Discount Rates

332.

January 28, 1928

Dear Mr. Austin:

This will acknowledge receipt of your letter of January 27, enclosing a memorandum prepared by you in reference to discount rate policy. My desk is a bit crowded and I would prefer not to get into a lengthy discussion of this subject by correspondence, but I am attempting to cover the past six months briefly.

You will recall the action that was taken in July of last year and the reasons for taking such action. You will also recall that practically all of the western banks agreed to the plan, at the same time stating there was nothing in the local situation that would prompt a rate change and that their only reason for consenting was because of a national or international situation. Whether the action of the System brought about what has occurred, or whether the System was fortunate enough to anticipate what was going to happen, I am not prepared to say, but in any event, by the middle of November its objective, in the opinion of the Open Market Committee, was achieved. Since that time the System has not been offsetting gold earmarkings or exports by purchases of Government securities. In other words, by not offsetting, during the latter part of November and all of December, the System was taking money out of the market.

In the early part of January there was a meeting of the Open Market Committee in Washington and it was the unanimous opinion of that committee that firmer money rates were desirable. An informal discussion of discount rates was also indulged in and it seemed to be the opinion of the majority of the members of the committee that their directors felt a higher discount rate, comparable with the going rates for money in the various districts, would be desirable. The committee in its recommendations asked authority to sell a specified amount of Government securities to the market. The Board, by resolution, authorized the committee to sell from the open market holdings an unlimited amount and it also authorized the temporary purchase of securities to cover any unforeseen emergency that might develop. The results are that up to the present writing the System has disposed of about $121,000,000 of Government securities. Up to a week ago this action apparently had but little effect upon money rates.

The Chicago bank fixed its rate at 4% and laid it before the Board for review and determination. The review by the Board was not an impulsive one, but covered three or four days, and was approved almost unanimously. Chicago's reason for changing the rate was just the same as it was in August of last year for not lowering the rate. It is extremely difficult to give the Board's reason for approving the Chicago rate because one member approved it for one reason and another for another reason. All I can do is to state why I approved it:

1. The program of the Open Market Committee in July had accomplished its purpose.

2. I do not believe uniform rates in the System are always necessary.

3. Four percent is a more normal rate in the Chicago district than $3\frac{1}{2}$%.

4. I was assured that the foreign situation was taken care of and that there was no further need for consideration or assistance from this country.

5. If the Open Market Committee had unanimously agreed upon firmer rates and no Federal reserve bank interposed an objection to such program, I felt it was only a question of time until rediscount rates would have to be raised anyway.

6. I felt that the Chicago directors were better able to determine what was advisable in their own district than I was.

7. The only thing that made me hesitate was the possibility of chilling business. The majority of Federal reserve people with whom I talked assured me that a 1/2% raise would have but very little if any effect upon business.

To be concise, I could find no good reason for disapproving Chicago's action.

After ten years experience, I have found rate-fixing to be an extremely complicated problem. One factor is seldom a determining factor. Many things must be taken into consideration. I have also observed that no definite formula can be used that is applicable at all times and under all conditions.

We had a wire from a western reserve bank the early part of this week asking what the Board desired to have the bank do in reference to rediscount rates. I replied by stating that the Board wanted the directors of that particular reserve bank to use their own good judgment.

I assume that your inquiry was made for a specific reason and all I can say to you is that the Board would be very glad to have your directors consider the question at their next meeting and act according to their good judgment.

I have written to you a more or less confidential letter and I would appreciate it very much if you would use the contents with discretion, although I have no objection to acquainting your directors with its contents.

Yours very truly,

(Signed) R. A. Young

R. A. Young,
Governor.

Mr. R. L. Austin, Chairman,
Federal Reserve Bank,
Philadelphia, Pennsylvania.