OPEN MARKET INVESTMENT POLICY

EXCERPTS

1923 - 1928

CONFIDENTIAL (FR)

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Explanatory Note

The record of discussions and policy decisions relating to the operations of the Federal Open Market Investment Committee during the years 1923-1930, and of the Open Market Policy Conference during 1930 and the first half of 1931, has been re-examined recently. In the belief that this record may have a continuing reference value to present and future members of the Federal Open Market Committee, the parts describing actions taken and the reasons for those actions have been reproduced. The parts omitted consist largely of routine reports which do not seem essential to an adequate historical review of Committee operations in those years.

Copies of this record are being furnished to each of the members of the Committee, to the Presidents of the Federal Reserve Banks not currently serving on the Committee, and to members of the staff who are working on Committee matters. The first volume of the record covers the years 1923-1928 and it is expected that two additional volumes will be required for the years 1929 to mid-1931. No similar review has been made for the period subsequent to July 1931.

Winfield W. Riefler, Secretary,
Federal Open Market Committee.

February 1956

Developments During 1923

Organization of Open Market Investment Committee.

Board resolution. The present Open Market Investment Committee for the Federal Reserve System, which comprises the Governors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland and Chicago, was created in accordance with the terms of resolutions adopted by the Board on March 22, 1923, as follows:

"Whereas the Federal Reserve Board, under the powers given it in Sections 13 and 14 of the Federal Reserve Act has authority to limit and otherwise determine the securities and investments purchased by Federal reserve banks;

"Whereas the Federal Reserve Board has never prescribed any limitation upon open market purchases by Federal reserve banks;

"Whereas the amount, time, character, and manner of such purchases may exercise an important influence upon the money market;

"Whereas an open market investment policy for the twelve banks composing the Federal reserve system is necessary in the interest of the maintenance of a good relationship between the discount and purchase operations of the Federal reserve banks and the general money market;

"Whereas heavy investments in United States securities, particularly short-dated certificate issues, have occasioned embarrassment to the Treasury in ascertaining the true condition of the money and investment markets from time to time,

"THEREFORE, Be It Resolved, That the Federal Reserve Board, in the exercise of its powers under the Federal Reserve Act, lay down and adopt the following principles with respect to open market investment operations of the Federal reserve banks, to wit;

"(1) That the time, manner, character, and volume of open market investments purchased by Federal reserve banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation.

"(2) That in making the selection of open market purchases, careful regard be always given to the bearing of purchases of United States Government securities, especially the short-dated issues, upon the market for such securities, and that open market purchases be primarily commercial investments, except that Treasury certificates be dealt in, as at present, under so-called "Repurchase" agreement.

"Be It Further Resolved, That on and after April 1, 1923, the present Committee of Governors on Centralized Execution of Purchases and Sales of Government Securities be discontinued, and be superseded by a new committee known as the Open Market Investment Committee for the Federal Reserve System, said Committee to consist of five representatives from the reserve banks and to be under the general supervision of the Federal Reserve Board; and that it be the duty of this Committee to devise and recommend plans for the purchase, sale and distribution of the open market purchases of the Federal reserve banks in accordance with the above principles and such regulations as may from time to time be laid down by the Federal Reserve Board."

Organization. The Conference of Governors of the Federal Reserve banks held in Washington during March, 1923, to which the plan of open market operations as outlined in the Board's resolutions was submitted, expressed itself in favor of the plan and of the establishment of the Open

Market Investment Committee for the Federal Reserve System to supersede, on and after April 1, 1923, the existing Governors' Committee on Centralized Execution of Purchases and Sales of Government Securities. At the suggestion of the Governors' Conference, the Federal Reserve Board appointed the members of the Committee on Centralized Execution of Purchases and Sales of Government Securities (Governor Strong, Chairman, Governors Harding, Norris, Fancher and McDougal) as members of the new Committee.

Policy adopted at April 13 meeting. The first meeting of the Open Market Investment Committee for the Federal Reserve System was held at the Federal Reserve Bank of Philadelphia on Friday, April 13, 1923, at which meeting the Committee adopted the following policy governing open market purchases by Federal Reserve banks and the administration thereof:

"The Committee believes it important that the twelve Federal reserve banks should be in agreement on the subject of a System policy and in this connection calls attention to the minutes adopted by the Governors' Conference in October 1922, to wit:

'That for the present the credit policy of the Federal Reserve System should aim to furnish credit and currency to member banks for their seasonal and emergency requirements, but such policy, as well as open market operations, should be administered in each district in such manner as to assist the system in discharging, as far as it may be able, its national responsibility to prevent credit expansion from developing into credit inflation.'

"The view therein expressed is sound and, supplemented by the policy outlined at the recent Conference (Resolutions of Federal Reserve

Board adopted on March 22, 1923), presents a safe and sane program for Federal reserve banks to follow.

"A policy as drastic as that of the Bank of England, for instance, which always aims to make the market pay a penalty rate upon recourse to the bank, is not always suited to the American bill market, and if applied might have an adverse effect upon the establishment of dollar credit and dollar bills in overseas trade and world markets, and it seems reasonably certain that the sterling credit would quickly drive the dollar credit from those markets. It is probable therefore that we must continue for some time a somewhat paternalistic attitude toward the market for dollar bills in this country.

"Therefore, it may be assumed with respect to rate policy as applied in open market purchases of bankers' bills and prime trade paper, bearing suitable banking endorsement, that the rates made effective from time to time should be established with regard to the general credit situation, the state of the open market, and the rates therein obtaining, but with a primary regard for the accommodation of commerce and business. The secondary regard must be for the effect of reserve banks' open market rate on the development of dollar acceptance credit in domestic and foreign markets and dollar exchange in world markets.

"The Open Market Investment Committee for the Federal Reserve System is charged with the duty of devising and recommending plans 'for the purchase, sale and distribution of the open market purchases of the Federal reserve banks' in accordance with the principles outlined therein. The reference to sales is intended to relate to sales which may be made from time to time by and between Federal reserve banks, of bankers' and trade bills, but that with respect to Government securities it is intended to refer also to resale of them to the market or elsewhere upon occasion.

"The reference to purchase is understood to relate to the collective or individual purchase by reserve banks of both bills and securities and the distribution referred to is understood as intended likewise to apply both the bills and securities.

"In respect to the System's attitude toward open market operations in bills, it has been recognized repeatedly at conferences of Governors that the stabilization and support of the bill market at rates closely related to the rates established by the market itself is a responsibility of the System and not of individual Federal reserve banks, and it is to be hoped that the operations carried on under the auspices of the new Committee will provide for a more uniform practice in that regard.

"When occasion requires that support be rendered to the bill market, it may be impracticable for every bank under all circumstances to be a continuous participator in the purchase of bills, and therefore a way must be devised that will permit some of the banks to participate regularly in purchases when their loanable funds are not seasonably employed in serving the requirements of their member banks, but will relieve them from such participation when their local demands are heavy; at such times their proportionate participation should be assumed by the other banks and appropriate adjustments made. It is suggested that to accomplish this ratios of participation in general purchases in the principal markets be worked out so as to make an equitable distribution among all twelve banks at times when the reserves of all permit, and that appropriate ratios be worked out that would be applicable to the purchases at such times as there are a smaller number of participants. The base for these ratios is a matter for consideration and mutual agreement. Inasmuch as the development of local markets by the regional bank is incumbent upon each bank, its local purchases should not be discontinued but should operate to reduce its allotment from the general purchases made elsewhere, and it is suggested that this might be accomplished by each bank regularly advising the Committee of its local purchases, as has recently been the practice in transactions in Government securities.

"With respect to the shorter Government issues which freely circulate in the discount market, the position may be somewhat different. They are in essence short-term investment securities which, in the case of tax certificates and notes, are equally self-liquidating. Their market value perhaps fluctuates more in accordance with the price of money and when their yield, plus tax exemption, is considered, it is found that their relative yeild more closely approximates the price of time money than call money. Therefore the rates at which such issues should be bought for investment by Federal reserve banks should reflect (1) the general credit situation, (2) the present and prospective price for money and (3) their current status in the market. The rate at which temporary advances should be made to dealers on such securities should be more closely related to their yield and money rates than would be the case in advances on bills.

"The effect of collective purchases and sales of securities by the reserve banks is of great importance in its bearing on the general credit situation. It should be remembered that the injection of reserve bank funds into the money market acts as a stimulant to it and the resale of such securities has the reverse effect.

"Advances to dealers under sales contracts, of course, are not allocated but the volume of such advances held at each regional bank may well be taken into consideration in effecting the equitable distribution of all bills purchased and reported in the same way as local purchases. Adjustments in the allotment of general purchases can then be made just as if they had been locally purchased outright. It is believed that when ratios are once established the adjustments will be neither difficult nor cumbersome."

Sales of Securities during 1923.

At a meeting of the Committee on May 23, 1923, as a result of the discussion and the general feeling that an ease in money had recently occurred, occasioned partly by an increase in imports of gold and partly by lessened demand for credit, it was felt that the time was opportune to dispose of a moderate amount of securities held by the System (not in the Open Market Investment account). It was voted to authorize and direct the Chairman to undertake to arrange with the twelve Federal Reserve banks for the sale of $50,000,000 of securities on a pro rata basis at as early a date as practicable. During the following month, the System disposed of not only the $50,000,000 of securities referred to, but of an additional $30,000,000 as well.

Covering the period from the date of the organization of the Open Market Investment Committee (April 1, 1923) to the time of the Governors' Conference held in Washington on November 12, 1923, transactions in Government securities by the Federal reserve banks affecting their own investment accounts resulted in a reduction of their holdings of $148,000,000 from the total holdings of $222,000,000 (exclusive of sales contracts), while holdings of bankers acceptances reflected a reduction during the period of $89,000,000 from a total of something over $261,000,000.

Creation of Open Market Investment Account, December 1923.

At a meeting of the Committee held on December 3, 1923, the Committee reported to the Federal Reserve Board that in its opinion it was expedient at that time to give the Reserve banks permission to assume a position toward the money market by the purchase of a suitable volume of Government securities of short time maturities, provided such purchases could be made without disturbing the conditions of the money market and of the market for Government securities. The Board declared itself in favor of the purchase of a limited volume of short term Government securities, reserving to itself the right to discontinue purchases and to require the sale of any of the securities purchased at any time it might deem such action to be expedient. This authority constituted the first step toward the creation of a System open market portfolio.

The minutes of the meeting of the Committee held on December 3, 1923, show that it was the understanding of the Committee that the Chairman would ask for the views of the Federal Reserve Board and of the participating Reserve banks as to further purchases after a total of $100,000,000 had been acquired. At the beginning of the year 1924, the Open Market Investment Account stood at approximately $13,000,000, and at the end of January amounted to something over $51,000,000.

Developments during 1924

Meeting of January 14, 1924.

Another meeting of the Committee was held at the Federal Reserve Bank of New York on January 14, 1924. At this meeting, two members of the Federal Reserve Board (Governor Crissinger and Mr. Miller) were present. Data was presented to the meeting with respect to the investment holdings of the System, the status of the Special Investment Account, which then amounted to about $35,000,000, and the state of the market for short term Government securities.

New York Bank memorandum on credit conditions. There was also read to the Committee the following memorandum addressed to the Chairman of the Committee by Mr. Burgess of the New York bank, with reference to basic conditions in the money markets and suggestions for open market program:

"1. Basic Conditions. While money is now extraordinarily easy and many of the conditions are present for a period of inflation and speculation, it does not seem to me that such a period is yet upon us. In the field of business and commodity prices there is no evidence whatever of inflation or speculation. Commodity prices are hovering at the low points reached in the past month or two. Business is continuing to recede in volume rather than increase. The employment figures for December showed a decrease, as did also the production of steel, carloadings and a number of other indexes. The flood of return of currency and the decrease in bank loans since the first of the year seems to me clearly to reflect reduced business activity and continued caution in operations. In the stock market alone is there evidence of an expansion and there we have very far from a runaway market, in spite of the pronounced efforts of many speculators to create a bull market. While stock prices are comparatively high, the street loan accounts are only moderately so, particularly if allowance is made for a seasonal increase at the beginning of the year. It is my belief, therefore, that while the situation clearly contains a threat of serious inflation, the time has not yet come to sell securities, particularly in view of the limited amounts now held, but that we should rather continue to acquire more as far as we can do so, without making easier a market already very easy.

"2. The Program. It seems to me wise to continue buying certificates and notes carefully as they are offered and as far as it can be done without affecting the market. The best opportunity for purchasing would appear to be in the latter part of February and early March, when spring needs of business begin to be felt and when there is ordinarily some tightening in money rates, but some small quantities might be purchased before that time.

"3. Purchased Bills. It seems clear that some arrangements should be made by which the $300,000,000 of bills held by the system should be subject to somewhat the same control as our holdings of certificates and notes, and that in general the policy should be followed of maintaining the bill portfolios at present, but letting them diminish as they mature at times when certificates were being sold. In order to accomplish this end it is clearly necessary to secure some understanding between the reserve banks.

"4. Earning Assets. If the present movement toward reduction of the earning assets of the system continues, it is clear that many of the banks will be flat and unable to earn expenses. This makes more difficult an agreement as to purchased bills and raises the question as to a common policy in the whole matter of earnings. Of course, if a business boom should begin this difficulty would hardly arise."

Action of Committee. Following a general discussion as to the existing temporary ease in money and the importance of gradually moving forward in acquiring a moderate portfolio of short term Government securities, the Committee's minutes of the meeting state that "all present were in agreement that in view of existing conditions in the money market this was a time for extreme caution and that for the moment we should adopt a waiting policy rather than to change our buying prices (thereby affecting yields) and follow the market downward." A motion was adopted that buying prices for the purchase of short term Government securities be not advanced above those already authorized and that the Committee be authorized to purchase prior to its next meeting not exceeding $15,000,000 of Treasury notes maturing December 15, 1925.

Meetings in February 1924: Purchases Authorized.

At a meeting of the Committee held in Washington on February 8, 1924, at which the principal subject of discussion was the increased price of Government securities, one of the actions of the Committee was that the prices at which the Committee was authorized to purchase Government securities be revised so as to permit of increased purchases in moderate volume, say up to the amount of $100,000,000 previously agreed upon.

At the same meeting, the question was raised as to whether the program of the Committee should be determined solely with regard to credit policy or whether it should be influenced by the desire of some of the banks to increase their investments in order that their earnings might at all times be large enough to pay their expenses and dividends without going into surplus. The Committee recognized that there was a division of opinion among the banks on this question and it was suggested that it would be desirable for members of the Committee, together with representatives of the Federal Reserve Board, to meet periodically with the boards of directors of the different Federal Reserve banks represented on the Committee in order to create a better understanding by discussing with the different boards of directors the various transactions of the Committee.

On February 25, 1924, the Open Market Investment Account stood at about $85,000,000, and on that date a meeting of the Committee was held in Washington at which a motion was made and carried that the Chairman be authorized to submit to all participating banks the Committee's recommendation that further purchases not exceeding $100,000,000 be made after the first $100,000,000 purchase had been completed.

(Secretary's note: I do not find anything in the minutes of that meeting of the Open Market Investment Committee nor in the minutes of the Board to show that the question of authorizing an increase in the account to $200,000,000 was approved by the Federal Reserve Board, although in a letter which the Chairman of the Committee addressed to the Governors of the other Federal Reserve banks, the following statement appears: "It was felt that in order to carry out the purpose of the account, it would be necessary to increase purchases at a somewhat more rapid rate than was possible under the existing limitations, and the committee, therefore, took the action which is expressed in . . . the minutes of that meeting. All of this was submitted to the Federal Reserve Board, and we understand was informally approved.")

Meeting of April 22, 1924.

Action of Committee. At a meeting of the Committee held on April 22, 1924, the Chairman of the Committee stated that in accordance with the authority given at the meeting on February 25, 1924, purchases for the Special Investment Account had almost reached the $200,000,000 mark, and asked the views of the Committee and others present with regard to further purchases. The Committee voted that additional purchases in the Special Investment Account for the Federal Reserve System be authorized up to an amount not exceeding in the aggregate $250,000,000.

At this meeting, Mr. Winston, Undersecretary of the Treasury, brought up for discussion problems raised by Treasury operations on March 15, 1924, and their effect on the money market. Various means were discussed for avoiding disturbance of the money market as a result of Treasury operations at times when discounts at Reserve banks are small and the suggestion was advanced that Federal Reserve banks might at such times temporarily sell short Governments to member banks to an amount that would equalize their excess reserves during the few days pending the collection of tax checks. No definite decision, however, was reached.

Memorandum on credit conditions. The report of the Secretary of the Open Market Committee submitted at the April 22 meeting, has attached to it a memorandum entitled "Credit Conditions and the Open Market Program," which reads as follows:

"The Credit Situation

"Since the meeting of the Open Market Investment Committee in February price and credit inflation has become much less probable for the immediate future. Practically all of the available indexes for March indicated a considerable decrease in the volume of production and business transactions. There is evidence that production has been running somewhat ahead of consumption and that there are considerable stocks of manufactured goods on hand. Commodity prices have been working slightly lower. The prospect for the future, therefore, appears to be for somewhat less active industry and great caution in business enterprise. The stock market has weakened and become inactive. While there has been no marked reduction in bank loans, money rates have become slightly easier. . . .

"We have a situation where easier money is likely to help rather than hinder a normal rate of business activity. There therefore appears to be in the business situation no impediment to carrying through a program of building up a portfolio by the Federal Reserve Banks.

"Future Money Rates

"The usual seasonal tendency of money rates would lead us to anticipate moderately stable rates until about the middle of May, followed by some easing until early in July, when the fall seasonal demand will begin. In addition to the seasonal tendency a continuation of gold imports at the rate of about one million dollars a day, and quiet business are factors making for easier rates in May and June.

"The Buying Program

"In view of these conditions it seems probable that buying can be carried on safely during the next two or three months, but at progressively lower rates. In order not to drive the market down rapidly it will be necessary to buy slowly and cautiously. The yields on Government securities for the coming three weeks are apt to be more favorable than in the latter half of May and in June.

"Probable Results of Buying Program

"It is well to note that even a gradual program of purchases will tend to ease rates somewhat further. It also seems probable that with or without a buying program the credit situation may lead to lower discount rates at some of the Federal Reserve Banks. This in turn would result in lower market rates and a necessarily lower schedule of purchasing rates. It seems probable also that, as buying is carried further, holdings of United States securities will become large enough to make it apparent in the published statements that such buying has been taking place. This means that public discussion of the program and its effect on money rates, etc., will have to be reckoned with. These do not appear to us as reasons which should stand in the way of carrying on the buying program, but they are results which should be taken account of."

> (Secretary's note: Two members of the Board were present at the meeting of the Open Market Investment Committee held on April 22, 1924, but the minutes of the Board do not show any discussion of the proposals of the Committee nor of approval having been given to increasing the account as the Committee recommended.)

Meeting of May 29, 1924

The next meeting of the Open Market Investment Committee was held in Washington on May 29, 1924. At this time, the Open Market Investment Account stood at $258,000,000

New York Bank memorandum on credit conditions. Attached to the report of the Secretary of the Committee, which was submitted at this meeting, was a memorandum from Doctor Burgess to Governor Strong, reading as follows:

"The tendencies in business and credit conditions are in the same general direction as at the time of the last meeting of the Open Market Committee in April, but more definitely marked than at that time. There is a decline in production and in wholesale trade, although distribution to the consumer continues in fairly heavy volume. Commodity prices and stock prices are weak. Reflecting these movements, member bank commercial loans have begun to decline somewhat and their investments to increase. Gold imports have continued heavy, amounting to 45 million in April, and money has grown progressively easier.

"As far as the business and credit situation goes there appears to be no immediate danger of inflation or uncontrolled speculative activity. Easier money is likely to be a benefit rather than a detriment to sound business activity. In so far as slightly easier money is likely to result from further purchases of securities by the Reserve Banks, a program of further purchases would be desirable. Moreover the continued inflow of gold at a higher rate than last year emphasizes the importance of the buying program.

"In view of the usual seasonal influences it would seem probable that purchases can be made more easily in a few weeks, in late June and early July, when business begins to prepare for the autumn trade, than at the present. But the experience of the past few months would appear to indicate that some purchases might be made before that time in a moderate amount without unwholesome effect on the market for government securities and the money market generally.

"It is perhaps worthy of note that the purchase of securities by the Federal Reserve Banks has not evoked any adverse criticism, although the amounts have now become large enough so that the purchases have been commented upon from time to time in the newspapers."

Action of Committee. At the meeting on May 29, 1924, the Chairman of the Committee stated that in view of present and prospective credit conditions in New York, the directors of the Federal Reserve Bank of New York felt strongly the necessity for being in a position, either by the acquisition of a portfolio consisting of assets under their sole control or by the use through the Committee of the securities in the Special Investment Account, to exercise a stabilizing influence on the money market during periods of heavy Treasury transactions and to counteract by the sale of securities, if and when such action should be warranted, any undesirable effects caused by abnormal ease of money, growing out of Treasury operations, when the market was already under the influence of heavy gold imports. Discussion was also had at the meeting of the question of increasing the amount of securities in the Special Investment Account and the question of the use of investments held in the System Special Investment Account to neutralize abnormal money conditions in New York on quarterly tax periods.

The Committee voted to recommend to the participating banks an increase in the holdings of Government securities for Special Investment Account of another $150,000,000 such purchases to be made at the discretion of the Committee at current market prices, and also that the Chairman be authorized to make temporary sales of Government securities from the Special Investment Account during quarterly tax periods in such amounts as may be deemed advisable under a suitable plan for their repurchase for the Special Investment Account.

At a meeting of the Board on June 4, 1924, there was submitted a letter from the Chairman of the Open Market Investment Committee, reporting the Committee's action as taken at its meeting on May 29, and on motion the Board voted that the Chairman of the Open Market Investment Committee be advised that the action reported in his letter is in accordance with the understanding of the Board, making it clear that the banks are authorized to purchase through the Committee up to $400,000,000 of short term Government obligations, and that the Board should be advised when the purchases have been completed.

Meeting of July 16, 1924

The next meeting of the Open Market Investment Committee was held in Boston on July 16, 1924, and was attended by Doctor Miller. At that meeting, the Chairman submitted a memorandum pertaining to the work of the Committee with especial reference to a program for the future.

(Secretary's note: A copy of the memorandum referred to does not appear to be in the Board's files.)

At the July 16 meeting, it was voted to authorize the Chairman of the Committee to sell and repurchase securities held in the Special Investment Account on the next quarterly tax period, in September, 1924, in the same manner as such sales and repurchases were made through the New York and Chicago banks during the June 1924 tax period.

(Secretary's note: This was apparently the first sale of securities out of the Special Investment Account to offset the effect of the quarterly Treasury operations.)

At the July 16 meeting, the Committee also discussed its future policy with respect to increasing the volume of short term government securities in the Special Investment Account, and the Chairman's view, which was concurred in by those present, was that the situation in the New York money market was then such that it would be more advantageous to have purchases made as largely as possible in Federal Reserve cities other than New York for the reason that the New York banks were discounting practically nothing and purchases at that time in New York would have a tendency to increase the volume of loanable funds in New York, whereas purchases made in other districts would have a tendency to increase the volume of loanable funds in other sections of the country.

Following the discussion, it was voted by the Committee that the limit on purchases of Government securities for the System Account be raised from $400,000,000 to a maximum of $500,000,000, such purchases to be made at the discretion of the Chairman as to prices and to be so conducted as to avoid or minimize changes in the credit situation or the market quotations for the securities. The Chairman was also authorized to carry out the suggested plan of having purchases made in other districts than New York. The Committee, by formal vote, also expressed the view that it would be in favor of increasing still further the limit of $500,000,000 if conditions remain substantially unchanged and to request that the Federal Reserve Board give the proposal its consideration and furnish the Committee with an expression of its views.

At a meeting of the Federal Reserve Board held on July 29, 1924, at which the Chairman of the Open Market Investment Committee was present, formal consideration was given to the actions taken by the Open Market Investment Committee at its meeting on July 16. The Board approved of the Committee increasing the account from $400,000,000 to $500,000,000, with the understanding that in carrying through this program of purchases all effort be made to avoid disturbance to the money market. No action was taken with regard to the suggestion of the Committee that the account be increased to $600,000,000.

Meeting of October 24, 1924

The Open Market Committee next met at the Federal Reserve Bank of Chicago on October 24, 1924. This meeting was attended by the Governor of the Federal Reserve Board. At that time, the Open Market Investment Account stood at about $500,000,000, purchases up to that amount having been completed early in September, and the Committee's operations since having involved only temporary purchases and sales with no net change in the amount of Government securities held.

Memorandum on credit conditions. Attached to the report of the Secretary, which was submitted at the Chicago meeting, was a memorandum on credit and market conditions which reads as follows:

"When the Open Market Committee began its purchases of government securities in December 1923, the holdings of such securities by the System had been reduced to a point where the reserve banks were practically out of the market. At the present time the banks hold a portfolio of such securities sufficient in size to constitute a weapon of considerable power in dealing with the money market.

"Last December there appeared to be a real possibility of price inflation and undue speculative activity based upon the continued flow of gold. At the present time this threat, while it has not been removed, appears to be much less dangerous because of the fact that the volume of gold imports has been greatly reduced, and other influences such as growing business activity and prospective foreign loans appear likely to give employment to surplus funds. There is clearly no such occasion for open market purchases of government securities as there was a year ago.

"In the absence of any such major considerations as were present a year ago other factors must be considered in determining the open market program for the future.

"The easy money of the past five or six months has been a favorable influence in a number of particulars. It has occurred at a time when business depression was becoming pronounced, and was a factor in lessening the extent of the depression and terminating it early. It also seems clear that easy money during these months has been an influence in checking the gold movement to this country, stimulating the movement of funds from this country to London and aiding a recovery in sterling. Easy money has also created a favorable market for the flotation of important foreign loans. These are all advantages to be conserved if possible during the coming few months and it may be that they can only be conserved by some further purchases of securities by the reserve banks.

"There are a number of factors making for firmer money for the balance of the calendar year. The volume of gold imports appears to be definitely reduced and there is even some prospect of gold exports. A number of foreign loans are in contemplation which may lead to direct gold exports, or the equivalent in the locking up of funds in New York. It seems probable, for example, that the proceeds of the recent $90,000,000 Canadian Government loan will be locked up in gold as a basis for currency issues in Canada. The proceeds of the $100,000,000 loan to Germany may be similarly locked up, or may be exported. We have then the possibility of the loss of $190,000,000 of gold, equivalent in its effect on the market to the export of that much gold. More active business is likely to absorb more funds.

"As against these tendencies toward firmer money we have still the prospect of some continuing gold imports, although in reduced volume, but, more important, a prospect of some flow of funds from the interior as a result of the gradual spread through the country of the effects of the gold import of the past months, and the liquidation of frozen loans as a result of higher prices for farm products.

"We are dealing at present with a nicely balanced money market. This is the natural result when member banks are largely out of debt at the reserve banks and every change in the money supply is directly reflected in rates. In this situation it would appear unwise to carry through any continuous program of buying. It would rather seem wise for the Committee to have leeway to meet situations as they may arise. The changes which may result from foreign issues, gold imports or transfers of funds to or from the west, may be so abrupt in character as to require rapid action. The committee would be in the most favorable position if it were free to expand or diminish the System's portfolio of securities by approximately $100,000,000 as occasion might require. This would enable the committee to meet any emergency situation as it might arise while at the same time the boards of directors of the various Federal reserve banks and the Federal Reserve Board could be consulted in case any program of purchases or sales beyond $100,000,000 appeared to be desirable."

Action of Committee. At the Chicago meeting a resolution was passed recommending that the Chairman of the Committee should be given authority to buy or sell, after conferring with the other members of the Committee, up to $100,000,000 of Government securities in order to meet any situation in the money market which might develop. The Board's files show that a copy of the minutes of this meeting was received on October 31, 1924 but there does not appear to be any reference made thereto in the minutes of the Board prior to November 10, 1925. At the meeting on that date Mr. Cunningham called attention to the entry in the minutes of the meeting of the Committee to the effect that "a resolution was passed recommending that the Chairman should be given authority to buy or sell, after conferring with the other members of the Committee, up to $100,000,000 of government securities in order to meet any situation in the money market which might develop." Following the discussion which ensued as to the intent and purpose of this resolution, the Secretary of the was instructed to confer with the Chairman of the Open Market Investment Committee and report the present status of the resolution at the next meeting of the Board.

Meetings of November 12, 1924.

(Secretary's note: The next meeting of the Board was held on November 12, 1924, at which all members of the Open Market Committee were present and the question of the purpose and intent of the resolution referred to was made the subject of discussion.)

Recommendations approved by Board. At the meeting on November 12, the following recommendations were submitted to and approved by the

Federal Reserve Board:

"1. That the committee continue to make such temporary sales and purchases from the special account as are necessary to stabilize money conditions at tax periods.

"2. That any purchases of government securities or acceptances be distributed as recently on the basis of estimates of deficiencies of earnings of the twelve reserve banks.

"3. That the committee be authorized by the Governors Conference to commence as soon as practicable to exchange certificates maturing after December 31, 1925 for shorter term certificates.

"4. That action on the recommendation of the Advisory Council relative to the purchase of foreign bills be deferred until such time as we may be in a position to know more about the development of conditions relating to foreign exchanges; and that the System make no purchases of such bills until that time.

"5. That the committee be given authority

"(a) to replace the $65,000,000 of December maturities to such extent as may be advisable in consideration of market conditions at that time; and

"(b) to offset the export or earmarking of gold for foreign account to such extent as may be advisable in consideration of market conditions, but not to exceed $100,000,000.

"6. That the committee be authorized to sell investments in the special account in order to reduce that account to the amount of $500,000,000, as rapidly as money conditions make it practicable."

Report to Governors' Conference on operations of Committee since organization. The Chairman of the Open Market Investment Committee reported to the Governors' Conference the effect of the Open Market Investment Committee's operations since its organization and the effect thereof on money rates, etc., the full text of the memorandum containing the Chairman's report follows:

"TO THE JOINT CONFERENCE NOVEMBER 1924

"A little less than a year ago, in December 1923, the reserve banks undertook to acquire a portfolio of investment securities in order that they might be prepared to meet any price inflation or undue speculative activity based upon the huge imports of gold from abroad, which at that time were amounting to about $1,000,000 a day. The System was then threatened by a situation in which it would be powerless to exert any influence by advance of discount rates were its loans to members largely repaid, as seemed likely.

"The First $250,000,000

"When your committee made its report to the Gofernors' Conference in May of this year, there had been purchased Government securities to the amount of nearly $250,000,000. While these purchases had been made on a progressively easier money market, the evidence seems clear that the purchases had little influence on the money markets outside of the market for Government securities. The operation did not result in any net increase in the earning assets of the reserve banks, which in fact declined approximately $300,000,000 during the period. Increases in holdings of U. S. securities were more than offset by decreases in bill holdings and discounts and advances. The operation really resulted in an exchange of one type of earning asset for another type which would be under the control of the reserve banks in the event of a credit emergency, rather than subject to repayment at the will of the borrowing members.

"The Second $250,000,000

"Since the Governors' Conference in May, there has been purchased a further $250,000,000 of Government securities bringing the portfolio to a round $500,000,000. This amount was reached early in September. The changes in the money markets accompanying the purchase of this second $250,000,000 were more marked than during the period of the first purchase.

"Since early in May, money rates have moved to substantially lower levels. . . .

"Aside from changes in money rates, evidence of the changes within the financial structure are found in changes in bank loans and deposits. Between December 1923 and the end of April 1924, there was only a moderate increase in bank deposits, but from the end of April to the end of September deposits of New York City reporting member banks increased $738,000,000 and those of reporting banks outside of New York City increased $829,000,000. These increases appear to correspond with similar increases in the middle of 1922 when the reserve banks were carrying on a somewhat similar buying program.

"The precise responsibility of the open market program for these money conditions is very difficult to determine. Until the end of July, when $450,000,000 of the special accounts had been acquired, purchases of securities were more than offset in the total earning assets of the reserve banks by declines in discounts and advances and bills held. It was only during the purchase of the last $50,000,000, between August 1 and September 24, that there was a net increase in total earning assets, and this increase, amounting to $100,000,000 may be ascribed largely to an increase of $67,000,000 in holdings of acceptances brought to the reserve banks partly because of conditions within the bill market, and partly because of firmer call money from time to time.

"It is important to note that our purchases did not, except perhaps at the very end of the buying program, as stated, add directly to the volume of credit as many have supposed. But they rather changed the form of reserve bank credit in the market from discounts to investments. The indirect result of relieving member banks from their indebtedness was to allow incoming gold and returning currency to affect the market directly. We simply removed for a time the buffer of rediscounts which the reserve banks have held between gold imports and the money market. The time was coming when the buffer of rediscounts would have been eaten away in natural cource by the incoming gold and by a longer period of loan liquidation. We have simply hastened the natural effect of gold imports. The results have, we believe, justified the program. First, we have secured an adequate weapon against any gold inflation. Second, this has been done without busines disturbance or price inflation but rather with considerable benefit to business. Third, the program has aided the readjustment of world finance. The effects of the easier money conditions of the summer and fall on American business and on world finance may well be reviewed with some care.

"Effects of Easy Money

"1. On Business - It is generally agreed by economists that the swings of the business cycle may be lessened by making credit readily available when business has begun its downward swing or is in a state of depression and conversely by making credit less easily available when business is booming and speculation is becoming rife. The program of the Open Market Committee in contributing toward easier money during the past nine months is directly in keeping with this economic principle. We have had in these nine months, and particularly in the summer of 1924, a considerable business recession. The decline in factory employment for example, amounted to more than 15 per cent, production in basic industries declined 26 per cent and our index of the volume of trade 15 per cent from the high points of the spring of 1923. A genuine recovery appears, however, to have begun and the bottom of the depression appears to have been passed without serious unemployment, business failures or the like. It is entirely logical to believe that easy money has been a factor in shortening the duration of depression and loan liquidation and lightening its effects. Further, the easy money has made possible a large amount of domestic financing of which business was much in need. There has been no other period since some time before the outbreak of the World War, when refunding issues could be sold in large volume on advantageous terms. The financing of the last few months has straightened out the financial position of many concerns, furnished capital for improvement and construction, and in many ways facilitated needed capital financing.

"2. On the International Balance of Payments - Early in the summer, interest rates for short term money in New York fell to levels below the current rates in London and this difference has been maintained. We have knowledge that there has been concurrently a considerable movement of American funds to London and gold imports have gradually diminished until in September, the excess of imports over exports was negligible. While this change in the movement of funds between New York and London may in part be ascribed to gradual financial recovery abroad, and increased demand from India for gold, it is certainly due in some part, to the easy money conditions here. To the extent that this is true, easy money conditions have acted as a kind of inoculation against gold imports. Easy money, caused in part by artificial means, has been operating to prevent further gold imports and the dangerously easy money which they might well induce. Thus, to a certain extent, the open market program which was designed as a weapon against the inflation which might result from gold imports has already proved itself an effective instrument. Likewise conditions have been made more favorable to the attempts of European countries to stabilize their exchanges.

"3. On the flotation of foreign loans - Easy money during the past summer has undoubtedly been an aid to the flotation of large issues of foreign securities in this market. In the ten months through October foreign issues in New York have totaled a billion dollars (including refunding issues) and have far exceeded those of any previous year.

"We need no argument to recognize that these issues have been an important instrument in world recover. The German loan is the keystone of the operation of the Dawes Plan. Many of the other loans have given foreign nations that outside aid which enabled them to start on the process of financial recovery and others are now pending of important amounts. Easy money here during the past summer has been a world benefit. Moreover, these loans always result eventually in an increase in our export trade.

"4. On Member Bank Earnings - The money conditions of the past six months have reduced for a time the rates of return to banks on some of their loans and short term security holdings. This should not necessarily result in any considerable reduction in bank earnings. The credit and business situation has been such that there are comparatively small losses to be written off. If there is a reduction in earnings it is largely due to inability of the banks to adjust the interest they pay on deposits to the going rate for money. This inelastic feature of

American banking is clearly not a factor which should receive consideration in determining Federal reserve credit policy. Our credit policy should be determined in the interest of the whole of the country's business. It is entirely fitting and proper that at times our policy should run counter to the immediate interest of some banks. This would seldom be true if the banks were geared up to modify their interest rates and their lending and investment policy to meet changing credit conditions. It is interesting that the Chicago banks have just taken action in this direction and the Philadelphia banks propose to do so.

"Future Program

"The first results at which the open market program of purchases aimed have been achieved in that we now possess a considerable portfolio of Government securities available against any emergency. Moreover, the danger of inflation now appears to be more remote than it did a year ago, because of the diminution in gold imports. It does, however, appear to be desirable that relatively easy money should maintain for a further period. While business has begun its recovery it is still below normal and requires fostering. It continues to be desirable that our rates should be under the London market in order to check the flow of gold and to assist in the recovery of the exchanges. It still appears to be desirable to encourage conservative foreign borrowing in this market. In order to achieve these ends, however, it is not necessary that money should be any easier than it is now or, in fact, that the present exceedingly low level of rates should maintain. It is sufficient that we should avoid any marked tightness of money.

"There are a number of tendencies towards firmer money which must be taken account of. As business increases in volume it will require more funds. It is also probable that certain of the foreign loans being made in this market will result in the earmarking of gold or other removal of reserve money, i.e., gold, from the market. The suggested retirement of some amount of national bank notes would have a similar tightening influence.

"In the light of this probable development it would seem wise for the committee to have leeway to meet any emergency situation. A number of the possible causes of tight money are such as would produce abrupt changes in the money markets. The committee would be in the most favorable position if it were free to expand or diminish the System's portfolio of securities by approximately $100,000,000 as occasion might arise. This would enable the committee to meet any changes in the situation, while at the same time the Federal Reserve Board and the boards of directors of the various Federal reserve banks could be consulted in case of any program of purchases or sales beyond $100,000,000 appeared to be desirable.

"Public Criticism

"At the meeting of the American Bankers' Association, in Chicago, the following resolution was adopted:

"'The Federal reserve banks have been driven, in order to earn their expenses and dividend charges in these more normal times, to compete for business with their own member banks in such fashion that there is danger that in the future the operations of the reserve banks may tend to accentuate the swings of the financial pendulum, rather than to keep the swings from going too far in either direction.

"'We earnestly recommend that a careful investigation be made by those who are properly qualified to investigate whether it might not be wise to limit the Federal reserve banks to their primary functions as banks of issue and rediscount.'

"This resolution gives evidence of misunderstanding on the part of many bankers of the nature and purpose of the open market program. While the resolution of the Bankers Association is restrained in its terms and in its form, it seems clear that the open market procedure of the system may be criticised in the future. It would appear to be the course of wisdom to meet this criticism before rather than after it has become acute and widespread. The conference might well consider whether a careful article in the Federal Reserve Bulletin might not be wise, in the same general form as the treatment in last year's annual report, but giving somewhat more definitely the facts and results of the program, and such as could be reprinted in the Monthly Review of the reserve banks.

"Detailed Procedure of Committee

"In the work of the committee during the past six months a number of experiments have been tried and precedents established. At the June 15 tax period the Federal reserve banks of Chicago and New York made temporary sales of securities from the Special Investment Account to offset the ease in the market resulting from a temporary excess of government disbursements over receipts. The experience at the March 15 tax date, when money had been abnormally easy for some days, had given evidence that at periods when member banks are out of debt at the reserve banks government operations are likely to unsettle the money markets unless some special offsetting operations are carried through. The temporary sale of certificates at the June 15 period appeared to meet the situation successfully. At the September 15 tax period the same type of operation was carried through in Chicago, but not at New York. This transaction is similar to what frequently takes place at the Bank of England at tax periods, and is clearly an operation which will be found useful in the future. At the Chicago meeting of the open market committee on October 24 it was recommended that appropriate action of this character be taken on the December 15 tax date.

"On June 1 the committee began apportioning purchases of government securities and bankers acceptances among the various reserve banks on the basis of the estimated deficiencies in their earnings. This seemed to the committee the best equitable method of distribution, rather than based upon capital or other relative proportions and it appears to have met with the favor of the reserve banks.

The committee has discussed, but has not yet taken definite action, on a number of important problems which must be settled in the near future. On December 15, $65,000,000 certificates held in the special investment account mature, and a decision should be reached as to whether they should be replaced or the account automatically diminished by their maturity. The decision in this regard should be influenced by the probable credit developments of the next few weeks. At the present time there do not appear to be any evidences of inflation or undue speculation which would make it particularly desirable to withdraw $65,000,000 from the money market. On the contrary there appear to be a number of influences making for firmer money, and thus indicating the desirability of replacing these certificates with other securities of the new issue or some issue now outstanding.

Another problem which the committee has discussed but upon which no final decision has been reached concerns the maturity of issues now held in the Special Account. While more than $300,000,000 of the account matures within the coming fourteen months the balance is of considerable later maturity and hence would be affected as to price by amy tightening of money. The banks have a considerable profit on these longer maturities and it would be wise to consider whether this profit should not be taken now and the risk of loss avoided by purchasing shorter term issues in their place. Such a program would make the portfolio somewhat easier to use. In case it was desired to withdraw funds from the market it would only be necessary to let approaching maturities run off.

