F E D E R A L R E S E R V E B O A R D

STATEMENT FOR THE PRESS

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Address delivered by

Governor Roy A. Young,

before the

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of the

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on

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In the eighteenth century Frederick the Great, who knew whereof he spoke, said that there were three things necessary for war: first - money; second - money, and third - money. This statement made more than two hundred years ago is even more completely true at the present time. Changes in methods of doing business, however, have changed the character of money which was then primarily specie, and now consists largely of bank credit. The fundamental importance of money and, therefore, of banks to the prosecution of wars makes banks carry the chief financial burden of the struggles, and central banks which conduct their business primarily with reference to the public interest feel the strain of war even more than do commercial banks. It is the central bank that supplies to the government whatever currency it may need during periods of war inflation, and central bank reserves in times of war are put at the disposal of the nation and, therefore, become one of the stakes whose fate depends on the fortunes of war.

The terrible experiences of the struggles of 1914-1918 have demonstrated that the soundness of monetary conditions cannot withstand the onslaught of war. Central banks at the present time, therefore, are interested in maintaining peace and for that purpose of maintaining international goodwill. As a matter of fact, cooperation between the central banks rather than mutual jealousies, has characterized the post-war period. The United States, for example, has come to the assistance of all the principal central banks when they have undertaken the reconstruction of their currencies, and all the important banks of issue have joined together in supporting the endeavors of smaller countries to reestablish their currencies on a sound basis. When Belgium stabilized her currency there were fourteen or fifteen central banks that lent their support to the undertaking and the same was true at the time of stabilization in Italy and in Poland. This cooperation between central banks towards a common end has contributed to the establishment of mutual respect and understanding which will be helpful in finding solutions to international financial problems long before they can develop into causes of misunderstanding or friction, to say nothing of war.

In playing its part in the world's monetary reconstruction, the Federal reserve system has been placed in a position that has enabled it to render more valuable assistance to other countries than could at this time be rendered by any other central banking system. As a consequence of the war, the United States has 40 per cent, or more, of the world's monetary gold stock, and also has larger foreign investments than any other country in the world. In these circumstances, the Federal reserve system has realized that cooperation with other countries towards the reestablishment of sound monetary conditions is not merely an act of international comity, but is also essential in the interests of this country itself. Sound money conditions abroad enable American producers to supply the needs of their foreign customers without running the hazards arising from unstable foreign exchanges. They also increase and stabilize the buying power of foreign countries and thus contribute to the ability of these countries to purchase our goods. In these post war days, the United States can no longer remain economically aloof from the affairs of the world. Her foreign trade amounts to close to $10,000,000,000 a year; her foreign investments aggregate no less than $25,000,000,000, and her financial and commercial relations with the outside world have become a much greater factor in national prosperity than they were fifteen or twenty years ago. Sound domestic credit policy, therefore, as well as the desire to be of service in world reconstruction, have caused the Federal reserve system, in formulating its credit policies, to take into consideration the effect that these policies may have on the reestablishment and maintenance of the international gold standard.

The course of credit developments in the United States since the middle of 1927 illustrates the manner in which foreign conditions may enter into the consideration on which Federal reserve policy is based and it will be of interest to review briefly events during this period. In the summer of 1927 credit conditions in Europe were extremely tight. Of the great countries England, though on the gold standard for over two years, was struggling under the handicap of a serious economic depression; France and Italy had maintained stable the value of their currencies, but had not yet established a definite legal relationship between their monetary units and gold. Autumn was approaching, when foreign countries import the largest volume of American products, and when their exchanges are under the severest pressure for making payments to the United States. It appeared as though it would be impossible for European countries to pass through the period of autumn strain without either losing gold, which they could ill afford, or tightening interest rates, which would further delay the recovery of trade and industry. In the United States trade and industry were showing signs of recession. Commodity prices had been declining for about two years; the temper of the business community was cautious, though the stock exchange was active and the volume of credit it employed was large and growing. After carefully canvassing the situation the Federal reserve system reached the conclusion that its influence should be exerted towards easier money conditions in this country, which would encourage business at home and simultaneously would assist the foreign countries to pass safely through a period which otherwise might endanger the maintenance of the gold standard. Although the system realized that easy money in this country might be an encouragement to further stock exchange activity, nevertheless it determined that this would be the lesser of two evils and decided to adopt a policy of easing the money market.

