

POLICY GOVERNING OPEN MARKET PURCHASES BY FEDERAL RESERVE BANKS
AND THE ADMINISTRATION THEREOF AS APPROVED BY THE OPEN MARKET
INVESTMENT COMMITTEE, APRIL 13, 1923

At the recent conference between the Federal Reserve Board and the Governors of the Federal reserve banks, the following principles with respect to open market investment operations of the Federal reserve banks were agreed upon:

"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.

"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.

"In order to provide for the proper administration of the policy defined above, the Board rules 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Committee of Governors on Centralized Execution of Purchases and Sales of Government Securities be discontinued, and be superseded by a new committee known as the Open Market Investment Committee for the Federal Reserve System, said committee to consist of five representatives from the Federal 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."

The foregoing memorandum with respect to Open Market Operations of the Federal reserve banks was referred by the Conference to the Open Market Investment Committee and the Committee submits the following as a basis for the carrying out of the policies agreed upon.

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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 minute 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, 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 to both 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 yield 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.

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