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A BRIEF DISCUSSION OF PRESENT CONDITIONS

Address by

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

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There is an old saying - of Chinese origin, I believe - that "Things are never as good or as bad as they seem". We should take this philosophy to heart at the present time.

Price recessions and the resultant conditions are not peculiar to this country alone, but obtain everywhere [(1)] and in countries where there has been the greatest inflation of credits and currency the distress is most acute. Nor are present conditions unprecedented as far as particular nations are concerned, although it is true that a world-wide situation which depresses all basic industries and productive activities is unusual. In this country we are passing through a period of readjustment which it was expected we would enter into immediately after the signing of the armistice. In fact for a few months after that event there was an unsettlement in prices and a hesitation in business, but an urgent demand for commodities and manufactured goods soon developed which required satisfaction at any cost and prices bounded upward until they attained levels never before reached in the memory of the present generation.

In reviewing the conditions which existed a year ago, we all realize now what was sensed by many at the time, that things were not as good as they seemed, for price levels were unnatural and the burden of the high cost of living was too great to be permanently endured. It was generally recognized many months ago, following the collapse of the Japanese silk market early last spring, that sweeping price readjustments were inevitable. In fact, a year ago last summer the continued expansion of credits and the constantly advancing costs of living became objects of grave public concern. The Senate

(1) See Appendix "A".

of the United States on August 5th, 1919, addressed a communication to the Federal Reserve Board on the subject. Shortly afterwards the President in an address to Congress discussed these questions. From that time until the adjournment of Congress last June these matters were the subject of frequent discussions in both houses. On the 17th of May last, the Senate addressed a resolution directing the Federal Reserve Board "to advise the Senate what steps it purposes to take and to recommend to the member banks of the Federal reserve system to meet existing inflation of currency and credit, and consequent high prices, and what further steps it purposes to take or recommend to mobilize credits in order to move the 1920 crop." Reference is made to these incidents in order to direct attention to the trend of legislative sentiment a few months ago. In marked contrast are the efforts now being made to secure legislation to force expansion of credit and currency with a view of advancing prices.

The Federal Reserve Board is not charged with any responsibility for prices or living costs. It is a banking board, which exercises a general supervision of the Federal reserve banks, and the rates of discount which are fixed by the Board, following recommendations of the directors of the Federal reserve banks, are not fixed primarily with reference to prices. The Board cannot with propriety establish rates with a view of putting prices up or putting them down. In the determination of Federal reserve bank discount rates consideration must be given to general conditions and to current rates, and in the rate revisions which the Board has approved from time to time the view has always been taken that discount rates should not be pegged or fixed arbitrarily, for there are always certain basic conditions related to the demand for and the supply of credit in this country and throughout the world which must be taken into account, and the formal establishment of a Federal reserve bank rate is merely an interpretation of these conditions.

Federal reserve banks are not permitted by law to have direct dealings with the public but they may rediscount for member banks upon their endorsement eligible paper as defined by the Federal Reserve Act representing loans or advancements made by the member banks to their customers. The lending powers of National banks are broadly defined in those sections of the Revised Statutes of the United States commonly known as the "National Bank Act", and those of the State banks and trust companies which are members of the Federal reserve system as well as those of the institutions which are not members are governed by the laws of the respective states in which these institutions are located. There is no centralized control over the discount policy of the individual member and non-member banks, and the Federal Reserve Board cannot compel banks to make loans which they do not desire to make nor can it restrain them from making loans which in the lawful exercise of their discretion they may make.

