Present Condition and Future Prospects of the Automotive Industry from the Standpoint of the Federal Reserve Banking System

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

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It is a great pleasure to me to have the privilege of addressing the representatives of the credit department of one of our major industries. I am glad to have the opportunity of stating some facts to you which I think ought to remove any misapprehension that any of you may have as to the policies of the Federal reserve banks and of the Federal Reserve Board. I know that some people have had an idea that the policy of the Federal reserve system for several months past has been one of repression and of restriction. I am not going to burden you with a long array of figures this afternoon. I have already made one speech today from notes in which I went very thoroughly into detail. That may be printed a little later on and you can get all of the figures you wish from that. But I merely want you to know that instead of there having been any contraction in credit or in currency during the past twelve months or at any time during that period with the exception of about two weeks in January and about two weeks in July, there has on the other hand been a steady increase in the volume of bills discounted by Federal reserve banks and of loans made by member banks, as well as a considerable increase in the volume of currency represented by Federal reserve notes in circulation.

The net increase from September 1, 1919, to September 1, 1920, in the volume of Federal reserve note circulation was about six hundred and thirty millions of dollars, of which amount three hundred and sixty million dollars represent the increase since the 23rd
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of January last when the Federal reserve bank discount rates were advanced to approximately their present level.

During the twelve months there has been an increase in the commercial bills discounted by Federal reserve banks of about one billion one hundred and forty-six millions of dollars. There has been a decrease in the amount of paper discounted for member banks secured by Government obligations so that the net increase in the loans and advancements of Federal reserve banks to their member banks for the twelve month period ending the 1st of September has been about eight hundred and ten millions of dollars. The increase in the loans of member banks, as gauged by figures furnished by eight hundred and nineteen banks which make regular reports every week to the Federal Reserve Board, has been during the same time about eleven hundred million dollars in commercial paper and the net increase in the accommodations for those eight hundred and nineteen reporting banks which represent all of the important member banks in the Federal reserve and branch bank cities and clearing house cities of the United States, has been about seven hundred and fifty-five million dollars. The resources of those banks represent between sixty-five and seventy per cent of the resources of all member banks and between thirty-five and forty per cent of all commercial banks in the country.

The credit situation has materially improved since last spring. That improvement is manifest not so much in the figures shown because, as I have already said, there has been no reduction in the loan account either of member banks or of the Federal reserve banks. On the other hand there has been a greater expansion in bank credit and in currency in circulation as represented by Federal reserve notes during
the past twelve months than there has been at any period in the history of the country, with the exception of the twelve month period from September, 1917, to September, 1918, when we were in the midst of the war; but the improvement lies in the greater liquidity of the assets of the Federal reserve banks and of the member banks.

The Federal reserve banks are the custodians of the ultimate banking reserves of this country. The law has been changed so that no member bank can count as reserve any gold or lawful money or currency that it has in its own vault. No member bank is required to keep any specified amount of currency on hand. That is a matter that is left entirely to the determination of each bank. The lawful reserves are the collected balances with the Federal reserve banks.

In the various crises which this country has experienced in the past, and we have had some very serious times, such as 1873, 1893 and 1907, the years of the major panics, we had Europe to fall back on. Then our banks were able to sell finance bills and to bring in gold. The panic of 1907 was relieved by the use of finance bills and by the export of goods which were paid for in gold, so that while we had acute panic conditions the latter part of October and the first of November in 1907, we had a period of extreme ease of money by the latter part of January, 1908. That was due to the importation of gold and to the subsidence of panic conditions.

You all know better than I can tell you the condition of Europe due to the four years and a half of the most destructive war in history. You are familiar with the destruction not only of human life, but of the capital, of the real property and of the liquid wealth of the world. You know what the expansion of credit has been in Europe on account of war con-
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ditions and the destruction of capital, and you know that most of the countries of Europe are no longer on a gold basis. They have a depreciated currency. Their exchange has declined to minimum figures, in many cases five to ten per cent of their normal parity, so that today the Federal reserve banks stand as the final resort of credit not only in this country, but throughout the world.

