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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6250

February 27, 1929.

Dear Sir:

There is enclosed herewith for
your information, copy of the reply
made by the Board under date of Febru-
ary 26th to Senate Resolution 323,
adopted February 11, 1929.

Very truly yours, .

E. M. McClelland,
Assistant Secretary.

TO CHAIRMEN AND GOVERNORS
OF ALL FEDERAL RESERVE BANKS.

(Enclosure)

February 26, 1929.

Sir:

The Federal Reserve Board is in receipt of Senate Resolution 323, reading as follows:

Whereas in press dispatches recently, the Federal Reserve Board has complained that money is being drawn from the channels of business and used for speculative purposes, and that some of said speculation is illegitimate and harmful; Therefore be it

Resolved, That the Federal Reserve Board is hereby requested to give to the Senate any information and suggestions that it feels would be helpful in securing legislation necessary to correct the evil complained of and prevent illegitimate and harmful speculation.

Inasmuch as this Resolution was occasioned by the statement issued by the Federal Reserve Board on February 6th, wherein the attitude and viewpoint of the Federal Reserve Board with respect to the growing volume of credit in speculative security loans was indicated, the statement is repeated here in order that there may be no misapprehension of the Board's position with reference either to the matter discussed in its statement or to that which is the subject of the Senate's Resolution.

"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 con-

tributing 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."

The Board begs leave to call the attention of the Senate to the fact that the purport and language of its statement do not agree with those in the preamble of the Senate resolution. The Board's statement concerned itself with credit conditions. It disclaimed both the authority and the desire "to set itself up as an arbiter of security speculation or values". That still is the Board's position.

At the time of the issue of its statement, it was the belief of the Board that it could count upon the cooperation not only of the Federal reserve banks but of leading member banks everywhere in the country in making successful an effort to bring about an orderly readjustment of the credit situation; and the Board has been confirmed in this belief by what has taken place since.

This also is the view of the Federal Advisory Council, as will be seen from the following minute of its proceedings which was presented to the Board February 15th on the occasion of its recent quarterly meeting:

"The Federal Advisory Council approves the action of the Federal Reserve Board in instructing the Federal reserve banks to prevent, as far as possible, the diversion of Federal reserve funds for the purpose of carrying loans based on securities. The Federal Advisory Council suggests that all the member banks in each district be asked directly by the Federal reserve bank of the district to cooperate in order to attain the end desired. The Council believes beneficial results can be attained in this manner."

This whole matter is engaging the earnest attention and efforts of the Federal Reserve Board. If it should develop that the Board, through exercise of the powers granted under the provisions of the Federal Reserve Act, or through cooperation with the Federal Reserve and member banks, should be

unable to bring about a solution of the problem which has awakened the concern alike of the Senate, the Federal Reserve Board, and the general body of public opinion, it will be glad to give consideration to the possibilities of remedy by way of legislation.

By direction of the Federal Reserve Board.

Respectfully,

Walter L. Eddy,
Secretary.

The President of the Senate,
Washington, D.C.