Normally the discount rate of a Federal reserve bank should not control the rates at which member banks loan money to their customers. In the countries which have central banks there is a well-established policy that the central bank discount rate should be maintained at a figure slightly in excess of the current market rate. The wisdom of such a policy is apparent for it eliminates all consideration of profit in rediscount transactions and gives the central bank better control over its own reserves and causes the banks which deal with the public to rely to a great degree upon their own resources in extending accommodations while still affording them an outlet for any undue accumulation of loans. Because of the exigencies of war financing, it has not been practicable for the Federal reserve banks up to this time to adopt this policy and as a rule Federal reserve bank discount rates are lower than the rates charged by member banks. It is believed that conditions are gradually adjusting themselves so that Federal reserve bank rates may be maintained at a level slightly higher than current rates not only without any disturbance to commerce and business but to their distinct benefit. In fact, this adjustment has already begun in some cities where member banks have reduced their rates on commercial loans.

In ordinary circumstances banks rely upon their own lending power as measured by the sum total of their capital, surplus and deposits, and rediscount or borrow money only at certain seasons of the year, or at other times when unexpected demands are made upon them. Formerly it was not regarded as a sound policy or good practice for a bank to permit its loans to be habitually extended to a point which obliged it to be constantly indebted to other banks for borrowed money. Before the Federal reserve system was established banks were required to carry in their own vaults a certain percentage of their net deposits in gold or lawful money as a reserve. This percentage of reserve was considerably higher than that which is now carried. As regards national banks, the reserves required were 25% in gold or lawful money for banks in the central reserve cities, New York, Chicago and St. Louis, for all other reserve city banks 12½% cash in vault, and 12½% with banks in central reserve cities, and for country banks 6% cash in vault, and 9% with banks in reserve or central reserve cities. This percentage of reserve applied to the time deposits as well as to demand deposits. The framers of the Federal Reserve Act felt that with the Federal reserve banks established and a dependable means of rediscount provided, these reserves could be lowered with safety, thus increasing the lending power of the banks in a corresponding degree. The present law does not require any member bank of the Federal reserve system to carry any specific amount of cash in its own vault. All lawful reserves are kept with the Federal reserve banks. Banks in central reserve cities must carry with the Federal reserve bank a balance equal to 13% of their net demand deposits, banks in reserve cities 10% and country banks 7%. On time deposits the reserve required in all cases is only 3%. The Federal Reserve Act, therefore, has greatly increased the normal lending power of the member banks out of their own resources, leaving out of consideration entirely the additional lending power they can acquire by rediscounting with the Federal reserve bank.

The extent to which the discount facilities afforded by the Federal reserve banks are now being used shows that through the medium of member banks the Federal reserve banks are participating actively in extending credits. On August 22, 1907, just before the panic of that year, bills payable and rediscounts of all national banks amounted to $59,177,000 against total loans and discounts of $4,709,027,000, the percentage of bills payable and rediscounts to total loans being 1.26%. On September 23, 1908, the percentage was 1.11%; on September 12, 1914, total bills payable and rediscounts had increased to the then unprecedented amount of $150,071,000, or

2.34% of the total loans, which amounted to $6,417,910,000. This increase was due to the disturbance incident to the outbreak of the European War. On September 12, 1916, bills payable and rediscounts had fallen to $91,893,000, or 1.16% of the total of loans of all national banks. On September 11, 1917, the first year of our participation in the war, bills payable and rediscounts amounted to $285,104,000, or 3.09% of the total loans, $9,234,289,000. These figures, of course, reflect war financing. The same observation will apply to figures compiled from reports of conditions of national banks on August 31, 1918, and September 12, 1919, when the percentages of rediscounts to total loans were 12.8% and 13.04%, respectively. There has, however, been no new financing by the Government since the flotation of the Victory Loan; the total volume of Government obligations outstanding has decreased since September 12, 1919, when rediscounts and bills payable of all national banks amounted to $1,505,516,000, while on September 8, 1920, the national banks' liability for money borrowed in this way amounted to $2,299,640,000, or 16.8% of their total loans of $13,723,611,000. The figures for state banks and trust companies are not available, but there is no reason to believe that the proportion of money borrowed by these institutions to their loans and discounts is any less than that shown by the national banks.

