A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, March 10, 1939, at 11:00 a. m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. Davis
Mr. Draper

Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Dreibelbis, Assistant General Counsel
Mr. Williams, Assistant Counsel

Mr. Thurston stated that Eugene S. Duffield, Assistant to the Secretary of the Treasury, had called on the telephone and stated that the Secretary of the Treasury desired to publish in the Treasury bulletin the holdings, classified as to maturities, of United States Government securities of all insured banks, and would like to know whether the Board would have any objection to the inclusion of the data covering the holdings of State member banks which had already been sent to the Treasury. Mr. Thurston said that he had taken the matter up with Messrs. Smead and Goldenweiser, that they saw no objection to the publication of the information, and that he did not see how the Board could object because of the fact that it had sponsored the change in the form for call reports of condition of banks to provide for the

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submission of this information and the information covering the holdings of State member banks would appear in due course in the combined member bank call report issued by the Board. He added that Mr. Duffield had informed him that there was no objection on the part of the Federal Deposit Insurance Corporation or the Comptroller of the Currency to the publication of the information covering the holdings of insured nonmember and national banks, respectively, and that it was the intention of the Treasury to lump the maturity classifications for all banks.

> It was agreed unanimously that the publication of the information was desirable and that Mr. Thurston should advise Mr. Duffield that the Board would interpose no objection thereto.

There were then presented telegrams to Mr. Kimball, Secretary of the Federal Reserve Bank of New York, Mr. Leach, President of the Federal Reserve Bank of Richmond, Mr. McLarin, Vice President of the Federal Reserve Bank of Atlanta, Messrs. Dillard and Powell, Secretaries of the Federal Reserve Banks of Chicago and Minneapolis, respectively, Mr. McKinney, President of the Federal Reserve Bank of Dallas, and Mr. Hale, Secretary of the Federal Reserve Bank of San Francisco, stating that the Board approves the establishment without change by the Federal Reserve Bank of San Francisco on March 7, by the Federal Reserve Banks of New York, Richmond, Chicago, Minneapolis

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and Dallas on March 9, 1939, and by the Federal Reserve Bank of Atlanta today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

At Mr. Ransom's request that Mr. Williams advise the Board as to the existing situation with respect to the reorganization bill which was passed by the House of Representatives on March 8, 1939, Mr. Williams stated that the bill had been rushed through the House of Representatives with only two amendments and that no amendments had been offered to exempt any of the bank supervisory agencies from the provisions of the bill. He also said that the bill was sent to the Senate yesterday and referred by it to the Select Committee on Government Organization. Mr. Ransom referred to the discussions at previous meetings of the Board when it was decided that the Board should take no action at the time with respect to the bill and inquired whether any member of the Board felt differently about the matter at the present time. All of the members of the Board agreed that no action should be taken at this time but that the progress of the bill in the Senate should continue to be watched closely so that the Board would be in a position to take any action that might appear to be desirable in the circumstances.

Reference was made to a memorandum dated March 8, 1939, from

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Mr. Ransom to which were attached three letters received from the Chairman of the Banking and Currency Committee of the Senate under date of March 7 requesting an expression of the Board's opinion as to the merits of bills S.1701, to amend section 12B of the Federal Reserve Act, S.1684, to amend the Gold Reserve Act of 1934, and S.1696, to terminate the power to issue United States notes under the provisions of the Act of May 12, 1933. The memorandum requested that the letters be brought to the attention of the Board so that a decision could be reached as to what action, if any, was to be taken in connection with the requests.

Mr. Ransom stated that while the Board had taken the general position that it would not reply to routine requests for reports in the absence of special circumstances, he felt the Board should consider whether the bills in question related to matters regarding which it might be interested in making a report.

Mr. Wyatt discussed briefly the purposes of the bills, stating that S.1701 would enlarge the authority of the Federal Deposit Insurance Corporation to waive claims on account of liability of stockholders of closed insured banks, that S.1684 would provide for the coinage of gold coins and issuance of certificates redeemable in gold, and that S.1696 would repeal the authority granted by the Act of May 12, 1933, for the issuance of $3,000,000,000 of greenbacks.

