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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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Statement by Chairman Eccles on inflation and reserves.

There appears to be widespread misunderstanding of the situation now existing with respect to inflationary possibilities, as well as a misconception of my own attitude with regard to inflation. I sought to emphasize in my speech before the American Bankers Association that it was the duty of the Government to intervene in order to counteract as far as possible the twin evils of inflation and deflation. The word inflation is used by some people to mean any expansion of credit, or any rapid advance in prices. In order to make it clear what I have in mind when I speak of inflation as a phenomenon that needs to be controlled, I define inflation as a condition brought about when the means of payment in the hands of those who will spend them increases faster than goods can be produced. In other words, the volume of money must be related to the volume of actual and potential production of real wealth.

I asked the question: "How is it possible to have inflation when men are idle and plants are idle?"

"There can be speculative excesses when surplus funds bid up stocks or real estate, but inflation in the generally accepted sense can only come about by increasing the means of payment in the hands of people who are willing to spend faster than we can increase production. We are a long way from such a period of inflation."

Considerable confusion seems to exist in some quarters, as reflected in some of the newspapers, about the dangers of "inflation" at present. But it is evident that what is meant in most cases is not inflation in the sense I have indicated, but a stock market "inflation". In other words, there seems to be concern about a repetition of the stock

market excesses of 1929 and a lack of understanding of the Federal Reserve System's power to deal with the situation. I wish so far as possible to clarify the picture in order to correct the notion that the Federal Reserve System could, by action at this time, reach the stock market situation, and secondly, the totally mistaken idea that the Chairman, or for that matter, the other officials of the Federal Reserve System, are indifferent to or disinclined to do whatever is within their power to prevent the development of an unsound condition.

Anyone who will take the trouble to consult the Reserve System's reports on the condition of member banks will see at once that the total of security loans by banks both to customers other than brokers and to brokers have shown no growth since the middle of March, when the present rise in security prices began. In fact, the figures show something of a decline between March 13 and November 13, as is indicated by the following table:

LOANS ON SECURITIES BY REPORTING
MEMBER BANKS IN 101 LEADING CITIES
(In millions of dollars)

	<u>March 13</u> <u>1935</u>	<u>November 13</u> <u>1935</u>	<u>Change</u>
Total loans on securities*	3,239	3,052	- 187
To brokers and dealers:			
Total	1,031	974	- 57
In New York City	854	815	- 39
Outside New York City	177	159	- 18
To customers*	2,208	2,078	- 130

STOCK PRICES
(1926= 100)

421 stocks	63.1	93.3	+ 30.2 (+ 48%)
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—*Exclusive of loans to banks

The rise in security prices has not been financed by bank credit. The securities are being bought mostly for cash out of the abundant investment funds in the hands of corporations and individuals and out of funds sent to this country by foreigners who wish to invest here because they believe that this is the safest and most profitable use for their money.

I wish to emphasize two points as strongly as I can: First, I think that there is an element of safety and of strength in the fact that the security purchases are being financed out of cash without increased use of bank credit. I am doubtful whether a run-away stock market situation can proceed very far without being reflected in an increased demand for borrowed funds.

In this connection I wish also to point out that the amount of money going into the stock market is not, as some have contended, depriving the capital market of adequate funds and thus retarding recovery. That ample funds are available in the capital markets is evidenced by the fact that offerings of long term securities and mortgages are being absorbed at yields which have been steadily declining.

The second point which I wish to emphasize even more strongly is that those who are suggesting that the Federal Reserve System should do something about stock market conditions at present are under the mistaken impression that the System can intervene in the market at any time. As a matter of fact, the System has no authority whatsoever to curb buying of securities by individuals or corporations, whether foreign or domestic. Its only authority in this matter is over margin requirements, which apply only when transactions

are on credit, as is not the case to any extent at the present time. The only power the System has is to control the speculative use of bank credit. There is no speculative use of bank credit in the present situation.

Therefore, I should like to nail once and for all, if possible, the idea that the Federal Reserve System is neglecting at this time to exercise its power over stock market speculation. There is no truth in this idea.

As for the general business and credit situation and the volume of member bank reserves - it is clear that there is no excessive expansion in any field at this time. There is no evidence of accumulation of inventories, or of frantic bidding for a limited amount of goods, or of an expansion of bank credit, save through the purchase of Government securities. The turnover of deposits is still low.

The general credit situation as well as developments in the stock market require close and careful study as to the appropriate time for and method of action. This close study is being given by the System, including not only the Board of Governors itself, but the Open Market Committee and the Advisory Council as well.