The impression exists in the minds of many that the Federal reserve system has adopted a policy of radical deflation and that the farming interests have been the chief sufferers from this policy. No such policy has ever been undertaken and as a matter of fact there has been during the past year an increase and not a reduction in the net volume of bank credit and currency. There has been no policy looking towards a broad curtailment or deflation of credit but efforts have been made to correct abuses and to bring about moderation and better judgment in the use of credits which a year ago were being diverted into all kinds of speculative and non-productive channels. Efforts have been made also to conserve the resources and credit power of the member banks and of the Federal reserve banks in order that they might better respond to the seasonal needs occasioned by the harvesting of the crops.

I do not wish to burden you with statistics, but in order to correct wrong impressions I desire to call your attention to the following. On September 19, 1919, the total earning assets of all Federal reserve banks were in round amounts $2,350,000,000, while on January 27, 1920, the total was nearly $3,300,000,000, an increase of almost $1,000,000,000, or nearly 50% within a period of four months. There is no banking system strong enough to sustain itself very long at so rapid a rate of expansion of credit, and while no drastic deflation was attempted, measures were taken to regulate the credit expansion. Discount rates were advanced and this action brought about a moderate amount of liquidation, the earning assets of the Federal reserve banks being reduced in the course of sixty days by about $100,000,000. By the middle of May, however, the total loans and investments of the Federal reserve banks approached again their previous high level and the Board called the attention of the banks and the public to the importance of marketing the crops of 1919 before those of 1920 were harvested, and of reducing borrowings at the Federal reserve banks until the seasonal requirements of the autumn should develop. Banks were advised in cases where it should become necessary for them to discriminate in the matter of making loans to give preference to essential credits, which included all credits related to legitimate productive activities, and they were told at the same time that they themselves must be the judges of the essential character of the purposes for which loans were asked of them.

On July 23rd, just before the crop moving demands began to be felt, the total loans and investments of the Federal reserve banks had declined from the high point about $150,000,000, and stood around $3,150,000,000. Since that date they have advanced steadily with occasional slight recessions until December 3rd when the total amount reached $3,333,792,000, as compared with $2,933,082,000 on December 5, 1919. Federal reserve notes in circulation on December 3, 1920 amounted to $3,312,039,000, as against $2,881,359,000, on December 5, 1919. You will see therefore that as far as the Federal reserve banks are concerned, no contraction of credit or currency has been had during the past twelve months, but on the other hand there has been an increase in Federal reserve bank credit of $400,000,000 and in currency of $430,000,000.

You are, however, most interested in knowing to what extent credit has been available for agricultural purposes. It will be impossible to give precise information on this point until the reports recently called for by the Comptroller of the Currency from national banks have been tabulated and the digest made public. The Comptroller has asked each national bank for a statement both of direct and indirect loans to farmers. The Federal reserve banks in agricultural districts have been rediscounting heavily for several months past with Federal reserve banks in the industrial districts. Three banks, the Federal reserve banks of Boston, Philadelphia and Cleveland, have advanced at times as much as $250,000,000 to seven other Federal reserve banks, whose districts are largely agricultural. The total amount of bills discounted by Federal reserve banks in distinctly agricultural districts is about $1,500,000,000. Early in the season Federal reserve banks in these districts were asked to estimate the proportion of their total loans directly in support of the agricultural and livestock interests. The estimates for September, 3, 1920 were as follows: Federal Reserve Bank of Richmond, 27.3%; Atlanta, 23.7%; Chicago, 48.3%; St. Louis, 22%; Minneapolis, 65.6%; Kansas City, 59.8%; Dallas, 50% and San Francisco, 58.7%. In some of these banks the proportion of agricultural paper held is much greater now than on September 3rd. It is certain that there has been no curtailment of agricultural credits by the Federal reserve banks and while, as I have stated, exact figures of member bank transactions are not yet available, it seems reasonable to assume that there has been a very large volume of credit extended by member and non-member banks in support of the agricultural interests.

