



FEDERAL RESERVE BANK OF DALLAS

AMENDMENT TO THE FEDERAL RESERVE ACT PROGRESSIVE DISCOUNT RATES

May 7th, 1920.

TO THE PRESIDENT OF THE MEMBER BANK ADDRESSED:

Under instructions from our Board of Directors, I respectfully invite your attention to the following amendment to the Federal Reserve Act, which was approved by the President and became a part of the law on April 13th, 1920:

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled: That Section 14 of the Federal Reserve Act as amended by the Act approved September 7th, 1916, and June 21st, 1917, be further amended by striking out the semi-colon after the word 'business' at the end of subparagraph (d) and insert in lieu thereof the following: 'And which, subject to the approval, review, and determination of the Federal Reserve Board, may be graduated or progressed on the basis of the amount of the advances and discount accommodations extended by the Federal Reserve Bank to the borrowing bank.'"

The far-reaching effects of this amendment may not be generally understood, and it is for the purpose of giving the officers of our member banks the opportunity to study its possibilities that we repeat it here.

Our Board of Directors has not yet adopted a method of applying the progressive rates provided for in the amendment to the Act which has been quoted above, nor has it yet decided that such application is necessary in this District. We sincerely hope that all of our member banks will realize the pressing need for curtailing their loans, and consequently their demands upon us, to the end that the credit situation may be stabilized and the banks may not suffer by the application of rediscount rates higher than the rates of interest received by them from their borrowing customers. It has been our constant effort and our earnest desire to bring to every bank of our District, member or non-member, a full realization of the danger of our present Nation-wide inflation of credits, while we have repeatedly appealed to our banks for a real co-operation in the establishment of that conservative credit policy which is so vitally necessary. It must be remembered that the problem is not national only, but one which has to do with each individual bank, and that it can not and will not be solved until the influence of the banks in each community is thrown against senseless extravagance and reckless expenditures, whether public, private, personal or corporate.

If the application of the progressive rates authorized by law, and already adopted by some other Federal Reserve Banks, is to be avoided in the Eleventh District, each of our banks must do its part toward clarifying the situation. It must be realized that credit has become so cheap as to cause widespread borrowing for the purpose of furthering extravagances and speculations already encouraged by incomes and salaries which are the largest in our country's history. With that realization must come the restriction of loans to those absolutely necessary to take care of urgent seasonal needs, and the complete discouragement and refusal of loans made solely for the purpose of obtaining new business, or those to activities which must largely depend upon capital borrowings.

No matter how attractive a credit risk may appear when a loan is solicited, the accommodation should be granted only in the light of a due and careful consideration of its purpose, the ability of the maker to pay at maturity out of his own resources, and with even a more careful consideration of the ability of

the lending bank's own resources to take care of it and any other loans, without excessive borrowings from the Federal Reserve Bank or elsewhere. \1

This is a most opportune time to remind every thoughtful bank that the primary purpose of establishing the rediscount facility of the Federal Reserve Banks was to provide a means whereby member banks might maintain their reserve balances at the required figures, and obtain temporary accommodation to meet unusual demands of a legitimate nature.

It was not contemplated that any member bank would rediscount its eligible paper and use the proceeds thereof for the purpose of acquiring ineligible bills or paper of a speculative or non-essential character and thereby contribute to inflation, nor was it intended that member banks should look upon the Reserve Banks as unlimited reservoirs of loanable funds, upon which they might draw at will to augment their own resources, after those resources had been allowed to expand beyond safe limits. Not only is that latter idea a perversion of the original purposes of the Act, but it is responsible for the beginning of a vicious process of inflation which has unlimited possibilities of disaster.

Where the rediscount facility is rightly used, it is not necessary for a member bank to offer its paper in lump sums sufficient to meet all anticipated or probable future needs. Offerings should be limited to the amounts necessary to take care of reserve impairment, unless some sudden and unforeseen circumstance renders a request for greater accommodation unavoidable. In such cases the offering should be accompanied by a letter setting forth the nature of the demand which makes large rediscounting necessary, in order that the request for accommodation may be acted upon by our Executive Committee with all the facts before them.

While under the Federal Reserve Act, even as amended, there is no limit set upon the amount of paper which a Federal Reserve Bank may rediscount for its member banks, there is, nevertheless, a very real physical limit to the amount of the accommodation which may be granted. To be of the greatest service, the resources of each Reserve Bank must be at the disposal of the largest percentage of its membership, and, bearing this in mind when passing upon applications for loans, our Executive Committee gives proper consideration to the rights and probable needs of all other members.

We are not addressing you in a pessimistic spirit, nor would we convey the impression that our financial system is anything but intrinsically sound. It is our purpose to point out, clearly and unmistakably, that credit deflation must have its inception in the loan policies of our banks, and in the influence of our bankers on their communities. Those policies must be so adjusted, and those influences so brought to bear that radical revisions of our relations with our membership may be, if possible, avoided.

Respectfully,


Governor.

WE WILL APPRECIATE YOUR HAVING THIS LETTER READ TO YOUR DIRECTORS
AT THE NEXT MEETING OF YOUR BOARD.