FEDERAL RESERVE BOARD

S T A T E M E N T   F O R   T H E   P R E S S

For release 3 o'clock p.m.
August 29, 1928.

There is quoted below a communication received by the Federal Reserve Board from a clearing house association:

"Referring to loans made member banks secured by United States securities we feel preferential rate of interest should be charged on transactions of this character, rate not to exceed rates borne by securities in accordance with previous ruling. In view of forthcoming financing by Treasury Department we feel this matter should receive the immediate and careful consideration of Federal Reserve Board. Present rates penalize banks assisting in financing."

The following is the Board's reply:

"Gentlemen:

This will acknowledge receipt of your wire of August 27th to Governor Young recommending preferential discount rates by Federal reserve banks on collateral notes secured by Government obligations, the discount rate in each case to be the same as that borne by the security. Your proposal has been laid before the Federal Reserve Board, and, first, the Board feels justified in reminding you that the usual procedure under the law is for the Directors of the reserve banks to initiate rates. When such rates are initiated they are laid before the Board for review and determination. While the Board undoubtedly has the power to fix rates of discount for reserve banks we see nothing in the present situation to require such arbitrary action. At the same time the Board is not attempting to sidestep any responsibility it may have for reserve bank discount rates, and we advise your Association that if any reserve bank should initiate such preferential rates as you suggest the Board would be opposed to such procedure for the following reasons:

(1) It would not care to discriminate against commerce and industry by approving a rediscount rate of as low as three and one quarter percent on collateral notes secured by Government obligations while simultaneously certain reserve banks would be permitted to charge five percent on eligible commercial, agricultural and industrial paper.

(2) There is nothing in the present situation which would justify a lower rate on one class of Government securities over another. The previous action of the reserve banks that you refer to was a wartime measure only.

(3) If your proposal was put into effect at the present time it would permit a member bank to buy United States bonds in the

present market on a yield higher than the bonds bear and the member bank would be prompted to rediscount to make such purchase solely for profit.

(4) Member banks own over four billions of United States Government bonds, and, upon reflection, we believe your Clearing House will agree with us that the invitation for profit would be too great for many of the banks to resist and only result in inflation that eventually would work widespread disaster to our entire financial structure and, indirectly, to the business interests of the country.

(5) The proposed plan would have a strong tendency to appreciate the market value of the outstanding United States obligations bearing low rates and simultaneously depreciate those bearing higher rates, developing artificial and unwarranted prices for the various Government issues.

(6) Under normal peacetime conditions the Treasury Department should and does pay the ordinary market rates for money the same as any other borrowers. Moreover, the credit of the United States Government is so good that there is no occasion whatsoever of attempting by artificial means to place United States Government securities in a favored position as compared with commerce, industry and agriculture.

Very truly yours,

(signed) A. W. Mellon,
Secretary of the Treasury and
Chairman of the Federal Reserve Board."