

THIRTY-SEVENTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1950

for undue monetary expansion and increase the likelihood of maintaining production and employment at high levels.

JUNE 13-14, 1950

1. Authority to Effect Transactions in System Account.

The following direction to the executive committee which, except for one change, was in the same form as the direction issued at the meeting on March 1, 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 changing economic conditions and the general credit situation of the country, for the practical administration of the account, for the maintenance of orderly conditions in the Government security market, and for the purpose of relating the supply of funds in the market to the needs of commerce and business; 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 2 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. The direction in this paragraph will terminate on June 30, 1950, unless the authority of the Federal Reserve Banks to purchase securities directly from the Treasury is extended by the Congress.

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

The only change was the addition of a sentence at the end of the second paragraph of the direction to provide for the termination on June 30, 1950,

of the authorization for action covered by the paragraph in the event the authority to make direct advances to the Treasury was allowed by Congress to terminate on June 30. (This authority was subsequently extended until July 1, 1952, by an Act of Congress approved June 30, 1950.)

The intent of this direction and of actions expected to be taken under it was to continue the general line of previously adopted policies and to adapt them to the developing economic situation.

In the weeks immediately before this meeting, Treasury refunding of June 1 and July 1 maturities with offerings of 13-month notes at 1¼ per cent required substantial Federal Reserve purchases of the maturing issues in order to assure a satisfactory exchange. The Committee felt that the developing economic situation with strong demands for housing and durable goods, growing capital expenditures, expanding credit, and rising prices presented dangers of imbalance in the economy and called for a credit policy that would try to restrain a too-rapid increase. It was felt that as one means of carrying out this policy, after the Treasury's July 1 financing was completed, the System should revise its recent policy of purchasing short-term securities. It was believed that substantial changes in interest rates were unnecessary, as well as impracticable, in the prevailing situation, but that the System's policies should be directed toward restricting increases in bank reserves in a timely and flexible, though modest, manner. The Committee felt that an increase in Federal Reserve Bank discount rates might be considered as an appropriate part of this program, particularly as an indication of Federal Reserve views as to the need for restraint in the developing situation. It was also expected as a part of the program that, in the absence of a long-term Treasury offering or a change in the business and credit situation, Federal Reserve sales of long-term bonds in response to market demands would be continued.

AUGUST 18, 1950

1. Authority to Effect Transactions in System Account.

The following direction to the executive committee, which, except for the changes noted below, was in the same form as the direction issued at the meeting on June 13-14, 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 for the temporary accommodation of the Treasury shall not be increased or decreased by more than 2 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, Draper, Eccles, Erickson, Evans, Peyton, Szymczak, Vardaman, and Young. Votes against this action: none.

The direction was changed from that approved at the meeting on June 13-14, 1950, to provide that in the light of current and prospective economic conditions and the general credit situation of the country, open market operations should be carried on with a view to exercising restraint upon inflationary developments, as well as for the other purposes stated in the previous direction. Also, the last sentence of the second paragraph of the direction approved on June 13-14, which provided for termination of the authority on June 30, 1950, was deleted since the authority for the System to purchase securities direct from the Treasury has been extended until July 1, 1952, by Act of Congress approved June 30, 1950.

This meeting of the Committee was called to consider Federal Reserve policies that might be needed in view of the drastic change in economic developments and prospects resulting from the sudden outbreak of war in Korea and this country's participation in international efforts to deal with it. Because of this sudden development, some of the actions decided upon at the meeting of the Committee on June 13-14 had been held in abeyance.

Injection of prospective large increases of Government expenditures into an economy that was already close to capacity output and was showing signs of price inflation seemed to the Committee to call for more vigorous policies of credit restraint than had been contemplated. There were evidences of substantial increases in individual and business expenditures for consumer goods, housing, inventories, and other capital purposes, and that further expansion was to be expected. Credit extensions by banks and others had increased to excessive amounts, and commodity prices were rising sharply.

It was felt by the Committee that immediate action to restrain credit expansion should be taken as an essential part of the broad anti-inflationary program of the Government. The immediate problem, the Committee believed, was to curtail over-all civilian spending and to restrain speculative commitments in order to curb the development of an inflationary spiral. Assurance of an increasing demand for goods and services by the Government and of rising incomes, the prospect of possible shortages in some lines, and the recent memories of wartime shortages and of postwar price rises, as well as the abundance of readily available funds, were all conducive to increased spending and investment to a point beyond the productive capacity of the economy. This would cause advancing prices and costs with the danger of an inflationary spiral.

