



FEDERAL RESERVE BANK
OF DALLAS

Circular No. 13
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February 23, 1921.

TO THE MEMBER BANK ADDRESSED:

Quite recently we received a letter from one of our best banks, in substance, raising the question as to whether we were consistent in our counsel to member banks against raising their rates when, in the same paragraph, we advised that our own rates had been increased, and, also, making mention of the large earnings of the Federal Reserve Banks.

While not intended for publication when written, it has occurred to me our reply to that letter might be of some value to our member banks generally. For your information I am herewith submitting a copy of it.

"I am just in receipt of your letter of the 15th, with reference to interest rates. I am glad to have heard from you and I want you to feel free at all times to write us about any matter in connection with the management of the Federal Reserve Bank of Dallas.

I note that the part of the circular which has prompted you to write is that which admonishes banks not to raise their rates. The admonition that you refer to is necessarily implied from what is said in the letter, and yet the suggestion is made modestly, I think, and respectfully. You seem to think we are inconsistent in advising our member banks that we are raising our rates and in the same paragraph tell them that they should not do the same thing we are doing; but, do you not overlook the fact that you have all along been lending money to your customers at a very considerable increase over the rates of the Federal Reserve Bank, whereas we have, for many months, been borrowing money from other Federal Reserve Banks at a considerably larger and heavier rate than we have been lending? In other words, you have all along been making money on such sums as you borrow from us, whereas we have all along been lending money to our member banks at considerably less than we have been paying other Federal Reserve Banks.

However, aside from that, you should remember, and of course recognize the fact, that it was never intended that the Federal Reserve Bank should be a mere source of loanable funds, or that loans should either be solicited or made by you with a view of passing them on to the Federal Reserve Bank for profit. The whole theory was that banks, as a rule, would make loans with reference to their own ability to handle them, depending upon securing funds by rediscount of their paper with us with a view of meeting unexpected withdrawals of deposits or such unusual seasonal needs as you would not be able to meet out of your own resources.

Even at our present rate, seven per cent, you would have, under your statement, a profit of one per cent on all loans and a profit of three per cent on many loans. Of course, yours is not a large borrowing bank and I am glad to say it has never imposed in any way upon our facilities. But, if to take care of your customers, you were required to borrow even a fairly considerable sum from us, under our rates and your rates it would involve no loss to your bank and yet would accommodate your customer and help out the business and commerce of the country. While we have no absolute control over rates charged by our member banks, we do feel that the slight increase in our rate should not be made the occasion generally of a raise of interest rates to the trade and commerce of the country. I am strongly inclined to believe that such a course by our member banks would be bad business for them and most unfortunate for the country at large.

Again, you seem to have the erroneous view and idea that our purpose in raising our rate was, and the effect of it would be, to increase our profits. The matter of profit has nothing to do with it at all. In fact, I am inclined to believe, and certainly strongly hope, that raising the rate may so focus attention upon the borrowing habit as to reduce our rediscounts and decrease our profits. The pretty heavy profits which Federal Reserve Banks have made have been misunderstood and the result has been unduly emphasized. This complaint usually comes from those who insist upon free extensions of credit, and from those also who are complaining that credit is being unduly restricted.

There is practically only one way in which the Federal Reserve Bank makes money, and that is by lending money to our member banks. If member banks would quit borrowing so heavily, our profits, of course, would immediately decrease.

Again, there is also another mistaken idea about the source of our profits. Our lending ability is largely dependent upon the note issuing power which is granted by the Government and which enables us to immensely increase the amount of credit we can extend to member banks. If we were limited solely to the capital invested by member banks and their reserve deposits, we should not today be making any considerable sum of money. Our lending ability is due largely to the note issuing power which is granted as a franchise by the Government, to which, after accumulation of the surplus, practically all our profits go for the purpose of paying the national debt.

All these matters may have occurred to you, but the statement of them seems appropriate. We are hoping to be able to take care of the needs of the member banks in this district, but, if we do this adequately, it is going to be absolutely essential that these needs be held to the lowest possible minimum and that all banks join us in an honest effort to restrict credits to indispensable needs.

I am glad to have heard from you and shall always be glad to discuss any matter relating to the management of the Federal Reserve Bank with you or with any other member banker."

Respectfully,



Chairman.