



FEDERAL RESERVE BANK  
OF DALLAS

January 9, 1920.

CURTAILMENT OF LOANS FOR SPECULATIVE PURPOSES.

TO ALL BANKS AND TRUST COMPANIES  
OF THE ELEVENTH FEDERAL RESERVE DISTRICT:

The year before us will develop a new phase in our financial situation. The Government has actually begun a gradual retirement of its war debt, but the problems ahead of us, although different are no less important than those of the past; in many respects they will, perhaps, require more skillful handling. In view of the close relation of the Federal Reserve Bank of Dallas to the financial support of the banks of its District, we believe that the following presentation of the more important factors underlying the situation will be of value in shaping financial policies for the future along sound economic lines.

Mainly due to war conditions and the necessity for aiding our Government in carrying through its great program of war finance, there has arisen and still exists a tremendous and unparalleled expansion of credits. However, it is not possible for us to overlook the fact that there are other contributing causes to the present condition of inflation, which is nation wide. Incomes generally have advanced materially during the last two years, and the principles of economy inculcated during war time have been generally relaxed, with the result that there has been created an increased demand for commodities by individuals who restricted their purchases during the war, but who are now buying freely in competition with export demand. This rising scale of income has led to the purchase of luxuries rather than necessities and to the diversion of labor and material from essentials to non-essentials.

It is becoming evident, also, that the extravagance of individuals, and the indiscriminate granting of credits by some banks for investments and speculative purposes have caused the resources of the Federal Reserve Banks to be used, by an indirect process, for purposes other than those intended or authorized by law.

It was the intent of the framers of the Federal Reserve Act to provide, through the Federal Reserve Banks, a source from which funds might be obtained to meet unexpected or strictly seasonable demands which the resources of their member banks might be temporarily unable to supply. It was not contemplated that the Reserve banks should be looked upon as inexhaustible reservoirs of loanable funds, or that their assistance be obtained, even indirectly, for the financing of speculative enterprises, or for investment.

Governor Harding of the Federal Reserve Board has sounded an unmistakable note of timely warning to the banks of the country when he urges them to restrict their loans to those borrowers requiring funds for agricultural, commercial and industrial activities. The effect of this warning has already been felt in the speculative stock markets of the East, as an Associated Press report of January 7th states that the New York Exchange witnessed on that day a very heavy selling movement, with abrupt declines in prices of leading speculative stocks, notwithstanding extremely easy rates for call money.

The only way in which the existing situation may be met satisfactorily, and further dangerous inflation be avoided, is for our banks, one and all, to realize fully the gravity of our present credit condition, and to make their advances to their customers in accordance with sound and prudent banking judgment. On December 31st Governor Harding addressed a message to the Governors of the Federal Reserve Banks which was so timely and pertinent, and which so ably discussed the necessity for credit conservation and the part to be taken by our banks in its accomplishment that we desire to quote it in part as follows:

"---- The Federal reserve banks should take advantage of the fact that the Government has actually begun a retirement of the war debt, to strengthen their position very materially, thus making progress toward a normal situation ----. The Federal reserve banks should maintain a strong position in order to meet legitimate demands. This can only be done by eliminating demands of questionable propriety. There is much discussion of America as the world's financial center and many conditions favor our aspirations to that position, but we shall not be able to attain or to retain it simply because of our resources. We must strengthen our financial position in order to meet probable calls and drains. As the only free gold market, we are losing large amounts of gold principally to oriental countries such as Japan, China and India. Thus far this drain has been largely offset by receipts of German gold, but we must look to orderly liquidation to offset further demands upon us. So far as orderly liquidation is accompanied by lower prices, commodity exports will be stimulated and gold exports to countries receiving our commodities will be curtailed. Constantly advancing prices lead to uneconomical production and may stimulate the expansion of our productive facilities beyond our power to consume or to export in normal times. But, at the moment, underproduction and over consumption are the real menace, resulting in a continuous rise of prices and making it more difficult, through saving, to accumulate capital for foreign investment. Calls for aid in the restoration of Europe should carry with them an appeal to economize in our own consumption, in order that there may be available, not only commodities for export, but also funds for foreign loans and investments to supply means of payment."

It should be thoroughly understood that the resources of the Federal Reserve System will continue to be at the disposal of commerce and industry, and that the Federal Reserve Banks in the future,

as in the past, will continue to take care of the legitimate and reasonable requirements of business and agriculture. However, it will be the policy of the Federal Reserve Bank of Dallas to determine not only the eligibility of paper offered, but, as far as possible, to determine also whether the purpose which prompts requests for accommodation is in actual conformity with the spirit of the law and with the principles of conservative credit judgment.

The banks of this District, both member and non-member, should carefully analyze the necessity for each loan made by them, and do their best to discourage the seeking of accommodations which have not to do directly with legitimate production, or which are not sought as a means of supporting commercial, industrial or agricultural enterprises which are vitally essential to the common good.

If such a policy is not universally adopted and followed, it is conceivable that many banks may find their resources so completely tied up in loans made either for speculation or investment that they are unable to take care of the legitimate reasonable demands of their customers when those needs arise. It will be difficult, if not impossible, for such banks to liquidate loans of the character mentioned, and certainly they would not be able to rediscount such paper with the Federal Reserve Bank. If an appeal for aid from other banks should be of no avail, there would be left only the embarrassing alternative of stating the situation to the customer seeking accommodation, with an explanation of the causes leading to it.

It is our sincere hope that we will be given the close and constant co-operation of all banks in the Eleventh District in our efforts looking toward the establishment of that conservative credit policy which is so urgently necessary. The resources of the Federal Reserve System are not unlimited, if used directly or indirectly for purposes not contemplated by the Act, and it will be necessary that the present expansion of credit be sharply checked before it results in wide spread injury to our business and our people.

Respectfully,

Governor