



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

February 12, 1938.

MEMORANDUM:

TO - The Secretary of the Treasury
FROM - Chairman Eccles

Attached is a rough draft of what would be my interpretation of the proposed action, and the way in which I would try to answer some of the questions that are likely to be asked by the press.

Attachment.

*Carbon copy left with
Secy for his files*

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It will be recalled that when the inactive gold account was set up, we were experiencing a very heavy inflow, which not only increased the deposits of the banks, but was allowed to take effect in adding to the excess reserves of the banking system. By using authority given by Congress to the Reserve System, a large proportion of this excess was in effect sterilized, and the action setting up the inactive gold account served to prevent additional acquisitions after that date from again building up the excess to a disproportionate size relative to credit needs and business conditions as they then existed.

The inactive fund was, of course, a new sort of instrument which could be made flexible in its application as conditions warranted, and, in fact, it has afforded a convenient instrumentality for placing funds directly and quickly in the money market, as was the case last fall when we had a desterilization of \$300,000,000, which the Treasury undertook at the request of the Reserve Board, acting on the recommendation of the Federal Open Market Committee. This was to meet a specific situation.

Since the fund was originally set up there has been a considerable change in the general business, fiscal and monetary situation. In the light of the changed conditions, it would appear to be appropriate to adapt the operation of the fund to the changed situation since it has the advantage of flexibility

in operation, whereas changing reserve requirements, for example, does not have the same advantages.

You might ask why the same thing could not be accomplished by some other means. That might be possible if the sole consideration were only to create additional excess reserves. However, I do not think under present conditions we would be justified in carrying out open-market operations or in reducing reserve requirements for the purpose of creating more excess reserves. Instead, it is obviously more appropriate to take the present action, which has the effect of adding to bank reserves while relieving the Treasury of borrowing for the purpose of keeping gold acquisitions from adding to bank reserves.

As to the question of what effect it might be expected to have, I would not want to venture into the realm of prophecy, but it seems to me that if it tends to have any monetary influence or psychological effect, it would not be deflationary. As you will note from the Treasury statement, gold that is withdrawn from the Treasury will not be deducted from the amount of incoming gold in computing the \$100,000,000 quarterly. The gold so withdrawn will provide an equivalent amount of cash and thus make the public debt less by this amount than would otherwise be

the case.

As to the reason for a figure of \$100,000,000 quarterly, it, of course, takes account of the general movement of gold at this time, and in effect puts a top on the amount that is to be permitted to flow into the monetary base. So that from the standpoint of the Reserve System, we know the maximum amount that may be added to the reserves in any quarterly period as a result of the action. This would not be the case, for instance, if sterilization were to be entirely discontinued. In that event, of course, the amount that would flow into excess reserves would be unpredictable and depend largely upon how much foreigners sent to us.

With regard to the timing of this particular action, that is always a matter of judgment, but it seems to me, in the light of the changed situation as compared to the time when the policy was instituted, that under present monetary, fiscal and business conditions, the action is appropriate.

As I view it, this adaptation of the operation of the fund relates to this whole general changed picture and is occasioned by general considerations which I have outlined, and not by any one consideration by itself. It would be a mistake, accordingly, to assume that it is prompted, for example, by purely monetary or fiscal considerations, or that it is regarded as anything in the nature of a major or cure-all move. It is, as

I have said, in line with the desire to adapt the operation of this fund to changed conditions, taking into account various elements and considerations that exist in the picture at this time.