

THIRTY-SEVENTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1950

"The Board of Governors of the Federal Reserve System today approved an increase in the discount rate of the Federal Reserve Bank of New York from 1½ per cent to 1¾ per cent effective at the opening of business Monday, August 21.

"Within the past six weeks loans and holdings of corporate and municipal securities have expanded by 1.5 billion dollars at banks in leading cities alone. Such an expansion under present conditions is clearly excessive. In view of this development and to support the Government's decision to rely in major degree for the immediate future upon fiscal and credit measures to curb inflation, the Board of Governors of the Federal Reserve System and the Federal Open Market Committee are prepared to use all the means at their command to restrain further expansion of bank credit consistent with the policy of maintaining orderly conditions in the Government securities market.

"The Board is also prepared to request the Congress for additional authority should that prove necessary.

"Effective restraint of inflation must depend ultimately on the willingness of the American people to tax themselves adequately to meet the Government's needs on a pay-as-you-go basis. Taxation alone, however, will not do the job. Parallel and prompt restraint in the area of monetary and credit policy is essential."

SEPTEMBER 28, 1950

1. Increase in Authority to Effect Transactions in System Account.

The members of the Federal Open Market Committee on August 22, 1950, approved an increase from 2 billion dollars to 4 billion dollars in the limitation in the first paragraph of the direction issued at the meeting on August 18, 1950, within which the total amount of securities in the System account could be increased or decreased. At this meeting of the Federal Open Market Committee that action of the members of the Committee was approved, ratified, and confirmed.

Votes for this action: Messrs. McCabe, Chairman, Sproul, Vice Chairman, Davis, Eccles, Erickson, Evans, Norton, Peyton, Powell, Szymczak, Vardaman, and Young. Votes against this action: none.

Immediately following the meeting on August 18, 1950, the Treasury announced that the September 15 and October 1 refunding would be through

the medium of a 13-month 1¼ per cent note. This issue required substantial support in the market and in order to carry out its policy of maintaining orderly conditions in the Government securities market as agreed upon at the meeting of the Federal Open Market Committee on August 18, 1950, the full Committee increased the authority of the executive committee to purchase securities for the System account so that the necessary market support could be given to the new offering.

2. Authority to Effect Transactions in System Account—Further Measures to Restrain Credit Expansion.

With respect to future policy, the Committee issued the following direction to the executive committee, which was in the same form as that adopted at the meeting on August 18, 1950:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the aggregate amount of securities held in 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 4 billion dollars.

The executive committee is further directed, until otherwise directed by the Federal Open Market Committee, to arrange for the purchase for the System open market account direct from the Treasury 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; provided that the total amount of such certificates held in the account at any one time shall not exceed 1 billion dollars.

Votes for this action: Messrs. McCabe, Chairman, Sproul, Vice Chairman, Davis, Eccles, Erickson, Evans, Norton, Peyton, Powell, Szymczak, Vardaman, and Young. Votes against this action: none.

In this period, open market operations had been conducted in part for the purpose of assuring a substantial exchange of Treasury securities maturing on September 15 and October 1 for new 13-month $1\frac{1}{4}$ per cent notes. At the same time endeavors to absorb bank reserves and to restrain credit expansion had been made through the sale of other securities from the System account. In order to accomplish the latter policy, a rise in yields on short-term securities had been permitted to occur in the market.

In these operations purchases for System account included 8 billion dollars of the 13.6 billion of issues which were retired on September 15 and October 1, and these purchases, together with 2.4 billion previously held in the account, were exchanged for the new issues. Purchases by the System were made at prices designed to discourage cash redemption by the holders of the maturing issues and thus to aid in obtaining maximum exchanges for the new issue. At the same time, sales were made from the System account at relatively higher yield rates (lower prices) than were purchases of the maturing issues. The System's total holdings increased by a little over 1 billion dollars in the period, largely to replace reserves lost from an outflow of gold and an increased currency demand. Member bank reserves expanded by 300 million dollars in reflection of the over-all credit expansion. Market yields on short-term Government securities rose by about $\frac{1}{8}$ of a point.

At this meeting of the Committee, continuation of the previously adopted policy was decided upon because of the Committee's grave responsibility in the light of the continued rapid expansion of credit and the belief that a further effort should be made to restrain the selling of Government securities to the System and the resultant creation of bank reserves. This decision was based upon the continuation of dangerous inflationary elements in current and prospective economic developments, with pressures exerted by private spending and investment prior to an actual increase in Government spending. Measures that had been adopted to combat inflation, such as the increase in income taxes, limited allocations and inventory controls, consumer credit regulation, and a tightening of terms on Federal insurance and guarantee of mortgages, had not had time to become effective and prospective further measures would also require time to have an effect.

Under the circumstances, it was felt that, in order to limit the creation of additional bank reserves, the System should endeavor to hold down purchase of securities to the minimum consistent with maintenance of an orderly market. It was recognized that this policy, in the face of continued credit expansion and a resulting demand for bank reserves, would bring about a

rise in short-term interest rates. Such a rise in rates and the corresponding decline in prices of short-term Government securities would make it more costly for banks to sell Government securities to make loans and more attractive to hold them rather than shift to other assets. It would also encourage other buyers, such as corporations, to purchase short-term securities, thus relieving pressure on the Federal Reserve and avoiding an increase in bank reserves.

It was agreed that any rise in short-term interest rates should not be permitted to go to a point where market selling of long-term bonds would be encouraged, that an orderly market would be maintained, and that the timing and amount of any changes would be made with consideration to Treasury financing operations, such as the opening of Series F and G bonds to purchase by investment institutions during the first 10 days of October, November, and December.

The Committee also considered the timing of its operations with reference to possible action by the Board of Governors to increase reserve requirements of member banks. It was the consensus that money rates should be permitted to rise before, rather than along with, such an increase in order to avoid putting too much strain on the Government securities market.

OCTOBER 11, 1950

1. Authority to Effect Transactions in System Account.

The following direction to the executive committee, which was in the same form as the direction issued at the meeting on September 28, 1950, was approved:

The executive committee is directed, until otherwise directed by the Federal Open Market Committee, to arrange for such transactions for the System open market account, either in the open market or directly with the Treasury (including purchases, sales, exchanges, replacement of maturing securities, and letting maturities run off without replacement), as may be necessary, in the light of current and prospective economic conditions and the general credit situation of the country, with a view to exercising restraint upon inflationary developments, to maintaining orderly conditions in the Government security market, to relating the supply of funds in the market to the needs of commerce and business, and to the practical administration of the account; provided that the aggregate amount of securities held in the account at the close of this date other than special short-term certificates of indebtedness purchased from time to time