Senator Owen has recently called attention to the fact that "The individual deposits of New York City banks, which were November 12, 1919, $6,313,998,000, were reduced on November 10, 1920, to $4,916,375,000, a net loss of deposits in New York City of about $1,400,000,000, and a net reduction of loans amounting to a similar amount", and that "While the individual deposits and loans of New York City banks were coming down, the total deposits of all the banks of the country, including bank deposits, increased according to the Comptroller's letter of October 13, 1920, $4,045,164,000, and loans increased $5,805,736,000 (including overdrafts and discounts) for the fiscal year ending June 30th, 1920."

I am a firm believer in the policy of gradual and orderly methods of marketing our great agricultural staples. All will agree that agriculture is the basic and fundamental industry, for upon its fruits depend the lives of those engaged in all other industries. The farmer is a great consumer of manufactured products and anything that affects his buying power is soon reflected in the business of the merchant and manufacturer. Conversely a depression in manufacturing and other lines of business is reflected in the reduced demand for farm products. I cannot conceive of anyone questioning the fact that farming as a business must be remunerative or production will languish. It is highly desirable that the efforts of the farmer be supported and stimulated in every proper way and that he be aided in preserving the full measure of his harvests and that he be given an opportunity of marketing his products on terms sufficiently profitable to warrant his staying in the business of farming. It is well to consider, however, that in other lines of business, profits are not always continuous. This is also true with respect to farm industry. The farmer, however, as a rule, has only one turnover a year, while those engaged in other enterprises have the advantage of more frequent turnovers. Great staple crops, the production of which extends over a period of several months must meet the requirements of consumption until the next season's crops are produced. In order to prevent possibility of shortage, it is desirable that there be a certain surplus held over from one crop pending the marketing of the next. It is important, however, that the surplus held over be not too large or unwieldy, for the marketing of a crop and a half when the ordinary requirements call for only one crop means a loss unless an unforseen abnormal demand should develop. The gradual and orderly marketing of great staple crops is a matter of importance both to producer and consumer. The dumping upon the market within a short period of time of a large part of a crop, the consumption of which extends throughout the year, means not only loss to producers, often to those who can least afford it, but involves also a great strain upon our transportation facilities and upon the banks in providing the funds necessary for large purchases in advance of actual requirements for consumption. The dumping of farm products promotes speculation and usually results in higher prices to the ultimate consumer.

I take this occasion to say that the members of the Federal Reserve Board have a keen sympathy for the farmers in their present predicament and are desirous of doing everything they can legitimately and properly to help them. It is impossible, however, for any banking system to provide funds for withholding all staple crops entirely from the market for any length of time. The volume of our great staple crops is so large and their value so great that any efforts to valorize them by means of bank credits would inevitably result in disaster to the community in general and to the farmer especially. Orderly marketing means marketing; it means steady sales and steady purchases. Gradual sales make possible the gradual liquidation of debts, and as the maturity of so many obligations synchronizes with the marketing of staple crops, it is probably no exaggeration to say the liquidation of a million dollars of farmers' indebtedness means the liquidation of four or five millions dollars of general debts. Your convention will no doubt consider means of preventing in future a repetition of present conditions. I assume [redacted] that you will consider cooperative marketing, greater diversification of crops, and the maturing of farmers obligations over periods extending from October to March. I suggest also that you do not overlook the importance of minor crops as a means of giving the farmer an additional turnover. I assume also that you will consider the processes of marketing and ascertain why in many cases commodities which are sold by the farmer at less than the cost of production are sold to the ultimate consumer at high prices. I am aware also that there is much apprehension on the part of farmers as to their current indebtedness. The present crops were produced at abnormally high costs and many farmers, no doubt, have stuff on hand for which there is now no ready market, or which cannot be sold for enough to liquidate their debts. Such a situation calls for the closest cooperation between the farmer, and the merchant and banker with whom he deals. I have no authority to speak for the banking business in general, but I do know that as a rule the banker realizes that the welfare of his own institution depends upon the prosperity of the community in which his bank is located. The average banker is averse to foreclosures or other drastic methods of liquidating indebtedness, except as a last resort, and my opinion is that if the farmer will go to his banker or merchant creditor and make a frank statement of his condition, giving additional security if available and if required, and agree to make gradual sales of his produce as the market develops, applying the proceeds on his indebtedness, he will be able to make arrangements for present pressing needs and for requirements for another season. Many farmers have had this experience in years when there has been a crop failure. This is a year of physical plenty and the farmers' troubles arise from price derangements. The decline in prices of all agricultural staples has been very marked, and some may not be salable in the present circumstances at any price. Such commodities, of course, must be carried over for account of some one and they had better be carried for the account of the producer. Other staples can be sold at a price and gradual sales of these staples will, in my opinion, stabilize the entire situation. The resumption of activity on the part of woolen mills and cotton mills will revive the demand for wool and cotton, and the continued employment of labor will stimulate the demand for foodstuffs and all other farm products.

