

THIRTY-SEVENTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR
THE YEAR

1950

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

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.

The purpose of this meeting was to consider further the timing of actions to be taken under the general policies agreed upon at the meeting of September 28, 1950. Appraisal of economic developments showed that credit expansion had continued at a rapid rate and that although there were some signs or prospects of moderate abatement of inflationary pressures which might be detected in certain fields, the underlying forces in the economy were still strongly inflationary and would be accelerated by increasing Government expenditures as the rearmament program began to bring its huge demands upon the economy, unless stern fiscal policies such as had been advocated and further credit restraints were adopted.

In the light of these prospects, in accordance with the need for restrictive credit measures to support the Government's anti-inflation program, and in view of the statutory responsibilities of the Federal Open Market Committee, it was decided to proceed with policies decided upon. Accordingly, the direction quoted above was identical with that issued on September 28, 1950.

OCTOBER 30, 1950

1. Extension of Policy for Restraining Inflationary Credit Expansion.

At this meeting, the Federal Open Market Committee gave consideration to further extension of the policy determined at previous meetings for restraining inflationary credit expansion. It was agreed that continued flexibility in the short-term money market was essential to carrying out effective credit policy, but that operations under this policy must be carried out in a manner that would not induce holders of long-term bonds to sell securities and thus necessitate Federal Reserve purchases to maintain an orderly market,

which would interfere with the System policy of credit restraint, the main purpose of which was to avoid putting funds into the market. For this reason, it was felt, yields on short-term issues should not be permitted to rise above a point which, under existing conditions, might be considered as endangering the 2½ per cent rate on outstanding issues of long-term restricted bonds. At this meeting it appeared from current market developments that this point might have been reached, at least temporarily. Accordingly, it was agreed that for the present, pursuant to the policy adopted at the meeting of the Committee on October 11, 1950, the rate on short-term issues should not be permitted to rise further, but that if further inflationary or market forces should develop which would make it necessary to reconsider this decision, another meeting of the Committee would be held. No change was made in the form or limitations in the authorization to effect transactions in the System account which was approved on October 11, 1950.

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

NOVEMBER 27, 1950

1. Authority to Effect Transactions in System Account.

Consideration was given at this meeting to continuation of the general line of policy previously adopted, and the Committee approved the following direction to the executive committee, which was in the same form as the direction issued at the meeting on October 11, 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