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It was agreed unanimously that no report should be made on S. 1701.

Messrs. Goldenweiser and Wyatt were requested to prepare memoranda discussing the merits of the other two bills and the question whether reports on the bills should be made, and it was understood that after the memoranda had been considered by the Board a decision would be reached with respect to whether reports on the bills should be made.

Reference was made to the letter dated March 9, 1939, which was sent by Chairman Eccles after approval by Messrs. Eccles and Davis, in accordance with the action taken at the meeting of the Board on February 27, 1939, and by Mr. Ransom, to Honorable E. D. Smith, Chairman, Committee on Agriculture and Forestry, United States Senate, reading as follows:

"In response to your letter of January 28, 1939, you are advised that the Board of Governors of the Federal Reserve System does not favor the enactment of Senate Bill No. 1057, 'A Bill for the regulation and stabilization of agricultural and commodity prices through the regulation and stabilization of the value of the dollar, pursuant to the power conferred on the Congress by paragraph 5 of section 8 of article 1 of the Constitution, and for other purposes.'

"A statement of the reasons for this view is contained in the inclosed memorandum."

The statement of reasons referred to in the above letter read as follows:

"From time to time the Board of Governors of the Federal Reserve System is asked to give its opinion about proposals to require some agency of the Government to raise the general level of prices and then to keep it constant. Some would make it the duty of the Board to do this and some would create a new agency for the purpose. All would require that prices be controlled by

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"regulating the amount and cost of money.

"Those who favor such proposals believe that prices can be raised by increasing the supply of money, that prices can be lowered by reducing the supply of money, and that prices can be kept fairly steady by changing the supply of money in the right direction at the right time. They believe that, if prices were kept fairly steady, we would not have booms, depressions, and panics, business would run along on an even keel, and much suffering and hardship would be prevented.

"The Board of Governors is in complete sympathy with the desire to prevent booms and depressions, and has always considered it its duty to do what it could to help accomplish these results.

"Experience has shown, however, that (1) prices cannot be controlled by changes in the amount and cost of money; (2) the Board's control of the amount of money is not complete and cannot be made complete; (3) a steady average of prices does not necessarily result in lasting prosperity; and (4) a steady level of average prices is not nearly as important to the people as a fair relationship between the prices of the commodities which they produce and those which they must buy.

"Steady prices and lasting prosperity cannot be brought about by action of the Federal Reserve System alone, because they are affected by many factors beyond the control of the Federal Reserve System.

1. Prices do not depend on money alone

"Experience in recent years has shown that prices are not controlled by the amount or cost of money.

"If currency alone is considered as money, the facts are clear and simple. There was $3,600,000,000 of currency in the hands of the public, outside the banks, in the middle of 1926 and about the same amount in the middle of 1929, while at the end of 1938 the amount of currency had increased to $5,700,000,000. If prices were governed by the amount of currency, prices would have been about the same in 1929 as in 1926 and would have increased sharply by the end of 1938. The facts are that the average of wholesale prices, expressed in an index number, was 100 in 1926, 95 in 1929, and 77 in 1938. From 1926 to 1929, there was no change in the amount of currency but there was a drop of 5 per cent in prices. From 1929 through 1938, there was an increase of 60 per cent in currency while there was a decrease of 20 per

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"cent in prices. Evidently cash and prices do not move together.

"It is easy to understand why the amount of currency does not control prices. Currency is not the principal means used by people in paying for what they buy. In fact, it is the small change of business. Most people keep only as much money in their pockets as they require for their day-to-day needs, such as car-fares, lunches, gasoline, and other items, and what they do not need they deposit at the banks. Business firms require currency to meet payrolls, stores to make change. Banks keep on hand only a reasonable supply to meet the demands of their customers and send the rest to the Federal Reserve banks.

