

FORTY-SECOND

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1955

parts of the economy. Continuation of the policy of restraint on credit expansion seemed to be called for, with the understanding that doubts should be resolved on the side of dispelling any idea of an easing of System policy at this time. In renewing the existing directive to restrain inflationary developments in the interest of sustainable economic growth, the Committee did so with the understanding that pressure on the money market should not be increased drastically.

November 16, 1955

1. Authority to Effect Transactions in System Account.

The Committee approved another renewal of its directive to the Federal Reserve Bank of New York in the form that had been approved at several recent meetings providing that transactions for the System open market account be conducted 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, Earhart, Fulton, Irons, Leach, Mills, Robertson, Shepardson, Szymczak, and Vardaman. Votes against this action: none.

Analysis of the situation at the time of this meeting in mid-November showed that businessmen and consumers had thrown off doubts about economic prospects that had been created by the President's illness. Consumer spending and borrowing continued extremely high. Plans for business spending for plant and equipment during 1956 were being announced in substantially higher volumes than for 1955. Production was approaching or had reached capacity levels in more and more industries, and the labor market was showing further tightening. Markets for industrial commodities were very strong, manufacturers' unfilled orders were continuing to rise, and industrial price rises were spreading.

These factors suggested the need for additional restraint but, at the same time, the Committee noted that normal seasonal developments would require additional reserves to assist banks in supplying essential credit needs between mid-November and the year-end. The Committee was also aware that the Treasury would be in the market to refund \$12 billion of maturing securities toward the end of November or early in December and that it probably would have to borrow around a billion dollars of new money by the middle of December. In addition, the Committee noted that consideration was currently being given to a further increase to 2½ per cent in the discount rates of the Federal Reserve Banks, which had been increased to 2¼ per cent in August and September. In considering these several factors, the Committee agreed that, while the Federal Reserve should operate to restrain

excesses, it should avoid undue pressure on the supply of reserves through more restrictive open market operations at a time when the Treasury was getting ready to announce its financing and during a period in which the money market and banks might be adjusting to an increase in the discount rate. Under these circumstances, the Committee renewed the existing directive with the understanding that, while it was trying to move in the direction of maintaining tightness, it should not be concerned if operations in the open market during the immediate future did not achieve as great a degree of tightness as had existed recently.

November 30, 1955

1. 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, on a when-issued basis, up to \$400 million of 2⅞ per cent Treasury certificates of indebtedness to be dated December 1, 1955, maturing December 1, 1956.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Balderston, Earhart, Fulton, Irons, Leach, Shepardson, and Szymczak. Votes against this action: Messrs. Mills, Robertson, and Vardaman.

This meeting, which was held through telephone conference arrangement, was called for the purpose of considering what, if any, action the Committee should take in view of developments in the market which suggested that the current Treasury offering of approximately \$12 billion of refunding securities might be subject to unusually large requests for cash redemption. The Treasury offering had been announced on November 25 and books were open on Monday, Tuesday, and Wednesday, November 28, 29, and 30, 1955. The response to the announcement of the terms of the offering indicated that the market regarded the new issue as being properly priced. Shortly after the opening of the books, however, it became apparent that a large proportion of holders of the maturing issue had earmarked the proceeds of this maturity for other uses. This indicated that the volume of cash redemptions would be considerably larger than had been generally anticipated. Moreover, unexpectedly stringent money market conditions had developed during the latter part of November. Apparently this was in part a delayed response to an increase in mid-November to 2½ per cent in the discount rates of all Federal Reserve Banks.

In considering this situation, the Committee noted that on the basis of earlier projections of reserve needs to meet seasonal and other demands, it would probably find it necessary in any event to put into the market upwards of \$400 million of reserves within the next week. Further, addi-

tional reserves would have to be supplied to the market later during December to assist in meeting the seasonal increase in currency demand for holiday and other year-end needs.

The situation was considered in the light of the policy adopted by the Committee in March 1953 and last reaffirmed in March 1955, that, during a period of Treasury financing, the Committee would refrain from purchasing (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturity to those being offered for exchange; such policy to be followed until such time as it might be superseded or modified by further action of the Federal Open Market Committee.

Those who voted for making an exception to the foregoing policy and authorizing the purchase on a when-issued basis of securities being offered in the current Treasury financing felt that the Committee could not ignore the position in which it had been placed by a request made by the Secretary of the Treasury for assistance directed toward preventing undue cash redemption of the maturing issue, and by the possibility of psychological deterioration of the whole securities market if the Treasury offering came to be regarded as a failure. They noted that the Treasury had tried to price the new securities correctly in relation to the market situation. They also emphasized that, in making an exception to the general policy that had been followed since March of 1953 against purchasing securities involved in a Treasury financing, the Committee would not be abandoning that policy but rather deviating from it only because of the unforeseen circumstances that had developed in connection with the current Treasury refunding operation.

The members of the Committee who voted against this action were of the opinion that the possibility that an abnormal proportion of the maturing securities would be turned in for cash, rather than exchanged for an equivalent amount of the new issue, was an insufficient reason to deviate from the existing policy. They felt that if heavy cash redemptions developed in the refunding, the difference could be made up subsequently through the conventional means of selling additional Treasury bills or tax anticipation certificates. In their opinion, reserves that would be needed in the market to meet seasonal and other needs should be provided in the usual manner by purchases of other short-term securities, preferably Treasury bills. In short, they did not believe that the circumstances were such at that time as to warrant an exception to the general policy against purchasing Treasury securities involved in a refunding.

December 13, 1955

1. Authority to Effect Transactions in System Account.

The Committee renewed its directive to the Federal Reserve Bank of New York in the form in which it had been approved in August and since,

calling for transactions in the System open market 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, Earhart, Fulton, Irons, Leach, Mills, Robertson, Shepardson, and Szymczak. Votes against this action: none.

Economic activity in the countries of the free world generally had been at a high level and rising throughout 1955. Monetary and fiscal authorities everywhere had been faced with the problem of checking actual or potential inflationary developments. In recent months, pressures on labor and other resources had been spreading gradually, but measures of restraint had helped to limit price advances.

The rise in output within the United States recently had been less rapid than in the latter part of 1954 and the first half of 1955, reflecting in part capacity limitations in key industries and in part a leveling off in demand for new automobiles and houses. Because of seasonal influences, the number of unemployed had risen somewhat in November. Business was indicating plans for further expansion in plant and equipment during 1956, and a general feeling of optimism regarding the outlook prevailed.

It was in the light of this sustained high level of economic activity and of the generally favorable outlook that the Committee reviewed the policy of credit and monetary restraint that had been pursued during the fall months of the year. A sharp increase in pressure on the reserve position of banks had taken place during the four weeks ending November 23, but this had been followed by some easing after the System injected a substantial volume of reserve funds into the market during the last week of November and the first week of December, when market conditions were affected by a combination of seasonal reserve pressures, the increase in Reserve Bank discount rates in mid-November, and the Treasury's refunding and cash financing operations. With the passage of that difficult period, it seemed desirable to attempt to regain as far as possible the level of pressure that had existed around November 23, just prior to the announcement of the Treasury's refunding. The Committee recognized, however, that it might not be possible—or even desirable—to reestablish all of the pressure that had existed in November, partly because of the year-end needs that were developing. After considering these factors, it concluded that the general policy of restraint followed in recent months should be reaffirmed with a view to regaining, without causing sudden market disturbances, as much as possible of the level of pressure that had existed shortly before the announcement of the Treasury refunding operation near the end of November.