

Board Statements on Easy Money, 1929 - 1940

(largely from Annual Reports)

1929

"...At the end of October the drop in security prices was accompanied by a subsidence in the demand for credit from the stock exchange; a drastic liquidation of security loans; outflow of gold; and an easing credit policy by the Federal reserve system... In the latter part of the year large purchases of acceptances by the Federal reserve banks, followed in the last two months by purchases of Government securities, enabled member banks to reduce their borrowings, and by the end of the year discounts were in the smallest amount for nearly two years; this low level of indebtedness of member banks was an important factor in the easier condition of the money market...

"During the last three months of the year the net liquidation of loans on securities, by banks and by other lenders, may be estimated in the aggregate at \$3,900,000,000... This liquidation was accompanied by a reversal of the credit policy of the Federal reserve system. Over a period of about two years increase in the volume of credit utilized in the security market had been the principal consideration determining the firm money policy of the system; and the diminution in the demand for such credit was followed by a reversal of the system's policy. During the first week of liquidation, when the member banks were taking over in large volume loans previously carried by nonbanking lenders, the reserve banks bought \$150,000,000 of United States Government securities, thereby reducing for member banks the necessity of borrowing at the reserve banks. The reserve banks continued this policy of open-market purchases throughout November and the larger part of December, with the consequence that member banks were able to meet the seasonal demand for currency, as well as considerable withdrawals of gold for export, and at the same time to decrease their indebtedness to the reserve banks... Reserve system policy, therefore, during the last two months of the year, in contrast to the two preceding years, was exerted in the direction of easier money conditions.

"This reversal of policy, made possible by diminution in the demand for credit in the security markets, appeared desirable also in view of the sharp reduction in business activity. Industry, which had been operating in record volume up to June, and notwithstanding some recession had remained at an exceptionally high level in the following four months, declined abruptly in November and still further in December... Liquidation of

bank credit in the last two months of 1929 and the easing policy of the reserve system were reflected in a decline of money rates in the United States, and particularly of open-market rates on call and short-time money."
(Annual Report for 1929, pp. 1, 10-12.)

1930

"The year 1930 was marked by reduced demand for bank credit from trade and industry and by decreasing commodity prices and money rates, all characteristic of a period of declining activity in business. In these circumstances the Federal reserve system pursued a policy of monetary ease. This policy was expressed through the purchase at intervals of additional United States Government securities and in progressive reductions of reserve bank discount and acceptance rates...

"While discounts for all member banks were at a low level throughout the year, banks in the financial centers were practically out of debt during a considerable part of the year. This low level of indebtedness at the reserve banks was an influence in the direction of easier money conditions, which were reflected in lower rates both on open-market paper and on loans made by banks to their customers."
(Annual Report for 1930, pp. 1, 3.)

1931

"During the first nine months of the year the Federal reserve system pursued a policy of further easing credit conditions through reductions of rates and through open-market operations. In the autumn of the year, when, following upon the suspension of gold payments in England, the system was subjected to heavy withdrawals of gold from abroad and of currency for hoarding in this country, it met these demands freely by discounting paper for member banks and by the purchase of acceptances in the open market."
(Annual Report for 1931, p. 1.)

1932

"During 1932 the Federal Reserve System continued to pursue the policy of monetary ease which it had followed since the beginning of the depression. This policy was expressed through the purchase of United States Government securities

in the open market and through the reduction of rates charged for discounts and for acceptances... After the passage of the Glass-Steagall Act on February 27, 1932, the Federal Reserve System pursued a policy of large-scale open-market purchases of United States Government obligations, which carried their total to \$1,850,000,000 on August 10, a level that was maintained throughout the rest of the year...

"The increase in excess reserves of member banks after February 1932 was accompanied by further easing of the money market... Money rates usually tend to decline during a depression, because the low level of business activity results in diminished demands on the commercial banks for current financing and in an increase in their reserves through the return of currency from circulation. During the depression that began in 1929, however, member banks were under the necessity of meeting foreign demands for gold and domestic demands for currency, both developments which would have tended toward the tightening of conditions in the money market, had it not been for the fact that the Federal Reserve System through purchases of United States Government securities enabled member banks to meet these demands and at the same time to reduce their indebtedness to the Reserve banks and to build up a considerable volume of reserves in excess of legal requirements. At the end of 1932 short-term money rates were at record low levels, but low rates did not extend to the long-term markets, where yields on long-term issues, except those of the United States Government, continued high and flotations of new capital issues were small."