It is very necessary to keep the Federal reserve banks, particularly in these circumstances, in a strong, sound, clean position. The strength of the Federal reserve banks may be measured, not altogether in the amount of gold held by them as reserve against their liabilities—note issues and deposits, but as well by the liquidity and inherent soundness of their invested assets.

I do not minimize the importance of a gold reserve; for a gold reserve is the very foundation stone of any sound financial system, but I do not hold that the maintenance of any specified minimum reserve at all times is absolutely necessary. The main point is that if the demands of business, of agriculture, commerce and industry in this country along essential lines demand certain seasonal or extraordinary accommodations for the common good, they should be granted even though the reserve might fall to a point below normal or below the figure prescribed by law, for the law does not limit the use of these reserves under certain conditions and penalties.

But the point I wish to make is that any low reserve position at the Federal reserve banks caused by any temporary strain or emergency should not be regarded as a normal base from which future emergencies must be met. Whenever the reserve falls we must take action to build it up again.

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We had a meeting in Washington, on the 18th day of May last, with the members of the Federal Reserve Advisory Council, the Federal Reserve Board and the Class A directors of the Federal reserve banks.

We discussed credit conditions very fully. At that time we had just passed the peak of one of the wildest periods of extravagance and speculation this country has known in a long time. We found that not only had there been an abuse of credit for non-essential purposes to meet extravagances of various kinds, but that commodities produced on the farms last year were being held back, partly of necessity on account of lack of railroad facilities, and partly in the hope of getting higher prices, which tied up a vast volume of credit. We were looking forward to the seasonal movement of crops, the crop moving season into which we have now entered, and some concern was felt as to our ability to meet safely and efficiently the legitimate demands which were going to be made on the banking system during the next few weeks, unless we put some restraining influences into action to stop undue use of banking credit. After talking the matter over we decided that banks generally should be cautioned to use a more discriminating judgment in granting credits and that they should give preference to loans of an essential character rather than to those of a non-essential character. We felt then and we feel now that the advice given was sound, and that the country has been very greatly benefited by the action that was taken. The Federal Reserve Board, however, has distinctly declined to give any definition of essential or non-essential loans. When you think about it, you will realize what an exceedingly difficult thing it would be for any board of seven men sitting in Washington to undertake to define by any rule of country-wide application what is an essential industry and
what is a non-essential industry, and what is an essential loan and what is a non-essential loan. We stated then and I repeat today that the Federal Reserve Board will not undertake to give any definition of essential and non-essential loans. While a Federal reserve bank is in better position to undertake such a definition than the Federal Reserve Board is, still we feel that a Federal reserve bank itself will better conduct its business under the provisions of Section 4 of the Federal Reserve Act which require the directors to administer the affairs of the bank fairly and impartially, and without preference to any bank or group of banks, and in extending its accommodations to make such loans as may be “safely and reasonably made” to member banks “with due regard to the wants and requirements of other member banks.” That means that the directors should not permit any member bank for the purpose of unduly extending its business to receive an undue volume of rediscount accommodation at the Federal reserve bank particularly when these extended credits to a few banks might impair the reserve bank’s ability to meet the legitimate demands of other member banks. The matter of granting loans to the individual or to the firm or corporation is one which is entirely in the hands of member and non-member banks with which these individuals and corporations deal. The Federal Reserve Board has no discretion, nor has the Federal reserve bank any discretion in the matter of a loan which a member or non-member bank may wish to make or decline. If the bank is a national bank, it is governed by those sections of the revised statutes of the United States which are commonly known as the National Bank Act. If a state bank, it is governed by the laws of the state and by the rulings of the state banking department. Neither the Federal Reserve Board nor
the Federal reserve bank has any jurisdiction at all over the loan transactions of commercial banks. What the Federal Reserve Board and the Federal reserve banks are concerned with is to keep the assets of the Federal reserve banks in a clean, sound and healthy condition, having as much paper of a liquid character as possible to be paid at maturity so that if the occasion should arise to make it necessary to use the reserves in order to meet some unusual emergency or some unusual seasonal credit requirement, they can do it.

