The Papers of Charles Hamlin (mss24661)

362_05_001-	Hamlin, Charles S., Scrap Book – Volume 194, FRBoard Members

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Scrap Book - Volume 194
FRBoard Members

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CONFIDENTIAL (F.R.)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 29, 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 194 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 194

Page 26 - Earnings & Expenses of F.R. Banks, July 1929

Page 67 - Memo to Mr. Hamlin from Mr. Wingfield re History of Commodity Paper.

Page 72 - Changes in Discount rate of F.R. Bk. of N.Y. from October 31, 1923, to April 30, 1928, Also Prevailing Rates on Call Loans and on Customers Paper in N.Y. City.

Page 75 - Letter to Mr. Hamlin from W. Randolph Burgess re Open Market Operations.

Page 77 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching table showing net demand and time deposits, etc.

Page 79 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching table analyzing movements of gold, currency, and Reserve Bank credit by quarters in 1924.

Page 81 - Memo to Mr. Hamlin from Mr. Goldenweiser re extent to which Reserve Bank credit has been used in speculation.

Page 83 - Memo to Mr. Hamlin from Mr. Goldenweiser re Quarterly analysis of Reserve Bank credit 1925 - 1927.

Page 87 - Memo to Mr. Hamlin from Mr. Goldenweiser re Monthly averages of daily figures for all of the factors entering into the reserve fund equation.

Page 89 - Memo re Effect of Gov. Security Operations on Member Bank Reserves during the period of the 3½% rate, namely, from August 4, 1927 to February 3, 1928.

Page 91 - Memo to Mr. Hamlin from Mr. Goldenweiser re increase in gold stock and Reserve Bank credit.

Page 95 - Memo to Mr. Hamlin from Mr. Goldenweiser re extent to which Federal Reserve System has contributed to credit inflation in recent years.

Page 97 - Memo re Control by Direct Action or by Increase in Discount Rates.

Page 99 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching tables showing Changes in Banking Statistics at Time of Discount Rate Changes in 1928.

Page 103 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching tables showing the total volume of loans and investments of member banks at end of each year from 1914 to 1928; and showing distribution for reporting member banks back a few years beyond the table given you yesterday.

Page 105 - Memo to Mr. Hamlin from Mr. Goldenweiser re Customers' rates, July 1927--March 1928.

Page 109 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching table which shows the elements in the demand and supply for Reserve Bank credit.

Page 111 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching chart showing Open Market money rates in New York City and the discount rate of the F.R. Bank.

Page 113 - Memo to Board from Mr. Goldenweiser re Bank Credit 1922-29.

Page 115 - Memo to Mr. Hamlin from Mr. Goldenweiser re restricting growth of Federal Reserve credit.

Page 132 - Letter to Mr. Hamlin from Gov. Harding stating that F.R. System should not be charged with having brought about stock market speculation.

Page 133 - Letter to Mr. Hamlin from Gov. Norris re effects of the reduction in discount rates and the accompanying purchases of government securities.

Page 134 - Letter to Mr. Hamlin from F.R. Agent Heath re effect of reduction of rates.

Page 135 - Letter to Mr. Hamlin from Chairman Curtiss of Boston re responsibility of Reserve Banks for the present speculative course of N. Y. Stock Market.

Page 136 - Letter to Mr. Hamlin from J. S. Alexander, of National Bank of Commerce in N. Y. advising against an explanation or defense of recent Federal Reserve policy (October 10, 1928).

Page 137 - Letter to Mr. Hamlin from Chairman Austin, Philadelphia, re effect of lowering of discount rate in August 1927.

Page 138 - Letter to Mr. Hamlin from Owen D. Young re effect of lowering of discount rates.

Page 139 - Letter to Mr. Hamlin from Mr. Burgess of F.R.Bk. of N.Y. re effect of lowering of discount rates.

Pages 140 & 141 - Letter from Mr. Ripley of Merchants National Bank, Boston, re effect of lowering of discount rates.

Pages 142 & 143 - Letter to Mr. Hamlin from F.R. Agent Heath re effect of reduction of rates.

Page 144 - Letter from Mr. Roberts on reserve policy.

Page 145 - Letter from Mr. Ayres on reserve policy.

Page 146 - Blank

Page 147 - Letter from Gov. McDougal re effect of lowering of discount rates.

Pages 148 & 149 - Letter to Mr. Hamlin from A. D. Noyes re effect of lowering of discount rates.

Pages 150 & 151 - Letter from Gov. of F.R. Bank of Dallas re effect of lowering discount rates.

Page 152 - Blank

Page 153 - Letter to Mr. Hamlin from Gov. Fancher, Cleveland, re effect of lowering discount rates.

Page 154 - Letter from Mr. Wetmore re effect of lowering discount rates.

Page 155 - Letter from Fed. Res. Bk. of San Francisco re effect of lowering discount rates.

Page 156 - Notes on Conference of Board with Federal Reserve Governors, Aug. 7, 1929.

CONFIDENTIAL
Not for publication

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, JULY 1929

St.6281

Federal Reserve Bank	Month of July 1929									Jan. - July 1929		
	Earnings from -					Current expenses		Current net earnings		Current net earnings	Dividends accrued	Available for reserves surplus and franchise tax*
	Discounted bills	Purchased bills	U. S. securities	Other sources	Total	Exclusive of cost of F.R. currency	Total	Amount	Ratio to paid-in capital			
									Per cent			
Boston	$344,827	$46,694	$23,118	$7,731	$422,370	$156,877	$167,343	$255,027	28.8	$2,074,692	$361,173	$1,679,799
New York	1,741,186	94,844	102,264	51,450	1,989,744	540,484	568,136	1,421,608	28.3	6,222,913	1,932,932	4,241,047
Philadelphia	332,664	22,727	56,441	3,802	415,634	161,316	175,766	239,868	18.2	2,156,096	527,475	1,575,235
Cleveland	363,691	17,871	81,838	16,410	479,810	209,678	219,408	260,402	20.0	2,220,159	520,880	1,656,542
Richmond	243,499	9,688	4,168	6,136	263,491	124,609	127,836	135,655	25.8	894,419	216,219	619,653
Atlanta	290,409	23,160	9,463	7,824	330,856	105,678	134,192	196,664	42.8	1,516,734	186,614	1,301,916
Chicago	519,594	38,519	83,201	37,179	678,493	313,317	340,371	338,122	20.1	3,360,095	671,949	2,616,763
St. Louis	237,004	831	49,483	1,772	289,090	114,697	118,662	170,428	38.1	1,056,825	188,308	549,945
Minneapolis	73,488	7,721	28,798	16,489	126,496	76,833	81,532	44,964	17.2	360,236	107,249	238,099
Kansas City	149,670	8,233	-	30,030	187,933	149,002	154,671	33,262	9.1	541,848	149,727	456,081
Dallas	126,734	29,647	34,192	7,739	198,312	105,546	109,115	89,197	23.6	503,458	154,614	326,553
San Francisco	254,347	46,005	34,045	9,756	344,153	198,884	203,387	140,766	14.6	1,403,775	385,910	979,231
TOTAL												
July 1929	4,677,113	345,940	507,011	196,318	5,726,382	2,256,921	2,400,419	3,325,963	24.4			
June 1929	4,005,777	448,306	598,237	428,294	5,480,614	2,239,670	2,637,482	2,843,132	21.9			
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			
Jan.-July 1929	27,856,272	6,542,851	4,144,216	1,465,364	40,008,703	15,483,556	17,697,453	22,311,250	24.9	22,311,250	5,403,050	16,240,864
1928	17,674,692	6,498,820	6,922,856	1,037,446	32,133,814	15,150,513	15,780,512	16,353,302	20.4	16,353,302	4,817,272	10,323,851

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
AUGUST 7, 1929

W.

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

VOLUME 194
PAGE 26

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Section

Date August 3, 1929

To Mr. Hamlin

Subject: History of Commodity Paper.

From Mr. Wingfield, Ass't Counsel.

B67

2—8495 G P O

There is attached hereto for your information a mimeographed copy of a memorandum with reference to regulations issued by the Board governing the rediscount of "commodity paper", which was prepared at the request of the Federal Reserve Board.

Respectfully,

B.M. Wingfield

B.M.Wingfield,
Assistant Counsel.

Memorandum
attached.

VOLUME 194
PAGE 67

COPY

X-6353

August 2, 1929.

To: Federal Reserve Board

Subject: History of Commodity Paper.

From: Mr. Wyatt - General Counsel.

In accordance with the Board's request, there is given below a review of the history of commodity paper with quotations from the Board's various regulations on this subject.

The rediscount of "commodity paper" at special rates of rediscount was first provided for by Regulation Q, Series of 1915, issued by the Federal Reserve Board under date of September 3, 1915, which read as follows:

"COMMODITY PAPER.

"In this regulation the term 'commodity paper' is defined as a note, draft, or bill of exchange secured by warehouse terminal receipts, or shipping documents covering approved and readily marketable, nonperishable staples properly insured.

"Commodity paper, to be eligible for discount by a Federal Reserve Bank under section 13, at the special rates hereby authorized to be established for commodity paper below the usual commercial rates, must (a) comply with all the requirements of Regulation B, series of 1915, paragraphs I and II, or with the requirements of Regulation C, series of 1915; (b) and be [illegible] on which the rate of interest or discount, incl[illegible]ng [illegible] commission charged the maker, does not exce[illegible] per cent per annum, and also (c) comply with such regulations as may be issued by Federal Reserve Banks covering requirements as to warehouse or terminal receipts, shipping documents, insurance, etc., adapted to the particular needs of its district as a condition of the special rate herein authorized.

"Federal Reserve Banks are now authorized to submit rates for the discount of commodity paper in accord with this regulation for review by the Board."

This provision next appeared as Section VII of Regulation A, Series of 1916, issued under date of September 15, 1916, which read as follows:

"VII. COMMODITY PAPER.

"(a) Definition. - Commodity paper within the meaning of this regulation is defined as a note, draft, bill of exchange, or trade acceptance accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt covering approved and readily marketable, nonperishable staples properly insured.

"(b) Eligibility. - To be eligible for rediscount at

"the special rates, authorized to be established for commodity paper, such a note, draft, bill of exchange, or trade acceptance must also comply with the respective sections of this regulation applicable to it, must conform to the requirements of the Federal Reserve Bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount - including commission - charged the maker, does not exceed 6 per cent per annum."

The provision for "commodity paper" last appeared in the Board's Regulations as Section VII of Regulation A, Series of 1917, issued under date of June 22, 1917, which read as follows:

"VII. COMMODITY PAPER.

"(a) Definition. - Commodity paper within the meaning of this regulation is defined as a note, draft, bill of exchange, or trade acceptance accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt covering approved and readily marketable, nonperishable staples properly insured.

"(b) Eligibility. - To be eligible for rediscount at the special rates, authorized to be established for commodity paper, such a note, draft, bill of exchange, or trade acceptance must also comply with the respective sections of this regulation applicable to it, must conform to the requirements of the Federal Reserve Bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount - including commission - charged the maker, does not exceed 6 per cent per annum.

"(c) Suspension of commodity rate. - As the special rate on commodity paper is intended to assist actual producers during crop-moving periods and is not designed to benefit speculators, the Board reserves the right to suspend the special rates herein provided whenever it is apparent that the movement of crops, which this rate is intended to facilitate, has been practically completed."

The provision for "commodity paper" was omitted from the next edition of the Board's regulations, which was the Series of 1920, issued under date of October 6, 1920, and has not appeared in any regulation issued by the Board subsequent to that date.

A possible explanation of the omission of the section regarding commodity paper from the Board's Regulations of 1920 appears in a

letter addressed to Senator Owen by Governor Harding under date of March 18, 1918, which reads in part as follows:

> "This special rate on commodity paper was, of course, given to facilitate commerce in various commodities. The demands on the banks at the present time are such, however, that it was found to be necessary to merge the discount rates on commodity paper with those for commercial paper of corresponding maturities.
>
> "This action by the banks was approved by the Board on November 28, (1917), so that the special rates on commodity paper are not now in force."

From a circular letter addressed to the Federal reserve banks under date of August 2, 1922, (X-3494), a copy of which is attached hereto, it appears that the Federal Reserve Board at that time considered the subject of reviving special rates on commodity paper; but the Board did not actually revive such rates at that time.

Under date of October 9, 1926, I prepared at the request of Mr. James, two alternative drafts of regulations on commodity paper copies of which are attached hereto. Neither of these regulations, however, was ever promulgated.

There is also attached hereto for the Board's information a copy of a draft of a proposed circular letter providing special rates on "seasonal crop-marketing paper", which I prepared for Dr. Miller under date of August 11, 1928, but which was never sent out.

Respectfully,

Walter Wyatt
General Counsel.

Papers attached.

WW-sad

(COPY)

CIRCULAR LETTER

August 11, 1928.

SUBJECT: Special Rates on Seasonal Crop Marketing Paper.

Dear Sir:

Prior to 1918 there were in effect at some of the Federal Reserve Banks special rates of rediscount on so-called "commodity paper". Lower rates of rediscount for such classes of paper were fixed by the Federal Reserve Banks and approved by the Federal Reserve Board with a view of meeting the seasonal demands for credit facilities in the crop producing districts.

The Federal Reserve Board believes that the revival of this practice will be especially helpful during the forthcoming crop moving period and accordingly has defined a special class of paper growing out of the movement and marketing of crops which, for convenience, will be called "Seasonal Crop Marketing Paper" and as to which the Federal Reserve Board stands ready to approve a rediscount rate of from one-half of one per cent to one per cent below the rate on other classes of paper, with a view of adjusting the present rate structure so as to facilitate seasonal accommodation to commerce and business.

The Board's definition of "Seasonal Crop Marketing Paper" and the conditions of eligibility applicable to such paper are as follows:

"Definition. Seasonal Crop Marketing Paper is defined as a negotiable note, draft, bill of exchange or bankers' acceptance arising out of the marketing of agricultural products produced during the current year or the proceeds of which have been or are to be used to finance the marketing

of such products or the carrying of such products pending orderly marketing.

"Notes, drafts, bills of exchange or bankers' acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products shall be deemed to be included within the above definition if -

"(1) The proceeds thereof have been or are to be used by such association in making payments or advances to any members thereof on account of agricultural products produced during the current year and delivered by such members to the association; or

"(2) The proceeds thereof have been or are to be used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparing for market or marketing of any agricultural product produced during the current year and handled by such association for any of its members; or

"(3) Such paper otherwise complies with the above definition.

"Eligibility." To be eligible for rediscount at the special rate authorized to be established for seasonal crop marketing paper, such a note, draft or bill of exchange must also:

"(1) Be secured by shipping documents or a warehouse, terminal, or other similar receipt covering readily marketable, nonperishable, agricultural products produced during the current year and comply with the requirements of the Federal Reserve

Bank as to insurance;

"(2) Comply with the respective sections of Regulation A, Series 1928, applicable to it; and

"(3) Be a note, draft or bill of exchange on which the rate of interest or discount (including commissions) charged the borrower, does not exceed 6% per annum.

"Paper which is issued or drawn or the proceeds of which have been or are to be used for speculative holding of agricultural products as distinguished from the carrying of agricultural products pending the orderly marketing thereof is not eligible for rediscount."

In authorizing special rates of rediscount pursuant to this letter, it should be understood that this is for seasonal crop marketing purposes only and such authority will be withdrawn at the conclusion of the forthcoming crop marketing period.

The Federal Reserve Board is prepared to give prompt approval to special seasonal rates for seasonal crop marketing paper and requests the several Federal Reserve Banks to give immediate consideration to the advisability of establishing such seasonal rates in time to be of assistance during the forthcoming crop marketing period. Prompt advice as to the attitude of the respective Federal Reserve Banks toward such special rates on seasonal crop marketing paper is desired.

By Order of the Federal Reserve Board.

Walter L. Eddy,
Secretary.

COPY

X-6353-b

Oct. 9 - 1926

NO. I.

BE IT RESOLVED BY THE FEDERAL RESERVE BOARD: That Regulation A, Series of 1924, be amended by inserting therein, immediately after Section VIII, a new section reading as follows:

" SECTION VIII½. COMMODITY PAPER.

"(a) DEFINITION. Commodity paper within the meaning of this regulation is defined as a note, draft, bill of exchange, or trade acceptance accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt covering approved and readily marketable, nonperishable staples properly insured.

"(b) ELIGIBILITY. To be eligible for rediscount at the special rates, authorized to be established for commodity paper, such a note, draft, bill of exchange, or trade acceptance must also comply with the respective sections of this regulation applicable to it, must conform to the requirements of the Federal Reserve Bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount -- including commission -- charged the maker, does not exceed 6 per cent per annum.

"(c) SUSPENSION OF COMMODITY RATE. As the special rate on commodity paper is intended to assist actual producers during crop-moving periods and is not designed to benefit speculators, the Board reserves the right to suspend the special rates herein provided whenever it is apparent that the movement of crops, which this rate is intended to facilitate, has been practically completed."

COPY

X-6353-c

October 9, 1926.

NO. 2.

BE IT RESOLVED BY THE FEDERAL RESERVE BOARD, That Regulation A, Series of 1924, be amended by inserting therein, immediately after Section VIII, a new section reading as follows:

" SECTION VIII½ - COMMODITY PAPER.

"(a) DEFINITION.- Commodity paper, within the meaning of this regulation, is defined as a note, draft, bill of exchange, or trade acceptance accompanied and secured by shipping documents or by warehouse receipts issued by a warehouse regularly licensed and bonded under the United States Warehouse Act or by any other public warehouse approved by the Federal Reserve Bank of the district in which it is located, which shipping documents or warehouse receipts convey or secure title to readily marketable, non-perishable staples properly insured.

"(b) COMMODITY RATE.- Federal Reserve Banks are hereby authorized to submit to the Federal Reserve Board for approval special rates of discount for commodity paper as defined in this regulation.

"(c) ELIGIBILITY.- To be eligible for rediscount at the special rates authorized to be established for commodity paper, such a note, draft, bill of exchange, or trade acceptance must also comply with the respective sections of this regulation applicable to it, must conform to the requirements of the Federal Reserve Bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount (including commission) charged the maker, does not exceed 6 per cent per annum.

"(d) SUSPENSION OF COMMODITY RATE.- As the special rate on commodity paper is intended to assist actual producers during crop-moving periods and is not designed to benefit speculators, the Federal Reserve Board reserves the right to suspend the special rates herein provided for, whenever it is apparent that the movement of crops, which this rate is intended to facilitate, has been practically completed."

X-3494

August 2, 1922

CONFIDENTIAL

SUBJECT: Special Rates on Commodity Paper.

Dear Sir:

It has been proposed that the Board revive the special rates on commodity paper which were first established during the year 1915. Before taking action, however, the Board is desirous of obtaining the opinion of the officers and executive committees of all Federal Reserve Banks as to the advisability of reestablishing special rates on commodity paper. There is enclosed herewith a tentative draft of a letter which it is proposed to send to all Federal Reserve Banks in case the Board should decide to authorize special rates on commodity paper; and your comments, criticisms and suggestions are invited. You are requested also to advise the Board whether your bank would feel disposed to establish a special rate on this class of paper and, if it should, whether in your opinion your member banks generally would be inclined to avail themselves of it.

Very truly yours,

Governor.

(Enclosure)

TO ALL FEDERAL RESERVE AGENTS
COPIES TO GOVERNORS.

X-3494a

CONFIDENTIAL TENTATIVE DRAFT.

SUBJECT: Revival of Special Rates on Commodity Paper.

Dear Sir:

Prior to 1918 there were in effect at some of the Federal Reserve Banks special rates on so-called commodity paper. Section VII of Regulation A, Series of 1917, and earlier regulations, defined commodity paper and prescribed the conditions under which such paper would be eligible for rediscount by Federal Reserve Banks. All such special rates were suspended during November and December 1917 and the regulations issued since that time have not contained any special provisions regarding commodity paper.

The Board has considered the matter and has decided that it will, at the request of any Federal Reserve Bank, approve the establishment by the applying bank of a special rate of not less than 3½% on commodity paper on which the rate of interest or discount - including commission - charged the borrower does not exceed 6% per annum.

The Board's definition of commodity paper, and the conditions of eligibility applicable to such paper are as follows:

> Definition.- Commodity paper is defined as a note, draft, bill of exchange, or trade acceptance accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt covering approved and readily marketable, nonperishable staples properly insured.

Eligibility.-To be eligible for rediscount at the special rates, authorized to be established for commodity paper, such a note, draft, bill of exchange, or trade acceptance must also comply with the respective sections of this Regulation A, Series of 1922, applicable to it, must conform to the requirements of the Federal Reserve Bank relating to shipping documents, receipts, insurance, etc., and must be a note, draft, bill of exchange, or trade acceptance on which the rate of interest or discount - including commission - charged the borrower, does not exceed 6 per cent per annum. Paper which is issued or drawn, or the proceeds of which have been or are to be used, for the speculative holding of commodities, as distinguished from the carrying of commodities pending the orderly marketing thereof, is not eligible for rediscount.

The foregoing definition and conditions of eligibility are substantially the same as those prescribed in the Board's former Regulation A, Series of 1917. In approving any special rate pursuant to this letter it should be understood that the Federal Reserve Board reserves the right, which it always reserved when it approved similar rates in the past, to suspend such rate whenever such a course seems desirable.

Very truly yours,

Governor.

C 72

Dec rate - Call
Term rate
Cust rate

CHANGES IN DISCOUNT RATE OF FEDERAL RESERVE BANK OF NEW YORK FROM OCTOBER 31, 1923, TO APRIL 30, 1928, ALSO PREVAILING RATES ON CALL LOANS AND ON CUSTOMERS PAPER IN NEW YORK CITY

	Changes in Federal Reserve Bank of New York discount rate	Average call loan renewal rate- New York Stock market			Prevailing rates on customers paper in New York City
		Preceding week	Week Reserve bank rate was changed	Following week	
May 1, 1924	4-1/2 to 4	3.95	3.90	3.50	4-3/4 - 5-1/4
June 12, 1924	4 to 3-1/2	2.95	2.10	2.00	4-1/2 - 5
Aug. 8, 1924	3-1/2 to 3	2.00	2.00	2.00	4 - 4-1/2
Feb. 27, 1925	3-to 3-1/2	3.50	4.06	4.10	4 - 5
Jan. 8, 1926	3-1/2 to 4	6.00	4.70	4.40	4-1/2 - 5
Apr. 23, 1926	4 to 3-1/2	4.40	3.85	3.60	4-1/2 - 5
Aug. 13, 1926	3-1/2 to 4	4.30	4.40	4.50	4-1/4 - 4-3/4
Aug. 5, 1927	4- to 3-1/2	3.85	3.95	3.75	4-1/4 - 4-1/2
Feb. 3, 1928	3-1/2 to 4	3.70	4.55	4.40	4-1/4

Week ending Apr. 15, 1928:
Discount rate 4
Call loan rate 5.45
Customers rate 4-1/4 - 4-3/4

VOLUME 194
PAGE 72

FEDERAL RESERVE BANK

OF NEW YORK

P75

PERSONAL

May 29, 1928.

