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TELEGRAM

1945 JUL 9 PM 128

BOARD-CARPENTER

WE HAVE GIVEN CAREFUL CONSIDERATION TO YOUR WIRE REGARDING
ELIMINATION OF SPECIAL DISCOUNT RATE ON ADVANCES
SECURED BY GOVERNMENT OBLIGATIONS MATURING OR CALLABLE IN
ONE YEAR OR LESS. AT THE JOINT MEETING OF PRESIDENTS AND
MEMBERS OF BOARD OF GOVERNORS I STATED IT WAS IN FAVOR OF
ELIMINATION OF OR AN INCREASE IN THE RATE FROM 1/2 to 3/4,
BUT SINCE THAT MEETING THERE HAVE BEEN A NUMBER OF
DEVELOPMENTS IN WASHINGTON INCLUDING APPOINTMENT OF A NEW
SECRETARY AND HEAVY OVERSUBSCRIPTION OF SEVENTH WAR LOAN AND
I FEAR THAT ANY CHANGE AT THIS TIME WOULD BE GIVEN WIDE
PUBLICITY AND THAT PRESS COMMENTS WOULD BE MISINTERPRETED
BY THE PUBLIC. WE BELIEVE IT WOULD BE WELL TO DEFER ACTION
UNTIL A LATER DATE. MATTER WILL BE DISCUSSED THOROUGHLY AT
MEETING OF OUR EXECUTIVE COMMITTEE ON THURSDAY OF THIS WEEK.

YOUNG.

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1945 JUL 10 PM 3 37

BOARD

IMZIL DUE TO FACT THAT ONLY A FEW DIRECTORS WERE PRESENT AT
MEETING TODAY, AND IT IS ANTICIPATED THAT ONLY A FEW WILL BE
PRESENT AT MEETING JULY 17, CONSIDERATION OF CHANGE SUGGESTED
BOARD'S WIRE JULY 7 WAS DEFERRED UNTIL DIRECTORS' MEETING JULY 19.

EARHART.

July 11, 1945

Carpenter - Washington

Regarding Board's wires July 7 and 10, with respect to proposed elimination of preferential discount rate on advances secured by Government obligations maturing or callable in one year or less, believe elimination of that rate at this time undesirable for following reasons:

- (1) Banks might be influenced to sell certificates in large volume to adjust reserve positions as war loan deposits are withdrawn and to purchase longer term securities as reserve positions ease.
- (2) If conditions in (1) develop, the System would be obligated to absorb the excess supply of short term issues in the market and the difficulty of maintaining the pattern of rates would be increased. Also, flow of bank funds into longer term issues, together with System's inadequate supply of such issues for purposes of control, might tend to depress further the yield on longer term securities.
- (3) Doubtful as to extent of decline in total bank credit in use, because decrease in borrowing would probably tend to be counterbalanced by increase in System purchases of securities.
- (4) If rate were eliminated on grounds need for it has passed, and such action later proved wrong, System would not be in favorable position to reinstate rate.
- (5) Elimination of rate would unquestionably be regarded by market as an increase in rate rather than an elimination of rate no longer needed.

Believe increase in special rate to three-quarter percent at this time would accomplish desired objectives without disadvantages which would result from elimination of preferential rate for following reasons:

- (1) Less tendency for banks to shift out of certificates into longer term issues, because banks could resort without penalty to borrowing on short term securities to adjust reserve positions. As a result of this tendency, management of the pattern of rates would be less difficult.
- (2) Three-quarter per cent rate would tend to discourage use of certificates for purposes of borrowing for profit or for lessening excess profits taxes, perhaps even to as great an extent as elimination of rate.
- (3) Three-quarter per cent rate would probably lead to increase in bank rates to customers, dealers, and brokers, although not to same extent as would result from elimination of rate. In any event, tendency would be to curb speculative activity.

