A meeting of the Federal Reserve Board was held in the office of the Federal Reserve Board on Friday, February 21, 1930 at 11:30 a.m.

PRESENT: The Chairman
Governor Young
Mr. Platt
Mr. Hamlin
Mr. Miller
Mr. James
Mr. Cunningham
Mr. Pole
Mr. McClelland, Asst. Secretary
Mr. Noell, Asst. Secretary

PRESENT ALSO: Mr. Wyatt, General Counsel
Dr. Goldenweiser, Director, Division of Research and Statistics.

The Governor referred to the several matters which are special order of business for this meeting and suggested that inasmuch as the Chairman is not familiar with the previous consideration which has been given by the Board to its Annual Report, the other matters be acted upon first.

He presented, and the Assistant Secretary read, a letter dated February 10th from the Deputy Chairman of the Federal Reserve Bank of New York, expressing the views of the directors of the bank on the question of the Governor's salary as he was requested to do at the preceding meeting of the directors at which he presided in the absence of the Chairman of the bank; the letter stating that the directors feel that the present salary of the Governor of the bank satisfies neither the principle of an honorarium or of compensation, but represents an illogical compromise between the two; that if the honorarium basis is to be observed men of independent means must be secured for the position, or if the compensatory basis is to govern the salary should be sufficiently high to enable the Governor to live in a way worthy of the office and allow a reasonable margin for savings, inasmuch as the Governor of a Federal Reserve bank should not resort to other financial ventures; that the directors, therefore, request reconsideration of their earlier recommendation of a salary of $60,000 per annum, but that if the Board under the circumstances thinks the increase is not warranted the directors will reluctantly fix the salary of Governor Harrison at $50,000.

During the discussion which ensued, Governor Young reviewed the action taken by the Board on increases in salaries recommended by the directors of five of the Federal Reserve banks for the Governors of the respective banks, stating that since that time the directors of the Federal Reserve Banks of Cleveland, Atlanta and Dallas have fixed the salaries of Governors Fancher, Black and Talley at the figures which were in effect last year. He also referred to the fact that on January 23rd the Deputy Chairman of the Federal Reserve Bank of Chicago was advised that the Board would appreciate it if the directors of that bank would not bring up at the moment the question of reconsideration of Governor McDougal's salary, and that if any of the other recommended salaries which were disapproved by the Board do come up for reconsideration the Board would give reconsideration to the recommendation on Governor McDougal's salary.

After considerable discussion, Governor Young moved that the Board reconsider its action of January 16th in disapproving the salary of $60,000 per annum fixed by the New York directors for Governor Harrison, and in advising that it would approve a salary of $50,000 for Governor Harrison during 1930, if recommended.

Governor Young's motion, being put by the Chair, was carried, the members voting as follows:

The Chairman, "aye"
Governor Young, "aye"
Mr. Platt, "aye"
Mr. Hamlin, "aye"
Mr. Pole, "aye"
Mr. Miller, "no"
Mr. James, "no"
Mr. Cunningham, "no"

The Governor then moved that the Board approve the salary of $60,000 fixed by the New York directors for Governor Harrison, effective January 1, 1930.

Governor Young's motion, being put by the Chair, was lost, the members voting as follows:

The Chairman, "aye"
Governor Young, "aye"
Mr. Pole, "aye"
Mr. Platt, "no"
Mr. Hamlin, "no"
Mr. Miller, "no"
Mr. James, "no"
Mr. Cunningham, "no"

Mr. Hamlin and Mr. Platt stated that although they had voted against an increase in Governor Harrison's salary, they voted in favor of reconsideration of the Board's previous action as a matter of courtesy to the New York directors.

Governor Young then moved that the Board reconsider its action of January 16th in disapproving the salary of $37,500 fixed by the Chicago directors for Governor McDougal, and in advising that it would approve a salary of $35,000 for Governor McDougal during 1930, if recommended.

