THIRTY-EIGHTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1951

further expansion of bank credit consistent with the maintenance of orderly conditions in the Government securities market.

MARCH 1-2, 1951

1. Treasury-Federal Reserve Accord.

At this meeting the Committee voted to approve a statement to be released by the Secretary of the Treasury and the Chairman of the Board of Governors and of the Federal Open Market Committee of the Federal Reserve System on March 4, 1951 reading as follows:

> The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt.

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

Since the meeting of the Committee on February 6-8, 1951, there had been intensive discussions with representatives of the Treasury on System credit and Treasury debt management policies. These discussions continued during this meeting of the Committee and resulted in agreement on the program referred to in the above press statement.

The fundamental problem which both the Treasury and the Federal Reserve faced in the postwar period developed out of the serious issue created by the existence of a huge public debt in a period of growing private demands for goods and services. Liquidation of Government securities on the part of holders was an important source of funds for current spending and for credit expansion. In order to give some assurance to investors that their securities would not be subject to severe declines in prices and to encourage the holding of such securities and to aid Treasury refunding operations, the Federal Reserve had been following a policy of supporting the market for Government securities. In view of the recurrent heavy demands for funds during the period, these purchases had the effect of monetizing substantial amounts of Government securities, creating bank reserves, and laying the basis for excessive credit expansion.

Both the Federal Reserve and the Treasury recognized the dilemma presented by the conflicting problems of debt management and credit restraint in the inflationary situation which developed. Various measures were adopted through credit, fiscal, and debt management policies in an endeavor to restrict credit and monetary expansion, to retire debt, especially that held by banks, and to attract the investment of savings into Government securities, while at the same time maintaining stability in the Government securities market. In general, the Treasury and the Federal Reserve were in agreement as to the main objectives, i.e., the maintenance of a broad and healthy market for Treasury securities, and restraint of further inflationary expansion of bank credit.

The interrelated problems of exercising credit and monetary restraint, of endeavoring to maintain stable markets for Government securities, and of debt management became most acute with the recurrence of inflationary pressures following the outbreak of hostilities in Korea. There developed a growing volume of sales of Government securities by holders wishing to obtain funds to extend other credits. This selling later was augmented by sales, particularly of long-term bonds, on the part of some holders influenced by uncertainties as to the future of prices of the securities and by others wishing to protect themselves against declines in the purchasing power of money resulting from rising commodity prices. Large-scale purchases of securities by the Federal Reserve to maintain a stable market resulted in monetization of the public debt and creation of bank reserves, which in turn helped to finance the inflation. Confidence in Government securities, as well as in the value of the dollar, was in danger of being impaired, and this fear was augmented by public discussion of disagreement between the Treasury and the Federal Reserve. Throughout the period from August 1950 to February 1951, there were frequent consultations between Federal Reserve and Treasury officials, and on some occasions with the President, concerning the coordination of monetary and debt management policies. The policy actions taken at the meetings on January 31, 1951, and February 6-8, 1951, were adopted in the light of these discussions, precedent to working out of the accord between the Treasury and the Federal Reserve.

The Treasury and Federal Reserve felt that everything possible should be done to terminate the unwholesome situation that had developed and to coordinate the debt management responsibility of the Treasury with the Federal Reserve responsibility for restraining credit expansion. It was the immediate object of the Treasury to restore conditions in the market that would be favorable to refinancing the large volume of maturing obligations, as well as financing several billions of new money required during the remainder of the year. It was the immediate object of the Federal Reserve to endeavor to curb the unprecedented inflationary loan expansion that had continued uninterruptedly since Korea by minimizing the monetization of the public debt and by making it necessary for member banks to borrow from the Federal Reserve in order to obtain additional reserves. It was agreed that there were both immediate and long-run factors which had to be taken into account in arriving at an accord, and that the purpose of the negotiation was to reach agreement upon policies that would reduce to a minimum the monetization of the public debt without creating an adverse market psychology with reference to Government securities.

First, consideration was given to the matter of long-term bonds overhanging the market and at the time being offered for sale daily in large amounts. It was agreed that a substantial portion of these bonds could be taken off the market by a Treasury offer to exchange for them a nonmarketable 2¾ per cent, 29-year bond, redeemable at the holder's option before maturity only by conversion into a 5-year marketable Treasury note. The purpose of offering this new security, as announced by the Treasury, was to encourage long-term investors to retain their holdings of Government securities, in order to minimize the monetization of the public debt through liquidation of outstanding holdings of the Treasury bonds of 1967-72.

Second, there was the problem of the long-term Government securities which private holders might try to sell on the market after the terms of the exchange offering became public. It was agreed that a limited volume of open market purchases would be made after the exchange offering was announced; and that if sales on the market were excessive, the situation would be assessed daily, the market would be kept orderly, and open market purchases, if any, would be made on a scale-down of prices.

Third, the pending task of refunding the large volume of short-term securities maturing or callable in the near future presented difficult problems both for the Treasury and for the Federal Reserve. It was agreed that the Committee, in order to minimize monetization of the debt, would immediately reduce or discontinue purchases of short-term securities and permit the short-term market to adjust to a position at which banks would depend upon borrowing at the Federal Reserve to make needed adjustments in their reserves. This contemplated a level of short-term interest rates which, in response to market forces, would fluctuate around the Federal Reserve discount rate. It was expected that during the remainder of the year the Federal Reserve discount rate, in the absence of compelling circumstances not then foreseen, would remain at 1¾ per cent and that the Federal Reserve would operate to assure a satisfactory volume of exchanges in the refunding of maturing Treasury issues.

Fourth, the raising of new funds by the Treasury to finance the defense mobilization program presented other problems. It was recognized that there were no substantial amounts of nonbank funds seeking investment, and that it would be some time before such funds would accumulate. It was agreed that more frequent conferences between the Treasury and Federal Reserve officials and staff should be held so that the Treasury and the Federal Reserve might work together more closely on a joint program of Government financing as well as in maintaining orderly markets for Government securities.

2. Authority to Execute 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 February 6-8, 1951, was approved. The change in policy described above did not require any change in the direction for the reason that the direction issued at the meeting on August 18, 1950, was changed in the light of the policy adopted at that time, to provide that 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.

> 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 3 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, Evans, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, Vardaman, and Williams. Votes against this action: *none.*

This direction was approved for the purpose of carrying into effect the credit policy agreed upon earlier at this meeting. While the form of the direction was unchanged from that issued on February 6-8, the limitation in the first paragraph was increased from 2 billion to 3 billion dollars in anticipation of the possibility of an increased volume of transactions which might be necessary over the period immediately ahead in carrying out the policy.

March 8, 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 March 1-2, 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. McCabe, Chairman, Sproul, Vice Chairman, Eccles, Evans, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, Vardaman, and Williams. Votes against this action: none.

In adopting the above direction, it was understood that the Committee would continue to carry out the policy approved at the meeting on March 1-2, 1951, but it was felt that the limitation in the first paragraph could

be reduced from 3 billion to 2 billion dollars without interfering with the execution of that policy.

May 17, 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 March 8, 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, Eccles, Evans, Gidney, Gilbert, Leedy, Norton, Powell, Szymczak, and Williams. Votes against this action: none.

The period March 8 to May 17, 1951, was one of basic readjustment to the new debt management and credit policies introduced immediately following the announcement on March 4, 1951, that the Treasury and the Federal Reserve had reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and,