OPEN MARKET INVESTMENT COMMITTEE
Chairman's Report
Joint Conference - November 1923

The Secretary's report of the operations of the Open Market Investment Committee has been distributed to the members of the Federal Reserve Board and of the Conference. It gives a detailed account of the proceedings of the Committee and the usual schedules of transactions, and will be submitted for comment and action by the Governors at their separate meeting.

As the Committee and its predecessor is the agency through which transactions in furtherance of the System's open market credit policy are executed, in part, a brief review of what has been done should cover the period from January 1, 1922, to the present time, as a radical change took place in the policy of nearly all of the Reserve Banks, commencing at about the first named date. It was then that, following a greatly reduced volume of discounts, many of the banks made large purchases of Government securities. These were on such a scale as to arouse objection by the Secretary of the Treasury on the grounds that an artificial market was being created - that Reserve Bank purchases and sales at times might conflict with the execution of Treasury Department orders - and with new issues being made - and that investments merely for earnings were not justified, especially if liable to cause any inflation of bank credit.

The appointment of the Committee, of which the present one is successor, promptly resulted in uniformity of operations by Reserve Banks, in all the markets; eliminated conflicts of orders between the Treasury and the banks and between the banks themselves; - and by centering the distribution of orders in the hands of the Committee, enabled it to distribute purchases and sales between Reserve Districts so as to promote an active market in many cities, rather than concentrate the market principally in New York City.

Since the summer of 1922 there has been gradual and continuous liquidation of Government securities owned by the System, the total held on October 31, 1923, being but $92,000,000 against a maximum of $618,000,000 on June 7, 1922.

The important results of this most significant development in the credit policy of the System, other than those already mentioned, can now possibly be summarized as follows:

At the end of the year 1921, following a period of extreme nervousness as to the solvency of many large industrial and commercial concerns, and even of large banking institutions which had made them heavy advances, there still continued to be pressure by banks to liquidate loans, and get out of debt to the Reserve System in spite of the considerable reductions in Reserve Bank discount rates which had already been made in all Districts. This pressure was widespread but especially noticeable in New York and with the type of bank loan described as "frozen". The purchases made by Reserve Banks steadily supplied new credit to the market and the surplus was at once applied to reducing discounts at the Reserve Banks, especially the larger Eastern ones. As the large member banks got out of debt, surplus funds were available for new loans, pressure upon borrowers ceased, money rates eased appreciably, nervousness shortly disappeared, and a general spirit of enterprise and hopefulness succeeded the depression of 1921.

But it must be recalled that as a general rule, the market will always borrow the minimum of credit from the bank of issue which is required to finance a given volume of business at the existing price level. No <u>surplus</u> of total reserve credit was, however, created by the purchases of the

Reserve Banks and no <u>inflation</u> of bank credit resulted because the discounts by members were reduced as the investment account increased. Banks no longer had to pay as heavy a tax, by way of discount, to the System and the desire to get out of debt was largely satisfied. As a result, whatever may have inspired the purchases by some Reserve Banks - whether for earnings (as in most cases) or otherwise - nevertheless the result was further to moderate the course of liquidation, reduce interest rates and firmly establish the foundation for economic recovery.

Throughout the latter part of 1922 and early in 1923, the impetus of the revival, spreading into all business, excepting some departments of agriculture, and affecting in marked degree building operations, wages of all the building trades, the automobile industry, and stock speculation, threatened to develop into an unhealty expansion, unwarranted price advances, and in their train bank loan inflation. The loans on the New York Stock Exchange reached the largest total ever recorded. A moderation of this movement was in part suggested to the public by the advance in discount rates by three Reserve Banks from 4% to 4½%; it was undoubtedly further assisted by the sale of Reserve Bank investments, which had been continuous throughout the period of advancing prices, and which drove our members to increase their borrowings; but probably was more than anything else due to the sensitive state of mind of the public generally, and to the frequently discussed desire among business men to avoid the events of 1919, 1920 and 1921. But little was needed to restore conservatism.

The System has still also been confronted with a problem of major importance, since January, 1922, in the large net imports of gold, the total for the period down to the latest reports available being $432,938,822. Had the earning assets of the Reserve Banks remained unchanged at the January, 1922 figure $1,471 millions this addition to our gold stock inevitably would have caused a greater expansion of bank loans and currency than has taken place - with all the disorders in prices arising therefrom. The reduction of earning assets by the Reserve Banks, partly through reduced discounts, at times, and largely by the sale of investments, has probably aided to hold in check any such development. Down to about August, 1923 this reduction in earning assets had more than offset net gold imports and net domestic production of the mines, and it is only since the usual seasonal demands of the late summer and fall have caused an increase in members' borrowings, together with additional gold imports, that this net reduction has not been maintained.

Since the new Committee was appointed about six months ago, transactions in acceptances have become one of its principal duties, and the importance of this account has increased with the gradual reduction in holdings of Government securities. Much the same comments as apply to our Government investment account, apply to this account - with the additional feature that the rates for purchases of bills have a close and important bearing upon our general discount rate. Transactions in bills conducted under the Committee's supervision are included in the Secretary's report.

