The Papers of Charles Hamlin (mss24661)

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Scrap Book - Volume 183
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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 24, 1941

To The Files

Subject:

From Mr. Coe

MPC.

After correspondence with Mrs. Hamlin (see letters of May 25 and June 4, 1941) the items attached hereto and listed below, because of their possible confidential character, were taken from Volume 183 of Mr. Hamlin's scrap book and placed in the Board's files:

<u>VOLUME 183</u>

<u>Page 50</u>
Memo to Mr. Hamlin from Mr. Goldenweiser re discounts by F.R. Banks on paper secured by bonus certificates.

<u>Page 60</u>
Earnings & Expenses of F.R. Banks.

<u>Page 109</u>
Credit and Business Developments in 1928. (Marked Confidential)

<u>Page 113</u>
Letter from Mr. Hamlin to Secretary Mellon enclosing memorandum--"The Effect of Gov. Security Operations on Member Bank Reserves During the Period of the $3\frac{1}{2}$% Rate, namely, from August 4, 1927 to February 3, 1928".

<u>Page 126</u>
Letter to Chairmen of all F.R. Banks (X-6151) re advice of change in rediscount rates.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

P. 5

Sec. bon

Date September 20, 1928

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

E A G

2—8495

Referring to your memorandum of the nineteenth about discounts by the Federal reserve banks on paper secured by bonus certificates, I wish to say that on August 31, 1928 the total of such certificates held by the reserve banks was $2,090,000, and that at no time has the figure been much larger than that. This represents about one-seventh of one per cent of the total earning assets of the Federal reserve banks. You will see, therefore, that Governor Harding's statement was well within the truth.

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS

<u>AUGUST 1928</u>. Total earnings of the Federal reserve banks in August were $106,000 more than in July, an increase during the month of $117,000 in earnings from discounted bills and of $17,000 in earnings from purchased bills being only partly offset by a decrease of $22,000 in miscellaneous earnings and of $6,000 in earnings from U. S. securities.

Current expenses (exclusive of cost of Federal reserve currency) were the same as in the month preceding, $2,199,000, as compared with $2,167,000 in August of last year.

<u>EIGHT MONTHS ENDING AUGUST 31.</u> During the eight months ending August 31 earnings totaled $37,944,000 as compared with $27,352,000 last year and $30,467,000 for the corresponding period in 1926.

Current expenses (exclusive of cost of Federal reserve currency) amounted to $17,350,000, an increase of $175,000 over the corresponding period of last year.

After providing for all current expense and dividend requirements, the Federal reserve banks on August 31 had a balance of $12,855,000 available for losses, depreciation allowances, surplus and franchise tax, as compared with a balance of $10,324,000 at the end of July and of $3,450,000 at the end of August 1927.

The last column of the statement has been so amended as to represent the balance available for reserves, surplus and franchise tax after deducting dividends accrued, net charges to profit and loss, cost of furniture and equipment purchased during the current year, etc. This change was deemed advisable since current deductions, which have in the past been small, are now rather large due to losses incurred on U. S. securities sold. The statement has been further revised so as to show cumulative figures for all Federal reserve banks combined for the years 1928 and 1927 to the end of the report month.

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Mr. Hamlin P.60

See Bk

CONFIDENTIAL
Not for publication

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, AUGUST 1928.

