Mr. Thomas

For the purpose of reply to Wallace, I think this is all right. The argument against encouraging capital expenditure is rather obscured by the substance of the letter – but I don't know how to highlight it more in this letter.

L.C.

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FEDERAL RESERVE BANK

OF NEW YORK 45

November 12, 1947.

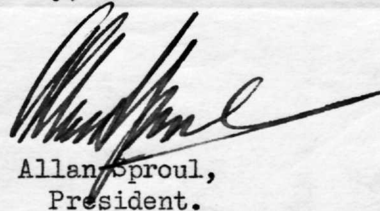
Mr. Elliott Thurston, Assistant
to the Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Elliott:

When I wrote the Chairman on October 24th about discount rate policy, I was putting down on paper the thoughts moving through my mind following a conversation with him on this subject. It was one way of carrying on the discussion without spending too much time on the telephone. If I had intended my letter for circulation throughout the System, I might have gotten our Research Department to prepare a memorandum for me, before writing the letter. It probably carries more punch as it is, however, and I am not averse to circulation of the correspondence providing I am given the usual opportunity of rebuttal accorded to a first speaker. My "rebuttal" is enclosed.

I agree with you that, if the correspondence is circulated, it might as well go to all of the Presidents. I am in favor of letting them have it.

Yours faithfully,



Allan Sproul,
President.

Enclosure

(2)

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November 28, 1947.

Dear Allan:

At the last moment the Chairman decided to fly up to New York to have Thanksgiving dinner with some of the members of his family who, I understand, are there. Before leaving, he said that so much water had gone over the dam (to coin a phrase) with regard to the discount rate that he had lost interest in sending the correspondence around to your colleagues of the Presidents' Conference, but did not wish this to be construed in any way as an admission that you have the better of the argument. I am sure he feels that you are stubborn while he is firm and that you would agree provided that the adjectives were reversed. In any case, he remarked that there was little chance that he would change your views, or vice versa. Pressures have been so great that he has not had an opportunity to rebut your rebuttal. But this thing could go on ad infinitum. I am personally relieved to drop it right here.

Let me also acknowledge your letter to the Chairman of November 24 enclosing a biography of Mr. Willitts.

Sincerely yours,

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York 45, New York.

ET:b

(1)

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FEDERAL RESERVE BANK

OF NEW YORK

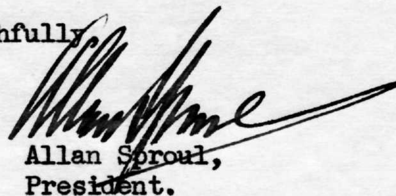
December 16, 1947.

Honorable Marriner S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Marriner:

Enclosed are copies of a recent exchange of correspondence which I have had with Mr. Thomas I. Parkinson, President of The Equitable Life Assurance Society. I thought that you and the other members of the Board might like to see it.

Yours faithfully,



Allan Sproul,
President.

Enclosures

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C
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Y

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES

393 Seventh Avenue, New York

Thomas I. Parkinson
President

December 2, 1947

Mr. Allan Sproul, President
Federal Reserve Bank of New York
33 Liberty Street
New York, New York

Dear Mr. Sproul:

I have your form letter of the 26th instant relating to "bank credit policy during the inflation" in which you "strongly urge directors to see that their banks" follow conservative lending policies.

My position as a bank director has worried me for some time. There are many loans, particularly the term loans, being made by member banks today which are perfectly sound in so far as ultimate repayment of both interest and principal is concerned. I have sometimes raised the question whether they should be made in view of the fact that their proceeds were adding to the inflationary money supply and have always been told that the public welfare involved in that matter was the responsibility of the Federal Reserve authorities.

For example, recently one of the oil companies borrowed more than $100 millions from several New York and Chicago banks for a period, as I remember, of eight years. The credit was perfectly good, the interest rate was low, but we in the insurance business, I must admit, would have been glad to make the loan for even a longer period at a little higher interest rate. At the time the loan was made, the lending banks did not possess excess reserves in any quantity. Indeed, as you know, these banks have been short of rather than over their legal reserve requirements many times during the past year. Nevertheless they made this loan. They made it out of reserves obtained from the Federal by selling to the Federal short term Government paper. As you know, it was necessary for them to sell only about $20 millions of such paper to obtain sufficient reserves to make the $100 millions loan. The effect of the transaction was to use short term Governments held by the banks, the purchase of which had originally increased the money supply by that amount, to create excess reserves enabling the banks to add another $100 millions to the money supply.

