voluntary surrender. At the end of 1959, there were 1,734 national banks holding permits to exercise trust powers.

Acceptance powers of member banks. During the year the Board approved applications of three member banks, pursuant to the provisions of Section 13 of the Federal Reserve Act, for increased acceptance powers. One member bank was granted permission to accept commercial drafts or bills of exchange to an amount not exceeding at any time, in the aggregate, 100 per cent of its paid-up and unimpaired capital stock and surplus; and one member bank was granted full permission, and

another limited permission, to accept drafts or bills of exchange drawn for the purpose of furnishing dollar exchange as required by the usages of trade in such countries, dependencies, or insular possessions of the United States as may have been designated by the Board of Governors.

Foreign branches of member banks. Under the provisions of Section 25 of the Federal Reserve Act, the Board approved during 1959 eighteen applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States. One member bank opened four branches in the Virgin Islands and a branch in Panama, Republic of Panama. Another member bank opened branches in Buenos Aires and Cordoba, Argentina; Nassau, Bahamas; Belo Horizonte and Curitiba, Brazil; Kuala Lumpur, Malaya; Singapore, Colony of Singapore; and Montevideo, Uruguay. Six of these branches had been authorized by the Board prior to 1959.

At the end of 1959, seven member banks had in active operation a total of 132 branches in 30 foreign countries and overseas areas of the United States. Three national banks were operating 101 of these branches, and four State member banks were operating 31. The branches were distributed geographically as follows:

Latin America	**69**
Argentina	12
Bahamas	1
Brazil	12
Chile	2
Colombia	4
Cuba	21
Mexico	3
Panama	6
Paraguay	1
Peru	1
Uruguay	2
Venezuela	4
Continental Europe	**5**
Belgium	1
France	3
Germany	1
England	**10**
Near East	**4**
Egypt	1
Lebanon	2
Saudi Arabia	1
Far East	**22**
Hong Kong	1
India	2
Japan	10
Malaya	1
Philippines	5
Singapore	2
Thailand	1
United States Overseas Areas	**22**
Canal Zone	4
Guam	1
Puerto Rico	13
Virgin Islands	4
Total	**132**

In 1959, examiners for the Board of Governors surveyed the overseas branches of three State member banks at their respective head offices in New York.

Foreign banking and financing corporations. In 1959, one corporation was organized under State law and opened for business to operate under agreement with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. Another "agreement" corporation ceased operations as a result of its merger into a State member bank. The head offices in New York of the three "agreement" corporations now in operation were examined in 1959 by examiners for the Board of Governors. One corporation operates two agencies at the New York International Airport, has a branch in England, and owns the stock of two banks organized under the laws of, and operating in, Liberia and the Union of South Africa, respectively. Another corporation owns the stock of a bank organized under the laws of, and operating in, the Union of South Africa. The investment in the latter bank was authorized by the Board in 1958 and the bank opened in Johannesburg in 1959.

During 1959 one corporation was chartered by the Board under the provisions of Section 25(a) of the Federal Reserve Act to engage in international or foreign banking. At the end of the year there were six corporations in active operation under that section; three of these are regarded as "banking corporations" and three as "financing corporations." The home offices of these six corporations are located in New York City, and all were examined during the year by examiners for the Board of Governors. Three corporations have no subsidiaries or foreign branches; one has a branch in France and an English fiduciary affiliate that has a branch in Canada; one has a subsidiary organized under the laws of Panama; and one operates branches in France, Germany, Guatemala, Hong Kong, Lebanon, Malaya, and Singapore, and also has an agency in Guatemala and owns substantially all of the stock of a bank organized under the laws of, and operating in, Italy.

In 1959, examiners for the Board of Governors surveyed the branches of one foreign banking corporation at its home office in New York.

Inter-Agency Bank Examination School. Two sessions of the School for Examiners and four sessions of the School for Assistant Examiners were held in 1959. The Inter-Agency Bank Examination School is conducted in Washington by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. Since the establishment of the School in 1952, the various sessions have been attended by 1,273 men, representing the three Federal bank supervisory agencies, one other Federal agency, the State Banking Departments of California, Connecticut, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, and Virginia, the Treasury Department of the Commonwealth of Puerto Rico, and one foreign country.