(Annual Report for 1932, pp. 10-11, 15-16.)

1933

"Throughout the period of the depression the Federal Reserve System lent its support to efforts to counteract deflationary forces and to facilitate expansion of business activity. With this end in view the System pursued a policy of reducing its discount and open-market rates and of purchasing United States Government securities in the open market, thereby placing a large volume of reserve funds at the disposal of member banks...

"Open-market operations in 1933 may be described as having been conducted primarily for the direct purpose of building up excess reserves of the member banks with a view to further easing conditions in the money market and encouraging the banks to adopt more liberal lending and investing policies and so to

facilitate the recovery of business... It is difficult to say what the course of the depression would have been had the Federal Reserve System not pursued a policy of liberal open-market purchases, which at first helped the banks to meet extraordinary demands upon them and later to build up excess reserves to an unprecedented level. This policy, together with the concurrent reduction in discount rates, was an important factor in the general decline of money rates to extreme low levels. Commercial paper, which at the opening of 1930 was at a 5 percent level, had declined by the end of 1933 to 1-1/2 per cent. Bankers' acceptances declined from 4 percent to five eighths of a percent. The call money rate declined from 6 to 1 percent. The rate on Treasury certificates declined from 3-1/2 to one fourth percent, and average rates charged by banks in leading cities to their commercial customers declined from about 6 to 4-1/2 percent...

A review of open-market operations by the Federal Reserve System during the 4 years indicates, therefore, that the placing of reserve funds in the market through the purchase of United States Government securities has been an effective means of preventing exceptional demands upon the member banks from tightening the credit situation and that these funds have been a powerful means toward the establishment and maintenance of ease in the short-term money market. Although the abundant credit provided was not effectively employed by business, it would appear that the maintenance continuously of a substantial volume of excess reserves through open-market purchases helped to avert a powerful deflationary movement and created conditions propitious to business recovery."

(Annual Report for 1933, pp. 17-18, 20-21.)

1934

"Developments in 1934 were all in the direction of easier credit conditions. The expansion in excess reserves during the year, which was caused chiefly by gold imports, was not accompanied by an increase in bill or security holdings of the Federal Reserve banks that could be sold for the purpose of absorbing the excess reserves, if that should become desirable. With this limitation on the System's power to reduce member bank reserves by the sale of assets in the open market, the System's ability to restrict credit expansion, if it should become excessive, rests chiefly on new powers conferred upon it by recent legislation. Among these are the power in an emergency and with approval of the President to raise reserve requirements of member banks, provided in the act of May 12,

1933; authority to restrain speculative activities of member banks under different provisions of the Banking Act of 1933; and control of margin requirements on security loans by brokers and by banks, granted by the Securities Exchange Act of 1934."

(Annual Report for 1934, pp. 1-2.)

1935

"Federal Reserve policy during 1935 continued to be directed toward monetary ease...

"In view of the large and growing volume of excess reserves, no further action directed toward obtaining easier money conditions was necessary during 1935. On the contrary, the continued growth of excess reserves raised the question of taking measures to reduce them...

"In the latter part of the year the Board gave frequent consideration to probable future changes in the volume of excess reserves, to possibilities of excessive credit expansion on the basis of these reserves, to methods of reducing the reserves and controlling credit expansion, and to the proper timing of such action. After a meeting of the Board of Governors with the Federal Open Market Committee on December 17 and 18, at which these matters were considered, the Board and the Committee issued the following statement:

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee have given extended consideration to the general business and credit situation and to the recommendation of the Federal Advisory Council and are of the opinion:

1. That continued improvement has been made in business and financial conditions but that the country is still short of a full recovery.
2. That the primary objective of the System at the present time is still to lend its efforts to a furtherance of recovery.
3. That there is at the present time no evidence of overexpansion of business activity or of the use of business credit.

4. That the present volume of member bank reserves, which have been greatly increased by imports of gold from abroad, continues to be excessive, far beyond the present or prospective requirements of credit for sound business expansion.

Therefore, the special problem created by the continuing excess of reserves has had and will continue to have the unremitting study and attention of those charged with the responsibility for credit policy in order that appropriate action may be taken as soon as it appears to be in the public interest."

(Annual Report for 1935, pp. 2-3.)

