REPORT OF THE OPEN MARKET INVESTMENT COMMITTEE TO THE GOVERNORS' CONFERENCE, March 22, 1926.

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. As the accompanying table of the earning assets of the System shows, 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.

EARNING ASSETS - FEDERAL RESERVE SYSTEM
(In millions of dollars)

	1922 Mar. 8-	1923 Mar.7-	1924 Mar.12-	1925 Mar.11-	1926 Mar.10
Discounts					
New York (City)	14	149	53	149	103
Chicago (City)	3	22	7	2	17
Other	614	400	423	259	382
Total	631	571	483	410	502
Bankers Acceptances	102	219	243	301	285
U.S. Securities-Committee	-	-	140	275	245
U.S. Securities-Other	444	345	72	113	115
Other Earnings Assets	-	-	-	15	12
Total	1,177	1,135	938	1,114	1,159

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.

The accompanying chart shows the amount of borrowing of New York City banks by weeks during the past four years. It shows borrowings to be large during 1923, when, as we all know, there was some pressure for liquidation. Allowing for the seasonal increase and decrease in December 1923 and January 1924 borrowings were very small during 1924 and we recall that during the balance of that year while there was considerable instability in money conditions, it was accompanied by a gradual revival of business over 1923. In 1925 borrowings were sufficiently high during parts of the year to place some pressure on the New York City banks. It was in this stage that rate advances were made. 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.

March 19, 1926.