As I said last week, we are not in a situation of clear and present danger - in this case the danger of inflation. Consumer prices have continued to move sidewise, wholesale prices have tended downward, and basic commodity prices have declined substantially. Inventories of distributors moved upward during the latter part of 1952 but may have levelled off as a result of Christmas trade. Inventories of manufacturers are at record levels but, as usual, there is the question of whether they are out of line with business volume. Business loans at banks increased substantially more than the estimated seasonal late in 1952, but we are now getting a pretty good seasonal run-off.

2. On the other hand, we have had a worrisome increase in consumer credit, even though consumer incomes and liquid resources are high, and an increase in non-farm mortgage credit on small dwellings which may contain hidden dangers. We have the prospect of continued high level private capital expenditures and Government spending. And we have a crystalization of sentiment that business is going to be good for at least six months and maybe throughout 1953. There is here, with a new business oriented administration, and the likely prospect of the prompt removal of remaining wage and price controls, the making of boom psychology.

3. The Treasury's financing needs and the effect of fiscal operations on the money market are timing factors. The Treasury must refund

nearly $9 billion of certificates as of February 15th and this refunding will have to get under way toward the end of January and won't be digested probably until the end of February. We shall then be running into the period of March 15 tax strain.

4. At this point, I would say that the argument for an increase in the discount rate is

   (a) The situation is so strong that it can't be hurt.

   (b) An increase may help to prevent healthy strength from becoming speculation.

   (c) If we don't act now we may be frozen in for some weeks, no matter what happens.

5. There are more positive reasons for a modest increase now. Our open market policy originally labelled one of neutrality has become a policy of restraint in the face of increased public and private demands for credit. That policy of restraint resulted in a very tight money situation during the latter months of 1952. In its simplest terms you might say we offset the reserve effects of increased currency circulation by purchases of Government securities, but we forced the banks to borrow every bit of the increased reserves they needed to support credit expansion. The situation has eased ~~reasonably~~ seasonally since the turn of the year,

but unless we change our open market policy, we shall continue to offset seasonal movements and the situation will continue tight. In these circumstances interest rates are unlikely to go back to the level of the discount rate - short-term rates are now well above the discount rate. They really have already adjusted to an increase.

6. I think it is now time to bring the discount rate into line with open market policy. We have unwound the special tangle of the year-end. Our New York City member banks have reduced their heavy borrowings, and the Government securities dealers have worked off most of their repurchase agreements. We can, therefore, take action which is technically correct without damage to the market. Modest action, I believe, will also be in line with the general business and credit situation without giving a false signal that we clearly see strong inflationary pressures immediately ahead. My recommendation is that the rate on discounts of and advances to member banks be increased from 1 3/4 to 2% effective immediately upon approval by the Board of Governors.

7. If this increase is made we should also change some of our other rates to maintain proper alignment of rates.

Advances under section 10(b)

Advances under last paragraph of Section 13

Advances under section 13b.