"Buying Sterling Bills

"The Open Market Committee has discussed the proposal of the Advisory Council that the reserve banks should purchase some quantity of sterling bills. The committee is not, however, prepared to make any recommendation on this point. The subject is one which, because of its complexity and importance, deserves consideration in a separate report rather than attempting to deal with it at this time.

"Recommendations

"In conclusion, the committee makes the following recommendations:

"1. That the committee be given authority to buy or sell up to $100,000,000 of government securities in order to meet any situation which may develop in the money market.

"2. That an article be prepared for the Federal Reserve Bulletin and the Reviews of the Reserve Banks, giving the facts and results of open market operation.

"3. That the committee continue to make such temporary sales and purchases from the special account as are necessary to stabilize money conditions at tax periods.

"4. That any purchases of government securities or acceptances be distributed as recently on the basis of estimates of deficiencies of earnings of the twelve reserve banks.

"Matters on which the committee does not yet make a recommendation, but which should be discussed by the conference:

"1. Replacing December, 1924 certificates in the open market portfolio when they mature.

"2. Replacing longer with shorter maturities in order to be in a position to affect the market simply by letting maturities run off and to void risk of loss and take present profits.

"3. Buying Sterling Bills."

Meeting of December 19, 1924.

On December 19, 1924, the Open Market Investment Committee met with the Federal Reserve Board in Washington.

Report of Chairman. At this meeting, the Chairman of the Committee presented a written report covering the transactions of the Committee since the last meeting reading as follows:

"The transactions of the committee since the last meeting in Washington have been comprised mainly of two operations: (1) the sale of March 15 certificates to facilitate the distribution of the new Treasury 4 per cent bonds, and (2) the redemption of $65 million of December 15 maturities.

"1. The offer of the Treasury to accept March 15 certificates of indebtedness and Treasury notes in exchange for the new issue of 4 per cent bonds immediately resulted in a heavy demand for these issues and the supply available in the market was soon exhausted. In order to make available a supply of these issues it seemed desirable to sell in the market the holdings in the Special Investment Account. Between December 4 and 16 sales of this issue were made to the amount of $85,050,000 and in partial replacement there were purchased $66,746,000 of later maturities. The difficulty in securing any amount of short-term issues of other maturities, together with a tendency towards ease in the money market, made it difficult and undesirable to make further replacements immediately. As a result of this operation alone there has been a net sale of about $18 million or a net loss to the market of that amount.

"2. Action in connection with the maturity of December 15 certificates to the amount of $65 million followed the course laid down at the meeting of the committee on November 11. A total of $30,000,000 of these securities was redeemed by the Treasury at intervals prior to December 15 and by this means the effect on the money market was distributed over several weeks rather than being felt at one time. On December 15 the balance, $35,000,000, was redeemed.

"The net result of these two operations was to reduce the Special Investment Account from $500,000,000 to $417,000,000 on December 16, or to take out of the money market $83,000,000. The effect on the market of this loss has not yet been felt fully because of a very heavy over redemption of securities in this district as against redemptions in other districts on the 15th. There was a temporary over supply of funds in the New York market on the 15th and the morning of the 16th of December, accompanied by a Treasury overdraft which amounted on the night of the 15th to $144,000,000. This oversupply of funds in the New York market was wholly artificial and the operations of December 16 indicate that as taxes are collected and the funds assembled at New York by transfer from the interior the temporary gain will be completely offset and the market will show a net loss as a result of the two days' operations, as these transfers to New York are always effected by heavy drafts upon New York balances belonging to interior banks.

"The Investment Committee has been in agreement that while conditions were developing which probably made it desirable to take surplus funds out of the market from time to time by the sale of small amounts of securities from the open market account, it was, however, not desirable to permit transactions in the account to create any sudden or radical change in money conditions which would be abnormal or temporary. It seems probable that in the next day or two the effects on the money market of the reduction of $83,000,000 in the Special Investment Account will be felt very markedly unless some action is taken by the committee. To prevent this effect from becoming too marked, arrangements have already been made for the purchase of $15,000,000 of securities for delivery on December 17 and $5,000,000 for delivery on December 18. This will bring the Special Investment Account up to $438,000,000. It may be wise to purchase further amounts to bring the account to at least $450,000,000 to prevent an undue tightening of money at this time.

"In these successive steps all of the members of the Open Market Investment Committee have been consulted by telephone, and in additional Governors Harding and Norris and Mr. Miller of the Federal Reserve Board were in New York on Thursday, December 12, as were also Mr. Wills and Mr. McKay. It has thus been possible to secure directly the opinions from all of the banks represented on the committee. Several telegrams explaining the operations of the committee were also sent to the governors of all the banks.

"As far as future policy of purchases and sales is concerned, it is believed that the committee should be prepared for transactions in either direction in the light of future developments in the money markets.

"For the immediate future it is desirable to give attention to the usual seasonal movement of funds. The figures for the past four years indicate that between the high point of December and the low point of January there is usually a decline of from 200 to 400 millions in the earning assets of all Federal Reserve Banks and of 50 to 150 millions in the earning assets of the Federal Reserve Bank of New York. Because of the general upward tendency of credit demands, we may anticipate this year the minimum, rather than the maximum easing of money conditions between December and January.

"In the light of the present security and commodity market situation, it would appear undesirable for this tendency toward easier money to find the member banks largely out of debt at the Federal Reserve Banks, so that easier conditions would be reflected in too sharp an easing of money rates. It therefore seems desirable that the Federal Reserve Banks should hold, as we enter the new year, a sufficient buffer of rediscounts and sales contract bills and securities to take up automatically any slack in the money markets.

"With the present outflow of gold and large demands for currency together with increasing business activity, it is probable that before the end of the year the needs for credit will lead to some further resort to Reserve Bank facilities perfectly normal at this season and will so create a buffer of rediscount and sales contract bills and securities. This would be a desirable outcome as it would make the readjustment after the first of the year automatic, without the necessity for any open market operations through the special account. This line of reasoning may make it desirable to maintain the open market account at about $450,000,000 even in the face of slightly firmer money conditions."

Action of Committee. At the December 19 meeting, it was the feeling of the Committee that from then on the account should probably not be increased from the present amount ($436,000,000) and that from time to time holdings should be liquidated. It was also the feeling of the Committee that if member bank borrowing should be necessary, it would be best in the form of discounts, and that when the seasonal return of funds takes place after January 1 the discounts would act as a buffer along with maturing bills and sales of securities to absorb the return flow of holiday currency, and that if then there was an excess of funds it might be advisable to market some of the investment account.

The Committee's report at the December 19 meeting was approved by the Federal Reserve Board, including the Committee's proposed future action as contained in statements made by the Chairman of the Committee.

Developments during 1925

Meeting of January 9, 1925

Action of Committee. Immediately after the turn of the year (January 9, 1925), members of the Open Market Committee met at the Federal Reserve Bank in New York. At this meeting, following the submission by the Secretary of the Committee of his report reviewing operations since the last meeting, and a discussion by the Chairman of the Committee's activities, as set forth in the Secretary's report, the Committee voted that it should stand ready to make such further sales of securities as seem necessary from time to time in view of changing money conditions to prevent undue ease in the market.

Report of Secretary on operations. The full text of the report made by the Secretary of the Committee, above referred to, is on file with the Federal Reserve Board. For the purpose of this memorandum the following is quoted therefrom:

"Since the last meeting of the Committee on December 19 the trend of money rates has been very much as was anticipated. Immediately following that meeting a considerable return flow of funds took place to the interior to fill the vacuum created by Treasury transfers to this district. There continued to be some gold withdrawals and these influences, together with year-end readjustments, resulted in firmer money conditions.

"Call money renewed at 5 per cent, and new loans were placed at 5-1/2 per cent, and the earning assets of the Federal Reserve Bank of New York increased to $410,000,000 on December 24, largely due to increases in rediscounts and holdings of bills under sales contract. This increase in our earning assets created a buffer to take up some of the slack which might develop after the first of the year.

"During the first week of the new year the return of currency from circulation, and the return of funds from the interior led to a rapid easing in money conditions bringing the call loan rate down to 2 per cent on January 8. This easing took place more rapidly than could be compensated for entirely by declines in bills discounted or holdings of acceptances. Earning assets of the New York bank declined from $410,000,000 on December 24 to $275,000,000 on January 7; bills discounted being reduced by $80,000,000, while holdings of bills and securities under sales contract were entirely wiped out.

"In view of these conditions the members of the Committee were communicated with and on January 5 a decision was reached to sell securities to the amount necessary to prevent undue ease in money conditions so far as this could be done without disorganizing the market. Accordingly $5,000,000 of securities were sold on January 5, $15,000,000 on January 6, $16,000,000 on January 7, and $5,000,000 on January 8. In addition $9,909,500 were sold to the Treasury, account Alien Property Custodian, in replacement for sales of Treasury bonds of like amount to the market. The total holdings in the System's account were thereby reduced from $449,035,000 on December 19 to $398,125,500 on January 8, 1925, effecting a net reduction of $50,909,500 in this account."

* * *

"The ease in money conditions at the beginning of the year usually continues through January. At present our earning assets have decreased to a point where further liquidation is limited except in the Special Investment Account. It is believed, therefore, that the Committee should stand ready to make further sales, as far as it is necessary, to prevent a period of unusually easy money conditions, during January. In order to affect the money market most directly any sales should be made in New York.

"It is customary for money conditions to become firmer in the latter part of February and in March, and with an increasing volume of business activity we may anticipate that this firming will be pronounced this coming spring. There will therefore probably be an opportunity for the Committee to repurchase without difficulty securities sold during January if that seems wise. The desirability of this repurchase can be determined at a later date when the trend of money and business conditions becomes clearer. It may be wise to allow the Special Investment Account to remain diminished for some months to come and to confine transactions for the account to sales."

Meeting of February 25, 1925

The account stood at $270,000,000 on February 25, 1925, on which date a meeting of the Open Market Committee with the Federal Reserve Board was held in Washington.

Report of Chairman. At this meeting the following written report was submitted by the Chairman, which reviews credit conditions and changes in the money market since the meeting of the Committee held on January 9. In submitting the report, the Chairman stated that all members of the Committee had approved same.

"Changes in money conditions in the past two months have followed very much the course which was anticipated in preceding reports of this committee. After Christmas there was the usual return of currency to the Reserve Banks amounting in this case to approximately 300 million dollars. There was also the usual flow of funds to New York from the interior, resulting in an increase of more than 250 million in the street loans of out-of-town banks, compared with a decrease of about 100 million in the street loans of New York City banks. The result of these tendencies was a rapid decline in Federal Reserve rediscounts, particularly in New York, to a point where member banks were practically out of debt at the Reserve Banks. Money rates moved to lower levels and on one or two days touched 2 per cent.

"As this situation began to make itself evident sales were begun from the Special Investment Account, reaching in the aggregate during

January about 150 million dollars. These sales were promptly followed by increases in the rediscounts of member banks in New York City of between 100 and 150 million and a comparative stabilization of call loan rates around 3-1/2 per cent. Gold exports amounting to nearly 100 million dollars during January and February and transfers to the interior over the first of February, were further factors making for firmer rates.

"Simultaneously with firmer money conditions the buying rates on bankers acceptances of 30 and 60 day maturities were raised from 2-3/4 and 2-7/8 to 3 per cent, thus placing all maturities up to 90 days at 3 per cent. The open market rate for 90 day bills has risen to 3-1/8, but other market rates are substantially where they were for the greater part of December.

"In case the flow of funds continues to New York it is believed that the committee should continue to sell securities from time to time to prevent undue ease in money conditions, such sales to be limited for the present to an amount to bring the Special Investment Account down to 200 million dollars.

"We may anticipate before many weeks that the usual spring demand for funds will make itself felt in the money market. Indeed, the spring demand taken together with gold exports, which are still continuing heavy, and the cumulative effect of active business may possibly lead to a rapid increase in rediscounts and a sharp upturn in money rates, which would make an early review of the committee program necessary."

(Secretary's note: No action was taken by the Federal Reserve Board with respect to the program considered at the meeting of the Open Market Committee on February 25, 1925. The individual members of the Board expressed their views, none of which, however, were contrary to the proposed program of the Committee.)

(Secretary's note: On February 27, 1925, the Federal Reserve Bank of New York increased its rediscount rate from 3 to 3-1/2 per cent.)

Meeting of April 6, 1925

Action of Committee. At a meeting of the Committee held on April 6, 1925, the Chairman submitted the report which he proposed to make to the conference of Governors then in session. The Committee voted to amend and approve the report. It was also voted to be the sense of the Committee that under authority now vested in it, the Committee should increase its holdings up to approximately $300,000,000, as and when market conditions warrant, it being the belief of the Committee that the present and prospective gold movements make this increase advisable.

Report to Governors' Conference. The text of the report of the Chairman to the Governors' Conference above referred to follows:

"Since the last joint conference in November the special investment account of the Federal Reserve System has been reduced from 500 million dollars to approximately 250 million. During a period of 3-1/2 months, from early December to the middle of March, 250 million of securities were sold in keeping with the purposes for which the account was first established at the end of 1923.

"The first reduction in the size of the account was made in the early part of December. Sales at that time were in part directed to steadying the money market and in part to facilitating the Treasury offering of December 15, by making available to the market Government securities maturing in March which might be exchanged for the new 4 per cent issue. The net result of the operation over December 15 was to reduce the special account by 50 million.

"Early in January it became apparent that the usual return flow of funds to New York, simultaneous with the return of currency from circulation, would create very easy money conditions unless funds were absorbed from the market. Further sales from the account were therefore made amounting to 150 million dollars and bringing the account to 300 million. Further sales of 50 million were made in February and March, with the same end in view. All but 31 million of the entire sale of 250 million were made in the New York market.

"The immediate result of these sales, occurring as they did simultaneously with gold exports, was to place New York City member banks in debt at the Federal Reserve Bank. As a consequence the call loan rate promptly took and maintained a position above the discount rate and showed an average of about 3-1/2 per cent, with irregular movements above and below that rate, and there was no period of undue ease as had been threatened. Other money rates worked steadily upward during the period; from early December to the end of February commercial paper went from 3-1/2 per cent to 4, time money from 3-1/2 to 4-1/4, 90-day bankers bills from 2-3/4 to 3-1/4. Bill rates were influenced by successive increases in Federal Reserve buying rates on bills from 2-3/4 to 3-1/8 per cent for 90-day bills. On February 27 the Federal Reserve Bank of New York raised its discount rate from 3 to 3-1/2 per cent. . . .

"Following these various changes speculative activity on the stock market became much less intense with periodic reactions, and finally after the middle of March price averages showed rapid reductions. It seems clear that to some extent the open market operations of the System had a deterrent effect on the continuation of heavy speculative activity.

"OPERATIONS AT TAX PERIODS

"In June of last year the committee inaugurated the policy of making temporary sales of securities from the special investment account to take up slack in the money market produced by the excess of government disbursements over receipts in the early days of the tax period. In December a review of money conditions indicated that such sales would not be necessary since the holiday demand for funds and prospective transfers out of the district might be expected to take up the slack in the money market, and this proved to be the case.

"At the March tax period there was an exceptionally large government disbursement in New York and a large Treasury overdraft outstanding for about a week. A reduction in member bank indebtedness took up much of the resulting slack in funds, but in addition temporary sales of 20 million from the special account were made in New York City and 4 million in Chicago. Slack funds were not entirely taken up by the liquidation of member bank borrowings or by these temporary sales, but the ease in money was not serious.

"The experience in recent tax periods appears to indicate the desirability of temporary sales to the market at any tax period when redemptions are large and member banks are not borrowing heavily at the Reserve Banks. December tax periods may be an exception, when demands for Christmas currency offset the tendency towards easy money. The results of such operations in the future will probably be more completely successful as member banks understand the purposes better and as sales are arranged earlier.

"APPORTIONMENT OF PURCHASES

"During the second half of 1924 purchases of Government securities and bills made by the open market investment committee were distributed to the different Reserve Banks on the basis of their estimated earning requirements. Purchases up to April 1, 1925 have been distributed on the basis of estimated expenses, including dividends but excluding chargeoffs. In the light of new figures received as of April 1, 1925 from all twelve Federal Reserve Banks, it is now proposed to apportion purchases in accordance with the earning requirements of the several banks."

Meeting of April 30, 1925

The Committee met again in New York on April 30, 1925. At this time the account stood at approximately $250,000,000. No action was taken with relation to operations in the account toward the market. Considerations were all with respect to readjusting apportionments in the account.

The minutes of the April 30 meeting were submitted to the Board on May 21, 1925, and it was voted that the Committee should be advised that the Board noted that no purchases had been made against the authority granted on April 6, and on review of existing conditions feels that before any purchases to increase the aggregate of the System's Special Investment Account are made, they should be submitted to the Board for consideration.

(Secretary's note: The Board in referring to an "authority granted on April 6th" had in mind that action of the Commitee taken at its April 6 meeting in voting that under authority then vested in it, the Committee should increase its holdings up to approximately $300,000,000, as and when market conditions warrant, it having been the belief of the Committee at that time that the present and prospective gold movements made this increase advisable.

In referring to the authority then vested in it, the Committee on April 6 referred to the authority granted by the Board on November 12, 1924, for offsetting the export or earmarking of gold for foreign account to such extent as may be advisable in consideration of market conditions, but not to exceed $100,000,000.

The action taken by the Board at its meeting on May 21 was communicated to the Chairman of the Open Market Investment Committee, who, in a letter dated May 25 advised the Board that it seemed to him that the redistribution of investments together with the situation in the money market made it unnecessary at that time to consider exercising the authorization, and that he did not feel willing to do so at that time without further consultation with the Committee and Board.

At the meeting of the Board on May 29, the Governor reported that $31,000,000 of Government securities held in the special account would mature on June 15, and it was voted to approve a request of the Open Market Investment Committee for authority to purchase in replacement at that time $15,000,000 of securities, the remaining $16,000,000 to be purchased after June 15.

Meeting of June 24, 1925.

On June 24, 1925, the Open Market Investment Account stood at about $221,000,000.

Report of Chairman. At a meeting of the Committee held on that date, the following report was made by the Chairman:

"Following the last meeting of the Open Market Investment Committee, $79,149,500 of the government securities held in the System Special Account were redistributed to reduce the participations of five banks and increase the participations of six. Special allotments were made of $10,000,000 of bankers acceptances to Minneapolis and $4,000,000 to Kansas City in lieu of governments which they were unable to take because of shortness of collateral for note issues. Allotments of $5,000,000 each of bankers acceptances were also made from the New York portfolio to Kansas City, Atlanta, and Dallas. Partly as a result of these changes estimated earnings of all of the banks, except Minneapolis, for the first half year have been slightly in excess of their estimated expenses and dividends, but not sufficient to cover charge-offs. . . .

"It may be noted that thus far earning assets of the System have averaged about $130,000,000 more than last year, while present indications are that expenses will be somewhat less. In view of the usual increase in earning assets in the fall of the year, it appears reasonably sure that the earning position of the System this year will be better than last year.

"Quarterly Tax Day Operations

"With the heavy redemption of about $400,000,000 of maturing issues and a consequent prospect of very easy money conditions, the following sales under repurchase agreement of securities from the Special Investment Account were made on June 13 and 15:

June 13 to New York banks	- - -	$47,000,000
" 15 " Chicago banks	- - -	4,000,000

"The sale in New York on June 13 caused a deficit in the reserves of New York City banks for two days, Saturday and Sunday, which was effective in offsetting large gains to the market resulting from redemptions on Monday. By Wednesday the collection of income taxes and wire transfers to other districts had withdrawn sufficient funds from the market to bring bank reserves practically down to the required minimum. By the end of the week the securities sold had all been repurchased. The net result of tax period operations was remarkably steady interest rates, the call rate remaining at 3-3/4 per cent throughout the entire period.

"Present Credit Situation

"Our best information indicates that for several months business activity has tended to recede from the high point reached early in the year. Business men do not generally regard the present situation as wholly satisfactory, although the current rate of activity is probably above normal and greater than last year. From the point of view of business, it seems desirable that money should continue to be easily available at moderate rates.

"Recent activity in the security markets has brought prices to the highest point of all time, and the amount of funds employed in the market is larger than ever before. The volume of new issues, both foreign and domestic, so far this year, has been in excess of the unusually large volume for the corresponding period of last year. While higher money rates would perhaps have some restraining influence upon the security markets the effect on business would probably not be favorable.

"In the light of these conditions no extended program of either purchases or sales in the Special Investment Account seems desirable. The member banks in principal cities are already substantially in debt at the Reserve banks and the pressure of this indebtedness is sufficient to maintain unusual stability in open market money rates at about present levels. There have been no excess funds in the market and the call rate has consistently remained above the Federal Reserve discount rate. At the same time business funds are readily available at moderate rates. This is a healthy situation and should be maintained.

"It is customary for the earning assets of the Reserve banks to reach their low point in midsummer--usually August--when the demand for funds is at a minimum. To avoid instability of rates during the summer the committee should be prepared, if necessary, to make sales from the special account. It is also recommended that replacement of the 16-1/2 million dollars of treasury notes, matured on June 15 and not yet replaced, be deferred until later.

"In the fall of the year there will normally be a considerable increase in the demand for funds and an increase in acceptance holdings and the amounts borrowed by member banks. At that time it will probably be possible, if indications suggest the need is to build up the Special Investment Account to a somewhat higher figure. The desirability of doing so would appear to depend largely upon the developments in business and finance before that time.

"There is a still further factor in the situation which should be considered in formulating open market policy, and that is the possible use of the British credit. The employment of this credit would have the same effect as purchases of securities in putting funds into the market. The Reserve banks should be in a position, if the condition of the money market made it desirable, to offset the use of the credit by the sale of securities. The Special Investment Account should therefore as a long time policy be maintained in an amount large enough to meet any such contingency.

"Possible Special Operations

"In addition to the regular quarterly tax day periods, the committee might well consider whether special operations in the account should be undertaken on the following occasions:

July 4 currency demand
Autumn trade requirements
Christmas currency demand
January ease in money

"The July 4 holiday customarily calls for from 100 to 200 million dollars of currency and usually leads to member bank borrowing of about that amount for a few days. This is a very temporary need and complete liquidation takes place within a few days. Hence it has little effect on the general credit situation and it is believed no special operations should be carried through to take care of it.

"By reason of advance redemptions the government maturity on September 15 will amount to but $229,000,000. Since tax payments will be around $300,000,000 the effect of tax day operations in the market will be quite different from the usual effects. As tax cheques are collected the market will probably be out of funds and the committee may need to consider the purchase of securities in order to prevent too rapid tightening in the money market, just at a period of the year when the commercial demand for funds is expanding. Action cannot be determined definitely until we know the details of Treasury program at that time.

"As suggested above the autumn trade demand together with the Christmas currency demand offer opportunity for increasing somewhat the portfolio of the Special Investment Account, without easing the money market. The experience of the past year indicates the desirability of having on hand a portfolio from which sale may be made in January to prevent the rapid return flow of funds from causing too great ease in the money markets; and the committee may need to consider purchasing securities for this purpose during the autumn trade expansion and currency demand in October, November and December.

"Allotments

"It is proposed that the committee continue to allot System open market purchases of Bills on the basis of requirements. As a basis for computations all banks are being requested to furnish figures as of June 30, 1925, showing (1) actual net earnings for the first six months of this year; (2) estimated gross earnings for the second half of the year; (3) estimated expenses, including dividends, for the second half of the year; and (4) for the information of the committee, estimated chargeoffs (in detail) for the entire year. These figures (exclusive of chargeoffs) will be used as a basis for making allotments during the month of July and will be revised monthly."

Action of Committee

After consideration of the above report, the Committee voted to authorize the sale to the Bank of England of $2,000,000 of Treasury certificates maturing September 15, 1925, and further sales up to the total holdings of this maturity amounting to $5,000,000. The purpose of this authorization was to prevent employment in the New York market of a balance obtained by the Bank of England through the purchase of ear-marked gold from another foreign bank and the employment of any further balance which that bank might acquire. The Committee also voted to sell $10,000,000 of Third Liberty Loans to the Treasury from the Special Investment Account. The Committee discussed further sales from the Special Investment Account and was in agreement that further sales might be necessary under existing authority in an amount sufficient to bring the account down to $200,000,000, if there appeared to be a large flow of funds from out of town to the New York district during the dull summer period. No vote was taken on this.

Meeting of September 22, 1925

Action of Committee. At the meeting of the Committee on September 22, 1925, the Chairman's report was adopted. There was also a recommendation made by the secretary of the Committee that during the balance of the year additional purchases of bills or securities be distributed among the banks in such manner as, first, to provide for the expenses and dividends of each bank and, second, to provide thereafter for estimated chargeoffs as completely as possible. The Chairman's report, which became the committee's report, was presented to the Federal Reserve Board, the Chairman calling the Board's attention particularly to that part of the report in which the suggestion was made that the present situation appeared to call not for open market operations but for careful consideration of the position of the discount rate which was outside the province of the Committee.

At the meeting of the Board, there was discussion of a suggestion to the effect that it would be desirable to make sales from the special investment account and to follow these sales shortly by an increase in the New York discount rate. It appears that most of those present at the meeting were not in agreement with this view.

Report of Chairman. The text of the Chairman's report is as follows:

"Credit Conditions

"Since the last meeting of the committee on June 24, business has continued in large volume, with a tendency in recent weeks toward still greater activity. Business continues free, however, from speculative tendencies and the price level is only slightly higher than it was at the end of June. Speculation in stocks and in real estate has increased.

"The effect of these changes on the credit situation has been to increase the borrowings of member banks at the Federal Reserve Banks and to tighten money rates by 1/4 to 1/2 of 1 per cent. . . .

"One feature of interest in the banking changes since the end of June has been that the entire increase in borrowings at the Federal Reserve Banks has been by banks in principal cities, whereas the banks outside of these cities have reduced their borrowings. Most of the recent increase in street loans on the New York Stock Exchange to a new high appears to have come from outside of principal cities.

"The net result of the credit changes since the end of June has been to increase the indebtedness at the Reserve banks of member banks in principal centers by nearly 200 million dollars--considerably more than half of this increase taking place in New York City. This result is very similar to what would have taken place if the Reserve Banks had sold 200 million dollars of Government securities in the open market while credit conditions remained otherwise unchanged. Member banks in principal cities are substantially in debt at the Reserve Banks and are under the influence of the discount rate. In other words, the situation is such that it will be more largely influenced by the position of the discount rate than by open market transactions.

"September 15 transactions

"A review of the changes likely to occur in the banking situation in connection with Government operations on and after September 15 appeared to indicate that sales from the special investment account would not be necessary to insure a reasonable degree of stability, because it was supposed that member banks in principal cities were sufficiently in debt at the Reserve Banks to utilize any excess funds in paying off indebtedness at the Reserve Banks. Such repayment actually did take place and the System's statement for September 16 showed a reduction of discounts and advances of 150 million, as compared with the preceding week. Repayment was not made, however, with sufficient rapidity to absorb all surplus funds, particularly amounts held by non-borrowing banks, and money was quoted as low as 3-1/2 per cent for parts of three days. In order to avoid even such temporary ease in money, which was misinterpreted by many, it may seem desirable in the future either to make sales to the market or else to enlist the cooperation of some of the large banks in adjusting the money position more rapidly at these periods.

"Future Program

"As indicated earlier, the principal question of Federal Reserve policy appears at present to be related to discount rates rather than to open market operations. Recent changes in money rates raise the question as to whether present discount rates are now a fair price for money.

"A second problem has to do with the preparation for the movement of funds over the end of the year. Last year very effective use was made of the special investment account by selling securities in January to offset the return of funds to principal centers, which is usual at that time of year. The present portfolio is too small to use effectively for this purpose without impairing its usefulness for any later emergency. It would seem wise for the committee to be prepared to increase the portfolio somewhat when and if it can be done without disturbance. The usual Christmas demand for funds may furnish such an opportunity. Experience over the fifteenth of the month and on previous occasions would indicate that semi-automatic changes in borrowings by member banks cannot be relied upon completely to make adjustment for any large or rapid movement of funds."

(Note: The discount rates at all of the banks having the 3-1/2 rate, except New York, were raised from 3-1/2 to 4 per cent between November 10 and November 23. The banks at which rate advances took place are Boston, Philadelphia, Cleveland, and San Francisco.)

Meeting of Governors' Conference, November 2, 1925

Report of Chairman of Committee. At the Conference of Governors of the Federal Reserve Banks held in Washington on November 2, 1925, the Chairman of the Open Market Investment Committee submitted the following report, which he stated had been approved by the members of the Open Market Investment Committee. The report was approved by the Governors' Conference, and the text of the report is as follows:

"Since the last Governors' Conference the Special Investment Account of the system has been reduced by 35 million dollars, from 245 million to 210 million. This reduction has taken place gradually in connection with the redemption of maturing issues at quarterly tax days, occasional sales to the Treasury for their accommodation, and a sale to the Bank of England amounting to 4 million dollars. The gradual reduction in the portfolio has been in keeping with the policy of maintaining the effectiveness of the discount rates of the Reserve Banks by insuring a round amount of borrowing by member banks in principal cities.

"Credit Conditions

"The changes in business and credit conditions since last spring have created a situation which is most unusual and most perplexing for the determination of Federal Reserve policy.

"When we met in April domestic business was experiencing some slight recession from the great activity of the early spring. This was more true in certain types of industrial activity than in the general distribution of goods. The recession did not prove to be serious and in the past two months there have been indications of an increase in activity and greater business optimism. Various indexes of the total volume of business indicate that business has been above what we may call normal, or average, conditions for the entire year. The construction industry and the automobile industry have been particularly active.

"Business appears generally to be in healthy condition. While forward buying has increased somewhat lately it continues to be generally conservative. Commodity prices are firm but there are as yet no considerable price increases. Looking into the future the features in the business situation which offer possibility of later disturbance appear to be:

"1. The automobile industry evidently now has a capacity and annual rate of production which is greater than the growth in the population or the increase in the domestic demand for cars can support for any extended period. We are approaching a saturation point in that industry, unless exports increase with great rapidity.

"2. The building industry is now operating at a pace which cannot be continued indefinitely. The war years left us with a shortage in homes. It is clear that most of that shortage has now been made up and that sometime, perhaps within the next year or two, there will of necessity be a diminution in new building construction and in the activity of the industries which are concerned with new building. This will naturally be accompanied by a slowing up in real estate speculation, which is now active in many places.

"3. There has been for some years past a steady increase in installment buying, involving the pledge of future income and the building up of what we may call consumer inventories. It is clear that this has created a situation in which any extended period of unemployment or any change in psychology might lead to a considerable diminution of activity in those industries serving the consumer directly.

"In none of these directions is there any evidence of an immediate change in the situation. The prospect is for sound substantial business at a high level for some months to come, but it is equally clear that the presence of these uncertain factors makes the continuance of a conservative temper in business most desirable.

"Stock Market

"The stock market appears to offer a fourth element of possible instability in the business situation, for stock market movements have a widespread psychological influence. The most serious element about the recent stock market movement is the possibility of a later recession in prices which might add impetus toward business reaction. There are a number of indications that a part of the recent increase in stock market prices is due to fundamental changes in values, but it is also possible that the swing of prices may now have gone beyond a level which can be maintained permanently.

"Credit Requirements

"The growth in business activity has been accompanied by an increase of currency circulation of 100 million dollars since the end of April and by an increase of about 300 million dollars in commercial loans of banks. This is larger than the usual seasonal increase and has come somewhat earlier in the year than usual. In addition, loans on stocks and bonds show an increase of 300 million, which represents largely the placing of additional funds into the stock exchange money market. The net result is an increase of 600 million dollars in total bank credit advanced by weekly reporting member banks, outside of an increase which may have occurred in other banks. This increase has been made possible by an increase of about 250 million dollars in borrowings from the Federal Reserve Banks. At the same time the nonreporting banks in smaller cities have decreased their borrowings slightly.

Accompanying this additional borrowing at the Federal Reserve Banksthere has been an increase since April of about 1/2 of 1 per cent or more in the various open market money rates.

* * *

"Gold Movement

"While money rates have been moving upward 1/2 of 1 per cent or more in this country, they have moved lower in London by about 1 per cent and the Bank of England has reduced its rate one per cent from 5 to 4 per cent. In recent weeks rates in London have become slightly firmer. The result of higher rates here and lower rates in London has been that considerable American balances which had been placed in London have returned to this country, and there has been a gold movement from London to New York of about 40 million dollars, partially offset by a movement of 21 million dollars from this country to Canada. The movement from London is slightly larger in amount than was customary in the fall in the years before the establishment of the Federal Reserve System.

It is clear that the relative level of interest rates in this and in foreign countries is an important influence on gold movements.

If our interest rates reach higher levels without a corresponding increase in London, a larger gold movement to this country may be stimulated.

"European Situation

"The general recovery in European business and credit conditions is under present circumstances, facilitated by low money rates in this country. With industry abroad below normal activity and struggling against high taxes and the necessity for many readjustments, the actual cost of money is an important factor in England and the European countries. In many of these countries, moreover, the supply of working capital is insufficient. As long as our extension of credit abroad either in the form of short-term or long-term credit is for productive purposes a considerable flow will be beneficial to the recovery of Europe and will react favorably upon our own trade. This flow is encouraged by low money rates. With the finances of Europe in unstable condition small changes in credit conditions may have large results one way or another, and it is clear that this country has a definite responsibility to determine its monetary policy with some regard to the effects of such policy outside of our own borders.

"Recommendations

"These are the outstanding facts in the broad credit situation. They do not seem to indicate the need for any change in our open market policy. With the member banks in principal cities substantially in debt at the Reserve Banks there is little to be gained in the sale of securities for the purpose of making discount rates more effective. The influence of our rates is now felt on a considerable body of borrowing and if it appears desirable the next step should possibly consist in changes in discount rates, rather than changes in open market holdings. It also seems desirable to maintain the present account at at least its present size that we may be prepared to deal with any emergency situation. The committee, therefore, is not prepared to recommend at present any change in our holdings of securities.

"QUARTERLY TAX DAY OPERATIONS

"The June and September tax days furnished additional opportunity for studying the need for special operations with the investment account to prevent any unusual and temporary ease in money. At the June tax date sales of 51 million dollars were made early in the tax day period, with the very satisfactory result that money rates remained at a constant level throughout the entire period. At the September period sales to the market did not appear to be necessary because of unusually large receipts relative to disbursements by the government and a considerable volume of rediscounts. No sales were therefore made and there was some easing in money rates for a few days. The experience of these two tax days would appear to indicate that it is usually desirable to make temporary sales to the market early in the tax day period.

"Turn of the Year

"Last January it was found desirable to make sales of about 150 million dollars of securities to take up the seasonal slack in credit resulting from the return of Christmas currency and the usual seasonal flow of funds to money centers. This coming year end it appears likely that city banks will be so largely in debt at the Reserve Banks that slack will be mostly taken up by the liquidation of discounts. Such liquidation is frequently a little slow, however, and if credit conditions remain as at present it would be undesirable to have the banks out of debt. It will, therefore, be well to consider some temporary purchase of securities at the time of the Christmas currency demand to be sold in January. The wisdom of such a policy cannot be determined far in advance.

"Method of Apportionment

"During the past few months further study has been made of the methods of apportioning purchases of bankers acceptances in the light of current earnings and expenses. The principle has been adopted of apportioning acceptances among the banks, first, on the basis of estimated expenses and dividends of the banks; and second, after these have been provided for, to apportion the remainder on the basis of required earnings to meet losses and ordinary chargeoffs as far as possible. The present estimate appears to indicate that the earnings of the banks for the year will be sufficient to cover all expenses and dividends and to cover the major part of the chargeoffs as well. Included in exhibits attached are tables reflecting Government security and bill transactions and distributions by the Committee during the year."

Board action. The above report was considered by the Federal Reserve Board at the meeting held on November 23, 1925, particularly the following portion thereof:

"With the member banks in principal cities substantially in debt at the Reserve Banks there is little to be gained in the sale of securities for the purpose of making discount rates more effective. The influence of our rates is now felt on a considerable body of borrowing and if it appears desirable the next step should possibly consist in changes in discount rates, rather than changes in open market holdings. It also seems desirable to maintain the present account at at least its present size that we may be prepared to deal with any emergency situation. The committee, therefore, is not prepared to recommend at present any change in our holdings of securities."

At that meeting the Board approved in general the report of the Open Market Investment Committee dated November 2, but advised the Committee that it desired an immediate meeting to consider whether changed conditions did not make a change in the open market policy of the Federal Reserve System desirable. It was also voted that one of the matters to be referred to the Committee was the question of allowing December 15 maturities of government securities to run off without replacement.

Meeting of December 1, 1925

On December 1, 1925, the account stood at $210,000,000, no material change having been made in the amount thereof since early in July 1925. The Committee met with the Board in Washington on December 1, the minutes of said meeting reading in part as follows:

* * *

"After thorough canvass of the System's open market policy, as well as the subject of rates of discount and bill rates, it was the consensus of opinion that the Treasury certificates held in the System account, amounting to about $38,000,000, maturing on December 15, should be replaced by other maturities to be purchased by the Committee. . . .

* * *

"The meeting formally approved [this] action . . .

"The balance of the session was devoted to a discussion of conditions bearing upon the discount rates of the System and especially of the Federal Reserve Bank of New York. It was the consensus of opinion that it would be better to await the turn of the year before the Federal Reserve Bank of New York made any rate advance, as at that time there was likely to be considerable liquidation and a large return flow of currency, with some easing of the money market, which might prove to be the appropriate time for selling some of the System's holdings of Government securities and for an increase in the New York discount rate.

"Dr. Miller expressed the view that the rate should be advanced to 4 per cent at once and Mr. Platt expressed the view that he would prefer to see it advanced to 4-1/2 per cent.

* * * "

On December 2 the minutes of the meeting of the Open Market Investment Committee of December 1 were presented and were received and filed and the recommendation contained therein was approved by the Board.

Authorization to Resume Purchases for System Account, December 1925

On December 21, 1925, the Board was advised that the Directors of the Federal Reserve Bank of New York had authorized the Governor of that bank to make open market purchases up to $50,000,000, the reason for this action being that call money had advanced to 6 per cent and the opinion in New York was that a period of tight money was likely to continue for several days. The Governor of the New York bank stated that when purchases were made they should be for the System Open Market Account in which all banks would participate rather than for the account of an individual bank. The Governor of the New York bank stated that as Chairman of the Open Market Committee he had taken the matter up with other members of the Committee, all of whom were of the same opinion. Consideration of the matter was given the following day, December 22, when the Governor of the Board reported a telephone conversation with the Chairman of the Open Market Investment Committee, during which he was advised that the Federal Reserve Bank of New York had already contracted for $18,000,000 of purchases, which would be carried in its own portfolio if the Board disapproved the recommendation of the Committee. After a discussion of the matter the Board approved of the Committee purchasing for the System Account from $25,000,000 to $50,000,000 of securities and under this authority the account increased.

(Note: The Board's records show that on December 30, 1925, the account stood at $260,000,000)

Developments during 1926

On January 8, the discount rate of the New York Federal Reserve Bank was raised from 3-1/2 per cent to 4 per cent, the level prevailing at all of the other Federal Reserve banks.

Meeting of Committee on January 18, 1926, and Subsequent Board Action

The Committee met on January 18, 1926. At that meeting discussion was had with respect to the disposition of the $50,000,000 short-term Government securities which had been acquired during the latter part of December 1925 for resale possibly in January 1926. It was agreed, in view of existing conditions in the market and the fact that there were $65,000,000 of March maturities in the account, that while it was not desirable to sell the $50,000,000 of Governments immediately, the situation should be carefully watched, in order that action might be taken at any time that developments disclosed the desirability of selling.

Governor Crissinger, who attended the meeting of the Open Market Committee reported the Committee's actions to the Board at a meeting of the Board held on January 19, 1926.

At the meeting of the Federal Reserve Board on January 25, the Board authorized the Committee to sell, not to exceed $50,000,000 of securities against definite orders. This action was taken following presentation to the Board of a letter from the Deputy Governor of the

Federal Reserve Bank of New York, in which he advised that money conditions in New York were easing considerably with the result that a moderate demand for short-term securities had sprung up, and further that officials of the New York bank were inclined to the view that it might be well to supply the market from time to time with a moderate amount of these securities, not exceeding $50,000,000 from the System's Open Market Investment Account, as and when definite orders for same were received.

(Note: By February 24, 1926, the Open Market Investment Account had been reduced from $260,000,000 to $210,000,000.)

The Chairman of the Open Market Investment Committee was present at a meeting of the Federal Reserve Board held on March 8, 1926, and discussed with the members of the Board prospective business and credit conditions. He stated that the System held about $100,000,000 of Government securities which would mature on March 15, about $34,000,000 of which were held for account of foreign banks and the remainder in the open market investment account. He stated that his bank had at that time received from foreign correspondents requests to replace about $31,000,000 of securities held for their account and that he thought it advisable and would recommend that the runoff of $66,000,000 of securities from the open market account be replaced, if possible to do so. He stated, however, that it might be found impossible to replace the entire amount.

The Board voted to interpose no objection to the Open Market Investment Committee replacing, so far as possible, $66,000,000 of Government securities held by it for the System account which matured on March 15, 1926.

(Note: At this point the authorized maximum amount of the account was $210,000,000.)

