

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 3103]
June 26, 1946

LOANS TO PURCHASE GOVERNMENT SECURITIES

*To the President of each Bank and Trust Company
in the Second Federal Reserve District:*

The program of the Government for the financing of the war emphasized that banks should not make loans to facilitate speculative purchases of Government securities. On October 8, 1945, prior to the Victory Loan, the Secretary of the Treasury addressed a letter to all banks in the United States requesting them to decline to make loans for speculative purchases of Government securities and to decline to accept subscriptions from customers which appeared to be entered for speculative purposes.

It was recognized, however, that there would be instances in which purchasers of securities for investment and not for speculation would want to anticipate income by borrowing temporarily from banks. It was understood that these loans would be repaid out of income and would have maturities of not to exceed six months. Loan arrangements of this character were recognized in the joint statement issued by the National and State bank supervisory authorities in November 1942, which said that "such loans will not be subject to criticism but should be on a short term or amortization basis fully repayable within periods not exceeding six months."

During the Victory Loan Drive, a large amount of long-term bonds was purchased with the aid of bank loans. It has been reported that many such loans have not been repaid out of current income and that bank credit has been used for speculative carrying of Government securities. Reports have been received also of the activities of money brokers and others seeking to arrange bank loans on Government securities for customers without provision for amortization and with margins and rates of interest which emphasize high returns on small amounts of the borrower's own funds required for relatively large transactions. The same general considerations which led to efforts to discourage speculative subscriptions to Government securities during the war loan drives clearly apply to this sort of loan.

Borrowing from banks creates an addition to the country's money supply to the same extent as direct purchases of securities by banks. The existing unprecedented supply of deposits and currency, in the face of an inadequate supply of goods and services, is a dangerous inflationary potential. Therefore, every effort should be made to reverse the wartime trend of increased borrowing for the purpose of purchasing and carrying Government securities and to reduce as much as possible the use of bank credit for that purpose.

It seems timely to ask your cooperation to this end, particularly as loans made to facilitate purchases of Government securities during the Victory Loan Drive, which are still unpaid, have now run for more than six months. You will realize, of course, that nothing will be accomplished if one bank makes a loan on Government securities to enable a customer to comply with the request of another bank to pay off a loan originally made to purchase Government securities.

ALLAN SPROUL,
President.