

FEDERAL RESERVE POLICY

Address
by
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When your genial and articulate presiding officer, President McDonnell of The First National Bank in St. Louis, invited me some weeks ago to address this luncheon meeting, I accepted with perhaps indecorous promptness. Let me assure you now that I was not motivated by an overwhelming desire to occupy the podium and to parade my views. As a matter of fact, the passing years suggest to me more and more that I am well advised to restrict my public utterances rather severely as to both frequency and content. However, in this case there were reasons - two of them - why the sober counsel of the passing years could not or at least did not prevail.

In the first place, I found it, as always, extremely difficult to resist Mr. McDonnell's artful and persuasive approach. This reason leaves out of account the further fact that Mr. McDonnell is one of my bosses, being a director of the Federal Reserve Bank of St. Louis and having been one when and since I was employed by that bank. In the second place, the invitation to speak here today affords me the opportunity to make good on a promise I gave five years ago and was prevented from performing. The record discloses that five years and two days ago there was a conference of bank correspondents of The First National Bank in St. Louis. Then, as now, I was invited to speak, and I had some remarks prepared, but the fates decreed that I should spend that day and a good many more in a hospital. Those of you who were here five years ago, and I suspect you are many, will doubtless recall that this place on the program was more capably filled than I would have done by Mr. Frederick L. Deming, then Vice President and now First Vice President of the Federal Reserve Bank of St. Louis.

It has seemed to me appropriate to refer back to the manuscript which I planned to use five years ago. It is entitled "Bankers and Money Questions". It evokes memories not much dimmed by the passage of five years. It contains a general description of the state of the economy of this country as it was then, and which without substantial modification could be used to portray the state of our economy today. Then I said, or was prepared to say:

"The American economy is operating at practical capacity. We have almost full employment of both the labor force and of our productive plant. "

My five-year old manuscript also attempted to state what I chose to call "the current money question of major importance" in these words:

"How can we hold the value of our money fairly stable over a period of time?"

And to that question I appended the comment that "the basic money question has to do with the integrity of the dollar. "

There are, of course, significant differences between the situation of five years ago and the situation today. Then we had but recently emerged from a long period of Federal Reserve support of the market for United States Government securities. Then there was war in Korea. Inflationary pressures generated largely by these two circumstances had created serious problems by early 1951. In efforts to curb the pressures, reserve requirements against demand deposits had already been increased by two percentage points and reserves against time deposits by one percentage point, an increase overall of more than 10 per cent. Selective controls of consumer credit and real estate credit were then in effect under Regulations W and X of the Board of Governors

of the Federal Reserve System and related regulations of the Federal Housing Administration and the Veterans Administration affecting real estate credit. Regulations T and U of the Board of Governors had been amended a few months before by increasing margin requirements on so-called stock market credit from 50 to 75 per cent. And in addition to all this, a voluntary credit restraint program had been inaugurated in an effort to direct the flow of credit away from nonessential and into essential uses.

Changes in Federal Reserve policy and policy action which attended and followed the Treasury-Federal Reserve accord of March 4, 1951 are well known to all of you. Suffice it for my purpose now to say that Federal Reserve support of the Government securities market was gradually withdrawn and Federal Reserve intervention in the money market was gradually reduced. Over time the inflationary psychology began to change and upward pressure on prices began to abate. Though shortly after midyear of 1951 the highly restrictive provisions of Regulation W had been somewhat eased, this did not signal the end of need for monetary and credit restraint. Inflation was still a threat.

This in sketchiest outline is where we were five years ago when a conference similar to this one was held in this very room. The objective of Federal Reserve policy was then to restrain the rate of credit expansion without handicapping the defense program and sustainable economic growth. Policy was aimed at the maintenance of a high level of economic activity without inflation but with enough new bank credit to accommodate the requirements of growth.