St. 5908

Federal Reserve Bank	Month of August 1928: Earnings from - Discounted bills	Purchased bills	U. S. securities	Other sources	Total	Current expenses: Exclusive of cost of F.R. currency	Current expenses: Total	Current net earnings: Amount	Current net earnings: Ratio to paid-in capital	January - August 1928: Current net earnings	Dividends accrued	Available for reserves, surplus and franchise tax.*
									Per cent			
Boston	$256,589	$69,357	$22,505	$4,104	$352,555	$154,076	$156,165	$196,390	23.2	$1,638,989	$388,711	$1,138,733
New York	1,365,378	148,725	103,787	12,325	1,630,215	536,465	540,848	1,089,367	26.6	6,375,239	1,753,358	4,284,627
Philadelphia	421,117	49,675	62,687	1,279	534,758	165,303	167,664	367,094	30.3	1,957,969	553,593	1,310,683
Cleveland	333,146	71,384	100,739	11,324	516,593	209,213	211,300	305,293	25.2	1,959,567	569,461	1,304,723
Richmond	234,808	28,154	8,460	4,540	275,962	115,747	116,964	158,998	30.9	773,320	248,666	476,390
Atlanta	310,126	46,705	15,436	4,337	376,604	103,905	104,970	271,634	61.6	1,085,505	207,554	841,579
Chicago	670,191	45,401	112,188	34,544	862,324	294,660	299,852	562,472	36.5	2,945,403	731,870	2,019,780
St. Louis	241,701	185	36,373	1,639	279,898	112,497	113,066	166,832	36.5	855,858	213,782	246,674
Minneapolis	69,813	35,926	35,324	2,757	143,820	77,492	77,813	66,007	25.8	377,565	120,987	217,501
Kansas City	84,820	34,888	59,658	22,061	201,427	133,544	134,667	66,760	18.8	454,288	169,126	227,971
Dallas	113,693	45,559	48,559	1,830	209,641	103,322	103,582	106,059	29.0	375,262	172,245	143,549
San Francisco	293,178	76,931	51,775	4,582	426,466	193,268	195,168	231,298	25.3	1,137,536	408,240	642,698
TOTAL												
Aug. 1928	4,394,560	652,890	657,491	105,322	5,810,263	2,199,492	2,222,059	3,588,204	29.4			
July 1928	4,277,022	636,016	663,906	126,945	5,703,889	2,198,681	2,241,312	3,462,577	28.7			
Aug. 1927	1,343,543	515,084	1,251,336	367,882	3,477,845	2,166,765	2,320,342	1,157,503	10.5			
Jan. - Aug.												
1928	22,069,254	7,151,707	7,580,347	1,142,768	37,944,076	17,350,006	18,002,565	19,941,511	21.6	19,941,511	5,537,593	12,854,908
1927	11,711,960	5,957,743	8,123,487	1,558,817	27,352,007	17,184,252	18,415,669	8,936,338	10.5	8,936,338	5,126,421	3,449,663

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
SEPTEMBER 22, 1928.

*After adjustment for current profit and loss entries, purchases of furniture and equipment, etc.

C.

Sec Bk

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CONFIDENTIAL

CREDIT AND BUSINESS DEVELOPMENTS IN 1928

Gold

Reversal of the gold movement has been the outstanding fact in banking and credit developments since last autumn. The monetary gold stock of the United States, which at its peak in May, 1927 was above $4,600,000,000, declined by June of this year to about $4,100,000,000. Comparison of this loss of gold with the growth in reserve bank credit shows that the increase in reserve bank credit has almost entirely reflected the withdrawal of gold. The other factors affecting the volume of reserve bank credit have been relatively unimportant. Currency demand has declined somewhat and member bank reserve balances have remained at about the same level as last year.

This considerable loss of gold during the year raises two questions: first, what purpose has it served? and secondly, what is the probable course of gold movements in the immediate future? In answer to the first question, it can be stated that the loss of gold by the United States has been an important factor in the return of the world to the gold basis. Gold reserves of countries outside of the United States and Canada have increased by about $800,000,000 during the period and the reserve position of most of the important central banks has improved. This year Europe is able to face the autumn demand for American exchange, with the possibility of a loss of gold, without serious apprehension as to the effects this loss may have on monetary stability or on availability of credit for domestic trade. At this time last year the gold standard was going through a critical period, and now it is firmly established; not only have France and Italy returned to the gold standard, but other countries, including England, have strengthened their position to such an extent that an abandonment of the standard is no longer to be feared.

Is the United States likely to lose more gold? Analysis of the destination of the gold shows that the principal taker was France, with Argentina next in importance. The movement to France was in connection with the reestablishment of monetary stability, and that to Argentina largely the result of a favorable balance of payments. From neither source are further demands upon our gold to be expected. France still has large holdings of foreign exchange, which would enable her to draw more gold, but her problem now is to maintain the stability of the franc and for that purpose foreign balances are better than gold in vault. Furthermore, with the critical period of stabilization safely passed, France is not likely to tie up more of her funds in an asset as sterile as gold. On the other hand, with her reserve ratio not far above the legal requirement, France is not likely to release much gold.