Meetings of March 22-24, 1926

The Committee held a meeting in Washington on March 22. The Governors of the Federal Reserve banks were also in conference in Washington at the same time.

Report of Committee to Governors' Conference. The committee made a report to the conference having previously discussed same informally with the Board. The Committee's report was approved by the Governors' Conference. The text of the Committee's report is as follows:

"Since the last Governors' Conference the changes in the special investment account have consisted of (a) temporary readjustments to offset the effects on the money market of government financing at tax periods, (b) purchases and sales to offset seasonal changes over the turn of the year, and (c) a reduction in total caused by the repayment of March 15 maturities, which have not yet been wholly replaced.

"At the December 15 tax period temporary sales of 30 million dollars were made to New York City banks, and at the March tax period temporary sales of $38,000,000 were made, of which $35,000,000 were made in New York and $3,000,000 in Chicago. The result of these sales was to exert a considerable stabilizing influence on the market at these periods.

"During the latter part of December the Committee purchased 50 million of short-term government securities to decrease the seasonal strain in the market, and these securities were resold in the latter part of January and early in February.

"On March 15 there matured 65 million dollars of securities held in the special account, and in addition $32,500,000 held for foreign account. These amounts have been fully replaced for the foreign accounts but only partially replaced as yet by the purchase of $34,355,600 of securities for the System account. This leaves a balance of $31,411,100 to be purchased for the special account in order to restore it to 210 million dollars; the $38,160,000 of Treasury notes which matured December 15, 1925, were replaced by purchases of other maturities, thus causing no change in the account.

"In the past few weeks, there has been some change in credit conditions, but more particularly in business and financial psychology. The stock market boom has lost its impetus and the amount of funds employed by the market has diminished by about 300 million dollars from the date when public reports were commenced. Real estate speculation has calmed down somewhat. There are also reports of business hesitation, evidence of which may be found in a weakness in commodity prices, a decline of unfilled orders of the Steel Corporation, some recession in retail trade and some decrease in the amount of building permits taken out, although the actual volume of current business transactions continues very large. But some business hesitation appears to be a not unusual accompaniment of a rather sharp arrest of stock speculation following a long extended period of activity.

"Thus far it would appear that the diminution of speculative activity is wholesome. The movements which have taken place have been orderly and there has been no indication so far of untoward consequences. It is not yet clear how far liquidation will be continued and it is, of course, still possible that there might be a revival of speculation with the dangers it involves. It appears more probable, however, that the peak of this speculative and business expansion has been passed. It therefore seems appropriate in view of the above to discuss at this time what our open market policy should be in the event a business recession calls for a revision of policy before we meet in another governors' conference.

"Experience in the past has indicated that member banks when in debt at the Federal Reserve Bank of New York, and in less degree at other money centers, constantly endeavor to free themselves from that indebtedness, and as a consequence such pressure as arises is in the direction of curtailing loans. This is now accentuated over a year ago as the discount rate at New York is a full 1% higher, and 1/2% higher at four other banks. . . . the amount of credit furnished by Reserve Banks on member banks direct borrowing, just prior to the March 15th operations, was larger this year than on any corresponding date since 1923.

"The total amount of borrowing undoubtedly exerts some pressure upon the business community. Should we go into a business recession while the member banks were continuing to borrow directly 500 or 600 million dollars, (if bills are included nearly 800 million dollars,) we should consider taking steps to relieve some of the pressure which this borrowing induces by purchasing government securities and thus enabling member banks to reduce their indebtedness.

"It is not possible to predict to what extent member banks will continue their borrowing on the present scale in the event of a business recession. The release of funds now employed in the security markets, a decrease in currency requirements, and some decrease in bank loans for business undertakings, would likely be partly offset by increased requirements for funds to carry accumulating inventories. Perhaps the major determining factor will be the movement of gold. During the first half of March we received 30 million dollars of gold from Canada and this movement resulted in easy money rates in New York in the second week of the month. It seems possible that this gold movement may be continued somewhat further, and, if so, it would correspondingly liquidate the borrowings of member banks in New York. The usual movement of gold, however, if seasonal causes operate, would lead us to anticipate gold exports rather than imports during the summer months, with perhaps further imports in the fall. With these conflicting tendencies future changes in our loan account are especially significant as a guide and we should see that the total does not become or continue too burdensome.

"Future Policy

"As a guide to the timing and extent of any purchases which might appear desirable, one of our best guides will be the amount of borrowing by member banks in principal centers, and particularly in New York and Chicago. Our experience has shown that when New York City banks are borrowing in the neighborhood of 100 million dollars or more, there is then some real pressure for reducing loans, and money rates tend to be markedly higher than the discount rate. On the other hand, when borrowings of these banks are negligible, as in 1924, the money situation tends to be less elastic and if gold imports take place, there is liable to be some credit inflation, with money rates dropping below our discount rate. When member banks are owing us about 50 million dollars or less the situation appears to be comfortable, with no marked pressure for liquidation and with the requisite elasticity. Under these circumstances no single bank tends to be in debt for any extended period and borrowings are passed around among the different banks. Call and time money rates tend to be but slightly above our discount rate. With this situation existing in New York, there is less tendency for funds to be attracted to New York (particularly since commercial rates at such times are apt to be higher than stock exchange rates for call money) and the situation has a considerable degree of stability.

" . . . In the event of business liquidation now appearing it would seem advisable to keep the New York City banks out of debt beyond something in the neighborhood of 50 million dollars. It would probably be well if some similar rule could be applied to the Chicago banks, although the amount would, of course, be smaller and the difficulties greater because of the influence of the New York money market.

"In general it would appear that we should not increase or diminish the special account immediately beyond gradually replacing the issues which matured on March 15 as market conditions warrant, but that we should prepare ourselves now for the prompt purchase of some further amount of securities if and when there should be further evidence of a recession in business activity, especially if there is no further liquidation in the amount of Federal Reserve credit employed."

Action of Committee and Board. On March 23 the report of the Committee was submitted to the Federal Reserve Board for formal action and the Board voted to approve the proposal contained therein to the effect that the System's special investment account should not be changed in amount except that the March 15 maturities should be replaced as conditions seemed to warrant.

At a joint meeting of the Governors' Conference and the Federal Reserve Board on March 24, Governor Crissinger advised the conference that the Federal Reserve Board had at its meeting on March 23 approved the report of the Open Market Investment Committee, although it was explained that the Board's approval related expressly to the repurchase of March 15 maturities. Governor Strong then referred to the advisability of giving the Committee authority to buy additional securities if and as soon as it may be apparent that conditions justify. He stated that in his opinion the latter part of the report of the Open Market Investment Committee, which was drafted almost a week before and which suggested the likelihood of the need for additional purchases, indicated that if the discounts of New York City member banks did not decrease after the quarter day movements in the money market had been reduced to normal, it would be advisable for the committee to make further investments. The Federal Reserve Board thereupon withdrew from the conference in order to consider this question Upon the Board's return, the Board's Secretary read to the conference the following extract from the minutes of the meeting of the Board held on March 23:

"After full discussion, upon motion it was voted that the committee be advised that the Board has considered the report and approves the proposal contained therein to the effect that the System's special investment account should not be changed in amount except that the March 15th maturities may be replaced as conditions seem to warrant."

It was pointed out, however, by the conference that the Board had taken no vote on the latter part of the report concerning the prompt purchase of further securities since the Board felt that the committee's report made no specific recommendation on this question. Governor Strong emphasized the fact that the Open Market Investment Committee's report had been drafted six days before, that the readjustments of the quarter day period were over, that New York City banks were still heavily in debt to the Federal Reserve Bank, that the conditions suggested in the latter part of the report as a guide for further purchases now appeared to exist and that the Committee's report should therefore be considered as a recommendation that it should be authorized to make the additional purchases. Governor Strong then informed the Federal Reserve Board that during its absence from the meeting the conference made the specific suggestion that the committee be authorized to buy up to $90,000,000 more if developments in the money market indicate the need for doing so before pril 15, 1926.

The Board left the conference and held a meeting to consider the matter of authorizing the increase in the account to $300,000,000. Several motions with respect thereto were voted on and all were lost.

At a meeting of the Board held on March 25 the question of authorizing an increase in the account to $300,000,000 no purchases to be made under such authority after April 15, 1926, was given further consideration and on motion the Board approved the recommendation of the Open Market Investment Committee and Governors' Conference.

> (Note: By April 15 the account had been increased to $275,000,000. On April 23 the discount rate of the Federal Reserve Bank of New York was reduced from 4 to 3-1/2 per cent. The account ran up to $295,000,000 on June 9 in anticipation of the June 15 maturities, and following the maturity date fell off to $239,000,000. As the securities were replaced the account was increased to $275,000,000 with the Board's approval. This transaction in replacing maturities was tkan with the approval of the Federal Reserve Board.)

Meeting of June 21, 1926

Action of Committee. The Committee met in Washington on June 21, 1926. The Undersecretary of the Treasury, who attended the meeting, reported that the Treasury would have surplus funds in the Federal Reserve banks during the month amounting to about 75 million, a substantial part of which it was proposed to use in the purchase and redemption of Third Liberty Loan Bonds, and that he contemplated buying additional bonds for delivery the first of July, when the Treasury would receive 40 million from the proceeds of a recent sale of Farm Loan Bonds. The Chairman of the Committee made the following report, and, on motion, the committee and the Federal Reserve Board voted that it was expedient that the System's holdings of Government securities should be maintained for the present at the existing amount--approximately 275 million--but with authority to make temporary purchases or sales within a range of 50 million as may be deemed advisable by the Committee; any such purchases to be liquidated within a reasonable time as market conditions warrant.

Report of Chairman. The report of the Chairman was as follows:

"The report of the secretary gives the details of operations since the last meeting. As far as policy is concerned, the two principal problems center around the changes in the money market due to the tax period, and the policy of the committee for the coming few months in view of the general credit situation.

"Tax Period.

". . . the New York banks started the tax period with reserves substantially under requirements, and as a consequence of this fact and of rapid income tax collections, the surplus of funds on June 15 and 16 was only temporary and by Friday, when the banks average up their reserves, the situation was again at equilibrium.

"As this week begins the prospects are that the banks in principal centers will be steadily losing in their reserves through the accumulation of Treasury balances at the Reserve banks. Just as the problem last week was to prevent too great ease in funds, so the problem this week will be to prevent too rapid a tightening; and the same may be true of next week, when semi-annual settlements will coincide with requirements of currency over the July 4 holiday. Various methods for offsetting a disturbance to the money market at this time may well be considered. The situation may be met partly by Treasury investment of part of its surplus. It may be desirable also for the committee to make temporary purchases for a few days, and authority should be secured for such operations.

"The General Situation.

"At the time of the governors' conference there was some anticipation of a recession in business. Since that time there has been a reduction in some lines of business activity. Production in various textile lines has been considerably curtailed. Production of iron and steel has decreased slightly. Building activity is not quite as intense and reports for May by the New York State Department of Labor, and by the Philadelphia Reserve Bank for the Philadelphia district, indicate a decline of about 2 per cent in factory employment. Wholesale and retail trade have been a little unsatisfactory, but that may largely be ascribed to the weather. This about concludes the evidence of recession, for, in general, business has continued at high speed above what we may call normal activity. Car loadings are large; production is large in most lines of industry; automobile output is exceptional; bank debits indicate a very large measure of activity; and taking all the evidence together there has been no such recession as was anticipated earlier in the year.

"As far as credit is concerned, the country has continued to require about the same volume of credit as in the spring and there has been no particular seasonal reduction.

"Industrial stock averages now within 6 to 8 points of February high, and 10 points above March low; and rails are practically at the year's high. The recent rise appears to be stimulated by general belief that money will be very cheap, and by apparent failure of expected business recession to materialize. In the past few days the market has apparently been influenced by temporary ease of money over tax period and some misunderstanding of effect on money of Treasury's not putting out new issue.

"The rise in stock prices has been accompanied by an increase of less than 100 million in brokers loans, which are still 700 million below the peak. Stocks are being carried much more largely on loans direct to customers by banks outside New York City. These banks are lending 400 million less to brokers in New York, but their total loans on stocks and bonds are as large as at year's high point. Thus the total amount of credit employed in carrying securities has decreased much less than the brokers loan reports indicate and is only about 200 million below the high point.

"The general situation may be summarized by saying that the picture is not clear as to which direction business and credit are likely to take. A further expansion in business and in speculation is possible; on the other hand, a continued recession in business is possible. Under these conditions it would seem wise for the Open Market Committee to maintain its holdings of securities at $275,000,000, or thereabouts, except for such temporary changes as may be necessary in the next two weeks."

(Note: On August 13, the discount rate at the Federal Reserve Bank of New York was raised from 3 1/2 to 4 per cent, bringing it back to the level prevailing at all other Federal Reserve banks.)

Meeting of August 17, 1926

Action of Committee. At a meeting of the Committee held in New York on August 17, 1926, attended by three members of the Board, the Chairman presented the report set out below, which contained among other things reference to a request made by the Treasury to purchase $40,000,000 of Third Liberty Loan $4\frac{1}{4}$ per cent bonds, $25,000,000 from the Special Investment Account and $15,000,000 from the assets of three Reserve banks. The Committee voted that the sale of the Third Liberty Loan bonds be made to the Treasury Department without replacement. The Committee also voted to approve of a sale without replacement made to a foreign correspondent on August 16 of $2,337,000 of $4\frac{1}{4}$ Treasury notes, and a sale of $5,000,000 additional notes to a foreign correspondent to be made some time during the current week; also a sale to a foreign correspondent during the next few weeks of approximately $15,000,000 of Treasury notes.

Report of Chairman. "Since the last meeting of the Open Market Committee on June 21 the business and financial situation has been somewhat clarified. The hesitation in business, and particularly in business sentiment, which was apparent in the spring, has largely passed away, and business is being carried forward at a very active pace, with optimistic sentiment as to the future. The present indications are that the year 1926 will establish new records in production, building, freight car loadings, and other phases of business activity. From the point of view of credit policy, perhaps the most important feature of the present activity of business is that it comes after a very long extended period of active business. In the past such a long period of activity has usually been followed by over-production and over-speculation and by a subsequent decline in activity.

"There are, however, few evidences of overdoing the present business prosperity. There is some indication of overbuilding. The textile industries have been ailing for some time. But in general it must be said that business men continue to conduct their affairs in orderly and conservative fashion. Prices of commodities have been remarkably steady, with the exception of farm products which have tended to decline. The principal example of speculative action is the stock market, in which higher prices and active trading appear to reflect not only heavy professional operations, but large earnings and an increasing public interest.

"Volume of Credit.

"The reporting member banks are extending about one billion dollars more credit than a year ago, an increase which is not far from the usual increase of credit from year to year due to the country's growth. The present volume of business is not requiring any exceptional growth in credit. About half of the increase since a year ago has been in bank investments and loans on securities.

"The country has been using about 100 million dollars more of Federal Reserve credit than it was a year ago, although thus far in August the increase has not been this large. The division between different types of holdings of bills and securities was as follows on August 11:

Total Bills and Securities
(in millions)

	August 12, 1925	August 11, 1926
Bills discounted	538	549
Bills purchased	212	231
U. S. Securities	329	366
Other	12	3
Total Bills and Securities	1,091	1,149

* * *

"Future Policy.

"It would appear that there is nothing alarming in the present situation, but that in view of the present large volume of business and financial activity the influence of the Reserve System should be in the direction of caution and conservatism.

"On August 12 the Federal Reserve Bank of New York raised its discount rate from 3 1/2 per cent to 4 per cent, and the results of this change are not yet fully apparent.

"It would seem wise to consider, however, whether sales should not be made from the special investment account in order that a larger proportion of the Federal Reserve credit outstanding may be converted into discounts, for which the member banks feel direct responsibility. This would have the effect of subjecting future extensions of member bank credit to still closer scrutiny and would make present discount rates more effective. There does not now seem to be, however, any reason for drastic or precipitate action in the sale of securities which might disturb the financing of fall trade and agriculture.

"An opportunity for testing the effect of sales of securities is provided by the Treasury program of purchases for the sinking fund. The Treasury is desirous of purchasing 40 million dollars of Third Liberty Loan bonds now held by the Federal Reserve Banks. A sale of these bonds to the Treasury would constitute a convenient means of increasing the indebtedness of member banks at the Reserve Banks, with least disturbance to the money market. Transfers to the Treasury could be made at intervals with continuous observation as to the effects of the transaction on money conditions. It would be well for the committee to have authority to replace the securities sold by purchases in the market, if at any time the money market was seriously disturbed.

"A still further problem which the committee will wish to consider is raised by the maturity on September 15 of 67 million of securities held in the special investment account, although the question as to whether or not these maturities should be replaced would depend somewhat upon the results of testing the market by the suggested sale to the Treasury."

Action of Board. At a meeting on August 23, 1926, the Board received and noted a letter from the Secretary of the Open Market Committee, advising that approval had been received from all Reserve banks to the sale to the Treasury from the System's holdings of approximately $40,000,000 of Third Liberty Loan Bonds without replacement. The minutes of the meeting of the Committee were presented to the Board on August 24 and were ordered circulated without any action being taken.

(Note: During the period August 17 to September 10, 1926, the account fell from $275,000,000 to approximately $210,000,000. The authorities held by the Committee at this time permitted purchases to be made up to $325,000,000.)

Meeting of September 10, 1926

Action of Committee. The Committee met with the Board in Washington on September 10. Following the reading of the Chairman's report, the text of which is quoted below, the view was expressed that the sale of Liberty Loan Bonds from the System's account to the Treasury Department had served a useful purpose in making effective the recent change in the New York discount rate. (Secretary's Note: By reference to the entry concerning the previous meeting, you will note it was proposed to sell $40,000,000 of Liberties to the Treasury, $25,000,000 from the account and $15,000,000 from the assets of three of the Reserve banks. It appears that the three banks exchanged Liberties with the account for other securities and that the entire sale of $40,000,000 was made from the account reducing it by that amount.) It was the sense of this meeting that the Open Market account should be maintained for the present at about its present level, and it was voted that the Open Market account should be maintained for the present at $200,000,000 or thereabouts, with the understanding that the Committee could in its discretion increase or decrease the account by not more than $50,000,000. It was also understood at this meeting of the Committee and the Board that in the event of further gold imports for the account of foreign correspondents, the Committee should continue to furnish the foreign correspondents with securities from the special account, as it had previously done, thus offsetting the effect of gold imports.

Report of Chairman. The report of the Chairman of the Committee was as follows:

"Changes Since Last Meeting

"Open Market Account:

"In accordance with the decision at the last meeting of the committee, on August 17, the special investment account has been reduced from 270 million dollars to about 210 million dollars. Of this amount 39 million represents sales to the Treasury and 21 million sales to a foreign correspondent, exactly offsetting gold imports. The net result of these operations was, therefore, to take out of the money market the amount of funds represented by the securities sold to the Treasury, which were paid for by withdrawals from depositary banks throughout the country.

"Federal Reserve Credit:

"The result of these sales was to increase the direct borrowing by member banks, and bills discounted on September 7 amounted to 611 million compared with 535 million dollars on August 18 and 639 million a year ago. Total bills and securities of the System on September 7 were 1,187 million, a figure which has been reached or exceeded several times this year and which is about the same as a year ago, whereas they have as a rule this year been exceeding last year's figures by about 100 million dollars. . . .

". . . the result of the open market sales has been to shift to the member banks the responsibility for a somewhat larger proportion of the total amount of Federal Reserve credit now outstanding, which should presumably have the effect of subjecting future extensions of member bank credit to a closer scrutiny and making present discount rates more effective.

"Money Rates:

"The combined result of these recent open market sales, the continued influence of the increase of rate of the New York bank, and increasing fall demands for credit, are shown in a considerable increase in money rates, . . .

"We are thus entering the Fall with a rate structure substantially higher than a year ago. Five of the Reserve Banks are also operating with a higher discount rate than was the case a year ago.

"Member Bank Credit:

"Total loans and investments of reporting member banks on September 1 were higher than at any time since June 30 but maintained about the same increase over the previous year, as has been the case for some months past, an increase which is not out of line with the usual year to year increase in the volume of credit to keep pace with the growth in population and trade. In the past month there has been an increase in commercial loans and in loans secured by stocks and bonds, partly offset by a decrease in investments. Total loans on stocks and bonds are slightly larger than at any time this year with the exception of January 6 and June 30.

"Business and Financial Situation:

"Business continues to be maintained at a high level, with few evidences of weakness. There has recently been some decrease in the amount of contracts and permits arranged for new building construction. This reduction will probably influence next year's construction rather than construction for the balance of this year, which promises to be maintained at a high level. In the main business continues to be conducted in conservative fashion and there is little evidence of over-production or of speculative tendencies outside of the security markets. The business public appears to be critically-minded to observe any unwholesome tendencies in the business situation, as may be indicated by the recent unwillingness of the public to purchase bonds from the G. L. Miller Company and their consequent failure. Further evidence may be found in the critical attitude toward the extension of terms for installment selling, in the continuance of hand to mouth buying, and in the stability of prices of other than agricultural commodities. It is difficult to discover any grounds for serious business disturbance in the immediate future. Even in the stock market, where speculative operations are most in evidence, the tendency is clearly toward a careful selection of stocks on the basis of earnings and fundamental values and the trading is of much more substantial character than it was a year ago. An excellent argument can be made in justification for much of the recent rise in stock prices.

"OPEN MARKET POLICY

"While it is clear that we are now at a high level of business and financial activity, and that we are in a situation where the influence of the Federal Reserve System should be toward caution and conservatism, there does not appear to be any emergency situation. The present volume of discounts, and the present rate structure now constitute a considerable restraint on further extensions of member bank credit. As the usual Fall needs for additional credit make themselves felt there will be a steady increase in the burden of indebtedness upon member banks, and money rates are likely to continue higher than a year ago.

"A further sale of securities at this time would in all probability be followed by an increase in money rates which would make it difficult to avoid rate increases at a number of the Federal Reserve Banks. Before such action was taken there should be careful consideration of its probable effect upon financing of the crop movement, agricultural prices, and the international relationship of money rates and gold movements. The special investment account is now down to about 200 million dollars and a further dissipation of this portfolio would leave the System with little control over the market in case of some future emergency.

"In the light of these various considerations it would appear to be wise to defer further open market action for the present until there is a chance to observe the effect on the situation of the causes now operative and to observe further the tendencies in the volume and quality of credit as the Fall season advances."

<u>Action of Board</u>. The Federal Reserve Board at a meeting on September 10 voted to authorize the Open Market Investment Committee to maintain the System's Special Investment Account at from $200,000,000 to $225,000,000.

Meeting of November 7, 1926

The account remained around $200,000,000 up to the time of the next meeting of the Committee on November 7, 1926. This meeting was attended by Governor Norris, Governor McDougal, and Deputy Governors Paddock, Case, and Harrison. The Committee met for the purpose of reviewing in advance of the Governors' Conference the report of the Open Market Investment Committee's activities prepared by the Acting Chairman of the Committee for submission to the Conference. The report was amended and approved.

Report to Governors' Conference. The text of the report follows:

"Since the Governors' conference last spring there have been two important changes in the special investment account, - a purchase of securities between March 29 and April 15, which increased the amount from 210 million dollars to 275 million, and a sale of securities between August 7 and September 15, which reduced the account again to 200 million dollars.

"Purchases in March and April

"The purchase of 65 million dollars of securities in March and April was made at a time when business psychology was pessimistic, when commodity prices were falling, and when there had been a considerable liquidation of credit employed in the security markets, and to a lesser degree in commercial loans. The result of the purchases was to reduce approximately to that extent borrowing by member banks at the Federal Reserve Banks, particularly in larger centers, and to operate together with other causes toward slightly easier money conditions.

"Sales in August and September

"As the year advanced no business recession such as had been anticipated by many earlier in the year developed. The volume of trade continued at a very high level, building activity and automobile production were well maintained, commercial loans increased, and the volume of credit employed in the security markets again showed an increase. Money rates showed an advancing tendency and the Federal Reserve Bank of New York raised its discount rate from 3-1/2 to 4 per cent on August 12.

"The sale of 75 million of securities from the open market investment account between August 7 and September 15 took two forms; first, the sale of 35 million to foreign correspondents to employ balances created by gold imports into this country. This sale of securities merely offset the effect of the gold imports. In addition 40 million of securities were sold to the Treasury Department for account of the sinking fund and the effect of this sale on the market was distributed throughout the country as the Treasury withdrew funds from depositary banks in all districts to pay for the securities.

"The sale of securities was naturally accompanied by a slight further increase in borrowing by member banks, by increased offerings of bills to the Reserve Banks, and by slightly firmer money conditions. The relationship between open market purchases and sales during the year to changes in bills discounted and holdings of bankers acceptances, is shown in the attached diagram.

"The Present Credit Situation

"The present credit situation does not appear to indicate the desirability of any change in open market policy. Business continues to be active and the volume of trade is at a high level. The business atmosphere, however, is conservative and there is some apprehension as to the future. There were reports recently of some decline in building and production of automobiles. In recent weeks there has been a considerable liquidation of brokers loans and some slight reduction in the total volume of credit outstanding. The October period of largest demand for commercial credit appears to have passed without credit stringency and, aside from a period of slight ease in the second half of October, money conditions have been steady.

"Turn of the Year

"In the past two years it has been found desirable to sell securities in January to take up the usual seasonal slack in credit resulting from the return of Christmas currency and the usual seasonal flow of funds to money centers. Last year a purchase of 50 million dollars of securities was made during the period of greatest currency demand in December, and these securities were sold in January and February. These transactions appeared to have a stabilizing influence upon money conditions, although the amount of purchases and sales was not sufficient to prevent a considerable tightening of money rates at the end of the year and a considerable easing in rates at the beginning of the new year. The committee therefore suggests that this year it may be desirable to purchase up to 100 million of securities during the coming six weeks, to be sold again at such time as credit conditions appear to make that course desirable. If business and credit conditions continue as at present it would seem wise to sell these securities shortly after the turn of the year, but in the event of a decline in business activity, such as some observers think may occur, it then might be desirable to retain a part of these securities in the Federal Reserve portfolio. In any event we should be prepared for either course.

"Temporary Sales of Securities

"At the June 15 tax period the usual temporary sales of securities were made from the open market account to stabilize money conditions, with the result that money rates were steady during the period. At the September 15 tax period the New York City banks were so largely in debt at the Reserve Bank that it was felt that temporary sales would not be necessary and this proved to be the case. The temporary supply of funds in the market, due to the redemption of maturing issues, was offset by the liquidation of member bank indebtedness and money rates were steady during the period. . . ."

Action of Board. The above report was approved by the Conference which requested the Committee to submit it to the Board with the approval of the Conference.

The Federal Reserve Board considered the report at a meeting held on November 10, 1926, at which meeting the following letter to the Acting Chairman of the Open Market Investment Committee was approved:

"The Board has considered the report of the Open Market Investment Committee and notes particularly the Committee's suggestion that 'it may be desirable to purchase up to 100 million of securities during the coming six weeks, to be sold again at such time as credit conditions appear to make that course desirable'. The Board understands from the Committee's report that as the Committee views the situation at this time there is no need for action looking toward a change in the amount of the special investment account, as approved by the Board on September 10, 1926, and in this view the Board concurs. The Board, therefore, construes the Committee's suggestion as an expression of opinion on the part of the Committee that in the event of a future change in the present situation, it may be desirable to give consideration to increasing the account temporarily.

"The Board assumes that should there be any change in the present situation or any new developments which would seem to warrant increasing the account temporarily the Committee will confer further with the Board."

Developments during 1927

Communications Concerning Reduction in Account, Early 1927

Views of Federal Advisory Council. The Federal Advisory Council at its meeting in February 1927 expressed formally to the Board the view that it did not believe that there was anything in the business situation at that time which would warrant any reduction of existing discount rates or necessitate any change in the open market policy. The Council also expressed the view that should interest rates continue to decline the Reserve banks should reduce their holdings of bills bought in the open market.

The views of the Council were communicated by the Board to the New York bank and in its advice to the bank the Board stated that the Council in referring to "bills bought in the open market" indicated they had reference rather more to short-term Government securities bought through the Open Market Committee than to bills. The Board requested the views of the directors of the New York bank, and in doing so, requested that cognizance be taken of the gold imports since the first of the year which amounted to $65,000,000, and the present state of the acceptance market, and to consider whether there should be any change in the volume of investments in the System's Special Investment Account, especially in view of the March 15 maturities from the account.

Letter from New York Bank. The following letter was received from the Federal Reserve Bank of New York and brought to the attention of the Board, which in acknowledging receipt of same, advised the New York bank that it (the Board) approved of the Committee allowing the March 15 maturities to run off:

"We are in receipt of your letter of March 2 transmitting the resolution of your executive committee, asking us to get the views of our board concerning recommendation No. 1 of the Federal Advisory Council.

"Your letter arrived while our directors' meeting was in session on Thursday and was read to the directors. There had not been, however, any time for us to prepare a review of the question for the directors and it was not possible to give the question the extended consideration which it warrants. Since the Open Market Investment Committee meeting has been postponed there will, we trust, be an opportunity to give it more adequate consideration.

"As you know, we are facing a very complex situation at the tax day period. In addition to the 30 million dollars of maturities in the system account, there are 90 million dollars of maturities in foreign accounts, all of which must be taken care of in one way or another. Total maturities of Treasury notes, of well over 600 million, constitute the largest maturity for some time and the new Treasury issues will probably be more difficult to handle than for some time past.

"In view of the complexity of the situation, we have not yet been able to make up a comprehensive balance sheet as to the probable effects on the money market of the operations on and following the fifteenth of the month, and before that is done it is difficult to lay out any satisfactory program for our operations.

"In discussing the matter, however, in a tentative way, it was the view of our directors that, if the Open Market Investment Committee concurred, it would be well to let these securities mature on March 15, thus having the effect, for the time being at least, of removing the funds from the market for the period when money tends to be very easy for the few days following the fifteenth, and that the time and manner of replacing these maturities be determined upon later as it becomes possible to visualize the situation more clearly.

"We hope to be able to make up a survey of the tax day operations before the end of next week, which we shall be glad to send you as soon as it is ready.

"With regard to the policy relating to bankers acceptances, our view here has coincided with the position taken by the Federal Advisory Council, and it has been the feeling of our officers that our buying rates at which we stand ready to purchase bills should be maintained at the present levels, so that if and when market rates declined there would immediately be some pressure on the market to reduce the amount of its offerings to the Reserve Bank. This process will, we believe, tend to absorb any substantial amount of money in the market available under 4 per cent, and keep our discount rate effective. Our directors have concurred in this general program.

"As you may have noticed, the New York City banks now owe us about $80,000,000. There is no danger of sloppy money as long as that is true."

Meeting of March 21, 1927

The first meeting of the Open Market Investment Committee in 1927 was held on March 21, and at this meeting the Secretary of the Committee submitted a report of transactions in the account since the meeting held on November 7, 1926. The Chairman also submitted a report reviewing briefly the December and March money market situations and the open market policies related thereto.

Report of Acting Chairman. "The secretary's report gives the details of operations in the special investment account since the last meeting of the committee. Beyond the shifting of securities, in order to accommodate the Treasury and foreign correspondents, the principal change in the account has been a decrease of $25,000,000 in the open market account and a decrease of $50,000,000 in the volume of Government securities held for foreign correspondents due to maturities of March 15 certificates which has had the effect of withdrawing about $75,000,000 from the market. It will be desirable at this meeting to determine whether or not these securities should be replaced.

"Before discussing this question, however, it may be well to review briefly the December and March money market situations and the open market policies related thereto.

"End of the Year Situation

"In view of the experience at the end of 1925, careful consideration was given to the avoiding of such a period of stringent money as appeared at that time, and such large borrowing by a few member banks. The principal steps taken were to discuss the problem thoroughly with a number of the large member banks in New York City and to make every effort to invest the Treasury balance after the tax day, so that no large Treasury balance would be built up. For a time it was feared that it would not be possible to avoid a large Treasury balance and open market purchases were contemplated. It proved, however, possible to reach the end of the year with only a normal Treasury balance, and as a consequence of this and the cooperation of the member banks in showing willingness to appear in debt at the Reserve Bank at the end of the year, there was no marked stringency of money.

"March 15, Tax Period

"The March 15 tax period was extraordinary in the very large amount of maturities to be redeemed in cash. Maturities of approximately 660 million dollars plus interest payments of approximately 95 million dollars, resulted in a large immediate net gain to the market, which was only partly offset by a Treasury call of 123 million and income tax check collections. The consequence was a larger Treasury overdraft and a larger gain to the market than has taken place for several years. The gain to the New York market on March 15 through these transactions was over $300,000,000.

"The taking up in some way of this large volume of surplus funds in the market was an acute problem. A number of the banks in New York City fortunately anticipated this situation and allowed their reserves to remain about 23 million in deficit for the Saturday, Sunday, and Monday preceding March 15. Thus they entered the tax day with an accumulated deficit in their reserves of 69 million dollars. The following methods were then used to offset large Treasury payments by the liquidation of Federal Reserve assets:

"(1) $75,000,000 of United States securities in the System and foreign accounts were allowed to run off. (Those held in foreign accounts were replaced by bills from our portfolio.)

"(2) $25,000,000 of sales contracts were taken out by dealers.

"(3) $65,000,000 of discounts were taken out by member banks.

"(4) $10,000,000 of securities were sold temporarily for one day on March 14th from the special investment account.

"(5) $63,000,000 of participations in the Treasury one-day certificates were sold to member banks.

"Total $238,000,000 - This, together with the aforementioned $69,000,000 deficit, provided an effective offset to the $300,000,000 excess reserves.

"The sale of participations in the one-day certificate was a new method of withdrawing funds from the market. It avoided taking away earning assets from the other Federal Reserve Banks, even temporarily, as sales from the special investment account would have done; it avoided the complicated bookkeeping which that transaction involves; and constituted a simple and logical means of offsetting Treasury payments into the market.

"As a consequence of the use of these different methods for removing surplus funds from the market, money remained reasonably steady all week and call money only dipped under 4 per cent on the exchange for a few hours on March 16. By Friday the banks were deficient in their reserves and found it necessary to increase their borrowing from the Reserve Bank to $150,000,000. Thus at the close of the week the money situation was restored to approximately the same position as before the tax period, but the Treasury still had an overdraft of $70,000,000 which is still to come out of the market.

"Replacement of March 15 Maturities

"The present outlook is for moderately firm money conditions, as the market settles down after the tax period. Business is active. The security markets are using more credit. Further large gold imports seem unlikely for the present.

"If this anticipation is correct, the country will require currently, as in early March, over one billion dollars of Federal Reserve credit. But there will be a difference in the makeup of this credit, because foreign correspondents replaced about 50 million dollars of securities matured on March 15 with bills, and the bill holdings of the system will probably be reduced to something about that amount and the borrowings by member banks increased. The effect of this operation will be the same as a sale of securities.

"Under these conditions borrowing by member banks throughout the country will be around 400 to 500 million dollars and by member banks in New York City upwards of 100 million dollars, and the call rate will be a firm 4 per cent, or possibly higher, even if the 75 million of securities in the system and foreign accounts, which matured March 15, are replaced. If, however,these are not replaced, about 75 million dollars additional of member bank borrowing will be required and call rates will be nearer $4\frac{1}{2}$ or 5 than 4 per cent.

"The principal argument for reducing our security portfolio, by not replacing the maturities, is that the security market is very active and using more credit, and firmer money conditions will tend to keep speculation within bounds.

"The principal arguments for maintaining our security portfolio by replacing the maturities are:

"1. A portfolio of securities is a protection against inflation, and its size should not be reduced without good cause.

"2. Higher rates here would tend to attract foreign balances and gold from countries which need them to us who do not want them.

"3. Higher rates here would force higher rates abroad and continue the pressure on world commodity prices.

"The foregoing was submitted to and unanimously adopted as the report of the Open Market Investment Committee, Washington, D. C., March 21, 1927."

Action of Committee. The recommendations of the Committee at the meeting last referred to were presented verbally to the Board at a meeting of the Board and the Committee held on March 21 and were as follows:

(1) That the Committee be authorized to replace the $25,000,000 of Government securities which matured from the Special Investment Account on March 15, and

(2) To purchase an additional $50,000,000 of short-term Government securities if and when a situation develops that would seem to justify such action.

The Board approved of the Committee replacing the $25,000,000 of Government securities which had matured on March 15, and advised the Committee that it (the Board) would stand ready to act upon a recommendation for the purchase of an additional $50,000,000 of short-term Government securities at any time such a course should appear desirable.

At this time (March 21) the account stood at $176,323,500, and the Committee had authority to increase it by the amount of the March 15 maturities to $201,000,000, which was done immediately following the meeting. The account remained at $200,000,000 all during the period from March 21 to a date early in May.

Arrangements for Gold Transaction with Bank of France

At a meeting of the Federal Reserve Board held on May 5, 1927, Governor Strong reported verbally arrangements being made to purchase

$60,000,000 of gold from the Bank of France, to be held by the Bank of England for the New York bank's account. The following is an excerpt from the minutes of that meeting:

"At this point, Governor Strong of the Federal Reserve Bank of New York, entered the room and advised the Board that the Bank of France had contemplated and made arrangements to ship $90,000,000 of gold to the American Exchange Irving Trust Company of New York City, that $12,000,000 of the gold had been received by the member bank and $18,000,000 is now in transit. He stated that the Federal Reserve Bank of New York has about completed an arrangement whereby the balance of the gold not yet shipped ($60,000,000) would be sold to it by the Bank of France and held for the Federal Reserve Bank, properly earmarked, by the Bank of England. He also referred to a telephone conversation this morning with Deputy Governor Harrison of the Federal Reserve Bank of New York, regarding impending arrangements for stabilization of the Polish currency."

No action was taken by the Federal Reserve Board at this meeting.

Meetings of May 9-11, 1927

Meetings of the Open Market Investment Committee were held in Washington on May 9, 11, and 12, during which period the Governors' Conference was in session.

Preliminary memorandum to Governors' Conference. The minutes of the meeting of the Open Market Investment Committee held on the morning of May 9 show that the Secretary read to the Committee a preliminary draft of a memorandum relative to the open market policy which was to be submitted to the Governors' Conference in connection with the Committee's report. The minutes of a meeting of the Open Market Committee held on the afternoon of May 9, 1927, show that the Committee considered a redraft of the preliminary memorandum containing the amendments agreed to at the morning meeting, and that the Chairman of the Committee was requested to transmit seven copies of the memorandum as amended to the Governor of the Board for the members of the Board, with advice that the Committee would be glad to meet with the Board and discuss the memorandum any time suitable to its convenience. The amended memorandum reads as follows:

"The principal transactions in the Special Investment Account since the last Governors Conference were reviewed in the chairman's report to the committee on March 21, and copies of this report were sent to all Governors. In accordance with the action taken at that meeting, purchases of 25 million dollars of securities were made in the market to replace March 15 maturities, and the Special Investment Account was thus restored to 200 million dollars, which is approximately the same amount as has been maintained for the past two years. Recent transactions resulting from large purchases of gold, are described hereafter.

"General Credit Situation

"For many months business has been active and has continued to maintain, and in some directions even to exceed, the rate of production and consumption of immediately preceding years, although a number of recent developments have been of a character which might have had a widespread unfavorable effect had the general business and financial situation not been fundamentally sound. These developments are, of course, the extensive floods in the lower Mississippi Valley, some overproduction and price declines in the oil industry, disturbing financial developments in Japan, reduced production and consequently reduced working time for labor in two or three large automobile concerns, and not so recently the collapse of a number of real estate and building speculations and of one or two large installments finance companies.

"The total volume of credit in use, estimated from the reports of the reporting member banks, is now about a billion and a half dollars larger than a year ago. The considerable expansion of the last two months has been distributed between increases in commercial loans, security loans and investments. On the other hand, the total amount of credit extended by the Reserve banks is about one hundred million dollars less than this time last year. As the net gold imports (excluding the movement now under way) within this period were about 105 millions, the reduction of Reserve bank credit has about offset gold imports.

* * *

"While total discounts at the Reserve banks are smaller than a year ago, the difference is largely due to reduced borrowings by country banks as reporting banks in principal centers are borrowing nearly as much as they did a year ago. . . .

"A review of the general credit situation, of rates and business, brings out the following striking facts:

"(1) That the general level of interest rates in New York, where changes of rates generally originate, is about 1/2 of one per cent above last year, the discount rate of the Federal Reserve bank also being 1/2 of one per cent higher.

"(2) The amount of bank credit employed for conducting the country's business, at a volume certainly much above the average of the last few years, is only $1,500,000,000 above what it was last year.

"(3) While irregularly distributed between the classes of goods, the general level of commodity prices has experienced a considerable fall, and over the greater part of the past year the decline in prices has been in both agricultural and non-agricultural commodities. Considering the reluctance of member banks to borrow from the Reserve banks, coupled with the considerable decline in interest rates which is occurring in Europe, the question is raised as to whether the somewhat greater restraint now being applied to the extension of credit at the money center (New York), coupled with the reduction of the total of the open market investment account over the past 18 months or two years from $500,000,000 to less than $200,000,000, has not gradually had the effect of exercising some pressure, imperceptible in any change over a short period, but now becoming apparent when examined as to its effects over a longer period.

