

Do Margin Adjustments Have An Effect on Stock Prices?

During the first quarter of 2000, Federal Reserve Chairman Alan Greenspan defended the central bank's decision not to adjust margin requirements by repeatedly asserting that margin adjustments do not affect stock prices.

Greenspan has cited no specific authority for his claims and several factors complicate a reading of the historical record. The available evidence is old, since the Fed hasn't changed margin requirements since 1974. Most observers assume that margin limits have a stronger impact on volatile small-cap stocks, for which 50- and 60-year-old data are not readily available. And the Fed has only raised margin requirements 13 times since passage of the Securities Acts in the 1930s – 14 times if you count the initial implementation – so there's unlikely to be statistically convincing evidence one way or the other.

Nevertheless, a historical review of stock prices suggests that, more often than not, changes in the margin requirements *have* had the intended effect on the Standard & Poor's Composite Index, a broad group of stocks.

To assess these changes, the Financial Markets Center compared the growth rates of the S&P Composite Index for similar periods before and after each adjustment in the margin requirement. As Table 1 shows, **the growth in stock prices tended to slow down after a margin requirement hike (tightening) and pick up after a margin requirement cut (loosening) during the 3-month, 6-month and 12-month periods after margin adjustments.** Only the 1-month results were mixed: loosening had the predicted effect, but tightening appeared ineffective in the short-run.

Table 1. Average Growth Rates Before and After Changes in the Margin Requirement

	1 month before	1 month after	3 months before	3 months after	6 months before	6 months after	12 mos. before	12 mos. after
Tightening	1.71%	2.79%	6.82%	5.37%	11.39%	10.03%	23.74%	19.24%
Loosening	-0.53%	1.18%	-1.13%	0.50%	-3.33%	2.67%	3.14%	5.69%

The charts on the following pages graph the movement of the S&P Index before and after each of the margin requirement hikes the Fed engineered between 1934 and 1974. In some instances, stock prices actually accelerated in the wake of a margin tightening. But in eight of 13 cases (excluding the initial implementation of a margin rule), raising the margin requirement did indeed slow the growth of stock prices. And in each of these eight instances, growth declined in a fairly measured fashion – not a calamitous collapse.

Greenspan on Margin Rules and Stock Prices

There is no evidence to suggest margin requirements have an effect on the level of stock prices.
-- Alan Greenspan, Remarks to the Economic Club of New York, January 14, 2000

Senator, as you comment quite correctly, the reason over the years that we have been reluctant to use the margin authority which we currently have is that all of the studies have suggested that the level of stock prices have nothing to do with margin requirements. That is, there is no evidence to suggest that changes in margin requirements up or down in years prior to 1974 when we did move them back and (inaudible), had any effect on prices.
-- Alan Greenspan, confirmation hearing, Senate Banking Committee, January 26, 2000

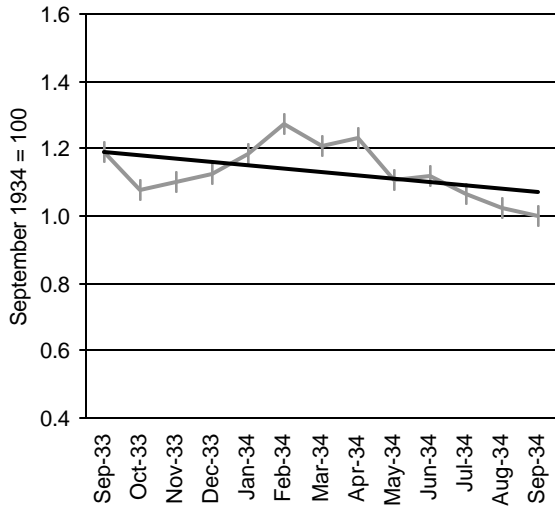
The problem that I have had with the issue of moving our margins is not concern of what it would do to the marketplace, it's the evidence which suggests that it has very little impact on the price structure on the market or anything else.
-- Alan Greenspan, Humphrey-Hawkins hearing, House Banking Committee, February 17, 2000

