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Stabilization

April 25, 1936

Secretary Morgenthau

Mr. Goldenweiser

In accordance with your request, I am transmitting herewith a brief memorandum on why it would not be harmful to the United States to lose a considerable amount of gold

April 25, 1936

WHY A CONSIDERABLE LOSS OF GOLD WOULD NOT BE HARMFUL TO THE UNITED STATES

Total stock of gold in the United States at present is $10,200,000,-000. Of this amount $7,675,000,000 is held by the Treasury against gold certificates and gold credits of the Federal Reserve banks, which have reserves of $4,200,000,000 in excess of their legal requirements. Of the remainder, the largest part, nearly $2,000,000,000, is in the Stabilization Fund.

Conditions in the money market are extremely easy and money rates are low. Member banks have reserves about $3,000,000,000 in excess of legal requirements (disregarding temporary fluctuations due to changes in Treasury cash and deposits with the Reserve banks). On the basis of these reserves the member banks, if propitious circumstances developed, could more than double the volume of bank credit in this country. Such a growth of credit would be far in excess of the needs of healthy business expansion and would constitute a grave danger of harmful inflation.

While the Federal Reserve System has instruments at its disposal for the absorption of the excess reserves, these instruments may not be sufficient and the timing of their use presents many difficult problems. An outflow of gold would reduce excess reserves, would help solve the problem of controlling an expansion of credit, and would not cause any loss whatsoever to either the Government, the banks, or the public. At the same time, an outflow of gold from this country might strengthen the financial position of other countries, and thereby increase their ability to purchase our goods.

To be more specific, the power of the Federal Reserve System to absorb excess reserves is limited to raising reserve requirements by 100 per cent, which would absorb $2,800,000,000; and selling its portfolio of United States Government securities, which would absorb $2,-400,000,000. The total power of absorption is, therefore, $5,200,000,000.

For the moment, this is sufficient, as excess reserves are far below that figure, being about $3,000,000,000. But to this amount should be added the $2,000,000,000 in the Stabilization Fund which may be spent some time and would then increase excess reserves by a corresponding amount, and such issues of silver certificates and purchases of domestic gold as may be made from time to time.

Existing and prospective excess reserves, therefore, are fully as large as the total of the Federal Reserve System's powers of absorption. The exercise of these powers to the full would involve: (1) raising reserve requirements by 100 per cent, and (2) selling out the entire portfolio of Government securities of the Reserve banks. The first would make it necessary for many individual banks to sell securities or to borrow, and this might result in a stiffening of money rates and might chill recovery. The second would not only deprive the Reserve banks of all earnings with which to pay expenses, but would also make it impossible for them to cope with any further expansion that might occur from any cause.

An outflow of gold, therefore, would facilitate the problem of credit administration by absorbing a part of the excess reserves without using up the powers of the System. It would also have the advantage of absorbing them at the money centers, where gold shipments are made, and where any temporary undesirable tightening of money conditions can be most readily overcome by open-market operations by the Federal Reserve System.

In view of all these considerations, it would appear that a loss of gold, even in considerable volume, would be a distinct gain to the United States.