June 16, 1948.

Dear Elliott:

Because of your official interest in the matter and corresponding action on reserve requirements, I thought you might be interested in seeing the following explanation which I wrote personally and confidentially to a prominent New York banker, an old friend of mine, who asked me to give him the background of this step which has been grossly misrepresented in some of the financial press. I wanted you to know why the majority of the Board felt, some of them even more strongly than I, that the action should be taken at this time.

"Your candid inquiry of June 7 regarding the recent 2 per cent increase in reserve requirements at New York and Chicago and the Board's reasons for the action calls for a frank reply which I am glad to give.

"You know, of course, that this was the second in a possible series of three steps, the first of which was effective last February. It simply tends to restore the relationship which the law contemplates between the central reserve, reserve and other cities, namely, the maximum of 14, 20 and 26 per cent on demand deposits which had existed in 1942. It was not an action taken hastily but on the contrary only after repeated consideration. It had a background of careful study and discussion before the first step was taken as well as during several intervening meetings since then. At some of these meetings Tom McCabe was present although he was not able to be present because of illness at the meeting to which the determination of the question had been postponed. In fact, action had been postponed four times on his account. When it was taken, the other members of the Board had the benefit of his views and he did not request further postponement.

"Time was running short because it had become apparent that the effective date must be prior to the June tax payments and the July 1st refunding or should be postponed until sometime in July or August, or until after the September financing. In the final discussions the question became one solely of timing. The postponements which had already taken place left less than two weeks for notice of the Board's action to become effective at the end of the last reserve calculation period before the June tax payments. I am sure that you will see from this that we were not trying to take advantage of Tom's absence, especially since his vote even if adverse would not have changed the result.

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"I may add that one of the factors entering into the decision was that if the support levels on certificates were to be dropped in July or August in preparation for a raise in the certificate rate in September to 1-1/4 per cent it would be difficult to justify a concurrent raise in reserve requirements. In other words, having sold the banks the 1-1/8 per cent certificates in July, it would not seem fair then to apply the pressure of increased reserve requirements on top of a drop in the support levels, if decided upon, for such certificates, as the banks might have to sell them in order to meet the increased requirements. The step which has been taken was for the purpose of applying some pressure now, and the dropping in support levels later would be for the purpose of continuing the pressure over the summer months; thus the timing of the third step in raising reserve requirements could be made in July or August, if the short-term certificate rate were not permitted to rise.

"You will see from what I have said that the possibility of a further two per cent increase in reserve requirements after the first step which became effective in February was in contemplation long before the Treasury decided against a rate increase for the June refunding and that the two acts were not necessarily interdependent. While the Board as well as the Open Market Committee had hoped that the Treasury would make the increase proposed in the rate from 1-1/8 to 1-1/4 per cent and they were disappointed, that decision was one which was recognized as being within the province of the Treasury. The Treasury equally recognized that it was within the province of the Board to raise reserve requirements at New York and Chicago if it felt warranted in doing so. The Treasury has the responsibility for the cost of Government financing while the Board has the responsibility for such anti-inflationary steps as lie within its powers. The step actually taken was relatively mild.

"In this connection you may recall that the Federal Advisory Council, the membership of which includes representatives of New York and Chicago, one of whom is president of the Council, unanimously opposed the Board's proposals for increased power over reserve requirements, on the ground among others that the Board 'still has the power to raise reserve requirements in central reserve cities and so tighten money' which it had not used. The Board had already used the full extent of its power in reserve and non-reserve cities and recognized the difficulty of convincing many people of the need for additional power when it had not used fully the pattern laid down by law for the principal money markets, New York and Chicago. Therefore the Board felt that it could properly go ahead within its own responsibilities even though the Treasury had not in its discretion seen fit to raise the certificate rate.

"We can well understand why some bankers who would be affected by the raise would be 'beefing' about it. That is a perfectly natural reaction, but we do not believe it is justified in the circumstances.

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"The fundamentals of the inflation picture have not altered and there is no present indication of a decline in the inflationary trend. It is generally accepted by the banking fraternity that the inflationary trend warrants an increase in the short-term rate. In the absence of action by the Treasury in this regard, a raise in reserve requirements might also have some anti-inflationary influence when taken as precautionary or preventive medicine, and would have less value as the disease advanced. These were the views of a majority of the Board Members and I wish again to emphasize that the action was neither hasty nor inadequately considered nor was it taken without due regard for any differing viewpoints. Contrary to some interpretations, it was not a slap at the Treasury nor was it taken without giving Tom McCabe every considerations."

While I know you must be more than busy in these crowded hours I felt that this matter was of enough importance so that I ought to pass the foregoing background information on to you.

With every good wish.

Sincerely yours,

M. S. Eccles.

Mr. Elliott V. Bell,
State Superintendent of Banks,
80 Center Street,
New York 13, New York.

ET:ra

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Federal Reserve Bank of St. Louis

STATE OF NEW YORK
BANKING DEPARTMENT
270 BROADWAY
NEW YORK 7, N.Y.

ELLIOTT V. BELL
SUPERINTENDENT OF BANKS

June 18, 1948

Hon. Marriner S. Eccles
Board of Governors of the
Federal Reserve System
Washington, D. C.

Dear Governor:

In the absence of the Superintendent who is temporarily out of the city, I wish to acknowledge your letter of June 16, 1948. Mr. Bell appreciates, I know, your courtesy in providing him with the information contained in your letter.

Very truly yours,

W. A. Lyon

W. A. Lyon
First Deputy Superintendent

WAL:DBR

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