Would not [raising] margins be better? If the evidence indicated that raising margins would affect stock prices, then the answer in that hypothetical question would be yes. But the evidence that we have, going back a long period of time, is that margin requirements per se do not affect stock prices. They do affect borrowing patterns, and they affect the prudential safety of brokers and dealers and banks and others. But they don't affect stock prices.
-- Alan Greenspan, Humphrey-Hawkins hearing, Senate Banking Committee, February 23, 2000

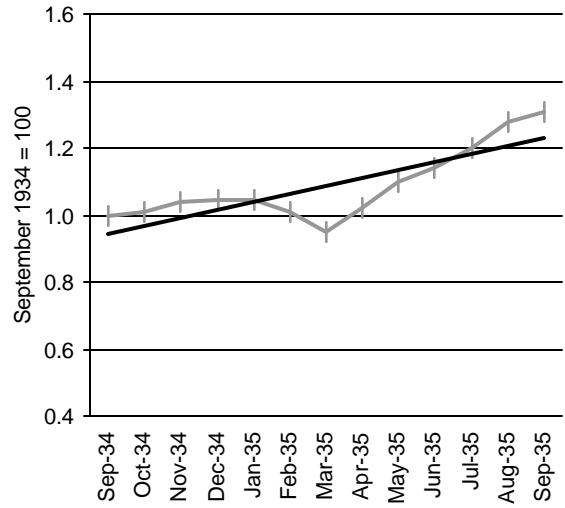
With regard to margin requirements, studies suggest that changes in such requirements have no appreciable and predictable effect on stock prices.
-- Alan Greenspan, Letter to House Banking Committee Chairman Jim Leach, March 30, 2000

October 1, 1934. Initial margin requirements set at 25-45 percent in a falling market. Nevertheless, stock prices rebound over the next 12 months.

S&P Composite Index Before Tightening

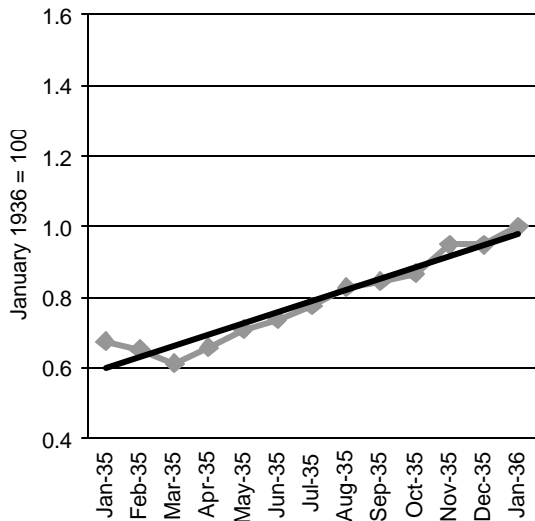


S&P Composite Index After Tightening

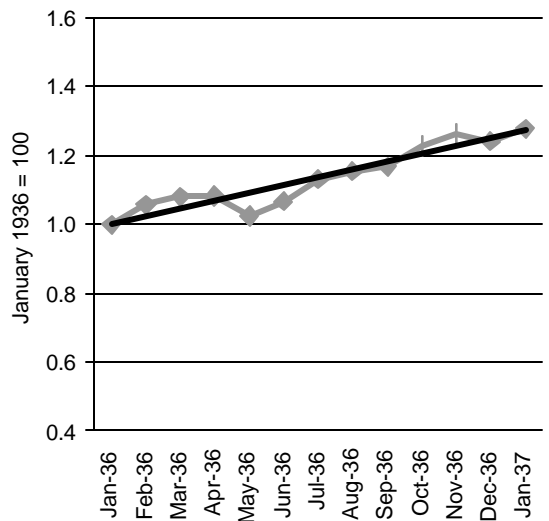


February 1, 1936. Margin requirements raised from 25-45 to 25-55 percent. Over 12 months, stock prices rise more slowly than they did prior to tightening.