LEGISLATION

Reserves of member banks. The Act of Congress approved July 28, 1959 (Public Law 86-114) amended certain provisions of the Federal Reserve Act and related laws with respect to reserves against deposits required to be maintained by member banks of the Federal Reserve System. The Act (1) authorizes the Board of Governors to permit member banks to treat vault cash as reserves; (2) reduces from 13 per cent to 10 per cent the minimum reserves against demand deposits that member banks in central reserve cities must maintain; (3) reduces from 26 per cent to 22 per cent the maximum reserves against demand deposits that member banks in central reserve cities may be required to maintain; (4) increases from 20 per cent to 22 per cent the maximum reserves against demand deposits that member banks in reserve cities may be required to maintain; (5) authorizes the Board of Governors to permit a member bank located in a central reserve or reserve city to carry lower reserves than other banks in the

same city, based upon the nature of the bank's business rather than upon its geographical location, as heretofore; and (6) provides for the termination of the classification "central reserve cities" on July 28, 1962. The law also authorizes the Board to designate which holding company affiliate, where there is more than one with respect to the same bank or a group of banks, may establish and maintain the reserves of readily marketable assets required by law.

Member banks dealing in obligations of Tennessee Valley Authority and Inter-American Development Bank. By Acts of Congress approved August 6, 1959 (Public Law 86-137), August 7, 1959 (Public Law 86-147), and September 16, 1959 (Public Law 86-278), paragraph "Seventh" of Section 5136 of the Revised Statutes of the United States was amended so as to permit national banks to deal in or to underwrite obligations issued by the Tennessee Valley Authority or by the Inter-American Development Bank. Such transactions remain subject to the limitation of 10 per cent of the national bank's capital and surplus. Subject, of course, to any applicable provision of State law, the permission also extends to all State member banks of the Federal Reserve System, as Section 9 of the Federal Reserve Act makes this paragraph of Section 5136 applicable to State member banks.

Federal Reserve Banks as fiscal agents for Inter-American Development Bank. The Act of Congress approved August 7, 1959 (Public Law 86-147) also authorized any Federal Reserve Bank to act as depository and fiscal agent for the Inter-American Development Bank.

Amendments to eliminate ambiguities and repeal obsolete provisions. The Acts of Congress approved September 8 and 9, 1959 (Public Laws 86-230 and 86-251, respectively) amended the national bank laws and certain other statutes so as to clarify or eliminate ambiguities and repeal certain laws which had become obsolete and also amended the lending and borrowing provisions applicable to national banks.

Statehood of Alaska and Hawaii. The Acts of Congress approved March 18, 1959, and June 25, 1959 (Public Laws 86-3 and 86-70, respectively) made certain technical amend-

ments to the Federal Reserve Act occasioned by the admission of Alaska and Hawaii to Statehood.

Bank Holding Company Act. The Board is required by Section 5(d) of the Bank Holding Company Act of 1956 to include in its annual report to Congress any recommendations for changes in that Act which, in the opinion of the Board, would be desirable. In a special report submitted to Congress on May 7, 1958, the Board recommended a number of amendments to the Bank Holding Company Act which would tend to clarify ambiguities in the law and facilitate its administration. The Board continues to urge favorable consideration of those amendments.

LITIGATION AND HEARINGS

On August 1, 1958, a suit for declaratory judgment was filed against the Members of the Board of Governors of the Federal Reserve System by Old Kent Bank and Trust Company, Grand Rapids, Michigan, in the United States District Court for the District of Columbia, challenging, among other things, the statutory authority of the Board to approve or disapprove the operation of branches acquired by a State member bank as a result of a merger and the authority of the Board to consider competitive effects in passing upon the operation of such branches. On April 22, 1959, the District Court granted a motion for summary judgment in favor of the Board and denied a cross-motion for summary judgment filed by plaintiff. On April 30, an order to this effect was signed and filed. The case is now pending in the United States Court of Appeals for the District of Columbia.

On January 7, 1959, a suit raising substantially the same question was filed by Wachovia Bank and Trust Company, Winston-Salem, North Carolina, and the parties have stipulated that the answer of the Board of Governors need not be filed until final disposition of the Kent Bank case.

On September 18, 1959, a petition was filed in the United States Court of Appeals for the Eighth Circuit to review an order of the Board of Governors denying an application of First Bank Stock Corporation under Section 4(c)(6) of the

Bank Holding Company Act of 1956. The time within which the Department of Justice may file its brief on behalf of the Board has been extended to March 8, 1960.

