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Open-market policy and operations

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from the middle of 1927 to the end of 1928

Throughout 1927 the Federal Reserve System pursued an easy money policy. In July the System held conferences with representatives of the Bank of England, the Banque de France, and the Reichsbank, at which it was pointed out that the United States was drawing large amounts of gold from Europe, that European currencies were under pressure, and that it might prove to be impossible for those countries that had recently returned to the gold standard to maintain it during the autumn months when the demand for dollars is seasonally large, unless definite efforts be made in the United States to establish and maintain easy conditions in the American money market.

On July 27, 1927 at a joint meeting of the Federal Reserve Board and the Open-market Investment Committee it was decided to recommend the adoption of lower discount rates by the Federal Reserve banks and to authorize the Open-market Investment Committee to purchase additional securities up to \$50,000,000. The most important consideration underlying the decision was that the differential between rates in New York and rates in London was not sufficient to enable London, and therefore the rest of Europe, to avoid general advances in rates during the autumn of 1927, unless the rates here were lowered, and that the consequence of higher rates in Europe would have been unfavorable to the marketing of our export products abroad, and would have endangered the maintenance of the gold standard.

Commodity prices had been declining in this country and there was a slackening of business activity. Heavy payments to this country had caused a drain on European central bank gold reserves. During the first five months of the year imports of gold into this country amounted to nearly \$200,000,000. The

prospect that this movement would increase with the fall movement of our crops to Europe made it seem more than likely that central bank rates in Europe would need to be further advanced during the autumn of 1927. The German and Austrian rates had already been advanced and other advances were expected.

After the middle of the year the inward gold movement ceased and in September gold began to be exported in considerable volume. During the six weeks subsequent to the authorization for open market purchases at the end of July the Federal Reserve System's holdings of United States Government securities increased by approximately \$100,000,000. This larger growth than had been anticipated was construed, in part, as an offset to the loss of foreign currency holdings which were taking place at the time. A part of the picture was that New York was losing funds to the interior, with the result that the New York City banks were unable to reduce their indebtedness at the Reserve Bank and that there was in consequence little easing in money rates.

Purchases of United States Government securities by the Open-market Investment Committee were continued until the middle of November after which they were discontinued, in view of the growth of speculative credit.

During the last half of November and the first half of December the System's holdings of United States obligations increased further, but independently of the System's open-market policy. The Treasury at that time issued special one-day certificates to the Federal Reserve banks to cover an over-draft which arose in connection with the refunding of the Second Liberty Loan bonds. This at one time amounted to more than \$200,000,000 and continued at around \$50,000,000 throughout most of the period. It was not retired until

December 20. In addition, the Federal Reserve banks bought \$40,000,000 of United States Government securities on resale contracts.

Federal Reserve bank holdings of United States Government securities on selected dates during the last half of 1927 are presented in the table below, which shows that between July 27 and December 28 the System acquired \$218,000,000 of United States Government securities.

UNITED STATES SECURITIES HELD BY FEDERAL RESERVE BANKS

(In millions of dollars)

Date	In System invest- ment account	Outside system investment account			Total
		Under resale agreement	1-day Treasury certificates	All other U. S. securities	
1927					
July 27	266	5	-	114	385
September 7	374	8	-	117	499
November 9	409	-	-	121	530
16	416	4	165	120	705
23	416	3	81	121	621
30	420	4	2	122	548
December 7	420	11	50	123	604
14	427	8	40	123	598
21	423	25	-	140	588
28	423	44	-	136	603

In addition, the System's holdings of purchased bills increased by \$217,000,000 and of discounted bills by \$211,000,000. These increases in the assets of the Reserve banks were in part an offset to a loss of gold, which amounted to \$193,000,000 during the period and to a seasonal increase

of \$267,000,000 in currency; member bank reserve balances increased by \$150,000,000 during the period. These developments are summarized in the following table.

RESERVE BANK CREDIT AND SELECTED RELATED ITEMS

(In millions of dollars)

Wednesday	July 27 1927	Dec. 28 1927	Dec. 26 1928	Change	
				July 27 to Dec. 28, 1927	July 27, 1927 to Dec. 26, 1928
Discounts	398	609	1168	+211	+770
Acceptances	169	386	489	+217	+320
U.S. Government securities	385	603	232	+218	-153
Other Reserve bank credit	76	41	52	- 35	- 24
Total Reserve bank credit	1028	1639	1941	+611	+913
Monetary Gold Stock	4578	4385	4149	-193	-429
Money in circulation	4776	5043	5089	+267	+313
Member bank reserve balances	2282	2432	2409	+150	+127

The policy of the Federal Reserve System during the second half of 1927, therefore, was to check the outflow of gold from Europe and then when gold commenced to move out of this country to Europe to offset the effects of this outflow on our market by open-market purchases.

By the early part of 1928 the Federal Reserve System had become alarmed

over the speculative situation and sold Government securities rapidly in order to offset the influence of the seasonal return of currency in January and to force member banks into debt with a view to tightening the money market. Total sales from the System's open market account amounted to \$350,000,000. The effectiveness of this policy was increased by an outflow of gold from this country amounting to \$240,000,000 for the year. There were three successive increases in discount rates at the Federal Reserve Bank of New York, from 3 1/2 per cent at the early part of the year to 5 per cent in July. In the autumn of the year, however, a large volume of bills was acquired by the System. This constituted a break in the policy of restraining credit.

From the point of view of the banking situation as a whole it is apparent that the policy of easy money pursued by the Federal Reserve System in the last half of 1927 increased the volume of member bank reserves and encouraged the extension of credit by these banks. There was no increase in the demand for commercial loans, but a considerable growth in the demand for credit to finance security transactions. The major part of the increase in member bank credit during 1927, therefore, was in the form of loans on securities chiefly to brokers and dealers in New York City.

In 1928 the efforts of the Federal Reserve System to restrict the volume of credit were reflected in the retardation of the rate of growth of member bank loans on securities. Credit used in speculation continued to increase rapidly during the year, however, through the medium of loans to brokers by lenders other than banks.

For the period from the middle of 1927 to the end of 1928, as a whole,

Reserve bank credit showed an increase of nearly \$1,000,000,000 and member bank credit an increase of \$3,000,000,000, the larger part of which was in security loans.

LOANS AND INVESTMENTS OF ALL MEMBER BANKS AND LOANS TO BROKERS

(In millions of dollars)

	June 30, 1927	Dec. 31, 1927	Dec. 31, 1928	Change
				June 30, 1927 to Dec. 31, 1928
<u>All Member Banks</u>				
Total loans and investments	32,756	34,247	35,684	+2,928
Loans on securities	8,156	-	10,172	+2,016
All other loans	14,782	-	14,983	+ 201
Investments	9,818	10,361	10,529	+ 711
<u>Reporting Member Banks In New York City*</u>				
Loans to brokers and dealers in securities	3,118	3,718	5,091	+1,973
For own account	1,132	1,374	1,109	- 23
For out of town banks	1,144	1,338	1,660	+ 516
For account of others	842	1,006	2,322	+1,480

- Not available

* Wednesdays nearest to dates indicated