Dear Mr. Hamlin:

I have reviewed with much interest your letter of May 26 and the enclosed table, which shows excellently the timing of our open market operations and some of the results of these operations. It clearly indicates, as you suggest, that we were not buying securities at the times of greatest increases in Federal Reserve credit, but on the contrary were selling securities at those periods and our purchases of securities did not result in swelling the aggregate total of Federal Reserve credit in use. It is true that member bank credit did show large increases at times when we were buying securities, as indicated by the increase in member bank reserve accounts between October 31, 1923 and October 31, 1924 and in the more recent period, which really would go back to July 1927 and carry on to November 1927. Concerning this increase in the total volume of credit, I think it may truly be said, however, that it took place at periods when an increase in the volume of credit was less likely to be injurious than ordinarily.

I confess that I am still a little troubled about the time lag and the cumulative effect of open market operations, and I am not fully satisfied in my own mind as to what if any responsibility we have for the tremendous increase in the volume of credit this spring. It took place several months after we had reversed our policy, but was it in some degree a cumulative effect of the policies adopted last summer? It may be that the answer is to be sought in the realm of psychology rather than the immediate action of monetary factors.

Federal Reserve Board,
Washington, D. C.

C75

My present feeling is that as we look into the future we shall need to give more attention to the probable effects of policy six or nine months beyond the time when action is taken, but that is a very difficult thing to do.

Sincerely yours,

W. Randolph Burgess

Honorable C. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

WRB:R

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Deposits Dem & Time See Bk 1922-28

Date June 2, 1928

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

EG

B17

I am sending herewith a table showing net demand and time deposits, reserve balances, and reserve ratio for member banks for June and December, 1922, for October, 1923 to 1927, and for April, 1928. There was no autumn call in 1922, and for this reason I am giving you the figures for the middle and end of the year.

The outstanding fact is the constant growth of time deposits and the increase in the proportion that these deposits constitute of the total deposits subject to reserves. It is because of this constant increase in the proportion of time deposits that the line for reserve balances does not move parallel with the line for total deposits, but lags behind it. Between October, 1924 and October, 1926, there was a growth of $2,250,000,000 in deposits and reserve balances increased only $60,000,000. This was possible because only about $500,000,000 of the increase was in net demand deposits and $1,375,000,000 in time deposits.

It is rather difficult to present this on a chart because the reserve balances are so much smaller in amount that they do not show up on a scale that brings out the deposit figures. To remedy this, I have had the line for reserve balances on the chart repeated in red on a ten-fold larger scale, in order to bring it closer to the line for total deposits also in order to show more clearly the movements in these balances. The extent to which the increase in the line for reserve balances falls behind the increase in the line for deposits measures the influence of the increasing proportion of time deposits.

DEPOSITS AND RESERVES OF ALL MEMBER BANKS

(In millions of dollars)

	June 1922	Dec. 1922	Oct. 1923	Oct. 1924	Oct. 1925	Oct. 1926	Oct. 1927	Apr. 1928
Net demand deposits	15,509	16,187	15,906	17,764	18,432	18,280	18,960	19,388
Time deposits	7,175	7,645	8,526	9,675	10,628	11,402	12,527	13,255
Net demand plus time	22,684	23,832	24,432	27,439	29,060	29,682	31,487	32,643
Reserve balances	1,820	1,840	1,864	2,141	2,203	2,219	2,326	2,396
Reserve ratio	8.0	7.7	7.6	7.8	7.6	7.5	7.4	7.3

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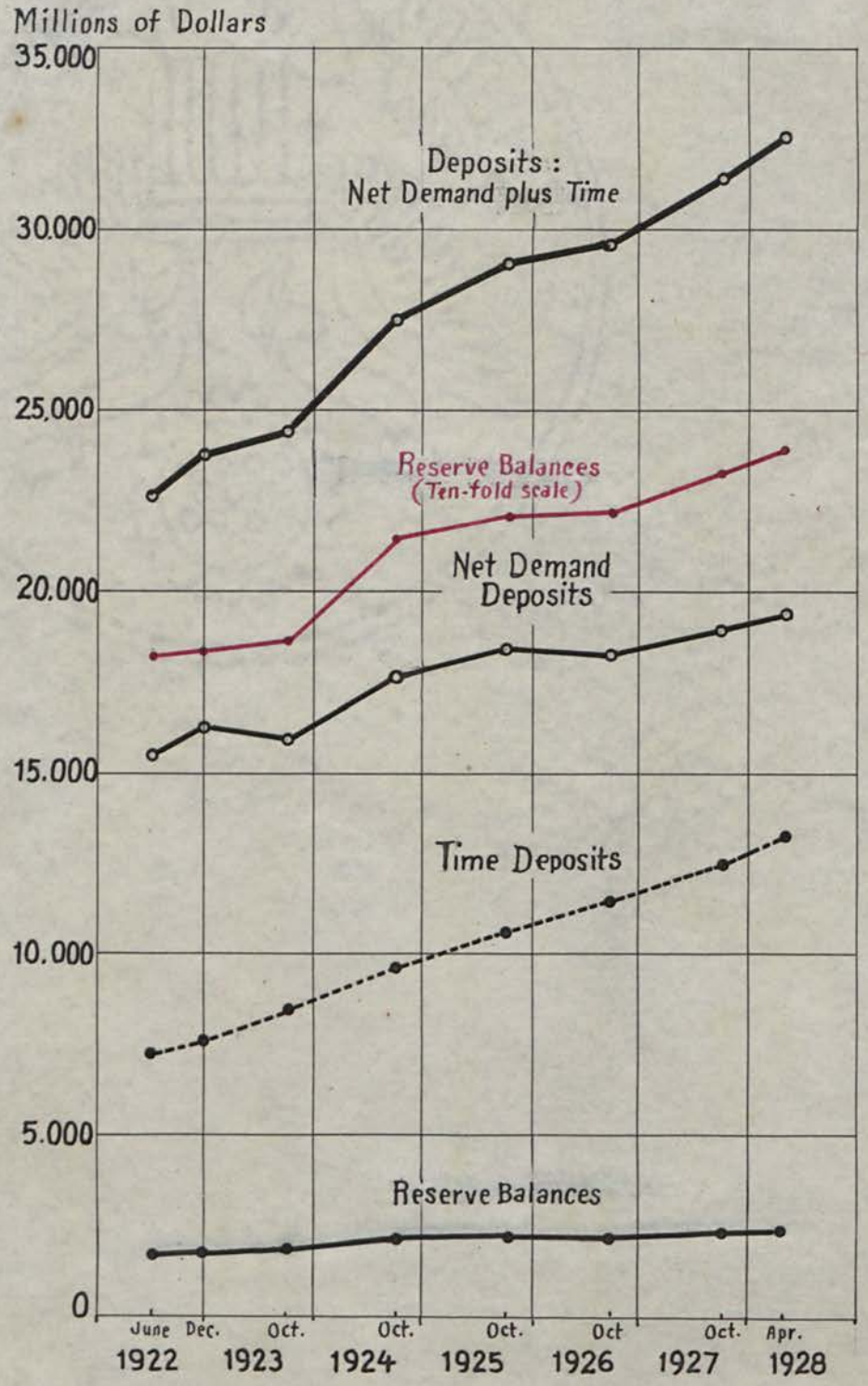
DEPOSITS AND RESERVES OF ALL MEMBER BANKS



Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Mr. Cardet. By Quarters 1924

Date June 5, 1928

To Mr. Hamlin

Subject: P79

From Mr. Goldenweiser

EAG.

In accordance with your recent request, I am sending you a table that analyzes movements of gold, currency, and reserve bank credit by quarters in 1924. The table is comprehensive, that is, it includes all items that enter into the sources of reserve bank credit and into the uses made of the funds thus obtained. The principal facts are that during the first quarter there was a growth of $120,000,000 in gold stock and at the same time a growth in the system's open-market purchases of securities of $129,000,000. There was a decrease of Treasury credit, and a large decrease of other reserve bank credit, which includes primarily discounts and acceptances. The reason for the decrease in total sources of reserve bank credit was largely the decline of $145,000,000 in money in circulation.

In the second quarter, the movements continued in approximately the same direction, but the decrease in money in circulation was much smaller and there was an increase of $59,000,000 in member bank reserve balances.

It is the third quarter of 1924 that best illustrates the period during which open-market policy resulted in an increase of member bank credit. During that quarter gold stock increased slightly - an increase which was practically offset by a decrease in Treasury credit. Security purchases by the Federal reserve banks increased by $145,000,000, and discounts and other reserve bank credit also increased by $38,000,000, so that the total sources of reserve bank credit increased by $186,000,000. There was only a slight increase of $14,000,000 in money in circulation, and practically the entire growth in reserve bank funds went into member bank reserve

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Office Correspondence

FEDERAL RESERVE BOARD

Date

To

Subject:

From

2—8496

balances, which increased by $167,000,000. You will note particularly that the increase in securities did not result in a decrease in discounts, and that largely for the reason that discounts at the central money markets were so low that they could not be reduced any further. In addition, the autumn demand for currency began to assert itself.

The last quarter of the year is so much dominated by this seasonal demand for currency that it is difficult to draw any conclusion. You will note, however, that member bank reserve balances increased further by $109,000,000.

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Factors in Supply and Demand for Reserve
Bank Credit by Quarterly
dates in 1924

(Millions of dollars)

Sources of funds:	Dec. 31 1923	Mar. 31 1924	June 30 1924	Sept. 30 1924	Dec. 31 1924
Gold Stock	4244	4364	4488	4511	4499
Treasury Credit 1/	1758	1686	1758	1738	1764
Reserve bank holdings of U. S. Securities.....	134	263	431	576	540
Other reserve bank credit 2/.....	1104	762	400	438	762
Total sources	7240	7075	7077	7263	7565
Uses of funds:					
Money in Circulation	5044	4899	4849	4863	5048
Member bank reserve balances	1898	1885	1944	2111	2220
Foreign bank and other deposits at Federal Reserve Banks.....	23	22	23	30	39
Unemployed capital and other items of reserve banks.....	275	269	261	259	258
Total uses	7240	7075	7077	7263	7565

	Change between--			
Sources of funds:	Dec.31,1923 and Mar.31,1924	Mar. 31,1924 and June 30,1924	June 30,1924 and Sept.30,1924	Sept. 30,1924 and Dec. 31,1924
Gold Stock	+120	+124	+23	-12
Treasury credit 1/	- 72	+ 72	-20	+26
Reserve bank holdings of U. S. Securities...	+129	+168	+145	-36
Other reserve bank credit 2/.....	-342	-362	+ 38	+324
Total sources	-165	+ 2	+186	+302
Uses of funds:				
Money in Circulation	-145	-50	+14	+185
Member bank reserve balances.....	- 13	+59	+167	+109
Foreign bank and other deposits at reserve banks.....	- 1	+ 1	+ 7	+ 9
Unemployed capital and other items of reserve banks.....	- 6	- 8	- 2	- 1
Total uses	-165	+ 2	+186	+302

1/ Including U. S. Government deposits at reserve banks.
2/ Including float.

Form

Offi[illegible]espondence

Date July 12, 1928

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

81

2—8495

I am sending you herewith a memorandum from Mr. Riefler, commenting upon the extent to which reserve bank credit has been used in speculation. This memorandum represents his statement based on the tables on factors of supply and demand for reserve bank credit by quarterly dates for the years 1924, 1925, 1926, and 1927. I believe that these tables were sent to you some weeks ago and are now in your files.

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Office Correspondence

FEDERAL RESERVE BOARD

Mr Crediet.

Date July 11, 1928

To Mr. Goldenweiser

From Mr. Riefler

Subject: Speculative Use of Reserve Bank Credit.

2—8495

It is practically impossible to formulate an airtight definition covering of the use of reserve bank credit for speculative purposes. The credit resources of the country comprise a pool of extremely liquid funds which is fed by increases in gold, Treasury credit, and reserve bank credit. Out of this pool are drawn funds to meet currency demands, commercial credit demands, and demands for funds to carry securities, possibly for speculative purposes. The reserve act is so drawn that reserve bank credit cannot be issued on the basis of speculative paper. Once issued, however, it enters the pool of funds at the disposal of the community and may release other funds for speculative purposes. In a narrow sense, therefore, it might be claimed that reserve bank credit were being used for speculative purposes whenever there was any speculative credit in the market. Under this narrow definition, however, it would be equally true that it would be impossible to have the reserve system at all without providing funds for speculation. It is obvious that the issue raised by speculative use of reserve bank credit rests on a broader view than this, and that the problem must be approached from a different angle.

The reserve system was inaugurated to provide a buffer between changes in the demand for gold, currency and commercial credit with the object of avoiding the sharp reversals in credit conditions which had previously characterized our money markets. In a broad sense, therefore, reserve bank credit can only be said to have gone into speculative uses when it increased the reserve balances of member banks and not when it contracted or expanded to offset changes in gold stock, Treasury credit, money in circulation. Such increases in member bank reserve balances occurred on a considerable scale in 1922, 1924, 1925 and 1927.

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Mr. Goldenweiser July 11, 1928

Statistics for reporting member banks in leading cities show that while part of the increase in member bank reserve balances in these years was due to increased demands for commercial credit, the larger part of the increase is accounted for by increased security loans. These are also the years in which stock prices and brokers' loans have increased most rapidly.

It can fairly be said, therefore, that the years 1922, 1924, 1925 and 1927 were characterized by an increased use of credit for speculative purposes, as evidenced by rising stock prices, rising brokers' loans, and rising security loans on the part of member banks. As these were also years in which changes in reserve bank credit were not completely dominated by the demand for currency and gold, but also by increased demand for reserve balances on the part of member banks, reserve bank credit may be said to have contributed in those years to speculative credit. In three of these four years, namely, 1922, 1924 and 1927 purchases of open market investments by the reserve banks on a large scale added reserve bank funds to the market while in 1925 reserve bank credit in use increased because of borrowing by member banks at relatively low discount rates. The exact figures of factors in supply and demand for reserve bank credit prior to 1924 are not yet available but those for succeeding years are shown on the table forwarded last month.

It should be noted in conclusion that speculative use of credit in the years discussed was only a by product of the reserve bank credit made available to the market and not the major result. In each of the four years, easy money conditions also facilitated commercial activity and monetary reconstruction abroad.

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Office Correspondence

FEDERAL RESERVE BOARD

M Credit. by quarter 1925-27

Date July 18, 1928

To Mr. Hamlin

Subject: Quarterly analysis of reserve bank credit 1925-1927.

From Mr. Goldenweiser

2—8495

B83

First Quarter 1925

Between December 31, 1924 and March 31, 1925, gold stock decreased 153 millions. This was more than offset by a decline in money in circulation amounting to 230 million dollars. Had member bank reserve balances remained constant, there would have been a decline of about 77 million dollars in reserve bank credit. The actual decrease in reserve bank credit during the period amounted to 187 million, however, because member bank reserve balances also decreased by 106 millions.

Second Quarter 1925

Between March 31 and June 30, 1925, member bank reserve balances increased by 58 millions 19 millions of which was supplied out of gold imports and 30 millions out of an increased use of reserve bank credit. Money in circulation and other factors did not change materially during this quarter.

Third Quarter 1925

Between June 30 and Sept. 30, 1925 a further increase in gold stock of 17 millions was about offset by a decrease in Treasury credit of 23 millions. Reserve bank credit increased 150 millions during this period, partly to supply an increase of 101 millions in the demand for money in circulation and partly to furnish increased reserve balances to the amount of 38 millions to the member banks.

Fourth Quarter 1925

During the fourth quarter of 1925 the dominant development was an increase in the demand for currency amounting to 188 millions. Of this amount 164

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millions was supplied through an increased use of reserve bank credit and 17 millions by a further increase in gold stock. Member bank reserve balances did not change greatly during this period.

Year 1925.

Summarizing the year 1925 as a whole, gold stock decreased 100 millions while the demand for money in circulation increased 56 millions, making a total increased demand for reserve bank credit from these two sources alone of 156 millions. As changes in other factors were small and offset each other during the year as a whole, the actual increase in reserve bank credit amounted to practically the same figure, 157 millions. There are two points to be noted in respect to the year as a whole, however. Member bank credit increased considerably during the year in spite of the fact that reserve balances did not increase. This situation arose largely because banks outside New York converted their balances with New York City banks into direct brokers loans on securities. This set free a considerable volume of reserves for credit expansion without calling for increased use of reserve bank credit. The other point is that U. S. Government securities were sold in considerable volume during the first quarter of the year, with the result that while total reserve bank credit increased only 157 millions during the year, reserve bank credit obtained on the initiative of the market increased by about twice this amount. Thus member banks expanded their credit during a period when borrowing at the reserve banks was also increasing, in part possibly because discount rates were relatively low.

First Quarter 1926

During the first quarter of 1926, the seasonal drop in money in circulation amounted to 244 millions. Of this amount 197 millions was used to retire

reserve bank credit. The remaining 47 millions together with an increase in gold stock of 43 millions was more than sufficient to offset a decrease of 85 millions in Treasury credit. Member bank reserve balances showed little change.

Second Quarter 1926

Between March 31 and June 30, 1926 there was an increase in Treasury credit of 101 million dollars and in gold stock of 5 million dollars. This was only partially offset by a decrease in reserve bank credit of 68 million dollars, leaving 38 millions available to the market. Of this amount, 25 million was used to supply increased demands for money in circulation and 14 millions went into increased reserve balances.

Third Quarter 1926

During the third quarter of 1926 member bank reserve balances decreased by 20 millions in spite of the fact that reserve bank credit in use increased by 120 millions. Of the 140 million represented by these two items 93 millions was used to supply an increased demand for money in circulation, and the remainder together with some increase in gold stock to offset a decline of 53 millions in Treasury credit.

Fourth Quarter 1926

During the fourth quarter of 1926, the pool of funds in the money market was supplied by an increase of 67 millions in reserve bank credit, 53 millions in Treasury credit and 26 millions in gold stock or 146 millions in all. Of this amount 117 millions was used to supply the fall increase in the demand for money in circulation. The remaining 29 millions together with 15 millions drawn from the reserve balances of member banks was used to build up deposits for foreign and non-member banks at the reserve banks which increased by 41 millions during

the quarter.

The Year 1926 As a Whole

During the year 1926 as a whole, gold stock increased by 93 millions, and Treasury credit by 16 millions while the demand for money in circulation fell off 9 millions, making altogether 120 millions available to the market. Of this amount 36 millions was used to build up foreign and non-member bank deposits at the reserve banks and 22 millions was absorbed in the unexpended capital of the reserve banks, leaving 62 millions available for the reduction of reserve bank credit. The actual reduction in reserve bank credit, however, amounted to 78 millions since member banks reduced their reserve balances 16 million dollars during the period. This reduction in member bank reserve balances coincided with a considerable reduction in loans to brokers and little change in other types of member bank credit outstanding.

First Quarter 1927

Between December 31, 1926 and March 31, 1927, the seasonal decrease in currency in circulation amounted to 233 millions. To this was added an increase in gold stock of 105 millions and a decrease in foreign and non-member balances at the reserve banks of 44 millions, making 382 millions in all. 308 millions of this amount was used to retire reserve bank credit and 28 millions to offset a decrease in Treasury credit while the remainder was used largely to build up the reserve balances of member banks which increased by 43 millions during the quarter.

Second Quarter of 1927

During the second quarter of 1927 there was little change in any of the factors affecting reserve bank credit. The total increase in reserve bank

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credit during the period amounted to 9 millions, all of which went into reserve balances of member banks which increased 12 millions.

Third Quarter of 1927

Between June 30 and September 30, 1927, reserve bank credit increased by 149 millions and Treasury credit by 9 millions making 158 millions available in all. Of this amount 97 millions was used to supply increased demands for currency, and 16 millions to offset a decrease in gold stock while the remainder went into member bank reserve balances which increased 44 millions.

Fourth Quarter of 1927

During the fourth quarter of 1927 reserve bank credit increased by 424 millions, and Treasury credit by 13 million making 437 millions in all. Of this amount ~~only~~ 192 millions was used to offset gold exports and ~~only~~ 55 millions to supply the fall demand for currency, while 194 millions went into increased reserve balances for member banks.

The Year 1927 As a Whole

Taking the year 1927 as a whole, there was a decrease in gold stock of 113 millions, 92 millions of which was offset by decreased currency demand and 8 millions more by increased Treasury credit. The remaining 13 million was more than offset by a decline of 39 million in deposits to the account of foreign and non-member banks at the reserve banks. The full increase of 274 millions in reserve bank credit, therefore, went into member bank reserve balances which increased 293 millions. It is noteworthy that U. S. security holdings of the reserve banks alone increased by about this amount or 302 millions.

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Office Correspondence

FEDERAL RESERVE BOARD

Bk credit 1927-28

Date July 18, 1928

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

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2—8495

Monthly averages of daily figures for all of the factors entering into the reserve fund equation have now been pushed back to January, 1926. These averages furnish a much better basis for a discussion of money market developments than the single date figures for ends of months which have been used heretofore. Single date figures are always liable to error because on a given date, member bank reserve balances may be many millions in excess or under the legal requirements. Monthly averages of daily figures on the other hand reflect accurately the underlying factors in the money market with which reserve bank policy deals. The accompanying table shows the factors affecting the supply and demand for reserve bank credit in January, 1927, July, 1927, and January, 1928, on the basis of monthly averages. The comparison between January and July, 1927 portrays developments during the period preceding the change in discount rates in August, 1927. During this period practically all factors tended toward a decrease in reserve bank credit except member bank reserve balances, as follows:

	(Millions)
1. Decrease in money in circulation.....	52
2. Increase in gold stock.....	48
3. Increase in Treasury credit.	20
Total.....	120

A decrease in reserve bank credit of 120 millions, therefore, might have been expected. The actual decrease, however, was 71 millions, and the remaining 49 millions went almost entirely into increased member bank reserve balances which increased 46 millions on the average.

The question that arises, therefore, is the reason for the growth in member bank reserve balances. Did this growth arise out of increased demand for

Factors affecting the Supply and Demand
for Reserve bank credit in
January 1927, July, 1927 and January, 1928.