Governor Young's motion, being put by the Chair, was carried, the members voting as follows:

The Chairman, "aye"
Governor Young, "aye"
Mr. Platt, "aye"
Mr. Hamlin, "aye"
Mr. Pole, "aye"
Mr. Miller, "no"
Mr. James, "no"
Mr. Cunningham, "no"

Governor Young then moved that the Board approve the salary of $37,500 fixed by the Chicago directors for Governor McDougal effective January 1, 1930.

Governor Young's motion, being put by the Chair, was lost on a tie, the members voting as follows:

The Chairman, "aye"
Governor Young, "aye"
Mr. Platt, "aye"
Mr. Hamlin, "aye"
Mr. Miller, "no"
Mr. James, "no"
Mr. Cunningham, "no"
Mr. Pole, "no"

The Governor then brought up for consideration the question of the petition which is before the Board for the establishment at Wichita, Kansas, of a branch of the Federal Reserve Bank of Kansas City. A detailed discussion then ensued regarding the merits of the application, based upon the information furnished the Board through the various briefs filed, the two hearings held and from other sources, as well as of the manner in which branch Federal Reserve banks have been established in the past and the policy which should be pursued by the Board in the future not only on the question of the establishment of additional branches, but in the matter of continuing branches now in operation. During this discussion, it was brought out that the application for a branch at Wichita has been before the Board in the past and has several times been considered by the directors of the Federal Reserve Bank of Kansas City who are unanimously opposed to it. The question of a thorough survey was suggested and discussed, but it was the consensus of opinion that the Wichita application should be acted upon on its merits and not made subject to any subsequent study which may be conducted by the Board.

Mr. Hamlin then moved that the petition before the Board to require the Federal Reserve Bank of Kansas City to establish a branch at Wichita, Kansas, be approved.

Governor Young moved, as a substitute, that the petition that the Board require the establishment of a branch Federal Reserve bank at Wichita be laid on the table until some future meeting of the Board, attended by the full membership, at which any member desiring to do so, may bring the matter up for consideration.

Governor Young's substitute motion was put by the Chair and carried, Mr. Hamlin voting "no".

Further discussion ensued, during which it was the consensus of opinion that it would be inadvisable to defer action on the application.

By unanimous consent, Governor Young's substitute motion was reconsidered and it was withdrawn by him.

Mr. Miller then moved that Mr. Hamlin's original motion be amended to read as follows:

"That the petition before the Board to require the Federal Reserve Bank of Kansas City to establish a branch at Wichita, Kansas, be approved, and that hereafter no application to require the establishment of a branch Federal Reserve bank be voted upon except at a full meeting of the Federal Reserve Board."

The Governor then moved, as a substitute for Mr. Hamlin's motion, that any application for the establishment of a branch Federal Reserve bank, including the Wichita application, be acted upon only at a meeting of the Federal Reserve Board attended by the full membership.

Governor Young's substitute motion was unanimously carried.

Mr. Hamlin then reintroduced his original motion that the petition before the Board to require the Federal Reserve Bank of Kansas City to establish a branch at Wichita, Kansas, be approved.

Mr. Hamlin's motion was then put by the Chair and lost, the members voting as follows:

Mr. Hamlin, "aye"
Mr. Miller, "aye"
Governor Young, "no"
Mr. Platt, "no"
Mr. James, "no"
Mr. Cunningham, "no"
Mr. Pole, "no"
The Chairman, "not voting"

The Governor stated that should any member of the Board desire to incorporate in the record a statement explanatory of his vote, he should submit same in writing.

The Secretary of the Treasury and Mr. Pole then left the meeting and the Governor took the Chair.

Consideration of the Annual Report of the Board for the year 1929 was then resumed, and in accordance with the understanding at the meeting on

February 12th suggestions for changes were submitted by several members of the Board in writing.

