

THIRTY-EIGHTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1951

at the same time, to minimize monetization of the public debt. That announcement was accompanied by an announcement by the Treasury of a conversion issue to be offered in late March and early April in the form of a new type of nonmarketable security available on an exchange basis only to holders of outstanding bank-restricted marketable bonds callable in 1967. The detailed features of the Treasury-Federal Reserve agreement had not been announced, but it was generally understood to mean the start of a new phase in postwar open market policy with greater flexibility in the market.

Although the Federal Reserve withdrew immediately from the market for bank-eligible Treasury obligations following the March 4 announcement referred to above, it continued to purchase long-term restricted 2½ per cent Treasury bonds in large volume with a view to facilitating the Treasury exchange offering. At the outset such purchases of restricted bonds were at fixed support prices but after a few days System purchases were reduced and prices of these bonds adjusted downward rapidly. During this period, longer term Treasury bonds were offered in the market by insurance companies and other investors who wished to shift out of Government securities for various reasons, including the need to obtain funds to meet other commitments for loans or investments, the necessity of pursuing a more prudent investment policy on the part of investors who had been getting a long-term rate on short-term funds, and the desire to get into cash or short-term Treasury obligations temporarily in the hope that the funds could be placed later in long-term Treasury bonds on a more favorable basis.

The conversion offering was generally well accepted by investors and 13.5 billion dollars of the 2½ per cent Treasury bonds callable in 1967 were exchanged for the new 2¾ per cent nonmarketable bonds of 1975-80, including purchases by Treasury accounts and the System Open Market Account of 5.6 billion dollars. Although fixed support for long-term Treasury bonds was abandoned following the close of the books on the conversion offering on April 6, 1951, and there were further declines in prices, the bulk of the bonds that had been overhanging the market was removed by the conversion operation and by Treasury and Federal Reserve purchases, and subsequent Federal Reserve purchases of long-term Government securities were reduced to amounts needed for maintaining orderly market conditions.

System purchases of short-term securities had been discontinued after March and thereafter the System was able to sell short-term securities in the market and to redeem maturing bills without replacement. The short-term market had thus operated without Federal Reserve support.

The foregoing direction was adopted in the light of the transition from a program of fixed support of Treasury securities to a period in which the market was left to react more completely to the natural forces of demand and supply, thus making it possible for the System to minimize the creation

of bank reserves that had been resulting from the earlier rigid support given to long-term Treasury issues and thus to pursue an anti-inflationary policy.

OCTOBER 4, 1951

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 May 17, 1951, 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. Martin, Chairman, Sproul, Vice Chairman, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, and Williams. Votes against this action: none.

At the time of this meeting the economic climate was markedly different from that existing when the Treasury-Federal Reserve accord was announced on March 4, 1951. In March, inflationary pressures were strong and it was anticipated that unless effective anti-inflation measures were taken such pressures would grow as the defense program took an increasing proportion of

the available materials and labor. As it turned out, the reduced availability of credit caused considerable tightness in money markets during the intervening months, consumer and defense buying was not as large as had been anticipated, and prices had not increased as had been feared. Sensitive commodity prices declined markedly, wholesale prices leveled off and later declined somewhat, and retail consumer prices showed a less rapid advance than previously. These developments were accompanied by (a) a change in the attitude of nonbank investors toward Government bonds and re-establishment of a normally functioning bond market and (b) a decline in Federal Reserve operations in Government securities, together with increased resort to borrowing by banks to make necessary reserve adjustments. Developments in both these areas indicated that the credit policies followed between March and October had made an effective anti-inflationary contribution.

Since the meeting of the Federal Open Market Committee on May 17, 1951, public debt operations had exercised a primary influence on the Government securities market, over 18 billion dollars of maturing notes and bonds had been refunded in four financing operations, and 2 billion dollars of new money had been raised by means of increases in the weekly Treasury bill offerings. The Federal Reserve continued to purchase restricted Treasury bonds in May and June but in greatly reduced amounts from preceding months, and subsequently there were no Federal Reserve purchases of such bonds. Further moderate sales by insurance companies and others were absorbed by small purchases by pension funds and by other nonbank investor groups, but the amount of shifts in securities was greatly reduced from that of the first few months of the year.