(Monthly averages of daily figures in millions of dollars)

Sources of funds	Jan. 1927	July 1927	Jan. 1928	Uses of funds	Jan. 1927	July 1927	Jan. 1928
Gold stock	4527	4575	4377	Money in circulation.....	4903	4851	4785
Treasury credit	1760	1780	1780	Member bank reserve balances	2243	2289	2426
Reserve Bank credit				Foreign bank and other deposits at reserve banks	33	33	26
Discounts	(481)	(454)	(465)	Unexpended capital of reserve banks	294	297	302
Acceptances	(343)	(190)	(373)				
U. S. securities	(310)	(381)	(512)				
Other reserve bank credit.....	(52)	(90)	(32)				
Total reserve bank credit 1/.....	1186	1115	1382				
Total sources	7473	7470	7539	Total uses	7473	7470	7539

Changes between --

Sources of funds	Jan. 1927 and July 1927	July 1927 and Jan. 1928	Uses of funds	Jan. 1927 and July 1927	July 1927 and Jan. 1928
Gold stock	+ 48	- 198	Money in circulation.....	- 52	- 66
Treasury credit	+ 20	---	Member bank reserve balances.....	+ 46	+137
Reserve bank credit			Foreign bank and other deposits at Federal reserve banks.....	--	- 7
Discounts	(- 27)	(+ 11)	Unexpended capital of reserve banks	+ 3	+ 5
Acceptances	(-153)	(+183)			
U. S. Securities	(+ 71)	(+131)			
Other reserve bank credit	(+ 38)	(- 58)			
Total reserve bank credit	- 71	+ 267			
Total sources	- 3	+ 69	Total uses	- 3	+ 69

1/ Including float.

funds on the part of the community or was it stimulated by the credit policy of the reserve banks? Business, production, and trade were moderately active during the period under review and had, possibly, larger credit demands. It would be difficult, however, to trace more than a small fraction of the increase of 46 millions in member bank reserve balances to this source. During this period discount rates at the reserve banks remained at 4 per cent, but open market policy was directed toward easier money. As the table shows, the reserve banks put 71 millions into the market through purchases of U. S. securities. To this should be added the 38 millions carried in the table as "other reserve bank credit", since most of this amount represented increased balances abroad, which put money into the market in the same manner as a purchase of securities or a gold import. In addition to the 120 millions which the member banks gained during the period from the return of money in circulation, gold imports, and Treasury credit, therefore, they received a further 108 millions from the reserve banks, or 229 millions in all. Of this amount 27 millions were used to liquidate discounts, ~~since these~~ which were already low. A further 153 millions was used in the reduction of acceptance holdings of the reserve banks. Most of the remaining 49 millions went into increased reserve balances of member banks, which accompanied the growth in the banks' holdings of investments and security loans.

Period from July, 1927 to January, 1928

In the period included between July, 1927 and January, 1928 a $3\frac{1}{2}$ per cent discount rate prevailed in contrast to the 4 per cent rate which had characterized the previous year. Business was moderately slow throughout the period, making no demands for additional credit on the member banks and at the same time releasing 66 millions of currency from circulation. The easy money conditions which prevailed at the same time stimulated gold exports and the gold stock of the

country decreased by 198 millions. On the basis of these two factors, reserve bank credit might have been expected to increase by 132 millions during the period. It actually increased by more than twice this amount or 267 millions, the excess going into member bank reserve balances which increased 137 millions. This increase of 137 millions in member bank reserve balances accompanied the rapid increase in member bank loans, extended for the most part in the security markets.

The increase in reserve bank credit during this period was to the extent of 11 millions in the form of discounts for member banks, the larger part of it, ~~250~~ 183 millions, being in the form of acceptances, and 131 millions in the form of U. S. securities purchased by the reserve banks. Thus the largest single channel through which reserve bank credit was extended was the increase in the acceptance holdings of the system of 183 million dollars. The period covered that portion of the year when the total volume of acceptances outstanding shows a considerable seasonal increase. This creates a larger volume of bills eligible for sale at the reserve banks and is generally accompanied by much larger purchases of bills. In the fall of 1927, the acceptance ~~situation~~ market was stimulated by the lowering of purchase rates on bills which accompanied the lowering of discount rates. One of the stated objects of the Board in lowering discount and bill rates in the summer of 1927 was to transfer a larger part of the burden of financing the foreign trade of this country from London to this market. That this object was successfully realized is shown by the extraordinary growth in the total volume of American acceptances outstanding which followed the reduction. As this growth was accompanied by increased offering of bills to the reserve banks, reserve bank credit outstanding on account of acceptances increased at a rapid rate.

The period from July to January, 1927 can best be summarized in ~~contrast~~ comparison with the previous period from January to July. In neither of these periods was there a large demand for currency or for funds to finance industry and trade. Both periods were characterized by relatively easy money and a rapid growth of credit in the security markets, and a growth in member bank reserve balances. In both periods the easy money policy of the reserve banks was a factor in the expansion of member bank credit which, in the absence of commercial demand, flowed largely into security loans.

Period from August 4, 1927 to February 3, 1928

The preceding comparison of monthly averages of daily figures for July and January presents, I believe, a more dependable picture of changes in conditions over the period than single date figures for August 4 and February 3. An analysis of the exact period between the reduction of the rate at the New York bank in the summer and its advance in February, however, is presented in the following table:

Factors in Demand and Supply for Reserve Bank Credit
on August 4, 1927 and February 3, 1928

(In millions of dollars)

Sources	Aug. 4, 1927	Feb. 3, 1928	Change	Uses	Aug. 4 1927	Feb. 3 1928	Change
Gold stock.....	4,579	4,376	-203	Money in circulation.....	4,828	4,723	-105
Treasury credit....	1,763	1,771	+ 8	Member bank reserve balances..	2,267	2,374	+107
Reserve bank credit:				Foreign bank and other deposits at Federal reserve banks.....	29	23	- 6
Discounts.....	(409)	(470)	(+ 61)	Unexpended capital of Federal reserve banks.....	296	309	+ 13
Acceptances.....	(170)	(375)	(+205)				
U. S. securities.	(412)	(410)	(- 2)				
All other.....	(87)	(27)	(- 60)				
Total reserve bank credit.....	1,078	1,282	+204				
Total sources.....	7,420	7,429	+ 9	Total uses.....	7,420	7,429	+ 9

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The differences between this table and the monthly averages of daily figures for the preceding months are chiefly in the volume of reserve bank credit in use, money in circulation, and member bank reserve balances, and the differences are largely accounted for by the fact that all of these items fluctuate over quite a wide range from day to day. Also beginning with January 10, the reserve banks sold securities and by February 3, 1928 they had sold a volume of securities equal to that purchased after August 4, 1927.

September 28, 1928.

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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

prior to, during, or subsequent to the 3½% 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.

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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 3½% period, as discounts would have taken their place.

In conclusion, it seems to me that the claim that the 3½% 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.

Taking the whole period during which the 3½% rate was in effect, - Aug 4. 27 to Feb 3. 28 -, while Govt security purchases moved up and down, being 2 million less at the end than at the beginning, the growth of acceptance holdings was steady and was 2.05 million more at the end than at the beginning.
The acceptance growth seems more valuable as the mechanism M. bank reserves than Govt securities.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Mr Credit 1922-29

Date December 14, 1928

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

Mr Credit 1922-1929

2—8495

P91

Between December 31, 1921 and December 5, 1928, gold stock increased $474,000,000 and reserve bank credit $198,000,000 making a total increase of $672,000,000 in funds added to the market from these two sources alone. These were more than absorbed by an increase in currency in circulation amounting to $223,000,000 and an increase in member bank reserve balances of $630,000,000 or $853,000,000 for the two items. The difference to be accounted for by the operation of other factors is $181,000,000. It is accounted for by the difference between an increase in Treasury credit of $244,000,000 and an increase in unexpended capital of the reserve banks of $62,000,000.

The increase of $62,000,000 in unexpended capital was due mainly to the increase in the capital and surplus of the reserve banks during the seven years. Of the increase of $244,000,000 in Treasury credit in the market, $70,000,000 was due to smaller balances held by the Treasury with Federal reserve banks, and $180,000,000 to increased issues by the Treasury of standard silver dollars in accordance with the provisions of the Pittman Act. Other elements in Treasury credit also changed during the period but offset each other in their effect upon the demand for reserve bank credit.

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(In millions of dollars)

	F.R. Bk. credit	Member bk. res. balances	Gold stock	Money in circulation	Brokers' loans: Own account	Brokers' loans: Other banks	Brokers' loans: Others	Brokers' loans: Total	All member bank dep.: Time & demand	All member bank dep.: Net demand	All member bank dep.: ~~Total~~ TIME
January 1 -											
1922	-156	+181	+269	+127	+357	+260		+617	+2,948	+1,754	+1,194
1923	-169	- 36	+315	+227	-223	- 41		-264	+1,175	+ 169	+1,006
1924	+ 64	+322	+255	+ 4	+486	+195		+681	+3,244	+2,090	+1,154
1925	+157	- 8	-100	+ 56	+173	+779		+952	+1,640	+ 792	+ 848
1926	- 79	- 18	+ 93	- 9	-315	-204	+181	-338	+ 451	- 336	+ 787
1927	+274	+293	-113	- 92	+419	+320	+222	+961	+2,506	+1,181	+1,325
1928 to Nov.30	+182	-114	-254	- 16	-207	+413	+1,320	+1,526	- 607*	-1,304*	+ 697*
Aug. 4, 1927 to Feb. 3, 1928	+204	+107	-203	-105	+ 61	+365	+237	+663	+1,336	+ 607	+ 729
Nov. 12, 1927to Nov. 10, 1928	+292	+ 5	-360	- 84	-209	+491	+1,242	+1,525	+ 482*	- 401*	+ 883*
Feb. 3, 1928 to Nov. 10, 1928	+391	- 40	-226	+169	-273	+254	+1,183	+1,165	+ 89*	- 383*	+ 472*

*To October, 1928

Jan. 1, 1922 to Dec. 5, 1928	+198	+630	+474	+223	+751	+3823 ✓	+4574		+11,632	+4572	+7060 ②

✓ Out of town banks & others combined

② Jan. 1, 1922 to Nov 7, 1928

	In circulat.	U.S. Res. Bal	Gold stock	Money in circulat.	Bankers Loans: Com'l paper	Investm'ts	Other	Total	U.S. Dep.	Demand.	Time.
1924	+64	+322	+255	+4							
1925	+157	-8	-100	+56							
1926	-79	-18	+93	-9							
1927	+274	+293	-113	-92							
1928											
Aug 4.27 to Feb 3.28	+204	+107	-203	-105	+61	+365	+257	+663			
Nov 12,27 to Nov 10.28	+292	+5	-360	-84	-209	+491	+1242	+1525			
Feb 4.28 to Nov 10.28	+391	-40	-226	+169	-273	+254	+1183	+1165			

Make another table showing average of above
betw Jan 1. 1922 and 1923 to date.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Mendel. Sublet

Date December 19, 1928

To Mr. Hamlin

Subject: P95

From Mr. Goldenweiser

FR credit

2—8495

You asked me the other day to prepare a general statement about the extent, if any, to which the Federal reserve system has contributed to credit inflation in recent years. In the following, I am summarizing very briefly my views on that subject.

There is no evidence of general inflation at the present time. Certainly not in the commodity markets where inflation interferes most violently with the nation's business and where the consequences of deflation are most disastrous. There probably is inflation in the securities market, since the prices at which securities sell are not justified by past or prospective earnings of many of the companies.

If it is admitted that there exists at the present time a measure of inflation in the securities market, the question is to what extent the responsibility for this inflation rests with the Federal reserve system. If the period from 1922 to 1927 be considered, and annual averages be used, it appears that between these two years there was an increase in the country's gold stock of $748,000,000 and in Treasury credit, due chiefly to ~~the~~ Pittman Act operations, of $184,000,000. Reserve bank credit, on the other hand, declined by $79,000,000. Of the net amount added by the three items just mentioned, $361,000,000 went into money in circulation, $497,000,000 into member bank reserve balances, while non-member clearing balances showed a decrease of $20,000,000, and unexpended capital - an increase of $15,000,000. These figures would indicate that the growth in the credit base during the period was chiefly due to gold imports and that Federal reserve credit has

added nothing to this base. It indicates, further, that a considerable part of the funds derived from gold imports have gone into money in circulation, which under our system has no direct bearing on credit inflation, and that member bank reserve balances have increased by about $500,000,000. Developments since the end of 1927 do not change the picture materially, except that an export of gold has been made up by additional borrowing from the Federal reserve banks.

When the period is considered as a whole, it would appear, therefore, that Federal reserve credit has had no part in credit growth and, therefore, in credit inflation. A closer analysis of developments by periods, however, indicates that a large part of the growth in credit occurred in three periods: February to June, 1922, when member bank reserve balances increased by $132,000,000; April to December, 1924, when they increased by $176,000,000; and February to December, 1927, when they increased by $187,000,000. During these three periods there was relatively little net addition to the gold stock of the country, and there were increases of $237,000,000; $286,000,000, and $300,000,000, respectively, in ~~the~~ reserve bank holdings of United States securities. There are, of course, lags and adjustments in the course of bank credit, but when the Federal reserve system places money in the market through purchases of securities, the member banks immediately build up their loans and investments to a point where the additional reserves are fully utilized. Subsequent losses to the base through gold exports or through sales of securities, furthermore, do not result in a corresponding reduction of member bank credit,

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Office Correspondence

FEDERAL RESERVE BOARD

Date

To

Subject:

From

2—8495

but in increased borrowing from the reserve banks. There appears to be a vested right in credit once extended, and rather than interfere with this right, the banks will borrow from the Federal reserve banks. It would seem, therefore, that a more conservative policy by the reserve banks at certain periods would probably have resulted in a smaller growth of credit, particularly if the policy were supported by a generally higher level of discount rates.

This would appear to indicate that a measure of responsibility for existing inflation rests upon the reserve banks. This statement should be qualified, however, by the consideration that any change in the direction of higher money rates by the Federal reserve system during the past five years would probably have had an effect on the gold movements, and changes in these movements might have upset the conclusions reached in the preceding paragraph. Had the system not bought securities and established easy money rates in 1924, it is possible that gold would not have flowed out of the country towards the end of the year and in 1925.* It is quite certain that if the system had not adopted an easy money policy in 1927, we would not have lost the $500,000,000 which has left this country since that time. It is, therefore, impossible to determine definitely how much different the situation would ~~be~~ have been at present if the system had pursued a policy of tight money. It is also a question whether under these circumstances we would have had the same degree of prosperity as we actually have had, and it is practically certain that the world would not have yet returned to the gold basis.

* 175 went to Argentina

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Office Correspondence

FEDERAL RESERVE BOARD

Date

To

Subject:

From

P95

2—8495

My general conclusion is along this line. Some degree of responsibility for existing inflation rests with the Federal reserve system. The inflation, however, which now prevails is not of the most pernicious variety because it does not affect commodity markets. To the extent that the Federal reserve system has contributed to existing inflation, this may be considered as a price paid for continuous prosperity at home and the restoration of sound monetary conditions abroad with ~~the~~ consequent benefits to the entire world.

EAG-DD

Direct action
See B1

March 25, 1929.

B97
3-25-29

DIRECT ACTION

Control of Credits by Direct Action or By Increase in Discount Rates.

Friday, October 13, 1922:

Debate between Federal Reserve Agent Perrin and Governor Strong before the Joint Conference between the Board, the Governors, and the Federal Reserve Agents. The question discussed was whether credit control should be exercised by discount rates or by direct action, or by both.

Mr. Perrin contended that the rate did not really control unless it was higher than the commercial rates of the member banks, and that this was not practicable, - certainly not where the state usury laws permitted a rate as high as 12% in some states. He took the position that the Federal Reserve banks should know what was going on in the member banks before they applied for rediscounts, and that this supervision should be exercised even though a member bank was not rediscounting at all.

Governor Strong contended that a Federal Reserve discount rate was effective although it was lower than the market rate for commercial borrowers, for when the Federal Reserve banks increase the discount rate the member banks increase the rate charged their customers, and conversely. He claimed that the Federal Reserve bank should simply consider the amounts of rediscounts made by member banks in proportion to their resources, and that if these rediscounts are in reasonable amount, the Federal Reserve bank should grant them, no matter what the member bank had been doing, e. g. loaning on Wall Street, real estate loans, capital loans, speculative loans, etc. etc. He stated, however, that as a fact the Federal Reserve Bank of New York often made direct inquiries.

He claimed that the member bank rediscounts generally to make good its reserves, and that to refuse rediscounts would be disastrous to depositors. Federal Reserve Agent Wills of Cleveland strongly supported Mr. Perrin, and showed how Cleveland had maintained a 6% as a maximum (while New York was charging 7%) by virtue of direct control.

Mr. Perrin contended that where direct action is used, it would be possible to keep a reasonable rate in force without change, and to retain control through direct action.

Governor Morss strongly supported Mr. Perrin.

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October 16, 1925:

Governor Crissinger, returning from New York, reported that the Federal Reserve Bank of New York was bringing direct pressure upon the New York member banks to reduce their stock exchange loans; that these efforts had been successful so far as the New York banks were concerned, but that the greater part of the funds used came from interior banks, either loans against balances or direct loans.

October 16, 1925:

Dr. Stewart reported to the Board that he saw evidence that the stock exchange market was being fed by Federal Reserve rediscounts; that there was absolutely no reason for increasing rates from the point of view of agriculture, commerce, or business, although the Federal Reserve rate was 1% below customers rates; that direct pressure would meet the situation if it could be applied.

October 19, 1925:

C.S.H. tells Governor Harding that the New York situation was being held well in hand by direct pressure, and that the Board felt he could use direct pressure in Boston.

October 19, 1925:

Governor Crissinger tells C.S.H. that Philadelphia is holding matters well in hand through direct pressure, and does not want to increase rates at the present time.

October 27, 1925:

Discussion of direct pressure at a meeting with the Open Market Investment Committee. Dr. Miller said the term "direct pressure" was invented by Assistant Secretary Leffingwell.

Governor Strong said it could not be completely carried out unless the Federal Reserve bank should refuse to discount for any bank having speculative loans, which should include real estate loans as well as Wall

Street loans; that this would mean rationing of credit, which would be disastrous.

January 8, 1926:

Governor Crissinger told the Board that the First National of New York had just borrowed 115 millions from the Federal Reserve Bank of New York on its direct note collateraled by Government securities, and had loaned it on the New York stock exchange at from 6 to 7%. C.S.H. suggested that this called for direct pressure, or perhaps for a higher rate on member bank collateral notes.

September 7, 1927:

Secretary Glass favored direct pressure during the war.

September 27, 1927:

C.S.H. favors direct pressure to discourage speculation.

January 23, 1928:

Dr. Miller says that direct pressure is not controlling the situation, therefore he favored an increase in discount rates.

April 17, 1928:

James said that direct pressure at New York was succeeding, and was driving borrowers from New York to Boston.

April 18, 1928:

Dr. Miller says that open market operations are working well in New York.

B97

May 1, 1928:

Dr. Miller demands that Governor Case use direct pressure on the New York banks.

June 9, 1928:

Dr. Miller, at a meeting of Directors of the Federal Reserve Bank of New York, objected to calling the banks into conference with a view to forcing direct pressure.

July 7, 1928:

Harrison says direct pressure should be continued at New York.

July 18, 1928:

James criticises Governor Case for not using direct pressure.

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Office Correspondence

FEDERAL RESERVE BOARD

Date April 4, 1929

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

Effect of changes in disc. rates

2—8495

99

The attached tables were prepared in compliance with your request of April 3, 1929. Each table shows changes in banking figures on an average basis between the month preceding a change in discount rates and the month following. Figures for the country as a whole are given in the upper section of each table and figures for New York in the lower. For the New York figures, I have assumed that you desire statistics for New York City reporting member banks rather than those for the district as a whole. Changes in the item - total bills and securities - have been omitted from the New York tables because they reflect chiefly allotments from the open market investment account rather than the effect of discount rate revisions on money market developments.

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CHANGES IN BANKING STATISTICS AT TIME OF
DISCOUNT RATE CHANGES IN 1928

(Millions of dollars)

Increases in discount rates from 3 1/2 to 4 per cent
A. System. Period - January 25, 1928 to March 1, 1928

	January average	March average	Change
Total bills and securities	1,350	1,272	- 78
Reporting member banks:			
All other loans	8,631	8,784	+153
Reserve balances	1,799	1,726	- 73
Security loans	6,811	6,586	-225
Brokers' loans	3,802	3,761	- 41

B. New York City banks -

All other loans	2,470	2,565	+ 95
Reserve balances	781	738	- 43
Security loans	2,710	2,449	-261
Brokers' loans	1,342	1,064	-278

Increase in discount rates from 4 to 4 1/2 per cent.
A. System. Period - April 20, 1928 to June 7, 1928

	April average	June average	Change
Total bills and securities	1,371	1,495	+124
Reporting member banks:			
All other loans	8,880	8,909	+ 29
Reserve balances	1,783	1,740	- 43
Security loans	6,924	6,962	+ 38
Brokers' loans	4,062	4,360	+298
B. New York City banks:			
All other loans	2,628	2,635	+ 7
Reserve balances	777	749	- 28
Security loans	2,675	2,613	- 62
Brokers' loans	1,193	1,048	-145

B99

Increase in discount rates from 4 1/2 to 5 per cent
A. System. Period - July 11, 1928 to August 1, 1928

	June average	August average	Change
Total bills and securities	1,495	1,449	- 46
Reporting member banks:			
All other loans	8,909	9,009	+100
Reserve balances	1,740	1,672	- 68
Security loans	6,962	6,816	-146
Brokers' loans	4,360	4,239	-121
New York City banks:			
All other loans	2,635	2,668	+ 33
Reserve balances	749	705	- 44
Security loans	2,613	2,518	- 95
Brokers' loans	1,048	835	-213

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Office Correspondence

FEDERAL RESERVE BOARD

Memorandum.

Date April 10, 1929

To Mr. Hamlin

Subject: 0103

From Mr. Goldenweiser

EDG

M Credit.

2—8495

Referring to your memorandum of April 9, I shall submit answers to your questions in order.

1. It is impossible to say whether there is over-expansion of member bank loans and investments at the present time, but it is clear that the growth of member bank credit during the past year has not been at an exceptionally rapid rate. As seen from the answer to question (2) the growth was only about 4 per cent in 1928 as compared with 8 per cent in 1927. If there is inflation, it is inflation that was generated in the period from 1922 to 1927, rather than in the past year. I would define credit inflation as an increase in volume of outstanding bank credit at a rate that produces a purchasing power in the hands of the public in excess of the amount of commodities and services available. The excessive purchasing power results in competitive bidding for a limited supply with a consequent rise in prices, either of commodities or of real estate, or securities.

