First Draft
(Basis for Policy Record)

Reasons for taking this action are as follows:

1. It is the statutory duty of the Board to raise margin requirements whenever, in the judgment of the Board, such action is "necessary or appropriate to prevent the excessive use of credit to finance transactions in securities." In making a finding for such action at any given time, the Board must be guided by the purposes for which the Congress has declared the statute to have been enacted. These purposes include the prevention of excessive speculation in securities and of sudden and unreasonable fluctuations of security prices, both of which have been explicity declared by the Congress to have the effect, when they occur, of precipitating, intensifying, and prolonging national emergencies characterized by widespread unemployment and the disclocation of trade, transportation, and industry.

2. At the present time, in consequence of developments arising out of the war, there is in the hands of the public, and available for financing transactions in securities as well as for other purposes, an altogether unprecedented volume of cash. In these circumstances, the purchase and sale of securities on a cash basis, for speculation as well as for investment, is of such actual and potential magnitude that any considerable volume of transactions in securities on a credit basis is both superfluous and inflationary. Such credit transactions nevertheless represent at present about 25 per cent of the public trading in stocks on the New York Stock Exchange, notwithstanding the fact that for the past six months margin requirements have been at the unprecedented level of 75 per cent. In other words, the volume of margin trading in stocks by the public, though at least one third less than it was during the first half of 1945, still amounts to several hundred thousand shares per day. This is one of the best measures of the extent to which borrowed money is being used to finance transactions in securities.

3. The level of stock prices has been rising for several years. It rose by about 30 per cent during 1945 and by more than half that amount in the last half of 1945. It is now the highest in about 15 years. Whether this advance of stock prices has gone too far -- in the sense that it is destined to give way sooner or later to a sharp decline with consequent damage to the national economy -- is not a question which, for the purpose in hand, the Board needs to decide. Experience has shown that a rapid and prolonged upward movement of stock prices tends to feed on itself, by generating speculative expectations which sooner or later become extravagant. It is for the purpose of preventing or restraining such a development, so far as this can be done through regulation of the use of credit, that the Board has been authorized and directed to raise margin requirements. This requires that the timing of such action shall be such as to have forestalling consequences.

4. If margin requirements should be increased at the present time, there is the further question of the extent to which they should be increased. An increase from the 75 per cent level to the 100 per cent level is an increase of one-third, which compares with an increase of one-half when the requirements were raised last July from the 50 per cent level to the 75 per cent level. In view of the limited consequence of the July increase, there is no reason to believe that in present circumstances an increase of less than another 25 points would exercise adequate restraint on the use of credit for stock-market purposes.

5. Raising margin requirements by 25 points, thereby bringing them for the present to the 100 per cent level and in effect outlawing the use of credit for making new purchases of listed stocks, may for that reason have restraining consequences greater than those of the equivalent increase of last July. If so, that additional restraint will in present circumstances be a desirable consequence. It will contribute to the forestalling of excesses that inflationary forces of unprecedented strength make only too probable. When these forces subside, margin requirements can be lowered again.

6. The Board must recognize that to raise the margin requirements at this time will affect directly only one part of the field in which inflationary forces are at work. This is not to be viewed, however, as a reason why the Board should not take the proposed action, but rather as a reason why the Board should in addition continue to give its full support to such other anti-inflationary measures, on a broad front, as the Government may be in position to employ.