But while we have never undertaken to define essentials, I think it is axiomatic, and that all will concede that there are four great fundamental essentials—food, fuel, clothing, shelter; and in order to provide these necessities, transportation looms up as an absolutely important factor. Now, the problem before an individual bank in granting credit seems to be very much simpler than that which would confront a Federal reserve bank if it undertook to grant credit along essential and non-essential lines, and far simpler than that which would confront the Federal Reserve Board if it should undertake to make any ruling that paper should be discounted or declined with reference to its essentiality or non-essentiality.

In the first place, some loans are essential at certain seasons of the year when they might not be essential at other seasons of the year. Take the canning industry, for instance, and the cold storage industry also. Along in June and the early part of July a great many of the small crops come in which ought to go in cold storage or to the canneries. These industries have occasion then to use the banks to get large credits in order to pay the farmers for the products that they use. Now, it is perfectly reasonable for the cold storage industry or the canning industry to use money
and credit, not only for their own benefit, but for the common good, at those seasons of the year, while, if the same industries should undertake to come in December and January to borrow large sums of money, any bank to which they should apply might well put them on inquiry as to the purpose of the proposed loan, because if loans are granted to cold storage concerns or canneries for the purpose of holding back for higher prices goods that the market is ready to absorb and that ought to go on the market in order to meet the requirements of the public, we should say that common sense would tell the banker that such a loan at that time would be unessential.

The whole question is a local matter. By leaving the member banks and the non-member banks entirely free to use their own judgment in granting loans, they are not bound to take our advice if they do not want to; the only thing that can be done is for the Federal reserve bank to say, "We think we have discounted enough paper for you. You do not seem to be very careful in the matter of holding your loans in check, and we are going to give you a certain line and we are not going any further;" that is as far as the Federal reserve bank can go because the Federal reserve bank is not allowed by law to deal directly with the public, with the exception of transactions in bankers’ acceptances which the Federal reserve bank may buy either with or without the endorsement of a member bank, and those acceptances have to meet all the requirements of eligibility which the law imposes upon paper offered for discount by member banks; the Federal reserve bank can only rediscount paper when endorsed by a member bank; it does not have any general dealings with the public. Now, please bear this in mind, that any member bank is entirely free to use its own discretion in the matter of a loan. If a mem-
ber bank wishes to carry out the policies suggested by the Federal Reserve Board, it would naturally apply the test to its own community because a bank is supported by the community in which it is located. It receives its deposits from that community. It is there to serve that community. It will grow or decline as the business of that community improves or retrogrades.

There are certain industries in this section of the country which you may well deem as being highly essential. They support a great population. They make business for other lines of industry and you are perfectly reasonable in regarding the business as highly essential and your member banks are entirely justified in making loans to support local industries, while banks located in other sections which have no such industries, but have other industries of an entirely different character dependent upon them may take the view that some particular loans which are highly essential here are not essential with them, and vice versa.

For instance, you would not regard here in Cleveland loans based on salt water fisheries as essential because you have a fresh water lake here and you do not have any salt water fishery business. Yet in other sections of this country those would be regarded as highly essential loans.

The whole question, therefore, of the essential and non-essential character of a loan is left for individual determination by each member bank.

I know that the business in which you are interested experienced a very great expansion in the months that followed the war, and I presume that some of you will admit that people in some cases bought the things in which you are dealing on credit who had no business using their credit in that direction. I have been
a banker and if I were a banker today, this would be my policy, regardless of whether this industry was essential to the particular locality in which I might be located—I would look out for my good customers. If a dealer in automobiles brought a lot of paper to me for discount, if I were satisfied with the solvency of the dealer, with the value of his endorsement, if he did not wish an excessive line of credit, out of proportion to the average balance carried with me or out of proportion to the credit which I might feel I should grant to merchants and other lines of industry which were dependent upon my institution for credit support, I would take his offerings. If, on the other hand, I felt that he was disposed to do too large a business for his capital and was undertaking to get from me, for the purpose of further expanding his business, an unduly large line of credit, I would hold him down under any circumstances. In that case, I would scrutinize his paper more carefully—if I found that he offered the paper of a man with whose credit standing I was perfectly satisfied, whom I knew was able to pay his obligation at maturity, I would take it. If, on the other hand, he should offer a paper of a man who had no credit rating, no responsibility whatever, who had merely bought an automobile, paying probably ten per cent in cash and wanted to give his note for the rest, I would decline to take that paper because I would doubt the maker’s ability to pay it. Certainly a well-managed bank does not want to become a dealer in second-hand automobiles.