2. There are attached two tables, one showing the total volume of loans and investments of member banks at the end of each year from 1914 to 1928 and the percentage of increase annually, as well as a distribution of these loans and investments between different classes for the past four years. There is also attached a table carrying the one showing this distribution for reporting member banks back a few years beyond the table given you yesterday.

3. It is impossible to say what proportion of the loans and investments of member banks is due to the different factors affecting member bank reserve balances. I attach a table showing the sources and uses of reserve bank

credit from June 30, 1914, prior to the organization of the system, to March, 1929. It appears from this table that during the period there was an increase of $2,275,000,000 in gold stock, of $224,000,000 in Treasury credit, and of $1,481,000,000 in Federal reserve bank credit. Of this total of $3,980,000,000, increase in money in circulation absorbed $1,890,000,000, increase in reserve balances and till money of member banks absorbed $1,698,000,000, nonmember bank clearing balances $31,000,000 and unexpended capital funds, $361,000,000. Broadly speaking, this table indicates that the two principal sources of credit were increases in gold stock and reserve bank credit, and the two principal uses were money in circulation and reserve balances. Just what would have been the situation if there had been no Federal reserve system, it is impossible to say, because the reserve requirements and the whole set-up would have been so different that it is impossible to draw conclusions from the figures as they stand.

4. In reply to question four I attach a table showing the number of member banks borrowing continuously in excess of capital and surplus during a given month for the period from January, 1928 to March, 1929. These figures are only roughly indicative of the point in which you are interested, but they show that there is a decreasing number of banks that are continuous borrowers.

5. The effect of direct action by the Federal reserve system would seem to be that loans to brokers in the aggregate have decreased somewhat and

loans to brokers by banks have decreased by the substantial amount of $375,000,000. This decrease, however, has represented chiefly a transfer of borrowing by holders of securities from brokers to banks, as security loans of reporting member banks have increased somewhat during the period. The principal result of the direct action has been wide publicity given to the position of the Federal reserve system and cooperation with it by prominent people. Pressure at the centers has resulted in a wider distribution of brokers loans and a smaller concentration of borrowings from the reserve banks. In addition to this the policy of direct action has resulted in wide fluctuations in call money rates and in a constant rise of rates to commerce and business.

6. Specific warnings against excessive use of credit in the security market have not been numerous, the principal ones being in Dr. Miller's Boston speech in November, 1925, Governor Young's Cincinnati speech in March, 1929, the Federal Reserve Board's statement of February 7, 1929, the annual report for 1928, and references to speculation in the Federal Reserve Bulletin for February and June, 1928 and April, 1929.

Following is a complete list of references to the use of credit in security markets in the Board's annual reports and the Federal Reserve Bulletins. In this list the ones that can be construed as warnings are underlined.

Annual report	
1925	Page 6
1926	" 8, 9, 10
1927	" 11, 12
1928	" 3, 4, 5, 7, 8, 9,

Mr. Hamlin, #4

April 10, 1929

Federal reserve bulletins

1926,	March	Pages	147,8
	April	"	221,2
	September	"	622,3,4
	November	"	759,60
1927,	January	"	1,2,3
	July	"	455,6
	August	"	555
	December	"	795,6
1928,	February	"	111
	March	"	168
	June	"	373
	September	"	617
	November	"	737,8
	December	"	823,4
1929,	February	"	93,4
	March	"	176,7
	April		

	Total loans and investments of all member banks 1/ (In millions of dollars)		Percentage distribution of total loans and investments of all member banks				
December 31:	Amount	Per cent annual increase	Year June 30	Investments	Security loans	Real estate loans	All other loans
1914	8,498	--					
1915	9,861	+ 16					
1916	11,275	+ 14					
1917	16,896	+ 50					
1918	20,593	+ 22					
1919	24,778	+ 20					
1920	25,531	+ 3					
1921	23,482	- 8					
1922	25,579	+ 9					
1923	26,487	+ 4					
1924	28,746	+ 9					
1925	30,884	+ 7	1925	29	22	8	38
1926	31,642	+ 2	1296	29	23	8	38
1927	34,247	+ 8	1927	29	24	9	35
1928	35,684	+ 4	1928	30	25	9	34

1/ Up to 1920 part of growth in total represents accession of new members.

CHANGES IN FACTORS AFFECTING RESERVE BANK CREDIT
BETWEEN JUNE 30, 1914 AND MARCH, 1929

(In millions of dollars)

Sources	June 30 1914	March average	Change
Gold stock	1,891	4,166	+ 2,275
Treasury credit	1,567	1,791	+ 224
Reserve bank credit		1,481	+ 1,481
Discounts		969	+ 969
Acceptances		265	+ 265
U. S. securities		197	+ 197
Other		50	+ 50
Total	3,458	7,438	+ 3,980
Uses			
Money in circulation less estimated till money requirements of banks	1,819	3,709 1/	+ 1,890
Reserve balances and till money of banks	1,639	3,337 1/	+ 1,698
Nonmember clearing balances		31	+ 31
Unexpended capital funds		361	+ 361
Total	3,458	7,438	+ 3,980

1/ Based on estimated average holdings of till money of $1,000,000,000 in March, 1929.

P103

REPORTING MEMBER BANKS - PERCENTAGE DISTRIBUTION
OF TOTAL LOANS AND INVESTMENTS FOR MONTH OF
MARCH EACH YEAR 1920 - 1929

	Investments	Security loans	All other loans
1920	22	26	52
1921	21	24	55
1922	25	24	51
1923	29	24	47
1924	27	25	48
1925	29	27	44
1926	28	28	43
1927	27	29	43
1928	29	31	41
1929	27	34	40

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Disc. rate - cust. rate

Date April 15, 1929

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

Customers' rates, July, 1927-March, 1928

2—8405

Effect of changes in discount rates on customers rates

C 105

As far as our information goes, customers' rates practically always fluctuate in a range above discount rates. Before the reduction in discount rates from 4 to 3 1/2 per cent in August, 1927, most member banks in Federal reserve bank cities reported customers rates as ranging above 4 1/2 per cent, the only exceptions as of the 15th of July, 1927, being Boston, 4 1/4 - 4 1/2 per cent; Richmond, 4 - 5 per cent; Chicago 4 1/4 - 5 per cent, and Minneapolis 4 - 5 1/2 per cent. Four per cent remained the lowest quotation for customers rates in the succeeding 6 months during which the 3 1/2 per cent discount rate prevailed, being quoted at one time or another during the period in Boston, New York, Philadelphia, Cleveland, St. Louis, and Dallas. In March, 1928. after discount rates were revised to 4 per cent, the lowest quotations on customers rates were 4 1/4 per cent. As you know, our quotations on customers rates vary widely both from city to city, and also for different types of loans. These quotations over the period in question are shown on page 248 of the Federal Reserve Bulletin for April, 1928.

On account of the difficulty of summarizing these varied quotations, we frequently make use of the weighted average of customers rates in different classes of cities which were given in chart form in the annual report. These weighted averages which are computed in this Division and take into account the relative importance of the

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cities and loans for which quotations of customers rates are available are given in the enclosed table. As you will note, customers rates in all three classes of cities averaged well above discount rates throughout the period, but did respond slightly to the easier credit conditions which accompanied the 3 1/2 per cent rate, especially in New York City and in the nine other Northern and Eastern cities.

C105

	Prevailing discount rates at F. R. Bks.	Weighted averages of rates charged customers - In New York City		In 8 other Northern and Eastern cities		In 25 Southern and Western cities	
1927:							
March	4	4.56		4.88		5.65	
April	4	4.63		4.90		5.56	
May	4	4.63	4.59	4.95	4.91	5.59	5.57
June	4	4.60		4.93		5.54	
July	4	4.56		4.90		5.52	
August	3 1/2-4	4.41		4.87		5.53	
September	3 1/2-4	4.44		4.77		5.61	
October	3 1/2	4.49		4.79		5.56	
November	3 1/2	4.35		4.82		5.56	
December	3 1/2	4.50	4.49	4.76	4.78	5.60	5.56
1928:							
January	3 1/2-4	4.56		4.73		5.53	
February	3 1/2-4	4.44		4.76		5.53	
March	4	4.59	4.65	4.81	4.86	5.54	5.54
April	4-4 1/2	4.72		4.91		5.54	
1929							
Jan.	5%	5.63		5.86		5.99	
Feb.	"	5.63		5.86		6.06	
Mar.	"	5.81		5.90		6.03	

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Office Correspondence

FEDERAL RESERVE BOARD

Fed Credit, Direct acts

Date April 18, 1929

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

Fed Credit
Direct acts

2—8495

Referring to your memorandum of April 17, I believe that the figures in your statement are in agreement with our statistical data. In accordance with your request to make a statement about Federal reserve credits since the turn of the year, I am attaching a table that shows the elements in the demand and supply for reserve bank credit for the weeks ending December 29, 1928, February 9, 1929 and April 13, 1929, and changes for the first and second of these periods and for the entire period.

Generally speaking, the table indicates that during the first period the entire situation was dominated by the seasonal return flow of currency, offset somewhat by a loss of gold due to the excess of earmarks for France over imports from Canada and England. The net result was a decrease of $370,000,000 in reserve bank credit for the period. This carries us up to the week ending February 9, during which the Board issued its statement. This week is a good dividing line not only because of the issuance of the statement, but also because it approximately coincides with the end of seasonal liquidation. During the period after February 9 the dominant fact has been an increase of $90,000,000 in gold stock, but there has also been a decrease of $56,000,000 in member bank balances, reflecting decreases both in demand and time deposits of the member banks. These decreases in member bank deposits are no doubt related to the large increase in brokers' loans for account of others. The net result for the period has been a decrease in reserve bank credit of $149,000,000.

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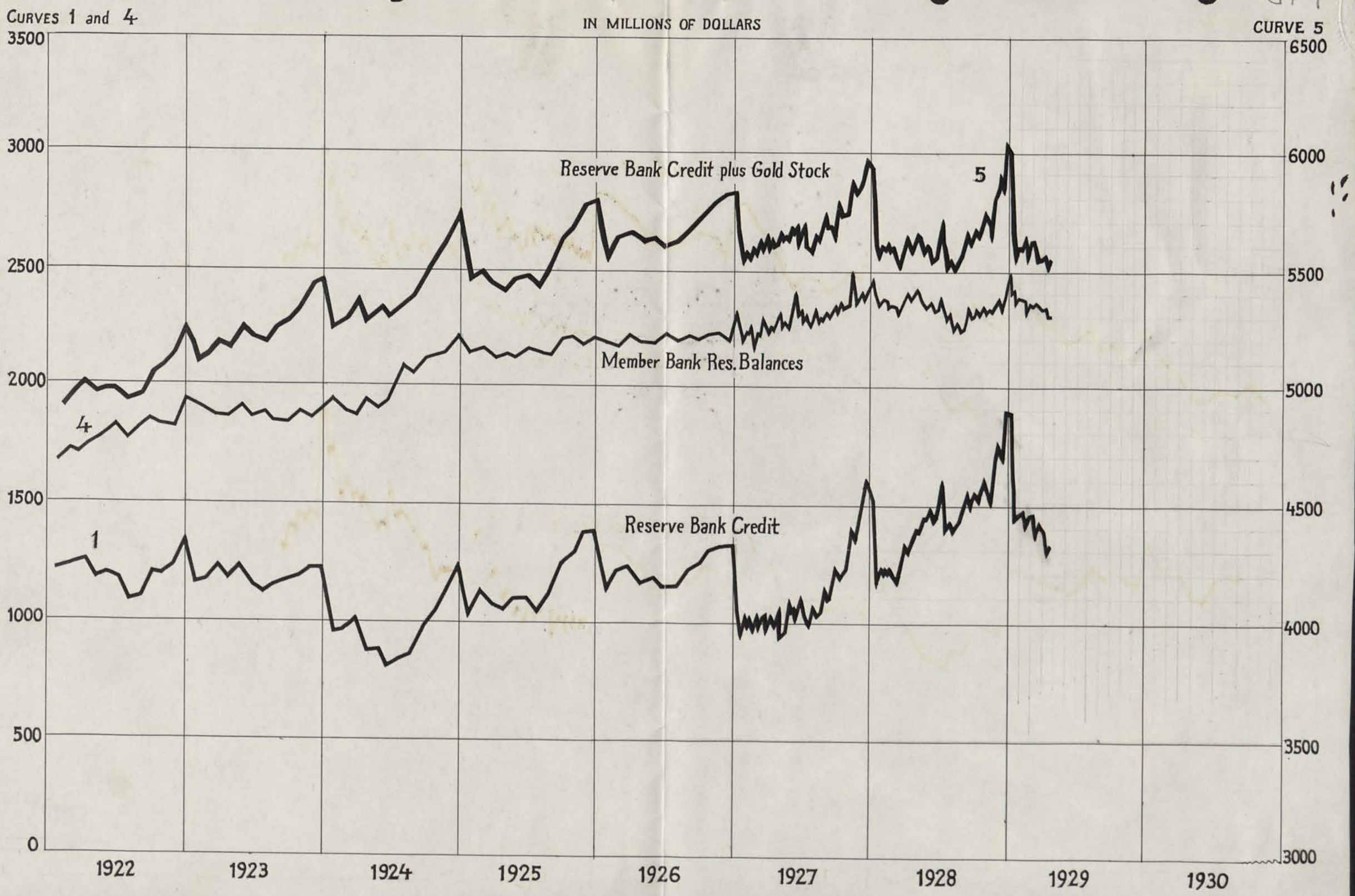
RESERVE BANK CREDIT OUTSTANDING AND FACTORS IN CHANGES

(Weekly averages of daily figures: millions of dollars)

Week ending	Reserve bank credit	Treasury credit	Gold stock	Money in circulation	Member bank balances	Clearing balances	Unexpanded capital
1928:							
Dec. 29	1,882	1,795	4,148	5,074	2,366	30	354
1929:							
Feb. 9	1,512	1,781	4,130	4,675	2,366	28	355
Apr. 13	1,363	1,801	4,220	4,679	2,310	31	365
Changes:							
1st period	-370	- 14	- 18	-399	--	- 2	+ 1
2nd period	-149	+ 20	+ 90	+ 4	-56	+ 3	+10
Total	-519	+ 6	+ 72	-395	-56	+ 1	+11

P109



Form No. 231

Office Correspondence

FEDERAL RESERVE BOARD

Prem. rates – open M'kt and cust. rates

Date May 18, 1929

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

P. 111

Relation bet. M'kt rates and open mkt com. paper & customers rates

2—8495

In reply to your memorandum of May 16, I am attaching a chart from the May Federal Reserve Bulletin showing open-market money rates in New York City, and the discount rate of the Federal reserve bank. Commercial paper is shown as 6 per cent on this chart, but there is evidence that the rate is 6 1/4 per cent in some cases and is firming.

Customer rates in New York City are not shown on this chart. At present they are about 6 per cent, practically the same level as open-market commercial paper.

In reply to question 1 in your memorandum, open-market commercial paper has usually been quoted at about one-half of 1 per cent above the discount rate; an advance of the discount rate in New York to 5 1/2 per cent would reestablish that margin, on the assumption that the commercial rate will remain unchanged.

The discount rate would also be one-half per cent below the present rate to customers. As regards this rate, it should be mentioned that it responds to changes in discount rates less promptly and less uniformly than do open-market rates. Usually the rate to customers is above the open-market commercial rate, but whenever in the past the latter has advanced to 6 per cent, the customer rate appears to have remained at the same level, and when the open-market rate has advanced above 6 per cent, as in 1920-21, the rate to customers has been below the open-market rate.

In reply to question 2, an advance of the discount rate in New York to 6 per cent would bring it up to the quoted rate on commercial paper. This condition would not be very unusual, as there have been numerous short

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date P111

To

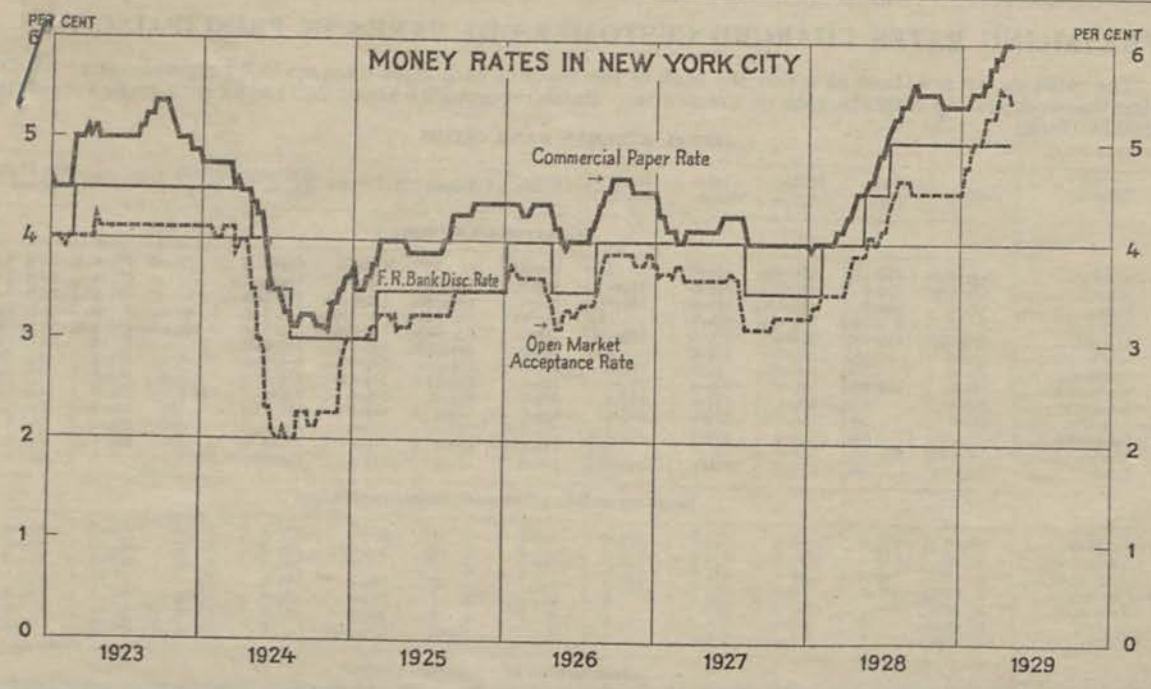
Subject:

From

2—8495

periods in 1924, 1927 and 1928 when the discount rate in New York has been at the same level as the rate on open-market commercial paper. In times of readjustment of rates this has not been unusual, as you can see on the chart.

In reply to question 3, I should expect that a 6 per cent discount rate at New York would probably be accompanied or followed by a rise to 6 1/2 per cent in the rate on open-market commercial paper, which is at present showing signs of advancing. Such a condition would restore the one-half of 1 per cent differential which has usually prevailed in the past. I should also expect customers' rates in New York, as computed in our weighted average, to rise somewhat further above their present level at 6 per cent, but not necessarily to as high as 6 1/2 per cent.



CONFIDENTIAL

Bank credit 1922-29

Memo 1922-29

May 18, 1929

P. 113

To: Federal Reserve Board

From: Mr. Goldenweiser

SUBJECT: Bank Credit: 1922-1929

No growth since the spring of 1928

Reports on the condition of all member banks at the end of the first quarter of this year confirm the indications, given by the course of developments for the weekly reporting member banks, that there has been practically no growth of bank credit during the past year. Total loans and investments of all member banks on March 27, 1929 were $332,000,000, or less than 1 per cent, above the figure for the end of last June and indications are that there has been a further decrease since the end of March. This absence of growth in bank credit has occurred during a year of exceptionally active business and a record breaking volume of trading in securities. It would seem appropriate at this time to review the course of banking developments for recent years.

Rapid growth: 1922-1928

The course of bank credit from the spring of 1922, when post-war liquidation came to an end, to the spring of 1929 is shown in the attached chart which also indicates, on the basis of the best available estimates, the course of the banks' investments plus their loans on securities, and the course of all other loans. For comparison, there is also shown a line of the physical volume of industrial production, which may be considered indicative in a rough way of the changes in volume of the country's business that required financing by the banks.

(Chart)

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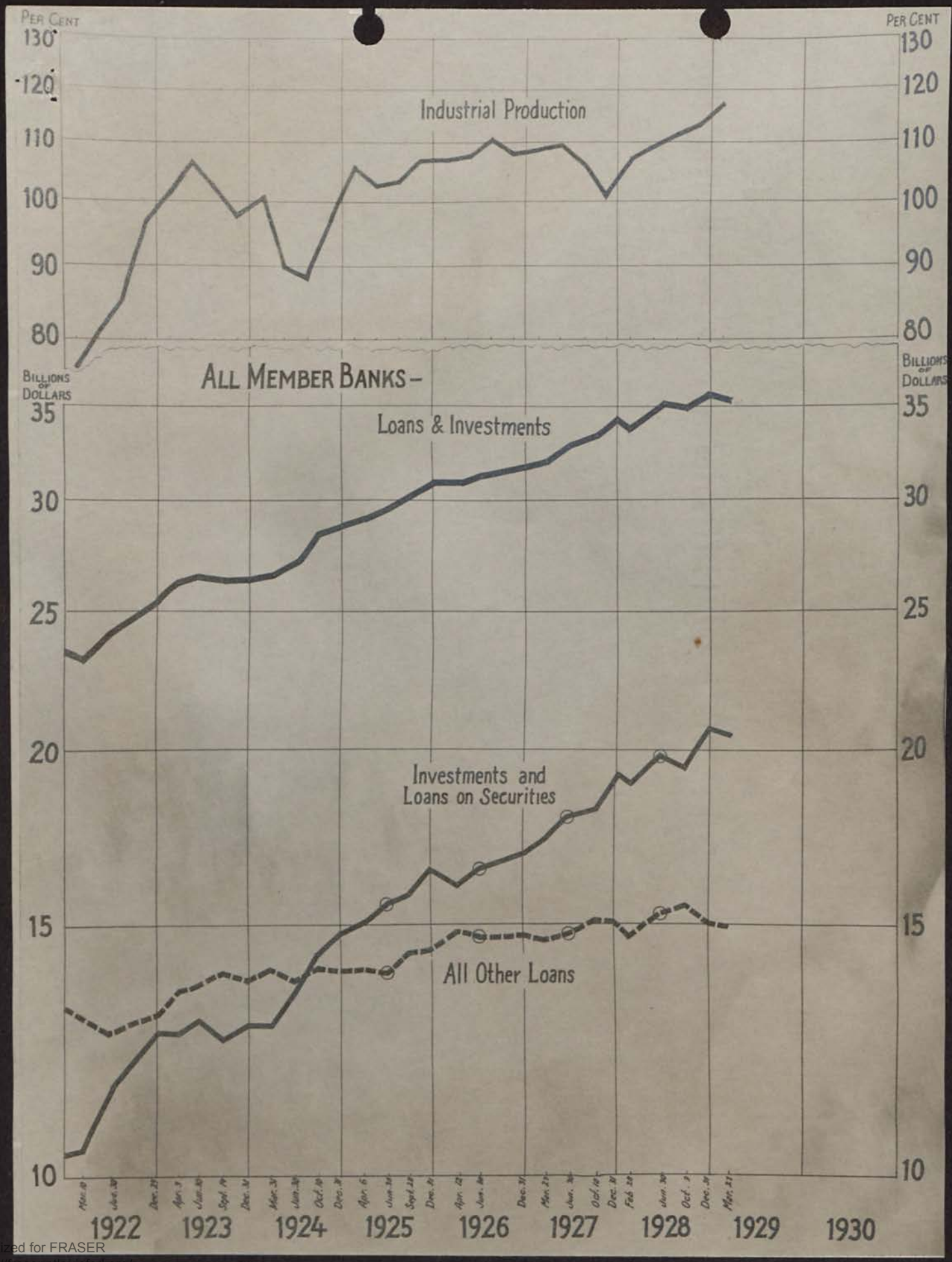


The outstanding fact brought out by the chart is the rapid and practically continuous growth of credit during the somewhat more than six years from March, 1922 to June, 1928. There was a slackening in the rate of growth between 1923 and 1924, when industry was going through a recession, and again in 1926, although at that time industry was more active. The recent retardation in the growth of bank credit followed a period of unusually rapid expansion in the early part of 1928.