"Gold Movements

"Between January 1 and May 1 of this year, gold imports into the United States have amounted to about $110,000,000, including $8,000,000 from Japan, and exports during the same period were $26,000,000. Net imports during this period were therefore $84,000,000. Inasmuch as approximately $14,000,000 of the gold exported was gold which had been earmarked before the period under discussion, about $98,000,000 was the net amount added to the monetary gold supply of the country during the first four months of the year. This gold movement, together with the imports of 1926, account largely for the fact that the System's earning assets show a decline during the past year, in spite of an increase of some billion and a half dollars in bank credit.

"Entirely apart from the movement of gold referred to above, there have been some significant developments since May 1, not included in the above figures. During the last part of April, the Bank of France recovered approximately $90,000,000 of gold from the Bank of England by the repayment of its credit to the Bank of England. Of this $90,000,000, $12,000,000 arrived in New York last week, $18,000,000 is still on the water, and $60,000,000 was purchased by the Federal Reserve Bank of New York on May 6 and is now held by the Bank of England under earmark for account of the New York bank. In addition to this Bank of France gold, $2,500,000 has recently been imported from Australia, and another $2,500,000 more is now on the water from Australia and expected to arrive in this country this week.

"A somewhat disturbing factor arose in the probability of the importation and sale to the Federal Reserve Bank of New York of the $90,000,000 of gold, negotiations for the purchase of which had been concluded by one of the New York member banks from the Bank of France. It was learned that space had been reserved on the steamers and arrangements had been made for shipping the entire amount of gold; in fact, one shipment was about to arrive in New York, and others were being loaded. In view of this situation, after consulting with all the members of the Open Market Investment Committee and with the Federal Reserve Board by telephone, it was arranged to purchase from the Bank of France all of the gold--nearly $60,000,000--which had not been shipped, and to sell the Bank of France a like amount of the September maturity of certificates of indebtedness held in the Open Market Investment account. By this arrangement, the money market status remained unchanged, except as to the gold which had already been shipped, leaving the committee in position to determine later at its meeting whether these securities should be replaced or not. Securities were sold to offset $9,000,000 of the $12,000,000 already arrived, but no arrangements have been made for sales to offset the balance of the gold which will arrive from London and from Australia, amounting in all to about $20,000,000. With the sale already made and further sales, if made to offset further gold arrivals, the securities remaining in the System's portfolio account will be a little over $100,000,000, too small an amount to afford security against possible future developments. This will be appreciated, for example, if the $90,000,000 now purchased had arrived at a time when we had no portfolio of government securities available. It is clear, therefore, that the committee must from now on give careful attention to meeting this gold problem, either by increasing its portfolio in anticipation of future developments, or by adopting other measures. The method of doing so should be determined with regard to whether the time has or has not arrived when the Federal Reserve System can afford to put new funds in the market, the effect of which would be to reduce the borrowings of member banks, principally in New York, and possibly to reduce the System's holdings of bills. There are various possibilities for dealing with the gold problem as a whole which have never heretofore been discussed in the committee's report and which are now submitted simply for discussion. None of them are recommended at this time, but are intended simply as a summary of all possibilities. They are:

"(1) The committee could replace the securities sold to the Bank of France. The immediate effect would be to reduce the amount of member bank borrowings in New York, which are now running on the average at from $100,000,000 to $150,000,000.

"(2) Those Federal Reserve banks which have considerable holdings of long time bonds could dispose of those bonds, realize their profit and repurchase through the committee as a part of the committee's account, an equivalent amount of short time securities. These, with other short term government securities owned by individual Reserve banks, could be added to the System holdings without reducing the total earning assets of the individual Reserve banks, and thus increase the committee's account to over $200,000,000.

"(3) Arrangements might be made with the Secretary of the Treasury for somewhat increasing balances carried with the Federal Reserve banks, and reducing the amount carried with special depository banks.

"(4) Some or all of the $75,000,000 of 2 per cent Panama Canal bonds could be called and the national bank notes issued against them retired. Further purchases of the 2 per cent Consols of 1930 could be made in anticipation of their possible retirement in 1930, as contemplated by the Secretary of the Treasury in his report of 1924.

"(5) By gradual stages, or all at once, the time schedule of the Par Collection System could be adjusted so as to increase the volume of uncollected checks and correspondingly reduce the reserve of members.

"(6) Plans could be undertaken for retiring the greenbacks, which however would require legislation.

"(7) Further amounts of the capital of the Federal Reserve banks could be called.

"(8) The reclassification of reserve cities could be gradually undertaken so as to increase reserve requirements.

"(9) A readjustment of the relations of the Reserve banks to the market for gold could be effected if the Secretary of the Treasury saw fit as authorized by law, to discontinue paying cash up to 98 per cent of the value of imported gold, thus throwing the market for gold entirely upon the Federal Reserve banks and enabling them to reduce the gold point for imported gold by the equivalent of a loss of interest for the period during which payment would be delayed. By reason of our Treasury practice, the United States is today paying the highest price of any world market for gold.

"(10) The Federal Reserve Board, of course, after adequate study, could revise the definition of what constitutes a time deposit, thus raising the reserve requirements. This is probably justified by the fact that something like 60 per cent of the increase in bank deposits in the United States over the past ten years consists of that class of deposits which require only 3 per cent reserve.

"(11) A revision of the regulations of the Federal Reserve Board in relation to the maintenance of reserves, by averaging reserves for a period of a week in Federal Reserve bank cities, and two weeks in the rest of the country, could have the practical effect of somewhat increasing the amount which member banks must borrow.

"(12) The Federal Reserve Board could revise its ruling relative to currency in transit, which in effect reduces reserve requirements in those districts where the ruling is now applied.

"The above comprehend most, if not all, of the possible measures available for dealing with the problem of gold imports in view of our reduced portfolio. They are submitted for consideration and study.

"The possibility of gold imports must not be overlooked, and may indeed be imminent. The underlying causes of such a movement would be:

"(1) The continued maintenance of our present level of interest rates, somewhat higher than a year ago, in the face of declining interest rates and reducing bank rates in Europe.

"(2) The fact that our technical practice in dealing with gold makes this the best market in which to sell it and one of the most difficult from which to export it.

"(3) The possibility, regarded by some as the probability, that within the next two years Germany will be forced to ship us large amounts of gold in order to meet reparation payments in the standard year.

"(4) Heavy foreign payments to meet the service on all foreign loans.

"Nor must the possibility be overlooked that conditions may change rapidly and instead of experiencing a large addition to our gold reserve, there is indeed a possibility, although more remote, that within the next few years we may sustain a large loss of gold.

"Gold exports from this country can arise from two causes:

"(1) The first is the perfectly normal movement resulting from exchange rates reaching a level at which it is cheaper to make payments abroad by shipping gold than by buying exchange.

"(2) The other, however, can occur irrespective of the gold shipping point, because of large balances held in this country for account of foreign governments and foreign banks of issue, which, as in the case of Germany, may decide to take gold for reserve purposes, irrespective of the gold point.

"No danger need be apprehended as to a normal export of gold, but we might sustain a large loss of gold under the second category at any time, and that we are now prepared to deal with successfully because of the large proportion of such balances held by the Federal Reserve bank, the export of which could easily be provided for by our purchasing the securities now held for account of our foreign correspondents. The only embarrassment likely to occur as a result of such a demand will be due to the lack of an adequate supply of American gold coin, concerning which discussion has been had from time to time with the Treasury.

"Looking, therefore, to the future, that is, say for the next three years, the committee is of the opinion that the policy of the Federal

Reserve System should be to prepare itself to deal with either a large import movement of gold or a large export movement of gold. Any other position would expose the System to the charge of lack of foresight.

"In view of the many alternatives to be considered, and especially in view of the fact that whatever may be the policy of the System it will involve taking a definite position as to the money market, the committee prefers to defer any recommendation until after discussion with the Federal Reserve Board and a definite expression of their views."

Action of Committee. A second meeting of the Open Market Committee was held on the afternoon of May 9, 1927, attended by six members of the Federal Reserve Board. The minutes of that meeting show that there was a long discussion by various members of the committee and the Federal Reserve Board of the preliminary memorandum previously distributed among the members of the committee and the Federal Reserve Board, and that Governor Strong explained that this preliminary memorandum did not embody any recommendations but merely raised points for discussion with the Federal Reserve Board which would enable the committee later to file a report with definite recommendations. The meeting adjourned with the understanding that the Committee would submit its final report to the Federal Reserve Board later on in the week.

A report of the Open Market Committee dated May 11, 1927, was submitted to the Board at a meeting held on May 12, 1927. In this report, the Open Market Committee made the following recommendations of policy for the period ending August 1, 1927:

"(1) That no further sales of system securities be made in order to offset arrivals of gold from abroad now known or anticipated.

"(2) That it shall be the policy of the committee between now and August 1 next, gradually to acquire, if possible to do so without undue effect upon the money market, sufficient additional short-time government obligations to bring the total of the committee's investment account up to $250,000,000. In interpreting the expression 'undue effect upon the money market,' the committee would expect to keep in mind any changes which might occur in the general level of money rates, as well as the extent to which these purchases might effect a reduction in the amount of borrowings by member banks.

"While this policy is not directed towards bringing about a reduction in discount rates by any Federal reserve bank, nor is that immediately anticipated, it is recognized that some lowering of market rates for money might nevertheless justify such a reduction later in the year, especially at the principal financial centers. The recommendation in paragraph two is also made after consideration of the fact that somewhat lower interest rates ordinarily operate to check gold imports; in fact, that was one of the effects of purchases of securities made in 1924.

"The committee further expects to continue studies of those methods set out in the preliminary memorandum by which increases in the System's portfolio might be brought about without increasing the amount of Federal reserve credit in the market. It expects to discuss with the Treasury Department those methods with which the Treasury is concerned, and requests that the Federal Reserve Board give consideration to those particular items, such as reserves on time deposits, which relate to the regulations of the Federal Reserve Board."

Action by Board. At the May 12 meeting of the Board, following submission of the above recommendations, the Governor of the Board called attention to the fact that the Board, under the impression that the Federal Advisory Council would meet here tomorrow recently requested the Council to make a careful review of the open market policy of the Federal Reserve System since the organization of the Open Market Committee and to give the Board the benefit of its views and to submit any recommendations that may seem desirable with regard to changes in the method or objectives of open market policy. The Governor stated that the Federal Advisory Council would not meet until next Friday, May 20, and consequently would not be able to discuss the matter as contemplated jointly with the Board and the Open Market Committee. Governor Strong, Chairman of the Committee, called attention to the fact that the preliminary memorandum presented to the Board shows the present condition of affairs and requested that consideration be given to that memorandum in connection with consideration of the Committee's recommendations. Thereupon ensued a detailed discussion as to the present Open Market situation and the desirability of increasing the System's portfolio of Government securities, as recommended by the Committee, and of methods whereby such an increase could be accomplished without disturbing the money market. Governor Strong stated that the purpose of the Committee was to agree with the Board upon the policy which would extend, under existing conditions, until August 1, and having done so that it would seem to be the responsibility of the Committee to put the policy into execution, keeping the Board informed daily of all transactions.

There followed a discussion as to the possibility of future imports of gold and the effect of such imports upon the money market, in conjunction with a policy of the Federal Reserve System which itself might result in adding to the present supply of money. Governor Strong expressed the opinion that the policy contemplated in the Committee's recommendations would not result in any increase in Federal Reserve credit in the money market, but would be offset by reductions in member banks' borrowings from the Federal Reserve Bank of New York or in the bill holdings of the System. Upon motion, the recommendations of the Open Market Investment Committee were received by the Board and made special order of business for a date to be fixed by the Governor after conference with the Chairman of the Board.

The Board reconvened during the afternoon of May 12, and during that session the Governor referred to the statement made by Governor Strong at the meeting of the Board on May 5 to the effect that the Federal Reserve Bank of New York was endeavoring to purchase from the Bank of France certain gold which the Bank of France was withdrawing from the Bank of England and had sold to and intended to ship to the American Exchange Irving Trust Company of New York City, which, if purchased, the Federal Reserve Bank of New York intended to have earmarked and held for it by the Bank of England. The Governor stated that he had been advised by Governor Strong that the gold in question totaling $59,548,000 had been purchased by the New York bank, had been earmarked and was being held by the Bank of England, and that at the Conference of Governors of the Federal Reserve banks now in session in Washington it had been voted unanimously that all Federal Reserve banks participate in the purchase and that said gold be not counted as part of the banks' gold reserves. The Governor stated that he had also been advised that the participation was to be made effective as of May 11, and recommended that in the Board's published statement showing the condition of the twelve Federal Reserve banks, the gold in question be reported against the caption, "Gold Held Abroad," immediately preceding the item "Due from

Foreign Banks," and that the published analysis thereof accompanying the statement contain the following brief comment in regard thereto: "During the week the Federal Reserve Bank of New York purchased abroad $59,548,000 of gold, the purchase being participated in by all Federal reserve banks. This gold is now held earmarked by one of the foreign correspondents of the New York bank and is shown in the statement against a new item 'Gold held abroad.'"

The only action taken by the Board at this meeting was with regard to how the gold should be reported, and to reaffirm a previous position taken that Federal Reserve banks should not regard as part of their reserves gold earmarked in foreign countries. Up to this point, no formal action had been taken, according to the minutes, approving of the purchase of the gold.

At a meeting of the Board held on May 13, 1927, consideration was given to the recommendations of the Open Market Investment Committee which had been submitted at the meeting held on the previous day. The action of the Board at this meeting was to adopt a resolution as follows:

"Resolved, that the Federal Reserve Board approve the report and Recommendations of the Open Market Investment Committee, with the feeling that the securities proposed to be purchased should be accumulated slowly and with a view to the possibility that it may not be advisable to purchase the full amount authorized withint the time limit mentioned."

The Board also approved the following draft of letter to the Chairman of the Open Market Investment Committee, advising of the action taken by the Board with respect to the Committee's recommendations:

"At the meeting of the Federal Reserve Board this morning, consideration was given to the report of the Open Market Investment

Committee, dated May 11, 1927, in which the Committee recommended: '(1) That no further sales of System securities be made in order to offset arrivals of gold from abroad now known or anticipated' and '(2) That it shall be the policy of the committee between now and August 1 next, gradually to acquire, if possible to do so without undue effect upon the money market sufficient additional short-time government obligations to bring the total of the committee's investment account up to $250,000,000. In interpreting the expression 'undue effect upon the money market,' the committee would expect to keep in mind any changes which might occur in the general level of money rates, as well as the extent to which these purchases might effect a reduction in the amount of borrowings by member banks.'

"The Board voted to approve the report and recommendations contained therein, with the feeling that the securities proposed to be purchased should be accumulated slowly and with a view to the possibility that it may not be advisable to purchase the full amount authorized within the period of time mentioned."

Communications on Open Market Operations and Gold Movements, mid-May - July 1927

At this point (May 13) the account stood at approximately $136,000,000, having been reduced during the previous week about $65,000,000 by reason of sales of approximately $60,000,000 of securities to the Bank of France and $5,000,000 for reasons not stated. The Committee, under the action of the Board above mentioned, had authority to increase the account up to $250,000,000.

On June 8, the account stood at $316,050,300.

Letter from Strong to Crissinger, June 9. On June 9, Governor Strong addressed a communication to Governor Crissinger, reading as follows:

"It will interest you to have a resume of the transactions in the open market which have been necessarily quite active because of the large amount of securities which we are called upon to buy.

"As you have been advised we have made purchases of a total of $100,000,000, offsetting exactly that amount of gold earmarked for account of one of our foreign correspondents, and that part of the transaction is concluded.

"We have also concluded purchases aggregating a total of $115,000,000 for delivery on or before June 15, to replace all of the maturities held in the System account and for the account of foreign correspondents maturing on that date. In addition to that we have purchased in round figures $16,000,000 for the System's open market investment account, this purchase having been made in connection with the adjustment of purchases currently being made for account of the Treasury Department, and so far that is all that has been done pursuant to the recommendations of the Open Market Investment Committee recently approved by the Federal Reserve Board.

"Preparations for the June 1 financing, occurring simultaneously with the holiday at the end of May, necessitated somewhat heavier borrowing here than would ordinarily be the case, and the rates in the money market showed a tendency to stiffen somewhat, but we believe that the effect was only temporary and that the return flow of funds from the interior and of currency, coupled with the purchases which we have made, will leave rate conditions not greatly above where they were during the latter part of May.

"The present situation is that the member banks in New York

City owe us about $50,000,000 and that the dealers owe us an additional $50,000,000 under sales contract agreement. Between now and June 15 this indebtedness of the banks and market to us may be somewhat further reduced. For a few days after the 15th as usual money will be easy, as Treasury maturities are in excess of tax payments, but after three or four days large tax payments will come out of the market. The amount of funds available to the market will be reduced from the present situation by approximately $65,000,000 as a net result of June 15 maturities. That means that the New York banks and market will have to be borrowing from us at least $150,000,000, and, on top of this, will come the usual extra demand for credit in connection with the end of the half year. This will give us a situation that we will have to think about and watch carefully. Further purchases will then be desirable."

Board discussions. Governor Strong's communication of June 9 was brought to the attention of the Board at a meeting held on June 10. No action was taken by the Board. In presenting the letter, the Governor of the Board stated that Governor Strong advised him yesterday (June 9) over the telephone that the Federal Reserve Bank of New York had purchased from the Reichsbank and earmarked abroad $2,600,000 additional of gold, making a total of gold earmarked abroad of between $62,000,000 and $63,000,000. The Governor further stated that Governor Strong advised him on the morning of June 10 that conditions were so shaping themselves as to probably make it necessary for the Federal Reserve System to convert this earmarked gold into earning assets through the purchase of bills abroad.

At a meeting of the Federal Reserve Board held on June 14, there was presented a letter dated June 11 from the Deputy Governor of the

Federal Reserve Bank of New York, with reference to the purchase of $2,600,000 of gold by the Federal Reserve bank from the Reichsbank, which was earmarked at the Bank of England, the Deputy Governor transmitting copies of communications addressed to other Federal Reserve banks regarding the transaction and their participation therein. At this meeting, the Governor also "reported a telephone conversation with Governor Strong during which he was advised of the sale to the Bank of France of approximately $60,000,000 of gold which the Federal Reserve Banks have held earmarked at the Bank of England. The Governor reported that the sale was made at a price approximately $85,000 above that paid for the gold which is to be taken down by the Bank of France at the rate of $15,000,000 a week, with an option to the Bank of France to take $30,000,000 the first week. The Federal Reserve Banks in payment will receive a deposit credit at the Bank of England, at interest, which is to be invested in sterling bills as and when such bills are available. The matter, he stated, was submitted to the directors of the Federal Reserve Bank of New York and unanimously approved by them and will be made the subject of a formal communication to the Board in the course of the next day or so." Following the Governor's report, a general discussion ensued as to the position of the United States in the world gold market and the policy involved in the purchase of foreign bills reported by the Governor.

At the meeting of the Board held on June 15, the Governor presented a letter dated June 14 from the Deputy Governor of the Federal Reserve Bank of New York, transmitting for the information of the Board copies of telegram and letter addressed to the Governors of all other Federal Reserve banks, concerning the sale to the Bank of France of approximately $60,000,000 of gold held under earmark in the Bank of England for account of the Federal Reserve banks, as reported informally by the Governor at the meeting of the Board on June 14. Thereupon ensued a discussion as to the authority of the Federal Reserve Board in connection with transactions of this kind entered into under the provisions of Section 14 of the Federal Reserve Act. The relations between the Federal Reserve Bank of New York and the Bank of England were also discussed, and by direction of the Board the Secretary opened and read to the Board the formal agreement between the New York bank and the Bank of England which has been carried in the files under seal. He also read the action of the Board at its meeting on December 19, 1916 in voting "That the Federal Reserve Bank of New York be authorized to appoint as its correspondent and agent The Bank of England of London, England, and that it be further authorized to open and maintain banking accounts with and for said correspondent and agent for the purpose of purchasing, selling and collecting bills of exchange, in accordance with the provisions of Section 14 and other provisions of the Federal Reserve Act, as amended; and for such other purposes as may be permitted under said Federal Reserve Act, as amended." Following the discussion, it was voted to request the Law Committee to report to the Board with respect to what limitations and restrictions the Board is authorized to impose on operations conducted by the Federal Reserve banks under Section 14 and as to the Board's general authority in such transactions.

Letter from Strong to Crissinger, June 16. On June 15, the account stood at $244,256,300, having been reduced during the week from about $316,050,300, the point at which it stood on June 8. Operations over this period are referred to in the following letter, dated June 16, addressed by Governor Strong to the Governor of the Board, and presented at a meeting of the Board held on June 17:

"Referring to my letter of June 9 in regard to transactions in the open market there has been some change in the position due to the unexpectedly large overdraft of the Treasury in connection with June 15 transactions which leads me to write you further as to the position of the money market and as to prospective purchases by the Open Market Investment Committee.

"We had calculated, with such information as we usually have, that the amount of the overdraft would be, in round figures, $180,000,000. It turned out to be $240,000,000, the disbursements for the Treasury's account being larger than the preliminary estimates. Against this large disbursement pending tax collections we distributed $104,000,000 of participations to various member banks, leaving the net amount of funds put into the market as a result of Treasury transactions $136,000,000. This means, of course, that there must be withdrawn from the money market between now and early next week not only the $136,000,000 which will repay the government's temporary certificate of indebtedness (net) but also possibly $30,000,000 more to restore the government's working balance in the Reserve banks. In other words, on top of borrowings from us aggregating between $25,000,000 and $50,000,000 at the present time, the market will lose, say $165,000,000, and we anticipate that the borrowing in all forms at this bank next week for a time may exceed $200,000,000, and this, of course, will be in the week prior to the double holiday when we have to meet quite a heavy demand for currency, a demand on the part of those who practice window dressing at semi-annual periods, as well as a demand arising from the very heavy July 1 interest and dividend disbursements.

"One hundred million dollars of the securities now held in the open market account were purchased to offset the loss of that amount of gold earmarked for foreign account as described in my letter of June 9, so we have only realized about $15,000,000 of the increase in the account which was contemplated when the committee and the Board discussed the matter at the May meeting. So that, to realize fully the aims we had in mind at that time, we might still purchase an additional $100,000,000 between now and August 1.

"Having in mind, however, the size of the Stock Exchange Loan account and the expressions of views contained in your letter of May 13, our directors today, after a full discussion, took the view which is held by the officers of the bank that it might be well to defer further purchases until possibly after the first of July, even though in the meantime money rates might advance somewhat in the general money market.

"This was the recommendation of the officers of the bank after full discussion of the situation, and we thought we should bring it immediately to the attention of the Board. We are, however, prepared to act promptly in making further purchases in case money market conditions indicate the need for it.

"I hope you will be good enough to bring this letter to the attention of the Board as it somewhat elaborates the report contained in my letter of June 9."

Board reply questioning purchase authority. At the meeting of the Board on June 17, following presentation of the last quoted letter from Governor Strong, discussion ensued as to the action of the Board at its meeting on May 13 in approving a recommendation of the

Open Market Investment Committee "That it shall be the policy of the Committee between now and August 1st next, gradually to acquire, if possible to do so without undue effect upon the money market, sufficient additional short-time government obligations to bring the total of the Committee's investment account up to $250,000,000." Attention was called to the fact that the System account then (June 17) amounted to approximately $235,000,000 and that regardless of the manner in which the account was built up the authority granted by the Board had been exercised and the aims which the Board had in mind had been realized. After discussion, it was understood that there would be prepared and submitted to the Board at its next meeting draft of a letter to Governor Strong along the lines of the discussion at this meeting.

At a meeting of the Board held on June 20, the Governor of the Board, in accordance with the action of the Board at its meeting on June 17 submitted draft of letter replying to Governor Strong's letter of June 16, reading as follows:

"Receipt is acknowledged of your letter of June 16th, supplementing your letter to me of June 9th, and commenting upon the changed position of the money market due to the unexpectedly large overdraft of the Treasury in connection with June 15 transactions. I note your views regarding the possibility of further purchases by the Open Market Investment Committee and note the opinion of the officers of your Bank concurred in by the members of your Board of Directors that it might be well to defer any further purchases until after the first of July, even though in the meantime money rates might have advanced somewhat in the general money market.

"Your letter was brought to the attention of the Board at its meeting this morning, and there was a discussion of several of the matters mentioned. Particular reference was made to your statement that the Open Market Investment Committee has realized only about $15,000,000 of the increase in the System's account which was contemplated when the Committee and the Board discussed the matter at the time of the Governors' Conference, and the further statement that 'to realize fully the aims we had in mind at that time, we might still purchase an additional $100,000,000 between now and August 1st.'

"Such purchase of an additional $100,000,000 would result in an enlargement of the System's investment account beyond the limit approved by the Board at its May 13th meeting. Action of the Board at that time was to approve the Committee's recommendation to purchase sufficient additional short term government obligations to bring the total of the investment account up to $250,000,000.

"The System's special investment account amounts at this time to approximately $235,000,000, leaving a leeway for future purchases of $15,000,000 to reach the limit previously approved.

"In view of the contingencies pointed out in your letter and such other information as the Board has regarding money market conditions, it may later on be advisable to make additional purchases of securities on System account. The enlargement of the System's account in the near future, however, raises a new question, and the matter should, therefore, be submitted to the Board in the usual course."

In presenting the draft of letter just quoted, the Governor stated that he understood from a telephone conversation with Governor Strong that a further letter on this subject is being forwarded to the Board, and action on the letter quoted above was therefore deferred.

Reply of Strong on authority to offset gold movements. At a meeting of the Board held on June 21, Governor Crissinger presented the following letter from Governor Strong, dated June 20, which he had stated at the meeting on June 20 was being forwarded to the Board:

"In our telephone conversation on Friday you mentioned that some members of the Board felt that the purchases already concluded by the Open Market Investment Committee had completed the amount which was recommended by the committee to the Federal Reserve Board in its last report, and that the position should now be reviewed again to determine whether any further purchases were justified.

"We have proceeded in making these purchases in accordance with my understanding of the policy agreed upon by the Board with the Open Market Investment Committee in the past, that large movements of gold such as we have recently experienced are, as a matter of course, to be offset by purchases or sales of Open Market Investment Committee holdings. I think you will find this general view of the committee's policy referred to in previous reports of the committee, three of which I have before me, that is, November 8, 1926, September 10, 1926, and the last meeting held in May. The records of the earlier meetings of the committee, are, as I recall, even more specific on this point, but they are not before me as I dictate this letter.

"To review the present situation, when the Bank of France secured the return of $90,000,000 of gold in London we negotiated for its purchase, as you know, on very short notice in order to avoid its getting into the country when, having once crossed the exchange barrier, it would form a permanent part of our gold reserves. $30,000,000 we were unable to arrest in London, but we partly offset the effect of its addition to bank reserves by sales, as I recall, of about $15,000,000 of the System's securities. The purchase of $60,000,000 in London was effected by our selling a like amount of the System's securities to the Bank of France and so avoiding the expansion of bank reserves which would have resulted from our paying for the gold without reducing our investment account. While the effect of this was to give the Bank of France dollar balances for $90,000,000 in New York, about $75,000,000 or thereabouts of this gold was actually offset by sales of securities.

"Now exactly the reverse operation has taken place as to $100,000,000, because the Bank of France has withdrawn $100,000,000 of their deposits with New York banks, transferred them to us, and purchased that amount of gold, thus effecting a reduction of bank reserves in this city of $100,000,000. As explained to you by telephone, this made it necessary to offset the loss of reserves by purchases of securities as rapidly as they could be made. Had we failed to do so we would have had a sharp advance in interest rates at a time when it would have caused inconvenience to the Treasury financing then under way and would have increased the likelihood of even higher rates which we also expected after the June financing was concluded.

"As in previous similar cases we did not feel that these purchases formed a part of the $115,000,000 authorized by the Board following the submission of the committee's report of May 9. In fact we felt that under that authority only $15,000,000 of purchases had been effected and that the general scheme of the report to continue purchases up to $250,000,000 before August 1, if money market conditions made that possible, clearly contemplates that regard for money market conditions and for the volume of borrowing in New York would be the guiding principle. Were this not the case the effect of this loss of $100,000,000 of gold would be to entirely nullify the action of the Open Market Investment Committee and the Federal Reserve Board.

"As explained by telephone and in my last two letters on this subject, we are anticipating heavy borrowing this week, although the amount cannot accurately be forecast. It will furnish the opportunity to enlarge the committee's holdings of securities which the committee believes, and which we felt the Board believed, was a desirable thing to accomplish if it could be done without creating an undue ease of money, but the continued enlargement of the security loan account seemed to justify our delaying these purchases for a short time so as to see what effect a brief period of somewhat higher rates would have.

"We realize, as the Board doubtless does, that there has been a considerable speculation in stocks, although far less active and menacing in its proportions than that which had developed in either Berlin or Paris. Just as is stated in the committee's report and in my previous letters this situation will require careful scrutiny from day to day until the true position of the money market discloses itself. But I am sure the Board has in mind that if a period of definitely higher rates now develops and no purchases are made practically all the bills in the market will come to the Federal Reserve Bank which might make it necessary for us to advance our bill buying rate, and that, in turn, make it necessary to advance our discount rate. Such action at this time we do not believe is justified, and our directors feel would be distinctly harmful.

"So, summarizing the position as it appears to be today, I should say that we are quite willing to watch the effect of somewhat higher rates for a short period, but we believe it would be hazardous at this time to allow a general revision of the level of interest rates to occur, for the reasons -

"(1) That it might force an increase in our bill rate and ultimately our discount rate,

"(2) That such an increase would be detrimental to the business of the country,

"(3) That it would have a tendency to depress the value of sterling and ultimately the continental exchanges, and possibly embarrass us by starting another gold import movement, and

"(4) That with the heavy refunding operations now under way and in prospect for the Treasury we believe that any general advance in the level of interest rates, unless necessitated by other impelling reasons, might have a detrimental effect upon the Treasury's plans which would be quite unnecessary.

"I have endeavored, by telephone and letter, to keep you and the members of the Board fully informed of these developments from day to day in the hope that what we are doing was fully understood and would meet with the Board's entire approval. If that is not the case may I ask you to let me know at once, as the situation is certainly one of sufficient importance to make it necessary that there should be no misunderstanding of the Board's action and the committee's policy."

Action of Board. During a discussion which ensued following the reading of the above letter, the Governor was called from the meeting and upon his return stated that he had received a telephone call from Governor Strong who suggested that if members of the Board desired more detailed information regarding present conditions than is contained in his letters, he would be glad to come to Washington tomorrow (June 22) for an interview. At the request of the members of the Board, the Governor of the Board expressed to Governor Strong the desire of the members that he come to Washington. Action by the Board on Governor Strong's letter of June 20 was thereupon deferred.

Accordingly, Governor Strong came to Washington and attended a meeting of the Board held on June 22. The following is quoted from the minutes of that meeting:

"Governor Crissinger stated that the meeting had been called for the purpose of discussing with Governor Strong in further detail the matters referred to in his letters to the Board of June 9th, 16th and 20th. The Board, with Governor Strong, then made an extended review of present and prospective conditions. Governor Strong reported upon the money markets, at home and abroad, and on the gold and exchange situation. During the discussion, it was brought out that if money rates should firm or rise it would be desirable to give relief to the situation through purchase of securities in the open market. The opinion was expressed by some members of the Board that authority to the Open Market Investment Committee to make such purchases up to $100,000,000 already exists under the action taken by the Board on May 13th, as the $100,000,000 of securities purchased since that time to offset gold exported to the Bank of France should not be considered as having been purchased under the Board's authority referred to. This opinion was not concurred in by all members of the Board."

The action of the Board at the meeting on June 22 was to adopt the following resolution:

"After hearing a report upon the money markets, at home and abroad, and of the gold and exchange situation, the Board authorize the

Governor of the Board to advise the Open Market Investment Committee that it does not consider the $100,000,000 of securities purchased by the Committee since May 13, 1927, as forming part of the authority granted to the Committee by the Board on that date."

During the period from June 22 to the date of the next meeting of the Open Market Investment Committee held in Washington on July 27, purchases were made for the account which increased the total from $250,448,300 to $265,998,300.

Meeting of July 27, 1927

Preliminary memorandum of Chairman. At the July 27 meeting of the Committee, consideration was given to a preliminary memorandum relative to open market policy, as follows:

"The gold movements of the past two months have illustrated the need for preparedness on the part of the Federal Reserve System to deal with either gold exports or imports, which was emphasized in the Chairman's memorandum discussed at the last Governors' Conference. This year's gold movements have included the import of 130 million dollars of gold from abroad, the purchase of 62 million dollars abroad, the sale of 100 million dollars for earmarking here, and the resale of 60 million abroad. There has thus been an import movement, or its equivalent, of 190 million dollars and an export movement, or its equivalent, of 160 million dollars. Fortunately these two movements have largely offset each other in their influence on the domestic credit situation. Otherwise they might have occasioned embarrassment. These movements were largely unforeseen and unforeseeable, although at any time possible under present conditions.

"Recent transactions in the special investment account have been largely for the purpose of dealing with these changes in gold. At one time, in May, the account was as low as 136 million dollars, and it has now been restored to 265 million dollars. The increase represents largely purchases to offset the earmarking of 100 million dollars of gold here, but includes in addition the purchase of about 30 million dollars of securities under the authority arranged at the time of the Governors' Conference. . . . It would appear that this portfolio should be increased from time to time when favorable opportunity offers, if the System is to be in a position to meet future extraordinary gold movements. . . .

"A temporary increase in the account in ordinary course may be involved in replacing 56 million of maturities in September which includes 30 million taken over from a foreign account in exchange for March certificates. It may be necessary to take over further amounts of securities from foreign correspondents.

"The Credit Situation

"A number of important changes have taken place in the domestic and foreign credit situation since the Governors' Conference. These may be summarized as follows:

"1. Money rates abroad have risen vigorously; open market money rates in London, Berlin, Zurich, and a number of other centers are markedly higher than they were three months ago. The Reichsbank and the Bank of Austria have raised their discount rates. Open market money rates are close to or above the bank rate in London, Berlin, Zurich, Amsterdam, and Milan, as shown in the attached table. These firmer money conditions are undoubtedly exerting continuing pressure upon world trade and world prices, which is liable to react unfavorably upon our own trade and prices.

"2. There has been some reduction in business activity in this country, not serious, but indicating a spirit of great caution in business.

"3. There has been some congestion of the bond market, due largely to undigested new issues. This situation has been partially corrected.

"4. Due largely to reduced industrial payrolls there has been a slight reduction in the past few weeks in the credit and currency demand, and total bills and securities of the Reserve System have dipped below one billion dollars. The New York Reserve Bank gained 50 million last week in transfers from the interior and New York City member bank borrowing was correspondingly reduced.

"5. There is growing ease in money conditions, although some rates are still slightly higher than a year ago, due probably to a higher discount rate at the New York Reserve Bank. . . .

"The Prospect for Autumn

"Normally the approaching seasonal demand for funds might be expected to tighten money conditions somewhat. If this takes place it would have the result (1) of increasing the pressure on world money markets and perhaps forcing up the Bank of England discount rate, and certain of the Continental discount rates, with consequent unfavorable reaction upon world trade and prices; (2) of accentuating the existing tendency towards some reduction in business activity.

"If on the other hand steps should be taken which would prevent any seasonal increase in money rates, and tend rather towards somewhat easier money conditions, the following results might be anticipated.

"1. An easing of the pressure upon world money markets, which would react favorably upon world trade. The results would be felt partly through the tendency for balances to move in the direction of the highest rate, and partly as lower bill rates here would attract financing to our bill market which might otherwise go to London and require funds there.

"2. Coming at the crop moving season easier money conditions would tend to facilitate the marketing of the crops at favorable prices.

"3. It would tend to remove any credit pressure which may now be exerted upon business, and would encourage business enterprise.

"4. There would on the other hand be danger that easier money might encourage speculation. The spirit of business is so cautious that it seems doubtful whether speculative tendencies in business would easily arise, but it is probable that easier money would stimulate speculation in securities.

"If under these circumstances it should seem wise to follow a policy favoring easier money conditions, the immediate problems would be (1) to localize the effects of easier money conditions, where they would be most beneficial; and (2) to prevent excessive speculation or excessive growth in the volume of credit.

"In this connection the attached table shows the total bills discounted at Federal Reserve Banks in the 12 districts. The total is nearly 100 million smaller than it was a year ago and the decreases in bills discounted exceed 25 per cent in the New York, Richmond, Minneapolis, Kansas City, and Dallas districts."

Action of Committee. The Minutes of the meeting of the Board and the Open Market Investment Committee held on July 27 read as follows:

"The meeting was called as a meeting of the Open Market Investment Committee with the Federal Reserve Board and representatives of two of the mid-western banks were present. The Chairman presented his report reviewing open market operations and credit conditions. The credit policy of the System was thereupon fully discussed.

"Consideration was given to the continued fall in commodity prices, to the fact that there was a diminution of borrowing from the reserve banks due apparently to some slackening in business, and especially to the relation of money rates in the United States to money rates in Europe. It was reported that because of heavy foreign payments which are likely to increase with the fall movement of commodities to Europe, there was a continued drain on European central bank gold reserves, which made it more than likely that central bank rates in Europe would need to be further advanced this fall. The German and Austrian rates have already been once advanced and there is some probability of a one per cent advance in the rate of the Bank of England.

"All present at the meeting recognized that these developments would necessarily have a depressing effect upon business abroad and might tend to restrict the freedom of purchases of goods in this country at the usual season. It was also brought out that it is the duty of the central banks to keep money rates at as low a level as may be attained with safety, and that at this time rates could be reduced not only without harm but with reasonable expectations of beneficial results. It was felt that the only possible adverse development resulting from a general lowering of discount rates would be in the speculative security markets, but that this possibility should not stand in the way of the execution of an otherwise desirable policy.

"There was no exception to the view that the time had arrived, or was approaching, when the discount rate in New York should be reduced, and with one or two exceptions there was no dissent from the view that a System policy of lower discount rates should in general prevail. It was pointed out, however, that local conditions in some of the interior reserve districts did not indicate any demand for rate reductions in those districts and that the small borrowings from the reserve banks indicate an adequate supply of credit for all needs at the present rates. Officers of some of the larger member banks were quoted as opposed to rate reductions. On the other hand, it was pointed out that reductions now, which would result in no harm and considerable possible benefit, would place the reserve banks in position to make increases later which might serve as warnings without penalizing business with high rates.

"It was also suggested that in order to make a three and one-half per cent discount rate effective some further purchases of securities might be desirable up to say $50,000,000.

"The most important consideration at the meeting was undoubtedly the fact that the differential between the rates in New York and the rates in London was not today sufficient to enable London, and therefore the rest of Europe, to avoid general advances in rates this autumn unless rates here were lowered, and that the consequence of such high rates as would result in Europe would be unfavorable to the marketing of our export produce abroad and would have an adverse effect generally on world trade."

The minutes were approved by the meeting, following which it was moved and carried that the authority of the Open Market Investment Committee be extended for the purchase, as and when conditions warrant, of not to exceed an additional $50,000,000 of investments.

At this point, July 27, when the account stood at $265,998,300, the Committee had authority to increase the holdings in the account up to $315,000,000.

(Secretary's note: On July 29, 1927, the rediscount rate of the Federal Reserve Bank of Kansas City was reduced from 4 per cent to 3-1/2 per cent and between that date and September 13, 1927, similar reductions were made at all of the Federal Reserve banks. The rate of 3-1/2 per cent was established at the Federal Reserve Bank of New York on August 5, 1927, at which time the Open Market Investment account amounted to approximately $290,000,000.)

Communications on Open Market Operations and Gold Movements, August - October, 1927

During the period from August 15 to 19, the following letters were exchanged between the Governor of the Board and Governor Strong:

Letter from Strong to Crissinger, August 15. "I am sending you a letter today as Chairman of the Open Market Investment Committee which I think explains itself, but wish to add something to it personally so that you may understand the atmosphere.

"There has been a considerable movement of funds away from New York. It resulted as you have observed in the money market remaining somewhat firmer than we had anticipated and it not only resulted in our purchasing somewhat more for open market account than I had expected, but in our doing so much more rapidly than had been anticipated. The transactions reported in my separate letter are simply routine and arose in connection with adjustments made in the various accounts as explained.

"We are about facing the need for a very considerable preparation for the September 15 financing. We hold for account of the Open Market Investment Committee and for account of our foreign correspondents something over $200,000,000 of the certificates maturing September 15. If repayment of these were received from the Treasury without any offsetting purchases it would of course result in a very severe stiffening of money rates and a large shortage of reserves in New York, much the largest in fact that we have experienced in some years. In view of this fact we are now proceeding vigorously to purchase several longer maturities against offsetting sales of the September 15 maturities as rapidly as these can be effected. The account will be up and down from day to day, but I want you to understand just what is taking place, and hope you will explain it to your colleagues in the Board.

"From this time on I anticipate there may be a fairly steady growth in demands upon us by the money market and we would not wish to have the money situation complicated by failure to anticipate these maturities."

<u>Reply of Crissinger, August 16</u>. "I have received this morning your private and confidential letter of August 15th concerning the market situation as it is now developing. It is very interesting. I think it was reasonable to expect it in view of the differential between the rates of New York and London.

