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STATEMENT FOR THE PRESS

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ADDRESS

DELIVERED BY

GOVERNOR ROY A. YOUNG,

BEFORE THE

COMMERCIAL CLUB OF CINCINNATI, OHIO,

SATURDAY EVENING,

MARCH 16, 1929.

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Mr. toastmaster and members of the Commercial Club of Cincinnati:

I am most grateful for the opportunity to visit your delightful city and I am particularly pleased to be with you this evening and to have the privilege of speaking before you. The situation is such at the present time that some of my intimate friends have suggested that I guard my language carefully so that excerpts from my talk can not be misinterpreted. This I have attempted to do, but at the same time, I am going to attempt to get across to you concisely the present credit situation as I see it.

Credit is a great invisible commodity which plays an important part in our everyday life. Economists, statisticians, and others tell us it is based upon gold, and their statement is correct as far as it goes. It has been my experience, however, that the big factor in the credit structure is confidence, and industry and energy contribute in no small way toward maintaining confidence. In other words, credit is synthetic - manufactured if you will. Gold is one element, but confidence is the predominant ingredient.

Tonight I expect to touch upon the volume of bank credit only incidentally and confine myself chiefly to the subject that I believe is uppermost in all of our minds at the moment, and that is the cost of credit.

The credit world is composed, as I see it, of borrowers, lenders, and bankers who are the middlemen. Borrowers are interested in low rates and lenders are interested in high rates. Inasmuch as bankers are borrowers from their depositors and lenders to their borrowers, they are opposed both to abnormally low rates of interest and to abnormally high rates. Their interest lies chiefly in a continuous smooth operation of the credit machinery.

During recent years we have experienced both low and high rates. From 1920 to 1924 there was a large import movement of gold into this country, which permitted an unusually large expansion of credit in all lines. With this unusual opportunity for manufacturing credit, it was brought into existence and pyramiding continued in great volume until 1927, even though our gold holdings were not increased in any appreciable amount between 1924 and 1927. Money rates during this period were at a low level.

In 1927 an export movement of gold started and continued until June, 1928, resulting in a total net reduction in our gold holdings of approximately $500,000,000. Therefore in June, 1928, we found ourselves supporting a greatly increased credit structure with $500,000,000 less gold than we had in 1924. The loss of gold compelled member banks to plug up the holes in their reserves by borrowing from the Federal Reserve System. When banks borrow from the System, tradition enters into the picture and because of the eagerness of individual banks to get out of debt, credit becomes less easily obtainable and rates begin to firm. Therefore, since August 1927, when this export movement of gold started, there was a gradual tightening of credit and a firming of rates. At first it was not appreciable, but at the present time I think we are all cognizant that rates are much higher for all kinds of credit than they were in August of 1927.

For six years or more there has been an unusual demand for a form of credit that can properly be termed speculative; in fact, the unusually high rates that prevail in that field make it evident that the demand has pressed hard on the supply, as measured by the willingness of the banks to lend for these purposes. However, when the funds were not forthcoming from the banks, which are the regular distributors of credit, the speculator made the rate so attractive that corporations and individuals, both foreign and domestic, supplied the funds. The unusual demand for this particular form of credit has had an effect upon the cost of all other forms of credit, so that practically all lines of commerce and industry have been affected to a certain degree, although from all I can observe at this time, the increased rates to commerce and business have not so far been a deterrent to active operation.

Generally speaking, the rates to the speculator have been increased from a minimum of 3-1/2% to a maximum of as high as 15%. The open market commercial rate, which enjoys the advantage of several markets, has risen from 4% to 5-3/4% and 6%. Bills which finance the distribution of commodities, have risen from 3-1/8 to 5-3/8% and 5-1/2%. Rates charged by banks for over-the-counter borrowing by customers have also advanced by between 1% and 1-1/2%. The intermediate credit banks are paying about 1% more to float their debentures, which of course, is passed on to the borrowers, and livestock loan companies have had to pay from 1% to 2% more, which also, to a more or less degree, is passed on to the producer. Those who have resorted to long-time investment credit and have financed their affairs through bonds, have also been required to pay a higher rate, depending upon the character of their business.