"Because of the way we have come to use our currency, chiefly for small payments, we cannot expect to raise prices or increase prosperity by the issuance of more currency either by the Treasury or by the Federal Reserve banks. Any surplus above the amount needed would only come back to the Reserve banks. People can always get all the currency they need so long as they have deposits to draw on.

"But more than nine-tenths of the bills in this country are paid by checks drawn on bank deposits. Therefore the deposits that the public holds in banks and can use as a means of paying for what it buys, as well as the currency outside of banks, need to be considered as money. Again the facts show clearly that the volume of money does not control the price level.

"The amount of demand deposits was $22,000,000,000 in June 1926, $23,000,000,000 in June 29, and $26,000,000,000 at the end of 1938. As already stated, currency outside of banks was $3,600,000,000 in 1926 and in 1929, and $5,700,000,000 in 1938. The amount of money, therefore, was larger in 1929 than in 1926 and larger in 1938 than in 1929. But what happened to prices? In 1929 they were 5 per cent lower than in 1926; and in 1938 they were 23 per cent lower than in 1926. This proves that factors quite apart from the volume of money, i.e., of currency and deposits together were influencing the price level.

"There have been times when the amount of money and prices have changed together; but usually they have not. When they have moved together this may have been due to the fact that it takes more money to do the same amount of business when prices are high than when they are low.

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"Whether prices and the volume of money do or do not move together depends on many other conditions, such as weather and the size of harvests, inventions, foreign trade, Government spending, taxes, wages, and the general attitude of business. When people are venturesome and expect good times, they lay in supplies and this tends to raise prices. When people are discouraged and expect things to go badly, they tighten their belts and buy as little as possible. The demand for goods declines and prices fall. Usually other things have a greater influence on prices than has the amount of money.

"Neither do prices depend on the cost of money. This also has been shown by the experience of the last 10 years. The cost of money now is lower than it has ever been at any time for which we have a record. This is true not only of the rate at which the Government can borrow, and of the rate at which large corporations can get money in the money market, but also of the rate charged by banks to their regular customers. The average rate charged by banks in 36 cities on their business loans was around 5 per cent in 1926; it rose to over 6 per cent in 1929, and fell to 3-1/4 per cent in 1938. Federal Reserve discount rates in 1926 were 3-1/2 to 4 per cent; in 1929, 4-1/2 to 6 per cent. In 1938 rates were 1 to 1-1/2 per cent. During this period when the cost of money was so drastically cut, prices went down by about one-fourth.

"In view of these facts the Board finds it impossible to believe that prices can be controlled by changes in the volume and cost of money.

2. Federal Reserve cannot completely control amount of money

"The Federal Reserve System, furthermore, does not and cannot have complete control of the amount of money and its use. It has an influence on the amount and when other things are favorable this influence can become effective, but there are many occasions when the System's powers are limited.

"As already explained, currency is not the most important item in our business life, and the Federal Reserve System supplies at all times the currency that the public demands. If the Reserve System should engage in so-called open-market operations, that is, if it should buy Government bonds, and if it should pay out Federal

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"Reserve notes for them, as has been proposed in some of the bills before Congress, this currency would come right back to the Reserve banks and would serve no useful purpose.

"The Federal Reserve System has more influence on the amount of deposits than it has on the amount of currency, but there are limits to the System's influence. The System has power to give the banks more reserves by buying Government bonds. The sellers would receive checks which they would deposit in their banks. The banks in turn would deposit these checks in the Federal Reserve banks, thus increasing their balances which under the law are the member banks' legal reserves.

"At a time when things are going well and there is a demand for as much bank credit as the banks can supply, increasing the reserves of the banks will usually increase the amount that they are willing and able to lend or invest. As the banks lend or invest the money they can pass on to the public not only the amount of unused reserves that they have, but all the banks together can pass on several times the amount of these reserves. This is because the banks are required to keep as reserves only a portion of their deposits. The proportions are different for different classes of banks; but, at the present time, all the banks together can lend or invest about six times as much as their reserves. (A detailed explanation of the way this works was given in the Board's Annual Report for 1936.)