Following a hearing held in connection with an administrative proceeding regarding capital adequacy instituted by the Board with respect to The Continental Bank and Trust Company, Salt Lake City, Utah, the trial examiner on March 16, 1959, submitted his Report and Recommended Decision in which he recommended that the proceeding be dismissed. Oral argument was presented to the Board on July 22, 1959; and the matter is now pending before the Board for its determination.

RESERVE BANK OPERATIONS

Loan guarantees for defense production. Incident to the Defense Production Act of 1950, the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, the General Services Administration, the National Aeronautics and Space Administration, and the Atomic Energy Commission are authorized to guarantee loans made by commercial banks and other private financing institutions in connection with defense contracts. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies under Regulation V.

During 1959 the guaranteeing agencies authorized the issuance of 20 guarantee agreements covering loans amounting to $84 million. On December 31, 1959, guarantee agreements in force authorized credit totaling $438 million, of which $340 million represented actual loans outstanding and $98 million represented additional credit available to borrowers. Of the total loans outstanding, 75 per cent on the average was guaranteed. During the year approximately $1,147 million was advanced on V loans, most of which are revolving credits.

Authority for the V-loan program, unless further extended, will terminate on June 30, 1960.

Volume of operations. Table 5 on page 113 shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1955-59. Volume was larger in 1959 than in 1958 in all activities except postal money orders,

which continued a downward trend. The number of discounts and advances increased sharply over 1958, but the amount involved was somewhat lower than in 1957, a peak year. Upward trends continued in coin, checks (other than Government and postal money orders), and transfers of funds. The amount of currency received and counted was the largest ever recorded.

Earnings and expenses. Current earnings, current expenses, and the distribution of net earnings of each Federal Reserve Bank during 1959 are shown in detail in Table 6 on pages 114-15, and a condensed historical statement is shown in Table 7 on pages 116-17. The table below summarizes the earnings and expenses and the distribution of net earnings for 1959 and 1958.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1959 AND 1958

[In thousands of dollars]

Item	1959	1958
Current earnings	886,226	742,068
Current expenses	144,703	137,722
Current net earnings	741,523	604,346
Net additions to current net earnings[1]	98,248	124
Net earnings before payments to U.S. Treasury	839,771	604,470
Dividends paid	22,722	21,197
Paid U.S. Treasury (interest on F. R. notes)	910,650	524,059
Transferred to surplus	−93,601	59,214

[1] Includes net profits on sales of U.S. Government securities of $190,000 in 1959 and $157,000 in 1958; and, in 1959, $98 million transferred from reserves for contingencies.

Current earnings of $886 million in 1959 were 19 per cent more than in 1958, largely because of an increase of $123 million in earnings on U.S. Government securities. The increase in the earnings on such securities reflected the combined effect of increases in average yields and average holdings, as is shown in the table on page 99. A growth of $21 million in earnings from discounts and advances reflected higher discount rates and larger holdings. Current expenses of $145

million were about 5 per cent more than in 1958. Current net earnings amounted to $742 million, an increase of 23 per cent from 1958.

After allowing for net additions of $98 million to current net earnings, resulting almost entirely from the discontinuance of certain reserves for contingencies, net earnings before dividends and before payments to the U.S. Treasury amounted to $840 million.

Statutory dividends to member banks amounted to $23 million, about $2 million more than in 1958. This expansion reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital of the Federal Reserve Banks.

Payments to the U.S. Treasury as interest on Federal Reserve notes amounted to $911 million in 1959. These payments consisted of (a) all net earnings ($815 million) after the dividends of $23 million and after provision of $2 million for raising surplus to the level of subscribed capital at the two Banks where surplus was below that amount, and (b) the amount (totaling $96 million) by which the surplus at the other 10 Banks exceeded subscribed capital.

The 1959 payments to the Treasury reflect a conclusion reached by the Board, after consultation with the Federal Reserve Banks, that the maintenance of surplus at the level of subscribed capital (which is twice paid-in capital) would be appropriate in the light of present circumstances. The surplus accounts of the Federal Reserve Banks had been building up over the years and at a number of Banks exceeded subscribed capital by substantial amounts. It was therefore decided to discontinue the practice followed in the years 1947-58 of adding 10 per cent of the annual net earnings of the Federal Reserve Banks to the surplus accounts, and to pay to the Treasury the amounts by which the surplus accounts exceeded the level of subscribed capital.