This is the whole proposition. There hasn’t anything been done by the Federal Reserve Board and in most cases nothing has been done by any Federal reserve bank that reflects in any manner upon one of the greatest industries of this country. It would be a very serious thing for any body of men to undertake [12]
to make an attack upon, or to destroy a business that is as firmly rooted and which has so many of the elements of essentiality as your business has, and I want to assure you that as far as the Federal Reserve Board is concerned, no such attempts have been made.

A great many letters have come to me from various sections of the country, making all kinds of complaints. I find in a number of cases there has been a misunderstanding about the facts, and I shall read you a letter by way of illustration.

We had a complaint some time ago that a western representative at Portland, Oregon, of a motor truck company in Detroit had been informed by the bank with which he dealt in Portland that he could no longer receive any credit from that bank; that it was not going to discount any paper for him, and gave as a reason that the Federal Reserve Bank of San Francisco had notified it that it must not take any paper of that character. I very much doubted that the Federal Reserve Bank of San Francisco had undertaken to dictate or to go beyond its powers in dictating to any member bank what paper it should discount or what it should decline to take. I telegraphed the bank and I got a firm denial from the officers of the Federal Reserve Bank of San Francisco. They said, "We have given no such instructions. We have never asked anybody to take our judgment on the paper that they should take. We exercise our own judgment in what we should discount."

They took it up with this particular member bank and here is the reply—"A letter received by the chairman of the board of directors of the Federal Reserve Bank of San Francisco from this particular member bank in Portland, Oregon"—the San Francisco bank says, "You are respectfully informed that this bank has at no time called upon its member banks
to restrict the financing of automotive concerns. A telegram from the Standard Motor Truck Company states its western representative reported that the vice-president of the bank in Portland had informed him that the Federal reserve bank had requested such restrictions. I wired the vice-president of this bank, asked if he had been correctly quoted, and if not, please advise me what foundation he had for his statement. I am just now in receipt of his reply as follows: 'Answering your wire of September 8th, I absolutely deny having made any such statement. We have been and are now financing responsible automotive concerns.'"

I know of a great many cases similar to this. I think the whole misunderstanding is due in very large part to the reluctance on the part of some good bankers to say "no." You know there has been a credit strain all over the country, that bankers are continually being asked to make loans that they feel they ought not to grant, and yet comparatively few bankers have the knack of saying "no" without giving offense. Banking, as you know, is a highly competitive business. The average banker is very much averse to offending any customer. A bank dislikes to lose an account, even an account that is regarded as an excessive borrowing account. It looks back in the ledgers and it finds that a few months ago or a few years ago this particular account was not a borrowing account, but kept a large deposit, and it never knows when it is going to become a large deposit account again. So that the primary consideration of nearly all banks in declining loans is to avoid giving any offense. We all know that under present conditions we have a lender's market rather than a borrower's market. Banks have no trouble in keeping their funds employed. They probably have a dozen applications [14]
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for loans to every one that they really wish to grant, and I know in some cases, because I have traced it down, that where a bank receives an application for a loan which it has no intention of granting, it follows the lines of least resistance. The routine is about like this: The bank officer says to the customer who comes in and wants accommodation, "Well, Bill, old man, I would like the best in the world to accommodate you. You have kept a good account with us in times past and I would really like to help you, but you know the Federal Reserve Board won't let us."

That is a very easy way of "passing the buck," but it is hardly fair to the Federal Reserve Board. It has caused me a great deal of extra work in answering telegrams and letters, asking how about it, and I want it distinctly understood that the Federal Reserve Board has never attempted to go beyond its lawful powers which are clearly defined in the seventy pages known as the Federal Reserve Act. We have not undertaken to dictate to any bank what loans it shall make or what it shall not make.