In carrying out this plan discount rates at all the twelve Federal reserve banks were reduced from 4 to 3 1/2 per cent in August and September and the system also purchased a moderate amount of Government securities. By thus placing funds at the disposal of member banks the reserve banks enabled them to reduce their indebtedness at the reserve banks and to put themselves in a position of granting loans to their customers at relatively low rates. This policy had a good effect on business in the United States and particularly on the volume of agricultural exports. At the same time, it not only obviated the necessity for foreign countries of shipping gold to the United States, but brought about a reversal in the direction of gold movements, so that gold began to move in large volume out of the United States. Owing to the lower rates of interest in this country a part of the financing, which would normally have been done in England and on the Continent, was done in the United States. Also surplus funds, which always flow to the most profitable market, were moved from the United States to Europe thus further relieving the tension. Sterling exchange advanced sharply and the Bank of England was able to maintain its discount rate without losing gold.

The gold movement, which began at that time and in the aggregate amounted to about $500,000,000, has been an important factor in strengthening the reserve position of European central banks. Italy and France have now legally stabilized their currencies, and financial conditions have been so much strengthened by this autumn that the firm money policy adopted by the reserve system with reference to domestic conditions has caused no embarrassment to foreign countries.

In the autumn of 1927, when the gold movement first began, the Federal reserve system, in pursuance of its policy of easier money, purchased Government securities to offset the effects of gold exports on the money market, but when the period of greatest strain was passed it discontinued this process and since that time exports of gold have been permitted to exert their influence on credit conditions in this country. Speculation on the stock exchange continued, and in view of a rapid expansion of loans on securities with only a moderate demand for credit from trade and industry, the Federal reserve system not only permitted the gold exports to operate as a tightening influence on credit conditions, but also exerted its influence in other ways toward firmer money conditions. Beginning in January the reserve banks sold a large amount of Government securities, and early in the year began gradually to advance discount rates from 3 1/2 per cent to a level of 5 per cent at eight of the reserve banks and 4 1/2 per cent at the remaining four banks.

Because of the loss of gold and of the system's firm money policy, together with a growth in the early part of the year in the volume of bank credit, money conditions became increasingly firm and interest rates in the autumn of this year have been higher than at any time since 1921. These firm conditions in the money market have resulted in discontinuance of the outward gold movement, and in fact, since the middle of the summer there have been gold imports amounting to nearly $50,000,000. The advance in money rates has been felt particularly by dealers in securities, as the call rate has frequently been as high as 8 per cent this autumn. The growth in the volume of bank credit, which had been very rapid in the early part of the year, slowed down in the late spring and after considerable fluctuations was not as high in November as in May. The decline has been in the banks' investments and in loans on securities, which include loans to brokers and dealers. Brokers' loans by banks, as distinguished from those by corporations and others, are smaller now than in the middle of May. Commercial loans, on the other hand, continue to increase and the demands of business in connection with autumn trade expansion and the marketing of crops were met by the banks without difficulty. It is true that the cost of credit to industry advanced somewhat, but the advance was much less than the rise in the cost of credit to traders in securities, and the advance in money rates appears not to have had any bad effects on business conditions. Inquiries made by the Federal Reserve Board on this point have brought in replies from all Federal reserve banks to the effect that business conditions have not been unfavorably affected by higher interest rates, and the latest business reports indicate continued and growing prosperity.

This story of reserve bank policy during the past year, which I have given in some detail, brings out the manner in which conditions abroad have been taken into consideration in the system's deliberations about its credit policies, and the way these policies have worked out. It shows that conditions abroad have become an important factor in the domestic and credit situation in the United States and as such receive consideration in the formulation of credit policies. The need of keeping informed on foreign conditions has brought about the necessity of broadening the system's sources of information, and for this reason the system has participated in international conferences of business economists. Last spring it sent delegates to a conference of central bank economists held in Paris, and at this moment it is represented at a conference of business statisticians in Geneva.

The conclusion that I have reached during the year that I have been with the Federal Reserve Board, is that participation in world affairs is a matter of enlightened self-interest for the United States. I feel confident that a similar attitude towards international cooperation prevails among the authorities of the principal European central banks. The mutual respect and confidence which have developed as a result of joint undertakings by the central banks and the consideration shown by them for each other's problems and difficulties augur well for the maintenance of cordial relations between nations; in other words, peace and world prosperity.