These decisions, along with the decision to discontinue certain reserves for contingencies, which had been set up largely out of earnings in 1948 and 1949, increased the 1959 payment to the Treasury by $266 million. Of this increase, $72 million

represented the difference between 90 and 100 per cent of net earnings, $96 million the surplus reductions, and $98 million the discontinued reserves for contingencies. The amounts resulting from the surplus reductions and from the discontinued contingency reserves are nonrecurring items. The decision to pay to the Treasury all net earnings after dividends and surplus allowances, rather than 90 per cent of such earnings, will have a continuing effect on the Treasury's income, although the amount will depend upon the financial experience of the Reserve Banks.

The practice of paying part of the earnings of the Federal Reserve Banks to the Treasury had its origin in the original Federal Reserve Act. The extent of the payments, however, has changed from time to time during the intervening years.

Prior to 1933 the Federal Reserve Act included a provision under which each Federal Reserve Bank was required to pay a franchise tax to the Government equal to 90 per cent of its net earnings after it had accumulated a surplus equal to its subscribed capital. The Banking Act of 1933 required each Federal Reserve Bank to pay an amount equal to one-half of its surplus on January 1, 1933, for capital stock of the Federal Deposit Insurance Corporation. These payments amounted to $139 million and reduced the surplus of the Federal Reserve Banks to an equivalent figure, which was considerably less than one-half of their subscribed capital at that time. Congress, therefore, eliminated the franchise tax in order to permit the Federal Reserve Banks to rebuild their surplus accounts from future earnings.

By the end of 1946 the surplus of each Federal Reserve Bank was at least equal to its subscribed capital and their combined surplus totaled $440 million. Under those circumstances the Board concluded that it would be appropriate to accomplish the purpose of the earlier franchise tax by establishing such rates of interest on outstanding Federal Reserve notes not covered by gold certificate collateral as would make it possible to transmit to the Treasury approximately 90 per cent of the net earnings of each Federal Reserve Bank after dividends and after such provisions as might be necessary to

bring surplus up to subscribed capital. This procedure began in 1947 and continued through 1958.

Holdings of loans and securities. Average daily holdings of loans and securities, excluding industrial loans, amounted to $27,036 million during 1959, $2,053 million more than during 1958. Holdings of discounts and advances increased $516 million, and holdings of U.S. Government securities increased $1,544 million. The average rate of interest earned on discounts and advances rose from 2.28 to 3.42 per cent, reflecting increases in the discount rate, and the average rate on Government securities rose from 2.98 to 3.27 per cent. The accompanying table shows holdings, earnings, and average interest rates on loans and securities held by the Federal Reserve Banks during the past three years.

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1957-59

[Dollar amounts in thousands]

Item and year	Total[1]	Discounts and advances	Acceptances	U.S. Government securities
Average daily holdings:[2]				
1957	$24,221,645	$850,097	$25,142	$23,346,406
1958	24,982,770	295,250	38,904	24,648,616
1959	27,035,989	810,981	32,246	26,192,762
Earnings:				
1957	763,011	26,792	848	735,371
1958	741,763	6,745	806	734,212
1959	885,831	27,728	1,075	857,028
Average rate of interest (per cent):				
1957	3.15	3.15	3.37	3.15
1958	2.97	2.28	2.07	2.98
1959	3.28	3.42	3.34	3.27

[1] Excludes industrial loans, the authority for which expired Aug. 21, 1959.
[2] Based on holdings at opening of business.

Foreign and international accounts. Gold and dollar assets held for foreign account at the Federal Reserve Banks increased $1,309 million in 1959. At the end of the year holdings amounted to $13,424 million, representing $8,032 million of earmarked gold, $4,477 million of U.S. Government secu-

rities (largely Treasury bills), $345 million in dollar deposits, $82 million of bankers' acceptances purchased through Federal Reserve Banks, and $488 million of miscellaneous assets. The latter item includes mainly dollar bonds issued by foreign countries and international institutions.

In 1959 the aggregate gold and dollar assets held for the International Bank for Reconstruction and Development, the International Finance Corporation, and the International Monetary Fund increased $2,772 million, reflecting principally the United States payment of its increased subscription ($1,375 million) to the Monetary Fund and payments by other member countries of the gold portions of their increased subscriptions.