The objective of credit restraint continued throughout 1952 and through the first quarter of 1953. The discount rate of 1 3/4 per cent established in August, 1950 was continued in effect until January, 1953 when it was advanced to 2 per cent. In late 1952 mounting pressures of new Federal financing and credit demands by businesses and consumers, in the presence of restricted availability of reserves, led to borrowing by member banks from the Federal Reserve banks which in December averaged \$1.6 billion, the largest since 1921. Nevertheless during 1952 certain selective and voluntary credit controls were discontinued. Regulations W and X were terminated and the voluntary credit restraint program was discontinued.

In late spring of 1953 a shift of policy occurred following development of severely tightened credit conditions and almost concurrent observation of indicated abatement of inflationary pressures. Injections of reserves through expansion of Federal Reserve holdings of Treasury bills occurred in May and June, again in August and September, and again in November and December. Moreover reductions in reserve requirements against demand deposits were made effective in July, amounting in all to two percentage points for member banks in the central reserve cities and one point for all others. Throughout the balance of 1953 and all or most of 1954 the policy of the Federal Reserve System, reflecting slackening or slackened economic activity, was, in the words of the Board of Governors Annual Report, "* * * to cushion defense and inventory readjustments and to foster business recovery and sustain economic growth." This came to be known as the policy of "active ease", in the accomplishment of which all three of the implements of general credit control

with which the System is endowed were used. Reserves were made available through System open market operations and reduction of reserve requirements. Reduction in the cost of reserves was aided and abetted by successively lowering the discount rate from 2 to 1 3/4 per cent and from 1 3/4 to 1 1/2.

Came the end of 1954 and with it or shortly after it the end of the "active ease" phase of Federal Reserve policy. Responding to indications that the forces of inflation were again coming into the ascendancy, policy was altered to moderate the pace of credit expansion. In broad terms, this return to a restrictive phase of policy is still in effect. How it has been implemented is such recent history that there should be no need to recount it here. Many participants in this Conference, however, perhaps find some solace in the fact that whereas in the previous policy of active ease all three of the System's general tools were used in measures of relaxation, during the current policy of restraint one of these tools has not been used as an active instrument of restriction. Reserve requirements remain at the point to which they were lowered in mid-1954. Reliance in this restrictive phase up to now has been on open market operations and repeated elevations of the discount rate.

Thus the wheel has come full turn in the five years since Mr. McDonnell first invited me to one of these conferences. Five years ago Federal Reserve policy was designed to resist inflation as a means of protecting the stability of our money and its integrity. Today we are again resisting inflation and for the same purpose. In the meantime we have passed through a period when for precisely the same purpose, stability of the value of our money, we have seen Federal

Reserve policy the very opposite of restraint and restriction. This comes as no news to you, I feel sure, but the point I emphasize is that Federal Reserve policy is flexible. It is not static. It changes direction and it varies emphasis as conditions change and situations develop. It is not rigid, though I dare to believe that once a course believed to be right is charted, it is unyielding to forces which would veer it this way or that for purposes not consistent with the objectives to which the System is dedicated. There may be, indeed there are, differences of opinion as to timing, as to matters of degree, and occasionally perhaps as to direction of policy. So long as judgments of men are involved in policy formation, which may well be forever, these differences of opinion, if informed and honest, are not to be decried. They tend to enhance the flexibility of policy and to guard against rigidity. They help to keep Federal Reserve people reminded of the fact that there is much wisdom and experience outside the System of which we should and must make continuous and unselfish use.

At this point it should be made abundantly clear that in thus describing and characterizing Federal Reserve policy I do not mean to say nor remotely imply that only the Federal Reserve is concerned with the integrity of our money or that only the Federal Reserve can do something about it. Though the major reason for the Federal Reserve System's existence is to be found in its responsibility for contributing what it can to this objective, using the powers delegated to it for that purpose, it does not follow by any means that the System has exclusive responsibility in the field or that it alone can do the job. In saying this I do not derogate from the importance of the System's role and responsibility. It is no derogation to say that one can do only what one can do.