"I quite agree that you should take vigorous steps to prepare for off-setting the September maturities.

"It appears to me that we have some problem on, but I feel confident that you will be able to work it out. I would be very glad to take this matter up with the Board if there was any Board here, but there is nobody here but Mr. James. . . ."

<u>Letter from Strong to Crissinger, August 15</u>. "At the opening of business this morning, the Open Market Investment Account stood at about $301,000,000, with additional purchases made last week, for delivery today, of $4,000,000, which will make the total $305,000,000. This brings us up to a total of $40,000,000 of purchases against the $50,000,000 recently authorized.

"This morning one of our foreign correspondents requested us to sell $10,000,000 of September 15, 1927 certificates, which we are taking for the System Account. This will complete our purchases for the present.

In addition to this $10,000,000 purchase we have been offered a block of $20,000,000 of the September 15 certificates, and as we hold in the System account $20,000,000 of the Treasury 3 3/8% bonds (for which we turned in Second Liberty Loan 4 1/4% bonds on June 15) which can now be sold to an advantage, it has seemed to us an opportune time to make the switch. We are, therefore, taking in the $20,000,000 of September 15 certificates, against which we will sell the long-term 3 3/8% bonds, and have today sold $10,000,000 of the latter at 100 22/32, for delivery tomorrow. The remaining $10,000,000 will undoubtedly be sold within the course of the next few days."

* * *

Letter from Strong to Crissinger, August 16. "Since writing you yesterday we have still another development which has a bearing upon the money market. Sterling exchange since our rate reduction has been consistently strong and yesterday we were able to liquidate £1,000,000 of our London account at a satisfactory rate. And the arrangement with the Bank of England to continue this policy will possibly result in further sales of sterling from time to time so long as the market justifies it.

"These sales of course have the effect of taking funds out of the money market in New York and consequently of impairing banking reserves. If sterling is strong enough to justify considerable sales it will possibly be necessary for us to extend our purchases of Government securities. This, of course, is one of the offsetting transactions which will be current from time to time, and it simply means that as the London portfolio decreases the New York portfolio will correspondingly increase, and vice versa. On the other hand, it may be that we can buy gold in London at satisfactory prices and hold it earmarked so as to be in position to sell it at a favorable opportunity."

* * *

Letter from Strong to Crissinger, August 19. "Matters are developing from day to day in money market affairs and once more I should advise you just what is transpiring.

"In the first place you will observe from the gold settlement fund figures that we have lost over $120,000,000 of our reserves in the last few weeks to the rest of the country. While this is not unusual at the season, I have a feeling, which is shared by some of my associates here, that the movement has been accentuated by the failure of Chicago and Philadelphia to reduce their discount rates. But after all that is a matter for them to decide and we must make our arrangements accordingly.

"Until the last day or two the trend of the money market disclosed an underlying strength which disturbed me somewhat, but within the last forty-eight hours it has shown evidence of ease, stock exchange rates today were reduced to 3-1/2%, there is a somewhat lessened demand for Federal Reserve funds, and signs that the commercial paper market has eased a bit as well as the rate on collateral time loans.

"One of the results of this ease, of course, is to strengthen the sterling rate somewhat and we have been successful in disposing so far of about £-3,750,000 of our sterling balances - in round figures about $18,000,000 - This, of course, takes money out of the money market and considering that it involves no change in policy and simply a shift in portfolio from London to New York, we have felt obliged to buy a moderate amount of governments in order to offset these withdrawals.

"Taking the situation as a whole, it has worked out most satisfactorily. If we find after the turn of January that our portfolio is larger than necessary we can readily liquidate a part of it. And as matters stand today I think it may be better later in the year to let the needs of the market be supplied by the member banks borrowing from us. The liquidation immediately following the first of January will enable us to judge of the extent, if at all, we should sell Government securities.

"I hope the whole program has worked out to your satisfaction. I know it has to ours, and our directors expressed satisfaction when the subject was reviewed at yesterday's meeting."

Letter from Strong, August 25. All of the above communications were presented at an Executive Committee meeting held on August 24. No action was taken by the Committee except to note the contents thereof.

At the meeting of the Executive Committee held on September 2, the Committee noted the following communication from Governor Strong dated August 25:

"Since my letter of August 16 in reference to changes in the Open Market Investment Account, the strength in sterling has enabled us to make further sales from our London account. Such sales have reached a total of £7,180,000 through the close of business tonight, involving the withdrawal from this market of approximately $35,000,000, and up to the close of business last night we had purchased for the System Account, as an offset, a total of $17,004,500 par value of Government securities.

"Today one of our foreign correspondents requests us to sell from its holdings $25,000,000 of Treasury certificates maturing September 15 next; of this amount we have purchased for the System account $15,000,000, making total purchases to offset sales of sterling $32,000,000 and increasing the holdings in the System Account to $347,000,000. The remaining $10,000,000 of these September certificates we have purchased for our own investment account, to be held there temporarily for sale to the Treasury early in September.

"With the continued strength in sterling, we will, no doubt, be able to make further substantial sales, in which event we shall continue making offsetting transactions."

(Secretary's note: On September 13, 1927, the Federal Reserve Bank of Minneapolis reduced its rate to 3 1/2%, being the last Reserve bank to reduce its rate during the period running from July 1927.)

Letter from Strong to Platt, September 28. "Referring to our recent telephone conversation about a possible meeting of the Open Market Committee, I recently wrote the members of the committee, as per enclosed copy of my letter, and I now have replies, the substance of which are as follows:

"All the members of the committee agree as to the wisdom of making purchases to offset shipments of gold to Argentina and, of course, they have already expressed a similar view as to making purchases of securities against sales of sterling. We should like to liquidate the balance of the sterling account very shortly, and this involves the purchase of $10,000,000 or $12,000,000 additional, so that these two accounts together at the present moment will involve the addition of about $25,000,000 to our Open Market Committee holdings, bringing it close to $400,000,000. You have in mind, of course, that the additions to the account so far made roughly comprise -

$100,000,000 to offset the loss of gold to the Bank of France
47,000,000 to offset sales of sterling
30,000,000 under the authorization arranged at the meeting last May
50,000,000 under the authorization arranged at the meeting of July 27

a total of $227,000,000, which with the committee's original holdings in round figures accounts for the present total.

"As to the suggestion of making additional purchases to meet the seasonal demand for funds, the replies are as follows:

"McDougal: Believes as the account is now $360,000,000, addition should only be made if demonstrated to be clearly desirable and, therefore, a meeting at a convenient date is important. Expresses some apprehension about status of Stock Exchange speculation.

"Harding: Believes we should increase our purchases in addition to those mentioned above so as to meet the fall demands without any considerable change in the open market rates.

"Fancher: Thinks we should have a meeting, and if we decide to increase our portfolio it should be done in the expectation of making liberal sales around the turn of the year.

"Norris: Is opposed to further purchases unless the demands upon us in New York become excessive. Expresses some doubt as to the speculative situation in the Stock Exchange. Would like to have meeting held in Philadelphia.

Personally, I should like to see a meeting held in New York if it could be arranged on the day that our directors meet, as an exchange of views with these gentlemen, who are in close contact with affairs here, I believe would be helpful to everybody.

"After considering this letter, could you not have your secretary call me on the telephone so that we can talk it over?"

<u>Letter from Strong to other members of Committee, September 20.</u>

"The accompanying letter which is being sent to the Governors of all Reserve banks explains itself. What with the transactions for account of the Treasury, for our foreign correspondents and for the Open Market Committee account, Mr. Case has been submerged with a mass of transactions, the net result of which could hardly be reported until now. They were forecast in our letter of August 26, and the details, of course, appear in the regular weekly reports.

"There are two questions about which we must give consideration at an early date. One is in regard to further purchases to offset the effect of exports of gold. We have been making these regularly to offset the withdrawal of funds from the market resulting from sales of sterling balances, but have not completed purchases to offset gold exports such as those under way to Argentina. That movement may run up to between $20,000,000 and $25,000,000. Our own view is that we should buy government securities for an equivalent amount as at this season of the year when there is a pretty heavy draft on New York reserves, the influence of the loss of that amount will be quite marked. We would appreciate an expression of your views.

"The second question is generally as to the outlook for the fall and whether it indicates the need for further open market purchases beyond those above referred to. The Federal Reserve System from some date in August, which varies, according to conditions, to the first of the following January each year, is called upon to supply an expansion of bank reserves aggregating around $400,000,000 as shown by past experience. Roughly, nearly half of that has already been taken. We anticipate there may be some little slackening of this demand after the first of October, but for only a short period, and thereafter the holiday demand will arise and we must be prepared to meet it. Our decision of course relates to the discount rate. Having reduced rates to 3 1/2 per cent, it seems to us that it would be rather unfortunate to have too much of this demand met by discount at the Federal Reserve Bank of New York, where most of it occurs, and we would prefer to moderate its influence upon open market rates by buying a round amount of governments with the understanding of course that immediately after the first of January, or even anticipating the large return of currency which then occurs, we should begin to liquidate a part of the Open Market account. If the entire requirements of the season were met by borrowing, it would automatically liquidate as it did last year and the year before, but if we furnish the entire amount by buying securities, we must of course be prepared to sell them promptly, otherwise money would be unduly cheap and we shall not experience the seasonal liquidation which is wholesome and to be promoted.

"In view of the possibility of its being misunderstood during the pendency of all of this discussion of rate changes in Washington, I have hesitated to suggest a meeting of the Open Market Committee there and believe it was wise to defer it. If, however, the committee will be willing to meet in the near future, I think it is important that they should do so, and if circumstances make it unwise to meet in Washington, I shall take the liberty of asking Mr. Platt to arrange for some of the members of the Board to meet with us in New York. Won't you please write me very frankly just how this impresses you."

Letter from Strong to Banks not represented on Committee, September 20. "Since I wrote you last on August 26, the principal change in the amount of Government securities held in the System Open Market Investment Account has been due to the continued purchase of securities to offset sales of sterling which would otherwise have had the effect of tightening the money market and possibly jeopardizing the object of recent System rate action. Because of the strength in sterling, it has been possible to make somewhat larger sales than had been anticipated with corresponding reduction in our sterling balance. Such sales now amount to $47,000,000, consequently our purchases for the Open Market Investment Account now total $47,000,000, increasing the account to $362,000,000 at the present time.

"In addition to this change in the total, there have been a number of changes in the composition of the account, as we advised you would be necessary. These changes consisted largely of the replacement of the September 15 maturities with other issues and the exchange of our Second Liberty Loan bonds for the new issue of 3-1/2 per cent notes.

"The weekly reports will show the details of transactions made in replacement of the September 15 maturities in the Open Market Account. Besides these we have purchased in the market approximately $80,000,000 of Government securities to replace the September 15 maturities held for foreign accounts. With all of these transactions our turnover of Government issues around the 15th of the month was about $320,000,000.

"As you will have noted, the tax period passed without any serious disturbance to the market. The Treasury overdraft here was $200,000,000, out of which we sold temporary participations of $50,000,000 to member banks to take up the temporary over-supply of funds. The overdraft has now been retired, which has caused the banks to enter this week deficient in reserves. With the Treasury balance in the reserve banks piling up, as income taxes continue to be received, there may be an appearance of somewhat tighter money for the balance of this month and possibly early next, but we are hoping that it will be only temporary.

"Since September 1 there have been losses to the money market due to net gold exports, largely due to shipments of $13,500,000 (and more in prospect) to Argentina, against which no purchases of Government securities have as yet been made. Further purchases to offset this gold loss will be made in due course, after consulting the Committee, if they agree with our own view, that we should endeavor to offset any undue influence upon the money market due to considerable gold movements.

"I am writing you again at this time in order to keep you fully advised. It is sometimes difficult to do this as frequently as we would like when in the midst of so active a period as the present. You no doubt will be interested, however, to learn that the various operations about which I wrote you previously, have gone through satisfactorily, all of which I trust meets with your approval."

Excerpt from letter from Strong to Platt, September 29. "I am attaching a statement from which you will observe that the difference between the amount of credit now being furnished by the Federal Reserve System this year and last year very nearly offsets the addition to our gold due to imports during the first seven or eight months of this year; also that the seasonal increase in the amount of Federal Reserve credit being employed since the first week in August is $130,000,000 for 1927 as against $120,000,000 for 1926. Roughly speaking, imports of gold this year are to some extent offset by reductions in our earning assets, and the seasonal increase is almost exactly what it was last year for the same period.

"In view of the replies received from the other members of the committee, and considering the fact that our money rates are still comfortable and that the exchange rates have held pretty firm, we are now disposed to suggest that the meeting of the Open Market Investment Committee be deferred for a fortnight or thereabouts and shall then be held in Washington after Mr. Young is there. We can then review the whole situation. And this meeting, coming but a few weeks before the Governors Conference, will enable us to discuss the results of the meeting at the time of the conference with all present.

"I hope this is satisfactory to you and your colleagues."

Letter from Strong to Board, October 25. Under date of October 25, 1927, the Chairman of the Open Market Investment Committee wrote to the Board with respect to the desire of the Bank of France to purchase $50,000,000 of additional gold to be earmarked at the Federal Reserve Bank of New York, $30,000,000 to be purchased with the proceeds of maturing bills held for the Bank of France, and $20,000,000 to be purchased with the proceeds of payments to the Federal Reserve Bank by member banks. The Chairman advised that the Executive Committee of the bank had suggested that bill maturities, as well as the member bank payments, be offset by purchases of securities. The letter from the Chairman of the Committee was read at a meeting of the Board and no action taken relative thereto. The letter follows:

"It was not possible until today to send you the particulars of the transaction in gold of the Bank of France, as the details of the arrangement had not been worked out until today's cables had been exchanged.

"They advised us by mail and cable that they now desired to purchase $50,000,000 of additional gold which they wished us to earmark for them, and suggested a method by which payment could be effected which, however, would have unnecessarily delayed the conclusion of the transaction because of their desire to avoid any interference with our money market.

"We explained to them that we could conclude the earmarking more promptly than they had suggested, and it has now been arranged by exchange of cables that we should earmark $10,000,000 this week and $10,000,000 next week, against the proceeds of maturing bills held for the Bank of France and, in addition, that we should earmark $2,000,000 each business day except Saturdays against payments to us from member banks until a total of $20,000,000 is earmarked in that way, and a further $10,000,000 should be earmarked of the proceeds of bills maturing the second week in November.

"As the bill maturities, if not replaced in the market, will impose by that amount heavier borrowings by the member banks at this season, our executive committee, at the meeting yesterday, suggested that we should offset these funds by purchases of securities which we are gradually doing. The same applies to the funds withdrawn from the member banks.

"As is customary in these transactions, we are conferring with the members of the Open Market Committee by telephone so that they may be fully informed and the transaction approved in behalf of the committee.

"This transaction will be made the subject of a supplementary statement at the meeting of the Open Market Committee to be held in Washington on November 1.

"You will be interested to know quite confidentially that this gold is purchased from us rather than taken in London, pursuant to the general desire to protect the London market against undue demands, and the Bank of France is able to do this because of the transactions conducted earlier this year which enabled them to convert a considerable amount of their sterling into dollars."

(Secretary's note: On October 26, 1927, the Open Market Investment Account stood at $387,000,000, and on November 2, 1927, it had increased to $403,000,000.)

Meeting of November 2, 1927

Preliminary memorandum of Chairman. At the meeting of the Board on November 1, 1927, the Governor stated that the Chairman of the Open Market Investment Committee had furnished him with a number of copies of a preliminary memorandum being considered by the Open Market Investment Committee which was meeting on that date, and he handed a copy to each member of the Board for consideration prior to the meeting which the Board was to hold with the Committee on the following day. The preliminary memorandum is as follows:

"In accordance with the general policy forecast by discussions at the governors' conference in May and at the meeting of the Open Market Investment Committee on July 27, all of the Federal Reserve Banks have since that meeting reduced their discount rates from 4 per cent to 3 1/2 per cent. . . .

"In order to make the change of discount rate effective in New York it was found necessary to purchase 50 million dollars of Government securities for account of the System, as previously authorized. The reduction of the rate in New York was followed by large transfers of funds to other districts, principally to the west. Between August 3 and September 7 (when the Chicago bank reduced its rate) the gold reserve of the New York bank declined 109 million dollars, most of the loss going to the Reserve Banks which still maintained a 4 per cent rate. Over the whole period from July 20 to October 12 the New York Bank lost 181 millions of gold, including transfers to other districts as well as gold exports and withdrawals of gold currency for circulation. As a consequence the borrowing of New York City member banks increased about 75 million dollars and, with prospects of even larger borrowings, it was necessary to purchase in August the 50 million of securities. Otherwise money rates would have experienced a sharp advance which would have defeated the purposes of the policies adopted.

"In this same period it has been possible to liquidate all of the special sterling account with the Bank of England at a profit [of] $163,000. In order to offset the loss of funds to the New York money market resulting from these sales a corresponding amount of securities has been purchased, a reversal of the operation which took place in the Spring when purchases of gold abroad were offset by sales of securities. . . .

". . . as a net result of the year's operations to date the Special Investment Account has been increased $174,000,000. Of this $95,000,000 represents offsets to market losses through earmarkings, etc., and $79,000,000 represents purchases made in keeping with policy aims.

"A further result of the movement of funds from New York to other districts has been that member banks in districts other than New York have been able to meet the seasonal increase in credit requirements without any increase in their borrowings at their Reserve banks, whereas banks in New York have increased their borrowings. . . .

"The decrease in total member bank borrowings as compared with a year ago arises partly from a lessened demand for Federal Reserve credit due to smaller currency requirements and gold imports and partly from the increase in the System's holdings of securities. . . .

"Under these conditions money rates have become relatively stable at levels about 1/4 to 1/2 of 1 per cent lower than at the middle of July and substantially lower than a year ago. . . .

"Consequences of Lower Rates

"Aside from the domestic movement of funds from New York to other districts, the following changes, related in some measure to the lower rate level, have taken place in the money market situation.

"1. Higher Sterling Exchange. Whereas a year ago sterling exchange moved steadily downward from early July until the end of October, and such a movement had begun early in July this year, the lower level of interest rates prevailing has been an influence toward stronger sterling exchange, and the demand rate has moved from a little above $4.85 the middle of July to nearly $4.86 3/4 recently, and the cable rate from $4.85 1/2 to $4.87 1/8, - this notwithstanding sales of over 12 million pounds of sterling by the Reserve Banks. This strength in the exchange reflects the tendency for funds to move from New York to London, and some tendency for short and long term financing to be shifted from London to New York. The rates London banks are now paying for deposits are about 4 1/4 to 4 1/2 per cent, and are higher rates than those at which funds can be employed at short notice in the New York money market. Acceptance credits are now cheaper to obtain in New York than they were and the dollar volume of bills outstanding in this market is as large as at any time since 1920. Sterling long bills are also bought here by our banks and "carried" in London after acceptance instead of being discounted.

"2. Net Gold Exports in September. In every month this year up to September there had been a net import of gold (if we exclude earmarkings). But in September there has at last been a net export movement of gold and gold imports for the moment are arrested. A net outgo of about 13 million dollars was largely the result of a shipment of 23 million to the Argentine, more than offsetting imports of about 10 million from Australia.

While the Argentine shipment was in the nature of a special transaction, the relation of exchange rates made it cheaper to purchase this gold in New York than in London.

"So far this year all movements of gold (exports, imports, and earmarking operations) have resulted in a net gain to this country of about 49 million dollars. This is contrary to general views, which are based on reports that omit earmarked gold held by us. In this connection it is interesting to note that in the past three years, 1925, 1926, and 1927, during which there has been considerable discussion of our sterilizing gold, this country has gained as a net result of gold operations only about 18 million dollars of gold, which is less than seasonal movements of single years at times prior to the war.

"3. Growth in Speculation. A further and less favorable result of easier money, and one which was anticipated, has been some stimulation of stock exchange speculation. There has been a growth of 336 million dollars since the middle of July in loans to brokers and dealers in New York, accompanying an irregular advance in stock prices.

"There is no means of knowing beyond question how far this recent rise in stock prices represents excessive speculation and how far it represents a gradual readjustment of values to increased industrial efficiency, larger profits, higher commodity prices, and a lower basic interest rate level than for some years past. It is clear from a study of such relationships as those of stock yields with bond yields and with money rates, that the current level of stock market prices is less abnormal than a casual inspection of prices alone would suggest. The investment trust and the growing popularity of common stocks as investments are factors which may also be changing somewhat the old price and yield relationships.

"4. Growth in Volume of Credit. There has been a considerable growth in the volume of bank credit, more rapid in fact than took place in either 1925 or 1926. . . .

"5. Greater Firmness in Commodity Prices. An index of prices of basic commodities, computed by the New York Reserve Bank, has been tending generally upward since early in the spring, due almost wholly to increases in agricultural prices, which may be ascribed largely to particular crop conditions but partly to success in marketing surplus production abroad. The upward movement has been accelerated, however, in the past two months and the larger index of the Department of Labor, made up from quotations for over 500 different commodities, also moved upward in July and August. This index is still, however, a number of points lower than it was a year ago.

"General Condition of Business

"There has been no marked change in the general business outlook. The general volume of manufacturing production is somewhat lower than a year ago and lower than it was early this year, a change which is reflected in a smaller currency demand than last year. The agricultural situation, however, has improved and there are prospects for larger crops than had been anticipated early in the spring, and an increase in the purchasing power of the farm population. The general business outlook is, however, for a continued fairly good volume of business activity during the balance of the year, without either a recession or a boom. Many authorities agree that increasing domestic competition is affecting profits adversely.

"Developments Abroad

"The outstanding new developments in European money markets are the increases of the discount rates by the Reichsbank from 6 to 7 per cent, and its Lombard rate from 7 to 8 per cent and but recently of Holland from 3 1/2 to 4 1/2. Aside from these changes the rates of central banks abroad have been at the same level as in July. The explanation of the change of rate by the Reichsbank is its reduced reserve assets, and in general it illustrates the narrowness of margin within which the banks of issue of Europe are operating and probably reflects some strain in meeting payments due to the U. S. The reserves of most European banks of issue are not adequate generally to undergo any considerable or continued strain without the necessity for increases in rates. The latest moves emphasize the importance of this country's maintaining, if possible, a rate relationship with Europe, such that at least the world's new gold output available for monetary purposes may not be diverted to this country but may flow to those centers where the reserves are most in need of reinforcement.

"The Sterling Position

"While our rate reductions, together with a recent increase in foreign loans placed in this market, a movement by American banks to accumulate balances in London, and probably some covering of short positions in sterling have led to the sharp advance in sterling rates commented upon earlier, there remains some question as to the position of sterling for the balance of this year. The movement of cotton, while smaller than last year, is at much higher prices and the delayed movement has probably not reduced total dollar requirements. The larger amount of bills being drawn in dollars than last year, simply defers the demand abroad for dollars.

"Some of these developments simply defer but do not finally effect dollars payments. It is hoped that the ultimate demand for dollars may go over until the period of liquidation and ease of rates immediately after January 1st. In the meantime, however, the committee should be prepared to intervene, if necessary, and again accumulate a London portfolio at the London gold export point, or buy gold in London when offered for export to New York. In case of such purchases the committee should consider whether offsetting sales of securities should not be made in New York just as they were in the spring when gold was acquired abroad.

"The Guilder Position

"The holiday delayed cable exchanges which might have enabled us otherwise to agree with the Nederlandsche Bank upon a plan to avoid their rate increase or limit it to 1/2 per cent, instead of 1 per cent. This situation may recur and should be considered by the committee.

"As to Offsetting Gold Movements or the Equivalent

"The experiences of this year have provided a demonstration of the effectiveness of the policy of offsetting gains and losses of gold through import, export, or earmarking by purchases or sales of securities. Purchases or sales of gold abroad or of exchange, which have just the same effect on the market as gold movements, have been similarly offset . . . whereas the open market account increased from 136 million in May to 375 million in October, only 79 million of the purchases were of a nature to affect the credit situation; the balance represented offsets.

"The effect of such offsetting purchases or sales has been to prevent disturbance to the credit situation from artificial causes. If purchases or sales of this sort are not made promptly, not only will money rates be affected, sometimes quite sharply, but the borrowings from the reserve banks will become readjusted automatically at times when not desirable. In the case of imports of gold, unless repayments of loans are at once made to the reserve banks, loan expansion occurs at once in the market.

"Failure to 'offset' a gold import or export (or equivalent earmark transaction) has the same result as a purchase or a sale of securities when no gold movement occurs. The same situation arises whenever large transactions for foreign banks alter the reserve position, and occasionally when changes occur in Treasury balances with the Reserve Banks.

"It should be understood that these necessary adjustments will be made from time to time, within reasonable limits and for a round amount, the members of the committee being consulted by telephone. At times action must be taken at once, - for example when a foreign bank desires to sell securities and earmark gold, or when our own foreign balances are being liquidated as recently.

"Sales of Securities in January

"In addition to any sales of securities which may be necessary to offset any purchases of foreign exchange, or gold abroad, it will be necessary to consider whether sales should be made in January. In case borrowings at the New York Reserve Bank, and possibly other Reserve Banks, are not sufficient to absorb the January return flow of currency and Reserve Bank credit, the committee should consider sales of securities.

"Future Program

"As to specific cases

"The committee should consider the following -

"1. The Reserve Banks being prepared to repeat the operation of buying gold or balances abroad, if necessary, to prevent gold movement from London or some other foreign center.

"2. A continuance of the general understanding that the committee will undertake to offset by purchases and sales of securities any such major gold, or equivalent, operations as have been offset this year. This would include the offsetting of purchases or sales of sterling or other foreign currencies.

"3. The desirability of sales of securities in January, if it appears necessary, to take up slack in the money market.

"As to general policy.

"A review of the events of the past two months makes it clear that the policies agreed upon in July have so far been successful, more so perhaps than could have been anticipated. Concerning the future, the principal questions are -

"1. How long will the firmness of sterling and other European exchanges be maintained, even with present rate relationships, when the full seasonal strain for making American purchases appears?

"2. Will money rates in this country rise later in the year with Christmas demands for funds, so as to disturb the international rate relationships?

"3. Is there likely to be increasing difficulty for Europe in meeting payments due in the United States?

"4. Is there likelihood of speculation in stocks or commodities, using so large an amount of credit as to constitute a danger?

"5. In view of these possibilities what flexibility in operations should be given the Open Market Committee?

"Supplementary Note on Gold Earmarking

"Since the preceding pages were written we have received instructions from a foreign correspondent to earmark 50 million dollars of gold for their account. This earmarking operation has precisely the same effect in withdrawing funds from the money market as the export of 50 million dollars of gold, or the sale of 50 million dollars of securities by the

Reserve System. In order that this operation may not disturb the money market and defeat the policy we have been pursuing, the committee is undertaking to offset these earmarkings by a purchase of 50 million dollars of securities, so that the net result of the operation will be to leave the money market unaffected.

"This transaction illustrates precisely what occurs when gold is earmarked. Under the instructions which have been received, 30 million dollars of the earmarked gold will be paid for by applying the proceeds of bankers acceptances now held for the account of this correspondent, which mature between now and November 11. The remaining 20 million will be paid for by funds to be deposited with the New York Reserve Bank by a number of the New York City banks, which hold balances for the account of this correspondent.

* * *

"It will be seen that, as the bills held for this correspondent mature, the market pays to the Federal Reserve Bank the amounts due, and that as these sums are applied to the purchase of gold and are not reinvested in the market they will constitute a loss to the market, reduce the reserves of the New York City banks, and (in the absence of offsetting operations) force those banks to increase their borrowings at the Federal Reserve Banks. Payments to the Reserve Bank by New York City banks have a precisely similar result. In order to maintain the present status quo it is necessary, therefore, to put 50 million dollars into the market to replace the 50 million dollars withdrawn by this earmarking operation. Securities are being purchased a little more slowly than gold is being earmarked and thus a daily test is made of market conditions.

"At present the New York City banks owe the Federal Reserve Bank of New York about 90 million dollars, and this amount of borrowing will normally be increased somewhat as Christmas approaches. Any large extended increase in this borrowing would be followed inevitably by firmer money rates, and would imperil the policy which the Reserve System has been following.

"One other phase of this earmarking operation is worthy of consideration. Exports and imports of gold from and into this country since the beginning of this year resulted in a net import of about 125 million dollars. If, however, earmarking operations are taken into account the net gain to the market through imports will, after the completion of this transaction, have been entirely offset by losses through the earmarking of gold. Thus the actual facts as to gold movements are quite contrary to the general belief based upon the published figures for gold exports and imports.

"The same thing is true if we go back a few years. Since the autumn of 1924 the figures for gold imports and exports indicate a net movement to this country of about 100 million dollars, and it is the common impression that in the past three years we have been absorbing and sterilizing the world's gold. When earmarkings are taken into consideration, however, the past three years (including this current transaction) show a net loss of $50,000,000 of gold rather than a net gain.

"In view of the important influence of gold movements upon money conditions, and the somewhat misleading character of statements which are now made public, it is believed that we should consider some weekly statement as to gold held under earmark. It is true that figures given out once a month by the Department of Commerce for the stock of gold in the United States do make allowance for earmarking, but these figures are published only once a month and some time after the event. The publishing of the weekly figures for gold earmarkings would correct possible erroneous impressions and aid in a general public understanding of Federal Reserve policies."

Action of Committee. On November 2, at a meeting of the Board at which the members of the Open Market Investment Committee were present, Governor Young presented the following report containing the recommendations of the Open Market Investment Committee, which the Chairman of the Committee stated had as its basis the preliminary memorandum quoted above:

"The committee has considered the confidential preliminary memoranda submitted by the Chairman, and upon the basis of the memoranda proposes that the open market policy of the System until March 1st next, unless developments not now anticipated require a further review, shall be: to maintain stable rates for money at about present levels and prevent further imports of gold.

"In order to carry out the above policy, the committee would adopt the following program and procedure:

"(1) The Plan of offsetting gold movements by purchases and sales of securities would be continued as heretofore.

"(2) Any considerable advance in rates for money towards the end of the year would be dealt with only if necessary by temporary purchases of securities.

"(3) During the return flow of currency which usually occurs in January, sales of securities would be made in amounts sufficient to insure retirement of the seasonal issue and prevent its being added to member banks reserves.

"(4) In event of the renewal of a gold movement to the United

States, gold may be purchased abroad in London, and possibly in Holland and Switzerland, if necessary, at approximately their gold export points, or exchange on those countries may be purchased, so as to arrest, if possible, a further importation of gold. The limit upon such purchases to be $100,000,000. Such purchases would also be offset the same as the gold movement. Gold or exchange purchased may be invested in bills or employed at interest, as in the case of the Bank of England account.

"(5) The considerations which will guide the committee as to when and for what amounts such transactions shall be made, are:

"(a) The amount of borrowings by member banks from the Reserve banks;

"(b) The general level of interest rates;

"(c) The movement of foreign exchange rates as an indication of possible gold imports.

"The committee would expect to be charged with the execution of the program for account of those Reserve banks which approve and participate."

Following the meeting with the members of the Open Market Investment Committee, a motion was adopted by the Board that approval be given to the policy governing open market operations as recommended by the Committee in its report.

(Secretary's note: It will be noted that as a result of the action taken by the Board on November 2, 1927, the Open Market Investment Committee was authorized to make purchases and sales for the Account to offset gold movements without limitation. The Committee was also authorized to sell securities in order to offset the seasonal return of currency during January and to purchase gold or exchange abroad, if necessary, up to $100,000,000 and to sell securities to offset such purchases.)

Communications on Open Market Operations and Gold Movements, November-December 1927

Letter from Strong, November 10. Under date of November 10, the following advice was received from the Chairman of the Open Market Investment Committee:

"In accordance with our conversation, I am writing you something of open market matters and will do so at frequent intervals, if you desire. Details of the activities of the Open Market Investment Committee and the changes in the holdings of Government securities are, as usual contained in the weekly report of the secretary of the committee, which is regularly sent you.

"You will observe that there has been a gradual increase in the Government security holdings during the past few weeks. As you know, these increases have been due to purchases to partially offset the current earmarking of gold, amounting in all to $50,000,000, for a foreign correspondent. . . .

". . . so far, offsetting purchases of $36,500,000 have been made against $45,000,000 of gold already earmarked. Further purchases of Government securities will gradually be made to offset the total of $50,000,000.

"In addition to the earmarked gold for French account, shipments to Brazil, amounting to $36,500,000, and to Poland, amounting to $15,000,000, a total of $51,500,000, are to be made this month. About $11,000,000 has already gone forward to Brazil, and it is expected that the total going to both Brazil and Poland will be shipped between now and November 30. No purchases have as yet been arranged as an offset to these latter prospective shipments, and we are inclined to await developments before doing so.

At the moment, therefore, we have deferred offsets to $8,500,000 on account of the French and $11,000,000 on account of the Brazilian transactions. The shipment of $31,500,000 to Argentina was not entirely offset, either.

"In our view, the continued steady rates for money and the strength of sterling, which closed yesterday at 4.87¼, justifies this delay in further buying of Governments."

(The above letter, after being circulated, was presented at the meeting of the Board on November 17 and noted.)

Under date of November 15, the following letter was received from the Chairman of the Open Market Investment Committee:

"I have received your letter of November 12 and am glad that you found the information contained in mine of the 10th, with regard to open market transactions, of interest.

"Since that time there has been but a small increase in the holdings of Government securities in the System Account. Including the transactions completed today, the par value of the securities held on November 15 will be approximately $415,000,000, against $375,000,000 at the middle of last month, the increase of $40,000,000 representing purchases to offset the $50,000,000 of gold earmarked for one of our foreign correspondents.

* * *

"It is also expected that further earmarkings or shipments will be made this month:

To Brazill	$ 14,500,000
To Poland	6,000,000
Total	$102,500,000

No further offsetting purchases have as yet been made to cover these transactions, as the satisfactory price of sterling (4.87 7/16 for cables today) and the favorable state of the money market have not seemed to justify such action.

"In other words, taking into consideration gold already earmarked or shipped, we are now upwards of $42,000,000 short of making offsetting purchases, with $20,000,000 outstanding commitments yet to be executed. The recent activity in the open market account has, therefore, been confined, in the main, to changes in maturities. The present state of the Government security market afforded a good opportunity to dispose of the longer maturities, and, with the approval of the Open Market Investment Committee, we have sold (at a profit) all of the $3\frac{1}{2}$% 3-5 year Treasury notes and Fourth Liberty Loan $4\frac{1}{4}$% bonds, aggregating some $79,000,000, replacing these with shorter maturities, mostly the new 3 1/8% Treasury certificates. This will result in the total holdings in the account being in short-time paper maturing within the next ten months . . .

"As to our future program, a good deal depends upon how the operation of redeeming the Second Liberty Loan bonds works out. It looks now as though the Treasury might run something of an overdraft for a number of days, which would tend to keep money moderately easy, but it also seems possible that toward the latter part of this month money conditions might tend to be considerably firmer and it might be desirable to offset more fully the amounts of gold exported or earmarked. We shall continue to watch carefully the condition of the money market, and will keep you informed as to the situation."

(The above letter, after being circulated, was presented at the meeting of the Board on November 21, 1927 and was noted, as a matter of record, inasmuch as the procedure being followed was in accordance with the recommendations made at the last meeting of the Committee, which were approved by the Board.)

Letter from Strong, November 17. "Referring to the last paragraph of your letter of November 16, the Treasury overdraft together with the November 15 financing undoubtedly has had a tendency to rather sharply ease the money market. Our large member banks today were about ninety millions over in actual reserves although only about six millions over in average. This situation should correct itself in a few days as withdrawals of Government deposits and their disbursement in payment of Second Liberty bonds subject the large amount of deposits to the usual reserve requirements when no longer held by the Government. We are making no further purchases of securities and probably will not do so until the true position of the money market is clearer."

(The above letter, after being circulated, was noted by the Board at its meeting on November 25th.)

The Federal Reserve Board received the following communication, dated November 23, from the Chairman of the Open Market Investment Committee:

"There have been no changes in the holdings of Government securities in the Special Investment Account since I wrote you on November 15 . . .

"Additional earmarkings and some further shipments of gold during the past week brings the total movement to date up to $101,500,000

While it is considered likely that further earmarkings or shipments will be made this month, we know definitely as to the following:

To Brazil	$3,500,000	
" Poland	3,000,000	6,500,000

No offsetting purchases beyond the $40,000,000 of which you have already been advised have as yet been made to cover these transactions. The large

'Treasury transactions in connection with the redemption of the Second Liberty Loan bonds have resulted in some ease in money, the Treasury having a temporary overdraft at the Federal reserve banks estimated to amount to about $72,000,000 as at the close of business to-night. The Treasury has made a call upon depositary banks for payment of this amount on Friday, November 25. Call money has remained easy all week at 3 1/2%, while sterling has remained steady, the cable rate being 4.87 5/8 to-day. With the covering of the Government overdraft, however, we may expect some firming up of money. It may therefore be desirable to make further purchases of Governments in the near future as a partial offset to the large amounts of gold exported or earmarked. We shall continue to keep a careful lookout in order to act promptly if conditions seem to warrant further action".

(The above letter was presented at the meeting of the Board on November 25, was noted and ordered circulated.)

Letter from Strong, December 2. "Since writing you on November 23, the anticipated firming of call money rates has taken place. As I explained to you yesterday, this is due partly to the heavy calls made upon depositary banks by the Treasury, and partly to the continued outflow of gold. Total shipments and earmarking of gold on this movement now amount to $128,500,000, while the total of Government securities purchased as an offset amounts to $44,000,000, leaving a net balance of $84,500,000 against which no purchases have been made.

"As you know, in our talk yesterday we pretty generally agreed that, under existing conditions, there is at the moment no occasion for making further offsetting purchases of Government securities. The

$4,000,000 purchased during the past week represents a single block of Treasury paper due December 15, which we took over from a foreign correspondent.

"There will, of course, be some necessary shifting about incident to the December 15 Treasury operation. For instance, at the request of the Treasury Department we are proposing presently to sell, from our Open Market Investment Account and from holdings for account of foreign correspondents, as nearly as may be $92,000,000 of the $4\frac{1}{2}\%$ notes maturing December 15, 1927, to the fiscal agents of the British Government for its payment to our Treasury on December 15. We shall, at the same time, acquire in their stead a like amount of other maturities. This program will enable the Treasury to reduce its current borrowing requirements by the amount of December 15 paper turned in on account of the British debt payment.

"I am inclined to think that it may be desirable to have a meeting of the Open Market Investment Committee within the next two or three weeks, and I am asking Mr. Case to arrange this with you during my absence from the bank."

(The above letter was presented to the Board on December 5 and noted.)

Letter from Acting Chairman to Board, December 13. "Additional shipments and earmarking of gold on the recent movement have now reached an aggregate of $148,000,000, with further anticipated shipments this week of $14,000,000. No additional offsetting purchases of Government securities have been made, however, beyond the $45,000,000 previously reported.

"The recent ease in call money has in part been due to the rather unexpectedly large redemptions of Second Liberty Loan bonds called for payment November 15, with a resultant overdraft of $57,000,000 now being carried by this bank. This overdraft will be further augmented, on Thursday, December 15, when the maturing 4½% Treasury notes will be presented here for redemption, at which time the overdraft, we estimate, may run as high as $150,000,000 or thereabouts. With the receipt and presentation of the income tax checks, this overdraft should be materially reduced from day to day until about Tuesday, December 20, when, by reason of a call from depositary banks, it is anticipated that the overdraft will be wiped out and the Treasury again have a normal balance. During the last ten days in December, we anticipate that the usual holiday currency withdrawals and the usual year-end "window-dressing" on the part of banks throughout the country, will cause money to be in good demand and that, temporarily at least, call money rates may range from, say 4½% to 5%.

"As you know, this situation was discussed with our directors when you were here in the bank two weeks ago, and the prevailing opinion was and is that it might be well to let our banks borrow any additional funds that may be needed (which we estimate may run as high as from $100,000,000 to $150,000,000) rather than to undertake to ease the situation by making further purchases of Government securities.

"There will be an unusually large volume of transactions in connection with the Treasury's turnover for December 15, perhaps the principal one having to do with our furnishing the fiscal agents of the British Government, from our open market portfolio, with $92,575,000 of the 4½% U. S. Treasury notes due December 15, 1927, which, in turn, are to be used immediately by the fiscal agents in making payment to the U. S. Treasury. We have agreed to take over from the fiscal agents, in replacement, a like amount of other short-term Government paper. This transaction is being made in order to simplify the Treasury's borrowing program as of December 15, 1927.

"The foreign exchanges continue strong: sterling has maintained its position at high levels, today's cable quotations being 4.88 5/16."

Excerpt from Reply of Board, December 14. "The Board was interested in your discussion of the probable money market situation in connection with the December 15th Treasury operations, and I was requested to advise you of the Board's concurrence in the opinion of your directors that it might be well to let your member banks borrow any additional funds that may be needed rather than to undertake to ease the situation by making further purchases of securities."

Letter from Acting Chairman, December 21. "Since my last letter to Governor Young under date of December 13, 1927 there has been no increase in the par value of the holdings of Government securities in the Special Account. There have, however, in connection with the December 15, 1927 operations been some changes in the maturities of the issues held. These changes were, for the most part, caused by supplying the fiscal agent of the British Government with the $92,000,000. odd of Treasury Notes due December 15, 1927 to be used by them in making the payment to this Government, and at the same time acquiring from these fiscal agents a like amount of other short-term notes. . . .