During the year new accounts were opened for the European Investment Bank, the Italian Foreign Exchange Office, the Bank of Taiwan, and the recently organized Central Banks of Malaya and Tunisia.

As in the past several years loans secured by gold collateral were of relatively minor importance. Loans of $17.9 million outstanding at the beginning of 1959 were repaid. New arrangements, including a stand-by commitment, amounted to a total of $41.1 million, of which $5 million was outstanding at the end of the year. Loans on gold are ordinarily made to foreign monetary authorities to help them meet dollar requirements of a clearly temporary nature.

The Federal Reserve Bank of New York, as depositary and fiscal agent, continued to perform various services for the international institutions mentioned above. As fiscal agent of the United States, the Bank continued to operate the United States Exchange Stabilization Fund pursuant to authorization and instructions of the Treasury Department. Also on behalf of the Treasury Department it continued the administration of foreign assets control regulations pertaining to assets in the United States of, and transactions with, Communist China and North Korea and their nationals.

Bank premises. During the year the Board authorized the construction of an addition to, and alteration of, the Federal Reserve Bank building in Atlanta.

With the approval of the Board, property adjoining the Federal Reserve Branch in Pittsburgh was acquired to avoid street parking of armored trucks awaiting entrance to the building.

BOARD OF GOVERNORS—INCOME AND EXPENSES

The accounts of the Board for the year 1959 were audited by the public accounting firm of Price Waterhouse & Co., whose certificate follows:

To the Board of Governors of the
Federal Reserve System

In our opinion the accompanying financial statements present fairly the assets, liabilities and fund balances of the operating fund and the property and equipment fund of the Board of Governors of the Federal Reserve System as at December 31, 1959, and the related assessments and expenditures for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of the financial statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary.

Price Waterhouse & Co.

Washington, D.C.,
February 4, 1960.

Assets, Liabilities and Fund Balances—December 31, 1959

Assets

Cash, exclusive of $177,845 representing withheld taxes		$ 824,969
Miscellaneous receivables and travel advances		20,394
Stockroom and cafeteria inventories, at cost		20,239
Total assets of operating fund		865,602
Property and equipment, at cost:		
Land and improvements		792,852
Building		3,940,050
Furniture and equipment		606,719
Total assets of property and equipment fund		5,339,621
Total assets		$6,205,223

Liabilities and Fund Balances

Accounts payable and accrued expense		$ 269,691
Fund balances:		
Operating fund—		
Balance December 31, 1958	$ 328,356	
Excess of assessments over expenditures for the year	267,555	595,911
Property and equipment fund—		
Balance December 31, 1958	5,233,320	
Expenditures for additions	139,430	
Excess of cost of assets disposed of over trade-in allowances	(33,129)	5,339,621
Total liabilities and fund balances		$6,205,223

Assessments and Expenditures
Year Ended December 31, 1959

Assessments levied on Federal Reserve Banks:		
For Board expenses and additions to property and equipment		$ 6,470,600
For expenditures made on behalf of the Federal Reserve Banks		4,943,223
Total assessments		$11,413,823
Expenditures:		
For printing, issue and redemption of Federal Reserve Notes, paid on behalf of the Federal Reserve Banks		$ 4,943,223
For expenses of the Board:		
Salaries	$4,045,223	
Retirement and insurance contributions	539,927	
Traveling expenses	274,627	
Professional and contractual services:		
Economic surveys	281,244	
Legal, consultant and audit fees	92,573	
Other	30,770	
Printing and binding	250,083	
Telephone and telegraph	90,626	
Postage and expressage	78,180	
Equipment and other rentals	142,200	
Operation of cafeteria, net	52,656	
Heat, light and power	52,064	
Stationery and office and other supplies	54,094	
Repairs, maintenance and alterations	30,541	
Books and subscriptions	19,708	
Insurance	4,866	
Miscellaneous, net	24,233	6,063,615
For property and equipment		139,430
Total expenditures		$11,146,268
Excess of assessments over expenditures for the year		$ 267,555

The Board's expenses for 1959 include the following special items: (1) an expenditure of $45,468 incurred in connection with the continuation of the Small Business Financing Study initiated in 1957; (2) an expenditure of $129,745 for Quarterly Consumer Buying Intentions Surveys; and (3) an expenditure of $87,905 incident to Civil and Defense Mobilization.