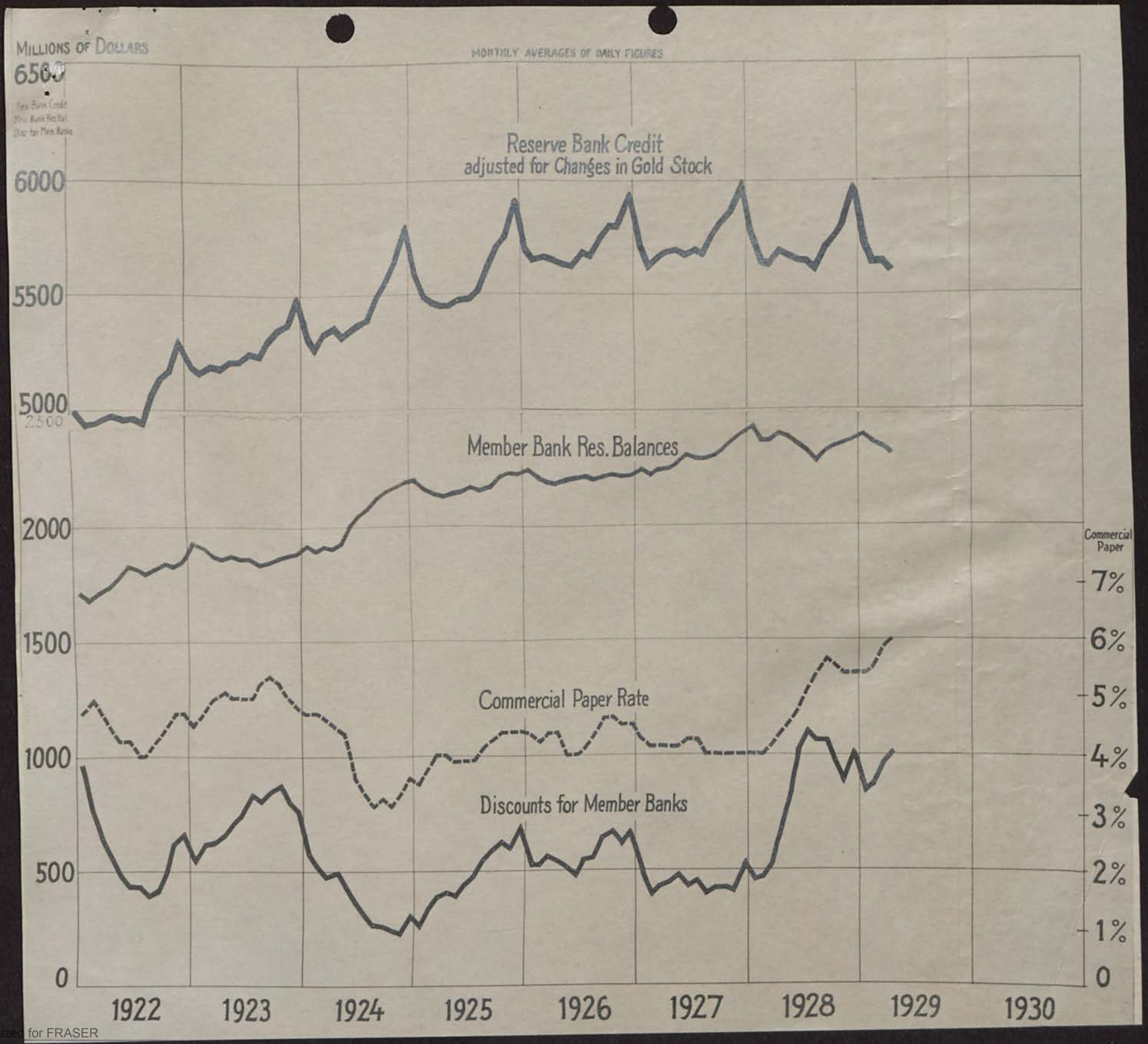
Composition of credit growth

Taking the six years 1922 to 1928 as a whole, the growth in bank credit, which has amounted to approximately $12,000,000,000, has been for the most part in the form of investments and of loans on securities, while all other loans, which comprise loans for trade and industry, including building, have not shown a rapid growth. This relatively slow growth of commercial loans during a period of active business has reflected in part a change in the financial methods of large enterprises, which have obtained funds by issuing securities in a favorable market, rather than by borrowing from banks. It has also reflected reduced inventories made possible by more scientific management of stocks of materials and by the improvement in efficiency of the transportation system. The more rapid growth in loans on securities than of commercial loans has been due in part to an increasing participation in the investment market of a large number of persons all over the United States, who have bought securities partly on credit obtained either directly from their banks or from brokers who in turn obtained it from the banks.

Money market factors

An explanation of the flattening of the bank credit curve during the past year is found largely in the conditions of the money market indicated on another chart which shows for the period since 1922 changes in the volume of reserve bank credit adjusted for changes in the gold stock, the course of member bank reserve balances, the volume of member bank indebtedness at the reserve banks, and the open-market rate for commercial paper.

(Chart)



This chart shows that when gold and reserve bank credit, which are the two principal sources of reserve funds for member banks, are combined, they show a rapid expansion during 1922, 1923, and 1924. In 1922 and particularly in 1923, however, a considerable part of this expansion was absorbed by a growth in currency and was not reflected in a growth of member bank reserve balances. Money rates were rising and the volume of bank credit, after a certain rebound from the low point of 1922, was not increasing rapidly. In 1924, however, when gold imports were large, these gold imports, together with purchases of United States securities by the Federal reserve banks, resulted in a rapid liquidation of member bank indebtedness and a sharp decline in money rates. This was a period when banks were having difficulty in finding employment for their funds. The proceeds of gold imports and of purchases of United States securities by the reserve banks were not used entirely in the reduction of discounts, which at the financial centers were exceptionally low, and there was a notably large growth in member bank reserve balances. This was the year when security loans and investments of member banks, representing open-market operations rather than dealings with customers, showed the sharpest increase. The latter part of the year was also characterized by great activity on the stock market, accompanied by a rise in security values. In 1925 and 1926 there was relatively little change in gold stock, money in circulation, member bank reserve balances, or reserve bank credit. Total loans and investments of member banks continued to grow, but this growth was reflected on the liability side chiefly in a growth of time deposits, which required little additional reserves. Business was active and commodity prices tended moderately downward.

The next period of rapid expansion in bank credit occurred in 1927. During the first half of the year gold continued to flow in, and the reserve banks were purchasing United States securities, with the consequence that discounts declined and money rates became easy. There was also a recession in industrial production.

During this period, again, the funds derived from gold imports and from purchases of securities and acceptances were not entirely absorbed in a reduction of member bank discounts and were in part added to reserve balances. The volume of member bank credit increased rapidly, particularly in the form of loans on securities and to a less extent of investments; commercial loans remained almost unchanged. This was another period of rapid expansion of stock exchange operations, of rising security prices and of growth of brokers' loans. It was also a period in which there was a rapid increase of demand deposits and of member bank reserve requirements.

Periods of most rapid growth: 1924 and 1927

When the period after the spring of 1922 is considered, the two times in which member bank reserve balances rapidly advanced were the second half of 1924 and the second half of 1927, both of which were periods following upon large gold imports and periods during which the Federal reserve banks were buying Government securities. They were periods when member bank indebtedness was relatively small and when money rates were low. There was what might be called a buyers' market for money, since banks were seeking employment for their funds and in the absence of commercial demand were lending them on the stock market and buying securities.

Reversal of easy money policy

The easy money policy of the Federal reserve system came to a close in the last month of 1927, and early in 1928, with gold moving out of the country and securities being sold by the Federal reserve banks, there was a rapid growth in member bank indebtedness and an advance in money rates. It is these developments that appear to have been the chief factors in causing the decline in the rate of growth of bank credit. Since that time there has been some reduction in member bank reserve balances and a decline in their investments.

Growth of security loans

Loans on securities and to a less extent commercial loans, however, continued to increase. With money rates at a high and rising level, with reserve bank policy exerting a restraining influence on the growth of credit, and with an outward movement of gold, the steady growth in security loans was attributable to the fact that speculation in securities had become so active that its momentum continued, even though credit conditions were not favorable. Not only did security loans by banks continue to grow, but in addition a large volume of funds of corporations and others were attracted into the market to help supply the demand for credit to finance trading in securities. The high level reached by money rates, and particularly by rates on call and time money in the stock market, can be explained adequately only by taking into consideration both the restraining influence of the policy of the Federal reserve system and the continued urgent demand for credit in the stock market.

Developments since February 6

Since February 6 of this year, which is a good date to measure from, both because it comes at the close of seasonal liquidation, and because it marks the time when the Federal Reserve Board issued its statement, there has been an increase in member bank indebtedness due chiefly to a liquidation of acceptances and of Government securities. Money rates have continued high; member bank credit in the aggregate has shown little change; for reporting member banks there has been a decline in security loans and in investments, and a rather more than seasonal growth in commercial loans. Brokers' loans have shown only a slight decrease, as a large decrease of loans by banks was partially offset by a growth in loans for account of others. The total volume of reserve bank credit during this period declined by about $180,000,000, a large part of it, about $165,000,000, being due to an increase in gold stock, while money in circulation increased somewhat seasonally, and there was a reduction of over $50,000,000 in member bank reserve balances.

This reduction in reserve balances has been due to a decline in demand deposits, caused chiefly by a reduction in bankers' balances.

Business under high money conditions

Dear money conditions, which have prevailed for more than a year, have gradually spread from the open market to rates charged to customers, and have had the effect of creating unfavorable conditions in the bond market, with a consequent decline in building operations, which are financed partly through the issue of bonds. Most of the other industries have continued active and there is evidence of over-stimulation in automobiles and steel. This over-stimulation may be due in part to the fact that the proceeds of brokers' loans have been used to pay for stocks of corporations which have used the funds in expanding their operations. Demand for goods by the consumers has been sustained, reflecting a good condition of employment, relatively large payrolls, large exports, somewhat improved conditions of agriculture, and also an increasing amount of profits made on the stock exchange and expended for luxury or semi-luxury goods.

Effects of high money on foreign countries

Abroad, the high money rates in this country have been an extremely disturbing factor. Not only have they caused a movement of gold to this country from Germany, which has lost all of its excess gold reserves, and from Argentina, but more important than that, it has caused persistent discount rate advances in other countries which could not afford to lose the gold. Discount rates have been advanced since the first of the year in thirteen foreign central banks, some of them, like Italy and Rumania, having made two advances. Since the rise in the rate at the Bank of England from 4 1/2 to 5 1/2 per cent on February 7 there has been some increase in the gold reserves of that bank. Industrial conditions in England, however, continue unsatisfactory and there is a large volume of unemployment. In Germany also there appears to be an industrial recession. The Reichsbank, which early in the year had reduced its discount rate to 6 1/2 per cent, was

obliged to raise it towards the end of April to 7 1/2 per cent and, notwithstanding that, has continued to lose gold.

Summary for past eighteen months

In retrospect, it would appear that during the past year and one-half Federal reserve policy has accomplished a great deal in slowing down the growth of bank credit, and though the volume of credit in the stock market has continued to grow, this growth would probably have been much larger, had the Federal reserve system not exerted a restraining influence. There has been little evidence of bad effects on domestic business, except on building operations, and it is not improbable that high money rates have prevented what might have developed into a serious over-expansion in certain lines of industry. The probable effect of a prolonged period of high rates on domestic business, however, required serious consideration.

P. 113

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Maine Barger Sheet
Hom. Secret. & Com. Loans

Date June 19, 1929

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

B 115

2—8495

I am returning herewith your memorandum in connection with your forthcoming speech, with a substitution for two paragraphs and some corrections in the others.

In addition to this, I should like to raise a question about the second paragraph, in which you say that the purpose of the firm money policy was to restrict the growth of Federal reserve credit. To be sure, you say that incidentally this was intended to retard the growth of speculative loans, but as a matter of fact, I do not think that the Federal reserve authorities at any time since 1920 have been interested in restricting the growth of Federal reserve credit. There has been little growth of such credit on the average. The reserve ratio has always been high, and Federal reserve authorities had no objection to the use of reserve bank credit, provided it was done according to the rules of the game, in the sense of not abusing reserve bank privileges, and provided also that there was no unhealthy development in the general credit situation. I think it is a fair statement that just as ~~we have~~ Keynes has paid little attention to the reserve ratio for the last seven years, ~~the system~~ it has paid little attention to the total volume of reserve bank credit and has been guided in its credit policy by business conditions and member bank credit developments.

I think that in the last sentence, your statement that the funds, instead of going into member bank reserves, were used to reduce reserve bank credit, should probably be modified. It is highly improbable that the

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PAGE 115

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date

To

Subject:

From

2—8495

entire decrease of reserve bank funds arising from gold imports and the seasonal return of currency, could have gone into member bank reserve balances, - it never has - and certainly would not have at a time when member bank indebtedness was $1,000,000,000. May I suggest that the sentence be changed to read: "The decline in Federal reserve bank credit was brought about chiefly by the seasonal return flow of currency from circulation, and the difference between the decline in 1928 and 1929 was due largely to the fact that in 1928 we were losing gold, whereas, in 1928 gold was coming to the United States. Nevertheless, it is true that in the absence of direct pressure some part of the funds released through the inflow of gold might have found ~~their~~ its way into the balances of the member banks and formed the basis of further expansion, while with the pressure on, member bank reserve balances, actually decreased by about $50,000,000 between January 29, 1929 and the week ending on June 15."

Substitute for paragraphs 3 and 4

That security speculative loans have been increasing rapidly is common knowledge. It is impossible to arrive at exact comparisons over long periods because of changes in membership in the Federal reserve system, but it is significant that the total loans on securities of reporting member banks (old series) averaged $3,603,000,000 in January, 1922 and (new series) $7,504,000,000 in January, 1929. This shows an increase of $3,900,000,000, or more than 100 per cent. At the same time commercial loans increased from an average of $7,458,000,000 (in January, 1922 at reporting member banks (old series) to an average of $8,796,000,000 in January, 1929 (new series), an increase of $1,338,000,000, or 18 per cent).

Comparing these same figures for January, 1922 and January, 1929, we find that the percentage of security loans to total loans and investments had increased from 25 per cent of the total to 34, while the corresponding percentages of commercial loans had decreased from 51 per cent to 39 per cent

June 18, 1929.

What is the so-called "firming policy" of the Federal Reserve System which has been exercised since the latter part of 1927, and since the first of the year under the name "direct pressure?"

It is simply cooperation between the Federal Reserve Board, the Federal Reserve banks, and the member banks, to restrict the growth of Federal Reserve credit, thus incidentally retarding the growth of speculative loans and bringing about a small liquidation thereof.

That security speculative loans have been increasing very rapidly will be realized when it is considered that they have increased from 3688 million (Jan. 1, 1922) to 7807 millions (Jan. 1, 1929), while commercial loans increased only from 7523 millions (Jan. 1, 1922) to 9000 millions (Jan. 1, 1929).

Comparing January 1, 1922 with the same date 1929, we find that the percentage of security loans to total loans and investments had increased from 25% to 34%, while the corresponding percentage of commercial loans had decreased from 51% to 40%.

Taking the year 1929, we find that security loans of reporting member banks had decreased from 7504 millions (the January average) to 7207 millions on June 12, 1929, - a reduction of 297 millions, or 3.9%.

Commercial loans increased from 8796 millions (the average of January, 1929) to 9157 millions (June 12, 1929), the increase being 361 millions, or 4.1%.

On the other hand, the member banks reserves decreased from ~~2686.7~~ 2387,000,000 (the average of Jan. 1929) to ~~1888 (June 18, 1929)~~ 2331,000,000 during the week ending June 15, 1929, the decrease being ~~704~~ 56,000,000 millions or ~~2.9%~~ 2.4%.

Comparing the averages for January 1929 and the figures for June 12, 1929, we find that security loans had fallen off from 33.6% to 32.6%, while commercial loans had increased from 39.4% to 41.4%.

Taking the figures as to Federal Reserve credit for the entire System, we find that comparing the average for January with the average for May, 1928, Federal Reserve credit increased from 1388 millions to 1472 millions, - an increase of 84 millions or 6%; on the other hand, comparing the same dates for 1929, we find that Federal Reserve credit decreased from 1613 millions (the average of January 1929) to 1303 millions (the average of May 1929) the decrease being 310 millions, or ~~19%~~. 19%

Unquestionably this decline in Federal Reserve credit was brought about largely by withdrawal of money from circulation and from gold imports, but

That security speculative loans have been increasing very rapidly will be realized when it is considered that they have increased from 3683 millions (Jan. 1, 1922) to 7807 millions (Jan. 1, 1929), - an increase of 4124 millions or 112%; while commercial loans have increased only from 7523 millions (Jan. 1, 1922) to 9000 millions (Jan. 1, 1929), - an increase of 1477 millions or 19%.

MEMBER BANK RESERVE BALANCES - AVERAGED -

$1,707,000,000 in January, 1922
2,426,000,000 in January, 1928
2,387,000,000 in January, 1929
2,331,000,000 in week ending
June 15, 1929

SECURITY PRICES

January, 1922:		Jaunary, 1929:	June, 1929:
342 Stocks and Industrials	55.6	191.4	188.8
33 Rails	63.4	141.0	141.7
35 Utilities	63.6	188.3	227.7
410 Stocks combined	58.7	183.6	187.9

the effect of the direct pressure, so called, was that these funds, instead of going into member bank reserves as the basis of further expansion, were used to reduce Federal Reserve credit, with the result as shown above.

June 18, 1929.

B115

What is the so-called "firming policy" of the Federal Reserve System which has been exercised since the latter part of 1927, and since the first of the year under the name "direct pressure?"

It is simply cooperation between the Federal Reserve Board, the Federal Reserve banks, and the member banks, to restrict the growth of Federal Reserve credit, thus incidentally retarding the growth of speculative loans and bringing about a small liquidation thereof.

That security speculative loans have been increasing very rapidly will be realized when it is considered that they have increased from 3683 millions (Jan. 1, 1922) to 7807 millions (Jan. 1, 1929), - an increase of 4124 millions or 112%; while commercial loans have increased only from 7523 millions (Jan. 1, 1922) to 9000 millions (Jan. 1, 1929), - an increase of 1477 millions or 19%.

Comparing January 1, 1922 with the same date 1929, we find that the percentage of security loans to total loans and investments had increased from 25% to 34%, while the corresponding percentage of commercial loans had decreased from 51% to 40%.

Taking the year 1929, we find that security loans of reporting member banks had decreased from 7504 millions (the January average) to 7207 millions on June 12, 1929, - a reduction of 297 millions, or 3.9%.

Commercial loans increased from 8796 millions (the average of January, 1929) to 9157 millions (June 12, 1929), the increase being 361 millions, or 4.1%.

On the other hand, the member banks reserves decreased from 2386.7 (the average of Jan. 1929) to 1682 (June 12, 1929), the decrease being 704 millions or 2.9%.

Comparing the averages for January 1929 and the figures for June 12, 1929, we find that security loans had fallen off from 33.6% to 32.6%, while commercial loans had increased from 39.4% to 41.4%.

Taking the figures as to Federal Reserve credit for the entire System, we find that comparing the average for January with the average for May, 1928, Federal Reserve credit increased from 1388 millions to 1472 millions, - an increase of 84 millions or 6%; on the other hand, comparing the same dates for 1929, we find that Federal Reserve credit decreased from 1613 millions (the average of January 1929) to 1303 millions (the average of May 1929) the decrease being 310 millions, or 13%.

Unquestionably this decline in Federal Reserve credit was brought about largely by withdrawal of money from circulation and from gold imports, but

FEDERAL RESERVE BANK
OF BOSTON

B 132

October 5, 1928

Dear Mr. Hamlin:

I have received your letter of October 3 and have read with much interest the memorandum which you enclosed with it.

I think you have shown very clearly that the Federal Reserve System cannot properly be charged with having brought about the orgy of stock market speculation which has taken place during the present year, by reason of its lowering the discount rate and purchases of government securities last Autumn. The speculative fever has been in the blood of the American people and I think it would have manifested itself in any event. Certainly the rate increases which have taken place during the present year, and the high call money rates which have prevailed, have not operated to check speculation. On more than one occasion, we have seen stocks advance in the face of an 8 or 9 per cent call money market. At the same time, looking back I believe that the $3\frac{1}{2}$ per cent rate last year was unnecessary and unfortunate in view of the fact that it has afforded a basis for criticism.

Sincerely yours,

W P G Harding

Hon. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

J

VOLUME 194
PAGE 132

FEDERAL RESERVE BANK OF PHILADELPHIA

925 CHESTNUT STREET

P133

October 6th, 1928.

My dear Mr. Hamlin:-

I have your letter of October 3rd, enclosing analysis of the effects of the reduction in discount rates and the accompanying purchases of government securities last fall. I think that to any banker capable of grasping the import and relation of the figures, you prove your case. The number of such persons, however, is very limited, and those who do not choose to see the light can easily shut their eyes, and marshal figures that point the other way.

