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FEDERAL RESERVE BANK OF CHICAGO

230 South LaSalle Street

May 4, 1935.

Honorable M. S. Eccles, Governor,  
Federal Reserve Board,  
Washington, D. C.

My dear Governor:

At a recent meeting of the directors of this bank discussion of our participation in the System Investment Account and the holdings in our own portfolio developed the opinion that steps should be taken to adjust our holdings of Government securities in the System account to the proper percentage and for reasons, in part, outlined as follows:

From January 3, 1934, to February 6, 1935, there has been an increase in the gold stock of \$1,515,000,000 and the net addition to excess reserves during that period was \$1,342,000,000. Since February 6, 1935, gold imports have continued in large volume and the monetary gold stock increased to \$8,721,000,000. There have been no additional purchases of Government securities for the System account during 1934 or in 1935 and the excess reserves of member banks have increased to \$2,272,000,000, caused principally by imports of gold and also by increases by the Treasury in expenditures of free gold and in silver currency. It was formerly the custom to offset imports of gold by the sale of Government securities from the System account, but no offsetting sales have been made during the period above mentioned.

The tremendous amount of excess bank reserves has so affected open market money rates that the return on Treasury bills has largely disappeared. This highly artificial money market is not considered a sound basis upon which to conduct Treasury financing or commercial borrowing and it would seem advisable to at least partly correct this unnatural situation, particularly on the shorter maturities. It is therefore suggested that maturing Treasury bills held in the System account, and in our own portfolio, be permitted to run off until the rate for nine-months maturities is at least  $1\frac{1}{2}$  of 1%.

As of April 17, the total amount of Treasury bills held in the System account was approximately \$530,000,000, and the maturities are about \$20,000,000 weekly.

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The question of reducing the System's holdings of Government securities has been discussed from time to time in the past, but objections have always been raised because of the fear that a reduction in the System holdings would cause banks to sell their Government securities and thus injure the Government market. It is suggested that any unfavorable reaction could be avoided if a public statement were made that the Federal Reserve banks were not selling securities but on account of the strong demand from the market were allowing Treasury bills to mature, as it was not their policy to compete with their member banks for securities of the shorter maturities. If the market was unduly affected, the policy could be promptly reversed.

It would appear that there could be no more opportune time than the present to thus reduce at least the holdings in the System account because of the abnormally low rates and the strong demand for not only Treasury bills but all maturities up to five years, and also for the further reason that the large excess reserves now carried by practically all member banks would promptly absorb any reduction in the System account. By a reduction in the portfolio of the Federal Reserve System the Federal Reserve banks would then be in a stronger position to assist the Treasury later on should such help be necessary.

If it be the duty of the System to furnish credit to the market when there is a scarcity thereof, it would seem equally its responsibility to withdraw credit where there is such a substantial excess.

The argument at times has been advanced that the System should not reduce its present investment in Government securities but be prepared to sell only for the purpose of checking inflation. Past experience has not shown this method as being successful as the sale of United States Government securities does not affect the price of stocks and real estate. Heavy sales of Government securities for the purpose of checking inflation would only result in heavy losses to the present holders of these securities and would undoubtedly greatly injure the Government's credit.

In any event, whether the total holdings of the System be reduced or retained, it is our opinion that the holdings in the System should be adjusted pro rata to the agreed percentage among the several Federal Reserve banks and we request the cooperation of the Federal Reserve Board to this end.

The foregoing is submitted for the consideration of the Federal Reserve Board, and we in turn shall be pleased to have your views.

Very truly yours,

(Signed) Geo. J. Schaller

Governor.

cc-Hon. M. S. Szymczak,  
Member, Federal Reserve Board,  
Washington, D. C.