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STATEMENT BY GOVERNOR ECCLES FOR POLICY RECORD

As the Federal Reserve Board has repeatedly stated beginning with its annual report for 1945 and in numerous appearances before Congressional committees, the Federal Reserve System was unable to perform effectively its traditional function during the period of post-war inflation because so long as it was necessary to support the Government bond market in accordance with a fixed pattern of rates, the System lacked adequate means of absorbing bank reserves and hence restraining over-expansion of bank credit.

So long as demands for credit were intensified by inflationary pressures and banks, as well as other holders of marketable Government issues, found it profitable to shift from Government issues into private loans or investments or from short-term to longer-term Government bonds no effective monetary restraint could be exercised unless the System gradually or altogether withdrew as the residual buyer. This it could not do if the rate pattern was to be maintained. In effect, the banks were able to create reserves at will. Accordingly, the System ever since 1945 has pressed for adequate means of immobilizing bank reserves whether created by open market operations or otherwise.

Except for a nominal, temporary authority granted by Congress in August of 1948, which expired June 30, 1949, the System has had no means sufficient to bring about a restrictive situation in the money market. The System used such means as it could, including increased margin requirements, regulation of instalment credit, higher discount rates, and as much of an increase in short-term rates as the Open Market Committee was able to negotiate to exert restraint. This modest program could not, however, adequately restrain bank credit expansion. As a result of war financing, the money supply has been and still continues to be redundant, and money rates, especially short-term rates, have continued to be low.

With the change in the economic situation, many of the banks of the country are experiencing a rapid credit contraction and in view of the deflationary developments the Board has taken a series of steps since the first quarter of the year to ease credit conditions still further including a reduction in reserve requirements by which approximately 1.2 billion dollars of bank reserve was released to the market. The easing effects, however, of this action were offset by reason of the fact that in supporting the short-term rates, open market operations had the effect of absorbing the reserves which had been released.

With the expiration of the supplemental authority of June 30, approximately $800,000,000 of additional reserves were automatically released. To the extent that open market operations would absorb these reserves, the easing effect in the money market would be nullified. With this situation in view and after consultation with the Treasury, the Open Market Committee decided at its meeting on June 28 to discontinue supporting a fixed rate structure and thus permit the additional reserves to have some easing effect on the money market.

For some months long-term Government securities have again been under such heavy buying pressure as to require no support operations. Instead, efforts have been directed towards reducing the upward pressure on prices with consequent lowering of yields. In announcing the changed policy, the Federal Open Market Committee stated that, "Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased". The Committee emphasized that this would not alter the policy of conducting transactions in the open market with a view also to orderly conditions and maintenance of public confidence in Government bonds. The purpose and net effect of this change in policy will permit the automatic release of about $800,000,000 of reserves to take effect in the money market without being nullified by open market sales from the System's portfolio. As far as practicable, the market will be free to determine prices and yields without the intervention of the Federal Open Market Committee.

Since we have had easy money conditions with relatively low rates all along in the money market it should not be supposed that still easier conditions with lower rates will correct or cure a deflationary trend, although they may encourage greater use of the existing money supply and put the banks in a position where they will have still less reason to restrict credit. To the extent that the Reserve System becomes a reluctant seller of its holdings of Government securities banks may be more disposed to make productive loans to private borrowers or at least avoid putting pressure on good borrowers to pay off loans. Monetary policy, by itself, cannot make lenders lend or borrowers borrow; it cannot correct maladjustments within the economic structure which have arisen from non-monetary causes. It cannot by itself bring about the very necessary price and other readjustments within the economy.

The consuming public, investors, and financing institutions of all kinds are in stronger financial position today than ever before. It is clear, therefore, that with the existence of this condition of underlying strength the only change in monetary and credit policy that needs to take place is in the emphasis and direction of Federal Reserve actions towards relaxation rather than restraint. If the System had been in a position during the inflationary period to exert adequate restraints, it would have had more elbow room to reverse policy when deflationary forces are setting in.

The Federal Reserve authorities are constantly watchful not only as to current developments but also for signs of change, they have demonstrated their consciousness of the desirability of flexible administration of their powers, and they are prepared to take any further action within their means through reserve requirements, discount policy, open market operations, continued coordination of bank examination and credit policy, and otherwise as may seem advisable in order to aid in combatting adverse developments in the economic situation.

It should be recognized, however, that the maintenance of an ample money supply and liberal credit policies cannot alone overcome deflationary developments without the constructive cooperation of industry, agriculture and labor as well as the Government.