The Committee is now, or shortly will be confronted with some difficulties in its bill purchases, unless there is easing of money rates, which in fact does usually arise after the first of the year. The market rate for prime bills, now about 4-1/8% - should normally be about 1% or more below the market rate for prime commercial paper. The difference in market rate represents roughly the value of the bank obligation, for which the acceptance commission is charged, plus broker's margins of profit. While that difference is maintained in the money market at the present time and usually will be, the difference between the rates at which we buy bills and our discount rate is less than 1/2%. If money rates ease, the spread between Reserve Bank discount rates and Reserve Bank buying rates will increase as the rates for bills are reduced. If, however, money rates advance, we must advance our buying rates for bills - and an increase of only 3/8% would bring the bill rate to the level of our discount rate - a wholly anomalous and rather unfortunate situation. If we did not advance our buying rate with market rates, all bills would be dumped on the Reserve Banks, causing too large an accumulation, destroying the broad market for bills which we have struggled to create and possibly defeating other purposes of policy later mentioned.

To increase discount rates, and so restore the differential, is just at this time probably not justified, and has the possibility of harm when business is hesitating and seeking an indication of the attitude of the Reserve System toward the credit situation.

On the whole the Committee's view is that we can afford to delay any considerable change in buying rates, until the New Year's developments disclose whether we shall experience some reduction im members' borrowings and lower market rates.

This will, however, leave the gold problem unsolved. If the System hopes to offset further gold imports by reducing investments, it will necessitate selling some or all of the small balance of $92 million of Government securities still held by a few of the Reserve Banks, and then reducing its holdings of bills, provided, of course, further large amounts of gold arrive. The result to the earnings of some of the banks would be such as to necessitate the transfer to them of other earning assets by those banks holding an excess over earning needs, as for example, New York. It would also make it difficult to avoid an advance in the rate for bill purchases, in case money rates do not ease. For this reason also a delay in any change of policy seems desirable.

Finally, quite another view is presented when we consider just what our policy should be in case the hesitation and uncertainty which seems to have arisen in some sections, notably New England, should threaten a real setback to business. While the country is now on the whole prosperous, labor quite fully employed, most mills busy and with a few exceptions no excess stocks of goods on hand - there are also some indications of a growth of distrust lest business is facing a slump. Steel orders are lower, production of New England cotton mills has recently been reduced, automobile tire business has slowed down, and we have had a long and rather sharp liquidation in the stock market resulting in a reduction of Stock Exchange loans, estimated at $532,000,000.

It is the view of the Committee that the Reserve System should not hesitate to resume open market purchases, thereby again reducing bank borrowings and easing money rates, rather than permit an unwarranted state of mind alone to disturb the even course of the country's production and consumption. There need be little fear of inflation from such a policy if total earning assets are not allowed to increase; nor are they likely to do so in the abs ence of speculation, increasing prices and increasing stocks of goods..

The attached schedules of figures are funished in detail so as to obviate the need of quoting them extensively in the body of this report.

Beyond the conclusions so far expressed, a study of the schedules annexed will disclose in general the growing importance to the banking system as a whole, of the policies adopted in open market transactions. The record of the past two years is convincing evidence of the need for a harmonious program. The Committee has agreed, at the request of the New York Bank, and subject to the approval of the Federal Reserve Board and of the interested Federal Reserve Banks, to supervise all foreign transactions, if such course seems to the conference as likely to promote a uniform system policy.

Respectfully submitted,

(Signed) BENJ. STRONG

Chairman.

TOTAL NET DEMAND AND TIME DEPOSITS

NEW YORK CITY CLEARING HOUSE BANKS

(In millions)

Date		Amount	Date		Amount
1923					
January	6	4,410	June	2	4,255
	13	4,485		9	4,212
	20	4,391		16	4,248
	27	4,355		23	4,231
February	3	4,361		30	4,296
	10	4,316	July	7	4,228
	17	4,339		14	4,235
	24	4,351		21	4,190
March	3	4,361		28	4,129
	10	4,281	August	4,	4,138
	17	4,298		11	4,065
	24	4,220		18	4,007
	31	4,266		25	4,025
April	7	4,218	September	1	4,096
	14	4,214		8	4,073
	21	4,264		15	4,133
	28	4,222		22	4,123
May	5	4,220		29	4,165
	12	4,231	October	6	4,131
	19	4,224		13	4,119
	26	4,219		20	4,178
				27	4,174
			November	3	4,194

TOTAL EARNING ASSETS

FEDERAL RESERVE BANK OF NEW YORK

(In millions)