I shall not undertake to predict the course of prices but I will say that prices are relative and that barring shortages prices of all commodities and goods tend in the long run to rise and fall together. While the decline in prices of the goods the farmer has to buy has not been commensurate with the slump which has taken place with respect to his own products, there is every reason to believe that within a short time these inequalities will adjust themselves - either the price of farm products will advance or the price of other goods will decline. Thus in the event that there is no substantial improvement in the price of farm products, it seems certain that the cost of producing next year's crops will be greatly reduced.

While it is true that the greater volume of our staple crops and the larger part of our manufactured goods are consumed at home, the maintenance of our export trade is of the greatest importance to farmers and manufacturers, for ability to dispose of surplus products abroad is a potent factor in the determination of the price at which goods are sold at home. The great need of the world today is peace and revival of the industries of peace, the reestablishment of trade relations between the nations, and in my judgment the surest means of relieving present conditions permanently lies in the development of our foreign trade upon a basis of assured permanency. This subject is too complex to admit of its discussion here, but I refer to it merely to emphasize the fact that the farmer is vitally effected by things which lie beyond his own horizon. All these matters are pressing for solution and are being considered by those in administrative and legislative authority and by banking and trade organizations all over the country. In the meantime it is most desirable that there be no feeling of undue depression or dispair. Remember that things are not as bad as they seem and that a morale which it is so necessary for an army to maintain in a military campaign is just as essential in fighting against industrial and business depression. Let us look on the bright side and take care before advocating measures which may seem to hold out promise of temporary relief to consider their ultimate results. One of the most effective utterances of the President-elect during the recent campaign was his statement that he favored "More business in Government and less Government in business". We must remember that war-time measures are not generally adapted to peace conditions; but no matter what the course of legislation may be, the solution of our economic and financial problems will depend mainly upon individual effort, and calls for good judgment and forbearance, self-reliance and cooperation, and a display of courage and optimism, which after all, is really justified by fundamental conditions.

PRICE REDUCTION OF IMPORTED ARTICLES

That the fall in prices, which has recently become pronounced in the United States is not confined to this country, but is well nigh world wide in its operation may be seen from an examination of monthly average import prices of commodities entering the United States. These figures, a summary of which for the most important commodities is presented below, are based on the wholesale price of articles in the markets of the countries from which they are imported:

Monthly average import prices of selected articles.