S&P Composite Index Before Tightening

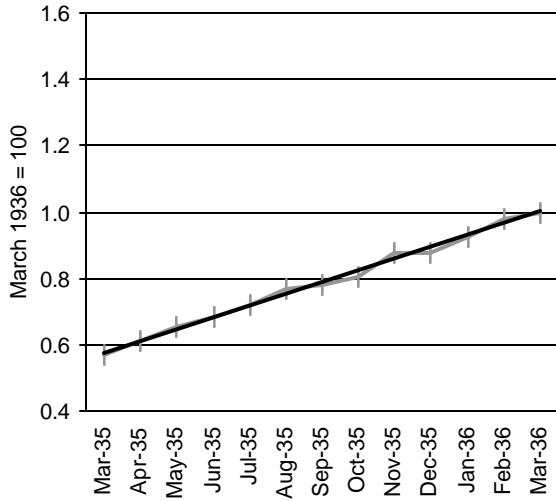


S&P Composite Index After Tightening

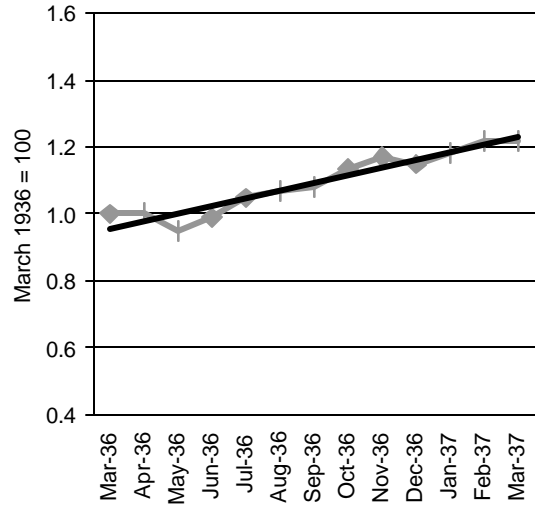


April 1, 1936. Margin requirement raised from 25-55 to 55 percent. Over 12 months, stock prices rise more slowly than they did prior to tightening.

S&P Composite Index Before Tightening

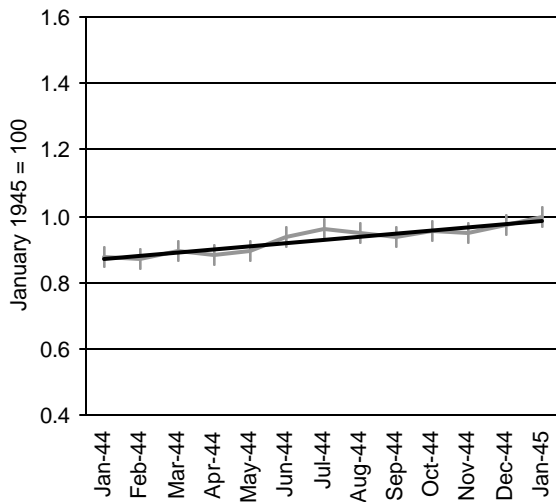


S&P Composite Index After Tightening

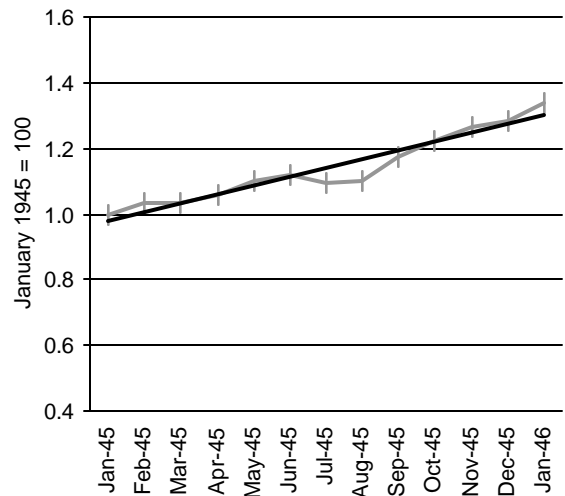


February 5, 1945. Margin requirement raised from 40 to 50 percent. Despite tightening, stock prices rise more quickly over 12 months than they did prior to tightening.