My question whether the loan should be made under the circumstances was not one of soundness, not even one of liquidity, but wholly one of the public welfare as affected by such increases in the already excess money supply of the country. The language of your letter seems to confine your suggestions entirely to the soundness of the loan from the point of view of possible loss by the lending bank.

What I am anxious to know is whether you are prepared to advise banks and directors of banks that such loans, which increase and inflate the money supply of

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the country and are not essential for commercial purposes, should be discontinued because of the detriment to the public welfare resulting from such inflation of the money supply? When I raise this point with some of my banking associates, I am met with the emphatic declaration that that is the responsibility of the Federal Reserve Board and the Federal Reserve Banks; that it is not the responsibility of the individual bank. I realize that the individual bank cannot be expected to do what its competitors are not doing and that you of the Federal Reserve alone can require everybody to do in this matter that which you believe essential to the public welfare.

Specifically, what I should like to know is whether you expect me, as a director of a commercial bank, to use my influence to prevent loans of the type which I have described, or purchases of assets, using reserves obtained by the process which I have described because of their increase in the already excessive money supply. Your letter is so pointedly directed at directors as well as officers of the banks and it is so definitely lacking in any reference to lending policies, the only objection to which is their increase in the money supply, that I feel justified in asking you for further comment on that part of our credit inflation problem.

Of course, I realize that the rule of the Federal Reserve Board which supports Government bond prices is the reason for the Federal Reserve Banks' supplying without question reserves to member banks which turn in their Government paper. I cannot help emphasizing my belief that it is that rule which is the source of the trend toward further inflation which President Truman emphasized in his recent message to Congress. I know you and your associates who administer the New York Federal Reserve Bank cannot change the rule but as you suggest that we directors of member banks should influence banking policy in the direction of sounder credit policies, may I not respectfully suggest that you of the Federal Reserve Banks do something vigorous to make the Federal Reserve Board change this rule?

Our Constitution and tradition give to Congress the power to fix the value of our money but what is going on under the present policies and practices of the Federal Reserve authorities gives to the commercial banks in their discretion the power to determine the expansion of our money supply and, therefore, the value of each unit of our money.

Faithfully yours,

/s/ Thomas I. Parkinson,
President.

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MISC. 1402—60M—1-47

FEDERAL RESERVE BANK OF NEW YORK

December 12, 1947.

Mr. Thomas I. Parkinson, President,
The Equitable Life Assurance Society,
393 Seventh Avenue,
New York, N. Y.

Dear Mr. Parkinson:

Since receiving your letter of December 2nd I have been in Washington and, while there, testified before the Banking and Currency Committee of the Senate on the general subject of Bank Credit and Inflation. Perhaps my statement to the Committee is also the best general answer to your letter which I can make, and I am enclosing a copy.

Now to be a little more specific. First, let me say that we in the Federal Reserve System have no inclination to shirk our responsibilities for general credit administration, nor to try to shift those responsibilities to the banks, or to others. It seems to me a little naive, however, for those who direct the investment of very large aggregates of funds to claim that they have no responsibility for the "public welfare" (which is what you say you have been told by bankers). To be sure, this was of the essence of laissez faire capitalism, but I think we now have the more delicate task of trying to strike a precarious balance between complete irresponsibility of action (in terms of public welfare) on the part of private business, and complete government controls. That is probably the most important and the most difficult economic question of our time.

We in the Federal Reserve System have been trying to discharge our responsibilities in the current inflationary situation. I know that you are aware of the steps which we have taken, in cooperation with the Treasury, to dismantle the wartime pattern of rates and to keep the reserve position of the commercial banks under more or less constant pressure, in order to combat existing inflationary forces. Perhaps you are not aware, however, of the over-all results of this policy in terms of bank reserves, since as a bank director you see more of individual transactions, such as the term loan to one of the oil companies which you mention. Between early October, when our present program began to take effect, and early December, the net result of combined Treasury-System action was a reduction of $186 million in the reserves of the banks. When it is remembered that this reduction was brought about, despite an inflow of gold amounting to $475 million during the same period, you can see that we have not been inactive. This program is being continued and I believe that it will be increasingly effective in terms of preventing or restraining current bank credit expansion.

Whether or not the commercial banks have been living up to their responsibilities, you may know better than I. Let me point out, however, that the

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language of the letter of the bank supervisory authorities, which I transmitted to you, was not confined to the soundness of bank loans, from the point of view of possible loss by the lending bank, as you suggest, nor did it omit reference to the effect of lending policies on the money supply. The next to last paragraph of that letter read as follows (underscoring supplied):

"It is recognized that a continued flow of bank credit is necessary for the production and distribution of goods and services. The banks of the country have adequately met this important need in the reconversion period. Under existing conditions, however, the banks should curtail all loans either to individuals or businesses for speculation in real estate, commodities or securities. They should guard against the over-extension of consumer credit and should not relax the terms of installment financing. As far as possible extension of bank credit under existing conditions should be confined to financing that will help production rather than merely increase consumer demand."