We have merely suggested as a policy in the best interest of the various communities in this country that each bank should exercise its judgment and support more particularly the local industries which are dependent upon it, which have no general credit, and that if it has to limit its loans, it discriminate in favor of those particular industries which in its judgment are essential and which are necessary for the support and upbuilding of the community in which the bank is located.

If you will take the figures to which I have referred, and analyze them, you will see that there has not been in any section of the country any contraction of loans in the aggregate. I think you will all agree that there was a general spirit of extravagance in this country [15]
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late last year and early this year, which was unhealthy. We all know that one of the most potent causes of disaster in manufacturing or commercial lines is over-production at high costs on expanded bank credit, because sooner or later the time comes for liquidation, and liquidation under those circumstances is a very unpleasant process and is liable to bring about disastrous results.

I can refer you to what happened in Japan. Early in the present year there was just as wild a boom, just as wild a period of speculation and extravagance in Japan as we had here. Silk is the main industry there. At one time last February and March, in spite of the warnings issued by the banks in Japan early in January to slacken up, silk had advanced to fifty-six hundred yen per bale, a yen being about fifty cents in American money, and that represented a value of raw silk of about eighteen dollars a pound. You may remember the overalls movement in this country last spring. This reflected the change in the buying attitude of the public. For some time it had been regarded as a smart thing to pay thirty dollars for a silk shirt or twenty-five dollars for a pair of shoes. People began to look around and to shop a little to see if they could not get more for their money. The result of it was that silk shirts declined from thirty dollars each down to eight and ten dollars, and the demand even at those figures fell off. The same thing happened in shoes and in clothing. This indicates the change in public sentiment regarding extravagant purchases.

What happened in Japan was that all of a sudden the price of silk fell from fifty-six hundred yen per bale down to about sixteen hundred yen per bale, and that brought about the failure of a great many important concerns engaged in the manufacture and
merchandising of silk, which caused the suspension of seventy-four Japanese banks.

As a result of the policy that the Federal reserve system has adopted, we have passed out of this period of exhilaration and intoxication, you might say, when money came easy and went easy, and there is now a more careful spirit manifested in this country. People are taking a little more critical view of what they are buying. They are consulting their own requirements more closely, and they are restraining themselves from certain extravagances. Certainly this makes for a better condition of affairs and argues well for permanent business. Our American institutions are permanent. I am an optimist on America. I do not believe that what we want to do is to maintain boom conditions here just for this season. Aren’t we going to be in business next year and the next, and so on? We must look ahead for the future. We do not want to take too much of a chance merely for the sake of continuing a wild boom and having abnormally good business conditions over a period of two or three months and then have a collapse that may take us years to recover from. Why not come back to a normal and more sensible, and orderly basis than that? That is our whole idea.

The expansion in loans which is noted at the present time is due very largely to the crop moving requirements. The crops this year are unusually bountiful. Some authorities estimate their value as high as twenty-two billions of dollars. The Federal reserve system has ample resources to enable it to furnish member banks with all the necessary assistance to move these crops and move them in an orderly manner. In due course the crops will be moved, for I am glad to say the railroads are functioning better now; and instead of getting twenty-one miles a day
as an average for a freight car they are working toward thirty miles a day. This means increased efficiency in the movement of freight and is just as effective as though we had added that proportion to the number of freight cars in use.

Business generally is looking forward and I think with reason, to a period of healthy activity. I feel that we are on a very much firmer foundation in every way than we were seven or eight months ago, and I believe that if you keep your heads and do business along safe and conservative lines, bearing in mind that most of you are young men, who have plenty of time ahead of you, bearing in mind also that you want to do business in the years to come; that you do not want to concentrate all your energies to "mopping-up," as you may say, during the next two or three months, and then retiring, taking all of the chances that are incident to an undue and unjustified expansion, you will all feel better if you go along at a more moderate gait, and on a safer basis, with a view of having good normal business next year and the next year, and so on indefinitely.

There is no occasion, gentlemen, for me to detain you any longer. I want to assure you that the Federal reserve banks and the Federal Reserve Board are keenly alive to the requirements of business in this country, and that it is our purpose to do everything that ought to be reasonably expected of us to assist the member banks in furnishing all reasonable accommodations to their customers, and that the member banks are the sole judges of their own credits.

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