On January 17, 1951, the Federal Reserve increased margin requirements on stocks from 50 percent to 75 percent. This increase was made during a period in which all agencies of Government were moving forward rapidly with anti-inflationary actions. It was one of a series of measures put into operation between July 1950 and the succeeding March to cope with the tremendous inflationary upsurge that was taking place in our economy.

Moves to meet the inflationary danger were first made, it is recalled, immediately after the Korean outbreak. A wide range of action was taken. Taxes were increased; the Defense Production Act was passed; priorities and allocations were established; export controls were invoked; and consumer credit and housing credit controls were imposed. These measures -- substantial as they were -- were not able, however, to cope with the renewed inflationary movement which followed the entrance of the Chinese into the Korean conflict. Accordingly, additional steps of importance were taken. A national emergency was declared, and mandatory price and wage controls were imposed. In addition, member bank reserve requirements were increased; limitations on loans for new construction were tightened; and a voluntary credit control program covering the major classes of lending institutions was organized. In addition, the margin requirements for stocks were raised.

The increase in margin requirements by the Federal Reserve in January 1951 was thus not an isolated action. It took place at a time when a variety of measures were being brought to bear on the inflation problem. It took place at a time when stopping inflation was one of the foremost problems on the national scene; at a time when every measure -- of either major importance or of minor importance, as far as inflation was concerned -- was being called into play.

The situation has changed, however, since early 1951. The inflationary upsurge which existed at that time has died down. The defense program has progressed continually. Many control measures have been relaxed in greater or lesser degree. Some measures of control have been discontinued altogether. The question that presents itself, therefore, is whether, under the circumstances, the increase in margin requirements which was promulgated in 1951 should be eliminated -- whether the margin requirements should be cut back from the present 75 percent to the 50 percent existing
for the year prior to Korea. (As may be noted in Table I attached, a figure of 50 percent or less existed also during the 8-year period from November 1, 1937, to July 4, 1945. Higher figures existed between July 1945 and March 1949 when the Government was engaged in its pre-Korean anti-inflationary program.)

An examination of the arguments pro and con makes it clear, however, that it is difficult to make a completely persuasive case either way with respect to relaxing margin requirements. On the one hand, it may be said that margin requirements should be cut back to 50 percent because

(a) the inflationary upsurge is no longer a problem;

(b) other controls have been relaxed or eliminated;

(c) the volume of stock market credit (see Table II attached) is lower now than in early 1951, notwithstanding the fact that prices (see Table III attached) are considerably higher;

(d) the volume of stock-market trading (see Table IV attached) has been at the lowest point since Korea in recent months— in fact, off about 40 percent from the level immediately prior to Korea; and

(e) stock prices themselves are not out of line with the earnings and dividends outlook for listed companies.

On the other hand, it may be said that margin requirements should be continued in force at the 75 percent level because

(a) a renewal of inflationary pressures is a constant danger when the Government is running a large defense program and a substantial deficit (the Federal Reserve's present monetary action is certainly based on this view);

(b) the relaxation of controls at this time may be interpreted as an invitation to the public to speculate in the stock market;

(c) the volume of stock market credit has been growing in the past year— even though it is still a little lower now than in early 1951— and is now very nearly back to the peak reached in January 1951; and

(d) the 75 percent margin requirement has not interfered with new capital investment in the economy— which is running at near-peak levels— because of the large amount of liquid assets which are distributed widely throughout the country, the large volume of personal savings each year, and the large volume of current earnings which are being reinvested each year by business and industry.
It is difficult to choose between the pros and the cons. Some of them are of considerable importance to people in the investment industry. But, from the point of view of the economy as a whole, however, they are of lesser importance. It is clear, however, that the situation today is strikingly different from that of January 1951. At that time the Federal Reserve Board noted, in voting on Regulations T and U to increase margin requirements, that

"Although the total amount of credit in use in the stock market had not assumed heavy proportions, there had been some increase during the preceding several months, together with increases in the volume of trading and in prices of securities. The expanding business and economic situation appeared to be encouraging stock market activity and speculation, and the Board of Governors believed that in the existing circumstances a further substantial price advance supported by a rapid expansion of stock market credit was a distinct possibility. The increase in margin requirements was effected as a preventive measure and as a supplement to the steps previously taken in the credit and monetary area to lessen inflationary pressures."

The situation described in the foregoing paragraph does not obtain today. On this basis alone, therefore, a case can be made for reducing margin requirements to the 1951 level, with the intention of raising them again some time in the future if the inflationary situation should warrant.

Attachments