FEDERAL RESERVE BOARD

WASHINGTON



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June 28, 1918.

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Dear Governor Harding:

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I have read very hastily Dr. Miller's memorandum. As I understand it, he favors a substantial increase in all rates of discount of Federal Reserve Banks, including the 4 per cent rate on 15-day collateral notes. His purpose seems to be to force contraction in non-essential industries and to indicate, as he says, "the desire and expectation of the Federal Reserve System that it is not to be made so easy for member banks to carry the certificates as an extra that they deed do nothing to curtail."

The position taken by him that the discount rate is the instrument by which the Federal Reserve Bank should control the credit situation, would appear to be sound in normal times, but I wish to point out that his argument logically would seem to require the putting up of all Federal reserve rates above commercial rates, for this is their normal position, unless for special reasons the reserve banks desire to reduce commercial rates, in which case by putting down Federal Reserve Bank rates, the desired reduction could be accomplished.

The present times, however, are not normal. Today war is the normal condition; and, to my mind, we must approach this rate question with a view to present conditions. I am inclined to believe that a general increase in rates would have little effect in the way of contracting, or wiping out, the non-essential industries. To my mind, it would be much more efficacious if we were to ration credit exactly as we now have to ration food, and in that way directly control non-essential industries. I think it is clear that a great deal of this has already been done by the banks throughout the country.

Dr. Miller points out that our reserve dropped between June 22, 1917, and June 21, 1918, from 71.6 per cent to 63.4; and he seems to think that our reserve situation is perilous. While these figures are accurate, they do not accurately show the whole picture. On April 5, 1917, when we entered into the war, our cash reserves were 83 per cent, while at the end of November they had fallen to 63.2 per cent, thus revealing that the placing of 6.5 billions of loans had pulled down our reserves about 21 per cent. There is, however, another more roseate view of this picture. On January 15, 1918, the last instalment of the Second Liberty Loan was due. On January 18, our reserves were 65.2 per cent, while on June 21, 1918, they had fallen to 63.4 or a decline of only 1.8 per cent. It should be remembered that during this period about 80 per cent of the Third Liberty Loan has been paid, and this, to my mind, tends to show that our reserve situation is not in as great peril as Dr. Miller fears.

On June 19, 1918, the Secretary of the Treasury offered 750 million dollars of Treasury Certificates, bearing interest from June 25. This offer has been before the people for nearly two weeks and the subscription closed on July 2nd. Meantime, the Federal reserve banks have given no notice whatsoever to the banks of any purpose to advance the rates on collateral notes secured by these certificates. It would seem to me that to increase rates on these certificates at the present time or in the near future, unless some startling new situation develops, would savor of bad faith with the banks which have taken these certificates.

It seems to me the banks had a right to assume, in the absence of some notification from the Federal Reserve Board, that no immediate change - at least in these rates - was contemplated.

I believe the discount of member banks' notes secured by United States bonds or Treasury Certificates, is largely confined to operations in the way of financing the Government by the purchase of these certificates. For the whole system, on June 21, about 50 per cent of the total bills discounted, excluding acceptances, consisted of member banks' collateral notes, of which about 92 per cent were secured by Liberty Bonds or Certificates. At the Federal Reserve Bank of New York on June 21, about 65 per cent of the total bills discounted, excluding acceptances, consisted of member banks' collateral notes, on which all of the collateral was Liberty Bonds or Certificates.

I believe we should move very cautiously and conservatively in the matter of increasing rates, and especially on member banks' collateral notes. In a matter such as this I should place great reliance on the judgment of the Federal Reserve Banks of New York and Chicago. They are in the field, and I should hesitate to disregard their judgment, unless it were shown beyond a reasonable doubt that their judgment is in error. I do not know what their judgment is, and regret that I can not be at the meeting, but I have given you my views very hastily, for such use as you may care to put them to.

Quote

Very truly yours,

C. S. HAMLIN.

Hon. W. P. G. Harding,
Governor, Federal Reserve Board.