"When conditions are such that banks lend or invest all the money they can, the Reserve banks by buying $1,000,000 of Government securities can enable the banks to increase deposits held by the public by $6,000,000. Conditions, however, are not always such as to bring this about. They have not been so for a number of years. The Federal Reserve banks have bought more than $2,500,000,000 of Government securities. There has been a large inflow of gold from abroad, and the reserves of our banks have increased from about $2,700,000,000 in December 1933 to $9,000,000,000 in January 1939. Deposits of banks, however, have not increased in anything like the same proportion; because the banks have not found it possible to use all the reserves they held. At this time they have about $3,500,000,000 more reserves than the law requires and are not finding any way to use these reserves.

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"The Federal Reserve System can see to it that banks have enough reserves to make money available to commerce, industry, and agriculture at low rates; but it cannot make the commercial banks use these reserves, it cannot make the people borrow, and it cannot make the public spend the deposits that result when the banks do make loans and investments.

3. Steady prices do not assure prosperity

"Even if the amount of money did determine prices and even if the Federal Reserve System could determine the amount of money, experience shows that steady prices would not necessarily mean prosperity.

"It is true that violent changes in prices are harmful. A very rapid rise in prices results in speculation, in accumulation of inventories and in unsound undertakings, which later result in a collapse with falling prices, failing business, and general distress.

"But that does not mean that lasting prosperity is assured when prices are steady. We had fairly steady prices from 1921 to 1929; but during that period there was developing a speculative situation which led to the collapse in 1929. It was during this period that billions of unsound foreign loans were made; that expensive and unsoundly financed apartment houses and office buildings were erected far beyond the needs of the people; that stock prices rose to fantastic levels. It was during this period that the ground was prepared for the depression which began in 1929 and from which we have not yet completely emerged. An unchanged average of wholesale prices alone, therefore, does not assure the people of lasting prosperity. While prices are stable, destructive forces may be at work that lead to panic and disaster. To require the Board to be guided in its policies entirely or principally by changes in the level of prices would prevent it at times from doing its best to serve the public interest.

4. Relations of prices more important than average prices

"One reason why steady average prices do not assure prosperity is that the average can be steady while prices of some of the commodities that make it up change violently. People are more interested in the relation between the prices of what they produce and sell and the prices of what they buy and use than in the general price level.

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"A farmer is interested not only in what he can get for his products over and above the cost of production but also in what he has to pay for the things that he needs to buy - how many bushels of wheat or pounds of cotton it takes to get a suit of clothes or a new plow. For the industrial producer the cost of his raw materials and labor compared with the prices that his products will fetch is what counts. To a wage earner or salaried man the important thing is the relation between his income and the cost of living. Even the ability of people to pay their debts does not depend so much on the average level of prices as upon the amount by which their net income exceeds their living expenses.

"A steady average of prices, furthermore, may cover up sharp movements in prices of important commodities upon which large sections of the country depend. For example, from March to September 1937, while the average of wholesale prices was steady, grains declined by 19 per cent and cotton by 38 per cent. Many people are misled by averages. At the present time, with the average of all wholesale prices at 77 per cent of the 1926 level, prices of farm products are at only 67 per cent, while industrial commodities are at 80 per cent. Even prices of different farm products differ widely. Cotton and grain prices are 50 per cent of the 1926 level, while livestock prices are 80 per cent.

"An attempt to maintain a steady average of prices would run into serious difficulty in years when prices of some commodities were forced up by drought, armament demand, or other things beyond the control of the monetary authority. When prices of industrial materials advanced in 1936-1937, a steady average of prices could have been maintained only if prices of finished products had declined, and if that had occurred, it would have made it unprofitable to buy materials on a rising market with the prospect of selling finished products on a falling market. This would have resulted in a slowing down of industrial and building activity. Differences between price movements of raw materials and finished products were, in fact, an important reason of the turn down in business in 1937.

