BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 7, 1947

To Chairman Eccles

Subject: Philippine loan

From Mr. Knapp

JAK

The Philippine Government has accepted the term of five years for the first 25 million dollar installment on the R.F.C. credit and a press release has been issued in the form agreed upon (see attachment).

I am also attaching a copy of excerpts from a letter which I have just received from John Exter in Manila. The first excerpt reports the argument made by the National City Bank in Manila for retention of the 100 per cent currency reserve as a protection to American business interests. The second excerpt indicates Mr. Exter's belief that there is a considerable untapped market in the Philippines for Philippine Government bonds.

Attachments 2

IMMEDIATE RELEASE RFC-2635

RECONSTRUCTION FINANCE CORPORATION

WASHINGTON

March 6, 1947

The Reconstruction Finance Corporation today announced that an agreement had been signed by the Corporation and The Honorable Joaquin M.Elizalde, Philippine Ambassador to the United States, consummating arrangements for a $25 million loan to the Republic of the Philippines, to mature on January 1, 1952, with interest at 2% per annum. The loan is a part of a credit of $75 million which the Reconstruction Finance Corporation was authorized by Congress, by the Act of August 7, 1946, to extend to the Philippine Government to aid the new Republic to meet its immediate financial requirements during the current period of adjustment to its new status as an independent nation.

The terms and conditions of the loan were determined in accordance with recommendations of the National Advisory Council on International Monetary and Financial Problems, which also approved the amount now requested by the Republic of the Phillippines. While the Council recognized that the widespread property damage and dislocation of the Philippine economy resulting from the war made it difficult to determine an appropriate maturity date for the loan, the Council, in the light of such information concerning Philippine resources as was available to it at the time, recommended that the loan mature on January 1, 1952.

Further data and information on Philippine resources will become available in the near future. A Joint Financial Commission established by agreement between President Truman and President Roxas is at the present time engaged in studying various aspects of Philippine financial problems and will submit a report to the President of the United States and the President of the Philippines.

Excerpts from letter dated February 27, 1947 from Mr. Exter to Mr. Knapp

"Howard Crosse and I have been making the rounds of the banks in town. The attitude of the domestic banks, and even of some of the foreign ones, toward a central bank is usually favorable and is sometimes enthusiastic. It should be said, however, that most of the bankers do not appreciate all the implications of the introduction of a system of monetary management. They are primarily interested in the protection of a central bank and in an opportunity to expand their loans.

"The National City opposes a central bank at this time and feels that it would be a mistake to make any change in the monetary system. The argument runs as follows:

American business men looking for investment opportunities in the Philippines look for several factors:

1. Nondiscriminatory treatment on the part of the Philippine Government
2. A stable labor market
3. The existence of law and order
4. A stable currency freely convertible into dollars

Investors feel reasonably assured about 1, 2, and 3 but are concerned about 4 because so many of the conditions ordinarily associated with currency depreciation and exchange control are now present here: low industrial and agricultural production, large budget deficits, and an adverse balance of trade. The only reassuring factor is the 100 per cent dollar-backed currency; the outlook would be dark indeed if that backing were to be removed. There should therefore be a trial period of three or four years during which the 100 per cent principle is preserved by borrowing from the United States because business men much prefer full dollar coverage of the currency, even at the cost of creation of Philippine Government dollar obligations, to the abandonment of the 100 per cent principle in order to avoid those obligations. At the end of three years business men could face a change in the monetary and banking system with equanimity because the Philippine economy will probably have achieved balance and stability, and government deficits will either be small or have disappeared. It may be that there will be no large volume of American investment beyond rehabilitation of properties to their prewar level. At any rate American capital, plus even more valuable American technical assistance, will have been given the opportunity to come in. Nothing will have been lost because the monetary reserves can be tapped as well in three years as now.

"The preceding paragraph is the long run argument. There is in addition the short run argument that a central bank would encourage Manila banks to become over-extended and increase the danger of their getting caught by a disastrous price decline such as that of 1920."

* * *

"The talks with bankers, as well as with insurance company executives, have convinced me of one thing of which I was in doubt before I came: that there is a considerable internal market for government bonds. I think long term issues could be floated at about 5 per cent, perhaps less, and the lower rates on shorter term obligations would reduce the average cost of government borrowing still further. So far the only plan for internal bond issues is that contained in the law establishing the Philippine R.F.C. A small "trial balloon" issue of 1 million pesos in 100 peso baby bonds has already been decided upon. The bonds are to mature in ten years, carry a government guarantee, and pay interest semiannually at the rate of 1 per cent the first year, 2 per cent the second, and 3 per cent thereafter. They are to be negotiable and redeemable by the holders on demand. They will be sold by the government to individuals only, but institutional investors may later buy them from individuals by endorsement. There does not seem to have been adequate consideration, should these bonds be issued in volume, of the danger of having a large demand obligation of the government outstanding. The head of the R.F.C. felt that large scale demands for redemption would not be his responsibility but the government's."