"Our loans to member banks on the fifteenth showed a slight reduction but with the collection of the income tax checks the New York City institutions have started borrowing again on a rather large scale, and their loans now stand some $50,000,000. higher than they were a week ago. However, despite the fact that shipments and earmarking of gold during this movement have continued and now reach a total of about $175,000,000, accompanied by the usual seasonal demand for currency, the volume of Federal reserve credit in use thus far has been due to the increase in our loans without further purchases of Government securities beyond the $45,000,000. previously reported.

"Call money today is 4 1/2% and while we expect that there may be a temporary hardening in money rates within the next few days with call money possibly going to 5% or higher, we anticipate no change in the program outlined in my letter to Governor Young of last week."

(The above letter was presented to the Board at its meeting on December 22 and noted.)

(Secretary's note: On December 31, 1927 the total in the Open Market Investment Account was $423,158,500.)

Developments during 1928

Communications on Open Market Operations and Gold Movements, Early January 1928

Letter from Acting Chairman, January 5. "Since my letter to Vice Governor Platt, which was written on December 21, 1927, there have been some changes in the maturities of the short-term Governments held in the Account, although there have been no changes in the total par value held, which remains at $423,158,500. Such changes in the holdings, which are contained in the Secretary's detailed weekly reports, have been the result, for the most part, of purchases and sales to accommodate the fiscal agent of the British Government and a foreign correspondent. . . .

"No further purchases have been made beyond the $45,000,000 previously reported to offset gold earmarked and shipped, the amount of which during the last two months has reached a total of $195,000,000. Our loans to member banks, as was to be expected, showed a large increase at the end of the year; also we have been carrying temporarily for dealers, under sales contract agreements, good sized amounts of Government securities and bankers bills.

"Call money, which has been firm since the turn of the year, yesterday dropped from $5\frac{1}{2}\%$ to $4\frac{1}{2}\%$, and today went to 4%. The indications are that with the return flow of currency we shall have a liquidation in loans and securities carried such as is usually experienced at this season of the year. It would not be surprising, therefore, if conditions in the near future would warrant consideration of the idea of making some sales of securities from the Open Market Account."

(The letter quoted above was circulated)

Authorization of New York Bank to sell securities. At the meeting of the Board on January 9, 1928, the Governor reported a telephone conversation a day or two before with the Deputy Governor of the Federal Reserve Bank of New York during which he, the Governor, was advised that in view of the existing situation in the money market it was felt that it might be expedient to sell from $40,000,000 to $50,000,000 of government securities from the System account and that the question of such a sale had been taken up with the members of the Open Market Investment Committee and approved by them. The Governor stated that being familiar with the attitude of the members of the Board through informal discussions and feeling that there would be no objection, he advised the Deputy Governor of the New York Bank accordingly. The Board then formally approved the sale of not to exceed $50,000,000 of securities from the Special Investment Account, if and when deemed advisable.

Letter from Acting Chairman, January 10. "I have your letter of yesterday, advising me that the Federal Reserve Board has formally approved the sale of not to exceed $50,000,000 of Government securities from the System Special Account, if and when deemed advisable by the Open Market Investment Committee.

"As you know, the report of the Open Market Investment Committee presented to the Federal Reserve Board at its meeting with the Committee on November 2, 1927, recommended a certain definite policy which was approved by the Federal Reserve Board. One of the steps which the Committee at that time stated it might be necessary to take, in order to carry out the policy approved by the Federal Reserve Board, was the sale of Government securities after the turn of the year. That being so, we had of course, assumed that the Committee had full authority to make the sales in question; and in my conversation with you on Saturday I intended merely to report to you, as a matter of information, what the Committee had in fact agreed to do without any thought that the formal approval of the Federal Reserve Board was, in the circumstances, necessary. I am writing this merely to explain our understanding in the matter, and also to give you the reason why we in fact made sales aggregating $25,000,000, on Monday, without expecting or thinking the Board's approval would be necessary."

Excerpt from letter of Acting Chairman. "Since January 1 the total losses of gold through payments for export or earmark have amounted to $33,150,000. Offsetting these losses, however, total gains through imports or releases from earmark have amounted to $22,250,000, making a net loss of $10,900,000 for the first ten days of the month. In order that you might clearly visualize the movement for this ten day period, I am enclosing a separate table showing by countries actual shipments as well as earmark transactions.

"It is a little difficult accurately to forecast gold movements for the next few weeks. We have, however, been advised that $5,000,000 will be shipped to Brazil on January 14 and $3,000,000 to the Argentine on the same date. We have also been advised that we will receive $4,500,000 from Canada tomorrow. Whether or not we will lose more to South America is problematical, but inasmuch as this is the period of our heaviest payments to the Argentine it is not unlikely that we may lose a few million to that country in spite of the fact that total shipments to the Argentine since January 1, 1927 have aggregated $68,000,000, apart from the shipment of $3,000,000 that is to be made on next Saturday.

"The various exchanges throughout the world were, as you know, very strong during the latter part of 1927, and while it is true that some of our shipments of gold were special transactions related to central bank operations or generally directed towards currency stabilization, nevertheless much of the gold that we lost was the result of the strength of the foreign exchanges as contrasted with the dollar. Since January 1 there has been some easing of most of the exchanges. . . .

* * *"

Meeting of January 12, 1928

Memorandum of Chairman. A meeting of the Open Market Investment Committee with the Federal Reserve Board was held in Washington, January 12, 1928, at which the following memorandum reviewing operations for the year 1927 was presented by the Chairman of the Open Market Investment Committee.

"The major features of the current credit situation as they relate to Federal Reserve Policy may be summarized as follows:

"VOLUME OF CREDIT

"Over the past 12 months the growth of bank credit in the United States has been more rapid than in any year since 1924, and more rapid than is ordinarily required by the year to year growth in the country's trade. It appears to have been much more rapid than was required by the growth of trade this year in view of recessions in many branches of business.

"As far as may be judged from the available statistics the country's bank credit expanded about 8 per cent in 1927 compared with a normal growth of possibly 6 per cent.

"USE OF CREDIT

"The amount of commercial loans as indicated by 'all other loans' of reporting member banks, is now no larger than a year ago. The increase in total loans and investments of these banks was divided almost equally between loans on stocks and bonds and bank investments. Of the increase in investments more than half has been in Government securities, reflecting in part the Treasury refunding program which retired three billion dollars of widely distributed bonds largely by issuing lower yield short term issues which were carried more largely by banks.

"In interpreting these member bank figures two other considerations should be borne in mind.

"1. 'All other loans' are not a complete measure of business use of credit. Much of the funds recorded as investments and loans on stocks and bonds find their way into business use. Through new financing for example, this year about 6 billion dollars has gone into construction of building, roads, bridges, plant equipment, etc. Business credit requirements of these sorts continue to grow even in periods of recession and these uses of credit are a factor in business recoveries from recessions. In the banking figures some of this appears in investments and loans on stocks and bonds.

"2. 'With our huge time deposits some considerable increments of bank credit are due to accumulation of interest. The country has perhaps 26 billions of time and savings deposits. Annual 4 per cent interest on this sum is over one billion dollars.

"But nearly half of the increase in deposits this year has been in demand rather than time deposits, and much of the increase in bank credit has been absorbed in increased prices of securities rather than in business enterprise. The rate of increase in credit has been clearly more rapid than can be continued without leading to abnormalities of value, the eventual readjustment of which might involve a severe strain on the country's business.

* * *

"CONDITION OF BUSINESS

". . . The principal recessions have been in productive activity and wholesale (primary) distribution. Retail distribution has been better sustained and financial activity which includes sales of stocks, new financing, and trading in cotton and grain futures, has been going forward at a tremendous pace. This very high rate of financial activity has accounted for the fact that debits to individual accounts have been at such high levels.

"While the figures show a distinct recession in business they do not show anything approaching a depression. In none of the groups are the figures appreciably below what may be estimated as normal. While industrial employment has decreased 5 or 6 per cent since a year ago there are no indications of serious unemployment.

* * *

"It is not easy to explain the recent recessions in business. There has been no general overproduction nor any credit stringency. New financing which reflects new enterprise has gone on in ever increasing amounts. It is likely that it is the effect of the accumulative action of a number of causes which include the Ford cessation of new car production, the soft coal strike, the floods, the collapse of the Florida boom, the let-down in new building and plant construction, conservation of railroads in ordering new equipment.

"If these are the causes of recession they are mostly temporary and the present almost unanimous opinion that business is likely to improve as the year advances appears to have some justification.

"As to the effect of changes in money conditions upon business recovery there are two phases of the problem, the real supply of funds, and the psychological reaction. Under present conditions banks are finding difficulty in employing their funds safely and profitably. This would still be true even if credit were increasing less rapidly and money were somewhat firmer; business could still obtain all the credit necessary at reasonable rates. As to the psychological effect of any action the Reserve System may take in the direction of firmer money there is perhaps some question since business is now probably very sensitive to changes in the credit picture. The question for Federal Reserve policy is how the present credit expansion can best be controlled if possible without adversely affecting business.

"FOREIGN EXCHANGES AND GOLD MOVEMENT

"When Federal Reserve discount rates were reduced last August and September, money conditions abroad were an important consideration. Sterling and other European exchanges were weak and stringent money conditions abroad, with increasing discount rates and consequent pressure on world commodity markets which might logically be followed by unemployment and declining purchasing power for our own goods, appeared inevitable unless money were easier in this country.

"Now the situation is quite changed. Much that was hoped to be accomplished by our rate action has been accomplished. Most of the European exchanges are above par and European countries have both taken gold from us and increased their holdings of dollars. Since the first of the year the exchanges have declined as bills drawn in dollars have come due and as short covering has become less of an influence. Firmer money here would put more pressure on the exchanges and might possibly lead to some rate advances abroad, but European money markets are now more firmly entrenched and much more able to take care of themselves.

"The gold outflow appears to be slackening as foreign exchanges have weakened and firmer money here would perhaps operate as a further check except for central bank transactions or for other unusual transactions which may be made regardless of the exchange position. The recent gold exports, however, have not only improved the monetary position of a number of countries but have also had good psychological effect. As a result, consideration of Federal Reserve policy at this time can properly be much more independent of the European situation than was the case last summer.

"PRESENT POSITION OF THE MONEY MARKET

"Between September 1 and January 10 net gold exports and earmarkings have taken approximately 230 million dollars out of the market.

"Of this only 45 million has been offset by purchases of securities thus leaving a net loss to the money market of about 185 million. During this week we have sold approximately 30 million of Government securities and anticipate selling an additional 15 millions within the next few days. In addition, the required reserves of member banks have increased about 100 million dollars. Thus since early autumn, taking all these changes into consideration, the requirements for reserve money for which banks or the market feel responsibility have increased 330 million dollars. The full weight of this borrowing has only just begun to fall on the market because of the extended Treasury overdraft from November 15 to December 20 and the distortion of the picture by year-end transactions.

"At the last report all member banks owed the Reserve Banks about 500 million dollars and banks in New York City 180 million, and in addition bill and security dealers have secured funds under sales contracts totaling 76 million. The experience of the past shows that this amount of burden on the banks and market will ordinarily keep the call money rate from 1/2 to 1 1/2 per cent above the discount rate with other rates in correspondence. Thus the conditions are now present for considerably firmer money conditions than in the autumn. The adjustment of the market to these conditions has been a little slow because of general expectancy of easy money after the turn of the year, but the adjustment now appears to be taking place.

* * *

"The foregoing may be summarized as follows:

"1. In recent months the volume of credit has been increasing more rapidly than appears to have been required for the needs of business.

"2. The increase seems to have flowed largely into the channels of investment and speculation, though business has probably benefited indirectly to some extent.

"3. Business has been receding due probably to causes which are temporary. Fundamentals are generally sound.

"4. Even with somewhat firmer money conditions, business is likely to get all the funds required, but business psychology may be sensitive to abrupt changes in money conditions.

"5. European money markets are now in a position largely to take care of themselves and consideration of Federal Reserve policy may well be more independent of them than was the case last summer.

"6. Conditions now seem to be present for substantially firmer money conditions than last autumn, though the market has been slow in adjusting to these conditions."

Action of Committee. The Chairman of the Open Market Committee also submitted the following committee report at the meeting on January 12:

"The Committee has considered the memorandum submitted by the Chairman and has reviewed the program adopted by the committee on November 1, 1927 and approved by the Federal Reserve Board. Thereupon, the following conclusions were adopted:

"1. The object of the policy adopted on November 1 has been accomplished.

"2. The Committee program should now work towards somewhat firmer money conditions as far as necessary to check unduly rapid further increases in the volume of credit.

"3. In order to accomplish this program the committee would expect to sell further amounts of Government securities and if necessary to deal with gold movements in such manner as necessary to carry out the program.

"As outlined in the program of November 1, the committee would expect to be charged with the execution of this program for the account of those reserve banks which approve and participate and would hope this program might guide the committee for the present, unless a change of conditions makes further review desirable."

The Chairman of the Committee then referred to the action of the Board on January 9 in approving the sale of not to exceed $50,000,000 of securities from the special investment account if and when deemed advisable by the Committee. He stated that up to the present time $35,000,000 of securities have been sold and delivered, while the remaining $15,000,000 authorized for sale were under contract for delivery within the next day or two. He called attention to the fact that this sale removed from the account all of the securities which were purchased by the Committee as an offset against gold exports and earmarkings on the recent movement.

The Board thereupon requested the individual members of the Committee to acquaint it with any discussions and considerations which had been had at their respective banks with respect to adjusting the rediscount rate. Each member of the Committee expressed the views of the officers and/or directors of his bank as he understood them. It appeared to be the general consensus of opinion that no immediate increase in the discount rate should be made at any Federal Reserve bank, but that the general business and money market situations should be carefully observed during the course of the succeeding few weeks and that in the interim any correction of money market tendencies should be through operations in the Open Market Investment Account.

Following the meeting with the members of the Open Market Investment Committee, the Federal Reserve Board voted to authorize the committee during the next two months to make sales of Government securities from time to time, with accompanying authority temporarily to purchase such securities should developments not now in sight require such action.

(Secretary's Note: On January 12, 1928 the total of the Open Market Investment Account stood at $376,030,000.)

Communications on Open Market Operations Mid-January-March 1928

Telephone conversations on retardation of sales. At the meeting of the Board on January 16, the Governor reported a telephone conversation with the Acting Chairman of the Open Market Investment Committee, during which he was advised that the Committee under authority granted by the Board on January 12 had sold Government securities until a point had been reached at which further securities would not be absorbed by the market except at a reduced price. The Governor reported advice given him by the Acting Chairman of the Open Market Investment Committee that the reduction in the System's investment account had already caused considerable discussion in New York and that it was now proposed for a day or two to withhold further offerings of securities.

(Secretary's Note: On the day of this telephone conversation the account stood at $370,330,000.)

The Governor was authorized to advise the Acting Chairman that the Board was in sympathy with the proposal reported, but did not favor any prolonged departure from the program recommended by the Committee and approved by the Board on January 12.

(Secretary's Note: This advice was given to Mr. Case over the telephone.)

At the meeting on January 18 the Governor reported that the Acting Chairman of the Open Market Investment Committee had advised him over the telephone that as agreed no securities had been sold to the market during the past two or three days and that it was not believed anything should be done for the balance of the week, although $15,000,000 of securities were being sold for the Alien Property Custodian. He further reported that arrangements had been practically completed for the sale of $25,000,000 of securities out of the System Account for delivery the following week and that it was expected $50,000,000 would have been sold by the middle of the next week. He further stated that in reply to an inquiry, the Acting Chairman advised him that there was no disposition on the part of the Committee to abandon the sale of securities from the System Account, but that the question then concerning the Committee related merely to the manner and time of selling.

Letter from Acting Chairman to Board January 20. Under date of January 20, the Acting Chairman of the Open Market Investment Committee addressed the following letter to the Board reviewing activities in the Account during the period from January 4 to January 20.

"As agreed upon at the meeting of the Open Market Investment Committee on January 12, 1928, the idea of reducing the System's holdings of Government securities has, as you know, been put into practice. Beginning with January 4, 1928:

The total amount held in the System Special Account was	$423,158,500
Amount held at New York under sales contract, was	76,061,400
Total	$499,219,900

"From the memorandum enclosed you will observe that during the week ending January 11, 1928:

Actual sales made, aggregated	\$23,628,500
Liquidation in advances to dealers, totaled	57,561,400

which accounted for the reduction of approximately \$81,000,000 as shown by the published statement of the System as of that date.

"For the week ending January 18, 1928:

Actual sales amounted to	31,450,000
Plus a complete liquidation of the remaining amount of our advances to dealers	18,500,000

which, of course, accounts for the reduction of about .... \$50,000,000 appearing in this week's published statement.

"We have made further direct sales to the market yesterday and today, amounting to \$25,000,000, which will appear in the weekly published figures as of January 25, 1928.

"To sum up:

The total reduction by direct sales from portfolio, from January 4 to this date, aggregates	\$ 80,000,000
Plus a liquidation (in the form of a reduction in advances to dealers) of	76,000,000
Making a total reduction of	\$156,000,000

* * *

"The Treasury's current Third Liberty Loan exchange program is to be closed on Monday, January 23, and this fact should enable us promptly to make further additional sales to the market. Money has become quite easy in this market, the call rate being down to 3½%; and our loans to New York City banks have shown a marked decrease, having gone down to something less than \$50,000,000 as against \$110,000,000 a week ago. Bank transfers this way and the return flow of currency have run into large figures."

(This letter was circulated and noted at the meeting of the Board on January 25.)

Authorization for further sales of securities. At the meeting of the Board held on January 24 the Governor announced a telephone conversation the previous day with the Acting Chairman of the Open Market Investment Committee during which he was advised that approval had been received from the Committee for the sale of an additional $50,000,000 of securities from the Open Market Investment Account.

(No objection was expressed to the proposed sale and under date of January 26 the following letter was addressed to the Acting Chairman of the Open Market Investment Committee:)

"Following our telephone conversation last Monday, January 23rd, I advised the Board of the desire of the Open Market Investment Committee to sell an additional $50,000,000 of securities from the System account, and of the statement I made to you that, as to the attitude of the Board, I felt the members would be quite willing to give the Committee authority to sell up to $100,000,000 of securities if it desired to do so.

"None of the members of the Board expressed any objection to additional sales of securities up to the $50,000,000 limit which you suggested."

(Secretary's note: At the meeting of the Board on January 24 approval was given to the rediscount rate of 4 per cent established by the Executive Committee of the Federal Reserve Bank of Chicago, effective January 25.)

Letter from Acting Chairman, January 27. "You will recall that in my last letter to you, under date of January 20, 1928, I reported a reduction in the Open Market Investment Account, by direct sales from portfolio, of $80,000,000. Since that time additional sales, aggregating $41,000,000, have been made, which will effect a total reduction in the account, of $121,099,500, leaving a balance of about $300,000,000.

"Partly as a result of these sales, the money market is noticeably firmer. . . . This morning the member banks in New York City owe us 130 million dollars, and I see by yesterday's statement that bills discounted for the System as a whole are 20 million larger than they were a year ago. Just in the past few days there appears to have been some evidence of a transfer of funds from New York to the interior, and a reduction of borrowing at some of the western Reserve banks, and a corresponding increase in New York.

"These various changes have taken place although we are now at what is usually the very bottom of the seasonal dip in money rates. The full effect of our action will be apparent only as the seasonal commercial demand begins about the middle of February.

"In view of these conditions, our present view would be that we might defer for the moment further sales of securities and study the situation as it develops."

(The above letter was circulated.)

(Secretary's note: The rediscount rate of the Federal Reserve Bank of New York was increased from $3\frac{1}{2}$ to 4 per cent, effective February 3, 1928.)

Telephone conversations on sales, early February. At the meeting on February 2, the Governor reported that the Acting Chairman of the Open Market Investment Committee had advised him on that day that there had been some improvement in the demand for Government securities and that, accordingly, the Committee had sold $10,000,000 of securities from the Account for delivery the previous day and contracted for the sale of $5,000,000 more for delivery on that day."

(Secretary's note: On February 2 the account stood at $287,394,000.)

The Governor on February 7 reported a telephone conversation with the Acting Chairman of the Open Market Investment Committee, who advised that recent sales from the System account had reduced the portfolio to about $278,000,000. The Governor stated that the member banks in New York City were then borrowing about $156,000,000 from the Federal Reserve Bank and that after discussing the matter with the Chairman of the Board of Directors of the New York Bank, the Acting Chairman of the Open Market Investment Committee advised him that they were of the opinion that no further sales of securities should be made for a few days.

Decision to suspend sales. At the meeting of the Federal Reserve Board on February 10 the following letter which had been circulated was read:

"Since my last letter to you, under date of January 27, $25,000,000 of additional sales of Government securities have been made from the System Special Account to the market, reducing the holdings in that account to $275,000,000 as at the close of business tonight, and representing a reduction of approximately $150,000,000 since the first of the year. These sales, together with advances in discount rates of this bank and four other Federal reserve banks during the past week, have resulted in slightly firmer money.

* * *

"In view of the foregoing, it seems to us here that it may be wise for the present to continue the Open Market Investment Account at about the present level and to watch the effect of the sales already made and the changes in the rediscount rate before taking any further action."

The Governor reported a telephone conversation with the Acting Chairman of the Open Market Investment Committee during which he was advised that the situation had been discussed by the directors of the New York Bank at their meeting on the previous day, and that the directors were of the opinion that no further sales of securities should be made for three or four days.

The Governor was authorized to advise the Acting Chairman of the Open Market Investment Committee that the Board was in agreement with the conclusion expressed in his letter of February 7, although there was a feeling on the part of some members of the Board that further sales should be indefinitely suspended.

(Secretary's note: This advice to the Acting Chairman of the Open Market Investment Committee was given over the telephone.)

On February 14, the following letter, dated February 10, from the Acting Chairman of the Open Market Investment Committee was read to the Board and noted:

"Referring to my letter of February 7, 1928, in which I reported on the sales from the Open Market Investment Account, and to my conversation with you by telephone this morning, I am glad to learn that the Federal Reserve Board is in sympathy with the idea expressed in the last paragraph of my letter.

"As to our future course, the condition of the money market since I wrote my letter and the conversations which we have had with our directors and with the members of the committee, confirms me in the belief that we would do well to continue the account at about the present level. If there should be any need for a change from this policy we would propose to confer with you before taking action."

(Secretary's note: Since the increase in the Chicago rate on January 25, the rediscount rate at all of the other Federal reserve banks, except Cleveland, had been increased from $3\frac{1}{2}$ to 4 per cent, by February 21, and the Open Market Investment Account on February 21 stood at $273,000,000.)

(Secretary's note: On March 1, 1928, the rediscount rate of the Federal Reserve Bank of Cleveland was increased from 3 1/2 to 4%.)

Letter from Acting Chairman on treatment of maturing securities, March 14. "Supplementing our daily informative letter to the Federal Reserve Board concerning gains and losses to the money market, I desire to summarize a few of the larger and more important transactions which are likely to take place tomorrow, particularly those affecting the Open Market Investment Account.

"In the first place, due to the very heavy redemptions in this market of U. S. Treasury obligations maturing March 15, 1928, we estimate that the Treasurer's overdraft with us (which will be covered by a one-day certificate carrying 3 1/4% interest) will approximate $250,000,000, with a resultant very heavy gain to the money market, which, if not dealt with in any way by us, would not only enable the city banks to liquidate their entire indebtedness to us, but would probably furnish them with something more than $100,000,000 in excess reserves. This would naturally be followed by considerable competition among the banks to get their money temporarily invested and would probably result in a reduction in the call money rate down to 4% or possibly 3 1/2%.

"In order to stabilize conditions over the tax period, it has, as you know, been our custom either to make temporary sales of Government securities from the Open Market Investment Account, or, latterly, to sell to our member banks day-to-day participations in the one-day temporary certificate of the Government during the four or five days in which the tax checks are collected.

"During the past year or so our problem on quarterly tax days has been increased by the very large amount of maturities of Government obligations held for account of foreign correspondents, agency accounts of the Treasury, etc. Such maturities tomorrow amount to no less than $165,000,000! Customarily we are requested to reinvest these maturities in other U. S. Government obligations, and we necessarily have to be prepared to furnish those accounts, for reinvestment, with the particular and specific maturities which they desire. This point can best be illustrated by saying that our reinvested orders in the June 15 maturity from foreign correspondents and the Treasury alone aggregate $110,000,000. We are enabled to fill these orders only by reason of the fact that we hold some $90,000,000 of June 15 maturities in the Open Market Investment Account, the balance being acquired in the outside market for delivery here tomorrow.

"As we advised you in our letter of February 10, it is planned to continue the Open Market Investment Account at about the level then agreed to; viz., $273,000,000. However, under the easy money market conditions which are likely to exist here tomorrow, we are proposing to have a temporary 'lag' in the delivery of some $83,000,000 of short-term Government securities purchased to replace the June 15 maturities which we are selling for delivery tomorrow.

"To sum up: the Open Market Investment Account tonight will stand at about $270,000,000. The securities sold from this account to foreign correspondents, the Treasury, etc., for delivery tomorrow, will aggregate $130,000,000. The securities purchased for delivery tomorrow in replacement will aggregate but $50,000,000, leaving the account, at the close of business tomorrow night, at approximately $190,000,000. The balance of $83,000,000 of short-term securities which have been purchased and delivery on which it is proposed to delay, will come in partly on Friday, Saturday and Monday. These delayed transactions should synchronize more or less with the payment of tax checks and thus keep a better semblance of order in our money market. In accordance with our usual custom, we are also planning to sell, tomorrow, to such member banks as are over in their reserves, participations in the one-day Treasury certificate covering its overdraft. It is estimated that such sales may amount to $100,000,000 or more.

* * *"

Meeting of March 26

Memorandum of Chairman. A meeting of the Open Market Investment Committee was held in Washington on March 26, 1928, at which the following memorandum was considered:

"At its last meeting on January 12, 1928, the committee recommended a System open market policy which should 'work toward somewhat firmer money conditions as far as necessary to check unduly rapid further increases in the volume of credit.' In accordance with this policy net gold exports, totaling $68,000,000, (exclusive of exports of earmarked gold) since that time have not been offset by purchases of securities, and sales have been made from the open market portfolio amounting to $150,000,000, and the portfolio has been reduced from $423,000,000 to $273,000,000. Accompanying these sales of securities the discount rates of all the Reserve Banks were increased from 3 1/2 to 4 per cent.

"Partly as a consequence of these actions, money rates have risen somewhat. . . .

"The total volume of member bank credit decreased during January and the first half of February at a somewhat more rapid rate than the usual seasonal decrease. The decline was largely in loans on stocks and bonds, and commercial loans increased. There has not been sufficient liquidation of credit to release any appreciable amount of reserve funds and total bills and securities of the Reserve Banks are currently about 200 million larger than last year. In the past two weeks, accompanying a very active stock market, brokers loans have begun to increase again and with them the total volume of credit.

"The policy adopted in January was thus effective in preventing further increases in the volume of credit, until the past two weeks. A partial explanation for the diminishing effectiveness of the policies adopted may be seen by observing the changes in bills discounted of member banks in New York City and member banks in other districts. As sales of securities were made in January the borrowings of member banks in New York City were increased, until they reached a point well above 100 million. From early in February, however, borrowings in New York City showed something of a downward tendency, accompanying transfers of funds from the interior and increases in the discounts for member banks outside of New York City. These figures are given in the attached diagram and table. They raise the question whether the amount of indebtedness of member banks in New York City is now sufficient to prevent further increases in the use of credit, particularly for speculation.

"Condition of Business

"In recent weeks the available evidence indicates a continued tendency toward business recovery, and this improvement has gone far enough so that Federal Reserve policy may be considered more independently of the condition of business than for some weeks past."

Action of Committee and Board. The report made to the Board by the Committee on March 26 was as follows:

"The committee has considered the memorandum submitted by the chairman and has reviewed the results of System open market operations during recent months.

"While it appeared for a time that the purposes set forth in the Committee's recommendations of January 12 were being accomplished, there has recently been a renewed tendency towards what seems an unnecessary expansion of credit indicating that the 4% discount rate in the larger money markets is not as effective as had been contemplated.

"The Committee therefore recommends that the general policy recommended in January be continued until another meeting is held at the time of the Governors' Conference unless or until a change in the situation makes an earlier reconsideration desirable. The committee would expect to make such changes in the open market account as are necessary to carry out the policy."

During the joint meeting of the Board and the Committee on March 26, at which the recommendations of the Committee were under discussion, the Chairman of the Committee stated that the situation had been discussed in detail by the Board of Directors of the Federal Reserve Bank of New York, which felt that the rediscount rate of that bank had not been effective because of the ability of New York City member banks to liquidate their borrowings at the Federal Reserve bank to a very low figure. He said that in the opinion of the directors of the New York bank, which was concurred in by the members of the Open Market Investment Committee, some further sales of securities should be made from the System portfolio, although there may be further exports of gold which will reduce the amount of sales that may be necessary.

During the discussion which followed, in reply to an inquiry by Governor Young, the Chairman of the Committee stated that the operations proposed by the Committee, if its recommendations were approved, would be conducted with a view to making more effective the prevailing rediscount rates of the Federal Reserve banks and not with a view to bringing about an increase in Federal Reserve bank rates.

The Governor of the Board then referred to the security holdings of the individual Federal Reserve banks which are not included in the System portfolio and which have increased since the establishment of the Open Market Investment Committee by approximately $50,000,000. He expressed the opinion that purchases of securities by individual banks for their own account if made at a time when the System, through the Open Market Investment Committee, is selling securities have the effect of offsetting the influence of the System operation. The matter was discussed at considerable length and it was agreed that it should be made a subject for consideration by the Spring Conference of Governors.

Following the joint meeting of the Board and the Committee on March 26, the Board at a separate session adopted the following resolution:

"Whereas, at a meeting of the Federal Reserve Board and the Open Market Investment Committee held on January 12, 1928, it appeared to the members of the Board and the Committee that operations in the Open Market Investment Account of the Federal Reserve System should be directed toward bringing about somewhat firmer money conditions, as far as necessary to check unduly rapid further increases in the volume of credit;

"Whereas, the Federal Reserve Board in line with the policy agreed upon on January 12, 1928, voted to authorize the Open Market Investment Committee to make sales of Government securities from the System Account from time to time during the following two months, and also authorized the Committee temporarily to purchase such securities should developments not then in sight require such action;

"Whereas, in furtherance of the above stated policy approximately $127,000,000 of securities were sold from the Open Market Investment Account, which sales together with an increase in the rediscount rate of the Federal Reserve Bank of New York and certain of the other banks, resulted in firmer money conditions and lead to discontinuance early in February of further sales of securities from the Account until the effect of sales already made and the changes in rediscount rates could be more closely observed;

"Whereas, the Federal Reserve Board at this meeting has considered the written recommendation made by the Open Market Investment Committee today and the verbal assurance received from the members of the Committee that the operations in the Open Market Investment Account should be conducted with a view to making more effective, and not increasing, prevailing rediscount rates of the Federal Reserve banks;

"Now, Therefore, Be it resolved, That the Federal Reserve Board approve the policy recommended by the Open Market Investment Committee in its written and verbal reports of this date and authorize said Committee to make further sales of Government securities from time to time up to May 1, 1928, at about which time another meeting of the Committee with the Federal Reserve Board will be held unless a change in the situation makes earlier reconsideration desirable."

The above resolution was transmitted to the Chairman of the Open Market Investment Committee in a letter dated March 26.

Letters on Open Market Operations, April 1928.

Letter from Acting Chairman and resume of current credit situation, April 11. Under date of April 11, 1928, at which time the Open Market Investment Account stood at $248,000,000, the Deputy Governor of the Federal Reserve Bank of New York, Acting Chairman of the Open Market Investment Committee, addressed a letter to the Governor of the Board, transmitting a resume of the current credit situation with a statement "It seems quite clear that, for the present, we should continue to make moderate sales of Government securities from the Open Market Investment account."

This letter, after having been circulated among all members of the Board, was presented at the meeting of the Executive Committee on April 17, and "Noted".

The resume referred to was as follows:

"The principal developments in credit and business during the past two months have been the following:

Gradual advance in money rates,
Continued outflow of gold,
Moderate recovery in industrial activity,
Substantial increase in commercial loans of reporting banks,
Unusual activity in stocks, prices advancing to new high levels,
Increase in brokers' loans to higher level than ever before,
Substantial increase in the demand for Reserve Bank credit.

"Money Rates

" . . . Money rates have shown an upward trend since the end of January, which, however, was quite gradual until within the past two weeks. The recent advance has carried rates considerably above the levels that prevailed last autumn, and also moderately above a year ago. . . .

"Until recently the effects of sales of securities from the System Account, the advance in rediscount rates, and some further loss of gold were partly offset by a heavy flow of funds from other districts. . . .

"A renewed gold export movement in March, the effect of which did not appear until the Treasury tax period overdraft was eliminated, together with a small reduction in the System Account, was reflected in a general, though moderate, advance in money rates near the end of March. The sharp advance in call money rates since the first of April has accompanied an unusually rapid increase in borrowings of New York City members from this bank, which in turn appears to have been due to the following circumstances:

"Month-end and Easter currency requirements in Second District, Loss of about 100 million dollars in transfers to other districts (probably reflecting currency requirements and collection of April 1 coupons and dividend checks),

"Increase in member bank reserve requirements, the result of a large increase in security loans, following a considerable increase in commercial loans.

"The usual tendency would be for funds to return to New York during the coming week, and for currency to be retired from circulation, with a resulting liquidation of member bank indebtedness here and an easing of call money rates.

"Demand for and Supply of Reserve Funds.

* * *

"[Over the past year there has been] a net increase in the demand for reserve funds, largely due to gold exports and earmarkings, of over 300 million dollars, a little less than half of which has been supplied through net increases in Reserve Bank bill and security holdings, the remainder of which member banks have had to obtain through borrowing from the Reserve Banks. Nearly 100 million of the increase in borrowing has occurred within the past week, due partly to a considerable increase in member bank reserve requirements accompanying credit expansion, and partly to currency withdrawals.

"Business Recovery and Commercial Loans.

"Industrial activity in general appears to have largely recovered from the decline at the end of 1927, although there is still considerable irregularity.. . . Accompanying this increase in industrial activity, commercial loans of reporting banks have shown the largest increase for a similar period in recent years.

"Data on distribution have not shown corresponding gains. . . .

"Commodity Prices.

"Commodity prices in general have shown very little change since the first of the year. . . .

"Renewed Rise in Stock Prices and Security Loans.

"Following a period of moderate recession in January and February, the volume of stock trading during recent weeks has been larger than ever before, and stock prices have risen with a rapidity that has seldom been equaled. For a time the rise in prices was not reflected in member banks security loans to any great extent, apparently due in part to funds received by the market from sources other than banks, but in the week ended April 4 member bank security loans increased 275 million dollars and were larger than at any previous time, with the exception of the temporary high point at the first of the year.

"The Standard Statistics Company index of prices of 228 stocks is 33 per cent higher than a year ago, when prices were then higher relative to either earnings or dividends than in a number of years. Apparently the recent advance was based on the feeling that there was an immense amount of idle funds in the country which were not needed for business purposes, and an impression that Federal Reserve discount rate changes and security operations had been largely ineffective and that the moderate advance in money rates was seasonal and would be followed shortly by a seasonal decline in rates. The advance in call money to 5, 5 1/2 and 6 per cent appear to have caused some doubts as to the plentifulness of money and to have resulted in some hesitancy in the stock market.

"Conclusions.

"(1) The effect of Reserve Bank security operations and advances in rediscount rates on money rates in New York has been partly counteracted until recently by a large movement of funds from other districts, which was made possible by an unusually large contraction in currency circulation, and by an increase in borrowings from other Reserve Banks.

"(2) Industry has largely recovered from the recent decline, but, in general, is not unusually active; distribution appears to have shown no corresponding increase.

"(3) Stock prices, and consequently brokers loans, have reached higher levels than ever before; the advance seems to have been based on the belief that the rise in money rates was largely seasonal and would be followed soon by a seasonal decline, and that the credit supply was ample for stock operations as well as general business.

"(4) Indebtedness of New York City member banks amounting to about 150 to 200 million dollars, which is likely to be accompanied by a call money rate of 5 to 5 1/2 per cent, appears to be necessary to check the expansion of loans for stock trading purposes.

"(5) Further Reserve Bank sales of securities will probably be required within the near future to keep indebtedness of New York City banks and call money rates at these levels, as the recent increase has been based partly on temporary influences."

Letter from Acting Chairman, April 17. Under date of April 17, 1928, the following letter was addressed by the Acting Chairman of the Open Market Investment Committee to the Vice-Governor of the Board and was read at the Board meeting on April 18, 1928:

"IN RE: Open Market Investment Account

"Last Wednesday and Thursday, before Governor Young left for his trip south, we had as you know a talk concerning the Open Market Investment Committee's contemplated sales during the ensuing week; and it occurs to me that you and your associates may be interested in having a complete resume of what has been done in this regard, as well as of other important pending transactions that will have an effect on the money market.

"(1) Total sales, between the close of business Wednesday, April 11, 1928, and the close April 18, 1928, amounted to $47,370,000....

"(2) At the request of one of our foreign correspondents, the Federal Reserve Bank of New York is today supplying them with a total of $20,000,000 bankers' bills, which now appear on our statement under the caption 'Sales Contracts,' and is simultaneously taking over from the foreign correspondent $20,000,000 of U. S. Government 3 1/8% Treasury certificates due June 15, 1928, for resale to the U. S. Treasury tomorrow, April 18, 1928. The initial effect of this transaction today will be merely to reduce our portfolio of bill holdings by $20,000,000 and to increase our holdings of Government securities by a like amount; but, as the Treasury is drawing down balances from depositary banks in order to pay us for the Treasury certificates tomorrow, this will presently have the effect also of taking $20,000,000 of funds from the money market.

"(3) Another item of major importance is the fact that we have been instructed by the Bank of France to earmark $25,000,000 in fine gold bars tomorrow, April 18. Payment for these bars will be made out of funds withdrawn from the market, $3,000,000 today, and $22,000,000 tomorrow.

"When these transactions have been consummated, the money market will have lost an aggregate of $92,000,000. . . .

"Under these circumstances, probably it will be desirable to defer any further immediate action."

(Secretary's note: Effective April 20, 1928, the discount rates of the Federal Reserve Banks of Boston and Chicago were increased from 4 to 4 1/2%.)

Letter from Acting Chairman, April 23, 1928. The following letter dated April 23, 1928 from the Acting Chairman of the Open Market Investment Committee was circulated among the members of the Board and "Noted" at the meeting on April 27, 1928.

"In response to your request we have prepared a balance sheet, which shows the loss of gold since November 10, and the resulting increase in the use of Reserve Bank credit, together with changes in currency circulation, member bank reserve requirements, and the effect of security sales on Reserve Bank discounts, which are needed to complete the picture. . . .

"Except for the sale of securities, the return of currency from circulation would have largely offset the loss of gold; the increase in discounts would have been comparatively small, and rates in the New York money market would have been considerably lower."

Meetings of April 29-30, 1928.

The next meeting of the Open Market Investment Committee was held on April 29, 1928, at which time the Open Market Investment Account stood at $152,318,300, and an increase in discount rate from 4 to 4 1/2% had been made effective at five of the Federal Reserve Banks - Boston, Richmond, Chicago, St. Louis and Minneapolis.

Memorandum of Chairman. At this meeting the following memorandum was considered:

"Since the last meeting of the Committee on March 26, 1928, there has been a renewed expansion of bank credit, largely in the form of loans on stock and bonds. . . .

"This increase occurred largely at the end of March and in the early part of April, but it is not clear that the tendency toward expansion has been checked as yet, notwithstanding a considerable rise in money rates during the month.

"Since March 26, further sales of approximately $119,000,000 of securities from the System account have been made, reducing the amount in the open market portfolio from $273,000,000 to $154,000,000. In addition there has been a loss to the market of about $57,000,000 through gold exports and earmarking since the last meeting, and reserve requirements of member banks have been increased approximately $50,000,000 as the result of credit expansion. The combined effect has been to increase member bank indebtedness at the Reserve Banks by over $200,000,000 during the past five weeks, and money rates in general have advanced. . . .

"Call Money Market

"Call money advanced to 6 per cent early in April partly as the result of Easter currency requirements and the usual first of the month flow of funds to the interior, but subsequently declined to 4 1/2 per cent on several days around the middle of the month, due to a heavy flow of funds to New York from other districts, which appears to have been accompanied by renewed borrowing by member banks outside of New York.

"Following the advance in the rediscount rate of several Reserve Banks from 4 to 4 1/2 per cent in the latter part of April, there was some withdrawal of funds from New York, indebtedness of New York City banks was increased, and call money advanced to 5 per cent.

"Commercial Borrowing and the Condition of Business.

"The increase in commercial loans of reporting banks from the end of January to the middle of April was unusually large this year, and it now appears that requirements are tending to diminish. Productive activity appears to be fairly stable following a rapid recovery in a number of important industries earlier in the year, and trade has been in moderate volume.