S&P Composite Index Before Tightening

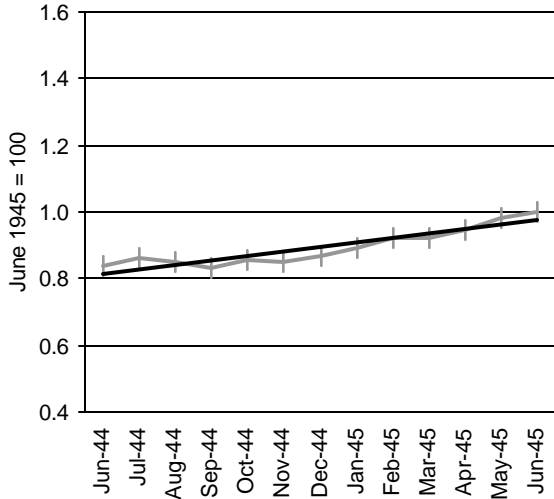


S&P Composite Index After Tightening

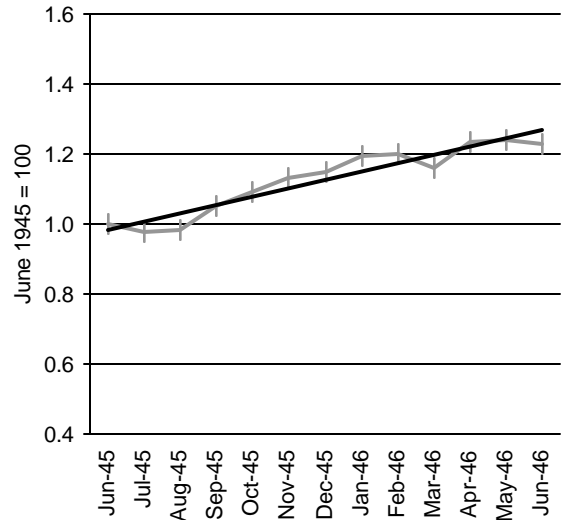


July 5, 1945. Margin requirement raised from 50 to 75 percent. Despite tightening, stock prices rise more quickly over 12 months than they did prior to tightening.

S&P Composite Index Before Tightening

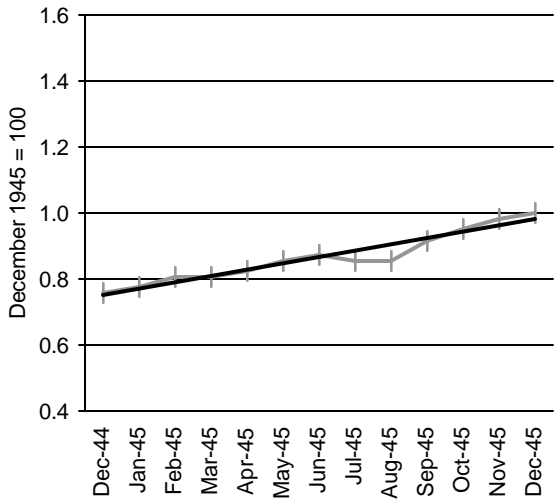


S&P Composite Index After Tightening

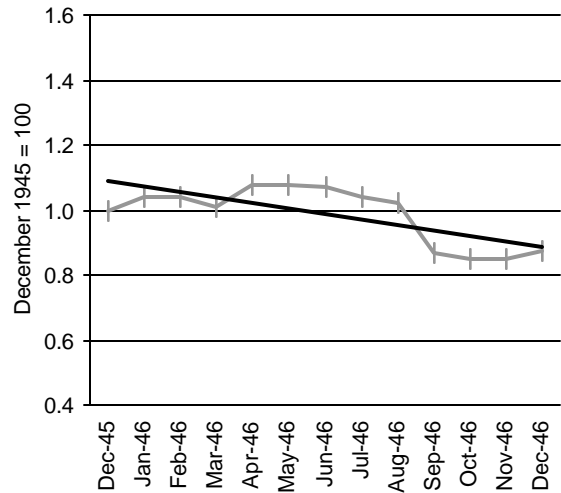


January 21, 1946. Margin requirement raised from 75 to 100 percent. Stock prices drop.