Federal Reserve purchases of short-term securities also were sharply reduced during this period. Although the System bought substantial amounts of maturing Treasury issues in June to aid in the Treasury refunding, these additions approximately counterbalanced reductions in the System's holdings in April and May. Subsequent to June, Federal Reserve operations in the short-term market, as in the long-term market, were negligible until September when again substantial purchases were made to aid Treasury refunding.

With Federal Reserve purchases of both short-term and long-term Government securities reduced to amounts needed at times to aid Treasury refunding operations plus occasional small amounts for orderly market purchases, which purchases were largely offset by sales or redemptions at other times, monetization of the public debt and the resulting creation of bank reserves was minimized. At the same time Treasury refunding operations were successfully accomplished and the Treasury was able to meet its new money needs by borrowing in the short-term market.

Important anti-inflation effects of the policies pursued since the Treasury-Federal Reserve accord early in March included a firming of the mortgage market which helped curtail inflationary financing of home construction and injected an important element of caution in the market for securities of corporations and of State and local governments. Higher returns on securities and improved confidence in the value of the dollar were reflected in increased savings by individuals. The discontinuance of widespread selling of Government bonds and consequent reductions in their purchase by the Federal Reserve meant that additional reserves were not being made freely available to banks for use in expanding bank credit. On occasion member banks had to borrow to obtain reserves, there having been some pressure in this direction because of increased currency demands, as well as because of temporary variations in other factors affecting reserves. The reduced availability of reserves and the necessity for borrowing at the Federal Reserve resulted in placing banks under restraint as to further credit expansion, and growth in bank credit extended to private borrowers during this period was smaller than in the corresponding period of any postwar year excepting 1949. Commercial bank loans in the four months, May-August, increased only about $\frac{3}{4}$ of a billion dollars compared with 3.1 billion in the comparable period of 1950 and 2.1 billion in the first four months of 1951.

The foregoing direction, which was in the same form and with the same limitations as that approved in May, was adopted with a view to the pursuit of a neutral policy by the System, which would permit market forces of demand and supply to operate with a minimum of Federal Reserve intervention. In the light of the reduced inflationary pressures of recent months and the prospect that developments during the remainder of the year might call for some expansion in credit to meet seasonal business demands, a seasonal increase in currency in circulation, and substantial borrowing needs on the part of the Treasury, a more restrictive policy seemed unnecessary. It was felt, however, that necessary credit demands should be met without making funds so easy that private borrowing and lending beyond minimum requirements would be stimulated. Thus, the System would be in a position to move again against inflation should such action prove necessary, or to respond to stem undue downward adjustment should that develop.

2. Repurchase Agreements.

At this meeting the Committee authorized each Federal Reserve Bank to enter into repurchase agreements with nonbank dealers in United States Government securities who are qualified to transact business with the System open market account, with the understanding that such agreements should cover only short-term Treasury obligations, be for periods of 15 days or less, be made at rates close to the average issuing rate on the most recent

issue of 3-month Treasury bills, and be for the purpose of aiding temporary money market adjustments.

Votes for this action: Messrs. Martin, Chairman, Sproul, Vice Chairman, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, and Williams. Votes against this action: none.

This authority had been granted to the Federal Reserve Banks prior to this date, but it had been used relatively infrequently and had not been regarded as a matter of important policy. It appeared, however, that the use of repurchase agreements was becoming increasingly important as one of the mechanisms available to the System in executing open market policy and that the authority within the limits set forth above should be available to each Federal Reserve Bank so that it could be used in the interest of orderly conditions in the Government securities market. It was considered that such authority would enable dealers to absorb as much of the buying and selling in the market as possible and to carry the necessary inventory of securities to provide a market, leaving the System as only a residual buyer.

NOVEMBER 14, 1951

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 October 4, 1951, 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. Martin, Chairman, Sproul, Vice Chairman, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, Vardaman, and Williams. Votes against this action: none.

There had been no basic change in the underlying conditions with respect to inflationary pressures or money rates since the meeting on October 4. The System had reduced its holdings of short-term securities by approximately the additional amounts acquired in September in aiding Treasury re-funding. The above direction was adopted in the same form and with the same limitations as the earlier direction since it was felt that no change in existing objectives of credit policy was needed. It was agreed that in maintaining orderly market conditions the System would permit prices of securities to reflect market forces so long as the market was an orderly one.