"Conclusions.

"1. An excessively rapid increase of bank credit has occurred during the past month, and it is not clear that the tendency toward expansion has been halted.

"2. Money rates have advanced further as the result of security sales, gold losses, and increased reserve requirements.

"3. The advance in discount rates of five Reserve Banks appears to have resulted in some withdrawal of funds from New York, and thus to have assisted in preventing softness in the New York money market.

"4. The highest point of seasonal business credit requirements has probably passed and there is no indication that the tightening of the money market has interfered with the extension of all necessary credit to business.

"5. After the May first interest and dividend requirements have been met, the normal tendency would be toward easier rates."

Action of Committee and Board. At this meeting (April 29, 1928) the following report and recommendations were adopted by the Open Market Investments Committee:

"The Committee has considered the memorandum submitted by the Chairman, and has carefully reviewed the Open Market operations of the System since the last meeting of the Committee, in the light of the general credit situation referred to in the memorandum.

"In view of the fact that it now appears that the expansion in the total volume of bank credit, referred to in its last report, has continued at what seems to be an unduly rapid rate since that time, notwithstanding the sales of securities made by the Committee and the recent increase in the discount rates of some of the Reserve Banks, the Committee now recommends that the general policy adopted at its last meeting be continued until its next meeting, which it would expect to hold shortly after the middle of June, unless conditions make an earlier meeting advisable.

"The Committee would expect to make such changes in the Open Market account as might be necessary to carry out the policy recommended."

This report was presented to the Board at a meeting on May 2, and the action of the Board was to address the following letter to the Acting Chairman of the Committee:

"The report and recommendations of the Open Market Investment Committee as of April 29, 1928, have been received and considered by the Board. We observe that the Committee now recommends that the general policy adopted at its last meeting be continued until the next meeting. The previous meeting, to which you refer, was held on March 26, and at that time your Committee recommended that the general policy established in January be followed. In January you stated the Committee program should work toward somewhat firmer money conditions and to accomplish the program the Committee would expect to sell further amounts of Government securities, the object being to check further unduly rapid increase in the volume of credit. The Board therefore assumes that your present policy is a continuation of the program adopted in January.

"We also observe from your report of April 29 that it is now expected by your Committee that this policy will be continued until the next meeting of the Open Market Investment Committee, which you contemplate holding shortly after the middle of June, unless conditions make an earlier meeting advisable. The Board realizes that it is extremely difficult for the Committee to outline any definite procedure to be followed between now and June 15, and in like manner, it is extremely difficult for the Board to approve any definite policy for any definite period. It, however, is in agreement with the procedure suggested by the Committee at the moment and therefore gives approval to its recommendations, but in doing so, reserves the same right that the Committee reserves of changing its position should conditions develop which would make a change advisable.

"By order of the Federal Reserve Board."

The Open Market Investment Committee minutes of a joint meeting with the Federal Reserve Board on April 30, read in part as follows:

"A copy of the report of the Open Market Investment Committee dated April 29, was presented to each member of the Federal Reserve Board, together with a copy of the formal report of the secretary of the committee and a preliminary memorandum prepared for the committee on money market and credit conditions generally. Mr. Case reviewed the conditions referred to in the preliminary memorandum and the reasons which prompted the committee's report, which he explained had been submitted to and accepted by the Governors Conference this morning. In discussing the report the question was raised as to whether the recommendation of the committee was intended to pave the way for further rate increases. It was explained that while the action taken by the committee was not designed to cause a uniform discount rate of 4 1/2 per cent throughout the Federal Reserve System, nevertheless it might be necessary in any event for some of the other reserve banks to raise their rates to that figure later on."

Letter on Open Market Operations, May 1928.

Under date of May 8, the Acting Chairman of the Open Market Investment Committee addressed the following letter to the Governor of the Board, which was circulated among all members and "Noted" at a meeting of the Executive Committee of the Board held on May 14:

"Since the week ended Wednesday, May 2, 1928, further sales from the Open Market Investment Account, approximating $17,000,000, have been made, reducing the account from $157,000,000 to an estimated total of $140,000,000 as at the close of business Wednesday, May 9, 1928.

" . . .since the beginning of this year, a total of $283,000,000 of Government securities has been disposed of, which sales in turn have been reflected in a very substantial increase in bills discounted and direct advances to member banks. The statement of the Federal Reserve Bank of New York as at the opening of business this morning, compared with a week ago, reflects a loss in cash reserves of $78,000,000 and an increase in total bills discounted of almost precisely that figure. A part of this loss in reserves represents the withdrawal of funds from New York, but even if these funds are returned, due to prevailing high rates for call money, it appears to be unlikely that New York banks will be enabled to reduce their indebtedness much below $200,000,000.

"You will recall that during the Governors Conference at Washington last week, Mr. Harrison reported the likelihood of one of our foreign correspondents (the Bank of France) withdrawing $67,000,000 of funds from the New York market; the procedure being to have the funds paid in here for its account and the proceeds thereupon applied to the earmarking of a like amount of gold. We have now received definite word from the Bank of France that it plans to withdraw a total of $37,000,000 this week, about as follows: $17,000,000 on Wednesday, May 9, and $10,000,000 each on Thursday, May 10, and Friday, May 11 - the remaining $30,000,000 to be similarly withdrawn on Monday, Tuesday and Wednesday of next week, May 14, 15 and 16, respectively, in units of $10,000,000 each.

"When the aggregate of this sum comes to be added to our already expanded volume of bill and security holdings, which today total $450,000,000, it would appear that our member banks will be indebted to us (in the form of discounts and advances) in an amount somewhere between $200,000,000 and $300,000,000; with total holdings of approximately $500,000,000. If member banks' indebtedness to us should hold somewhere between those two figures, it may presently be necessary to consider carefully the idea of making some slight changes upward in our rate structure. In any event, it seems reasonably clear that, with this large withdrawal of funds from the market, it may be unnecessary to make further sales of securities for the present."

Meeting of May 25, 1928.

The next meeting of the Open Market Investment Committee was held on May 25.

> (Secretary's Note: On which date the System Account amounted to approximately $100,000,000. On the same date a rediscount rate of 4 1/2 per cent was made effective at the Federal Reserve Bank of Cleveland and only three Federal Reserve Banks were then maintaining a 4 per cent rate - Atlanta, which increased on May 26th; San Francisco, which increased on June 2nd, and Kansas City.)

Preliminary Memorandum of Acting Chairman. At this meeting (May 25) the Open Market Investment Committee considered the following preliminary memorandum submitted by the Acting Chairman:

"Operations conducted since the meeting at the end of April have been successful in increasing materially the indebtedness of member banks, especially New York City members, and in tightening further the New York money market. . . .

"The increase in the indebtedness of all member banks at the reserve banks increased about 140 million during the three weeks, due chiefly to the following factors:

"Reduction in the System Account from $154,000,000 on April 27 to $100,000,000 on May 23.

"Gold loss through additional earmarkings of 68 1/2 million and net exports of 16 million.

"Reduced buying of bills and consequent reduction of about 25 million in Reserve Bank bill holdings.

". . . Most of the increase in member bank borrowing has been by New York City banks. Advances in discount rates of five Reserve Banks from 4 to 4 1/2 per cent in the latter part of April appear to have greatly assisted in keeping funds from flowing to New York, and consequently helped to make effective the further sales of securities in the New York market. The result is apparent in the course of money rates previous to the advance in the discount rate of the New York Reserve Bank on May 18. The advance at New York after New York City members had been placed heavily in debt at the Reserve Bank has been effective in tightening the money market further. Present money rates and changes since the latter part of April and since the latter part of last October are indicated in the following table:

		Change Since	
	May 23 1928	April 27 1928	October 28 1927
Call money	6	+ 1	+ 2 1/2
Time money, 90-day	5 1/2	+ 1/2	+ 1 1/4
Commercial paper	4 1/2 - 4 3/4	+ 1/8	+ 1/2 - 3/4
Bills, 90-day	4 - 4 1/8	+ 1/8 - 1/4	+ 3/4 - 7/8

"These rates are the highest for the time of year since 1923. It is evident that rates on security loans have been advanced much more than rates on commercial borrowing, which is in keeping with the nature of credit expansion in recent months.

"Loans on Stocks and Bonds.

"Notwithstanding the substantial increase in interest charges on security loans, such loans have continued to increase rapidly. A further increase of over 350 million during the past three weeks has carried the total of loans to brokers placed by New York City banks to 4 1/2 billion dollars, an amount 800 million higher than in the first week of March, and nearly 1,600 million or 55 per cent larger than a year ago. . .

"Most of the increase during [the past three weeks] has been in loans of New York banks for their own account, and in loans for others than banks. The heavy indebtedness of New York banks, together with the recent advance in the discount rate of the New York bank, should give these banks an incentive to restrict their lendings.

"It is too early to determine the effect of this latest move in checking credit expansion. The movement of stock prices, which rather than the volume of trading has caused the expansion of security loans, has been highly irregular during the past week, - evidence of fairly heavy liquidation on several days has been followed by a recovery.

"Interdistrict Movement of Funds

"The flow of funds to and from the New York money market is also an important factor in the extension of credit for stock trading purposes. It has been apparent in more than one instance since the beginning of this year that an inflow of funds to New York has largely offset the effect of open market operations; it has been apparent also that banks in other parts of the country as a whole have had no surplus funds since the end of January, but that these transfers were accompanied by increased borrowing by member banks outside of New York.

"The accompanying chart shows the accumulative movement of funds to and from New York City banks since April 18, the date that marked the culmination of a heavy inflow of funds to New York, and that just preceded the beginning of Reserve Bank advances in discount rates. Call loan renewal rates also are shown.

"The decline in call money renewals to 4 3/4 at the beginning of the period, together with Reserve Bank discount rate advances in several districts, appear to have caused some withdrawal of funds from New York until the end of April. The usual month-end inflow and subsequent outflow followed, and recently some movement of funds to New York has accompanied 5 1/2 to 6 per cent call money. This latest inflow thus far has been moderate, but the further rise of money rates since the discount rate of the New York Reserve Bank was advanced may tend to draw funds more heavily toward New York.

"Conclusions.

"1. Further Reserve Bank security sales, restriction of bill purchases, and gold loss have substantially increased member bank indebtedness, and have caused a further advance in money rates.

"2. Advances in discount rates of several Reserve Banks other than New York, most of which occurred in the latter part of April, appear to have been effective in preventing a further flow of funds to the New York money market, and in confining the increase in member bank indebtedness largely to New York.

"3. The increase in indebtedness of New York members and the rise in money rates previous to the advance in the discount rate of the New York Reserve Bank did not check the expansion of credit used for security trading purposes.

"4. The advance in the discount rate of the New York bank, after New York member banks had been placed heavily in debt, has resulted in a further tightening of the New York money market.

"5. This further advance in money rates may tend to attract funds from other sections of the country, which would neutralize the effect of further security operations."

Action of Committee and Board. After consideration of the above memorandum the Committee adopted the following report.

"The Committee has considered the memorandum submitted by the Chairman reviewing the credit situation.

"While there has been some pause in the expansion of credit, it is not yet clear that the expansion is definitely checked. The Committee believes that it is difficult to estimate the exact effect of the sales of securities that have been made to date, and feels that it is possible that a cumulative effect not yet apparent may make itself manifest in the near future.

"The Committee believes that sales of securities should be continued at least during the next week.

"To take care of any acute situation which may develop suddenly, the Committee believes furthermore that it should have authority to make purchases of securities to an amount not exceeding $100,000,000 as may be necessary to take care of such a situation if it should arise."

This report was submitted to the Federal Reserve Board at a joint meeting immediately following, and the Board's minutes of that joint meeting are as follows:

"The Acting Chairman of the Committee stated that the Open Market Investment Account has been liquidated to $100,000,000 and that the purpose of the Committee in seeking authority to continue sales of securities, at least during the next week, is to place the Committee in position to accept an offer made by the Fiscal Agents of the British Government for the purchase of $25,000,000 of securities out of a portion of the proceeds of the Australian bond issue recently floated in this country. He stated that these securities would be held by the agents of the British Government for probable use in meeting interest and principle payments due the United States on June 15th. He stated that if these bonds are not purchased from the Federal Reserve System they will be purchased in the open market, in which event in all probability no loss of credit to the market will result as the funds for the purchase are assumed to be on call and the latter transaction would merely exchange a call loan for government securities. The Acting Chairman stated that the Committee felt that the offer should be accepted by the Federal Reserve System.

"With regard to the recommendation of the Committee that to take care of any acute situation which may develop suddenly the Committee should have authority to make purchases of securities to an amount not exceeding $100,000,000, the Acting Chairman stated that this should be considered in the light of the statement contained in the report as to the possibility that the accumulative effect, not yet apparent, of the sales of securities that have been made to date may make itself manifest in the near future. He stated that this recommendation is not based upon any contingency which any member of the Committee can at this time foresee, but is made rather out of an abundance of caution in order that the Committee may be prepared to deal with any unforeseen movement which might dangerously affect the credit situation.

"The Acting Chairman having previously advised the Board that Governor Harding cast a negative vote on the Committee's report, at the request of Governor Young, Governor Harding explained his reasons for not concurring in the Committee's recommendations, principally that he believes the Committee should no longer operate on a day to day basis but should formulate its policies to cover wider intervals and because he felt that the Committee should not seek authority to deal with strictly emergency situations in the money market as, in his opinion, the Federal Reserve Bank of New York has ample authority to deal with such a situation of its own accord and, having taken action, could then consult with the Committee and the Board as to any System policy or action believed desirable.

Following a general discussion, it was agreed that the Open Market Investment Committee should meet again for the purpose of reconsidering their report in the light of the discussion at this meeting, later joining in another meeting with the Board for discussion of any changes which the Committee might decide to make in its report."

After recess the Board and the Committee reconvened and the Acting Chairman stated that the Open Market Investment Committee had met again and reconsidered the report submitted to the Board at the morning session, in the light of the discussion which took place at that meeting. He submitted a revised report just adopted by the Committee which was discussed with the Members of the Board and further amended so as to read as follows:

"At the time of the last meeting of the Open Market Committee on April 30th, it appeared that the expansion in the total volume of bank credit was continuing at what appeared to be an unduly rapid rate. Since then, sales of securities by the reserve banks have continued, several of the reserve banks have increased their rediscount rates and there have been further exports and ear marking of gold.

"While there has been some pause in the expansion of bank credit, it is not yet clear that the expansion is definitely checked. This meeting of the committee was, therefore, called to review and consider the present credit situation with the aim of determining whether any different policy than that adopted at the last meeting should be recommended.

"After considering the memorandum submitted by the Chairman and reviewing the various factors in the credit situation, the committee sees no reason to change the policy adopted at the last meeting and concurred in by the Federal Reserve Board. The committee believes that it may still be necessary to exert further pressure on the credit situation and, to this end, that it may be advisable to make further sales of securities.

"The committee would expect to meet again within the next month."

Following its meeting with the Committee, the Board gave further consideration to the final report quoted just above and voted - "That the Acting Chairman of the Open Market Investment Committee be advised that the Board has considered the report of the Committee, approves the policy outlined therein and authorizes the sale of further securities from the Open Market Investment Account if such sales are deemed necessary by the Committee."

At a meeting of the Executive Committee on May 31, the Governor reported a telephone advice received from the Acting Chairman of the Open Market Investment Committee that the $25,000,000 of securities referred to during a meeting of the Committee with the Board on May 25, had been sold from the System Account.

The Governor also stated that he was advised that the New York Bank had taken over temporarily from a foreign correspondent $7,000,000 of securities which were to be disposed of within the next three or four days.

(Secretary's Note: On May 29, 1928, the Open Market Investment Account stood at $82,000,000.)

Letters on Open Market Operations and Gold Movements, June 1928.

Letter from Acting Chairman on Open Market Operations, June 1.

"Supplementing our daily letter to the Federal Reserve Board concerning gains and losses to the money market, I am summarizing herein a few of the important changes which have taken place in New York and throughout the System during the past week.

"Except for a temporary rise in call money to $6\frac{1}{2}\%$ on Monday, and decline to $5\frac{1}{2}\%$ Tuesday afternoon, the money market has been steady and moderately firm during the past week, due largely to further sales of securities from the System Account, reduction in Reserve Bank bill holdings, gold exports and a holiday and month-end currency demand.

"There has been a fairly steady flow of funds to New York which, except for the reduction in Reserve Bank bill and security holdings, would have enabled the New York banks to reduce their indebtedness considerably and, consequently, would have eased the money market. As it was, the borrowings of the New York City banks totaled $246,000,000 yesterday, an amount slightly larger than a week ago, while borrowings by banks outside of New York increased about $90,000,000 during the week.

On Monday, a sale of nearly $26,000,000 of securities to the market was made and was immediately reflected in an increase in the borrowings of New York City banks. On Tuesday, there was a temporary increase of slightly less than $7,000,000 in the System Account, which was due to the temporary purchase of securities from a foreign account. Sales contract holdings of securities also increased $7,000,000 during the week; so that the net reduction in total security holdings was but $11,000,000. At the close of business tonight, the open market portfolio will stand at $75,000,000.

The present level of our buying rates on bills, which, with the cost of indorsement, makes them above the open market offering rates on the shorter maturities, has resulted in small offerings of bills to us and a consequent reduction of $27,000,000 in the total bill holdings of the System during the past week. Yesterday, maturities here exceeded purchases by an additional $10,000,000. A factor in the comparatively low open market rates on short bills has been the strong demand for bills for foreign account. The new law exempting income received by foreign central banks from bills (effective as of January 1, 1928) is likely further to stimulate the foreign demand for bills in this market.

"The gold movement continues to be an influence toward firm money. The principal item during the past week was an export of $15,000,000 to London by a New York bank. This shipment and the $5,000,000 shipment to London last week are reported to have been special transactions - they were not warranted by the position of sterling, figuring the usual costs involved in the calculation of the gold export point. Sterling exchange has advanced to the highest level of the year, notwithstanding the relatively high level of money rates here. We understand that a factor in its strength has been the $50,000,000 Australian loan recently floated here, the proceeds of which have been made available to the British Government.

"Holiday and month-end currency requirements have created a further, though temporary, demand for funds this week. A considerable part of this currency will probably return from circulation next week, but the influence of this on the money market is likely to be offset by the withdrawal of funds from New York, which usually occurs in the first week of each month.

* * *

"The immediate prospect, then, appears to be for continued firmness in the money market during the coming week. It seems likely that the total indebtedness of all member banks for the present will remain above $900,000,000. It is possible that New York banks may continue to gain, through transfers, for a day or two longer, but in view of the fact that they are now engaged in meeting first-of-the-month dividend and interest disbursements, they are not likely to offer funds freely in the call loan market. If, however, they do appear to be lending freely, additional security sales may be necessary to prevent a decline in money rates. Call money has just gone to $6\frac{1}{2}$%."

Letter from Acting Chairman on Gold Movements, June 1. "I am enclosing a preliminary statement of the gold movement during May from which you will observe that the net loss for the month was $109,000,000 including both actual shipments and earmarking transactions. This is the largest net loss in any one month since the present export movement began in September 1927. The total exports of gold for the month were $83,000,000 and although that figure was exceeded by slightly over $10,000,000 in both March and April, nevertheless there were practically no imports in May and the amount of gold earmarked was much larger than any month this year. As you know, the large amount of gold earmarked for the Bank of France at the beginning of the month was responsible for this.

* * *

"As I have said, the Bank of France was the most important factor in our earmarking transactions; so also with respect to actual shipments of gold the largest amount withdrawn during May was for account of the Bank of France. For the present this movement has stopped as we have no instructions at the moment to make further shipments to France and have received no intimation that the amount of gold which they now hold earmarked with us ($93,000,000) is to be taken home in the near future.

"The second largest withdrawals of gold during May were to Great Britain. Two shipments aggregating $5,000,000 and $15,000,000 were made to London by the National City Bank of New York and were in part brought about by the present strength of sterling exchange. Taking into consideration the present shipping costs from New York to London, it is impossible to see how any profit could be made on these two consignments with sterling at $4.88-5/16 to $4.88-3/8, unless the gold were sold in the London market at close to the maximum price of 77s. 10½d. Only a very small part of the first consignment of $5,000,000 was sold in the London market, most of the gold having been sold to the Bank of England at its minimum buying price of 77s. 9d. The second consignment of $15,000,000 has not yet arrived but there does not appear to be any strong demand for gold in the London market and we must, therefore, conclude that these transactions are of a special nature and are not being undertaken primarily for profit.

"Argentina took a fairly substantial amount of gold during the month as she has been doing now since the latter part of last year and there was a small amount sent to Italy. Otherwise there is nothing of importance in the gold movement during May which requires special comment."

<u>Letter from Acting Chairman on Gold Movements, June 6</u>. "We have received rather unexpectedly from the Bank of France instructions to ship to Paris the gold which we now hold earmarked for their account aggregating $93,000,000. There will be eight consignments in the neighborhood of $12,000,000 each, the first of which will leave New York on Saturday next and the last on July 8.

"We shall follow the same practice on this movement as we did in the previous one in regard to publicity, that is, when we hand to the newspaper men each week the statement of gold exports and imports we will explain to them that the amount shipped to France was released from earmarked gold."

Letter from Acting Chairman on Gold Movements, June 8. "Referring to my letter of June 6, there have been some further rather startling developments in the matter of withdrawals of gold in this market by the Bank of France. We have just received a confidential cablegram this morning stating that 'in view of forthcoming stabilization of our currency we shall need an additional amount of $50,000,000 of fine gold bars which we hereby ask you to earmark for our account.'

"The Bank of France desires the operation completed by next Thursday, and we are to-day setting aside $15,000,000 of gold for them against money paid in to us by certain of the New York City banks."

At the meeting of the Board on June 13, at which the last letter was submitted, the Governor reported telephone advice from the Federal Reserve Bank of New York that in addition to the $93,000,000 of earmarked gold that had been moved out of the country for the Bank of France and the $50,000,000 being earmarked for the account of that institution, the Bank of France had requested the sale of $50,000,000 of Government securities, of which, $30,000,000 had been sold for delivery on June 15.

Letter from Acting Chairman on Open Market Operations, June 8. "Reviewing the events of the past week, the call money market was very firm at the close of last week, and early this week, but has subsequently become rather easy, notwithstanding the fact that New York City banks were borrowing 285 million here this morning.

"During the week a substantial amount of funds was taken from the money market through the further reduction in the bill holdings of the System, through some further sale of securities and through gold exports. There was also an increase in member bank reserve balances. These were partly offset by a reduction in currency circulation and an increase in the 'float' of the Reserve Banks, but member bank borrowings increased about 38 million dollars, - almost entirely outside of New York City, however.

* * *

"Dealers' offerings to us of bills continue to be considerably smaller than maturities, partly because of the heavy foreign demand, and partly because our rates with the cost of indorsement are above the market rates, especially on short bills. The reduction of 9 million in securities represents the sale of 7 million securities, which, as we reported last week, were purchased temporarily from a foreign account, and also a reduction of 2 million in sales contract holdings. Aside from this, no further sales of securities from the System Account were made.

"There may be some further reduction in currency circulation during the coming week, and also some reduction in member bank reserve balances, as our records indicate that the balances of New York City members on June 6 were about 17 million above requirements. At least partly offsetting these reductions, it is probable that the 'float' of the Reserve Banks will be reduced during the week and will therefore take funds from the member banks.

"We discussed yesterday the advisability of conferring with some of the New York City members who have been borrowing rather steadily in recent weeks, to see if they could not, by reducing their offerings in the money market, effect a reduction in their indebtedness here. Dr. Miller, who was here during the discussion, informally expressed himself as doubting the wisdom of any such action at the present time.

"The appearance of the money market today seems to suggest, however, that such action may yet be necessary. The New York City banks at the opening of business today had surplus reserves amounting to approximately 20 million. They appear to have offered a corresponding amount of funds in the market, instead of reducing their indebtedness here, and consequently we have the unusual situation of a $5\frac{1}{2}$ per cent call rate with heavy offerings at the same time that the New York City banks are borrowing 285 million dollars here.

"We have received word that 15 million is being paid in here today and a total of 50 million within the coming week, the proceeds of which are to be earmarked for account of the Bank of France. This, of course, will assist very much in preventing undue ease in the money market."

(Secretary's note. On June 7, the rediscount rate of 4 1/2% became uniform for all banks, Kansas City increasing from 4% to 4 1/2% on that date. These rates remained in effect until July 11, when the Federal Reserve Bank of Chicago increased from 4 1/2% to 5%. The Chicago action was followed by similar increases at the Federal Reserve Banks of New York and Richmond on July 13, Atlanta on July 14, and Boston and St. Louis on July 19. During this entire period the Open Market portfolio remained constant at about $85,000,000.)

Meeting of July 18, 1928.

Memorandum of Acting Chairman. "The Open Market Investment Committee met in Washington on July 18. The following memorandum was submitted.

"MEMORANDUM TO THE OPEN MARKET INVESTMENT COMMITTEE

"Interest Rates.

"Interest rates are higher today than at any time since 1921. The primary reason for high money rates is that the member banks owe the Federal Reserve Banks about one billion dollars, compared with an average borrowing of about 500 million for the preceding six years and 400 million last summer. The heavy borrowing is due primarily to gold exports of 500 million dollars since last autumn, sales of 300 million of securities by the Federal Reserve Banks, and some additions to reserve requirements of member banks because of excessive credit expansion. Partly offsetting these losses of funds, there has been a gain through the retirement of over 100 million of currency (reflecting some reduction in factory payrolls and increased use of checks).

"As the autumn demand for funds comes on, larger borrowings and still higher money rates may be anticipated unless counteracting steps are taken. Ordinarily autumn trade requires nearly 100 million additional rediscounts (exclusive of additional Federal Reserve credit called into use through the seasonal expansion in holdings of bankers' acceptances).

"Testing the Credit Situation.

"The present high money rates are testing the credit situation and it seems reasonable to believe that pressure will be felt most at the weakest point, whether this is the prices of industrial securities, the volume of new issues, the amount of new building, or whatever else. It seems likely that a brief period of rates at present levels is likely to result in a check to movements which may have gone beyond a sound economic basis. The fact that such a testing is going on is evidenced by the changes in the total volume of credit, which with the exception of a temporary rise at the first of July has shown no increase since the early part of May. The volume of new long time security issues also shows some sign of pause, and security prices of various types are considerably lower than they were early in May.

"Effect on Business:

"If the present high interest rates are continued for several months it seems probable that business activity may be affected six months or a year from now. The evidence for this probability may be summarized briefly.

"1. Charts of business volume and interest rates since 1900 show that continued high rates have almost invariably been followed by business declines after a lag of six months to a year.

"2. A reasonable explanation is found in the restriction of new enterprises by high money rates.

(a) High money rates discourage speculative building construction - as indicated by declines in building six months to a year following high money rates.

(b) High money rates tend to discourage new financing, which would lead to business activity six months to a year distant.

"3. Present business conditions may be peculiarly susceptible to restriction of credit.

(a) There was considerable unemployment last winter. Outdoor work, particularly building, has largely absorbed surplus labor, but factory employment has increased very little. When outdoor work slackens, further unemployment is at best a danger.

(b) Any considerable unemployment will give installment selling its first considerable test.

"It should be noted, however, that high money rates have not continued long enough for any noticeable adverse effects. On the contrary, the figures which would first reflect adverse consequences show that -

"1. In the first six months of this year the volume of building contracts has broken all previous records. . . . .

"2. Similarly, the volume of new financing has broken all previous records. . . .

"The foregoing figures suggest perhaps an excess rather than a deficiency of new undertakings. A little slower pace would probably be wholesome. There is beginning to be some evidence that the pace is in fact slowing down. Just in recent weeks new issues have diminished.

"Effects on World Finance.

"In recent months European money centers have not been adversely affected by high rates here, largely because of extraordinary movements of funds connected with the French reconstruction. A more normal relation between rates and movements of funds is now beginning. Sterling has declined steadily since the French stabilization. The exchanges are still generally high, but long continued high rates here would undoubtedly draw funds from abroad and lead to higher money rates abroad and lower exchange rates, and perhaps eventually gold shipments to this country. It would probably take some weeks for these developments to occur, and it may also be said that the speculation which has taken place in this country has been paralleled by similar movements abroad, encouraged by cheap money; and somewhat firmer money conditions here may not be unwholesome.

"Germany is a particular case with peculiar conditions. She has had heavy speculation, rising prices and wages, together with high money rates; and as far as temporary money market conditions are concerned they may perhaps be bettered rather than injured by firm money rates here. In the long run, however, the payment of German reparations is dependent upon a steady flow of money from this country.

"The foreign aspects of future policy may be summarized by saying that they appear to offer no pressure toward immediately lower rates here, but in the long run would be adversely affected by a continuation of abnormally high rates here.

"Future Program.

"From these various considerations and other aspects of the current situation, it would appear that some further period of testing the credit situation by firm money conditions might not be undesirable. But it would also appear that too extended a period of high money rates would be detrimental to business and would react unfavorably on the world financial position.

"Looking into the autumn problem for Federal Reserve policy appears to be to find a means of bringing about somewhat easier credit conditions, without at the same time encouraging a renewed expansion of credit. It seems particularly desirable that money should be somewhat more easily available for the crop moving season.

"The two alternatives which naturally present themselves are a reduction in discount rates or the purchase of government securities.

"There are a number of objections to considering rate reductions under anything like present conditions -

"1. Even after recent increases discount rates are low relative to open market rates, and offer encouragement to borrow.

"2. The present volume of rediscounts is now so large that banks find it very difficult to keep out of debt at the Reserve Banks and the tradition against borrowing, which has been the principal source of effectiveness of Federal Reserve policy, appears to be breaking down.

"The chief danger in open market purchases is that, as they appear in the statement, they may be regarded as an indication of a change of Federal Reserve policy and made the occasion for excessive demands for credit.

"From these considerations it seems desirable -

"1. That no precipitate change in policy is called for;

"2. That rate reductions should be made only after the volume of member bank indebtedness has been materially reduced;

"3. That open market purchases should be made at such times and in such quantities that they will be absorbed either -

(a) In meeting seasonal needs for additional credit; or

(b) In reducing the amount of indebtedness at the Reserve Banks."

Action of Committee. The report which the Committee made to the Federal Reserve Board was as follows:

"The committee has considered the preliminary memorandum submitted by the chairman and other features of the current credit situation.

"The committee recommends that no open market action be taken at present, or until the moderately high level of money rates has continued long enough to provide a testing of the credit situation, which may have the effect of checking unsound uses of credit.

"The committee believes, however, that the present amount of member bank borrowing at the Reserve Banks and present money rates would not be wholesome if continued over an extended period and believes the Reserve System should be prepared, if and when conditions warrant, to exercise its influence to modify these conditions. The committee believes this situation should have careful, continuous study, and would expect to meet again for its consideration within a few weeks."

The report submitted by the Committee called for no action but it was agreed that it would be desirable to have another meeting about August 13.

(Secretary's note: - On July 26 the Federal Reserve Bank of Philadelphia established a rediscount rate of 5% and on August 1st the Federal Reserve Bank of Cleveland did so putting that rate in effect at eight of the twelve Federal reserve banks. The $4\frac{1}{2}\%$ rate was maintained at Minneapolis, Kansas City, Dallas and San Francisco.)

Meeting of August 13, 1928.

Consideration of Preferential Discount and Buying Rates. Just prior to the next meeting of the Open Market Investment Committee which was held on August 13 the Board discussed the question of facilitating seasonal accommodation to commerce and business and two suggestions were put forward - (1) that the Board define a new class of paper to be known as "Seasonal crop marketing paper" and advise the Federal Reserve banks that it stands ready to approve a preferential rediscount rate on such paper of from 1/2 to 1% below the rate on other classes; the other that the Board advise the Federal Reserve banks that it stands ready to approve such preferential rates for bankers' acceptances and trade bills. These suggestions were submitted to the Committee which was then in session.

At the joint meeting with the Board the Acting Chairman reported that the Committee, with the exception of one member, felt that preferential rates on special classes of paper would probably not accomplish what was desired and that the Committee felt that the question whether the season's crops could be moved expeditiously and reasonably involved the bigger question of the whole credit structure and would have to be dealt with through open market operations rather than through preferential rates on commodity paper. He expressed the opinion of the Committee that to reduce the bill rates would undoubtedly result in the dumping of a vast volume of acceptances on the Federal Reserve banks which though it might have the effect of easing the credit situation would undo the work of many years in the developing of a bill market.

Memorandum of Acting Chairman. At this meeting (August 13, 1928) the Committee considered the following memorandum of credit conditions:

"Since the last meeting of the committee the effects on the credit situation of gold exports and Federal Reserve action have become more evident and may be summarized as follows:

"1. Interest rates are generally higher. Time money in particular is firm and difficult to obtain.

"2. The total volume of bank credit is somewhat further reduced, (300 million dollars since May), though the reduction is still confined to New York City banks and total loans and investments are still 8 per cent larger than a year ago. Total deposits are about 2 per cent larger than a year ago.

"3. The volume of issues of new securities has decreased and the market is congested.

"4. Bond prices have declined further and average about 4 points under the year's high, and slightly under the 1927 low.

"5. The market for government securities has weakened further and the July issue is nearly two points under par.

"6. Stock prices have moved irregularly. Average prices (New York Tribune, 100 stocks) are about 8 points or 5 per cent under the year's high point. Trading is reduced in volume. Bank stocks continue weak.

"7. Banks are showing concern about the credit situation and applying pressure to reduce borrowing at the Reserve Banks. New York City banks have sold $118,000,000 of government securities since July 11.

"8. European exchanges have weakened further and those of England, France, Italy, and Holland are only slightly above the points at which gold will move to this country, unless prevented by higher rates abroad or sale of their balances here to support the exchanges.

"9. There is no evidence of restriction of business, though profits are reported small in some lines. Building and automobile production are particularly large. There appears to be an ample supply of credit for business at moderate rates.

"Another development, apparently unrelated to credit conditions, has been a sharp decline in prices of certain agricultural products, accompanying estimates of larger crops. As a result it seems probable that the farm income will be reduced from earlier estimates and possibly less than last year.

"These various developments raise the question as to whether and when a change of policy is desirable.

"Earlier Periods for Comparison.

"Bearing upon the question of the timing of any change in policy a comparison of this year's developments with those of recent previous periods of credit readjustment is made.. . .The three periods shown for comparison are 1923 and 1925, when the System sold securities heavily in the spring simultaneous with rate increases, and 1926 when readjustment followed rate increases in November 1925 and January 1926. The 1925 readjustment was so temporary as hardly to show in the figures, but in 1923 and 1926 bills discounted amounting to between 500 and 700 million, and discount rates at 4 1/2 and 4 per cent respectively, appeared to be sufficient to check the expansion of credit, though in neither case was there any substantial liquidation of the total volume of credit.

"What would be a Normal Status?

"The method or methods to be employed toward some relaxation in credit, when that becomes possible, depend upon the ends to be sought - especially what might be considered in the future to be a proper average of member banks borrowings and a normal level of rates.

"The comparative ineffectiveness of rate increases this spring at a time when member banks owed the Reserve Banks about 500 million dollars, raises the question as to the relation between open market rates and Federal Reserve discount rates, and this raises the further question whether it is possible to bring about a different relation between Federal Reserve rates and the market. Experience appears to show that large indebtedness forces market rates high relative to the discount rate, and that the most feasible method of securing a somewhat more effective adjustment of market and discount rates would be to reduce the amount of member bank indebtedness while leaving rates unchanged.

"But apart from any attempt to bring about a somewhat different relation between discount rates and market rates, there are some reasons for believing that the present amount of member bank borrowing is too large to be continued over an extended period without some unfortunate results.

"1. Almost regardless of the discount rate, it keeps severe pressure on the credit situation.

"2. By keeping open market rates high relative to the discount rate, it tends to make the cost of financing through acceptances higher than direct borrowing at banks and tends to dry up the bill market.

"3. By keeping open market rates high relative to the discount rate, it makes borrowing profitable and creates difficulty in dealing with borrowing banks. 'Good' banks work out of debt taking losses; less cooperative banks use the Reserve System for profit."

Minutes of Meeting. The complete minutes of the meeting of the Committee, including its recommendations to the Board as furnished by the Acting Secretary of the Committee, are as follows:

"A memorandum on credit conditions together with the report of the secretary covering the operations in the System Account since the last meeting of the committee were submitted and made the basis of an extended discussion of credit conditions and market rates generally.

"Reference was made to the report of the committee submitted at its last meeting, in which the committee expressed the opinion that the present amount of member bank borrowings at the Reserve banks and present money rates would not be wholesome if continued over an extended period and that the committee should, therefore, be prepared, when conditions warrant, to exercise its influence to modify these conditions. It was pointed out that we are now approaching a period of seasonal demand for crop movement and other purposes that make it important, that the committee should be prepared with authority, to act, if necessary, in order to avoid any undue credit stringency. There was a long discussion of various means which might be employed in case of need. It was generally agreed that while it might become necessary to put funds in the market through the purchase of Government securities nevertheless it would be preferable not to use that means any sooner than might be required or until it became evident that other means were not adequate to avoid an undue or unwholesome stringency.

"In discussing these various factors it was pointed out that the present level of rates in this country has depressed some of the principal foreign exchanges to very near our gold import point, and that there are three possible courses which might be followed by the banks of issue of those countries in meeting the situation: (a) to permit gold to move out, (b) to increase the discount rate, (c) to use some of their American balances in order to support their exchange, thus possibly avoiding the loss of gold or the need for an increase in rates. It was stated that some of these foreign banks, with this in view, have already liquidated commercial bills which the Reserve banks have held for their account, and that it has been necessary to take over those bills into the Reserve banks' portfolios, thus putting funds into the market. It was also indicated that if the pressure on these exchanges continues, we might be requested by some of the foreign banks of issue to liquidate government securities from their accounts, and that in view of the existing state of the government security market it might be necessary for the Reserve banks, at least temporarily, to take these securities into their own portfolios.

"The committee also reviewed the condition of the bill market, calling attention to the fact that we are now approaching a season when there is a normal increase in the total volume of bankers' acceptances outstanding and in the amount of offerings of those bills to the Reserve banks. Purchase of such bills by the Reserve System would also put funds in the market. The Committee felt, however, that in spite of all these influences it might still be necessary for the Reserve banks to purchase government securities in order to prevent any unwholesome restriction of credit, and with this in view, in order that the committee might be prepared to act immediately in the event of a necessity, the following report was prepared and adopted as the recommendation of the committee in regard to the System's open market policy:

"'The policy recommended by the committee in most of its meetings since January, has been to check or prevent unduly rapid or unnecessary increase in the volume of bank credit. While the total volume of loans and investments of reporting member banks is now considerably above what it was at the low point in February, nevertheless, it is approximately $300,000,000 below the high point of May, and there is evidence that member banks are making continued efforts to reduce their borrowings at Federal Reserve Banks.

"'The committee does not believe that conditions necessitate an immediate purchase of securities by the System. It is of the opinion, however, that as pointed out at its last meeting, an extended period of high money rates and heavy pressure resulting from large borrowings by member banks would not be wholesome and that there are some indications that with the approaching fall demands for credit it may soon be possible or necessary to take steps looking toward the reduction, or at least the avoidance of the necessity of any substantial increase, in the volume of member bank discounts. With these facts in view and realizing that if and when the time arrives undue delay may be hurtful to the situation, the committee recommends that it should be the policy of the System to purchase securities whenever that should become necessary to avoid undue credit stringency.

"'The Committee would expect to take such steps as may be needed to carry out this policy, if approved, believing, however, that it might be advisable to have another meeting of the Committee to review the effect of any steps that may be taken in pursuance of this policy.'

"Before adjournment, Governor Young joined the meeting and presented to the committee for its consideration and recommendation the following two proposals:

"(A) That the Federal Reserve Board should write a letter to each Federal Reserve bank indicating its willingness to approve a special preferential discount rate for agricultural paper drawn for the purpose of crop marketing; and

"(B) That it would be desirable for the Federal Reserve System to make a preferential buying rate for bankers' acceptances to be applicable to new acceptances drawn for the purpose of seasonal crop movement.

"After Governor Young left the meeting, each of these proposals was considered by the committee and while no formal action was taken in the short time available for discussion, it was the opinion of the majority of the committee with regard to suggestion (A) that the preferential rate on agricultural paper drawn for season crop marketing would be undesirable because it was unlikely such a preferential rate would in fact reduce the cost of credit to the farmer, who would pay to his member bank the same rate no matter at what rate his bank might be able to rediscount his particular note, and because it was felt that the whole problem of crop movement can be dealt with only as a part of the whole credit problem involving all rates in their application to the total volume of credit. In the opinion of the committee this was emphasized by the fact that much of the borrowing for seasonal requirements takes the form of borrowings from city correspondents on notes collateraled by securities, and that it is practically impossible to earmark credit once it has left the Federal Reserve banks. Funds loaned by the Federal Reserve banks, even at preferential rates, find their way into the general credit pool in the same way as other funds put into the market.

