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FEDERAL RESERVE BANK  
OF DALLAS

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DALLAS, TEXAS, May 25, 1918.

## THE PURPOSE OF THE REDISCOUNT FACILITIES OF THE FEDERAL RESERVE BANK

TO THE MEMBER BANK ADDRESSED:

Proper interpretation of the rediscount facilities of the Federal Reserve System will be found very helpful to member banks in the conduct of their business.

An important object to be obtained in the creation of the Federal Reserve System is to promote flexibility of bank reserves and the elasticity of the circulating medium, so that these two important elements in our financial structure can be made to respond to every demand of trade and commerce without undue disturbance.

The Federal Reserve System contemplates a legitimate control of the expansion of credit, rather than to make it possible by reason of the existence of the Federal Reserve System, for credit to expand to the point of inflation; and to increase or contract the supply of currency in exact proportion to commercial needs. In this light only can the Federal Reserve System be looked upon as a financial and commercial bulwark.

Where loan transactions are consummated upon the basis and with the thought that they may be immediately passed to the Federal Reserve Bank of which the bank making the loan is a member, the object of the Federal Reserve System is largely defeated, in that a general indulgence in this policy would create undue credit expansion.

Federal Reserve Banks should not be looked upon as a source of supply of loan capital, but as furnishing a facility for the maintenance of legal reserves against member bank's deposit liabilities. By reason of the Federal Reserve System furnishing a facility for the issuance of currency against the rediscount of eligible paper in the rebuilding of depleted reserves, member banks may meet the needs of their communities in a safe and legitimate way in a proper proportion to their resources. Whenever pursuance of such a policy expands the loan account in a legitimate way and according to seasonal requirements, or to satisfy existing conditions, to such an extent as to begin to encroach upon legal reserves, it is entirely proper to rediscount a sufficient amount of eligible paper to restore or maintain the required reserve balance with the Federal Reserve Bank. Should deposits decline prior to the normal period of seasonal liquidation, or during the period of normal loan expansion, reserves may be restored and maintained in the same manner.

In contradistinction to policies and customs prevailing in the inter-relations of banks prior to the advent of the Federal Reserve System, it is unnecessary for banks to rediscount with the Federal Reserve Bank in anticipation of future needs, but only to the extent necessary to maintain reserves as occasion arises.

Member banks should never place themselves in the position of acting as brokers between their customers and the Federal Reserve Bank by following the policy of lending freely upon the basis of rediscounting the paper representing such loans with the Federal Reserve Bank, for the sake of an arbitrage profit equal to the difference between the rate at which they lend and at which they can rediscount.

We are enclosing for your information, a copy of a booklet entitled "Facts You Should Know" which is just off the press this week. All essential information in connection with the preparation of an offering for rediscount will be found in its pages in convenient, concise form. If it is carefully preserved, and fre-

quent reference is made to its contents, we believe that our members will encounter no difficulties in receiving prompt action on their offering.

#### **The Purpose of War Loan Deposit Accounts.**

Our member banks should bear in mind that, in order to co-operate with the Government in the financing of its war activities, EVERY member bank should qualify as a War Loan Depository at the earliest possible moment, under the method outlined in Treasury Department Circular No. 92, and supplement thereto, and War Loan Circular No. 14, dated April 10th and 23rd respectively. The procedure necessary is extremely simple and is stated fully in the circulars noted above.

By so qualifying, member banks are enabled to pay for their subscriptions to the issues of Liberty Loan Bonds, (on installment dates or in full), and Treasury Certificates of Indebtedness, BY CREDIT on their own books, and may be thereby relieved of the necessity of discounting their receivables to establish credit balances in anticipation of their payments to the several issues. Qualifying banks may be assured that reasonable notice will be given (from three to five days) before the withdrawal of any part of the funds lodged with them as such Depositories. These deposits are withdrawn pro rata, in accordance with the total amount the Government intends to disburse, upon payment of funds to it.

It is the purpose of the Treasury Department, by the creation of War Loan Depository accounts, to avoid unnecessary dislocation of funds in the floating of the various issues of Government obligations, and to aid in maintaining those funds, as far as possible, in the ordinary channels of trade and banking until they are actually disbursed, whereupon they return naturally to these channels immediately. Theoretically, the funds raised by war credits, with proper co-operation of banks, are never withdrawn from trade channels. It must be recognized that the purpose of floating war issues is to raise a war CREDIT for the Government, and it does not necessarily follow that the Government desires the proceeds to be paid to it in cash at the time the credit is made available to it.

Yours very truly,

  
Governor.