1936

"In order to change a part of the excess reserves into required reserves and thus to eliminate the possibility of this part of the reserves becoming the basis of an injurious credit expansion, the Board on July 14 decided to exercise its power under the Banking Act of 1935 to raise member bank reserve requirements... These excess reserves have resulted almost entirely from the inflow of gold from abroad and not from the System's policy of encouraging full recovery through the creation and maintenance of easy money conditions. This easy money policy remains unchanged and will be continued...

"The present is an opportune time for the adoption of such a measure. While there is now no excessive credit expansion, since the excess reserves have not been utilized, later action when some member banks may have expanded their loans and investments and utilized their excess reserves might involve the risk of bringing about a severe liquidation and of starting a deflationary cycle. It is far better to sterilize a part of these superfluous reserves while they are still unused than to permit a credit structure to be erected upon them and then to withdraw the foundation of the structure...

"In the light of recent experience and in view of the fact that after the increase in requirements goes into effect member banks will still have approximately \$1,900,000,000 of excess reserves, the Board is convinced that this action will not affect easy money conditions now prevailing. It does not constitute a reversal of the easy money policy which has been pursued by the System since the beginning of the depression. Rather it is an adjustment to a changed reserve situation brought about through the extraordinary inflow of gold from abroad.

"The prevailing level of long-time interest rates, which has been an important factor in the revival of the capital market, has been due principally to the large accumulations of idle funds in the hands of individual and institutional investors. The supply of investment funds is in excess of the demand. The increase in reserve requirements of member banks will not diminish the volume of deposits held by these banks for their customers and will, therefore, not diminish the volume of funds available for investment. The maintenance of an adequate supply of funds at favorable rates for capital purposes, including mortgages, is an important factor in bringing about and sustaining a lasting recovery."

(August 1936 Bulletin, pp. 613-614.)

"During 1936 the Federal Reserve System, as reconstituted, continued to pursue the policy of monetary ease which had been in effect since the beginning of the depression, and money was available in abundance at the lowest rates of interest the country has known... In July 1936 and again in January 1937 the Board of Governors took action to increase reserve requirements and thereby to eliminate a large part of the excess reserves that had accumulated. The combined effect of these two actions of the Board was to double the reserve requirements of member banks. Thus the power conferred upon the Board by the Banking Act of 1935 to increase reserve requirements for the purpose of preventing injurious credit expansion was fully utilized.

"...Money rates declined almost continuously from 1929 to 1935, with brief interruptions in the autumn of 1931, when England and a number of other countries suspended specie payments and gold was leaving this country in large volume, and again during the banking crisis in 1933. From the middle of 1934 to the end of 1936 rates in the open market on short-term paper were extremely low and showed little change, and rates charged customers by banks in leading cities and bond yields continued to decline in 1935 and 1936.

"Rates on bankers' and Treasury bills were generally below 1/4 of 1 percent from the middle of 1934 through 1936. The lowest level reached by bankers' acceptances before 1930 was 2 percent in 1924. The rate on call loans with stock exchange collateral, until recent years the most important open-market rate, declined to 1/4 of 1 percent in 1935, but was fixed in May 1936 at 1 percent. There were only six scattered years in the period from 1890 to 1930 when this rate averaged below 2 percent and in only one month did it average less than 1 percent. Open-market commercial paper, which for more than half a century has been a popular medium for

investment of short-term funds by country banks, was at a rate of $\frac{3}{4}$ of 1 percent from early in 1935 until early in 1937. The lowest quoted commercial paper rate prior to 1930 was 3 percent in 1924.

"Prices of bonds continued to rise in 1936, and yields on high-grade long-term bonds, which were at the lowest levels since the early years of this century, declined further. Long-term United States Government bonds sold in the latter half of 1936 on a yield basis of less than $2\frac{1}{2}$ percent. The lowest level reached by these bonds in the twenties was $3\frac{1}{4}$ per cent. Pre-war rates are not comparable because most United States Government bonds then bore the circulation privilege, which was at that time of considerable value. The highest-grade corporate bonds sold in 1936 on a yield basis of 3 to $3\frac{1}{4}$ percent, compared with a low level for the twenties of 4 to $4\frac{1}{2}$ percent and with $3\frac{1}{4}$ to $3\frac{1}{2}$ percent in the years around the turn of the century.

"Low money rates prevailing in recent years were the result of the large supply of funds seeking profitable use and the small demand from acceptable borrowers. Excess reserves of banks were the principal factor of supply in the short-term market and were also an important influence in the decline in long-term rates. The abundant supply of available funds, together with the small demand for loans, encouraged banks to buy large amounts of securities, particularly United States Government obligations, and bank holdings of securities were the largest on record not only in total amount but also in proportion to total bank assets.

