THIRTY-SIXTH

ANNUAL REPORT

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1949

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 1.5 billion dollars.

Votes for this action: Messrs. Sproul, Vice Chairman; Clayton, Draper, Earhart, Eccles, Gidney, Leach, and McLarin. Votes against this action: none.

During July the decline in business activity continued for the eighth consecutive month. The decline had been orderly and, because of supporting factors in the economy with high levels of activity in some segments, had been relatively mild. The outlook was for a continued high level of activity with a likelihood of some moderate increase in the immediate future. It was not clear, however, whether the corrections that had been made had been sufficient to prevent further declines over a longer term period. The indications were that present credit policy should be one of continued monetary ease as one means of encouraging a high level of business activity while at the same time avoiding conditions of such ease as would prevent needed adjustments in the economy or would encourage undue expansion.

At this meeting it was stated that, if the Federal Open Market Committee should be willing to allow the System's holdings of Treasury securities to go into the market in amounts sufficient to absorb the reserves that would be released by a reduction in reserve requirements, the Board of Governors would reduce reserve requirements by two percentage points on demand deposits and possibly one percentage point on time deposits of all member banks, to become effective on various dates in August and September.

It was agreed by members of the Federal Open Market Committee that, in view of the tendency for declining economic activity in the United States, the release of additional funds to banks by the proposed reduction in reserve requirements was desirable. It was recognized, however, that unless banks were supplied with securities for immediate investment of their additional funds, there would be disorderly conditions in the money market and an unnecessarily sharp and largely temporary decline in interest rates. It was felt that sales of short-term securities by the System would provide banks with liquid assets and prevent an undue decline in interest rates without interfering with the major goal of the reserve-requirement reduction, namely, to encourage the extension of credit beneficial to increased production and employment.

Accordingly, the members of the Committee indicated that if the Board of Governors should reduce reserve requirements by the amount proposed

(approximately 1.8 billion dollars) they would act to reduce the System's holdings of securities to offset the released reserves, and that securities would be sold from the System account until transition to the lower reserve requirements had been made so that the reduction would not result in a general further lowering of short-term rates. The above direction was adopted for that purpose and for the further purpose of continuing the System policy of monetary ease.

December 13, 1949

1. Increase in Short-Term Rates.

The members of the Federal Open Market Committee, on November 22, 1949, upon recommendation of the executive committee, authorized the purchase and sale of bills and certificates in the market at somewhat lower prices (higher yields) than had recently prevailed. At this meeting this informal action was approved, ratified, and confirmed.

Votes for this action: Messrs. McCabe, Chairman; Sproul, Vice Chairman; Draper, Earhart, Eccles, Gidney, Leach, McLarin, Szymczak, and Vardaman. Votes against this action: none.

Until the middle of November, operations in the System open market account continued to be carried on under the policy of monetary ease adopted at the meeting of August 5, 1949, as one means of restraining further declines in production and employment. However, when the executive committee met on November 18, 1949, there had been a moderate recovery from the lows reached during the summer. The strength of the movement and the indication that it would continue well into 1950 prompted the executive committee of the Federal Open Market Committee to recommend to the full Committee that it authorize the executive committee to increase short-term rates somewhat in order to indicate a change from a policy of monetary ease to a policy of mild restrictions on the availability of bank reserves through open market operations. The purpose of this change in policy was to indicate the view on the part of monetary authorities that economic conditions had changed, that it was believed to be desirable to adopt a policy of some restraint and that, depending on developments, some further increases in rates might be called for. The full Committee approved the increase for the reasons that prompted the executive committee to make its recommendation.

2. 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 August 5, 1949, 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.

Votes for this action: Messrs. McCabe, Chairman; Sproul, Vice Chairman; Draper, Earhart, Eccles, Gidney, Leach, McLarin, and Szymczak. Votes against this action: none.

Before this meeting of the Committee there had been further discussions with the Secretary of the Treasury relating to Treasury financing and it had been decided that the issues of Treasury securities maturing on December 15 would be refunded with a 4¼ year 1⅜ per cent note and that a 1⅛ per cent certificate would be exchanged for the maturing January 1 certificate.

It was suggested that the likelihood of a higher level of economic activity during the next few months, accompanied by substantial Treasury deficits, indicated the desirability of greater flexibility in interest rates in order that the System's policy could respond to changes in the economic situation. In the circumstances, it was felt that the System should follow a policy of mild restraint within the limits imposed by the necessity of supporting a 1⅛ per cent one-year rate in connection with the January refunding, and that after Christmas the substantial amounts of funds which would seasonally be coming into the market should be absorbed by the sale of securities from the System account in order to keep interest rates from declining. The above direction was adopted for that purpose, the limitation of 2 billion dollars in the first paragraph of the direction being fixed with the thought that in carrying out the policy set forth above it would not be necessary to decrease the total securities held in the System account by more than that amount.