Summary

"To summarize, the Board of Governors is in complete sympathy with the real purpose of the price-stabilizing

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"bills, which is to prevent booms and depressions and have business always on an even keel. But experience has shown that prices do not depend primarily on the volume or the cost of money; that the Board's control over the volume of money is not and cannot be made complete; and that steady average prices, even if obtainable by official action, would not assure lasting prosperity. The Board exerts all its powers to provide a constant and ample flow of money at reasonable rates to meet the needs of commerce, industry, and agriculture. In order to maintain a lasting prosperity many other agencies of the Government, as well as many groups in the general public, must cooperate, since policies in respect to taxation, expenditures, lending, foreign trade, agriculture, and labor all influence business conditions.

"The Board believes that an order by Congress to the Board or to any other agency of Congress to bring about and maintain a given average of prices would not assist but would hinder efforts to stabilize business conditions. It would hinder, because the price average frequently would indicate a policy that would work against rather than for stability. Such an order would also raise in the public mind hopes and expectations that could not be realized.

Conclusion

"In view of all these considerations the Board does not favor the enactment of any bill based on the assumption that the Federal Reserve System or any other agency of the Government can control the volume of money and credit and thereby raise the price level to a prescribed point and maintain it there."

Approved unanimously, together with a letter dated March 9, 1939, to Honorable Robert F. Wagner, Chairman, Committee on Banking and Currency, United States Senate, reading as follows:

"In response to your letter of January 10, 1939, you are advised that the Board of Governors of the Federal Reserve System does not favor the enactment of Senate Bill No. 31, 'A Bill to amend the Federal Reserve Act, to restore and maintain a stable price level, and

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"'for other purposes', or any other legislation of this general character.

"A statement of the reasons for this view is contained in the inclosed memorandum."

In connection with Senate Bill 31, the following letter to Mr. E. H. Foley, Acting General Counsel, Treasury Department, was also approved unanimously:

"In response to the request contained in your letter of January 23, 1939, there is inclosed for your information a copy of a report on S. 31 which I am submitting on behalf of the Board of Governors of the Federal Reserve System to Honorable Robert F. Wagner, Chairman of the Senate Committee on Banking and Currency."

Mr. Goldenweiser stated that the memorandum referred to in the above letters had been prepared with a view to its being used in answering other inquiries received by the Board from time to time with respect to price stabilization and inquired whether there would be any objection to the release of the statement to the press and its publication in the Federal Reserve Bulletin.

Mr. Davis pointed out that the report made by the Board on the Barkley Trust Indenture Bill (S. 477) was not released to the press and he raised a question as to the desirability of the adoption by the Board of a general policy relating to the publication of reports submitted by it to committees of Congress on proposed legislation.

It was agreed that where the report deals with a specific bill the decision as to whether the report should be made

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public should be left with the chairman of the committee receiving the report, but that where, as in the present case, there is a memorandum dealing with the subject generally and not relating to a specific bill the memorandum, with the approval of the Board in specific cases, might be released to the press and published in the Federal Reserve Bulletin.

In accordance with this agreement it was understood that the statement enclosed with the letter to Senator Smith would be released to the press and included in the next issue of the Federal Reserve Bulletin.

At this point Messrs. Thurston, Wyatt, Goldenweiser, Dreibelbis and Williams left the meeting and the action stated with respect to each of the matters hereinafter referred to was then taken by the Board:

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on March 8, 1939, were approved unanimously.

Letter to Honorable Preston Delano, Comptroller of the Currency, reading as follows:

"This refers to Mr. Upham's letter of February 8, 1939, transmitting a letter of February 1, 1939, from National Bank Examiner L. H. Sedlacek submitting several questions relating to the contributions made by Bank of America National Trust & Savings Association, San Francisco, California, to Merchants National Realty Corporation, an affiliate of the bank. Mr. Upham and Mr. Sedlacek refer to section 23A of the Federal Reserve Act and it is understood that the matter has been submitted to the Board for rulings concerning the propriety of the contributions solely in the light of the provisions of that section.

