November 21, 1947.

Dear Joe:

Because you occupy a position of such leadership in the banking community and have so often approached national problems from the broadest understanding viewpoint I was somewhat dismayed to see a quotation in the American Banker of November 7, from your Chicago address to the effect that the real question is whether or not the Federal Reserve will fully use all of the powers already granted by Congress to control credit expansion, or use the present conditions in an attempt to impose entirely new forms of credit or investment control on the banks. One of the easiest ways, I suppose, to discredit any Governmental action regardless of its merits is to say that its proponents are seeking power. It is a shopworn familiar cry. It seems to me it should be used with discrimination if at all.

This Board does have a great public responsibility--a responsibility placed upon it by the Congress. We have taken great pains in our Annual Reports of 1945 and 1946 to set forth to the best of our ability the effects of the precise situation in which monetary authorities find the effects in the aftermath of the most expensive war in all history. There is a great body of public opinion which erroneously supposes that this System alone has the power to prevent or cure an inflation, even though it is generated and intensified by forces completely beyond the reach of any monetary powers we have, or could be given. I think it is the plain duty of this Board not only to try to correct such misunderstanding, but to point out what might possibly be done within the limits of monetary policy to restrain excessive expansion of bank credit. That is what we tried to do in both Reports in as simple, factual language as possible.

We are not seeking power. We have not been out on the stump seeking these suggested additional powers or any others. When we have been summoned before Committees of Congress--and I am the one who almost invariably has to appear--we have tried to explain the situation and felt that we could do no less in the light of our responsibilities. To characterize that as grasping for power is not dealing with the matter on the high level of debate that the importance of these problems deserves, particularly from leaders in the business and financial world.

You recognize, I know, as I do, that we are in a critical situation. You particularly are conscious of the responsibility resting upon our banking system. It, too, is a convenient scapegoat for the unthinking to blame when things go wrong. No one knows better than you how essential it is that the bankers of this country do not justify any future charge that they were blind to economic forces and bent only on profits and so did nothing to curb inflationary pressures so far as they arise from expansion of bank credit. Nobody could be more eager than I am to preserve our private banking system. It does seem to me that banking leadership should face the problems confronting the banks today very frankly and be willing to consider impartially what practical steps might or could be taken to restrain excessive growth of bank credit. I do not see how they can do less in their own interest.

It is not facing up to the question merely to dismiss the subject by suggesting that a reasonable or practical alternative is for the Federal Reserve to use fully all of the powers already granted by Congress to control credit expansion. What powers? Should we abandon the policy of stability and support in the Government bond market under the illusion that interest rates would rise so rapidly and so high as to knock the boom in the head? Certainly I do not need to point out to you the chaotic consequences of any such abdication by central banking authorities including the incalculable additional cost to the Government in carrying the public debt.

One of the keenest analysts in the Government bond market, who has been a crusader for higher short-term interest rates and a severe critic of the Treasury and Federal Reserve, will state in a forthcoming speech, an advance copy of which he sent me, that failure to support the 2 1/2 per cent rate "would be front page news, and would invite dramatic and large scale redemptions of Series E, F and G Bonds and Savings Notes".

"In other words", he states, "failure to support 2 1/2 % marketable bonds today would invite a wholesale transfer of non-bank holdings of Treasury securities into cash or bank deposits. The comparative inflationary repercussions would be so catastrophic as to make the present fears appear as one raindrop in a storm."

"The structure of debt, and the psychology of this 2 1/2% rate, is such that a failure to maintain it would be the most inflationary move which might be devised at this time because it would threaten the conversion of billions of Treasury securities into cash or bank deposits. While the Government talks loudly against inflation, its actions continue to promote it. To believe that moves in the field of debt management or credit control will mitigate inflation is to misread the mechanics involved. There is no easy road out of our present predicament."

Incidentally, he highly commends the Treasury and Reserve System for permitting the short-term interest rate to adjust to a more reasonable relationship with the long-term rate.

There is, of course, some relatively small remaining leeway in existing powers for raising reserve requirements from 20 to 26 per cent in New York and Chicago, but the fact is that the disturbing increases in bank credit have been outside of these two areas.

As you know, System policy is not made by me alone or by the Board alone, but in large measure by the Open Market Committee on which five Presidents of the Federal Reserve Banks serve in rotation. They are not reaching for power. They are rightly concerned because there is no check upon the banking system at will getting reserves through gold inflow and through selling Government securities to the Federal Reserve System, and under present conditions those reserves will support a multiple credit expansion of at least six to one. Even if interest rates were permitted to rise substantially, and unless they did rise substantially they would be ineffective at best as a deterrent, they would not appreciably influence the decisions of business borrowers to ay when demand for goods is seemingly insatiable, and any added interest costs would be passed on in the price just as increased labor costs are passed on these days. More important, however, the increased interest rate would be an incentive to the lenders. There would still be nothing to deter the banks from getting reserves virtually at will by selling Governments to the Federal Reserve Banks or through gold acquisitions. I cannot believe that you seriously think the problem could be met in this manner, although it is difficult to draw any other implication from your speech.

I have felt I should write you very frankly not only because of my regard for your public spirit and approach to national problems, but because I think you can contribute so much to wise leadership at this critical state in banking history.

With my best personal regards,

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.

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