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April 3, 1947

Margin Requirements, etc.

When the margin requirements were lowered recently from 100 per cent to 75 per cent, it was explained in a statement by the Chairman of the Board (copy attached) that the "adjustment to changed economic conditions is restrictive without being prohibitive" and that "further action will depend on the course of economic events."

There has been no change in the basic economic situation since that time which would warrant further relaxation of the requirements. Inflationary pressures have not weakened. The price level for commodities is in fact somewhat higher and the money supply, the "spendable deposits" in the hands of corporations and individuals, is still very large. In these circumstances, further increase in the use of credit for purchasing securities would have no economic justification. In fact, the increase of about 40 million dollars during February in the volume of customers' debit balances added to existing inflationary pressures. [Bank loans for purchasing securities (other than Government securities) declined by a small amount -- about 10 million dollars for the weekly reporting member banks -- between the middle of January and March 26.]

This is not a time when stock-market activity needs to be stimulated, by credit, for the purpose of encouraging new capital issues to finance business expansion. Investment funds are ample, and the money raised by new issues tends to strengthen the already strong demand for basic materials, such as steel, which are in short supply. It is at present not lack of financial capital but the shortage of materials and labor that restricts production.

The argument that the present requirements discriminate against listed securities, as was reiterated recently in the Annual Report of the President of the New York Stock Exchange, is so familiar as to deserve little discussion. Congress withheld from the Board authority to regulate bank loans to purchase unlisted securities -- on the two grounds that (1) for such securities there are no dependable quotations against which to compute margins and (2) that it is activity in the markets for listed securities that generally dominates the market movements for other securities. The exchange market is where the instability is greatest and most conspicuous. And there is no reliable evidence that at present people are in fact using much credit to buy unlisted securities; speculators for the rise seem to be "holding off" from both markets.

There is some complaint against the present rules in Regulation T which prohibit "switching" in undermargined accounts (rules sometimes referred to as the "incidental squeeze"). The claim is made, for example, that they restrict a customer's freedom of action -- if his account is not margined up to the 75 per cent level. They do have this effect, of course, but what some people fail to understand is why such restriction is needed in order to support the 75 per cent requirement. Without it, the customer could always

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be using the credit already in his undermargined account to buy securities that are rising -- or to sell short securities that are falling -- thus increasing speculative activity at a time when the regulations are intended to restrain it. To put this in another way, without the "incidental squeeze" the Board's regulations could apply the same restraint only if (1) the margin requirements were fixed at a level above 75 per cent or (2) the Board were to use its power to require partial liquidation of undermargined accounts. The pressure from brokers, and from a few of their customers, to revoke or relax these rules, in short, is merely another form of the argument for reducing the margin requirements and is open to essentially the same objections. It can also be noted that the recent reduction in margin requirements had the effect of making the "incidental squeeze" less severe than it was before, and that any further reduction would of course make it still less severe.

Both in raising and in lowering margin requirements, as in performing all its statutory duties, the Board undertakes to exercise its best judgment in the light of current economic conditions and prospects. Its decisions are neither arbitrary nor based on prejudice.

One thing the Board must always take into account is the "symbolic" significance of its action. For the Board, at this time, to lower the margin requirements could easily be mistaken by the public to mean that the Board anticipates imminent deflation and is getting ready to use all its powers to expand credit as a means of combatting that development.

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