S&P Composite Index Before Tightening

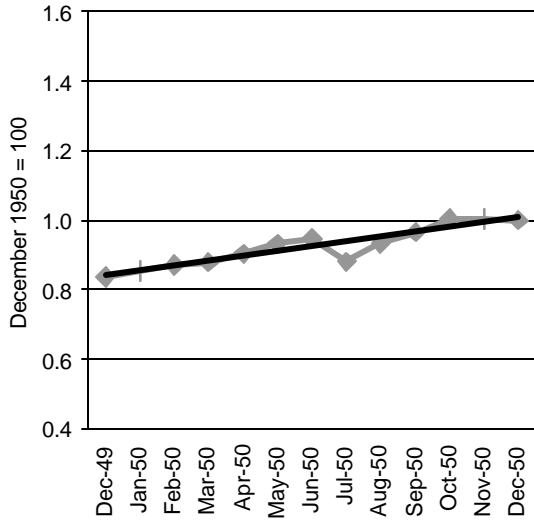


S&P Composite Index After Tightening

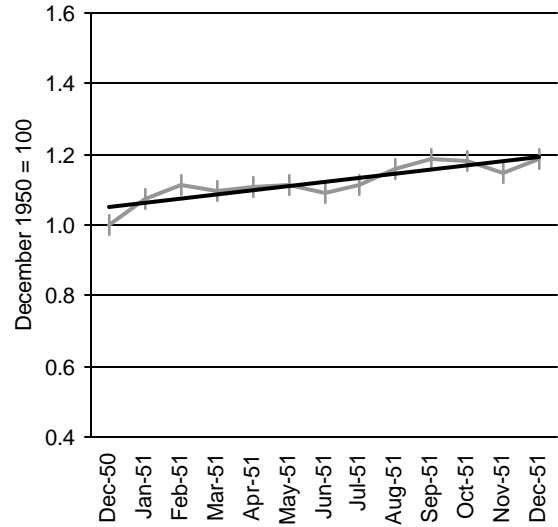


January 17, 1951. Margin requirement raised from 50 to 75 percent. Over 12 months, stock prices rise somewhat slower on a percentage basis than they did prior to tightening.

S&P Composite Index Before Tightening

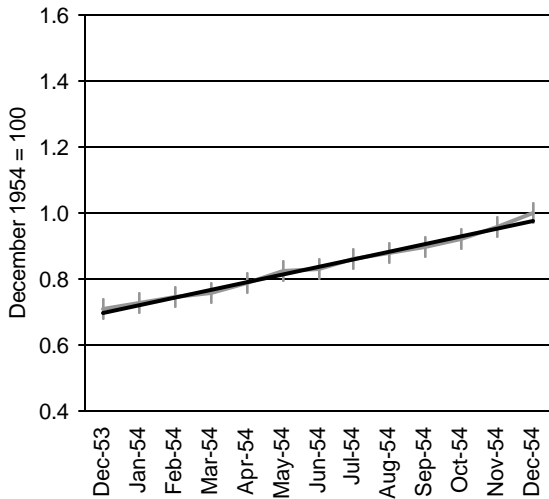


S&P Composite Index After Tightening

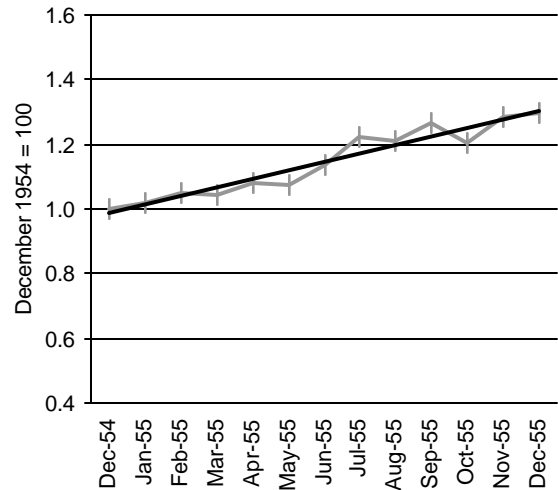


January 4, 1955. Margin requirement raised from 50 to 60 percent. Over 12 months, stock prices rise more slowly on a percentage basis than they did prior to tightening.