(4) Time is as propitious for increase to the three-quarter per cent rate as for increase to one per cent rate. Since problem involves important factors which cannot accurately be measured at this time, increase to three-quarter per cent rate with subsequent reappraisal preferable to increase now to one per cent rate. Among most important factors to be considered are (a) effect of action on pattern of rates and (b) effect on curbing borrowing for profit and speculation. Inasmuch as there is not way of knowing extent to which these factors will be affected, we believe preferable to take partial step in desired direction at this time. After experience with three-quarter per cent rate, reexamine situation to determine whether further action necessary and what consequences might be. Increase to three-quarter per cent rate would put banking system on notice that preferential rate is not frozen in rate structure.

(5) Three-quarter per cent rate would have less unfavorable effect on market and might therefore be more acceptable to Treasury than elimination of the preferential rate.

If all Reserve Banks should finally decide to eliminate preferential rate with approval of Board, strongly urge that Treasury give further consideration to simultaneous announcement that banks would be required to collateral seventy-five per cent of war loan deposits, above a minimum amount, with short term issues.

Will present matter to our Board Thursday for discussion. If different views develop in that discussion, will advise you accordingly.

Gilbert

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1945 JUL 7 PM 1 31

CARPENTER

REPLYING I PERSONALLY FAVOR ELIMINATION OF SPECIAL DISCOUNT RATE
ON ADVANCES SECURED BY GOVERNMENTS MATURING OR CALLABLE IN ONE YEAR
OR LESS BUT WILL ADVISE YOU OF VIEWS THIS BANK ON SUBJECT FOLLOWING
MEETING OF OUR BOARD NEXT THURSDAY. IF EARLIER ADVICE OF ATTITUDE
OUR BOARD IS DESIRED PLEASE LET ME KNOW AND I SHALL CANVASS MEMBERS
BY TELEPHONE

LEEDY

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1945 JUL 9 11 18

CARPENTER BOARD

REURTEL 7 WE WOULD FAVOR ELIMINATION OF SPECIAL DISCOUNT RATE ON
ADVANCES SECURED BY GOVERNMENT OBLIGATIONS MATURING IN ONE YEAR
OR LESS. ASSUMING BOARD WILL APPROVE SUCH CHANGE WE WILL ACT
AT NEXT MEETING OF OUR EXECUTIVE COMMITTEE.

PEYTON.

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TELEGRAM

1945 JUL 10 PM 4 01

REURTELS 7 and 10 REGARDING PREFERENTIAL RATE, AT A MEETING OF OUR DIRECTORS COMMITTEE TODAY THE ELIMINATION OF THE PREFERENTIAL RATE WAS DISCUSSED AND THE COMMITTEE AGREED TO THE DESIRABILITY OF THE MOVE BUT SUGGESTED IT MIGHT BE DESIRABLE TO REQUEST THE TREASURY TO INCREASE THE RATE ON BILLS FROM $\frac{3}{8}$ TO $\frac{1}{2}$ SO THAT COUNTRY BANKS WOULD BE INTERESTED IN THEIR PURCHASE IF THEY DESIRED TO SUBSTITUTE BILLS FOR CERTIFICATES IT BEING UNDERSTOOD WE WOULD INCREASE OUR REPURCHASE RATE ACCORDINGLY OUR DIRECTORS COMMITTEE STANDS READY TO ELIMINATE THE PREFERENTIAL RATE AS SOON AS YOU HAVE ADVISED US THAT THE TREASURY AND THE OTHER FEDERAL RESERVE BANKS ARE IN AGREEMENT.