To my mind, the justification of the policy of last fall is the fact that it did accomplish the two purposes in view - the facilitation of our exports, and the rendering of assistance in the stabilization of foreign currencies. I am inclined to think that we must admit one or two mistakes - (1) that in undertaking to offset exports of gold by purchases of securities, we gave the impression that these exports could be and would be absolutely negatived, and might therefore be ignored by both bankers and business men; (2) I think that our purposes were substantially accomplished early in January, and that the policy should have been reversed about a month earlier than it was, and that the action then taken should have been taken more energetically - there should have been an increase of 1% instead of 1/2% in discount rates, and the sales of securities during the early weeks should have been in larger volume. These, however, were merely mistakes as to time and amount. The essential policy was right last fall, and right in the spring and summer of this year.

In my opinion, the most conclusive proof that easy money in this country was not the chief factor, or even an important factor, in the stock market speculation, is the fact that through last spring and summer a similarly active speculation was in progress on almost all the European stock exchanges. Just as the existence of world-wide deflation in 1920 is the most conclusive proof that the deflation in this country was not due to any Federal Reserve policy, so the world-wide speculation in securities this year is the best evidence that the speculation on the New York Stock Exchange is not the result of Federal Reserve policy.

B.133

With best wishes, and many thanks for the opportunity of seeing your analysis, I am,

Very sincerely yours,

Geo. H. Norris

Governor

Hon. Chas. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

B134

FEDERAL RESERVE BANK OF CHICAGO

230 SOUTH LASALLE STREET

Personal

October 8, 1928

Hon. C. S. Hamlin
Member, Federal Reserve Board
Washington, D. C.

Dear Mr. Hamlin:

Your letter of October 4, enclosing copy of a confidential article prepared by you was received during my absence in attendance on the American Bankers Association Conference at Philadelphia, and only this morning have I returned to my desk and have not as yet had opportunity to give more than casual attention to your article, which, however, at first reading, impresses me as very carefully prepared with evidence presented to support your own conclusions. I shall endeavor within the next two or three days to give the article more careful consideration, and will probably write you again after I have done so.

It is one thing to prepare an analysis on which you and I might be in substantial agreement, and quite another thing to have that analysis accepted by those who have been for the last year commenting and criticising. Inasmuch as your letter indicates that your analysis is a confidential one, I infer that you are not yet ready to make it public.

You probably are aware that last summer when the matter of rates was in question, a large part of our communication with the Board was over the telephone with Governor Crissinger, and both Governor McDougal and I stated to Governor Crissinger in the course of such conversations that one of the reasons urged by the Chicago directors against any reduction in rate was that it would undoubtedly result in greater stimulation of speculative activity in the stock market. Our directors were all very careful about giving public expression to their views, but the Chicago papers and others took up this very feature of the situation and commented on it in a way that was very hurtful. It is still a matter of comment out this way in certain circles that the condition which the Chicago directors pointed out developed, and was furthered by the reassuring comments of Mr. Mellon, Governor Young, and of President Coolidge himself; while the average newspaper writer and the average business man has had little real comprehension of the gold situation and the effect of gold exports in affecting the credit situation. We frequently

Hon. C. S. Hamlin. October 8, 1928 P. 134

hear this comment:

"If those who are in position to know what is going on were as frank in enlightening the public while situations are in the making as they are in discussing them after the fact, the public would probably be less critical."

This letter of mine may after all not be at all to the point. It is, as I have stated, written before I have had opportunity to consider carefully your own observations, and for that reason, I would not care to have you circulate it.

Very truly yours,

W A Heath

Federal Reserve Agent

WAH HH

B135

FEDERAL RESERVE BANK
OF BOSTON

FREDERIC H. CURTISS
CHAIRMAN

October 9, 1928

PERSONAL AND CONFIDENTIAL.

Honorable Charles S. Hamlin,
c/o Federal Reserve Board,
Washington, D.C.

Dear Mr. Hamlin:

I have read with the greatest interest the article enclosed in your letter of the 3rd on the question of responsibility of the reserve banks for the present speculative course of the New York Stock market. While I agree with many of your conclusions, I do not feel that the Federal Reserve System is entirely free from some responsibility for what happened during the period from August 4, 1927 on. In other words, I have come fairly definitely to the conclusion that the easy money policy adopted in the Summer of 1927 did much to aggravate a situation which already had dangerous features. I am enclosing herewith two charts which I have had prepared here at the bank,- one showing the volume of Federal reserve credit in use for the period of 1926-1927 to date. Each of the sections shows the volume of each form of credit that was furnished by the Federal Reserve System to the market. You will notice that in the Fall of 1927 there was somewhat less than the seasonal increase in the volume of rediscounts to member banks, an increase in the volume of acceptances carried and a large increase in the holdings of Government securities and of the total reserve credit. From January to April, the volume of credit furnished by the Federal Reserve System, which ought to have shown a seasonal decline even more than 1927, did not show as much as the previous year, for while the Federal Reserve System was selling its Government securities on one hand, it was buying acceptances on the other, and you will see very graphically by this chart that the total volume of reserve credit given to the market during the year 1928 (up to date) was considerably more than was given during the year 1927.

The second chart shows in the same manner the loans and investments of the reporting member banks for the same period. You will notice that while there has been very little change in the volume of commercial loans, there has been a considerable increase in collateral loans and bonds and stocks held by these reporting member banks, continuing to increase over the period under discussion.

During this same period there was a loss of gold in this country of some $500,000,000. The loss of gold should have been reflected in the reduction of deposits of reporting member banks, which should have obliged the member banks to reduce and not increase their collateral loans and bonds and stocks. In other words, the large increase in the volume of acceptances issued and which went into the Federal Reserve Banks or into the purchases for foreign correspondents not only replaced commercial loans which would have been made by the reporting member banks but released credit to those banks, which,

in turn, they invested in securities or collateral loans.

When the policy of easy money was discussed here at the bank in the Summer of 1927, it was pointed out that this policy was necessary to prevent gold from coming to this country during the period of crop moving time, but that that policy would be reversed and the additional credit withdrawn immediately after the first of the year, and my own feeling is that this policy was not carried out, largely due to the desire by the reserve system to assist an increase in the volume of bankers' acceptances. I think you will find by the records that the purchasing rate maintained by the Federal reserve banks on bankers' acceptances was either at or below the market rate during the entire period in question. The fact that a large volume of acceptances outstanding are carried directly or indirectly by the Federal reserve bank credit has released credit which has gone into the security market. The transfer of demand deposits to time deposits during this period, no doubt was a considerable factor in the condition shown by the reporting member banks and retarded the reduction in the volume of stock exchange credit which should have followed the loss of gold by this country.

On page 5 you make reference to the criticism that while the lowering of the discount rate to 3½% produced "easy" or "cheap" credit, it should not be forgotten that credit was easy or cheap before the reduction of the rate. It would seem to me that the psychological effect of a reduction of the discount rate at a time when the speculation craze was lapping up all the credit it could get probably made much worse a situation that was already aggravated,- the speculator feeling that he could continue in his wild career.

All of the studies that I have made here at the bank have convinced me that it is the total volume of credit that is supplied the market by the Federal reserve system and not so much the particular form in which that credit is made. that is the important factor.
I am writing this letter to you personally and trust that you will consider it in confidence, for these are only my personal views and may not be in accord with the views of some of the other officials of the Federal Reserve System, and a portion of what I have said above might be considered a criticism of some of the policies that have been put into operation; on the other hand, I appreciate that the Federal Reserve System has been operating and is still operating under very unusual worldwide conditions and that only through time can we find out just what effect its operations have upon the general credit situation and only then after the world has gotten on a free gold basis. My only hope is that matters of this kind can be discussed dispassionately between the members of the Board and the officials of the reserve banks and that ultimately some plan will be devised to bring such a discussion about.

I am,

Sincerely yours,

Frederic H. Curtiss

Chairman.

FHC/D
Enclosures.

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 3½% 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 3½% period, as discounts would have taken their place.

In conclusion, it seems to me that the claim that the 3½% 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.

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NATIONAL BANK OF COMMERCE
IN NEW YORK

OFFICE OF THE
CHAIRMAN OF THE BOARD

October 10, 1928

Dear Mr. Hamlin:

I have received your letter of October 4, and read your accompanying memorandum with much interest. I very much appreciate your giving me the opportunity to read it.

The subject is a very difficult one because there have been so many cross currents and conflicting interests that have had to be taken into account. It does not seem to me that the memorandum offers a convincing reply to the criticisms, many of which are unintelligent, that have been leveled at the Federal Reserve System. My feeling is that it would not be possible to prepare a convincing reply at this time, and that the publication of any memorandum would only arouse more controversy.

There may come a time when it will be desirable to explain and defend recent Federal Reserve policy, but I think that it would be unfortunate to attempt to do it now, when business is confronted with the problems that accompany high money rates.

Sincerely yours,

J. H. Alexander

Chairman of the Board

Mr. Charles S. Hamlin
Federal Reserve Board
Washington, D. C.

VOLUME 194
PAGE 136

FEDERAL RESERVE BANK OF PHILADELPHIA
925 CHESTNUT STREET

B137

OFFICE OF THE
CHAIRMAN OF THE BOARD AND
FEDERAL RESERVE AGENT

October 10, 1928

Honorable Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin -

Your letter of October 4th, enclosing a confidential article discussing the effect of the lowering of the discount rate in August '27 was duly received.

I have read the article carefully, discussed it with some of my associates in the Statistical Department and think that the figures you submit and the statements you make distinctly prove that the changing of the rate did not cause easy money, and is not responsible for the speculation craze. It might be noted that brokers' loans did not begin to mount with the lowering of our rate, their upward movement began a year or so before that and the System has to adjust its policy to other business activities than the New York Stock Market.

One would expect the editors of the Financial Chronicle to be able to know the meaning of our figures, as they show, as you prove, that there was practically no increase, in the period during which the 3½% rate prevailed, in the amount of credit in the market. The System did not by that rate add any additional fuel to the speculative fire. At the end of last year, many prominent business men made most optimistic statements about the business conditions that were to prevail during the new year. That, with the knowledge on the part of the public, that the Reserve System still had potentially a great credit granting power, together with a large buying power lodged in the

hands of individuals, pools and investment trusts (do not overlook the latter) gave the fervor to the speculative movement.

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When we subsequently considered the advancement of our rates we were given to understand that an advance of 1/2% would have no effect on the market, and as you know, it did not. The continued advance of the market, when it had to pay 7 - 8 and 10% for money, showed that our rate had little to do with the prices of stocks.

The System had certain objectives in lowering the rate on August'27. They were accomplished, and not only this country but the world was helped by them, and that should be a sufficient justification for our action for anyone. One wonders what kind of glasses the editor of the Chronicle wears, to be able to see on every side "the ill effects of the speculative folly" It is a great pity that a journal of so high standing is not more careful in its statements.

Very truly yours,

A. L. Austin

Chairman

120 BROADWAY, NEW YORK
ROOM 2555

OWEN D. YOUNG

B 138

October 11, 1928.

Mr. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

I have read with the greatest interest the article which you prepared regarding the effect of the lowering of the discount rate and the purchase of government securities in the summer of 1927. I think it is a most illuminating statement, and I hope it may become unconfidential, and therefore useful to the public.

My congratulations.

Very truly yours,

Owen D. Young

FEDERAL RESERVE BANK

OF NEW YORK

October 11, 1928.

Dear Mr. Hamlin:

A number of copies of your interesting memorandum of September 28 have by this time drifted into me from various sources about the bank, with the request that I undertake to give you a joint reply. I have asked Mr. Roelse of our department to look it over and I am taking the liberty of sending you his technical suggestions.

While I quite agree with you that our critics have very much overemphasized the influence of last autumn's easy money policy, I wonder if perhaps your memorandum does not prove too much. It seems to me difficult to escape the conclusion that the policy last autumn did ease the money market. In fact we undertook it for that specific purpose, and I think the results attained can justify the action. It seems to me unavoidably true that if we had not purchased securities and if we had not lowered our discount rates, money would have been considerably firmer and less stimulus would have been given to the speculative tendency. Frankly, your tables do not seem to me to prove your case. We were after all buying securities at a time when member bank balances were increasing.

The most important point you make is, it seems to me, that money was easy before the autumn of 1927 and the speculation was not something which arose immediately out of our autumn policy, but had been moving forward with increasing impetus for a number of years. The psychological strength of the movement is further evidenced by the fact that it has continued so vigorously for many months after we applied the brakes. Here is a force which has moved forward somewhat regardless of our policy.

I should think then that our best defense was, first, the presentation of the very important purposes we sought to accomplish, somewhat as Owen Young has presented them; and second, an analysis of the speculative movement to show its origins and its impetus.

Sincerely yours,

Colandorf Burgess

Honorable Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

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enc.

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FEDERAL RESERVE BANK
OF NEW YORK

B 139

OFFICE CORRESPONDENCE

DATE October 5, 1928

TO Dr. Burgess

FROM H.V. Roelse

SUBJECT: Mr. Hamlin's memorandum on the effects of Reserve Bank operations during the latter part of 1927.

There are several loopholes for adverse criticism in Mr. Hamlin's article.

While the table and interpretation on page 2 are technically correct, it might be argued that the decline of 105 million in money in circulation should have resulted in a corresponding decline in the total amount of Reserve Bank credit in use, rather than in an expansion of member bank reserves.

The interpretation of the table on page 3 makes no mention of the fact that the increase in discounts and acceptances during this period exceeded currency requirements by 220 million, and that this increase was reflected in member bank reserve balances. Mr. Hamlin is quite right in pointing out that the increase in Government securities just about offsets the gold exports during the period, but he can hardly evade the conclusion that the increase in other forms of Reserve Bank credit furnished the basis of a large increase in member bank loans and investments. It might also be pointed out, in connection with this period, that a considerable part of the increase in securities was involuntary so far as the Reserve Banks were concerned - part of the increase reflected simply the temporary accommodation of the market through sales contracts at the end of the year.

The final paragraph on page 3 rather overstates the case and is contradicted by the second paragraph on page 7.

The idea contained in the section at the top of page 6 - that money was already easy in the early part of 1927, due to reduced currency circulation and gold imports - might well be stressed. It could be further pointed out that the rapid expansion of member bank credit did not begin with the reduction of the discount rate in August. The figures for reporting member banks show that there was as large an increase in loans on securities from February to the end of June as from the end of June to the end of December.

The fourth paragraph on page 6 states that business had been in a state of recession but was just beginning to improve. So far as industrial conditions were concerned, it might better be said that business was just entering a period of recession and might be considered to need the stimulus of easy money. It is true, however, that low prices for agricultural products had obtained for at least a year previous, and that there was the possibility that the recovery in this direction might be facilitated by low acceptance rates and conditions favorable to foreign financing.

CAPITAL $ 3,000,000 SURPLUS & UNDIVIDED PROFITS $6,500,000

THE MERCHANTS NATIONAL BANK
OF BOSTON

28 STATE STREET
BOSTON, MASS.

B,40

October 16, 1928.

Hon. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

I regret exceedingly if I have seemed remiss in delaying a reply to your letter of October 5. Unfortunately, I have been very much occupied with some outside matters.

The statistical argument is not one that makes much impression on me as a general thing; and the reading of your article left me in some doubt if you had proved your case. I own, however, that I did not follow closely the various figures.

I believe myself that the action of the Federal Reserve Bank of New York in lowering the discount rate to 3½% last August probably did increase at the time the supply of credit available. The intent of this action, as I understand it, was two fold; first, to aid the crop movement and help maintain the prices of farm produce by opening our market for acceptances, which would otherwise have gone abroad, and at a higher rate; secondly, to discourage the possible importation of gold at a time when our supply was excessive.

The supply of credit which is furnished by bank acceptances is carried almost entirely by the Federal Reserve banks. Our own free balances are occasionally invested in that form, and there are a few institutions and individuals which make a practice of buying bank acceptances, but the largest bulk by far of this kind of paper gets into the Federal Reserve banks. In so far as the financing of the crop movement was carried on by

Hon. Charles S. Hamlin

acceptances rather than by bank loans, the banks had a larger volume of credit to use elsewhere.

I do not believe that the supply of credit is the main thing which has influenced the stock market. We are dealing here in the first place with a state of mind, that is to say a general public desire to speculate, and a belief that even when prices are high they will be followed by higher prices. Once get the general public in that frame of mind, and it makes comparatively little difference what rate they are paying for money, as is abundantly clear in the present market.

You will, I fear, find the foregoing of but little help. As I said above, I do not go far with the purely statistical argument, and the human side of the problem seems to me in this case by far the more important one.

Let me thank you for sending me copy of your article, and again apologize for lateness in writing.

Yours very truly,

Myron T. Ripley

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FEDERAL RESERVE BANK OF CHICAGO

230 SOUTH LASALLE STREET

October 16, 1928

Hon. Charles S. Hamlin
Member, Federal Reserve Board
Washington, D. C.

Dear Mr. Hamlin:

I have again read, and more carefully, your memorandum on member bank reserves, etc., enclosed with your letter of October 4, and I do not know that I can add anything in the way of intelligent comment to what I wrote you on October 8.

Permit me to say again that your memorandum impresses me as very carefully prepared, with evidence presented to support your own conclusions. It is confirmatory of an opinion which I have expressed on more than one occasion; namely, that your "memory box" appears to be in wonderfully good order, for I have observed that you are always in position to produce statistics or facts in support of any statement or argument which you may make.

I am disposed to agree substantially with you in the conclusion stated on page six of your letter, to the following effect:

"While psychologically easier feeling was created, increase in member bank reserves can be explained without reference to lower discount rates or government security operations."

I cannot quite follow you, however, in your final conclusion - "that the 3-1/2 per cent 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." In other words, your intermediate conclusion recognizes a psychological effect, while your final conclusion apparently ignores any psychological effect.

In my own opinion, the psychological effect is a thing which was perhaps not sufficiently considered during the period under consideration. Speculation was in the air and our own directors feared that the thing which we were asked to do would give it a stimulus. Mr. John J. Mitchell, although not a member of our board, took it upon himself to write Governor Strong, and possibly some members of the Board, expressing himself as strongly of the opinion that a reduction in the discount rate at the time it was made would inevitably result in a great stimulus to stock market activity, a thing which, in his opinion, should be avoided if possible. I think that Governor Strong himself was quoted publicly, at least he privately expressed the opinion, that a general reduction in rate probably would be followed by greatly increased

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October 16, 1928

Hon. C. S. Hamlin.

activity on the stock exchange, but that the Board and the Federal Reserve banks should not because of that fact be deterred from moving to effect the accomplishment of the greater things which the rate reduction was intended to assist and which, as you aptly state on page six of your letter, "were accomplished in more or less degree."

The objections raised by the Chicago board "before the fact" and the admission of Governor Strong as to the probabilities of material increase in stock exchange activity following reduction in rates, were followed by such reassuring public statements from the officials referred to in my former letter that I think the public largely lost sight of the major benefits to be accomplished, and became obsessed to an undue extent with the idea of prosperity and easy money. This is the psychological effect which I have in mind, which has no doubt in some degree at least been responsible for the speculative frenzy which followed, the extent of which no one could have foreseen.

Very truly yours,

W A Heath

Federal Reserve Agent

WAH HH

The National City Bank
of New York
ESTABLISHED 1812

C.144

New York October 18, 1928

CABLE ADDRESS "CITIBANK"

IN REPLYING PLEASE QUOTE INITIALS

GER

Hon. Chas. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

I duly received yours of the 5th instant with accompanying discussion of the Effect of Security Operations During the Period from August 4, 1927 to February 3, 1928. It has happened that I have been exceedingly busy in the meantime and although I have not had opportunity to study it as I wanted to, without waiting longer, ~~however~~, I wish to acknowledge it and to make the general comment which occurs to me.

I am, as you know, a defender of reserve policy over the period under review and of the action in reducing the discount rates in the summer of 1927. Only one point occurs to me upon which to base a criticism of the argument which you have presented. I have not had time to go over the record carefully, but as I remember it the Reserve banks began the purchase of securities about the same time that they lowered the discount rates or perhaps a little earlier. This action would obviate the necessity for member banks to rediscount, hence the fact that rediscounting did not begin until after September is not very significant.

In short, my impression is that the situation was eased by the purchase of securities before exports of gold began and that the influence of reserve policy thus was exercised continuously and kept a little in advance of the tightening influence resulting from gold exports.

I give this to you without supporting figures, because, as I have said, I have not had time to make a close study. You know I am not an unfriendly critic of the Reserve authorities and am not looking for material to use against them.

It is always a pleasure to hear from you.

Cordially yours,

Geo. E. Roberts

Vice President.

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PAGE 144

The Cleveland Trust Company

B 145

CAPITAL AND SURPLUS
$ 15,000,000.00

MEMBER
FEDERAL RESERVE SYSTEM

LEONARD P. AYRES
VICE PRESIDENT

CLEVELAND

October 19, 1928.

My dear Mr. Hamlin:

Thank you for sending me the memorandum which accompanied your interesting letter of October 16. I have little sympathy with the views expressed by the New York Commercial Chronicle, and I am not at all in accord with the spirit and temper in which they couch their comments. It has seemed to me that the Federal Reserve System has steered a careful course through an especially difficult and puzzling series of business and financial situations during these past two years, and in the main with distinct success.

Despite these convictions and my steadfast friendship for the System, I am still of the opinion that the lowering of the rediscount rate to 3½ percent in August of 1927 was primarily responsible for the tremendous and additional outburst of public speculation in the security market that has continued ever since. It seems to me that the mere figures of the volume of trading go far toward bearing out this inference.

Of course, I cannot prove this, and I think there would be little use in attempting to do so even if it might be possible. I suspect that we should have been better off if the rate had been held at 4 percent a year ago, and I have always believed that the gold exports were bound to take place and would have occurred last year whether our rediscount rate had been lowered or not. I think that the controlling factor there was the entire financial ability of the French to take the gold that they needed, and I do not believe that they required any extra help in doing so. However, all these are considerations of technical policy and they form good material for the professional students of such matters, and I doubt if much is to be gained by discussing them further now until we have a much clearer insight than is as yet possible concerning the ultimate outcome of the difficult present credit situation.

Sincerely yours,

Leonard P. Ayres

Mr. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

VOLUME 194
PAGE 145

FEDERAL RESERVE BANK OF CHICAGO

230 SOUTH LA SALLE STREET

C 147

Est begins aug 4 1926 - Feb 3. 1927

OFFICE OF THE GOVERNOR

October 23, 1928.

CONFIDENTIAL.

Honorable Charles S. Hamlin,
Member, Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

I duly received the confidential memorandum enclosed with your favor of the 4th instant, and meantime we have been giving very careful consideration to the question involved and to the conclusions reached by you. Mr. Heath has written you at length concerning his views in relation to the matter, and I am writing at this time to let you know that I concur, generally speaking, in the views which he has expressed.