Argentina now has more than $600,000,000 of gold, a large amount for a country with Argentina's population and trade activity. With the present price of wheat and the position of the capital markets her balance of payments may not be as favorable as last year, and in that event she may meet some of her balances on current and on capital account by gold exports. It is also expected that she will reorganize her central bank and in that case may wish to convert a part of her gold into foreign balances. For a country as far removed as Argentina, with shipping costs as high as they are, a foreign balance is preferable to gold in vault for exchange operations.

England now has about $125,000,000 more gold than at the time of her return to the gold standard and she has neither incentive nor capacity to buy more gold at a time when it is particularly important for her to maintain a favorable balance of payments with the world.

Germany has greatly increased her gold reserves, chiefly through acquisitions from Russia, and she cannot be expected to be an important buyer of gold in the immediate future.

Italy is still gold poor, but she is poor also in other respects and she can hardly afford to exchange her products for the yellow metal.

Gold movements in and out of Canada generally offset each other in the course of a few months and there is no prospect of considerable gain or loss of gold from that source. In the long run this country receives from Canada approximately as much gold as Canada produces, which is about $35,000,000 or $40,000,000 annually.

India may be expected, as usual, to take a part, but not a large part, of the total amount of between $200,000,000 and $300,000,000 of gold that is annually added to the world's gold stock in excess of industrial demands. The remainder will probably be more than sufficient to meet whatever demands the minor countries may make upon the world's gold stock.

To sum up, it would appear that the United States is not likely to lose gold during the next year, and that on the contrary, there is every probability of some addition to our gold stock, and a possibility of this addition being considerable. On the other hand, no substantial proportion of the gold now held by central banks, which has been built up to insure the stability of the countries' financial structures, is likely to be released for export. Since last June there has been a gradual increase in our gold stock amounting to about $15,000,000 or $16,000,000, ~~but~~ and in September there has been a further inward movement. Whatever gold comes to the United States in the next few months will be largely absorbed in the reduction of member bank indebtedness, and in view of the large volume of this indebtedness, such a reduction will not materially affect the credit situation.

Money rates

The tightening of money in this country during the past year has also been due largely to the loss of gold. At the present time the level of rates is higher in this country than abroad, except in Germany, where normal conditions have not yet been established. It would seem that the loss of gold by the United States, together with the growth of credit in this country and the policy of the reserve banks, have tightened credit conditions throughout the world. The rise of money rates in this country has made it necessary for foreign countries to maintain a sufficiently high level of rates to prevent considerable losses of reserves to the United States.

A measure of the tightening of money in the United States can be obtained by reference to changes in rates prevailing on the different classes of loans. Rates on stock exchange loans have advanced since the summer of 1927 from about 4 per cent to 7 1/2 per cent; commercial paper rates have gone up from 4 to 5 1/2 per cent, and acceptances from 3 1/8 to 4 1/2 per cent. It is to be noted that rates increased most in that field in which there has been the largest expansion of credit, namely, in loans on securities. Open-market rates on bills and on commercial paper have advanced, but much less than rates on security loans

Another phase of this development is brought ont by the fact that money rates to customers have increased less than open-market rates. Rates to customers at banks in New York City have increased more than rates in other Eastern cities, and rates in Eastern cities have increased a great deal more than the average of rates in Western and Southern cities, which shows an increase of less than one-half of one per cent. This indicates that the burden of high money has fallen much more heavily on those who are financing transactions in securities than on those who are financing productive activity.

The question that is sometimes raised in this connection is whether high rates have not attracted money to New York to the detriment of the legitimate needs of communities in the interior. An analysis of out-of-town bank funds in the New York market shows that balances held by New York banks for out-of-town banks have been declining throughout this year, while brokers' loans on account of out-of-town bank correspondents have changed relatively little. The total of these two amounts, which measures the volume of out-of-town banking funds in New York, has had a downward tendency throughout the year. It is notable that out-of-town banking funds in New York increased throughout 1927 during a period of cheap money and declined in 1928 at a time when money was dear. This is not as surprising as might appear at first glance, because money goes to New York in the great majority of cases after the demands of local customers have been satisfied. In a broad sense the money market absorbs surplus funds and not funds currently needed by trade and industry. Easy money in 1927 was due in part to the lack of commercial demand and this lack caused money to flow into the money market. In 1928 the local demand for credit has been larger and additional bank funds have not sought investment in the money market.

