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REVIEW OF MONETARY POLICY ACTIONS

by

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With their productive capacity expanding more rapidly than total demands and output, businesses cut back their investment plans. Defense orders also were declining as a result of Government efforts to avoid exceeding budget estimates and the debt ceiling. At the same time consumers failed to respond to the new model automobiles and apparently were reluctant to add further to their debts. Thus there was no possibility this time of a rolling adjustment. The general change in the economic climate left business stocks in an exposed position and businesses proceeded to reduce them rapidly.

In the past nine months, most of the reduction in total output and employment has been accounted for by inventory liquidation, falling business outlays for plant and equipment, and reductions in consumer spending for durable goods, especially automobiles. Industrial production has declined 13 per cent and nonfarm employment by about 4 per cent.

Into the early autumn of 1957 monetary policy had remained restrictive in the face of rising prices and a spreading sentiment of creeping inflation. In view of developing uncertainties in the economic picture, open market operations began to ease bank reserve positions slightly in the latter part of October. In mid-November, Reserve Bank discount rates were reduced from 3-1/2 to 3 per cent, signaling a decisive change in System policy. From this point on, restraints on bank credit expansion were progressively relaxed.

In its effort to mitigate the downward movement in output and employment and to encourage early resumption of economic growth, the Federal Reserve System has utilized each of its three major instruments of policy: changes in reserve requirements, open market operations, and changes in discount rates.

Reserve requirements have been reduced on three occasions in 1958, freeing a total of almost \$1-1/2 billion of reserves.

Open market operations were used to supply reserves to member banks in late 1957. In early 1958, when the seasonal return-flow of currency was adding substantially to bank reserves, only a part of this addition was offset by open market sales. Since February, Federal Reserve purchases of Government securities have amounted to about \$700 million.

Following the initial reduction from 3-1/2 to 3 per cent in November, Federal Reserve Bank discount rates were lowered again on three occasions, and they now stand at 1-3/4 per cent--or just half of what they were in November.

As a result of these various measures, bank reserve positions have been eased substantially. Between September and May, member bank borrowings at Reserve Banks declined from about \$1 billion to little more than \$100 million. Excess reserves have increased and thus member banks have shifted from a net borrowed reserve position of about \$500 million to a free reserve position of more than \$500 million.

The shift in net reserve positions by more than \$1 billion does not tell the whole story. The point to be noted is that in maintaining a free reserve position while member banks are expanding their assets and deposits, the System is pursuing an active policy. As banks have utilized the reserves provided by System operations, additional reserves have been made available.

That the banks have been using the reserves made available by the System is indicated by the fact that commercial bank loans and invest-

ments increased more than \$8 billion in the seven months from the end of September 1957 to the end of April. In the same period a year earlier, bank credit had increased only \$3 billion.

The growth in bank credit has been mainly in the form of United States Government and other securities, and this has contributed significantly to an easing in the money and capital markets. Bank loans to businesses and consumers have declined with economic activity. On the other hand, mortgage holdings of banks have increased somewhat and loans on securities, which provide important support to the capital markets, have also risen.

The substantial increase in commercial bank credit in the period since last fall has been reflected on the deposit side primarily in a record growth in time and savings deposits. The active money supply, as represented by demand deposits and currency, has increased about \$1-1/2 billion or 1 per cent since September. But time deposits at commercial banks have gone up almost \$5 billion or 9 per cent as depositors have elected to transfer demand deposits to time accounts. Whether in time or demand form, the growth of bank deposits is serving to increase the liquidity of the economy and thus to provide the financial basis for renewed economic growth.

The transition from restraint to ease in monetary policy has produced a marked reaction in financial markets. Short term interest rates have fallen sharply. For example, the rate on Treasury bills, an indicator of the availability of funds in the money market, has declined from over 3-1/2 per cent in October to less than 3/4 per cent recently.

Longer term market yields have come down about  $3/4$  of a percentage point from their peaks last autumn. But there has been a heavy volume of security flotations in these markets--and this, of course, is the desired objective of lowered interest rates. State and local governments, which in some cases postponed borrowings during the period of monetary restraint, have borrowed 30 per cent more in the capital market this year than in the first five months of 1957. Corporate borrowing has so far been only slightly below the record volume of 1957. Foreign borrowers and international institutions have also borrowed more heavily in the United States capital market than last year.

Thus monetary policy has contributed to an increase in the availability and a reduction in the cost of borrowed funds. Commercial banks have reduced their lending rates and, with their reserve positions eased, they are in a condition to respond to increased loan demands. Meanwhile, their security purchases have provided a large flow of funds to the money and capital markets, thereby facilitating private and governmental borrowing in those markets.

I have given this review to point up the fact that, in the light of the economic situation, money and credit policy is fulfilling its function of providing a climate favorable for resumption of our economic progress so far as that can be done by actions in this field.