October 22, 1935

There has been a continuous flow of capital to this country accompanied by gold imports and this movement has been accentuated in recent weeks by apprehensions of war.

The flight of capital from the uncertainties of war is familiar. More significant is the longer-time movement which represents largely a transfer of funds, and consequently of gold, from the gold bloc countries whose currencies are over-valued in relation to the dollar. The reason that this flow is more significant is that it is likely to be a continuous tendency until an equilibrium is once more reestablished by one of three developments: (1) deflation in the gold-bloc countries; (2) inflation in the United States and other countries, (3) devaluation of the gold-bloc currencies.

So long as the internal price level of these countries is not adapted to the external value of their currencies, there is bound to be deflationary pressure at home, with political repercussions, and the insecurity of the situation will lead to sensitiveness of capital which will take flight at the slightest opportunity.

The second road to adjustment, namely, inflation in the United States, appears to be a long-time proposition, because, in view of our unused capacity, an adjustment of prices of manufactured commodities to the new value of the dollar is not likely to occur in the proximate future, while prices of international commodities are already adjusted to the new currency position. It would seem that inflation in the United States is not likely to occur soon enough to help solve the problem.

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This leaves the third alternative, namely, devaluation of the gold bloc currencies. This method also will encounter difficulties, but it is, nevertheless, the one that is most likely to be followed. Belgium has already devalued; the movement for devaluation in Holland is growing. In France resentment by the unemployed and by industrialists, who suffer from declining prices and lack of exports, is pitched against the fears of recipients of fixed incomes. The former are for devaluation, the latter are against it. Inroads, however, are being made on the opposition of the rentiers by the fact that coupon rates on securities are being cut.

There appears to be nothing that the United States can do to prevent the inflow of gold. Silver purchases operate in that direction, but so long as the Treasury issues silver certificates in an amount equal to the purchase price of the silver, the effect on member bank reserves in the United States is the same as that of an equivalent inflow of gold. The only way in which the situation differs is that, to the extent that silver comes instead of gold, the reserves of those countries which are on the gold standard suffer no losses. If the Treasury were permitted by law not to issue silver certificates for the silver it purchases, this would diminish additions to excess reserves. But it would mean that the silver would have to be paid for out of the budget.

There appears to be little that can be done about the situation, except to encourage devaluation by international agreement and be prepared to use the powers of the Reserve System and the Treasury to control inflation if and when it develops.

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