Form F. R. 511

TO Off the Record Outline

REMARKS: 2/5/41

Other material taken to New York for address 1/30/41 (N.Y.Financial Writers), but filed elsewhere:

Copy of Goldsmith transcript of Treasury press interview 1/9/41

Copy of suggested Press release re the report to Congress by Fed. Reserve Board, Fed. Res. Banks and Fed. Advisory Council.

Copy of Dave Coyle's "Memo on the Nature of Total Preparedness"

Z-161 From Address of Right Hon. Réginald McKenna 1/26/39

CHAIRMAN'S OFFICE

Excerpt Weekly report German Institute for Business Research 12/1/38

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 30, 1941.

To Chairman Eccles

Subject:

From Mr. Thurston

NY Speech 1/30/41

As the President doubtless has been told that the System's special report to Congress is a banker move for high interest rates, it might be well for you to set this matter straight in order to offset misunderstandings that may crop up in the future writings of the New York financial writers.

You might explain, as you have in conversations, that the existing volume of deposits, even if there were no excess reserves, is so great that it would tend to keep interest rates at relatively low levels; that if these existing funds were in high velocity you could have inflationary conditions without basing any more credit on excess reserves -- and, of course, existing deposits will grow as business borrows, even if Government does not, and as gold continues to flow in. However, with the present and immediately prospective velocity and the heavy pressures of existing funds on the money market, all that might be expected from an absorption of excess reserves would be firming of short-term rates which, in particular, have tended toward zero with the bill rate already there or under.

If the System were, however, in a position of control it could, through open-market operations, offset the tendency of the rate structure to get out of line with economic activity, but, in any case, it is not the purpose in requesting these powers to mop up all of the excess reserves at any one time or, in fact, at any time unless such a move becomes imperative as a remedy against monetary inflation. That condition would not appear until we had reached full economic activity, which is difficult to achieve in any case, especially when threatened by industrial and labor bottlenecks arising from a great variety of causes in our complex industrial economy.

The purpose, rather, is to arrest at this stage a further downward trend of the rate structure, and the purpose is not to bring about rates which would retard business expansion, and that means preserving a mortgage rate structure that is not out of line with what has already been accomplished in this field where rates, if anything, are somewhat too high compared with the rest of the rate structure. An arresting of the downward trend is particularly necessary at this stage of rapidly rising economic activity, the more so because with the existing volume of funds it is desirable to avoid adding to this supply so far as possible.

For that reason, the Treasury has emphasized its purpose to sell securities to non-bank customers. However, this cannot be done without halting the downward trend and a firming of the short-term rates. I think you might then explain the three major sources that the Treasury should tap, in line with your memorandum sent over to Danny Bell.

It would be well also, I think, to bring out the point that with the proposed statutory reserve requirements, the potency of the reserve dollar has already been cut in two, as compared with pre-1936, and as reserve requirements increase, the so-called high power of the reserve dollar diminishes more and more. It may be that in view of this and the fact that the banking system has become accustomed to a very large volume of excess reserves, we will not see duplicated the condition that prevailed in the Twenties when the System as a whole frequently had a deficiency and banks were forced to borrow.

Likewise, I think you might reiterate your well-stated concept of interest rates as a means to an end and not an end in themselves.

It is significant that in the special report the bankers of the Advisory Council and the presidents of the Reserve Banks agreed unanimously as to monetary measures that while they are necessary, "There are protective steps equally or more important that should be taken in other fields", etc. This is rather sharply in contrast with the traditional gold standard viewpoint that interest rates are a comprehensive weapon. It signifies a dawning recognition of the fact that "the bank rate" is no longer a cure-all and in fact that high rates are relegated to that perhaps unattainable time when actual monetary inflation threatens because full activity has been reached and there is danger of continued substantial additions to the existing money supply.

I have an idea that some of these financial writers suppose that traditional notions still prevail with the Reserve System and that it wishes to move rapidly into a position to force all rates up and make them the potent instrument of control that they theoretically were in the Twenties. If this impression could be removed, it should be helpful in the future when and if this subject comes on for public debate.

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