"With regard to suggestion (B), that is, that the System should make a preferential rate for new bankers' acceptances drawn for the purpose of seasonal crop movement, it was the opinion of the majority of the committee that any drastic change in the general practice of buying bills, such as a preferential rate on a particular class of agricultural acceptances, might have unfortunate results in disorganizing the bill market as a whole without at the same time accomplishing the purposes desired. It is also felt that buying rates for bankers' bills are necessarily related to the entire rate structure and that very deliberate consideration should be given to the question before adopting a preferential rate out of line with general market rates. It was felt by a majority of the committee that advantages that might result from such an action might be more than offset by the disadvantages.

"The meeting adjourned at 1:15 p. m. to reconvene at 2:30 p.m.

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"The meeting reconvened at 2:30 p. m. in joint session with the Federal Reserve Board. . . .

"The memorandum on credit conditions and the report to the Open Market Investment Committee were submitted to and read by the Federal Reserve Board. Before discussion of the report, Governor Young asked the committee for its views on the two questions submitted by him at the morning meeting. Mr. Harrison reported orally the conclusions of the committee as given above. After this there ensued a full discussion of the two proposals, especially that respecting the preferential rate on bankers' bills. The committee reviewed to the Board much of the discussion which took place at its morning meeting, emphasizing especially the fact that while the committee believes it might be necessary to purchase Government securities in order to avoid any undue stringency during the seasonal fall demand, nevertheless it was felt by the committee that this action should not be taken unless the various other means of influencing the situation, which were discussed and reviewed, should be inadequate.

"In response to an inquiry from Governor Young, the members of the committee expressed the informal opinion that as they see the situation at the present time there is not now any occasion for a change in the discount rates of the banks which they represented.

"Before adjournment of the meeting, it was pointed out, as discussed at the morning meeting, that the effort of certain foreign banks of issue to stabilize their exchanges through the sale of dollars might possibly result in their sale of Government securities now held for their account and that it might be necessary, because of the state of the Government securities market, for the Reserve banks to take over those securities, at least temporarily, pending an opportunity to sell them to the market.

"The meeting adjourned at 5:00 p. m., with the understanding that the Federal Reserve Board would act upon the recommendation contained in the report of the committee at the Board meeting the following morning."

During the discussion which followed presentation of the Committee's report the Acting Chairman stressed the fact, which was confirmed by other members of the Committee, that the recommendation for the purchase of securities was intended to cover only an emergency situation and that securities would be purchased only as a last resort if a dangerously tight money situation should arise despite efforts to prevent such a situation through purchases of acceptances, exchange operations or otherwise.

Action of Board. The recommendations of the Committee were considered by the Board at its meeting on August 15, 1928, at which consideration was also given to the proposals for the establishment of preferential rates on paper arising out of the marketing of the current crop or on bankers' acceptances and trade bills, as a method by which the seasonal credit demands incident to the movement of crops could be met. The Board was in agreement that the increased demands for credit for seasonal requirements might put a strain on the whole credit situation which would react unfavorably to business and industry, and that if such a situation should develop, some relief should be given by the System. A motion looking toward the establishment of preferential rates on notes, drafts, and bills of exchange, the proceeds of which had been or would be used for the orderly and systematic marketing of current crops was defeated and a suggestion was made that the recommendation of the Open Market Investment Committee as well as the proposals for preferential rates might be submitted to all Federal Reserve banks for consideration. It was the consensus of opinion however that some affirmative action should be taken by the Board either to approve the recommendations of the Committee or to suggest some other definite course of action.

At the meeting of the Board on August 16 consideration of the matter was resumed and some members of the Board expressed themselves as being unalterably opposed to the granting of any authority to the Open Market Investment Committee for the purchase of Government securities except of course those offered by Foreign banks of issue which it was agreed should be taken over and absorbed into the system account if they could not be resold to the market. After a detailed discussion of the recommendations of the Committee the following communication was addressed to the Acting Chairman:

"The Board has reviewed carefully the report of the Open Market Investment Committee and its recommendations of August 13, and has also considered the verbal discussion which took place during the meeting, and it is in agreement with the Committee that the seasonal requirements of credit will probably develop a strain upon the future credit situation which may react unfavorably upon commerce and industry, and that if such a situation should develop, the System should take some action to relieve the strain.

"The Board would not care to agree to the purchase of Government securities, except as a last resort. We understand from the discussion had with your committee that you favor easing through the bill market, if possible, and through the Government security market only if unavoidable. With this understanding, the Board approves the purchase of Government securities by the committee but limits the amount to $100,000,000. If a situation should develop which will require reconsideration, the Board will be glad to meet the committee at any time for that purpose."

Communications on Open Market Operations, September- Mid-November 1928.

At the meeting of the Board on September 12, 1928 the Governor reported a telephone advice received from the Deputy Governor of the Federal Reserve Bank of New York that the bank had taken over from a foreign correspondent about $23,000,000 of Government securities, $3,000,000 of which were resold. He stated that the remaining $20,000,000 would be disposed of as quickly as possible.

(Secretary's note - During this period the Open Market Investment Account fluctuated temporarily from $75,000,000 to $92,000,000 due to the fact that the Committee first took over and then resold the security holdings of the Federal Reserve Bank of St. Louis.)

Letter of Acting Chairman, September 26. Under date of September 26 the Acting Chairman of the Open Market Investment Committee forwarded to the Board copy of a letter with enclosure addressed by him on that date to each member of the Committee as follows:

"There seems no real occasion for a meeting of the Open Market Committee at this time and I am therefore writing this letter to keep the other members of the Committee currently informed as to the latest developments in the money market.

"The renewal of speculation on a wide scale and the renewed increase in the volume of credit in recent weeks appear to have made it undesirable to consider buying securities for the Committee account. Business appears to be getting all the funds necessary at reasonable rates and no emergency situation has developed.

"On September 15, we found it necessary to take over temporarily in our own account $15,000,000 of short-term certificates which a foreign correspondent was selling but for which we could not find a market outside. We have not yet been able to dispose of these securities, nor can we do so in the present condition of the Government securities market. There is almost no market for large blocks of Governments. When the September 12 press statement appeared, we explained to the press that the increase in Governments represented a temporary taking over of securities from one of our agency accounts and not a purchase in the market. This explanation served to avoid a bullish interpretation of the increase.

"We have had a good deal of discussion about the bill market, particularly at our directors meeting on September 13 when Governor Young and Mr. Cunningham were present and raised the question whether the bill rate should not be reduced to attract more bills. In response we prepared a memorandum for our directors meeting last week, a copy of which I enclose. The result was a decision to retain the present rates.

"I am also enclosing a copy of a tabulation we have recently made showing the increase in Federal reserve credit usually required to finance autumn requirements. The most significant figures seem to be the following for the average amount of Federal reserve credit required in the last four months of the past six years:

	Increase in F. R. Credit from August after allowance for gold Movements	Amount Supplied through Bills Purchased	Balance met by Discounts or Securities
	(Millions of Dollars)		
August	0	0	0
September	+ 89	+ 32	+ 57
October	+160	+ 83	+ 77
November	+205	+139	+ 65
December	+322	+181	+141
September 1928 to date	+ 74	+ 31	+ 43

"These figures appear to show that so far this autumn we are following closely the precedent of previous years. If we continue to do so it will only require about 35 million of discounts above the September average to meet October needs, and that increase need not disturb business. The December need due to Christmas currency is so largely temporary that banks are willing to borrow to meet it without increasing the pressure on the money market. Thus the October peak is the one likely to cause the maximum of strain and that should not be severe.

"Moreover, it seems likely that this year we shall get the usual increase in bills. The prospects are for a considerable increase in the volume of bills created and under present money conditions there will probably be few buyers of bills outside the reserve banks to absorb the increase, so that we are likely to get most of the additions to the amount now outstanding. This being the case, it seems reasonable to believe that the seasonal requirements of business will be met without any further substantial firming of commercial money rates although it is always necessary to keep in mind that we may have to buy some short governments to carry out the program indicated above and I think we should be ready to do this on occasion without hesitation or delay.

"I should be glad to hear from you as to the situation in your district and any thoughts or suggestions you may have."

"PROPOSAL FOR DISCRIMINATORY RATES FOR BILLS

"The suggestion has been made that the Federal Reserve System should maintain its buying rate for bankers acceptances this autumn at a lower point than usual relative to other money rates and the discount rate. The objects of this proposal are: first, to encourage the creation of bankers acceptances and thus assist in making credit more readily available for the movement or storage of farm products and other goods at moderate rates; and second, to draw into the Federal Reserve System portfolios a larger than usual amount of acceptances; so that the increased autumn demands for Federal reserve credit may be met in this way rather than by additional borrowing, which would tend to tighten money conditions further. Two possible methods have been suggested of giving effect to this proposal.

"1. That the buying rate for bills be reduced 1/4 per cent from the present point so that 90-day bills would be purchased at 4 1/4 per cent rather than 4 1/2 per cent.

"2. That the present rate of 4 1/2 per cent on 90-day bills be maintained without increase during the autumn, when an increase of about 1/4 of one per cent usually occurs, and that the Reserve System stand ready to buy bills freely. The rate is already lower, relative to other rates, than usual for this time of year.

"Either one of these methods would serve to encourage the creation of bills and to bring a larger volume of bills into the Reserve System than normally.

"It is recommended by the officers that the second proposal be followed, that is, that a 4 1/2 per cent buying rate for 90-day bills be maintained and the Reserve System stand ready to take bills freely as has been done the past few weeks. This proposal seems preferable to lowering the buying rate for bills for the following reasons:

"1. The lowering of the bill rate would attract widespread comment and probably encourage the increase in credit for speculative uses which has been resumed. The psychological effect of such action might be nearly as great as reducing the discount rate or buying securities.

"2. A 4 1/2 per cent rate is low enough, in relation to other rates to attract a large volume of financing into the acceptance market and we understand from dealers and others that with this rate the seasonal increase in bills is likely to be unusually large. It is doubtful whether a lower rate would bring out many additional bills.

"3. It is probable that a 4 1/2 per cent rate will draw into the reserve banks a sufficient amount of bills so that the autumn requirements for Federal reserve credit will be met almost entirely through that channel unless unexpected demands arise."

Letter from Acting Chairman, October 8. Under date of October 8 the following letter was addressed to the Board by the Acting Chairman of the Open Market Investment Committee:

"As stated to you over the telephone this afternoon, we have received cable instructions from one of our foreign correspondents to convert into cash, on Thursday, October 11, 1928, $40,200,000 - 3 1/2% Treasury notes due December 15, 1930-32, and to pay the proceeds into the market.

"In order to consummate this program we have today arranged with the Treasury to sell to them, from the Open Market Investment Account, $30,000,000 3 1/4% certificates due December 15, 1928, delivery to be made as follows:

$15,000,000 - Thursday, October 11, 1928
15,000,000 - Monday, October 15, 1928.

As to the remaining $10,000,000, we are hopeful of being able to dispose of this between now and October 17, so as not to show any increase in the Government security account on our published statement next week. As a matter of fact, we are today temporarily reducing the portfolio of this bank by $2,500,000, being the net amount sold to another foreign correspondent for immediate delivery, which we are planning to replace on Thursday, October 11, by taking over $2,500,000 Treasury notes from the $10,000,000 which we have still to market. (You will be interested to know that the Federal Reserve Bank of St. Louis has today repurchased from the Open Market Investment Account $5,000,000 - Fourth Liberty Loan 4 1/4% bonds which we have been holding temporarily in the account.)

"If we are successful, as we hope to be, in effecting a sale of the remaining $7,500,000 Treasury notes, we will have cleaned up this large order without in any way distorting our picture."

Letter from Acting Chairman, October 10. Under date of October 10 the Acting Chairman addressed the Board as follows:

"We have been keeping current records of the demand for Reserve Bank credit this autumn, and of the manner in which that demand has been met. These records seem to indicate that the policy of supplying autumn credit requirements through bill purchases has so far been entirely successful.

* * *

". . .the average amount of Reserve Bank credit needed in September was practically identical with the average for the past six years, but . . ., even without a reduction in our buying rates, the amount of bills we acquired was 50 per cent larger. Of the remaining increase in Reserve Bank credit, a considerable part took the form of increased holdings of U. S. securities, largely explained by the Treasury overdrafts around the 15th; so that the average amount of member bank borrowing at the Reserve Banks for the month of September was practically the same as in August. This probably was an important factor in preventing a further rise in commercial borrowing rates during September, and the heavy buying of bills undoubtedly was mainly responsible for keeping bill rates low compared with other money rates, and made possible a much larger volume of financing through the bill market than would have been the case otherwise.

"During the first week of October the increase over August in Reserve Bank credit outstanding has been somewhat below the six-year average, and the increase in bill holdings has reached such large proportions as to supply almost the entire amount. The security holdings of the System are somewhat above the August average, and discounts are slightly smaller.

"It appears probable that we shall continue to have a large volume of bills offered to us during October and November and that our bill holdings may increase faster than the demand for Reserve Bank credit. If that is the case, discounts for member banks will tend to decline below the volume of August, and money rates are likely to be easier than in recent weeks. It would not be surprising if the principal effect of this situation were to appear in the call money market."

Discussion by Board. At a meeting of the Board on October 17, 1928, the above letter was further discussed, after having been circulated among the members of the Board, and it was voted to address a letter to the Deputy Governor of the New York Bank advising that members of the Board are not quite clear as to the meaning of the last paragraph of his letter and wish that it could be clarified, stating that one or two members of the Board have so interpreted it as to reach the conclusion that it involved an abandonment of the policy which the System has been following of keeping certain pressure on the money market. It was also voted to enquire as to the position of the directors of the New York Bank in the matter.

At a meeting of the Executive Committee on October 24, 1928, the Governor reported a telephone conversation with the Acting Chairman of the Open Market Investment Committee, during which he was advised that the government bond market is improving and gradual sales have been made of about $24,000,000 of securities which had been taken over from foreign correspondents with the result that by the end of the present week, the system account probably would be back to the figure at which it stood at the end of August. He also reported that the Acting Chairman stated that if an easy moeny situation continued for any length of time, requests will probably be received from other foreign correspondents for the liquidation of their security holdings, but that it is believed the market would absorb them.

Letter from Acting Chairman, October 26. At a meeting of the Board on October 26, 1928, there was noted a letter from the Deputy

Governor of the New York Bank dated October 24, 1928, as follows:

"As I stated to you over the telephone this morning, we are gradually melting down, by direct sales to the market, the remaining $9,000,000 of the total of $23,100,000 of short-term Government securities which we had acquired from one of our foreign correspondents under date of September 8, 1928. Offers now made us for $5,500,000 of these securities have been accepted for delivery and payment October 26, 1928; so that there will remain but $3,500,000 in this account. As you know, it was generally understood that we would temporarily carry these securities only until such time as they might be advantageously disposed of in the market.

"You will be interested to know that the Federal Land & Intermediate Credit Bank has taken up from us and resold to the market a total of $1,550,000 of the $1,750,000 which we had purchased; so that we are now carrying but $200,000 of these debentures due January 15, 1929.

"The situation in the money market seems to be working out much in line with our expectations, as indicated in my letter of two weeks ago. Bill holdings have continued to increase without a corresponding increase in the total demand for Reserve Bank credit, member bank indebtedness has been reduced, and the call money market is temporarily easier.

"It now appears that the average demand for Reserve Bank credit during the month of October will show somewhat less than the usual increase compared with August. Currency requirements have been running about the same as in previous years, but commercial borrowings have not shown so large an increase as usual, possibly due to the relatively high level of such borrowings during the summer. At the present time the total amount of Reserve Bank credit outstanding is running somewhat over $100,000,000 higher than the August average, and the peak of seasonal requirements, until the holidays, appears to have passed.

"Bill holdings, however, are now more than $200,000,000 higher than the average for August, and the average for the month of October will show a larger increase than in any previous year. Consequently member bank borrowings have declined to the lowest average level since May, both in New York City and for the country as a whole.

"A comparison of the increase in our bill holdings with the increase in bills outstanding indicates that we have acquired all of the new bills that have been created and more, too. The additional bills we have purchased have come largely from foreign holdings, and there is at least a possibility that some of the proceeds have gone into 'the street.'

"While the demand for loans for speculative purposes shows no sign of abating, it is encouraging to note that member banks in the main are using the additional funds they are receiving, to repay indebtedness rather than to increase their loans. The continued increase in brokers loans placed by New York City banks has not in any degree represented an increase in the loans for their own account. A part has been for the account of out-of-town banks, which, of course, is in part for the account of others, and most of the remainder has been for the account of customers of New York banks.

"The total volume of member bank credit, which we have been inclined to accept as the criterion for our policy, has shown comparatively little increase recently, especially after allowance for the effect of purchases of New Treasury issues in September and October. However, the prospect seems to be for comfortable conditions in the call money market until December, except for the usual month-end tightening, and it seems likely that after the first of the year member bank indebtedness will be considerably below a billion dollars and money conditions will be easier still. In view of this situation, the figures on member bank credit will need close watching."

Letter from Acting Chairman, October 26. Under date of October 26, 1928, the Deputy Governor of the Federal Reserve Bank of New York replied to the Board's inquiry regarding his letter of October 10, as follows:

"Replying to your letter of yesterday, and confirming our conversation over the 'phone today, your interpretation of the final paragraph in my letter of October 10 states exactly what I had in mind.

"It seemed probable then that the increase in our bill holdings would not be accompanied by a corresponding increase in the demand for Reserve Bank credit, with the result that member bank indebtedness would be reduced. As the call money market is always first to reflect any such change, it seemed likely that call money rates would ease somewhat and that, as you have indicated, this would have a tendency to relieve the pressure on speculative credit.

"The easier tendency in call money did develop, but there has been an apparent reversal during the last day or two. There seems to be no explanation in member bank indebtedness for the 8 per cent money of yesterday and today. The best explanation we have been able to hit upon is that there has been an active demand for new loans, and, as there appears to have been no corresponding increase in the supply from other sources, the New York City banks have had to provide most of the additional funds and have been willing to do so only at a fairly stiff price. Under present conditions, however, it hardly seems to us that an 8 per cent rate can be maintained more than temporarily."

(Secretary's note - On October 10th the Open Market Investment Account was back to the figure of 75,000,000, at which it stood at the time of the last meeting of the Open Market Investment Committee, and no change in the account was made up to the time of the next meeting of the Committee on November 13th. However, bills bought in the open market had increased from about 190,000,000 to 332,000,000 and continued to further increase until on November 13th they amounted to about 450,000,000.)

Meeting of November 13-16, 1928.

Preliminary Memorandum of Acting Chairman. On November 13, 1928, while the Governors' Conference was in session, the Open Market Investment Committee met and considered the attached preliminary memo.

"In the summer of 1927 the Federal Reserve System adopted a policy favoring easier money conditions, given effect by the purchase of a moderate amount of Government securities and a reduction in discount rates from 4 per cent to 3 1/2 per cent. The primary purposes of this policy were: first, to avoid a continued gold import and a serious stringency in world money markets, which might have delayed world financial recovery and reacted adversely upon world trade and the trade of this country; and second, to cushion, as far as it could be done by easy money, the business recession which was beginning in this country. When this policy was adopted, it was recognized that there was danger of stimulating excessive use of credit in speculation.

"In general, the results desired from this policy came to pass. Foreign exchanges which in several cases had been close to the levels at which gold would tend to flow to this country were almost immediately strengthened, stringency in world money markets was thus avoided, and our foreign trade was maintained at high levels. In fact the gold and the dollar exchange which other countries acquired in the summer and autumn of 1927 placed them in a position of such strength that they have since that time been less dependent upon conditions in this country. Although the recession in business activity continued until the end of the year and there was some unemployment during the winter, the recession was not serious and was followed by a quick recovery which was probably aided by easy money.

"Gold Outflow.

"The strengthening of the exchanges proceeded to such an extent that in the autumn of 1927 gold began to move from New York on exchange transactions. These exports were in addition to a large movement of gold to France in connection with that country's preparations for the return to the gold standard, a movement which would probably have taken place regardless of the exchange position. Altogether net gold exports totaled over $500,000,000, an unexpectedly large amount.

"During the early part of this gold outflow the policy of buying Government securities to prevent a tightening of the market was adopted. Additional securities were purchased also to offset sales in August and September of sterling which had been acquired earlier in the year by a sale of gold. As the autumn advanced, however, it became evident that credit was expanding more rapidly than the country's business required. To meet this situation and in view of the fact that the purposes of the easy money policy adopted earlier had been largely accomplished, the purchase of securities was discontinued in November, although the gold movement continued. In January the Reserve Banks began selling securities, a procedure the necessity of which had been forecast in the Open Market Committee report to the Governors' Conference in October. The effect of these sales, together with gold exports, was to lessen the seasonal liquidation of member bank borrowings and largely to prevent the usual softening of money rates in January.

"Effects of Security Sales and Discount Rate Advances.

"The sales of securities were followed in February by a general advance in discount rates, which with later advances are shown in the accompanying schedule of discount rates of the different Reserve Banks. For a time speculative activity subsided somewhat, and reporting member bank loans and investments decreased moderately in January and February. However, a new outburst of speculation on a larger scale than ever before occurred in March and April, which led to a renewed and more rapid increase in bank credit. Within a period of ten weeks the loans and investments of reporting member banks increased a billion dollars, an increase nearly equal to a full year's growth under ordinary circumstances.

"The sale of securities from the System Special Investment Account was resumed in the latter part of March and continued more rapidly in April, although the market for governments was so weak that it was difficult to sell such securities. As securities were sold open market money rates advanced. But as a consequence funds were attracted from other districts, and there was increased discounting at the Reserve Banks in those districts. This flow of funds to New York largely offset the effect of security sales in New York, so that the indebtedness of New York City banks showed for some time no material increase. Moreover, as money became tighter, the general distribution of bills was retarded and the Federal Reserve portfolio declined less than usual at this season. In this situation, funds coming into the money market from sources outside of New York were supplemented by a substantial increase in the loans of New York City banks for their own account.

"It was not until the second advance in Reserve Bank discount rates was made effective in the latter part of April and in May that expansion of credit was halted. Except for a temporary rapid increase early in July which was followed by a further rise in discount rates in all but four western districts, the loans and investments of New York City banks tended to decline from May to August, and in other districts the expansion was checked.

"Although the activity of the security markets has again increased to new high levels during the past two months, and prices have advanced higher than ever before, a considerable part of the required credit has been obtained from sources other than member banks and the total loans and investments of the weekly reporting banks have remained below the May levels. The increase in brokers loans for account of others represents, however, a potential expansion of bank credit because the banks would be obliged to take over loans called suddenly by the other lenders.

"Autumn Credit Requirements.

"As the season of autumn currency and credit requirements approached it was recognized that the steady rise in money rates, which had followed the gold outflow and Reserve Bank sales of securities and rate advances, constituted a danger to the business of the country if it proceeded much further.

* * *

"While the largest advances had occurred in rates on 'street loans,' the advances in commercial rates had been substantial and the tendency was toward still higher rates. It was pointed out at the July meeting of the committee that high commercial money rates in past years had been followed frequently by a recession in business activity after an interval of six months to a year, attributable mainly to the curtailment of building activity and to the partial stoppage of new capital for business enterprises.

"To prevent money conditions from becoming more stringent during the season of autmn trade and crop moving, the purchase of Government securities was considered but it was felt that such action would be followed immediately by a new outburst of speculative demand for additional credit which might absorb the credit extended for business uses. It was finally decided that the policy of maintaining bill rates at their current levels and purchasing freely bills offered by banks and dealers would probably put into the market sufficient Federal Reserve funds to meet autumn credit needs, thus preventing a further rise in commercial money rates.

"Effects of 1928 Bill Purchases.

"Due to an extraordinarily large volume of bills in the market and the presence of few other buyers of bills because of the low level of acceptance rates relative to other open market money rates, the volume of acceptances offered to the Reserve Banks for purchase has been much larger than in any previous year and has exceeded the seasonal increase in the demand for Federal Reserve credit, thus tending to cause a reduction of about 100 million dollars in member bank indebtedness and some easing in money rates at a time when the demand for credit for speculative use is as strong as ever before.

"Unless conditions change it seems probable that money rates will continue at present levels, with call money between 6 and 7 per cent, for a few weeks before the holiday currency requirements are encountered. Further, it seems likely, if present tendencies continue and if the bill portfolio continues large, that the total indebtedness of member banks after the return of currency from circulation in January will be reduced temporarily to 750 million or less, and the indebtedness of New York City banks may be reduced to an extent that would be an incentive to expansion of loans by these banks.

"Credit Policy.

"Methods which the Reserve Banks may well consider to avoid too easy money are: an increase in bill buying rates, the sale of securities, and dealing directly with member banks.

"The question, therefore, to which the open market committee should give consideration is whether sales of Government securities should be made either immediately or after the first of the year, if it seems wise to continue the policy pursued in recent months.

"The Three Major Factors.

"As bearing upon the question of continuing the present policy directed toward high money rates, especially for speculative use, the outcome of the present situation would appear to depend mainly on three factors and on the timing of these factors:

1. Culmination of expansion of credit for stock speculation.
2. Effect of present money rates on the volume of business.
3. Effect of present money rates on world money rates and world trade.

"1. As far as stock speculation is concerned, it is, of course, impossible to set a date when the present movement will culminate. It is impossible to pass judgment now upon the extent to which the recent movement is upon a sound economic basis and the extent to which it represents boom psychology. The question can only be settled by time and the test of high interest rates.

"2. Although rates on commercial loans are 1 1/4 to 1 1/2 per cent higher than a year ago, and higher rates usually react upon business, there is as yet no evidence that these rates or the condition of the money market have been found prohibitive to the issuance of all necessary short-term credit for agricultural and business purposes. Industrial activity showed a rapid recovery early in the year and has since maintained a high level, and commodity prices have risen moderately. The higher money rates have caused a substantial decline in the flotation of long-term bond issues, but domestic corporations have continued to obtain large amounts of new capital, as conditions have been favorable to obtaining larger amounts through stock issues than in any previous year. . . .

"3. Present money rates have plainly had a depressing effect on foreign exchanges and have retarded the flotations of foreign securities in the market. A relatively small return flow of gold to this country has occurred during the past two months, and some of the European exchanges have required support to prevent larger gold shipments. Nearly all countries are in a much better position than a year ago to protect their exchanges, but present money rates in this country, if long continued, would probably force higher rate levels in other markets. . . .

"This consideration of major factors affecting policy may be summarized by saying that there does not appear recently to have been any change in the situation which would suggest the desirability of discontinuing the policy pursued since the early part of 1928."

Action of Committee. The following is quoted from the Committee's minutes of that meeting:

"The secretary distributed to each member of the committee present a copy of the formal report of the secretary of the committee dated November 12, together with a copy of the preliminary memorandum dated November 14. After reading and discussing these documents and reviewing credit conditions generally, the committee decided informally that it would be advisable to renew the recommendation contained in the last report of the committee on August 13, 1928, that it should be authorized to purchase government securities if and when that might become necessary in order to avoid an acute credit stringency. It was understood by the committee, however, that it would defer preparation of a formal report and recommendation until after another opportunity for a meeting at which Governor McDougal could be present.

"Before adjournment, the committee discussed the matter of a possible adjustment of buying rates for bankers acceptances. While it was realized by the committee that it has no formal jurisdiction over the matter of bill rates, which are subject to adjustment by individual reserve banks as provided in the law, nevertheless each governor present expressed the opinion that it might be advisable for the Federal Reserve Bank of New York to increase its buying rates for bills of all maturities by 1/8 of 1% in the near future."

On November 15, at another meeting of the Committee, the following report was adopted:

"The Committee has reviewed the preliminary memorandum submitted by the Chairman in relation to credit and money market conditions of the past year. It has given special consideration to the development of conditions since the last report of the Committee on August 13th and to the effect of Federal Reserve policies on the volume of credit and the rates for money during the period of credit movement whose peak has probably now passed. The Committee feels that the policy of the System has been substantially effective in providing credit for seasonal agricultural and commercial purposes at relatively low rates and without any abnormal increase in the total volume of member bank loans and investments for this period of the year.

"The Committee is of the opinion, however, that it should still be the policy of the System, if possible, to prevent any unduly rapid or unnecessary further increase in the total volume of bank credit, although in fact the total loans and investments of all reporting member banks are now slightly below the high point of May in spite of the usual Fall increase in the demand for credit for crop movement purposes. But we are approaching the usual seasonal demand for currency for holiday purposes. This will result in increased borrowings from the Federal Reserve Banks except to the extent that further gold imports offset the demand for Federal Reserve accommodation. It is not possible to estimate the extent of the present gold movement or its ultimate effect upon credit conditions and money rates. Already there is some evidence of easier money rates contributed to partly by the inflow of gold and partly by the large increase in the bill portfolio of the Federal Reserve Banks, each of which has caused a reduction of member bank discounts in the New York district. Some of this increase in the bill portfolio is due to the sale of bills by foreign banks to support their exchanges, which have felt the pressure of high rates in this country.

"But while these conditions appear to have an easier tendency at the moment, nevertheless the uncertainty of the gold movement, the approaching demand for currency, and the usual demand for Federal Reserve credit during December suggest to the Committee that the System should still be prepared in the event of an emergency to prevent any undue stringency of credit during this period.

"With all these facts in mind, the Committee renews the recommendation contained in its report of August 13th that it should be the policy of the System to purchase Government securities if and when it might become necessary to avoid an acute credit stringency.

"The Committee would expect to take such steps as may be needed to carry out this policy, if approved, with the understanding however that it would be advisable to have another meeting of the Committee in the event that any substantial change on conditions makes that necessary."

The Committee submitted the report to the Conference of Governors on November 15 and it was accepted as the recommendation of the Conference to the Board. The following is quoted from the Committee's minutes of that meeting:

"In connection with the consideration of the report, there was an informal discussion of the matter of buying rates for bankers' acceptances, and while no formal action was taken, it appeared to be the general sentiment of the conference that it might be advantageous soon to increase the buying rates for bills, especially in view of the expansion of the bill portfolio since September in relation to the net increase in the total volume of Federal reserve credit outstanding."

The Board met with the Open Market Investment Committee and the Governors of the Federal Reserve Banks on November 16, at which meeting the report and recommendations of the Committee were submitted and discussed. In response to an inquiry by the Governor, the Board was advised that under conditions as they existed, it was not believed by the Committee that any change in the Open Market Investment account should be made in the near future.

Discussions of Open Market Operations and Related Developments, Mid-November-December 1928.

Communications on Taking Over Securities from Bank of England.

At a later meeting of the Board on November 19, the Governor reported that he was advised over the telephone from the Federal Reserve Bank of New York that the question of an increase in the bill rates of the bank was discussed at considerable length at a meeting of the directors the day before with the result that any increase was disapproved. He stated that he was also advised that inquiry was made several days ago by the Bank of England as to the condition of the government bond market and that a cablegram had been received requesting the Federal Reserve Bank to take over about $40,000,000 of securities the first of next week. Simultaneously, he stated, a cablegram was received from the Bank of France, advising that it would want earmarked $100,000,000 of gold over a period of the next three or four months. He stated that the Deputy Governor of the New York bank advised him that there did not appear to be anything the bank could do except to take over the securities offered by the Bank of England, which would put $40,000,000 in the market temporarily. He stated, however, that the bank might negotiate with the Bank of France with the idea of having that institution take over $40,000,000 of bills prior to its gold earmarking transaction, in which event, the Federal Reserve Bank could then determine whether or not it wished to sell the securities taken over from the Bank of England.

A letter dated November 19, from the Deputy Governor of the Federal Reserve Bank of New York, confirming the telephone conversation reported by the Governor at a meeting on that date follows:

"Confirming our conversation by telephone this afternoon concerning the block of $38,800,000 of U. S. Treasury 3 1/2% notes due

March 15, 1930-32, which amount we are taking over from one of our foreign correspondents under date of today and tomorrow, I have this afternoon sent the following two telegrams to the governors of the other Federal reserve banks, with the exception of Kansas City which is not participating in the account: 'Purchase has been made from a foreign correspondent of $38,800,000 par value 3 1/2 per cent Treasury notes March 1930-32 at 97 28/32 net and interest being market price quoted Friday November 16. These notes will be taken over temporarily in open market investment account $18,800,000 today and $20,000,000 tomorrow. Have made sales therefrom to market of $15,800,000 at 98 net and interest delivery on or before November 21. Any profit that may accrue from sale of these notes will be held in New York Suspense Account temporarily pending final consummation of the entire transaction. You will receive advice through regular channels of all details. CASE.'

"'Supplementing my telegram of today have sold to market from Open Market Account, delivery tomorrow, $5,000,000 par value December 15, 1930-32 Treasury notes at 98 2/32 net and interest regular advices of which will be sent you. CASE.'

"The foregoing will, I think, give you a complete picture of the transaction. We are hoping it may be possible to make further sales from this account between now and the close of business Wednesday, November 21, 1928. In any event we shall be glad to keep you informed concerning the matter."

On the following day, November 20, a supplementary letter, as quoted below, was addressed to the Board by the Deputy Governor of the New York Bank:

"Supplementing my letter of November 19, reporting the purchase from a foreign correspondent of $38,800,000 U. S. Treasury 3 1/2% notes, for Open Market Investment Account, and the subsequent sales, against this purchase, of a total of $20,800,000, this is to inform you that we have today made a further sale of $10,000,000 of the March 15, 1930-32 notes, for delivery tomorrow, on precisely the same basis as reported to you yesterday. This $10,000,000 sale now makes the aggregate of offsetting sales, $30,800,000.

"Since the close of business last Wednesday our sales contracts have been reduced by approximately $3,500,000, so that the net of the week's operations will be to show but a small increase of between $4,000,000 and $5,000,000 in the System's holdings of Government securities. We anticipate that during next week we may be able to sell to the market the $8,000,000 overage of these notes remaining in the Open Market Investment Account.

"The foregoing seems to us a fairly satisfactory disposition of the matter."

Letter from New York Bank on Authorization to Purchase Securities. In connection with the report and recommendations of the Open Market Investment Committee, there is quoted below a letter addressed to the Board under date of November 23 by the Chairman of the Board of Directors of the Federal Reserve Bank of New York:

"As you perhaps know, Mr. Miller attended the meeting of our board of directors yesterday when the recent report of the Open Market Investment Committee was presented to the board for their approval. After a discussion of the report, in which reference was made to the action which the board of directors have taken each week since the adoption of the August report of the Open Market Investment Committee, Mr. Miller suggested that it might be interesting to the Federal Reserve Board to have a copy of the weekly resolution passed by our directors authorizing the officers to participate in the purchase of securities for the account of the System.

"As you will remember, the report of the committee in August recommended that it should be the policy of the System to purchase government securities if it should become necessary in order to avoid undue credit stringency. When this report was presented to our directors, they took one vote approving the policy recommended by the committee, and approved by the Federal Reserve Board, and then, in order that the officers might have authority to participate in the purchase of securities taken for account of the System between meetings of the directors, the following resolution was adopted each week:

"'VOTED to authorize the officers to participate in the purchase in the market of government securities up to $25,000,000 for the Open Market Investment Account if it were deemed necessary by the officers to do so prior to the next meeting of the board of directors in order to carry out the policy recommended at the last meeting of the Open Market Investment Committee, with the understanding, however, that before exercising this authority the officers would consult with at least two of the directors.'

"As the resolution itself implies, our directors felt that as long as the System policy was to purchase securities, in the event of a possible emergency, the officers should be free to act instantly in the event of such an emergency, even between meetings of our board and executive committee. Appreciating, however, the importance of determining the emergency which should justify the purchase of securities, as recommended in the report of the committee, our directors felt that, before exercising the authority given to the officers, at least two of the directors should be consulted. The resolution quoted above is an exact copy of the one approved at each meeting of our directors between the August and November meetings of the Open Market Investment Committee.

"You may also be interested to know that at the meeting of our board, yesterday, Mr. Case presented the report of the Open Market Investment Committee dated November 15, which was read by the secretary, and which embodied the recommendations of the committee adopted at its meeting in Washington last week. Our board duly voted to approve the report recommending the System policy, with the understanding, as explained by the officers, that the report contemplated the purchase of government securities only in the event of an emergency. After action was taken upon the report, the directors then passed a resolution similar to the one quoted above, giving specific authority to the officers to participate in the purchase of government securities up to $25,000,000, if deemed necessary by the officers to do so, prior to the next meeting of the board, in order to carry out the policy recommended in the report. It was understood in this vote, as in the ones which have been passed each week, that before exercising this authority the officers would consult with at least two of the directors."

Letter from Board on Committee Report. The report and recommendations of the Open Market Investment Committee were taken up by the Board at its meeting on November 27, 1928, and the following letter to the Acting Chairman of the Committee was unanimously approved:

"The Federal Reserve Board has had under review the preliminary memorandum of the Open Market Investment Committee dated November 14, 1928, together with the report of the Committee dated November 15, 1928. It is pointed out in both reports that there are many undetermined factors in the present credit situation and the Board is in agreement with the conclusions of the Committee that for the present at least the policy should be one of 'marking time".

"The Board further observes that the Committee suggests the System should be prepared, in the event of an emergency, to prevent any undue stringency of credit, and that it should be the policy of the System to purchase Government securities if and when it might become necessary to avoid such credit stringency.

"If the Board approves this recommendation it will give approval to a policy of buying an indefinite amount of Government securities. It does not care to give this approval for three reasons:

"1. It would not be in harmony with expressions and actions already taken by certain reserve banks.

"2. It is not prepared at this time to say definitely that an emergency should be handled by the purchase of Government securities, or whether other avenues should be resorted to.

"3. It believes that if any real emergency develops in the country, it might be advisable to have another meeting of the committee.

"During the interim, however, adjustments of temporary credit situations, which would not be in the nature of serious emergencies, may be advisable and the Board will hold itself in readiness to act promptly upon written or telephone request from the Committee in an amount not to exceed $25,000,000."

On November 28, 1928, the Deputy Governor of the Federal Reserve Bank of New York reported that sales from the Open Market Investment Account had been made aggregating a total of $38,800,000, being the exact amount acquired on November 19 and 20th from the Bank of England.

Letter from Acting Chairman to Board, December 18. Under date of December 18, the following letter was addressed to the Board by the Deputy Governor of the New York Bank:

"As there has been a considerable number of transactions in the Open Market Investment Account from December 3, 1928, to and including December 17, 1928, it occurs to us that you may be interested in reviewing the enclosed memorandum (copy of which is being forwarded today to the governor of each of the other eleven Federal reserve banks) showing the replacements which were necessary in order to take care of the $10,000,000 of U. S. Treasury certificates maturing December 15, 1928, and the sales to foreign correspondents of $32,420,000 March 15, 1929 U. S. Treasury certificates."

"MEMORANDUM IN RE OPEN MARKET INVESTMENT ACCOUNT
December 3, 1928, to and including December 17, 1928.

"On December 3, 1928, the total holdings in the Open Market Investment Account were $75,488,300, a figure at which the account had been maintained for some months but which statistically was well below the average of recent years.

"Immediately prior to each quarterly tax period we are confronted with the problem of dealing with current maturities and with the necessity for supplying our foreign correspondents with United States Government securities of their own selection to replace their current maturities. In this particular instance both of these transactions involved the acquisition of other short-term Government paper.

"On December 3, 1928, we owned $10,000,000 of the maturing December 15 certificates and were requested to supply foreign correspondents with about $33,000,000 of March 1929 certificates. . . A classification of issues held at the close of business December 17, 1928, follows:

3 3/8%	C/I	due	March 15, 1929	$8,091,000
3 7/8%	"	"	March 15, 1929	6,993,000
4 1/2%	"	"	June 15, 1929	6,582,000
4 1/4%	"	"	Sept. 15, 1929	2,500,000
4 1/4%	"	"	Dec. 15, 1929	16,125,000
3 1/2%	T/N	"	March 15, 1932	5,000,000
3 1/2%	"	"	Dec. 15, 1932	30,300,800
				$75,591,800

* * *

Board Discussion of Interest Rate Developments. As a result of the usual year end demands, the total bills and securities of the Federal Reserve System at the beginning of 1929 (January 2), amounted to $1,890,000,000, consisting of $244,000,000 of government securities, $76,000,000 of which were in the Open Market Investment Account, $484,000,000 of acceptances and $1,151,000,000 of rediscounts.

At a meeting of the Board on December 31, 1928, there was discussion with respect to the advisability of an increase in the rates of the Federal Reserve banks for purchases of acceptances, the market rates having hardened during the month. It was pointed out that an increase in bill rates would undoubtedly result in a further stiffening of call rates which would furnish an added incentive to member banks to carry call loans rather than to employ the proceeds of the end of the year return flow of currency to the liquidation of indebtedness at the Federal reserve banks. The discussion touched upon the procedure followed at some of the Federal Reserve banks in seeking to restrain member banks from rediscounting for the purpose of making or maintaining loans on call, and the desirability of some suitable procedure to accomplish this purpose being worked out and applied at other Reserve banks. The following resolution was adopted:

"It is the opinion of the Federal Reserve Board that the spread between the rediscount rates of the Federal reserve banks and rates for stock exchange loans (both call and time) is such as to offer a temptation to member banks to use Federal Reserve credit facilities for the purpose of making or sustaining such loans, and that, therefore, steps should be taken by the Board to ascertain what the Federal Reserve banks are doing or propose to do to prevent the improper use of Federal Reserve credit facilities by their member banks."

At the same meeting it was voted that the next meeting of the Open Market Investment Committee be held on January 7, 1929, the date suggested by the Acting Chairman of the Committee.