You may see that this does not cover the term loan to one of the oil companies which you mention; that this lending was not for speculation and that it will help production, as well as increase consumer demand. Well, I suspect that the reason the supervisory authorities were not more precise, lies in the difficulty of being explicit about this particular kind of loan. For myself, I would say that it would now be good policy for commercial banks not to encourage capital expenditures which are not urgently needed, or which will not add to productive capacity in time to help alleviate current shortages of goods. I would also say, however, that if the banks are looking to the Federal Reserve System or other supervisory agencies to make such decisions for them, they are inviting a degree of interference with their affairs, which neither they, nor you, nor I would like to contemplate. Or else they are asking for the imposition of such drastic general credit controls, as would dry up not only this kind of credit, but probably a lot of other credit which is necessary for the continued flow of goods and services at a high level.

As to the question of whether the financing of business needs for funds should be met by the banks, or by other institutions or investors -- a question which you ask only indirectly -- it is difficult to suggest a hard and fast rule. I can say, however, that it will accomplish nothing in the way of curbing further expansion of the money supply if savings institutions, such as insurance companies, take over the financing of business on a scale beyond their current accumulations of new funds, and then sell large amounts of Government securities which the banking system, including the Federal Reserve Banks, will have to absorb. As you know, that has been going on, and it is one of the reasons why the steps which we have taken to control the further expansion of bank credit have not been more effective.

I am sorry that I have been so long in replying to your letter. With kindest regards,

Yours sincerely,

Allan Sproul

Allan Sproul,
President.

Enclosure
AS:DHP

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 16, 1947

To Chairman Eccles

Subject:

From Ralph A. Young

In its report for the third quarter ending November 30, the Bank Examinations Department of the New York Federal Reserve Bank comments particularly upon the continuation of liberal lending policies on the part of many banks, including some of the larger institutions. The report adds that some banks, most of them the large conservative institutions, seem to be joining in a movement toward liberal lending and that they see no evidence of bankers getting more selective in their credits.

Another item of special interest is that although bankers are commenting upon their disinclination to make term loan commitments, current examination reports show that term loans continue to increase. In the opinion of the New York Bank Examinations Department "a sizable proportion of the increase may be in loans of a nonproductive nature and very likely consists in part of credits which ordinarily would be handled in the capital markets."

Mr. Sproul and Mr. Williams ought to read the report of their own Examination Department before further pontificating upon the productive quality of the current loan expansion. Maybe a letter ought to be written calling their attention to this report if they have not had an opportunity to read it yet.

RAY

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December 19, 1947.

Dear Allan:

This will acknowledge your note of December 16, enclosing the exchange of correspondence with Mr. Parkinson. I found it most interesting and have circulated it to the other members of the Board. His analysis is right and able, but his remedy, wrong, as you will admit. You would be in a much better position to reply if you had a real remedy yourself, i.e., if you supported the special reserve plan or even a straight across-the-board increase in existing requirements.

And this reminds me that your economists should make the acquaintance of your examiners sometime in the interest of consistency, if nothing else. For example, if I understood correctly, and I think I did, your prepared statement and testimony you said in effect that the modest (your word) program was effectively curbing bank loan expansion. I would like, therefore, to quote for your information from the "Summary of Current Trends in the Second Federal Reserve District, Quarterly Report, November 30, 1947, prepared by Bank Examinations Department." This document lists first and foremost among important trends, "(1) continuation of liberal lending policies." The report states that most banks show some increase in loans over June 30 and that "we have been noting a continuation of liberal lending policies on the part of many banks, particularly some of the larger institutions." The report then states:

> "(a) Some banks, most of them large, including some usually numbered among our more conservative institutions, seem to be joining in the movement toward more liberal lending and are going out aggressively for larger loan volume. We hear some talk to the effect that bankers are tightening up on their credits or getting 'more selective', but we don't see much evidence of that.
>
> "(b) According to current examination reports, holdings of term loans continue to increase. The totals are much higher now than they were a year ago and this is despite the fact that some very large credits of highly regarded obligors still are going to the big insurance companies. In our opinion, a sizeable proportion of the increase may be in loans of a non-productive nature and very likely consists in part of credits which ordinarily would be handled in the capital markets."