S&P Composite Index Before Tightening

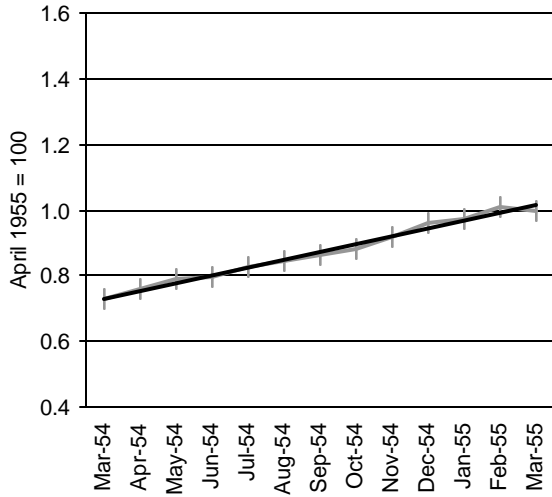


S&P Composite Index After Tightening

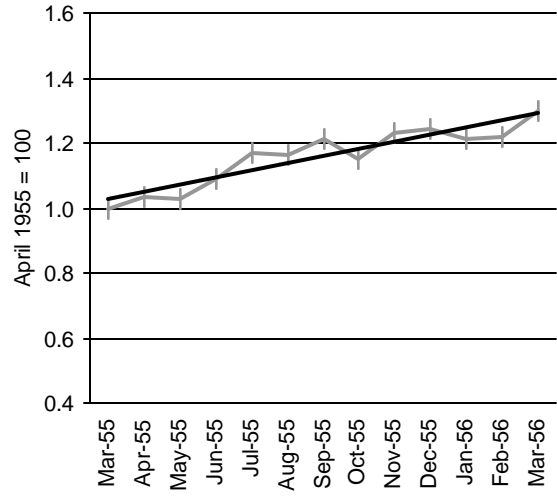


April 23, 1955. Margin requirement raised from 60 to 70 percent. Over 12 months, stock prices rise more slowly on a percentage basis than they did prior to the tightening.

S&P Composite Index Before Tightening

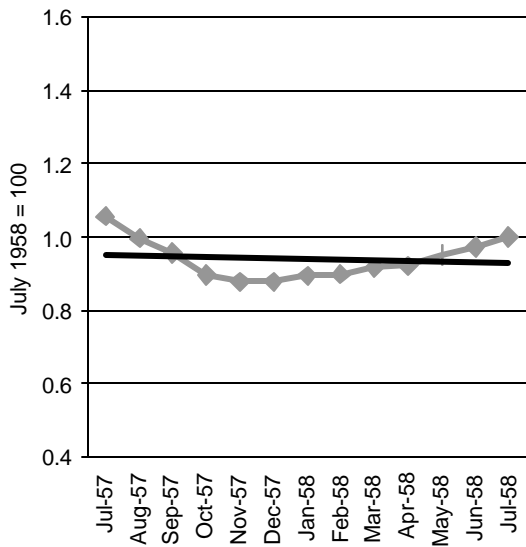


S&P Composite Index After Tightening

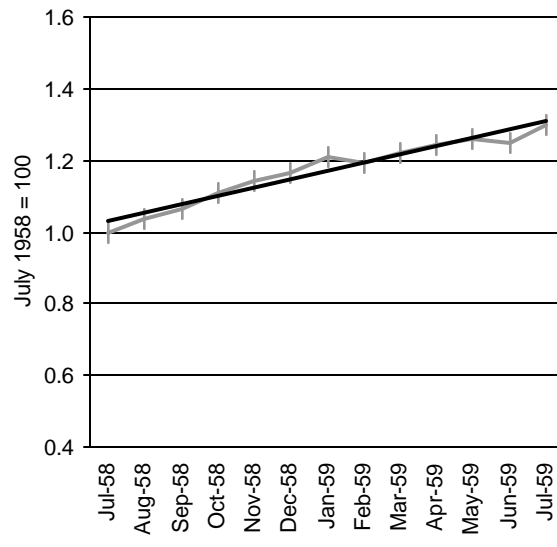


August 5, 1958. Margin requirement raised from 50 to 70 percent. Despite tightening, stock prices rise over 12 months, compared to a dip prior to tightening