It is true, however, that corporations have greatly increased their funds in the money market. This fact, which is one of the conspicuous banking developments of the year, is essentially the consequence of high money following upon a long period of easy money. Corporations taking advantage of the low level of rates have put themselves into a strong cash position by the flotation of large amounts of securities. In the absence of considerable growth of industry, these funds are temporarily idle and have been utilized in the money market. The effects of this development have been greatly over-emphasized. Brokers' loans have not greatly increased as a consequence of corporate funds coming into the market, since the corporations have for the most part taken over loans which otherwise would have been carried by the banks. The consequence has been some decrease in the reserve requirements of member banks, which in effect sold some of their loans to customers who paid for them by drawing upon their deposits. When the corporations will want to use their funds, they will gradually withdraw them, and then the member banks will reassume the loans, and the effect will be primarily a growth of deposits and consequently of reserve requirements.

The important phase of the situation is that there is a volume of $2,000,000,000 of loans that is made by corporations and is, therefore, neither subject to the customer relationship which devolves upon member banks, nor subject to supervision by banking authorities.

Banking developments

Growth of bank credit during the fiscal year ending June 30, 1928 has been at an unusually rapid rate. Taking all the banks in the country there has been an increase of $3,500,000,000 in loans and investments amounting to about 6 1/2 per cent, the largest percentage of growth since the year ending in June, 1925. This growth has been chiefly in loans on securities and in investments. The growth in other loans has been much less and of this increase a part has been in real estate loans. The increase in loans for industrial and commercial purposes has been moderate. Bank holdings of paper eligible for rediscount at the Federal reserve banks have declined by about $120,000,000 since June of last year.

Member bank deposits increased only about one-half as much as loans and investments, $1,200,000,000 as compared with $2,400,000,000; and all the growth has been in time deposits which accounts for the slight growth in member bank reserve requirements. The difference between the growth in loans and investments and in deposits is explained once more by the loss of gold. Deposits have been withdrawn from the member banks in gold and the member banks have replenished their reserves by borrowing from the Federal reserve banks. An indication of the use by foreigners of their American balances to draw gold is given by the figures of the amounts due by member banks to foreign depositors. Between the end of 1927 and the middle of 1928 those amounts decreased by about $175,000,000.

The rapid growth of bank credit, to which reference has just been made, occurred largely in the latter part of 1927 and the early part of 1928. Since May there has been a decline in loans and investments of reporting member banks, and in all probability in the total volume of bank credit outstanding. This decline has been in part in loans on securities and in part in investments, as banks have met the pressure for credit in part by selling securities. So-called "all other loans," including loans for commercial and agricultural purposes, have increased since May and recently have been showing a seasonal expansion which generally comes to a peak at about the middle of October.

Business conditions

Throughout the period of rapid growth of bank credit, followed by a period of relative constancy, business conditions have remained unusually stable. Industrial production has been maintained at a high level and during the past month there has been a considerable increase that carried the total to the largest volume on record. There are industries in which depressed conditions prevail, particularly in the textile industry. Of the two mainstays of recent industrial prosperity, automobiles and building, automobile production has kept up its remarkable record, and figures for August indicate the largest production in the history of the industry. The year 1928 bids fair to replace 1926 as the banner year in output of automobiles. The building industry has shown some signs of recession, as indicated by a decline in building contracts awarded in August to a level lower than at any time since the early months of 1925. It has been suggested that this abatement of building industry is due in part to the prevailing high money rates. In September, however, there has been some growth in building contracts awarded.

Employment and payrolls have been stable at a high level during the year. Distribution of commodities to the consumer both at wholesale and at retail has continued at a high level and there has been no growth in accumulated inventories. Stocks of department stores, for which good figures are available, are exceptionally small.

Conditions in agriculture show improvement for the year. Crops are abundant and farm income is expected to be larger than in 1927.

Prices

Contrary to the usual belief that high money rates result in price declines the general level of commodity prices has been advancing with fluctuations since early in 1927 and has shown a more rapid advance in the past three or four months This rise in prices has been greatest in farm products, but has also been evident in nonagricultural commodities. Farm products, particularly grains and cotton, showed a rapid advance early in the year and have recently been declining. Livestock prices, however, are at an exceptionally high level and this is what accounts for the maintenance of the general level of agricultural prices. Among nonagricultural commodities, advances have occurred in the price of copper, and petroleum. Prices of coal and steel have also been firm. In general, the price situation presents a condition of firmness without an advance sufficient to induce speculation in inventories.