One who contemplates the role of Federal Reserve policy in today's scheme of things in this country finds a good deal to chalk up by way of accomplishment and a very great deal that is still to be learned. In the past there have been changing fashions in beliefs concerning the effectiveness of general monetary controls. Although there is still lack of unanimity on that point it is not my intent to debate it today. Upon the twin propositions that money will not manage itself and that monetary management is a vital function of government, however, there is substantial agreement. The unresolved questions, therefore, and the areas of controversy have to do mostly with the "hows" of monetary management and monetary policy making. Recognition of monetary management as a function of government unavoidably complicates the subject by raising questions whether and to what extent the aims of monetary policy embrace the social objectives of government, as they are from time to time, as well as economic objectives. I do not suggest that the two categories are mutually exclusive. My only point is that without a reasonably clear understanding of the aims of monetary policy and agreement with respect thereto, lack of agreement with respect to means, methods, and techniques is to be expected. This may be tantamount to saying that until the social and economic objectives of government are settled and decided for all time, the techniques of monetary management are doomed to remain subjects of dispute and debate. If so, this is not a forecast of despondent pessimism. It is no more than acceptance of the facts that men have heretofore striven, and presumably will continue to strive, for improvement of their lot on earth, and that improvement necessarily implies a dynamic rather than a static society.

Basic to the continued and continuing search for improvement in the methods of monetary policy making is a substantial measure of agreement on the role of decision making by the monetary authorities. The idea of an easy automaticity in monetary management has been generally abandoned although, as some have pointed out, even under a so-called automatic monetary system decisions had to be made. In the present state of the art, however, the requirement for conscious decision making is more and more recognized. Decision making involves human judgment, and the application of human judgment raises questions of criteria and guide-posts. Though these questions have not been finally answered by any means, nevertheless here is where a good deal of the accomplishment of which I spoke a moment ago has occurred.

For one thing our techniques for the accumulation and presentation of the economic intelligence indispensable to monetary policy making have been vastly improved and are continuing to improve. There are times, I suspect, when bankers and other business men feel that the collection of statistics by the Federal Reserve System and other agencies imposes unprofitable burdens upon them. With that view it would be easy for me to sympathize if I were not in good conscience convinced of the pertinence and essentiality of the requested information to important aspects of policy making. It is such a self-evident principle that I assume none would controvert it that one has to know the pertinent facts before he can reach sound conclusions. I therefore suggest that when bankers and others are asked to furnish data with respect to which they are the only sources, or in any event the best sources, it may ease the burden

of compliance somewhat to reflect upon the request as an opportunity to participate in an important way in the formulation of national monetary and credit policy. In return for your valued cooperation and assistance you are entitled to the assurance that you will not be called upon unless the need is real and the relevance of the requested data reasonably clear.

In another respect there has been significant accomplishment in the evolution of the art of monetary management. Through a combination of experience by practitioners and theoretical appraisal and formulation by scholars in the field, a substantial body of knowledge has already been accumulated. It will be expanded and enlarged as time goes on. We may even discover that some of the things we have learned are wrong. The economic climate is right, however, for the exploration of monetary policy as an essential responsibility of government to proceed at accelerated pace. If the world can but remain at peace so that the incontestable necessities of war do not displace the peaceful objectives of government, we shall almost surely witness in the coming years a large degree of preoccupation with monetary affairs. Indeed it has already commenced. Readers of current newspapers, periodicals, and journals must be aware of the fact that the space devoted to matters of finance and monetary and credit policy has grown by leaps and bounds in recent years. Up to a point this is good. Since I believe that monetary policy vitally affects the lives of our people, I also believe that it should be as well understood as is reasonable to expect so that the people may intelligently appraise it and express their wishes with respect to its general place in the framework of government. But there is a point beyond which I do not believe that preoccupation with money and

the monetary management is productive of good. The power of money is great, but it is not all powerful. No matter how skillful the regulation of the money supply may be, that fact alone and by itself cannot guarantee the economic and social health of the nation. There are decisions to be made by others which are quite as important as the decisions of the monetary authorities.

