BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

March 15, 1951.

Mr. Clinton B. Axford,
Secretary and Editor,
American Banker,
New York, New York.

Dear Mr. Axford:

In your March 7 issue you printed a Washington dispatch quoting from an address I made in Iowa on October 27, 1948. The apparent purpose of this article was to make it appear that I am inconsistent in advocating a freer market for long-term Government securities now whereas at that time I favored supporting the 2-1/2 per cent long-term yield. The article attempts to give color to this misrepresentation by stating that I was then Chairman of the Board of Governors and infers that I was subject to political pressures to which I no longer yield.

In the first place, I was not Chairman of the Board. I was then, as I am now, only a member of the Board. In the second place, the position I took then, as now, was in no way influenced by political pressures but was based solely on analysis of the monetary and credit situation as was that of Allan Sproul, President of the Federal Reserve Bank of New York, as well as all of the other members of the Federal Open Market Committee. All of us were in complete agreement in support of the long-term bonds at that time. In the third place, the article completely fails to take into consideration the great difference between the monetary and credit situation then as compared with the situation now.

By the end of 1948 inflationary forces were diminishing. Inventories in many cases had become excessive relative to demand and there were signs of the downturn that was rapidly developing. At the end of October, when the address you referred to was made, a better balanced economic situation had developed. As a protective measure, however, I continued to advocate, as I had ever since the end of the war, that Congress arm the Federal Reserve System with additional authority to deal with creation of bank reserves and I stated, though you did not quote it:

"But if, in spite of some deflationary aspects in our economy, inflation continues or if prices are held at present levels by a further overall credit expansion, then effective monetary and fiscal control would be essential. I feel that Congress should deal realistically with this problem at the coming session, no matter how unpleasant the task may be.

"If credit growth continues, or if velocity of existing money increases significantly, and if no additional authority over bank credit growth is given to the System by Congress, or if because of the activities of nonbank investors further inflation cannot be stopped by such additional powers, then the authorities would have to face an unpleasant dilemma. Either they must permit further inflation to develop, or they will have to adopt the full use of traditional methods of credit control."

We are now obliged in the face of grave inflationary threats to use those traditional methods, i.e., open market operations, since Congress did not see fit to grant us additional means of restricting the availability of bank reserves.

However, to recur to the situation as it was when my speech was made and the contrast with conditions today, it should be remembered that by the end of 1948 an effective anti-inflationary program was making itself felt, the principal feature of which was the fact that the Treasury had a cash surplus of $8.1 billion for the calendar year 1948 which exerted a strong deflationary influence because it was largely used to pay off Government debt held by the Federal Reserve System. As a result of this and other factors in the program bank credit, that is the money supply, instead of being rapidly expanded as it is today was actually declining. As the Board's Annual Report for 1948 stated: "The net result of all factors was a small decline in bank deposits and currency held by the public -- the first decrease for any year since 1937."

The factors referred to were:

(1) Use of Treasury surplus to pay off maturing securities held by the Federal Reserve System which directly reduced available reserves,

(2) Interest rates on Treasury bills and certificates were permitted to rise and banks and others were thereby encouraged to hold more of these securities which in turn made it possible for the Federal Reserve to reduce its holdings,

(3) Discount rates were increased at all Federal Reserve Banks,

(4) The reserve requirements of member banks were increased so as to absorb additional reserves arising from gold inflow as well as from Federal Reserve purchases in support of the Government bond market,

(5) Regulation of consumer instalment credit was reimposed, and

(6) High margin requirements were retained on stock market credit.

These combined measures exerted a definite and effective restraint without necessitating withdrawal of support of the long-term 2-1/2 per cent issues. During 1948 total deposits and currency held by businesses and individuals declined by about $1 billion. This contrasts sharply with what happened during the last seven months of 1950. In that period Federal Reserve purchases of Government securities enabled the banking system to expand loans and investments by about 20 per cent, or some $10 billion. The result has been an estimated increase of 8 per cent of the money supply in the form of new deposits in the banking system. The contrast in the situation now, as compared with 1948, is emphasized by the Board's 1948 Annual Report, which stated:

> "For the year as a whole, sales of long-term Government securities by nonbank investors as a group were practically balanced by their purchases of short-term issues. On balance, therefore, these transactions tended neither to increase nor decrease the supply of bank deposits."

There is no comparability between the situation at the time of the Iowa speech and the situation now. As the foregoing figures indicate, since Korea we have had the greatest and most inflationary expansion of bank credit on record. The prospect in 1948 was that the postwar boom would wear itself out; the prospect today is for continuing inflationary pressures for an indefinite period. Even though there should be some downward adjustments in the economy in coming months as a result of overbuying and inventory accumulation, such a leveling off will only be temporary and will not reduce the need for restrictive monetary and credit policies as well as an adequate tax program. We will still need legislation on reserve requirements to reinforce the System's open market operations which are necessarily limited in scope by the size, structure, and distribution of the public debt. All the underlying forces are still inflationary and will continue to be so long as the international tension continues.

Faced with this long-run outlook the Federal Reserve System has no alternative consistent with its statutory duty except to use the traditional methods, that is, open market operations, to which I referred in the Iowa speech and which we are now using, always with due regard to the Government's debt-management problems.

Credit and monetary policy alone cannot insure economic stability but we cannot have economic stability without effective credit and monetary policy.

I hold no particular brief for consistency, but your article was so misleading that I cannot refrain from this commentary.

Sincerely yours,

M S Eccles

M. S. Eccles.

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