Mr. Platt moved that the Report, as submitted by the Director of the Division of Research and Statistics, be adopted after amendment, by inserting the sentence, "In this view the reserve banks generally concurred, but several of them in addition voted to establish higher discount rates", on Page 3 preceding the sentence, "It was the Board's belief, however, that an effort should be made to readjust the credit situation through the cooperation of member banks with the Reserve banks without at that time further advancing the discount rates, which had been brought up to a 5% level at eight of the Reserve banks."

Mr. Hamlin moved, as a substitute, that the draft of the Report prepared by the Director of the Division of Research and Statistics, be amended so as to include the following:

"At the beginning of the year 1929, the Board felt much disturbed at the alarming increase in speculative security loans, sustained in material measure by the use of Federal reserve credit.

"During the period 1922 to 1928, security loans of reporting member banks increased from 3.6 billions to 7.5 billions, - an increase of 3.9 billions, or over 100%; on the other hand, commercial loans increased from an average of 7.4 billions to 8.7 billions, - an increase of 1.3 billions, or only 18%.

"During the same period, the percentage of security loans to total loans and investments, increased from 25% to 34%, while the percentage of commercial loans to total loans and investments, decreased from 51% to 39%.

"Member bank reserves during this period increased from an average of 1.7 billions to 2.4 billions in January, 1928, - an increase of 700 millions, or 40%.

"Federal reserve credit in December, 1928, was 1.8 billions, taking daily averages, while the corresponding figure for the year 1927 was 1.5 billions, - an increase of 300 millions.

"The Members of the Board felt that in view of the speculative conditions, there might not be the customary liquidation of credit during the first part of the year, and that decisive action was necessary.

"Requests had been made by several Federal reserve banks to increase discount rates from 5 to 6% to correct this situation. The Board felt, however, that an increase to 6% would have little effect on speculative activity, and that to bring about any restriction through discount rates would require drastic progressive increases, perhaps up to 7 and 8% or even higher, and that such a policy would bear heavily upon business and agriculture, the cost of whose credit was already enhanced by the unreasonable diversion of Federal reserve credit into reserves against deposits created by speculative loans.

"The Board determined, therefore, to keep the 5% rate in effect, but to bring direct pressure on the member banks to reduce, or at least not to increase, their borrowings for the purpose of maintaining reserves against deposits arising from such speculative credits.

"A warning was accordingly issued by the Board on February 7th, the gist of which was that further increase in speculative credits must cease.

"The banks, as a whole, complied with this warning, and while it was in effect, - from February 7th to about June 15, 1929, there resulted a great decline in security loans. Taking the average for January, 1929, and comparing it with June 12, 1929, we find that security loans for reporting member banks decreased from 7.5 to 7.2 billions, - a reduction of 297 millions; that commercial loans, on the other hand, for the same period, increased from 8.7 billions to 9.1 billions, - an increase of 361 millions. Member bank reserves for the same period decreased from 2,387 millions, the average for January, 1929, to 2,331 millions for the week ending June 15th, - a decrease of 56 millions.

"The percentage of security loans to total loans and investments decreased during this period from 33.6% to 32.6%; on the other hand, the percentage of commercial loans increased from 39.4% to 41.4%.

"Federal reserve credit, comparing the averages for January and May during 1928 and 1929, had decreased 310 millions during 1929, as against an increase of 84 millions in the same period of 1928.

"While this decline in Federal reserve credit was caused primarily by the seasonal return flow of currency and gold imports, it was nevertheless true that, in the absence of direct pressure, some part of the funds released would have found its way into member bank reserve balances, and would have formed a basis of further expansion.

"On June 12, 1929, the Board prepared a letter to the Federal Reserve Bank of New York which was given to Governor Young and Mr. Cunningham as a Committee, to deliver to the New York Bank. This letter was not left with the New York Bank at this meeting, but on June 14th the Board voted to send the letter to the New York Bank.