Article	Unit	1919 September	1919 December	1920 March	1920 June	1920 September	1920 October	Principal Country from which imported.
Cocoa, crude	pound	$ .184	$ .156	$ .179	$ .168	$ .116	$ .117	British West Africa and Ecuador
Coffee	"	.24	.223	.215	.206	.166	.164	Brazil, Central America and Colombia
Hemp	ton	582.25	338.90	430.50	456.66	545.60	475.79	Philippines
Jute and jute butts	"	96.88	180.40	113.65	122.12	51.80	77.55	India
Manila	"	225.90	237.93	300.80	348.71	292.58	310.62	Philippines
Sisal grass	"	295.00	207.66	214.17	202.21	150.14	125.98	Mexico
Calf skins	Pound	.497	.577	.632	.561	.367	.364	France, Dutch East Indies and India
Cattle hides	"	.33	.363	.354	.341	.258	.222	Argentina, Canada
Goat skins	"	.776	.366	1.21	1.19	.994	1.07	China and British India, Brazil
India rubber	"	.372	.452	.453	.458	.393	.367	India and Brazil
Olive oil	Gallon	2.13	2.16	2.54	3.26	3.01	3.11	Spain, Italy and France
Paper, newsprint	pound	.0355	.0363	.0421	.0431	.0512	.0552	Canada
Silk, raw	"	8.04	9.61	12.28	9.99	6.56	6.42	Japan and China
Sugar cane	"	.0555	.0651	.0832	.1611	.1501	.1395	Cuba
Tea	"	.257	.241	.243	.305	.264	.266	Japan, India and China
Tin	"	.534	.541	.566	.615	.551	.522	Straits Settlements
Pulp, wood	Cord	10.53	9.85	10.35	14.12	14.61	14.93	Canada
Wood pulp, unbleached	ton	73.70	76.85	77.80	114.83	142.10	148.98	Canada and Sweden
Wool, clothing	pound	.473	.553	.663	.659	.437	.433	Argentina, Uruguay, United Kingdom, Australia and British South Africa.

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Appendix "A"

Decided reductions are shown for many articles of food. Cocoa, for instance, worth about 18 cents a pound in September of last year was valued at less than 12 cents a pound in September and October of this year. Coffee dropped in price from 24 cents in September, 1919, to 16.4 cents in October, 1920; cane sugar, valued at 5.5 cents a pound in September of last year, rose to 16.1 cents of June of the present year, but dropped below 14 cents in October; since that time a further precipitate fall is known to have occurred and the November price of sugar will be likely to be only a little higher than a year ago. The price of olive oil, on the other hand, was $3.01 per gallon last October, as compared with $2.13 in September, 1919. The October price, however, is 15 cents a gallon lower than the peak price shown for June. Tea is also somewhat more expensive than a year ago, but its price of 26.6 cents a pound in October marks a perceptible recession from last June, when the average was 30.5 cents a pound.

Notable declines in price are shown for hemp, which was valued at $475.79 a ton in October, compared with $545.60 in September of this year, and $582.25 in September, 1919, for sisal grass, and for cattle hides, while goats skins have advanced in price from 77.6 cents a pound in September of last year to $1.07 a pound in October of this year. Rubber was somewhat cheaper than a year ago, and twenty per cent cheaper than last July. Raw silk, which had risen to $12.12 a pound last March, had dropped to $6.42 a pound in October, and wool, which also was at its maximum price in March, when it averaged 66.9 cents a pound, had dropped to 43.3 cents a pound in October.

Among the principal commodities, for which advances in price are shown is jute, which rose from $51.80 a ton in September to $77.55 a ton in October, but is still far below its maximum price in June and below the price shown for September, 1919; in view of the very poor jute crop reported from India, it is possible that a further advance in the price of jute will take place. The largest and most consistent price advances are shown for paper and the raw materials from which it is manufactured. Paper rose from 3.5 cents a pound in September, 1919, to 5.5 cents in October of this year; pulp wood rose from $10.53 to $14.93 a cord, and wood pulp from $73.20 to $148.98 a ton during the same period. In the case of paper, a growing world-wide demand combined with a decreasing supply of raw materials, results in a price movement at variance with the general downward trend.

A column is added in the table indicating the principal countries from which each article is imported and thus emphasizing the fact that the price movement under discussion encircles the world.