Federal reserve policy

The record of the year indicates that Federal reserve policy has had no unfavorable effects on business conditions. An inquiry sent out by the Board to the Federal reserve banks and by them passed on to some of their member banks has brought in replies which with surprising unanimity indicate that there has been so far no bad effect on industry from the prevailing high money rates.

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It would appear that the easy money policy adopted in the summer of 1927 has had far reaching consequences. Among these consequences has been the re-establishment on a firm basis of the international gold standard. In this country the easy money has been a factor in the acceleration of trading in securities both by investors and by speculators. The large growth in the use of bank credit for these purposes, particularly in the absence of any considerable growth in the demand for credit by trade and industry, has caused the Federal reserve system gradually to use its influence towards higher money rates. Security holdings, which were accumulated in 1927 and reached their peak towards November of that year, began to be sold in January and the program of sales continued until the latter part of May, soon after the last meeting of the Federal Advisory Council. The open-market investment account by that time was reduced to about $80,000,000 and the total security holdings to about $200,000,000, a level which has been maintained since then.

Discount rates, which were reduced to 3 1/2 per cent at all the banks in the course of August and September, 1927, were gradually advanced, first to 4 per cent between January 25 and March 1, then to 4 1/2 per cent between April 20 and June 7, and finally at eight of the banks to 5 per cent between July 11 and August 1. In four Western agricultural districts the 4 1/2 per cent level still prevails. The system's policy has undoubtedly been a factor in arresting the growth of bank credit in the past few months.

The decline in the reserve banks' security holdings, together with gold exports, has resulted in an increase of member bank discounts to a level which has been almost continuously above $1,000,000,000 for several months and is now about $1,100,000,000. In recent weeks there has been a seasonal increase in the system's holdings of acceptances which are now at a somewhat higher level than a year ago. During the remaining months of the year a growth of reserve bank credit of about $300,000,000, largely in response to the seasonal demand for currency, is to be expected.

Sec. Dll

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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

October 2, 1928.

Dear Mr. Secretary:

I have spent some time analyzing the claims so often heard, that the reduction of the discount rate in August, 1927, and the purchase of Government securities, created "cheap" money in the United States, which was responsible for the speculation on the New York Stock Exchange.

I find no evidence of this, and I wish you would read the enclosed memorandum and see how it strikes you.

Sincerely yours,

C S Hamlin

Hon. Andrew W. Mellon,
Secretary of the Treasury.

Dear Mr Hamlin

I have read the memorandum and think it clearly states the facts, and demonstrates the position you take. It is useful & I am glad to have it

Yours sincerely

A W Mellon

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PAGE 113

September 28, 1928.

The Effect of Government Security Operations on Member Bank Reserves During the Period of the 3½% Rate, Namely, from August 4, 1927, to February 3, 1928:

The claim is often made that the reduction in the discount rate from 4 to 3½%, and the accompanying purchases of Government securities during the period in which this rate was in force, - August 4, 1927 to February 3, 1928, - caused "easy" or "Cheap" credit which was responsible for the speculative craze on the New York Stock Exchange.

For example, the New York Commercial Chronicle of August 4, 1928, stated:

> "Who is responsible for the speculative folly, the ill effects of which are now visible on every side? Not the banks, no matter how their course is to be deprecated, but the Federal Reserve, every move of which during the last twelve months has been fraught with latent mischief. Did not the Federal Reserve banks last summer reduce their rates of rediscount to 3½%, even compelling one obstreperous Reserve bank in the west to make the reduction against its emphatic objection and protest? At that time, the member banks were not borrowing, as they are today, over $1,000,000,000 at the reserve banks, but barely half that amount, and could not be induced to increase their borrowings even at the low rate of 3½%, since they had no use for the money. Did not the Reserve banks then undertake to thrust out Reserve credit on unwilling banks by purchasing several hundred million dollars of Government bonds, thereby flooding the market with Reserve funds to a corresponding amount?"

The 3½% discount rate was in force, at least at New York, from August 4, 1927, to February 3, 1928, and it will be interesting to consider just what was the course of Federal Reserve credit in the whole System during this period, and examine as to how far the above criticism of "cheap" money through lower discount rates and Government security operations, is justified.