Under the system of monetary policy making which has been provided by law in this country, the monetary authorities are, with a relatively minor exception, limited to the use of general, quantitative controls. With these instruments they may influence the quantity of money in existence and its rate of change. They may also influence the cost of money both indirectly by affecting the balance of supply and demand and somewhat more directly by fixing the rate at which reserves may be borrowed from the Reserve banks. With but one exception at the present time the monetary authorities are not authorized by law to undertake direct, qualitative regulation of the uses to which the existing money supply and additions thereto may be put. The exception, as you know, is to be found in Regulations T and U of the Board of Governors with respect to so-called stock market credit. I do not forget, of course, that there have been, at prior times, interludes of qualitative regulation of consumer credit and real estate credit.

Who, then, makes the decisions concerning the uses to which the money supply of this country shall be put? In answering the question, one must take

into account the flow of spending that results from the production, distribution, and consumption of goods and services. One must take into account the savings of those who elect to save rather than spend. Since savings are generally spent, too, by borrowers who employ the savings of others, one must take into account the institution of credit in answering the question, "Who decides how the money supply shall be used?" And in considering the economic instrument called "credit" one must also be aware of the fact that in addition to the credit resources derived from savings another source of credit is to be found in the ability of the commercial banking system, if supplied with reserves, to create additions to the money supply by making loans. All these things considered, the answer may be truly made that the people of the country, operating in and through their political institutions, their private financial institutions, and their market places, decide how the money supply shall be used and how fast it shall be turned over in the stream of spending for consumption and investment. The people make the decisions, not the monetary authorities.

At this juncture in such a discussion one is face to face with a number of tangents. The temptation may be irresistible to some, for example, to follow a tangent which takes them into the social aspects of free markets, the much discussed free enterprise system, or one of a variety of profound questions of wide ramifications. Fortunately for you, and for me too, the hour is so late and my allotted time so nearly spent that we are at least momentarily spared an excursion along such a philosophical tangent. Before closing, however, I should like to expose briefly two thoughts which perhaps you may take home with you and ponder during the coming long winter evenings.

There are some people in the world, not to say in this country, who have no confidence in the ability of the people to make sound decisions with respect to the uses to which the money supply shall be put, even in times of peace and normalcy, whatever that means. There are others who profess confidence in the people and in their institutions for deriving democratic judgments, such as free markets, but who are inclined to become so unhappy when they find themselves in the minority with respect to specific issues that they begin to clamor for the inauguration of governmental controls to prevent similar miscarriages in the future. Whatever the cause or the motivation, a question which, in my judgment, will have to be faced and decided in the future is whether the people shall continue to possess the prerogative of deciding in the main how their money supply shall be used or whether qualitative controls of money and credit shall be extensively added to existing general, quantitative controls. I do not argue the question one way or the other. I merely state it.

The second thought I wish to leave with you is actually a subdivision of the first but is, I think, of special significance to bankers. In the composite decisions of the people concerning the use of our money supply, a most important sector of decisions is in the hands of commercial bankers. Bank credit, as I have already indicated, constitutes the principal source of additions to the money supply. It therefore follows that in a time of monetary restraint bank credit is a scarce resource and the task of allocating it falls upon bankers and especially bank lending officers. This means that one of the economic functions of commercial bankers is to effectuate monetary policy. Their multitudes of individual decisions, the essence of a free market, bring about better allocations of funds than any

other system yet devised. But with the overall results of their allocations it can not be denied that there are, in some quarters at some times, dissatisfactions. There are complaints that too much is allocated for this or that purpose and too little for another. There are complaints that bank credit is available to this or that size of borrower but not to another. In substance there is complaint that the same economic motivations which produce good results in the economy generally work evil in the commercial banking system. Bankers should be aware of these things. They should give constant attention to the improvement of their allocative decisions. As leaders in the financial community they can and of right ought to accept a major share of responsibility for the decisions of the people concerning the use of their money supply.

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