At my request, Mr. McKay has devoted a good deal of thought to the matter and has prepared a memorandum, copy of which I shall enclose herewith for your perusal. You will note therefrom that he has submitted figures showing a comparison of the condition of the Federal reserve banks from August 4, 1927, to February 3, 1928, the dates designated in your memorandum, with the corresponding period in the previous twelve months, and also a similar comparison of the condition of the reporting member banks for the same periods.

It seems quite evident that during the period covered by you, there was a very material expansion in the total amount of Federal reserve credit extended, whereas in the previous year there was a very substantial reduction. With regard to the credit extended by member banks during the period from 1926 to 1927, there was only a very moderate increase, whereas in the period 1927 to 1928 there was an increase of about $2,000,000,000 or approximately ten times the amount of the increase of Federal reserve credit extended.

The purchase of Government securities released actual funds to the market, and the reduction in the discount rate to 3½% stimulated a state of mind which, in my opinion, resulted in greater activity in the stock markets, and the credit employed in this direction increased accordingly.

Sincerely yours,

J. B. McDougal
Governor.

LK
Enc.

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FORM 46-18 50M 1-27-28 B-25450

FEDERAL RESERVE BANK OF CHICAGO

MEMORANDUM FOR

Governor McDougal

FROM

October 23, 1928

C. R. McKay

With regard to confidential article prepared by Mr. Hamlin of the Federal Reserve Board on the subject; "The effect of Government security operations on member bank reserves during the period of the 3-1/2% rate, namely, from August 4, 1927, to February 3, 1928," he arrives at the following conclusion; "In conclusion, it seems to me that the claim that the 3-1/2% 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 had no foundation in reality."

During the period from August 4, 1927, to February 3, 1928, total Federal reserve credit increased $204,000,000, and member bank reserve balances increased $107,000,000, while the gold stock decreased $203,000,000. Mr. Hamlin states that the increase of Federal reserve credit during the period, $204,000,000, just offsets the gold exports of $203,000,000, while the decline in circulation of $105,000,000 accounts for the increase in member bank reserves of $107,000,000 during the period.

This is only one side of the picture. Consideration should also be given to the increase in the total loans and investments of reporting member banks in the principal cities of the country during the same period, which rose from $19,787,000,000 to $21,788,000,000, an increase of about $2,000,000,000. During the same period the total deposits of all reporting member banks increased from $18,968,000,000 to $20,589,000,000, an increase of $1,621,000,000.

Let us compare the period from August 4, 1927, to February 1, 1928, with the corresponding period in the previous year, August 4, 1926, to February 3, 1927, and we find that the total Federal reserve credit during that period decreased from $1,149,000,000 to $1,031,000,000, a <u>decrease</u> of $118,000,000, as compared with an increase of $203,000,000 for the corresponding period, as quoted in Mr. Hamlin's figures. During the period of August 4, 1926, to February 3, 1927, the total loans and investments of reporting member banks show an increase of only $66,000,000, whereas from August 4, 1927, to February 1, 1928, they showed an increase of $2,000,000,000.

Whether or not the reduction of the rate to 3-1/2% from August 4, 1927, to February 3, 1928, was responsible for this large expansion of credit in the member banks may be difficult to prove, but it happens that the increase of $2,000,000,000 in the total amount of the reporting member banks' loans and investments is just about ten times the amount of the increase of $200,000,000 in Federal reserve credit and the reporting member banks received by far the major portion of this Federal reserve credit, as the increase was almost entirely in the large cities and not, at least to any extent, in the country banks.

FORM 46-18 50M 1-27-28 B-25450

FEDERAL RESERVE BANK OF CHICAGO

C 147

MEMORANDUM FOR

Governor McDougal

FROM

C. R. McKay

October 19, 1928

While the increase in Federal reserve credit might have easily occurred if the rate had not been reduced below 4%, nevertheless the System purchases of Government securities supplied the market with additional funds, thereby making money easier, and the reduction of the discount rate to 3-1/2% had a strong psychological effect and created in the minds of the public the belief that the Federal Reserve System was committed to an easy money policy at a time when speculation, in the minds of the more conservative bankers, was considered to be at a dangerous level. It also created the impression that the Federal reserve authorities, at least, were not at all concerned about any danger of speculation or inflation.

On October 17, 1928, Federal reserve credit had reached $1,551,000,000, as compared with $1,201,000,000 a year ago, an increase of $350,000,000. Total loans and investments of reporting member banks during the same period increased $1,154,000,000.

During the past year we have exported approximately $500,000,000 of gold, which under normal conditions would cause a decrease in the total amount of credit extended by member banks. The facts are, however, that notwithstanding this large exportation of gold, total loans and investments of reporting member banks have increased $1,154,000,000 and the total earning assets of the Federal Reserve System have increased $350,000,000.

Looking backward to the reduction of the discount rate of the Federal reserve banks from 4% to 3-1/2% in August, 1927, and in view of the expansion of loans which has occurred since that time, would it not have been wiser to have increased the rate to 4-1/2% or possibly 5%, if necessary, in order to discourage speculative loans rather than encourage them by a reduction of the rate. While business in this country and abroad might have been penalized temporarily by such action, it might have prevented the high commercial rates for money which have been in effect during the greater part of this year.

J-

The New York Times
Times Square

P 148

October 24, 1928

Hon. Charles S. Hamlin
Federal Reserve Board
Washington, D. C.

Dear Mr. Hamlin:

Your letter reached me after an absence from town, and I have been studying it over since then. As you know, I have never criticized the action of the Reserve banks in reducing the rate to 3 1/2 per cent. last year, feeling that the reduction recognized the course of the open market. Some of your conclusions regarding the subsequent detailed operations puzzle me, however, and I wish I could talk them over with you personally. In particular, I do not quite grasp your point that the gold exports of $200,000,000 between August 4 and December 31 would have forced deflation of ten times the amount in member bank deposits if they had not been offset by government purchases of United States securities. Was not the reduction in the gold stock offset by the increase in discounts? If so, then the purchase of United States securities much more than balanced the decrease in gold.

One or two other points are not entirely clear to me in your exposition. How do your calculations square with the fact that, whereas total gold reserves decreased $104,000,000

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The New York Times
Times Square

Hon. Charles S . Hamlin - 2 - October 24, 1928

between the end of last December and the beginning of September this year, while government securities held were reduced in the same time by $406,059,000, member bank deposits nevertheless decreased only $137,000,000?

Very truly yours,

A W Noyes

ADN:A

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PAGE 149

G150

FEDERAL RESERVE BANK
OF DALLAS

October 26, 1928.

My dear Mr. Hamlin:

Your letter of October 4 was duly received and I have read with much interest your confidential memorandum of September 28, in which you discussed the effect of government security operations on member bank reserves during the period of August 4, 1927, to February 3, 1928, during which a uniform 3½% rediscount rate was maintained.

I have wanted to send you an earlier reply in response to your request to let you know what I think of your memorandum, but I have been out of town visiting our San Antonio and Houston branches with Governor Young, Mr. James and Colonel Walsh, and I also wanted to avoid a hasty comment, and this could not be done without a review of the activities in the period covered by your memorandum.

If one would read the minutes of the Open Market Investment Committee meeting with the Federal Reserve Board on July 27, 1927, he would find set out all of the reasons upon which a reduction of the rate was based. He would also find that the probable effect upon speculation was considered but that considerations of business as reflected by the need of a proper international accommodation was made the paramount factor.

Thirty days later Governor Strong addressed a memorandum (under date of August 26, 1927) to the Governor of each Federal reserve bank, in which he clearly set out in detail the actual transactions of the Open Market Investment Committee in the purchase and sale of government securities, and these transactions check so closely with the figures in your memorandum as to resolve all doubt in favor of the Federal Reserve System in the pursuit of a fundamental policy. These arguments impressed me as clearly showing that to avoid the purchase of government securities to offset gold exports and gold earmarkings would have been inimical to the considerations of international accommodation which were the underlying, if not the direct basis upon which the policy was determined. If earmarkings and gold exports at that time had been allowed to take their course there would have been a different effect upon the money market and the 3½% discount rate would not have been effective for its purposes.

I am clear in my own mind that the loss of gold from a credit base through exports and earmarkings and the effect of these transactions were not clearly appreciated by the money market and were especially ignored by the public. The psychology of the public was toward an era of active speculation and whether it used its own funds or secured-credit for its purposes are matters which I think are entirely beside the question.

The Open Market Committee accurately forecasted a condition that would likely prevail in the future when it made a record in the minutes of its meeting of July 27 of its position as stated in the following language:

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"It was pointed out, however, that local conditions in some of the interior reserve districts did not indicate any demands for rate reductions in those districts, and that the small borrowings from the reserve banks indicated an adequate supply of credit for all needs at the present rates. * * * * On the other hand it was pointed out that reductions now which would result in no harm and considerable possible benefit, would place the reserve banks in position to make increases later which might serve as warnings without penalizing business with high rates."

On September 17, 1927, I wrote Mr. Platt, at his request, a letter that revealed our reaction to the rate reduction after we had on August 12, also lowered our rate to 3½%. Perhaps Mr. Platt's secretary can find the original letter if you would like to read it but if you should desire a copy of it, I shall be glad to send you one. I shall, however, quote this expression from it -- "The divergence or the relationship that exists between these two circumstances (the contrast between the autumn of 1926 and the autumn of 1927 in this district) rather tends to support the view that we cannot at this time or at any other time probably adopt as a fixed policy a seasonal reduction of rediscount rates in the fall of the year."

To me the figures in your memorandum and your explanation of them are sufficiently conclusive but the average reader of your memorandum would have to know the background with which you and I are familiar in order to be completely sold by your argument. A broader chronology of the figures which you have used would, I believe, illuminate your argument to the lay or newspaper mind.

I am merely plagiarizing an observation which I understand was made by Secretary Mellon not long ago in a private conversation, when I say that whenever the American public makes up its mind to stop speculating, speculation will stop, and not before.

I am looking forward to seeing you at the Conferences in November and hope that we may have an opportunity to discuss this subject further.

With very kind regards, I am

Sincerely yours,

Governor

Mr. C. S. Hamlin,
c/o Federal Reserve Board,
Washington, D. C.

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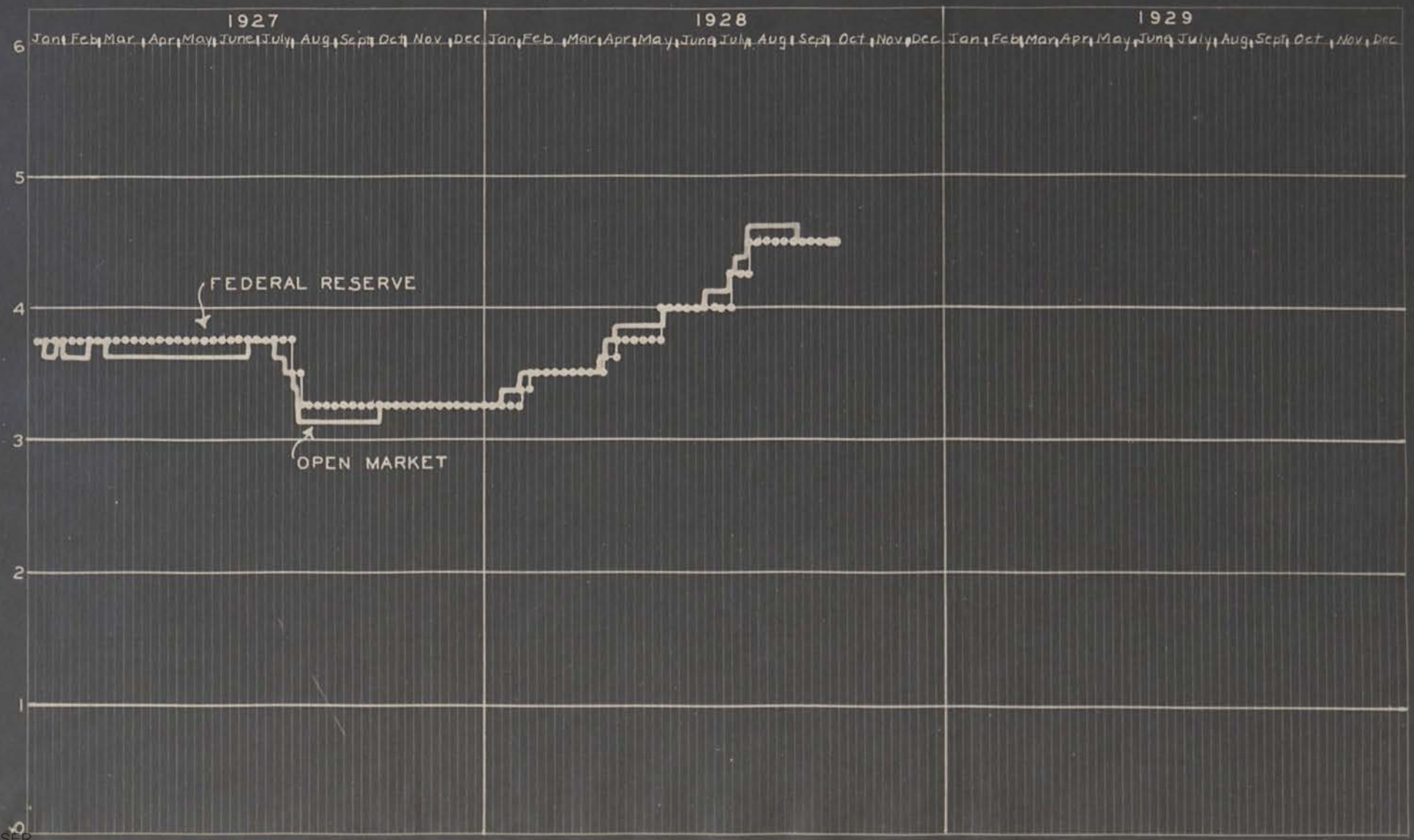
BUYING RATES ON BANK BILLS

FEDERAL RESERVE SYSTEM [redacted]

(90 DAY MATURITIES)



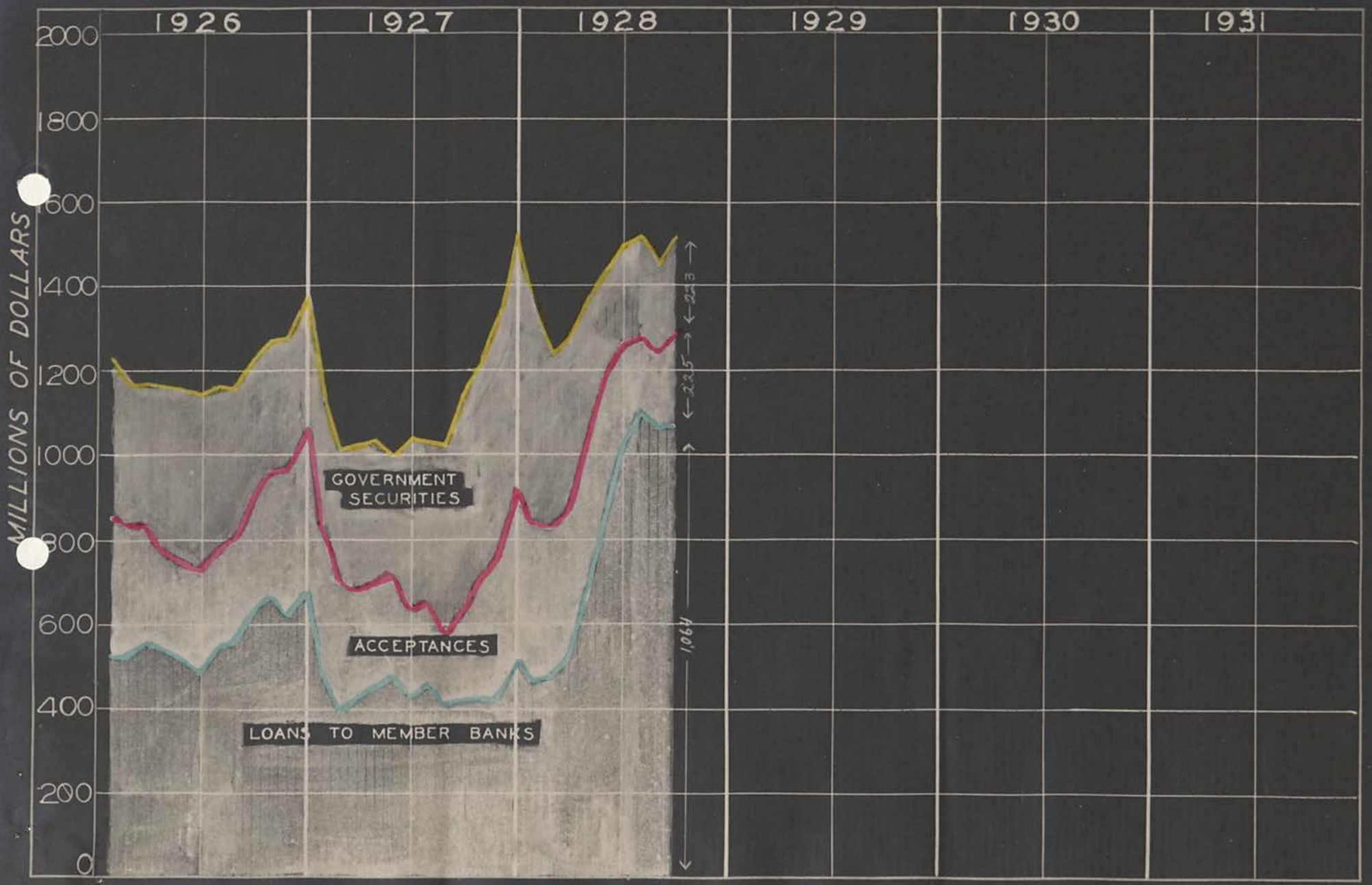
FINANCIAL STATISTICS DIVISION

FEDERAL RESERVE BANK OF BOSTON

FEDERAL RESERVE SYSTEM

VOLUME OF CREDIT IN USE

(MONTHLY AVERAGES)

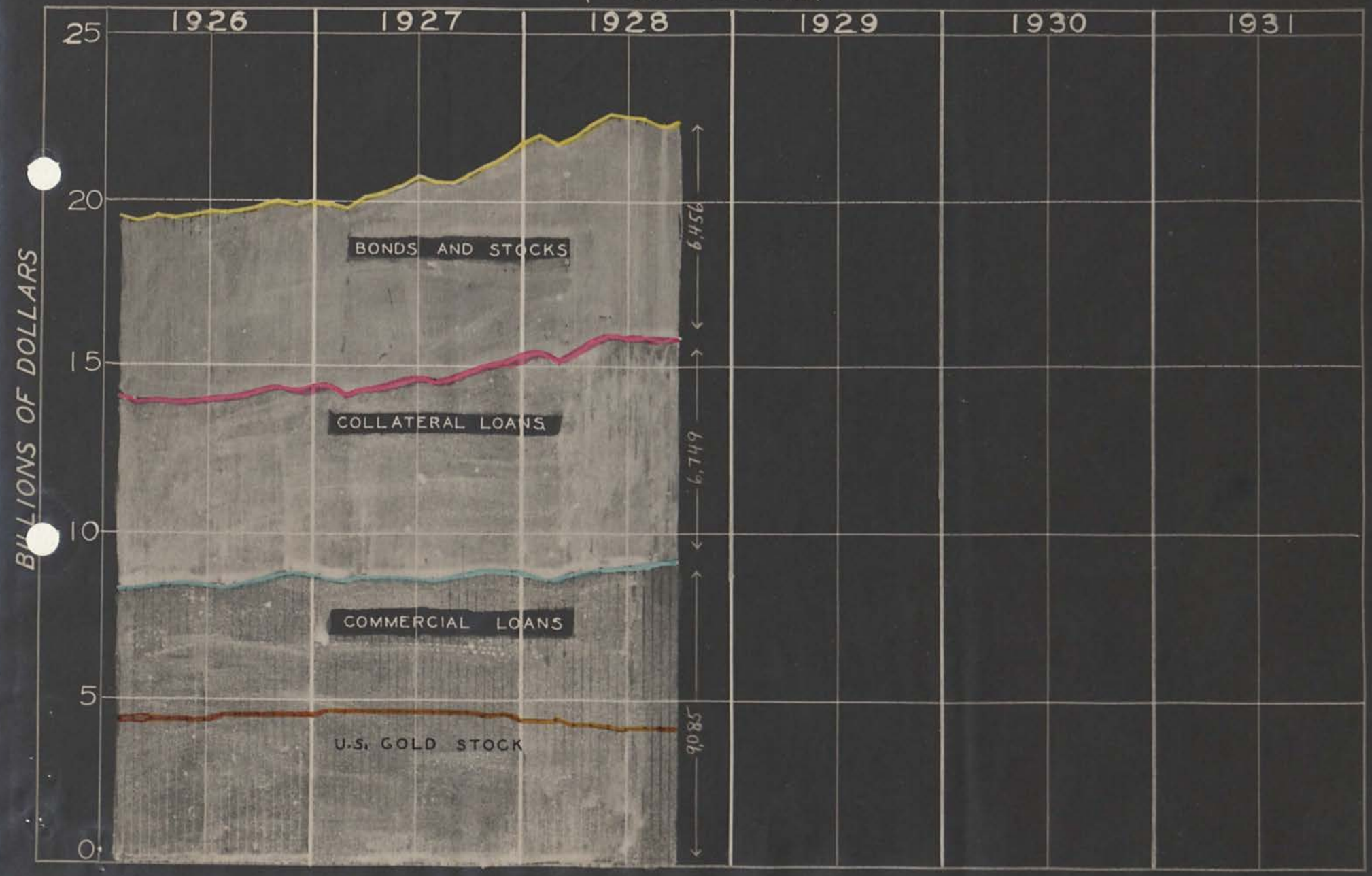


FEDERAL RESERVE BANK OF BOSTON
Financial Statistics Division

LOANS AND INVESTMENTS

SELECTED MEMBER BANKS - F.R. SYSTEM

(MONTHLY AVERAGES)



FEDERAL RESERVE BANK OF BOSTON
Financial Statistics Division

Dear Mr Curtis

I have read carefully your letter of Aug in which you express the view that the important factor is the total amount of credit supplied to the market by the FR system and not so much the particular form of credit supplied. I agree entirely with this view. You further point out that the buying of acceptances affect the object of the selling of securities.

My memorandum was confined to a refutation of the charge that the lowering of the discount rate and the purchase of Govt securities delayed the market with cheap money and encouraged speculative activity in the stock market.

My figures related solely to the period during which the 3 1/2% rate was in effect at N.Y. viz: from Aug 4.27 to Feb 3.1928

During this period the holding of Govt securities actually decreased while discounts increased very slightly - not in excess of a seasonal increase. During the same period total Member credit increased 204 million while the gold stock decreased 203 millions - the one offsetting the other.