The essential figures are as follows:

August 4, 1927 - February 3, 1928:

Member bank reserve balances increased	107,000,000
Gold stock decreased	203,000,000
Discounts increased	61,000,000
Acceptances increased	205,000,000
United States securities decreased	2,000,000
All other Federal Reserve credit decreased	60,000,000
Total Federal Reserve credit increased	204,000,000
Treasury credit increased	8,000,000
Money in circulation decreased	105,000,000
Foreign bank deposits, etc. decreased	6,000,000

Taking this period as a whole, it is clear that, comparing the beginning and end of this period, neither discounts nor Government securities were having any inflationary effect, for discounts had increased only 61 millions, a normal seasonal increase, at the end of the period, while Government securities had actually declined 2 millions. Furthermore, the total increase of Federal Reserve credit during the period, - 204 millions,- just offset the gold exports which were 203 millions, while the decline in money in circulation, - 105 millions, - practically accounts for the increase in member bank reserves, - 107 millions - during the period.

The above figures show that the hundreds of millions of Government bonds, the purchase of which by the Federal Reserve System "flooded the market" - as claimed in the above quoted editorial, - had been neutralized by the sale of even larger amounts of these bonds, there being at the end of the period 2 million dollars less of such holdings than at the beginning,- and all this under the 3½% rate!

It may be claimed, however, that these figures do not give a clear picture of what took place, because during the month of January, 1928, the tide turned, Federal Reserve credit declining 373 millions and member bank reserve balances declining 113 millions. Let us then consider the period from August 4, 1927, to December 31, 1927, excluding the month of January 1928 when credit conditions were reversed. The following table shows the situation:

August 4, 1927 to December 31, 1927:

Member bank reserve balances increased	220,000,000
Gold stock decreased	200,000,000
Discounts increased	173,000,000
Acceptances increased	222,000,000
United States securities increased	205,000,000
All other Federal Reserve credit decreased	23,000,000
Total Federal Reserve credit increased	577,000,000
Treasury credit increased	20,000,000
Money in circulation increased	175,000,000
Foreign bank deposits decreased	3,000,000
Other items increased	5,000,000

The above figures show that during that period there were gold exports to the amount of $200,000,000, while the purchase of Government securities increased $205,000,000. It would seem to me fair to set off the one against the other. So also the increase in money in circulation was $175,000,000, and this was practically offset by the increase in discounts of $173,000,000.

It would seem clear that the gold exports of $200,000,000 during this period, if not offset in some manner, would have forced a deflation of member bank deposits amounting to at least ten times the amount, or about 2 billions of dollars, and the worst that can be said as to Government security operations during this period is that they prevented a radical deflation caused by gold exports. They certainly, taking the period as a whole, brought about no inflation of deposits.

It may be claimed, however, that while these figures are correct, taking the whole period, yet that there were particualr times during this period when the purchase of Government securities placed money in the market which went directly into member bank reserves, thus making additional deposits growing out of loans, possible. Let us then consider the two quarterly periods of the latter part of 1927, during which the 3½% rate was in force.

Let us take the quarter beginning in July and ending in September, during all of which period, except July, the 3½% rate was in effect. The figures for this period are as follows:

Member bank reserve balances increased	44,000,000
Gold stock decreased	16,000,000
Discounts decreased	6,000,000
Acceptances increased	39,000,000
Government securities increased	136,000,000
All other Federal Reserve credit decreased	20,000,000
Total Federal Reserve credit increased	149,000,000
Treasury credit increased	9,000,000
Money in circulation increased	97,000,000
Foreign bank deposits decreased	5,000,000

The increase in member bank reserves during this period was very moderate, - only 44 millions, - and taking the quarter as a whole could be covered by acceptances, - 39 millions, - and foreign bank deposits, - 5 millions, while the Government security operations, - showing an increase of 136 millions, - would, as to all but 17 millions, have offset the gold exports 16 millions, the decline in discounts, 6 millions, and money in circulation, which latter increased 97 millions.

Let us now consider the quarter, October through December, 1927.