From the banker's point of view, he has had to pay higher rates to his depositors, and what he has gained by higher rates through his discount wicket, no doubt will be largely offset, in the last analysis by the higher cost of his deposits, by what he has lost in the depreciation of his bond account, and by losses that invariably develop during a period of expansion, although not usually discovered until periods of depression.

There are many people in the United States who feel that, because of some power that I am frank to confess is unknown to the Federal Reserve Board, low rates could be maintained to commerce and industry indefinitely, even though the speculator pays higher rates. I want to remind you that there are approximately 27,000 bankers in the United States, and in the conduct of their own institutions they operate as independent units, and while from what I have been able to observe, they take care of local needs, when they have funds to employ outside of their own community and are offered call loans at rates from 3 to 4% above credit based upon production and distribution, obviously, they extend that credit which brings the best rates, all other things being equal. This forces the commercial borrower to make his offer more attractive, with the result that in the course of time everyone pays higher rates. While up to the present time commerce and industry have enjoyed lower rates than the speculator, this process of lifting may go to a point where it will become a serious deterrent to business, and it is that phase of the present situation with which the Federal Reserve System most concerns itself.

Nor is this problem a local one. It is not alone of national but of international significance. High rates have drawn credit and gold from many quarters of the globe to satisfy the appetite of the speculative borrower. Two foreign banks of issue have already had to raise their rates to protect their own position. If this continues others will no doubt have to follow, and those countries will go through the experience of lifting rates around a circle until they may get to a point where they will not only have a bad effect on the trade of the foreign countries, but would seriously interfere with the exports of this country. It is needless for me to go into details and remind you what will happen to our own people and our own industries if our exports, particularly of agricultural products, do not flow freely because of lack of credit or because of the cost of it. To put it baldly, the final cost may not be reckoned in terms of interest charges alone but may involve the impairment of the prosperity of our commerce and industry.

Many remedies for the present situation have been advanced. One solution suggested is that the System should reduce rates and buy Government securities in an effort to ease the situation to such an extent that lower rates will be available to commerce and industry. However, the advocates of such a plan apparently overlook the fact that any such procedure at this time would result in an invitation to the speculator to proceed at an even more rapid rate than in the past.

Another solution offered is that we do nothing and let "nature take its course". There are many prominent men in the United States who feel that the System, for the past year, has in fact, followed that course. However, when I remind them that the System has taken approximately $700,-000,000 out of the market by failure to offset gold exports and by the sale of a substantial amount of Government securities, and has raised the discount rates on three occasions, I think they will have to agree that the System has done a great deal; in fact, if any such procedure had been suggested in August of 1927, I am afraid the originator of the idea would have been branded as a panic producer.

There are others who believe that the System is able to earmark its credit in such a manner that it can, by some wonderful formula, brand the credit it releases and confine its use to approved purposes, but anyone with practical banking experience knows that this is impossible, except for what the System may be able to accomplish through the cooperation of the banking and business interests. It was in an effort to enlist this cooperation that the Federal Reserve Board issued its public statement on February 7.

Another group believes that the System should resort to the orthodox and traditional method of correction by a rediscount rate which they think will accomplish the results desired. In making such a suggestion, however, they overlook the fact that high money rates may not deter the speculator when he is optimistic, but, if they continue long, may seriously depress trade and industry. It is for this reason that the System believes that it should first use every effort to accomplish the desired results by other means, though it may be compelled in the end to resort to higher discount rates.

Now Mr. Businessman, Mr. Banker, and Mr. Speculator, I believe as a citizen of the United States, I would have been remiss in my duty as a public official if I had not this evening painted this picture to you as I see it. This is not a problem alone for the Federal Reserve System or the banks, but for all of us, and I feel justified in making a strong appeal to you to give it serious consideration.

There is no occasion to become unduly excited, because we must recognize the fact that the changed methods of financing business have developed very rapidly. Financing business through shares or bonds can be on a sound basis and when it is sound is entitled to credit, but it is not entitled to all the credit or to an unreasonable proportion of the total.

It seems to me that it would be the part of prudence for all who are lenders to see first that business gets credit at reasonable rates and let the others get what is left.

In conclusion, let me remind you that credit is not a mechanical contraption, but a human institution. In solving the problem that is before us experience and judgment must play the leading parts. Reflection and cooperation will be big factors. In other words, my friends, just a little application of the remedy that has always been so successful in the past - just a little "hoss sense".