PEYTON

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1945 JUL 11 PM 1 24

CARPENTER

RETEL JULY 7 BELIEVE CHANGE SHOULD BE MADE IN SPECIAL DISCOUNT RATE ON ADVANCES SECURED BY SHORT GOVERNMENT OBLIGATIONS. DO NOT BELIEVE THAT ACTION WOULD HAVE ANY GREAT EFFECT ON POLICIES OF BANKS IN EIGHTH FEDERAL RESERVE DISTRICT. UP TO THE PRESENT TIME BORROWINGS BY MEMBER BANKS HAVE BEEN LARGELY CONFINED TO A RELATIVELY SMALL NUMBER OF CITY BANKS AND HAVE NOT REACHED UNDUE PROPORTIONS. ASIDE FROM ONE OR TWO CASES BORROWINGS HAVE BEEN FOR TEMPORARY ADJUSTMENT OF RESERVE POSITIONS AND THE ABUSES MENTIONED IN CHAIRMAN ECCLES' LETTER HAVE NOT GIVEN US ANY REAL CONCERN IN THIS DISTRICT.

AS BETWEEN DOING NOTHING AND COMPLETELY ELIMINATING PREFERENTIAL RATE, WOULD DEFINITELY FAVOR THE LATTER. ON BALANCE, HOWEVER, I FEEL THAT A CHANGE TO ONLY $3/4$ PERCENT MIGHT BE PREFERABLE AT THIS TIME. THE PROFIT FROM BORROWING WOULD BE EFFECTIVELY ELIMINATED. MOREOVER, IT MIGHT HAVE SOME INFLUENCE ON BANKS IN THIS DISTRICT AT LEAST IN KEEPING THEM IN CERTIFICATES AND .90 PERCENT NOTES INSTEAD OF SHIFTING TO LONGER TERM HIGHER YIELD SECURITIES. THIS IS ESPECIALLY TRUE IF BANKS ARE REQUIRED TO COLLATERAL WAR LOAN ACCOUNTS WITH GOVERNMENTS DUE OR CALLABLE WITHIN ONE YEAR AS SUGGESTED IN EXECUTIVE COMMITTEE'S MEMORANDUM. FEEL THAT AN INCREASE TO $3/4$ PERCENT WOULD BE JUST AS EFFECTIVE IN CASTING DOUBTS ABOUT INDEFINITE MAINTENANCE OF PRESENT PATTERN OF RATES IN THE SHORT-TERM MARKET.

OUR BOARD MEETS TOMORROW FOR ITS LAST FORMAL MEETING UNTIL SEPTEMBER. WE COULD DISCUSS THE PROPOSED CHANGE AT THIS MEETING BUT WOULD LIKE TO HAVE MORE INFORMATION ABOUT VIEW THROUGHOUT THE SYSTEM. I PLAN TO CALL THIS AFTERNOON TO DISCUSS THE MATTER MORE FULLY.

DAVIS.

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TELEGRAM

1945 JUL 10 PM 1 05

BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM

IN PRINCIPLE, IT IS DESIRABLE TO ELIMINATE THE EXISTING PREFERENTIAL DISCOUNT RATE OF $1/2$ PER CENT ON ADVANCES SECURED BY GOVERNMENT OBLIGATIONS MATURING OR CALLABLE IN ONE YEAR OR LESS, BUT AS A PRACTICAL MATTER IT IS PREFERABLE AT THIS TIME TO RAISE THIS RATE TO $3/4$ PER CENT RATHER THAN ABANDON IT. THIS STEP WOULD BE SUFFICIENTLY MILD NOT TO UPSET THE MARKET, AND AT THE SAME TIME WOULD GIVE INDICATION OF SOME FLEXIBILITY IN SYSTEM POLICY AND ALSO CREATE A DESIRABLE ELEMENT OF UNCERTAINTY IN THE MARKET.