Date		Discounts	Securities Owned	Acceptances Bought	Total
1922					
January	4	199	98	58	355
February	1	119	108	37	264
March	1	90	162	32	285
April	5	88	132	38	258
May	3	68	211	46	325
June	7	39	192	38	269
July	5	108	171	47	326
August	2	39	158	33	230
September	6	48	161	59	269
October	4	58	163	81	302
November	1	161	67	80	308
December	6	208	65	59	332
1923					
January	3	186	121	52	359
February	7	221	52	27	301
March	7	200	26	29	256
April	4	211	19	27	257
May	2	212	4	54	270
June	6	194	21	74	290
July	3	260	5	40	305
August	1	209	12	40	262
September	5	210	18	41	269
October	3	204	14	22	240
October	31	202	11	52	265

TOTAL EARNING ASSETS

FEDERAL RESERVE SYSTEM

(In millions)

Date		Discounts	Securities Owned*	Acceptances Bought	Total
1922					
January	4	1,113	231	127	1,471
February	1	838	305	90	1,233
March	1	708	413	96	1,216
April	5	625	463	98	1,186
May	3	509	609	107	1,226
June	7	420	618	136	1,174
July	5	499	551	155	1,204
August	2	400	497	150	1,048
September	6	405	508	188	1,102
October	4	434	483	235	1,153
November	1	588	360	261	1,209
December	6	705	312	267	1,284
1923					
January	3	628	457	255	1923 High) 1,339)
February	7	569	353	185	1,107
March	7	571	345	219	1,135
April	4	695	239	260	1,194
May	2	730	185	275	1,191
June	6	735	183	248	1,166
July	3	1923 High) 930)	95	199	1,223
August	1	806	94	183	1,083
September	5	850	99	175	1,123
October	3	882	95	173	1,150
October	31	884	92	205	1,181

* Municipal warrants included

STREET LOANS
AND
BALANCES OF OUT-OF-TOWN
CORRESPONDENTS
(000 Omitted)

	1923	Street Loans for account of Correspondents	Street Loans for own Account	Total Street Loans	Balance of Out-of-Town Correspondents	Total Street Loans for account of Correspondents and balances for account of Out-of-Town Correspondents
January	3	651,623	937,851	1,589,474	714,454	1,366,077
	10	736,791	815,280	1,552,071	760,567	1,497,358
	17	795,426	818,045	1,613,471	735,530	1,530,956
	24	792,018	763,883	1,555,901	673,109	1,465,127
	31	750,285	798,917	1,549,202	651,859	1,402,144
February	7	804,407	774,389	1,578,796	667,879	1,472,286
	14	801,228	807,873	1,609,101	662,790	1,464,018
	21	801,606	818,457	1,620,063	659,827	1,461,433
	28	792,532	864,710	1,657,242	712,477	1,505,009
March	7	811,739	813,182	1,624,921	708,966	1,520,705
	14	843,564	799,856	1,643,420	707,295	1,550,859
	21	813,445	837,699	1,651,144	682,075	1,495,520
	28	810,137	812,901	1,623,038	658,173	1,468,310
April	4	804,358	862,623	1,666,981	715,291	1,519,649
	11	841,150	776,453	1,617,603	690,167	1,531,317
	18	847,288	767,795	1,615,083	673,385	1,520,673
	25	837,487	805,785	1,643,272	640,486	1,477,973
May	2	831,029	864,538	*1,695,567	647,687	1,478,716
	9	821,490	809,624	1,631,114	611,557	1,433,047
	16	814,377	787,450	1,601,827	616,932	1,431,309
	23	767,612	784,701	1,552,313	597,726	1,365,338
	29	756,070	779,419	1,535,489	583,541	1,339,611
June	6	756,165	754,569	1,510,734	600,156	1,356,321
	13	742,084	750,120	1,492,204	595,934	1,338,018
	20	731,014	745,606	1,476,620	587,346	1,318,360
	27	681,219	758,955	1,440,174	572,858	1,254,077
July	3	615,146	768,818	1,383,964	636,682	1,251,828
	11	643,095	710,360	1,353,455	617,004	1,260,099
	18	660,136	658,830	1,318,966	606,309	1,266,445
	25	669,199	636,635	1,305,834	573,394	1,242,593
August	1	653,733	619,371	1,273,104	587,914	1,241,647
	8	684,905	557,887	1,242,792	586,174	1,271,079
	15	664,984	560,363	1,225,347	583,535	1,248,519
	22	661,937	534,020	1,195,957	563,893	1,225,830
	29	639,759	555,228	1,194,987	559,831	1,199,590
September	5	649,841	552,438	1,202,279	576,337	1,226,178
	12	654,246	563,457	1,217,703	582,419	1,236,665
	19	667,962	569,766	1,237,728	594,151	1,262,113
	26	637,821	557,856	1,195,677	575,680	1,213,501
October	3	633,671	574,667	1,208,338	621,406	1,255,077
	10	666,309	531,951	1,198,260	595,759	1,262,068
	17	653,018	535,832	1,188,850	621,507	1,274,525
	24	632,380	537,343	1,169,723	581,314	1,213,694
	31	611,156	552,506	1,163,662	594,783	1,205,939

* High for all times.