"The abundant supply of investment funds held by others than banks was also a factor in the low yields on long-term obligations. Insurance companies, other institutional investors, corporations, and individuals have in recent years held a large volume of idle deposits awaiting investment. Continued business recovery and improved corporate earnings to some extent encouraged active investment of those funds. Many investors, holding idle funds awaiting the return of what they would consider as normal interest rates, gradually began to put funds to use at prevailing rates."

(Annual Report for 1936, pp. 1, 29-30.)

1937

"During 1937 the principal objectives of Federal Reserve policy were to assure the continued availability of bank credit

at low rates for current requirements of business and at the same time so to regulate the available volume of member bank reserves as to avoid the likelihood of injurious credit expansion in the future."

(Annual Report for 1937, p. 1.)

Increase in reserve requirements

"On January 30 the Board announced a further increase in the reserve requirements of member banks... 'This action completes the use of the Board's power under the law to raise reserve requirements to not more than twice the amount prescribed for member banks in section 19 of the Federal Reserve Act.

'By its present action the Board eliminates as a basis of possible credit expansion an estimated \$1,500,000,000 of excess reserves which are superfluous for the present or prospective needs of commerce, industry, and agriculture and which, in the Board's judgment, would result in an injurious credit expansion if permitted to become the basis of a multiple expansion of bank credit. The Board estimates that, after the full increase has gone into effect, member banks will have excess reserves of approximately \$500,000,000, an amount ample to finance further recovery and to maintain easy money conditions. At the same time the Federal Reserve System will be placed in a position where such reduction or expansion of member bank reserves as may be deemed in the public interest may be effected through open-market operations, a more flexible instrument, better adapted for keeping the reserve position of member banks currently in close adjustment to credit needs...

"It is the Board's expectation that, with approximately \$500,000,000 of excess reserves remaining with the banks, credit conditions will continue to be easy... The Board's action does not reduce the large volume of existing funds available for investment by depositors, and should not, therefore, occasion an advance in long-term interest rates or a restrictive policy on the part of institutional and other investors in meeting the needs for sound business, industrial and agricultural credit.'"

(February 1937 Bulletin, pp. 95-97.)

Autumn easing

"Early in August, total excess reserves of member banks were in the neighborhood of \$700,000,000, but, owing to substantial withdrawals of balances by country banks, excess

reserves at New York City banks had declined to below \$50,000,000 as compared with \$200,000,000 in May. It appeared, therefore, that the New York banks might experience some pressure in meeting the autumn demands for currency and for credit.

"To avoid the development of such pressure, easing action in the money market was undertaken. The Board of Governors in September requested the Secretary of the Treasury to release \$300,000,000 from the inactive gold account, and at the same time the Reserve System announced that it would stand ready to buy additional Government securities in order to meet the expected seasonal demands on the banks for currency and credit during the coming weeks. The Board stated that the purpose of this action was to maintain at member banks an aggregate volume of excess reserves adequate for the continuation of the System's policy of monetary ease for the furtherance of economic recovery. The action was in conformity with the usual policy of the System to facilitate the financing of orderly marketing of crops and of autumn trade, and together with the reduction of discount rates at several Federal Reserve banks it placed the member banks in a position to meet readily any increased seasonal demands for credit and currency and contributed to the continuation of easy credit conditions...

"The Board's approval (of reduction in discount rates) was based upon the view that the reduction of discount rates at this time would assist in carrying out the System's policy of monetary ease and make Federal Reserve bank credit readily available to member banks for the accommodation of commerce, business and agriculture, without encouraging member banks to borrow outside of their districts or to liquidate their portfolios in order to be in a position to meet the needs of present or prospective borrowers...

"It is the Board's view, therefore, that at this time the Federal Reserve System can best discharge its public responsibility and promote the continuance of recovery by making it possible for member banks to obtain accommodation from Federal Reserve banks at rates which will encourage them to employ their funds to meet the needs of agriculture, industry and commerce.'

"The Federal Open Market Committee met in Washington on September 11 and 12 and reviewed the business and credit situation. In view of the expected seasonal demands on the banks for currency and credit during the coming weeks the Committee authorized its Executive Committee to purchase in the open

market from time to time sufficient amounts of short term U. S. Government obligations to provide funds to meet seasonal withdrawals of currency from the banks and other seasonal requirements. Reduction of the additional holdings in the open market portfolio is contemplated when the seasonal influences are reversed or other circumstances make their retention unnecessary.

