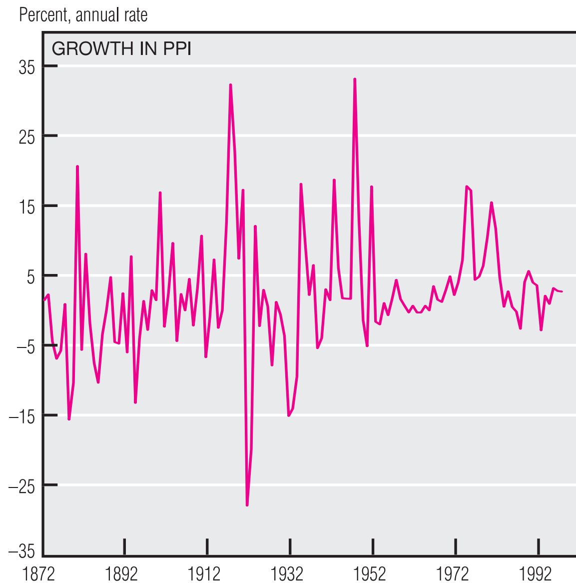
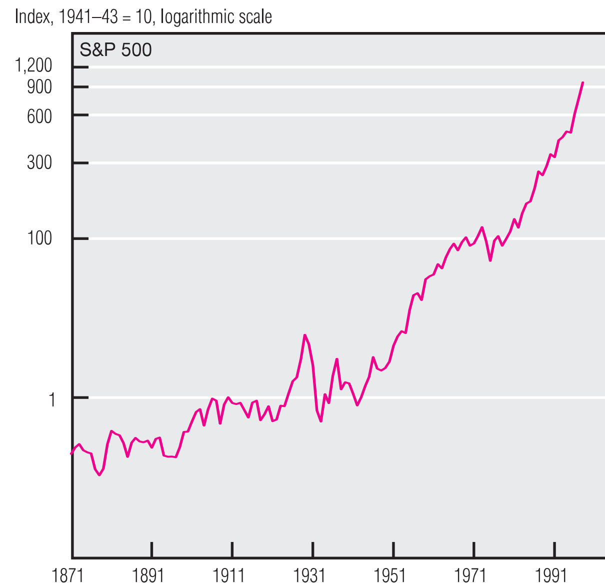
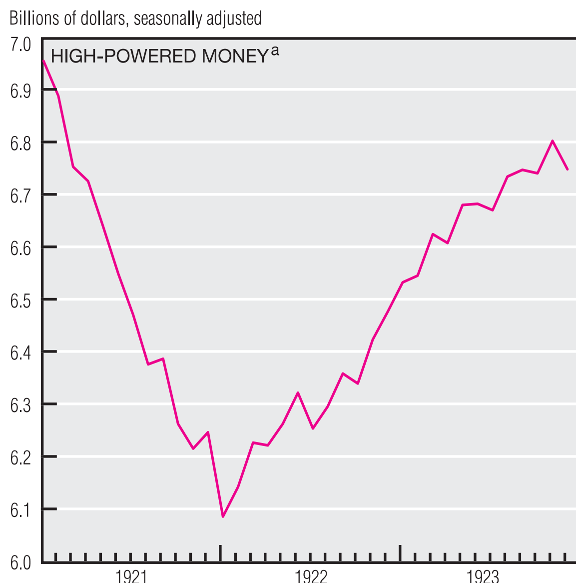
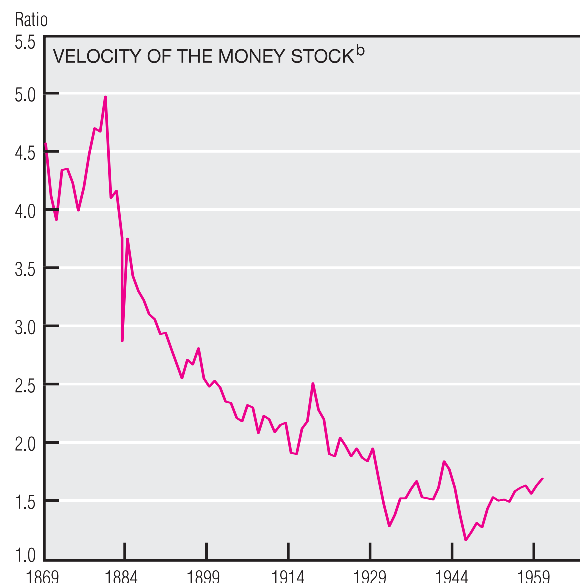
Monetary Policy, 1923









a. Currency held by the public plus bank vault cash.
b. Money income divided by money stock (currency plus demand deposits).
SOURCE: Robert Shiller, *Market Volatility*. Cambridge, MA: MIT Press, 1989; Standard and Poors *Security Price Index Record*; and Milton Friedman and Anna Schwartz, *A Monetary History of the United States 1867–1960*. Princeton, N.J.: Princeton University Press, 1963, pp. 774–802.

In 1923, the staff of the Federal Reserve Bank of Cleveland moved into a newly dedicated building with fresh responsibilities, for in the spring of that year the Federal Reserve Board had officially recognized the Banks' Open Market Committee. For the first time, Reserve Bank officials had a forum in which they could collectively exert a definite, conscious influence on economic developments. The tactics by which the Committee could affect credit conditions had only recently been developed.

The celebrated economist Irving Fisher later recounted how these powers were accidentally discovered: In an effort to increase earning assets in the early 1920s, the 12 Reserve Banks began to purchase government securities in the open market. To their surprise, profits declined. They soon realized that these purchases lowered the volume of rediscounting and increased the level of member bank deposits, depressing Reserve Bank income by more than the income earned on purchased securities. Most importantly, they recognized that the consequence of increased reserve deposits was an expansion in credit.

The strategy of policy then sought to mitigate the inflationary effects of excessive gold imports. Milton Friedman and Anna Schwartz noted, in their *Monetary History of the United States, 1867–1960,* that great emphasis was placed on the distinction between "productive" and "speculative" uses of credit. There was concern that credit expansion might finance a "speculative accumulation of commodity stocks, which in turn would produce a disequilibrium between production and consumption and subsequently a contraction in prices and economic activity."