

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 12, 1936.To Chairman EcclesSubject: Comments on the Meeting withFrom Lauchlin Currie
*L.C.*Secretary Morgenthau.

G P O 16-852

I had a feeling that a good deal was left unexplored last night. One thing of great importance is whether any understanding exists as to the present alignment of exchanges. On the one hand the Secretary stated that there was no agreement as to the future ratio of the dollar to the franc and sterling. On the other hand he stated that the risk of fluctuations in the exchange market over (short?) periods was over, which implies some understanding. It is perhaps of some significance that the statement of the British Treasury played down the importance of the development, saying merely that it would "facilitate the technical operations of exchange control".

I am not sure I am right, but the following appears to me to be sound. Sterling can fall in relation to the dollar unless our Stabilization Fund is prepared to take a loss on its operations. Suppose the English raise the price of gold. Sterling will tend to fall in reflection of this. (Or if sterling falls the price of gold in England will tend to rise). We can prevent a further fall by buying sterling and converting it into gold. We cannot bring about a rise in sterling or maintain the previous dollar sterling rate if the price of gold is raised in London, unless we are prepared to pay more dollars for sterling than we will recover when we convert into gold. This amounts to saying that we cannot prevent a fall in sterling unless we are prepared to pay more than \$35.00 an ounce for gold, and if we do, this will entail a "loss", i. e., in a bookkeeping sense, so long as our gold stocks are valued at \$35.00 an ounce. I have worked out various possibilities, and I come to this conclusion every time.

If this is so I think the Treasury should be prepared to take a loss on the Fund if by so doing we prevent a greater loss to the farmer, wage earner, etc. Of course, this may not prove necessary, as the English may cooperate in keeping the pound around the present level.

I feel quite strongly that we should not permit a further significant depreciation of sterling, which would mean not only a fall of sterling but of all the currencies linked with sterling, which comprise a good part of the world. The dollar was, if anything, overvalued (in terms of relative incomes and prices) before the recent depreciation of practically all foreign currencies. As I pointed out last night, we have much further to go on the road to full recovery than have the sterling countries. For full employment our national income will probably have to expand twenty to thirty billion dollars more. This means

that our demand for foreign goods, both to buy and to look at, may be expected to increase substantially as our income grows. Moreover, when, as and if we approach full employment the general level of our prices will doubtless rise somewhat. On two counts, therefore, we may expect our imports (including tourist expenditures) to grow more rapidly than our exports, so that excluding capital movements we will be more likely to lose than to gain gold.

This possible development has two aspects, one, if anything, favorable, and the other unfavorable. The one I have in mind as being, if anything, favorable, is the possible loss of gold which, as you pointed out, would be more of an aid than a hindrance to us. The other, and unfavorable aspect, while not so apparent, is, I think, real. It is that the increase in imports relative to exports, while a symptom of recovery, constitutes at the same time a drag on the recovery movement. It means that progressively more of the monetary circulation in the production-consumption stream is being withdrawn for foreign purchases than is being regained by sales to foreigners. This may be construed as an additional reason why it would be undesirable for the dollar to appreciate substantially in terms of other currencies. Of course, this possible drag might conceivably be defended as a desirable check on the recovery movement getting out of hand, but we have other instruments of control for that purpose.

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Ransom and Davis.