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I find it difficult to reconcile the foregoing report of the examiners with the pronouncements of the President of the Bank. I recognize, of course, that consistency is an obsession of small minds, but it still has some merit.

Sincerely yours,

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York 45, New York.

ET:b

For Circulation
First to Mr. Eccles

Mr. Szymczak ✓
Mr. Draper ✓
Mr. Evans ✓
Mr. Vardaman absent
Mr. Clayton ✓
Mr. Thurston ✓
Mr. Morrill ✓
Mr. Carpenter ✓
~~Mr. Hammond~~
Mr. Sherman ✓
Mr. Ralph Young ✓
Mr. Leonard ✓
Mr.
Please note, check and return to Mr. Brennan

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FEDERAL RESERVE BANK

OF NEW YORK

NEW YORK 45, N. Y.
December 24, 1947.

Honorable M. S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D.C.

Dear Marriner:

Our correspondence is assuming Jeffersonian proportions but, at the risk of further prolonging it, I must reply to your letter of December 19. Mr. Parkinson's analysis which you label "right and able" was able but not entirely right. I still think it can be said fairly that our present policy is exercising a restraining influence on bank lending. And I was particularly glad to have a chance to take him up on the point he seemed to be making about banks leaving to the insurance companies business financing such as the loan to the oil company he mentioned. As I suggested in my reply, "it will accomplish nothing in the way of curbing further expansion of the money supply if savings institutions, such as insurance companies, take over the financing of business on a scale beyond their current accumulations of new funds, and then sell large amounts of Government securities which the banking system, including the Federal Reserve Banks, will have to absorb." The fact is that we have reason to believe that Mr. Parkinson's company has been among the active sellers of Treasury bonds which we have had to buy in recent weeks. Furthermore, what I had to say about its now being a good policy for commercial banks not to encourage capital expenditures which are not urgently needed or which will not add to productive capacity in time to alleviate current shortages of goods, goes for insurance companies as well.

Admittedly, however, Mr. Parkinson posed a difficult question, but one which would still be difficult if the special reserve plan had been adopted. Your letter was more largely taken up with the seeming discrepancy between the quarterly report prepared by the Bank Examinations Department of this bank and my testimony before the Banking and Currency Committee. I write my own statements and I was aware of the report of the Bank Examinations Department as well as of the views of our economists when I wrote the statement I made to the Committee. My claims for the "modest program" were restrained. In answer to the question, "How effective is this program likely to be?" I said, "The frank answer is that no one can tell as yet." I went on to say that in my opinion it shows increasing signs of being effective, but my references to bank loans suggested only that we had created enough uncertainty in the market to restrain lending at long term and had "lessened the urge on the part of the banks to reach out for longer term Government securities or to make undesirable loans and investments, in order to maintain earnings."

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The second point to be noted is that the report of the Bank Examinations Department was based on reports of examination received from the examiners over the whole period from September 1 to November 30, and that the comments on growth in bank loans were based on comparisons of ✓loans at the time of the last examination with those of the previous examination -- usually about a year previous. Paragraph (a) quoted in your letter referred, I understand, to three New York City banks which had been examined fairly recently. I find that two of the three have shownlittle, if any, increase in their business loans during the past month and that the increase in the third bank has been relatively small. In other words, the bank examination reports are based on random samples, and while they may provide a basis for estimating what the banks have been doing in the past, they are not a wholly reliable source of information on current developments.

I might add that the man who is responsible for the preparation of the quarterly reports of the Bank Examinations Department also participated in the preparation of Mr. Rounds' letter of November 28 in reply to the Board's telegram of November 12. In response to the first question which, in effect, asked whether the recent developments in short term interest rates and in the Government bond market had had any effect on bank lending activities and policies, the answer given included the following statements: "We believe it has, although it is too early to attempt to measure statistically the effects on bank lending activities and policies... In our opinion, however, and in spite of the persistent and sizable current increase in loans, the recent stiffening of short-term rates and the bond market's reaction to it have been a positive influence in promoting caution and restraint in banks' lending operations in this district." In addition, the Bank Relations report, which accompanied the quarterly report of the Bank Examinations Department, showed evidence that the banks were becoming more selective in dealing with loan applications. Finally, I should say that the reference in paragraph (b), which you quote, to "loans of a non-productive nature" represents a poor choice of words. The remainder of the sentence suggests that the reference was to capital loans -- not necessarily non-productive loans.

I am going to continue to try to keep in touch with examiners and economists, as well as others, but there will probably be times when I disagree with some or all of them. It is an old Scotch habit.

Yours sincerely,

Allan Sproul.

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