"This letter stated that the Board was willing to suspend direct action for the present, except as to certain offending banks, in view of the need for more Federal reserve credit; that the Board recognized that some banks were so involved that they could not immediately cease to be frequent borrowers; that the 5% rate should continue for the present, and that the need for further Federal reserve credit, when it arose, should be met by easing the bill market, and if absolutely necessary, by the purchase of Government securities; that if speculation started up again unreasonably, because of any such easing, direct action would be resumed, "and if such policy were not believed to be quick enough, other action would be taken.

"This suggested policy of easing the market, outlined in the letter, was followed, in fact, by an increase in Federal reserve credit and loans on securities. Finally, on August 8, 1929, following a conference with the Governors of the Federal reserve banks, the Board voted that it would approve an increase to 6% at New York and other financial centers, together with a lower bill rate, on the assurance of the Governors that the Federal reserve banks at other than the financial centers could and would retain the 5% rate.

"The purpose of the increase to 6%, as stated by the Governor of the New York Bank, was to bring some pressure upon the member banks to take down their rediscounts with the proceeds of the purchase of acceptances at lower rates by the Federal reserve bank, and to prevent the banks from using the proceeds as the basis of further expansion of security loans.

"It was under this policy of easing the market, in fact, that the Stock Exchange collapse in October took place.

"The Board adopted this policy of direct pressure because it felt that the banks owed a duty to their stockholders, depositors, and to the public, to conduct their banking operations on sound banking principles, and that when the banks by unreasonably large and increasing security loans were threatening the soundness of the general credit situation, relying in material part upon Federal reserve credit to support this unreasonable and unsound banking condition, it became the duty of the Federal reserve banks and the Federal Reserve Board to see to it that this dangerous condition should be corrected, at the same time protecting business and agriculture from the higher rates, so far as was humanly possible.

"Although, as above stated, the banks generally cooperated with the Federal Reserve System to restrain the growth of speculative credit during this period of direct pressure, there was decided opposition on the part of some banks, which maintained that in a period of general credit or speculative expansion, a customer having a good balance and offering acceptable security, could not be denied a loan, but that he was entitled to the loan provided he was willing to pay the discount rate determined upon by the member bank. In other words, the contention was made that while individual banks loaning more on speculative securities than the other banks of their class, could be restrained, yet when all banks were expanding no restraint could be put upon this expansion except by increasing discount rates.

"The Board does not accept this principle of banking. On the contrary, it believes that the individual member bank, as above stated, owes a duty to its stockholders, its depositors, and to the public, to conduct its bank on sound banking principles, and when it deviates from this rule, it becomes the duty of the Federal reserve banks and the Federal Reserve Board "to bring about a return to such sound banking principles.

"The Board is gratified at the success attained by this policy of direct pressure, and feels that it has established a new technique in regulating the volume of Federal reserve credit to the productive needs of the country."

Mr. Miller moved, as a substitute for the motions of Mr. Platt and Mr. Hamlin, that the draft of the Report prepared by the Director of the Division of Research and Statistics, be amended so as to include the following:

"The year 1929 opened with total Reserve bank credit outstanding in larger volume than in any year since the post-war crisis. Security loans of member banks and brokers' loans had attained new peaks. Collateral indications derived principally from the intense activity of the securities markets and the unprecedented rise of security prices gave unmistakable evidence of an absorption of the country's credit in speculative security operations to an alarming extent. There was nothing in the position of commercial credit or of business to occasion concern. The dangerous element in the credit situation was the continued and rapid growth of the volume of speculative security credit.

"The measures taken by the Federal reserve banks in the year 1928 to firm money conditions by sales of open market investments and by successive increases of discount rates from 3 1/2 per cent at the opening of the year to 5 per cent by mid-year had not proved adequate. The second half of the year 1928 witnessed an aggravation of the conditions that had called forth the firm money policy of the Federal reserve banks in the first half of the year.

