

THIRTY-EIGHTH

# ANNUAL REPORT

*of the*

BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM



COVERING OPERATIONS FOR  
THE YEAR

1951

all the means at their command to restrain further expansion of bank credit consistent with the policy of maintaining orderly conditions in the Government securities market. Within the limits of this policy, it had been found necessary to give substantial support in the market for Government securities, particularly for maturing issues to aid Treasury refunding operations and also for long-term bonds which were being sold by institutional investors in large amounts. Endeavors to absorb bank reserves and to restrain credit expansion had been made through the sale of other securities from the System account, principally short-term issues, and a rise in yields on short-term securities had been permitted to occur in the market, but these operations also had to be moderated at the end of October. At its meeting on November 27, 1950, the Committee took the position that, since there had been no general abatement of inflationary pressures, and in the light of prospective developments, available measures of restraint on credit should be continued and reinforced wherever possible to the extent consistent with the maintenance of orderly conditions in the Government securities market. However, holders of Government securities continued to offer them in the market in large volume and, in order to prevent declines in their prices, Federal Reserve purchases during December 1950 and January 1951 were substantial, thus adding to bank reserves and providing funds for continued expansion in commercial bank loans, which, by the end of January 1951, had risen by approximately 7 billion dollars since August of 1950. In January, some of the additional reserves were absorbed by increases in reserve requirements.

The approval of the above direction was for the purpose of continuing in effect, for the reasons previously stated, the existing policy of restraint on further expansion of bank credit wherever possible consistent with the policy of maintaining orderly conditions in the Government securities market. In taking this action, however, it was realized that in maintaining orderly conditions in the Government securities market it probably would be necessary to purchase substantial additional amounts of Government securities and it was agreed that another meeting should be held shortly for the purpose of considering what the over-all policy of the Committee should be.

FEBRUARY 6-8, 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 January 31, 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, Erickson, Evans, Norton, Peyton, Powell, Szymczak, Young, and Gilbert. Votes against this action: none.

In the period following the meeting on January 31, 1951, the Federal Reserve continued to purchase Government securities, particularly long-term restricted bonds which private investors were offering in the market in large volume, and such purchases made additional reserves available to banks upon the basis of which there could be multiple expansion of bank credit. At this meeting of the Committee consideration was given to the whole problem of System credit and Treasury debt management policy and to the action that might be taken by the System and the Treasury to develop a coordinated program which, while providing for the maintenance of orderly market conditions, would remove the necessity for the System to purchase substantial amounts of Government securities which if continued would add to the already excessive money supply and might thereby seriously weaken the financial stability of the country.

It was agreed that, pending further discussion with the Treasury of steps that might be taken to develop such a coordinated program of credit policy and debt management to assist in the fight against inflation, no change should be made in the existing general direction of the Committee of restraint of

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 en-

deavor 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 uninterrupted 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