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"It is understood that on June 16, 1933, Merchants National Realty Corporation was an affiliate of Bank of America National Trust & Savings Association by reason of the bank's ownership of all of its common stock and that such relationship has continued unchanged. It is also understood that since prior to such date Merchants National Realty Corporation has been engaged in holding bank premises of Bank of America National Trust & Savings Association. Mr. Sedlacek reports that subsequent to such date the bank has made the following contributions to the affiliate: In 1933, 22 bank premises valued at $4,326,120.46; between June 20, 1934, and December 31, 1936, 32 bank premises valued at $3,410,474.34; between March 20, 1935, and January 15, 1937, $3,125,000 in cash to reduce mortgage indebtedness on properties owned by the affiliate; on October 7, 1935, $180,000 in cash to purchase bank premises; on December 31, 1935, $65,000 in cash to purchase a portion of a leasehold (apparently bank premises); on May 13, 1936, $1,670,900.36 in cash to retire the outstanding preferred stock of the affiliate; and on July 14, 1937, $5,875,000 in cash to purchase from Capital Company real estate described as 'Ex bank premises'.

"Section 23A of the Federal Reserve Act was enacted as a part of the Banking Act of 1933, approved on June 16, 1933, and amended by the Banking Act of 1935, approved on August 23, 1935. The first paragraph, which has not been amended, prescribes certain limitations upon the amount of its funds which a member bank may invest in the capital stock, bonds, debentures, or other such obligations of an affiliate.

"As originally enacted, the third paragraph of section 23A provided in part that the limitations of such section should not apply to any affiliate -

> '(1) engaged solely in holding the bank premises of the member bank with which it is affiliated'.

"The Banking Act of 1935 amended the law so that such exception now reads as follows:

> '(1) engaged on June 16, 1934, in holding the bank premises of the member bank with which it is affiliated or in maintaining and operating properties acquired for banking purposes prior to such date'.

"Having been engaged in holding bank premises of Bank of America National Trust & Savings Association since prior

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"to June 16, 1934, Merchants National Realty Corporation clearly has been within the exception since the law was amended. The affiliate need not have been engaged solely in performing the described functions on June 16, 1934, in order to be within the exception. Accordingly, since August 23, 1935, the contributions by the bank to the affiliate have not been subject to the limitations of section 23A.

"The question whether the contributions by the bank to the affiliate between June 16, 1933, and August 23, 1935, were subject to the limitations of section 23A involves the question whether the affiliate was engaged solely in holding bank premises of the bank, a matter not commented upon by Mr. Sedlacek. If it were ascertained that the affiliate was not engaged solely in holding bank premises of the bank during such period, a determination as to whether the contributions by the bank to the affiliate were subject to the limitations of section 23A would require further consideration. In view of the action taken by Congress in amending section 23A in 1935, you may, as a matter of policy, not desire to pursue the matter on the basis that the affiliate may not have been engaged solely in holding bank premises prior to such amendment.

"It is trusted that the foregoing comments will satisfactorily dispose of Mr. Sedlacek's questions in so far as they involve section 23A. It is assumed that your office has or will give consideration to any effect which other statutory provisions governing national banks may have upon the propriety of the contributions."

Approved unanimously.

Letter to Mr. Young, President of the Federal Reserve Bank of Boston, reading as follows:

"Acknowledgment is made of your letter of March 2, 1939, with respect to the proposed writing off of five Exchange Drafts aggregating $60.87, which have been outstanding for eight years or more.

"The Board sees no objection in principle to the writing off of exchange drafts of relatively small amounts when such drafts have been outstanding for over eight years

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"and the bank has no reason to believe that they will ever be presented for payment."

Approved unanimously.

Memorandum dated February 23, 1939, from Mr. Goldenweiser, Director of the Division of Research and Statistics, submitting for approval by the Board a plan for revising the Board's monthly series of customer rates charged by banks in 36 cities which had been developed in cooperation with the statistical departments of the Federal Reserve banks. The proposed changes were set forth in the memorandum and a draft of letter to the Federal Reserve banks regarding such changes was also attached to the memorandum.

Approved unanimously.

Thereupon the meeting adjourned.

Assistant Secretary.

Approved:

Chairman.

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