"The credit situation confronting the Federal Reserve System at the opening of the year 1929, therefore, still stood in need of correction: - the problem was to find suitable means by which the growing volume of security credit could be brought under orderly restraint without occasioning avoidable pressure on commercial credit and business. With the System's portfolio of Government securities depleted by the sales made in the first half of the year 1928, the main or exclusive reliance in a further firming of money conditions must have been a further marking up of Federal reserve discount rates, unless some other expedient could be brought to bear in the situation.

"The Board was not disposed to regard favorably further increases of discount rates as the appropriate method of dealing with the situation thus presented to it, and particularly as the Federal Reserve System was related to it. It set forth its views of how the Federal reserve banks should proceed in the circumstances in a letter to them under date of February 2nd, which was later supplemented by a statement further elaborating its position, issued to the public February 7th and reading as follows:

'The United States has during the last six years experienced a most remarkable run of economic activity and productivity. The production, distribution and consumption of goods have been in unprecedented volume. The economic system of the country has "'functioned efficiently and smoothly. Among the factors which have contributed to this result, an important place must be assigned to the operation of our credit system and notably to the steadying influence and moderating policies of the Federal Reserve System.

'During the last year or more, however, the functioning of the Federal Reserve System has encountered interference by reason of the excessive amount of the country's credit absorbed in speculative security loans. The credit situation since the opening of the new year indicates that some of the factors which occasioned untoward developments during the year 1928 are still at work. The volume of speculative credit is still growing.

'Coming at a time when the country has lost some 500 million dollars of gold, the effect of the great and growing volume of speculative credit has already produced some strain, which has reflected itself in advances of from 1 to 1-1/2 per cent in the cost of credit for commercial uses. The matter is one that concerns every section of the country and every business interest, as an aggravation of these conditions may be expected to have detrimental effects on business and may impair its future.

'The Federal Reserve Board neither assumes the right nor has it any disposition to set itself up as an arbiter of security speculation or values. It is, however, its business to see to it that the Federal reserve banks function as effectively as conditions will permit. When it finds that conditions are arising which obstruct Federal reserve banks in the effective discharge of their function of so managing the credit facilities of the Federal Reserve System as to accommodate commerce and business, it is its duty to inquire into them and to take such measures as may be deemed suitable and effective in the circumstances to correct them; which, in the immediate situation, means to restrain the use, either directly or indirectly, of Federal reserve credit facilities in aid of the growth of speculative credit. In this connection, the Federal Reserve Board, under date of February 2nd, addressed a letter to the Federal reserve banks, which contains a fuller statement of its position:-

'"The firming tendencies of the money market which have been in evidence since the beginning of the year - contrary to the usual trend at this season - make it incumbent upon the Federal reserve banks to give constant and close attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, beyond what may develop as inevitable.

"The extraordinary absorption of funds in speculative security loans which has characterized the credit movement during the past year or more, in the judgment of the Federal Reserve Board, deserves particular attention lest it become '"a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

'"The resources of the Federal Reserve System are ample for meeting the growth of the country's commercial needs for credit, provided they are competently administered and protected against seepage into uses not contemplated by the Federal Reserve Act.

"The Federal Reserve Act does not, in the opinion of the Federal Reserve Board, contemplate the use of the resources of the Federal reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

"The Board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal Reserve Act nor is it conducive to the wholesome operation of the banking and credit system of the country."'

"It is not for the Federal Reserve Board to estimate the general expediency or the larger public consequences of its intervention by 'direct pressure' in the complex situation existing at the time the above statement was called forth. It may be remarked, however, that the course adopted by the Board resulted in a substantial conservation of the credit resources of the banking system of the country, and particularly of the Federal reserve banks, for essential needs which arose later in the year. It may be remarked further that this outstanding experience with the application of 'direct pressure' demonstrated its practicability, effectiveness and reasonableness as a method of Reserve banking control under conditions appropriate to its use. Its potentialities and its availability in dealing with certain types of credit disorder can no longer be doubted."