"The purpose of this action is to maintain at member banks an aggregate volume of excess reserves adequate for the continuation of the System's policy of monetary ease for the furtherance of economic recovery.

"As a further means of making this policy effective, the Open Market Committee recommended that the Board of Governors of the Federal Reserve System request the Secretary of the Treasury to release approximately \$300,000,000 of gold from the Treasury's inactive account. The Board of Governors acted upon this recommendation and the Secretary of the Treasury agreed to release at once the desired amount of gold. This will place an equivalent amount of funds at the disposal of the banks and correspondingly increase their available reserves.

"This action is in conformity with the usual policy of the System to facilitate the financing of orderly marketing of crops and of autumn trade. Together with the recent reductions of discount rates at the several Federal Reserve banks, it will enable the banks to meet readily any increased seasonal demands for credit and currency and contribute to the continuation of easy credit conditions.'

"The Committee had given full consideration to general business and credit conditions and it was the general feeling that the existing volume of excess reserves was abundant for the continuance of easy credit conditions and for meeting the credit requirements of commerce, business and agriculture, that in the light of existing business and credit conditions effective action to meet and overcome the present business recession should be taken outside the field of the System's various monetary powers, and that the System could best contribute to the furtherance of economic recovery by being prepared in case of any change in conditions to act promptly in pursuance of the general objectives set forth in the resolution."

(Annual Report for 1937, pp. 9, 203-206, 219-220.)

1938

"In considering the problem of reserves at this time the Board wishes to emphasize that the long-view problem created by the existing large volume of bank deposits and bank reserves is distinct from the immediate problem of making ample bank credit available for the expansion of business from current levels.

"In recent years it has been the policy of the Government and of the Federal Reserve System to encourage the expansion of credit. This has constituted the so-called policy of monetary ease, which has been directed at keeping banks supplied with an abundant volume of reserves, so as to encourage them to expand their loans and investments. This policy has been one of the factors in the creation of the existing large volume of deposits in the hands of business enterprises and of individual and corporate investors, and has resulted in reducing interest rates to the lowest levels in history. It has been reflected in a decline in the carrying charges on mortgage debt for farmers and urban householders, has enabled many corporations to refund their debt at lower rates, and has lightened the cost of current financing to commerce, industry, and agriculture.

"Nor is there any immediate reason for considering a reversal of this policy. There is nothing in the present monetary or banking situation that would point to a proximate danger of injurious credit expansion. It is in such a period as this, however, when there is no call for quick action to meet emergency situations, that problems that may arise in the future should be analyzed and the efficiency of existing machinery appraised.

"It is from this point of view that the System's existing powers to absorb excess reserves should be considered. Member banks at present have excess reserves of \$3,600,000,000, and this total may be doubled in the future. To absorb these reserves the System has the power to raise reserve requirements by \$800,000,000 and to make sales out of its portfolio of United States Government obligations, which amounts to \$2,560,000,000. The use of these available means of absorbing reserves, to the extent that it may be in the public interest to do so, would still leave the banks with a volume of excess reserves upon which it would be possible for an injurious credit expansion to develop.

"The ability of the banks greatly to expand the volume of their credit without resort to the Federal Reserve banks would make it possible for a speculative situation to get under way that would be beyond the power of the System to check or control.

The Resorvo System would, therefore, be unable to dischargo the responsibility placed upon it by Congress or to perform the service that the country rightly expects from it.

"In view of this situation the Board has doemed it its duty to point out to Congress the prosent and prospective resorvo position of our banking system and the limitations on the powers of the System to regulate it...

"This action (reduction in reserve requirements in April 1938) had been agreed upon by the members of the Board as a part of the program announced by the President of the United States on April 14, 1938, for the encouragement of business recovery. Although there had been excess reserves in amounts considered ample to meet all probable needs of agriculture, commerce and business, the volume of business activity had declined with such rapidity as to produce injurious deflationary effects upon commodity prices, the capital market, and industry generally. In those circumstances and in view of the other stops proposed to be taken in the Government's program for encouraging business recovery, the Board decided that a reduction in reserve requirements of member banks might be helpful, as a part of a concerted effort by the Government to carry out the purposes of this program, by assuring the continued availability of ample funds for meeting business requirements and thereby proventing injurious credit contraction."

(Annual Report for 1938, pp. 21-22, 73-74.)

1939

No quotations

1940

No quotations