S&P Composite Index Before Tightening

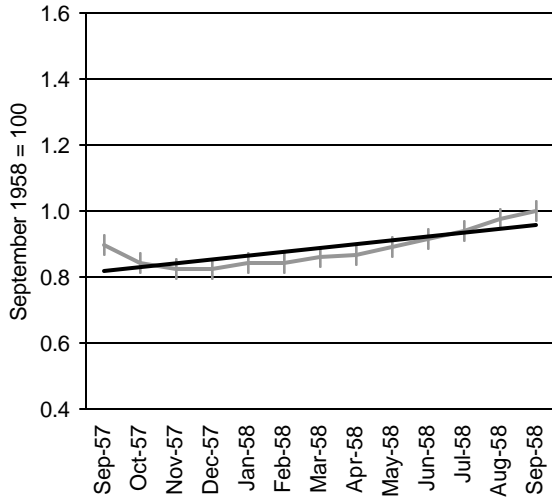


S&P Composite Index After Tightening

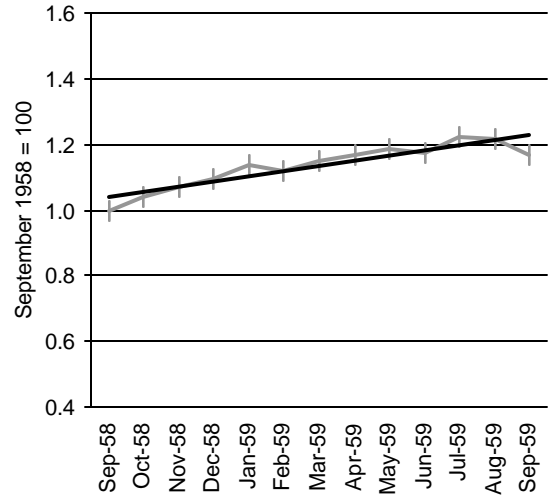


October 16, 1958. Margin requirement raised from 70 to 90 percent. Despite tightening, stock prices rise faster over 12 months than they did prior to tightening.

S&P Composite Index Before Tightening

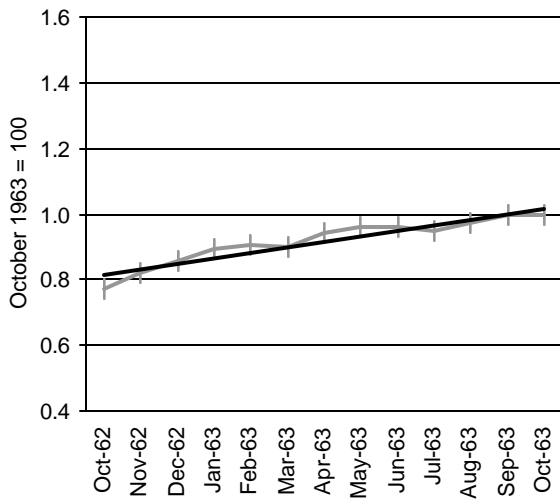


S&P Composite Index After Tightening

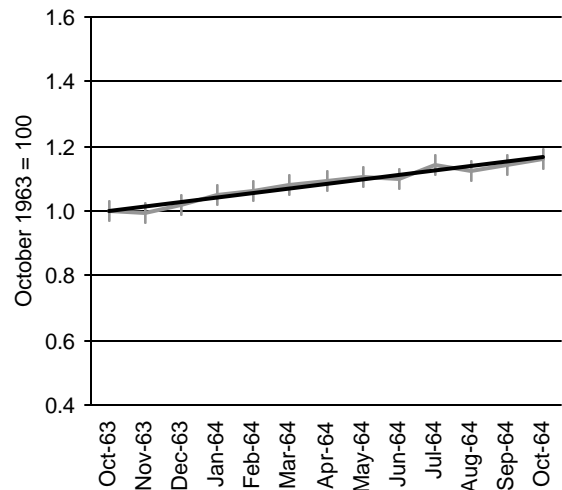


November 6, 1963. Margin requirement raised from 50 to 70 percent. Over 12 months, stock prices rise slower than they did prior to tightening.