It was the conclusion of the Committee that the prevention of inflation was a matter of critical importance and urgency. Spending and speculative ventures could be readily financed either by liquidating some of the existing large holdings of liquid assets or by borrowing from banks and other lending institutions. Sales of Government securities to the Federal Reserve could be an important source of funds for these purposes. Under the circumstances, the Committee felt that a broad-scale and firmly administered program of credit restraints was needed immediately and that in the longer run further credit restrictions would have to be an essential part of a broad program of economic policy that should be adopted by the Government. The Committee was of the view that without a broad program covering fiscal and other areas, credit restrictions alone would be inadequate and that, on the other hand, other measures could not succeed without appropriate credit restraints.

The objectives of economic policy would be (1) to assure that the military program would obtain the goods and manpower needed to accomplish the task assumed; (2) to finance the increased Government expenditures in a way which would avoid or diminish the possibilities of inflation both during and after the emergency; (3) to curtail or restrain private spending and investing, as well as nonmilitary expenditures of Federal, State, and local

governments, to the extent necessary not only to assure essential supplies to the military but also to reduce the current and future possibilities of inflation; and (4) to do these things in such ways as would interfere, as little as possible, with increased production and increased productivity.

This program would need to include appropriate fiscal and debt-management policies and measures to control the supplies and uses of essential resources in limited supply, as well as credit restraints. Such measures would be needed to restrict buying, check price rises, and provide a firm basis for confidence in the maintenance of the value of the dollar. Such a program, it was believed, would help to reduce the need for direct measures on a broad scale to fix prices and wages and to allocate goods, which would impair the operation of the price system as a guide to and regulator of consumption and production.

The required program in areas of credit, fiscal, and debt-management policies, the Committee believed, should include the following measures: (1) Taxes should be increased and Government expenditures reduced so as to keep the Government's budget in balance and to restrict demand for scarce goods. (2) Treasury borrowing, both for refunding and for any new funds needed, should be as much as possible from savings and as little as possible from banks. This would require maximum issuance of securities that would attract funds of nonbank investors who would hold them after, as well as during, the emergency period; minimum offerings of securities that would be purchased largely by banks; and maintenance of a balanced distribution of bank eligible issues so as to avoid excessive liquidity at banks. (3) Selective regulation of credit terms should be imposed in appropriate areas, particularly consumer instalment credit and real estate credit, and more restrictive measures should be applied as needed to stock market credit. (4) Bank reserve requirements should be increased at appropriate times. (5) Federal Reserve Bank discount rates should be raised. (6) Open market policies should be made more flexible so as to limit sales of Government securities by banks and others to the Federal Reserve for the purpose of expanding other types of credit.

Since the statutory responsibility of the Federal Open Market Committee provides that the time, character, and volume of open market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country, the Committee took into consideration current and prospective credit developments in reaching a conclusion as to its own immediate policies. Since midyear, bank loans to businesses, home owners, and consumers had been

expanding at an excessive rate, and it was evident that the increased use of credit was contributing to the rise in commodity prices. This expansion was made possible chiefly by sales of short-term Government securities to the Federal Reserve, which was providing relatively rigid support to the Government securities market at the low level of rates required for the success of periodic Treasury refunding offerings. Thus, Federal Reserve operations were supplying banks with cheap funds for credit expansion that was excessive in amount. The Committee reached the conclusion, therefore, that the situation called for the immediate adoption of a more flexible policy in order to restrain credit expansion to the extent possible within the powers of the Federal Reserve System and consistent with the maintenance of an orderly market for Government securities.

Accordingly, in issuing the above direction, the Committee had in mind that open market operations should be conducted primarily with the view to restraining further increases in bank reserves. At the same time, they should, to the extent necessary, carry out the existing policy of maintaining an orderly market for Government securities. It was recognized that the endeavor to prevent additions to bank reserves in the face of growing demands for bank loans would result in higher short-term rates in the money market. The higher rates would not only be an inevitable result of more restrained buying by the Federal Reserve but would also help to discourage sales and encourage holding and buying of short-term securities by banks and others. It was also felt that under the circumstances active selling of long-term bonds by the Federal Reserve should probably be discontinued, as the higher short-term rates might have the effect of reducing somewhat the demand for long-term securities, which had been stimulated by the wide spread between short-term and long-term rates. Also, other demands for funds might lessen investor buying of such securities, although a substantial demand from pension funds and other investor groups might continue.

On the same day the Board of Governors of the Federal Reserve System approved the action of the Board of Directors of the Federal Reserve Bank of New York to raise its rediscount rate. The New York Bank had acted to increase this rate on July 21 and again on July 27 and August 3, but approval of the increase was deferred by the Board of Governors pending further discussions of System monetary and credit policy and Treasury financing policies. Immediately after the meeting of the Committee, the following statement for publication was issued jointly by the Board of Governors and the Federal Open Market Committee in explanation of the decisions that had been reached:

"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.