Mr. Miller's substitute motion, being put by the Chair was carried, the members voting as follows:

Mr. Hamlin, "aye"
Mr. Miller, "aye"
Mr. James, "aye"
Mr. Cunningham, "aye"
Governor Young, "no"
Mr. Platt, "no"

In explanation of his vote, Governor Young made the following statement:

"I have voted 'no' on Dr. Miller's proposed amendment to the Annual Report for the following reasons:

(1) I question the accuracy of the following statements:

(a) (Page 1) 'With the system's portfolio of Government securities depleted by the sales made in the first half of the year 1928, the main or exclusive reliance in a further firming of money conditions*****'

"I direct your attention to the holdings of Government securities by the system on January 2; $76,000,000 were held in the Open Market Investment Account; $47,000,000 under resale agreement, and $122,000,000 held by the banks outside of the Open Market Investment Committee, or a total of $244,000,000. At the time the Board's statement was issued these holdings had been reduced to $200,000,000, and by June to $145,000,000, the reduction in the system's Special Account amounting to $55,000,000.

(b) (Page 2) 'The Board was not disposed to regard favorably further increases of discount rates as the appropriate method of dealing with the situation thus presented to it.'

"Rates on discounts to member banks were, to be sure, left unchanged, except in the four Western banks, where they were brought up to the 5 per cent level, but beginning with January buying rates on bills were increased at frequent intervals with the approval of the Board, with the consequence that the system's bill holdings declined from $484,000,000 to $113,000,000 in the first part of June, and to $69,000,000 in July. Liquidation of Governments and of bills resulted in a growth of discounts from $852,000,000 on May 29, and there is no way of telling to what extent it was direct action, and to what extent growth in discounts that caused the interruption in the growth of speculative credit.

(c) (Page 3) 'It may be remarked, however, that the course adopted by the Board resulted in a substantial conservation of the credit resources of the banking system of the country, and particularly of the Federal reserve banks, for essential needs which arose later in the year.'

I direct your attention to the fact that between June and the date of the stock market crash there was an advance in speculative security credit as rapid as, if not more rapid, than in any similar period in the history of the System, with the exception of the week between October 23 and November 1, and it had all the earmarks of non-essential rather than essential credit.

"(2) The amendment to the report carries the thought to the American public that direct action is a new discovery, and that it was not practiced previously to the Board's action in February. I know from my own experience in operating a reserve bank, and my observations of other reserve banks, that this is not correct. Direct action has always been practiced by the reserve banks and has been from time to time discussed by the Board, as, for instance, in its 1926 annual report.

I am convinced that by claiming credit for the success of its policy in the early part of the year and not mentioning the suspension of this policy in June, the Board lays itself open to the accusation of lack of candor. It also makes it hard to explain why, if it had an efficient means of controlling the growth of speculative credit, it failed to use this method later in the year, when all the indications pointed toward a more urgent need than ever for the exercise of restraint.

And, finally, I believe that the Board, by stating that it has devised a means of controlling speculation without subjecting business to higher rates for money, establishes a precedent that will be the cause of serious embarrassment. Whenever in the future the system will find it necessary to raise discount rates, it will be accused of disregard of the interest of business, and demands will be made upon it to use methods of handling the situation without resorting to advances of discount rates. I feel the more strongly on this point, because I am certain that no method of restraint can be put into operation through rates, through sales in the open market, or through direct pressure without increasing the cost of credit to business, and that direct pressure affects interest rates more, rather than less, than do the other policies."

It was understood that the draft of the Report would be revised by the Director of the Division of Research and Statistics, in accordance with the action just taken and resubmitted to the Board.

The meeting adjourned at 1:15 p.m.

E. M. McClelland

Assistant Secretary.

Approved:

R. A. Young

Governor.