The figures for this quarter are as follows:

Member bank reserve deposits increased	194,000,000
Gold stock decreased	192,000,000
Discounts increased	145,000,000
Acceptances increased	142,000,000
United States securities increased	111,000,000
All other Federal Reserve credit increased	26,000,000
Total Federal Reserve credit increased	424,000,000
Treasury credit increased	13,000,000
Money in circulation increased	55,000,000
Foreign bank deposits decreased	3,000,000
Other items decreased	1,000,000

From the above figures, it appears that gold exports had increased 192 millions, and money in circulation had increased 55 millions, which was offset by Government security purchases, - 111 millions, and discounts,- 145 millions. On the other hand, the member bank reserves at the end of this period had increased 194 millions, which increase was practically furnished from the increase in acceptances, - 142 millions, other Federal Reserve credit - 26 millions, and Treasury credit, - 13 millions.

An examination of the above table seems to show that neither the discounts under the 3½% rate, nor the Government security operations were, on the whole, primarily or necessarily responsible for the increase in member banks reserves upon which the pending speculation on the New York Stock Exchange rests.

While it is often claimed, as shown above, that the lowering of the discount rate to 3½% produced "easy" or "cheap" credit, it should not be forgotten that credit was easy or cheap, if you so wish to call it, before the rate reduction of August 4, 1927, from 4 to 3½%.

For example, on March 31, 1927, as compared with the previous

December 31, 1926, gold imports had increased 105 millions, money in circulation had decreased 233 millions, discounts had decreased 186 millions, and acceptances had decreased 142 millions, the total Federal Reserve credit decrease being 308 millions.

Similarly, comparing June 30, 1927, with March 31, 1927, we find that discounts had decreased 8 millions, acceptances decreased 28 millions, money in circulation decreased 11 millions, and that while Government securities increased 22 millions, the total Federal Reserve credit increase was only 9 millions.

The above gives a fair picture of the easy money conditions existing before the rate was reduced from 4 to 3½%.

The purpose of the reduction of the rate from 4 to 3½% was primarily to prevent a continuance of gold imports into the United States, which, in the absence of any large volume of discounts which could have been paid off, would certainly have tended to inflate the credit structure. Another reason was to give, if possible, some relief to business, commerce, and agriculture, which had been in a state of recession but was just beginning to improve. It is fair to state that this lowering of the rate did accomplish both of the above purposes in more or less degree.

The conclusion I reach from these figures is that while psychologically an easier feeling was created, the increase in member bank reserves can be explained without reference to lower discount rates or Government security operations.

Turning now to the so-called brokers' loans, a study of the charts will fail to reveal any material difference in the increase of such loans, either

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prior to, during, or subsequent to the $3\frac{1}{2}\%$ discount rate, except that the New York banks have shown a tendency to reduce these loans, more or less overcome by an increase on the part of out-of-town banks, while the loans made "for others" have steadily increased from the middle of 1926 to date, this increase being practically the same, whether during low rate or high rate periods.

As regards Government security operations, I am inclined to believe that Federal Reserve credit conditions would have been substantially the same had there been no such operations during the $3\frac{1}{2}\%$ period, as discounts would have taken their place.

In conclusion, it seems to me that the claim that the $3\frac{1}{2}\%$ discount rate and Government security operations during the period running from August 4, 1927, to February 3, 1928, created cheap money, and flooded the member bank reserve account, thus exciting speculation on the New York Stock Exchange, is a myth which has no foundation in reality.

Sec'y

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FEDERAL RESERVE BOARD

WASHINGTON

X-6151

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

October 5, 1928.

Dear Sir:

Prior to the last several months the Federal Reserve Board in the exercise of its function of "review and determination" over rates of discount established by the directors of the Federal reserve banks has been obliged to rely upon data as to conditions in the respective districts furnished by its own research department and scattered information received from the Federal reserve banks. More recently, it adopted the informal procedure, upon receiving advice that the directors of any Federal reserve bank had voted to change the rate in effect, of wiring the officers of the bank to furnish it with a statement of the reasons for the change in rate. Responses received to these inquiries have proven to be of value to the Board in acting upon suggested rate changes.

The Board feels that it would be of very great assistance to it, if at the time the directors of the Federal reserve bank vote to make a change in the rediscount rate they would authorize the Chairman in advising the Board of their action to inform it also of the reasons which actuated them in making the change.

The Board, therefore, has formally requested me to have you state to your Board of Directors that if the suggested procedure is followed by them, it will be of great benefit to the Board.

Yours very truly,

R. A. Young,
Governor.

TO CHAIRMEN OF ALL F. R. BANKS.

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