THE EFFECT OF THIS INCREASE SHOULD LESSEN THE PRESENT STRONG APPETITE FOR CERTIFICATES WITHOUT UNDERMINING THE INVESTMENT DEMAND FOR THEM. MUCH, OF COURSE, WILL DEPEND ON HOW THE OPEN MARKET COMMITTEE WILL CONDUCT ITS OPERATIONS. IF THE COMMITTEE SUPPORTS THE CERTIFICATE MARKET SO ACTIVELY AS TO MAINTAIN PREMIUMS, NOT MUCH CHANGE CAN BE EXPECTED IN THE EXISTING SITUATION. BUT IF THE CERTIFICATES ARE MAINTAINED ONLY AT PAR, THE DEMAND FOR THEM IS LIKELY TO BE LESS ACTIVE. THIS SHOULD NOT CAUSE CONCERN, BECAUSE BANKS NOW HOLD ENOUGH SHORT MATURITIES THAT THEY CAN READILY USE AS COLLATERAL FOR ADVANCES. IT WOULD STILL INDICATE OUR POLICY DESIGNED TO ENCOURAGE BANKS TO SECURE RESERVES FROM US BY DISCOUNTING AGAINST SHORT PAPER RATHER THAN SELLING SECURITIES OR BORROWING AGAINST LONG PAPER.

ANY ANNOUNCEMENT OF A CHANGE IN RATES SHOULD BE ACCOMPANIED BY A STATEMENT INDICATING THAT THE REASONS FOR THE DIFFERENTIAL RATE OF $1/2$ PER CENT ARE NO LONGER VALID AND THAT THE CHANGE IN THE RATE IS IN LINE WITH THE DEVELOPING CREDIT CONDITIONS.

TO MINIMIZE LAXITY AND ABUSES, PARTICULARLY DURING WAR LOAN DRIVES, WE FURTHER SUGGEST THAT THE PRESENT LIMITATION OF WAR LOAN ACCOUNTS TO 30 PER CENT OF TOTAL DEPOSITS EXCLUSIVE OF WAR LOAN ACCOUNTS BE STRICTLY ENFORCED.

A H WILLIAMS

1945 JUL 9 PM 4 27

BD.

RE TEL 7th. WE FAVOR INCREASE OF SPECIAL DISCOUNT RATE ON LOANS
SECURED BY GOVERNMENTS DUE WITHIN A YEAR BUT BELIEVE THAT INCREASE
TO $3/4$ PERCENT WOULD BE PREFERABLE TO COMPLETE ELIMINATION AND LESS
LIKELY TO HAVE UNDESIRABLE REPERCUSSIONS.

GIDNEY.

C O P Y

July 11, 1945

Carpenter - Washington

Will wire you with regard to elimination or modification of
special discount rate on obligations callable in one year
after consideration by directors next Monday.

Flanders

C O P Y

July 11, 1945

Carpenter - Washington

Your wire 7th. This Bank would be agreeable to having special discount rate on advances secured by Government obligations maturing, or callable, within one year eliminated, and further for the sake of uniformity would agree to a $3/4$ per cent rate if Board and majority of other Banks prefer that rate.

McLarin

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July 12, 1945

To Mr. Carpenter - Board.

Reurtel July 7 and 10, our Directors today authorized following:

That the special rate on advances secured by Government obligations maturing or callable within one year, which has been fixed at $1/2$ percent per annum since October 27, 1942, be changed and that the rate be fixed at not less than $3/4$ percent per annum, nor more than one percent per annum, the decision as to the rate and its effective date to be made by the executive committee after consultation with the Board of Governors and the other Federal Reserve Banks.

(Signed) Davis.

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July 12, 1945.

To Mr. Carpenter.

Our directors considered informally today question of preferential discount rate and agreed that a change should be made. They prefer a $3/4$ per cent preferential rate to elimination of preferential rate because the former would probably accomplish about what the latter would accomplish and (1) would be less abrupt, (2) would be less likely to interfere with sale of new certificates, (3) would preserve the discount window as the logical method of replenishing reserves, and (4) would leave member banks in a slightly favored position as compared with nonmember banks with respect to discount facilities of the System. There is no assurance that a 1 per cent rate would result in less speculative buying of Government securities by dealers and others on bank credit than a $3/4$ per cent rate. It is especially important that the certificate market be supported only at prices that would return par to the seller.

(Signed) Leach.