While Member bank reserves increased

107 million, money in circulation decreased 105 million - a complete offset.

I think the above figures show that on the whole period, the open market operations, including acceptances, acted not along the lines of inflation but rather along the lines of stabilization, i.e. of offsetting the effect of gold exports and of the increase in money in circulation.

It may be claimed that we should not have stabilized but should have allowed free play to gold exports and increased money in circulation. That, however, is not the question which I undertook to examine. I simply tried to show that the lowering of the rate and purchase of securities did not pour a flood of cheap money into the market.

My reason for voting to authorize the reduction of rate was, first, to try to give encouragement to agriculture & business, which was in a state of recession, and secondly, by widening the gap between the Bank of England rate and the FR rates, to prevent another flood of gold inflows which was seriously threatening, and which, in the absence of any material amount of

discounts which could have been turned off, would have gone into member bank reserves and would have threatened serious inflation.

Undoubtedly we began to purchase first securities in order to make the lower rate effective, i.e. with the intention of creating easier money conditions, but the lower rate not only stopped gold inflow-lations but brought about gold exportations, and the real result of the lower rate and the first security purchases was simply to offset the gold exports and supply the demand for more money in circulation.

Of course, there may have been occasions during the period when the purchase of first securities and acceptances went temporarily into Bank reserves, but it seems to me fair in considering the effect of the lowered rate and credit operations to take the whole period covering the beginning and ending.

FEDERAL RESERVE BANK

OF CLEVELAND

P 153

October 26, 1928.

Mr. C. S. Hamlin,
c/o Federal Reserve Board,
Washington, D. C.

Dear Mr. Hamlin:

The confidential article which accompanied your letter of October 3 has been carefully studied by us, as well as by the staff of our statistical department. While we have not been able to agree altogether with the conclusions to which your study has led you, we are entirely satisfied that reserve bank policy in 1927 was by no means the only factor which was an influence in stock market developments since August of last year.

In our own analysis, we have disregarded largely offsetting one item against another and have considered the matter more in its entirety. Some single features of the situation have been analyzed, but it seemed to us that if we were permitted to consider the matter in its broader aspects important points might be disclosed which otherwise might remain hidden.

To us, the significant feature of the whole situation is that the total of reserve bank credit expended $577,000,000 in the period following the rate reduction in August to the last of the year, when the increase in commercial demand was less than it had been in any of the three preceding years, and during the first part of which business was plainly reactionary. In no one of the three immediately preceding years, notwithstanding the business activity of 1925 and 1926 had the expansion of reserve credit equalled the 1927 increase, the average for the three years being about $350,000,000.

There appears to be ample evidence that throughout almost the entire year of 1927 the banks of the country were, generally speaking, in easy position. Between February 3, 1927, and February 1, 1928 (using figures of reporting members) "all other" loans, including commercial loans, increased but $16,000,000. Collateral loans, on the other hand, increased

more than a billion and investment account another billion. The table below gives February and August comparative figures for the past four years:

FEDERAL RESERVE BANKS REPORTING MEMBER BANKS
(Figures in thousands)

	Total Bills & Securities	Bills Disc'd	Coll.Loans	"All Other"	Inv'ts
Aug.6,1924	$832,502	273,638	4,219,109	7,941,006	4,554,727
Feb.4,1925	1,032,258	322,367	4,745,246	8,183,713	5,453,219
Aug.5,1925	1,101,653	543,837	5,072,428	8,071,054	5,482,975
Feb.3,1926	1,149,372	487,796	5,527,610	8,285,175	5,478,116
Aug.4,1926	1,149,517	547,605	5,523,946	8,406,735	5,647,188
Feb.3,1927	1,028,722	393,271	5,515,462	8,563,891	5,559,621
Aug.3,1927	1,031,835	445,373	5,872,955	8,593,633	5,948,451
Feb.1,1928	1,234,986	423,432	6,546,809	8,579,620	6,575,125

It is of interest to observe the credit expansion which occurred from February to August, 1927 - before the rediscount rate was reduced. Collateral loans were up $357,000,000, "Commercial" loans $30,000,000, and investments $390,000,000. This expansion took place without reccurse to reserve bank credit, as evidenced by an increase of but $3,000,000 in total bills and securities held by the reserve banks, and reflects the ease of the credit situation.

While it is pointed out in your article that in the period August-December, 1927, the purchase of Governments had offset the loss of gold through export, it is noted that the purchase of securities and the exportation of gold were not coincident. No important gold loss occurred until November, while the purchase of Governments began in August, the increase to November 1 being $120,000,000. Bill holdings had also increased $157,000,000, which would have rendered unnecessary the purchase of securities if the purpose of pushing credit into the market had been only to neutralize the effects of gold exports.

I In view of 1928 developments we are not convinced that gold exports in 1927, had it not been for the purchase of Governments would have forced a "radical deflation". A much larger exportation in the early months of 1928 than occurred in 1927 coupled with the sale of a large amount of Governments which left the reserve bank holdings below those of the middle of 1927, was accompanied by a further credit inflation, total loans, discounts and investments of reporting members having increased $300,000,000 since the first of this year and $1,800,000,000 since August of last year.

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FEDERAL RESERVE BANK

OF CLEVELAND

Mr. C. S. Hamlin,
Washington, D. C. - 3 - 10/26/1928.

It seems to be generally understood that the reserve system deliberately committed itself to an "easy money" policy in the summer of 1927. The Annual Report of the Board (p.10) quite frankly states that "during the period from June to September, while changes in gold stock were small, the reserve banks purchased about $80,000,000 of Government securities in furtherance of a policy of easing the credit situation . . . . By purchasing securities at that time the Federal reserve banks were in fact successful in easing the condition of the money market and in exerting a favorable influence on the international financial situation."

We rather incline to the view that reserve bank policy was not necessarily responsible for security market activity in late 1927. In our judgment the stage was set and speculation would have occurred on a large scale even had there been no transactions in Governments and even if the rediscount rate had not been lowered.

Looking backward at the situation, all factors which ordinarily influence market activity were favorable. Business was showing distinct signs of improvement, money rates were low, and the ease with which a large public following was attracted clearly indicates the temper of the public mind. What seems to us to offer convincing proof ot ehe soundness of our position is that speculation has continued to proceed at an unparalleled rate despite the fact that conditions in the money market have not been favorable to speculative operations for a rise.

These points have no doubt all occurred to you in connection with your study, but they seem to us to be the most important factors bearing on the situation. In any event, we are very happy to give you the benefit of our views.

Very truly yours,

E. R. Fancher

F.B Governor.

F. O. WETMORE
CHAIRMAN

P. 154

THE
FIRST NATIONAL BANK
CHICAGO

October 31, 1928.

Mr. C. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

My dear Mr. Hamlin:-

I owe you an apology for not having acknowledged the receipt of your favor of the 4th and the interesting article comparing the changes in the class of investments held by the Federal Reserve banks in connection with our boom in stock market values. The facts are, however, that I recently bought a farm and I plead guilty to having paid more attention to it during the last month than to important business matters. Your letter was received in due course and I filed it with papers not needing urgent attention, and promptly forgot it for which I now have to extend my apology.

Of course anyone who is extreme enough to lay the full responsibility of the present speculation in stocks on the Federal Reserve System is a very narrow-minded individual. I, myself, feel that the long period of relatively easy money, extending as it did over a number of years, and the crash in real estate speculation which followed the close of the war and reached the peak say two and one-half years ago, created the opportunity and our optimistic American spirit promptly took advantage of it.

I was glad to get your study of the question and I congratulate you on it.

With best personal regards, I remain

Sincerely yours,

F. O. Wetmore

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FEDERAL RESERVE BANK OF SAN FRANCISCO

P. 155

October 31, 1928

My dear Mr. Hamlin:

I wish to acknowledge and thank you for your letter of October 4th, containing your analysis of the charge that the Federal Reserve System's policy had brought about cheap money in the United States and was responsible for the stock market speculation.

I have read your discussion with a great deal of interest and should have acknowledged it sooner had I not been intermittently absent from my office and desirous, each time I thought of it, of reading it again before I answered.

The statistics which you have applied are interesting and, so far as you indicate conclusions, support them. It appears to me, however, that the gist of the matter is described when you say, "The conclusion I reach from these figures is that while psychologically an easier feeling is created," * * *, because I believe that, after marshalling all the available statistics and endeavoring to make deductions from them, we still have to say that the reduction of the Federal Reserve discount rate to 3 1/2% and the purchase of Government securities did bring about a belief (perhaps we should say a psychological condition) that money was easy and cheap and that this belief was conducive to the stock market situation which followed and still obtains.

I trust that I may have an opportunity to see you at the conference and, if you wish, discuss the matter further.

Yours very truly,

Governor

Mr. C. S. Hamlin,
Federal Reserve Board,
Washington, D. C.

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August 9, 192

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FR Board
Minutes of meeting
CSA analysis
Aug 7 + 8. 29

Conference of Board with Federal Reserve Governors.

August 7, 1929.

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Governor Young stated that there were several propositions as to which he wished the opinions of the Governors. The most important of these were:

1. Do nothing in the way of easing the situation.

2. Ease situation by lowering bill rates.

3. Ease situation by a lower bill rate policy, plus an increase to 6% in the rate of the Federal Reserve Bank of New York. The Governor also said he wished information as to whether an increase to 6% at New York would force the other Federal Reserve banks to go up to 6%.

Geery, Minneapolis: - Favors lowering bill rate and buying Government securities, postponing an increase in New York's discount rate until later. Thinks his bank would not leave the 5% rate even with a 6% rate at New York.

Harding, Boston: - Says his directors are now opposed to an increase in discount rates, but favor lower bill rates, down even to 4-7/8%; that some of his directors favored buying Government securities, but he was opposed to this. He felt certain that he could maintain the 5% rate in Boston, even if New York went to 6%; that his directors would certainly not vote to increase rates unless the reserves fell so that the public would see the absolute necessity. He said Mr. Curtiss wished to buy Government securities, but he opposed this. He said he would not favor an increase in the discount rate until his reserves got down to 45%; that he felt sure the member banks would cooperate with him, for they fear that higher discount rates might force them to pay a higher rate on bank deposits.

Seay, Richmond: - Present feeling is that discount rates at New York should not be increased. In his district there has been no increase in the volume of loans. He opposed a decrease in the bill rate as possibly hazardous, for foreign banks might unload their holdings on the Federal Reserve banks. He opposed buying Government securities. Said he would not participate if Government securities were bought by the System. He said loans "for others" had about reached their maximum, and that the Federal Reserve banks now would have to finance few increases in speculative loans; that while the banks would probably be conservative, increased bill holdings might encourage speculation. He said it was consistent to raise discount rates and lower bill rates, but he doubted if any good would come from it. He advised doing nothing, - to maintain the status quo.

McKay, Chicago: - Favored maintaining the status quo. Against lowering of bill rates. Should be kept at about 5¼%. Opposes any discount increase at New York. Advises keeping up the direct pressure on the large banks engaged in making speculative loans. Feared lower bill rates might encourage speculation.

Calkins, San Francisco:- Feels that it would be a reasonable policy if discount rates were raised in New York and in the principal centers, but bill rates lowered everywhere. Feels that even if New York went to 6% his bank could wait.

Martin, St. Louis: - Favored maintaining the status quo. Says if New York and Chicago increase rates, St. Louis must increase. Even if bill rate were lowered it would not help him much.

Black, Atlanta: - Believes the market should be eased by buying bills and Government securities. No Federal Reserve credit is being used in Wall Street by banks which are borrowing from our bank. Doesn't object to lowering bill rates. If New York increases to 6% we still would not want to increase, but might have to.

Talley, Dallas: - Reads a memorandum dated May 7th which he gave to his directors. Favors policy of lower bill rates with increase to 6% in New York and a few other banks. Favors continuing direct pressure on security loans. Says this would decrease gold imports and lower rediscounts; that merely increasing discount rates without lowering bill rates might break the stock market and cause drastic liquidation and lower prices. Said that even if the principal centers went up to 6%, he thought it would not be necessary for him to go up at the present time. We are nearing a natural period of liquidation, and would be opposed to going to 6% even if New York and others did this. Of course, in future it is possible we might be forced to do this. If New York wants the responsibility of going to 6%, let her do it. Rather favors buying Government securities to help bond market. Endorses the proposition to increase discount rates with a lower bill rate policy.

Fancher, Cleveland: - So far as his district is concerned, everything is comfortable, and he would maintain the status quo. He favors, however, generally, the proposition that New York go to 6%, with a lower bill policy. If New York and Chicago went to 6% we might have ultimately to follow, but we would certainly wait. The bill rate should be put in proper relation with the discount rates. He feels that ease is needed, and favors buying bills rather than seeing the rediscounts increased.

Norris, Philadelphia: - Our local situation has changed. Formerly we wanted to increase rates to protect reserves and curb speculation. Now our reserves are up, but speculative loans are enormously increased. Personally favors increase to 6% at New York, because the discount rate is

out of line. It will tend to prevent continuous borrowers and help member banks in their efforts to dissuade customers from making speculative loans. His board certainly would not vote to increase discount rates now, as the time is inopportune. Admits that direct pressure has not been wholly satisfactory in his district. He would welcome an increase at New York, though it is possible that he might have to follow later. Favors an increase in bill portfolio, as it will help agriculture and the foreign situation. Opposes buying Government securities except as a last resort in a crisis, as the proceeds will go at once into the call loan market. Would not oppose maintaining the status quo coupled with an easing in the bill market.

Bailey, Kansas City: - The peak of our trouble has paased, and a great liquidation is coming. We want to be let alone. We shall never increase rates unless and until we are compelled to. Putting up the rate at New York, coupled with an easier bill policy, would not affect us. Business rates should be lower.

Harrison, New York: - Gives his personal views entirely. Not yet authorized to speak for his directors. He said that an increased rate policy, beginning with 6%, would be at the present time politically impossible and economically unsound; that the bill portfolio now consists of 85% of rediscounts, a higher ratio than any since 1921; that rates are now firmer than ever, and will be more firm later; that bill rates abroad are higher than a year ago; that all the principal European banks have increased their discount rates, not because of any inflation, but in order to protect their gold; that the European banks have lost since January 390 millions of gold ~~in~~ and foreign exchange; that there has been a deflation of about 500 millions, and that the high money rates are caused by the loss of gold; that this is caused by the high call loan rates in the United States; that they can not place bonds with us, and have to send their gold to us to pay their net debt to us of 600 millions a year; that the problem is to lower the call loan rates in New York and restore the bond market for foreigners; that every solution will be subject to criticism and risk.

Governor Harrison said the policy of doing nothing would make money dearer, as 300 millions more of Federal Reserve credit was needed; that the real problem is to provide 300 millions of Federal Reserve credit with a minimum of risk. This could be done by lowering bill rates alone, or by increasing discount rates, or by both; that he favored a lower bill rate just as took place last fall. He answered the objection that a very low bill rate, say 4½%, might induce France to sell her holdings and withdraw the gold from the United States. He said France would not do this, but would merely shift to Government securities; that a lower bill rate would not result in diminishing France's investments here.

Governor Harrison said that there would be danger of encouraging speculation if we adopted an easing bill market policy without increasing discount rates. Governor Harrison favored the policy of an increase in discount rates to 6% with a policy of liberalization of bill rates to increase the holdings of bills. He said that this policy was really not inconsistent, as discounts were now too high, and that the increased rate would probably result in the banks paying off their rediscounts; that some banks would do this in any event, but most banks need help through increased discount rates in resisting the demand for speculative credit; that a 6% discount rate would affect customers rates only very slightly; that now they were generally 6% with some few favored customers as low as 5½%; that these customers would probably go up to 6%. He felt that to increase to 6% without lowering bill rates would probably force every other Federal Reserve bank up to 6%, but that with lower bill rates this result possibly might not follow. He felt it was important for the Board and banks to work together in harmony, and that he would not advise his directors to suggest any course not in harmony with the feelings of the Board and the other Federal Reserve banks.

Governor Young said that harmony was essential; that apparently five Federal Reserve banks favored an increased rate at New York with a lower bill rate, and that four of these five would try to keep their 5% rate; that four banks seemed to favor maintaining the status quo except that they favored lowering the bill rate.

Governor ~~Harrison~~ Harding said that the great increase in commercial demands in his district comes from corporations who allow their deposits on call in New York to continue and arrange for their present needs by new borrowers.

Dr. Miller said that if we decide to ease by buying bills, the question is whether we can get the ease better under a 5% or a 6% rate; that discounts would go down more quickly under a 6% rate, and the other question is - will buying bills result in a net increase of Federal Reserve credit? That if we feel we must increase Federal Reserve credit, it would probably be desirable to leave the banks still in debt; that we should examine present conditions; that business is good and he is under no anxiety; that high money has not embarrassed business except in a few individual cases; that a 6% rate in New York will practically not affect business at all; that once he felt that Federal Reserve credit must be increased through bill purchases, but he is not quite so sure about this now; that he has some apprehension that business may go too strong; that lower bill rates may encourage commodity speculation. Is skeptical whether increased rates will curb speculation; that whatever our policy may be, a high call loan ratio only could curb. He said that Mr. Alexander saw some signs of a stock market liquidation.

He believed that the only significance of a rate is its effect on business and speculation; that if the 6% rate in New York is followed in other districts, it will probably chill business more than speculation, unless an affirmative rate increase policy were adopted; that he was disposed to go rather slowly in building up a bill portfolio; that a 6% rate in other districts might hamper business. Favors the status quo until stronger indications arise that we must move, and then we should buy bills, and if speculation still increases we must then consider what to do; says that if the other Federal Reserve banks will say that they will try to hold a 5% rate even if New York goes to 6%, he would be disposed to agree to the 6% rate in New York as a local matter.

Seay, Martin, and Black were apparently the only Governors who are not for the plan to raise the New York rate and lower the bill rate.

Governor Young asks Dr. Miller if he will agree to New York going up to 6% and a reduction in bill rates to not less than 5%, when seven of the banks believed they could hold the present 5% rate. Dr. Miller said he was inclined to favor this, if workable.

Governor Young stated he believed the agricultural banks and San Francisco can hold the 5% rate, and that others can be helped by inter-bank rediscounting.

Dr. Miller says a general 6% rate would be bad for business. Dr. Miller says he thinks a 6% rate at New York will be justified, but that if it should become a dominating influence upon the other Federal Reserve banks it would be bad.

C.S.H. said that he believed the conference had brought out the fact that there is reasonable hope that the agricultural banks, at least, can hold to the 5% rate, with the aid possibly of inter-bank rediscounts, and that very likely some of the other banks can do the same; that he is inclined to think it safe to allow New York to go up, with lower bill rates; that he feels concerned about the situation in New York; that the growth of brokers loans until now has been largely fed by loans from others which later have apparently about reached their peak, and that this will involve a great increase in the demand on the New York banks for speculative credit; that if the Board and the other Federal Reserve banks will agree on a policy to help the agricultural banks retain their 5% rate, he would be inclined to approve a 6% rate for New York, but that the 6% rate should not involve an abandonment of direct pressure; that he hoped the speculators would not assume that by increasing the discount rate it meant that a borrower could have all the money he wanted provided he was willing to pay the price.

The Board and Governors Resume Their Conference

August 8, 1929.

The Governors reported to the Board a resolution which was voted for by a vote of 9 to 1, Governor Black of Atlanta being the only negative vote, and later he said he was tied up by the vote of his directors. Governors Harding and Fancher had left town, but it was stated that they approved the principles of the resolution. This resolution is as follows:

"It is the judgment of the Governors that the demand for increased credit incident to the autumn requirements of crop moving and business should be met, so far as possible, by an increase of the bill portfolio of such banks as care to participate in bill purchases.

"The Governors are also of the opinion that this procedure can best and most safely be undertaken, and with least risk in the use of Federal Reserve credit, under the protection of an effective discount rate in the New York district.

"They are further led to this conclusion by the expressed belief that an increase in the discount rate of the Federal Reserve bank of New York would necessitate increases in few, if any, of the other Federal Reserve banks during the period of seasonal business demand; and the desire of the directors and officers of all other reserve banks to avoid increases, if possible. It is, therefore, recommended that the Reserve Board act favorably on any application that may be made by the Federal Reserve Bank of New York for an increase in its existing rate."

C.S.H. noted that no bill rate was mentioned in the resolution.

Governor Young asked how many would approve an increase to 6% at New York, coupled with a reduced bill rate of 5-1/8%or 5%. Only two, McKay of Chicago, and Governor Seay raised any objection to this suggestion. Governor Harrison then said he desired to know the attitude of the Board; that he could communicate it to his directors. Governor Young stated what he believed to be the Board's attitude, and called on C.S.H. to state his attitude.

C.S.H. said that he should object to an increased discount rate unless it were coupled with a lower bill rate policy down to at least 5%, if necessary to obtain the needed Federal Reserve credit, and he asked Governor Harrison if personally he did not believe that the increase to 6% should be accompanied by a lower bill rate policy. C.S.H. said that

he appreciated that putting the discount rate to 6% would mean that the bill rate was made relatively lower, but that he wished to go further than this, - down,for example, to at least 5%.

Governor Harrison said that C.S.H. had stated his personal position correctly; that he believed the increased discount rate should be accompanied by a lower bill rate policy, although he did not specifically mention 5%.

Governor Norris then asked C.S.H. if a rate of 5-1/8% would bring in all the bills needed, whether he would still wish to go lower.

C.S.H. said No, it was simply a question of a rate which would bring in the desired number of bills.

Governor Calkins then said that the views of C.S.H. were substantially exactly like those of the Governor's.

The Board adjourned till afternoon, when a report was received from New York that they had voted to increase the discount rate to 6%, and to lower the bill rate to 5-1/8%.

Dr. Miller said that before voting on this he desired to move that the Governors' resolution be adopted as the policy of the Board for the next few months. This was passed:

Aye: Secretary Mellon, Governor Young, C.S.H., Miller, Pole
No: James
Not voting: Cunningham

A motion was then made to approve the New York increase to 6%. All voted Aye, including Dr. Miller, except Cunningham and James who voted No.

Dr. Miller then offered a statement to be given to the press as to the Governors' Conference. All voted Aye. The Governor was also unanimously authorized to give out a statement as to the New York rate if he considered it necessary. Prior to the above, Cunningham introduced his own resolution prohibiting Federal Reserve banks from rediscounting for member banks carrying call loans and speculative loans, without the consent of the Federal Reserve Board. There was some discussion on this, but on vote it was defeated, James and Cunningham voting Aye, Secretary Mellon, Governor Young, C.S.H. and Pole voting No. Miller asked to be recorded as not voting.
