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NEW YORK STOCK EXCHANGE
Eleven Wall Street
New York 5, N. Y.

EMIL SCHRAM
President

October 23, 1947

Dear Marriner:

Your concern and that of the Board about inflationary developments is certainly shared by me. You have urged greater production, to which I agree whole-heartedly, as the one way of effectively combatting inflationary tendencies. Since a substantial increase in the hours of labor seems to be out of the question from a practical standpoint, your attitude must lead to the conclusion that additional plant capacity is required to make this greater output possible. To be perfectly frank, it seems to me that whether or not business should enter upon capital expenditures is for business alone to decide.

We have been studying the effects of new financing on the capital markets and, as you can see from the attached tabulation, the common stocks of even the largest and soundest companies suffer almost invariably when equity financing is attempted. If the financing is to be done entirely through bank loans, because of the unwillingness or inability of investors to take up these new capital issues, it means that we are committed to a policy of financing through debt alone.

Bank loans, according to the latest weekly statement of the member banks in ninety-four leading cities, for the purchasing or carrying of securities other than United States Government obligations, amounted to only $486 million and similar loans made to brokers and dealers amounted to but $536 million. These classes of loans are about the only ones which have not risen very materially in the past twelve months.

With reference to the statement that this is not the time to encourage the growth of credit or expansion in the money supply, I must confess that unless the Board believes that business will not make loans - and this is not in keeping with the facts - its policy in reality is fostering additions to credit and the money supply. I sincerely believe that the authorities are chasing rainbows in their attacks on the various symptoms of present-day inflation. You cannot draw an iron curtain around each and every sector of inflation in an effort to isolate one segment of the economy thus affected from another. It is my contention that drastic margin requirements have driven an important degree of speculation, which is inherent in our system, from the common stock markets into our more volatile markets, directly increasing the cost of living to the masses of this country.

With any increase in equity financing, loans to underwriters and dealers would increase, but such loans are generally made only for the very short period between the time the underwriters pay the company for the issue and the time of sales of the equity securities to the public. Personally, I do not see any objection to any such temporary increases in bank loans.

Lower margin requirements, by encouraging equity financing, in my judgment, may lead to the use by investors of part of their savings, thus diminishing the need for bank credit.

Historically and logically, I do not believe that a 50 per cent margin requirement can be termed "low". If the Board wishes to attempt to curb inflationary pressures by qualitative credit controls, it would appear that other markets and industries obviously need more attention than the capital markets, but this is a matter of central banking policy and beyond my field.

With kindest personal regards, I am

Yours sincerely,

(Signed) Emil

Honorable Marriner S. Eccles,
Chairman of the Board of Governors,
Federal Reserve System,
Washington, D. C.

Comment on Tabulation Enclosed in Mr. Schram's Letter of October 23, 1947.

This tabulation is quite immaterial. A similar exhibit could be prepared for certain times before margin requirements were subject to any Governmental regulation. Some issues of new stock have not been well received of late, but there is no reason to believe that they would have looked much better to people who might have been willing to borrow 50 per cent on them than they did to people who were buying with their own money or perhaps borrowing 25 per cent. In each instance, the reasons currently set forth by investment analysts for the fate of an issue have not included mention of the prevailing margin requirements.

In any event, the tabulation does not give effective support for Mr. Schram's contention. The failure of the share prices of certain companies offering additional shares to behave as well as the Dow-Jones averages cannot logically be attributed to margin requirements, because the new-issue shares are no more restricted by margin requirements than the shares comprised in the Dow-Jones averages. In fact, many of them are less restricted because a 50 per cent loan value was established in the regulations last December 1 for stockholders' purchases under subscription rights. There are, no doubt, many reasons why some of the examples Mr. Schram selected did not perform as well as the averages, but his tabulation tends to prove, if anything, that this difference in behavior was not caused by the present margin requirements--because these apply to both groups of shares.

STOCK MARKET

November 3, 1947.

Dear Emil:

While it is fruitless to undertake to carry on a debate by letter over margin requirements, and the chief points in your letter of October 23 have already been pretty well covered by previous correspondence, there are a few comments that I feel I should make if only to keep the record straight.

I do not wish to be understood as contending that additional plant capacity is feasible or desirable at this time. Even if it were possible at this juncture to find the labor and materials to expand plant capacity to any significant extent, it would not be desirable to do so. It would be a serious mistake to overbuild plants in an attempt to fill rapidly the abnormally swollen demand for goods and services.

It would be far better to restrain the demand now, as far as possible, by putting the brakes on further credit expansion, than to try to build more plants on today's inflated markets. More borrowed money to buy stocks, more competition for labor and materials now would make a bad situation worse.

The margin requirements, in my opinion, have little or no influence on whether business decides to float stock or to borrow at banks. For one thing, there is often reluctance to dilute equities by issuing more stock. For another, bank interest rates are low and the interest can be charged off under the tax laws. In my opinion, these considerations have much more to do with the decisions than the fact that people can borrow only 25 cents--instead of 50 cents, as you propose--out of every dollar they use to buy listed stocks.

The stock market is the healthiest spot in the picture. When the long postponed shakedown comes, as it ultimately must, the stock market will not have to go through another ruinous liquidation as it did after 1929 when it was largely built on credit instead of on cash as is now the case.

Our staff people have studied the figures you enclosed and derive from them a conclusion directly the opposite of yours. They think that if the statistics prove anything of relevance to the subject, it is that margin requirements have no influence whatever in deterring stock offerings. I enclose a copy of a staff memorandum on this point.

Mr. Gisler

Gen. Files
12/5/47

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Finally, without attempting to cover the many points in your recent Pittsburgh speech with which I strongly disagree, I do want to remind you that margin requirements are determined by the Board of Governors--not by me alone. Congress, by statute, has placed the responsibility for these margins on a Board--not upon the Chairman alone. In your speech you repeatedly referred to "Eccles" doing this, or thinking that. Even if the purpose is not to single me out for personal attack such personalizing of the matter gives the public a wholly false and misleading impression. So far as I am aware, opinion within the System is unanimous, except for one individual, in supporting the present margins, as Allan Sproul specifically did in his latest annual report, as President of the Federal Reserve Bank of New York. In fact, the position of the Board and the System is approved, I am certain, by all those in Government who are concerned with combatting the current inflation, from the White House on down. In all fairness, Emil, I think public questions of this kind should be debated on the merits of the issues involved, and not by dragging in personalities.

There is one more thing I feel that I should say. I did not, in my talk to the State Bank Supervisors, advocate that the banks increase their risk assets, as you contended in your Pittsburgh address. What I said was that if banks do in fact increase their risk assets they should also increase their capital. In a word, any expansion of credit at a time like this adds to the already dangerous inflationary forces. If banks could be required to increase their capital ratios as they increase risk assets, it would tend to stop further credit expansion.

With kind regards,

Sincerely yours,

Enclosure

Mr. Emil Schram, President,
New York Stock Exchange,
Eleven Wall Street,
New York 5, New York.

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