S&P Composite Index Before Tightening

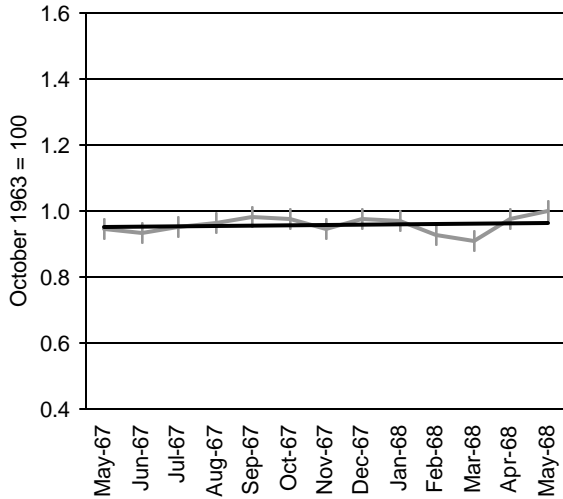


S&P Composite Index After Tightening

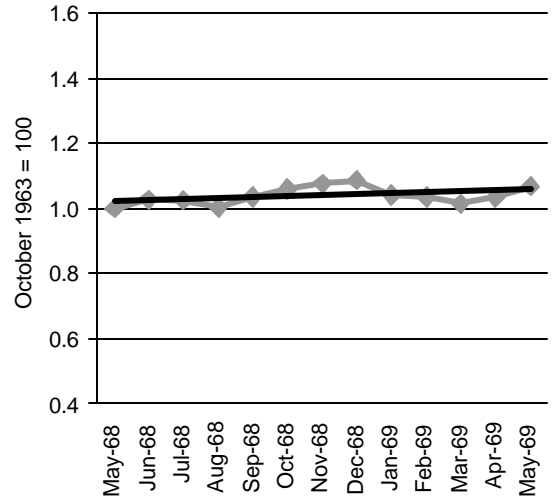


June 8, 1968. Margin requirement raised from 70 to 80 percent. Over 12 months, stock prices rise somewhat faster than they did prior to tightening.

S&P Composite Index Before Tightening

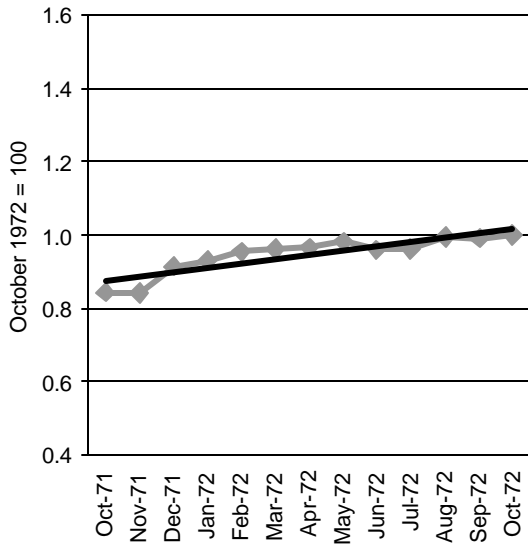


S&P Composite Index After Tightening

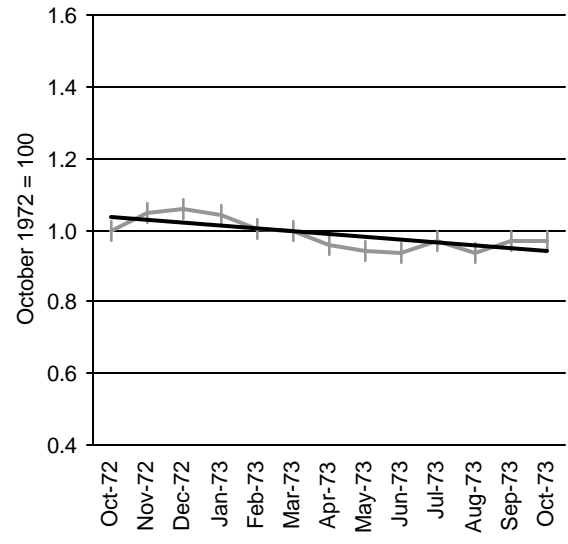


November 24, 1972. Margin requirement raised from 55 to 65 percent. Over 12 months, stock prices fall, compared to a shallow rise prior to tightening.

S&P Composite Index Before Tightening



S&P Composite Index After Tightening



Sources: Monthly S&P Composite Index data used in this analysis were obtained from the 1943 and 1976 editions of the Federal Reserve's *Banking and Monetary Statistics* (for years preceding 1971) and from Yahoo! (for 1971-1975). For ease of comparison, FMC normalized the data so that the last observation prior to a margin adjustment change would equal 100.