CONFERENCE OF STATISTICS DEPARTMENT

May 6, 1921.

SUBJECT: The influende of the Discount Rate ...... By Governor Strong.

Mr. Snyder opened the meeting, saying: "I am sure we are very much flattered to have the Governor with us to-day, and I am sure he is going to say some very interesting things. We are very much indebted that he should come."

.....

(Governor Strong)

"I understand that there are much more important matters relating to the organization of the bank coming up later this afternoon, at this present meeting, and I am going to try and shorten my remarks toa point where they will not interfefe with that important business, Mr. Snyder. Furthermore, now that the time has come for any statements I am about to make I should say that I am appearing here in fear and trembling, because Mr. Snyder and his able assistants in his department put such a topic before me as the influence of the bank rate. I am always afraid I am going to match my theory with Mr. Snyder's.

"The original company of thirteen, as I recall the figure, that started the Federal Reserve Bank, are the only ones that can go back to the days of our discussion of what rate was proper and would be satisfactory when this bank was organized. The conditions that existed at that time were those brought on by the outbreak of the war. We had called upon two agencies in the United States to meet the great crisis in credit and currency. The crisis in bank credit was met by issues in clearing house and loan certificates, bearing interest. A vast amount of credit was manufactured through the agency of clearing house issues, and that credit was bearing interest at from 6 to 7 per cent, and I think, in some cases, higher. In addition to that, credit was manufactured through the agency of the Aldrich-Vreeland Association, which was organized under the "Aldrich-Vreeland Act." The existence of that great mass of credit which was bearing various rates of interest throughout the country determined our bank rate. I think that the reserve rates established were from 6 to 6 1/2 per cent, and the rate was high enough so that it kept down heavy borrowing at a low rate, so that the first business conducted by the Federal Reserve Bank of New York at the rate level which was established was trifling, and we were gradually able to reduce our rates over quite a period, until finally, as I recall, we were buying bankers' bills, - that is, acceptances - as low as 2 % in the open market. We had, in fact, a rate for that class of paper in New York that averaged from 2 to 3 per cent at the same time that paper of similar character was selling in the London market at from 2 1/2 to 3 per cent. The rate in the London market was as low as it was because of the American mass of credit which was artificially manufactured there.

"In discussing the influence of the bank rate, you have got to bear in mind that the bank rate has no influence unless you have got an account on both sides. If you have no existing loans, you can't bring about contraction by an advance in rate.

"All that we were interested in doing in the early days of the Federal Reserve Bank was to earn a mere dividend of 6 per cent for the member banks, after paying all our expenses. I might say in these days we had a very distinct contrast in the character of the relations of the Reserve banks to what we have now. This is the great money market of the country where dealings in short time paper especially centered. All of these bankers' acceptances came to this market as a rule and opened up a market where the short-time Municipal borrowings were generally negotiated and consequently we had a peculiarly advantageous position in New York which enabled us to entice our funds. It resulted in an arrangement between the Reserve banks by which we divided up the various banks. I think it is no exaggeration to say that this has worked out to better advantage than we had expected.

"I am not going to attempt to review the period of the war, when we experienced all the difficulties of adjusting rates. It is a big subject, and it is full of controversy. Mr. Snyder gently suggested that that would be an interesting thing to talk about, and I ducked it. In general, I think I am safe in saying that we made about as many mistakes - I say "we" for we were simply one body after all, the Treasury and Reserve banks - as could be expected, but, on the whole, I think we made fewer mistakes than our friends on the other side of the water made, and certainly very fewer mistakes than the enemy on the other side of the water made in financing the war. Skipping that point, I want to come right down to the present and what is taking place now. I want to illustrate this by giving a few of my observations:

"On May 9, 1901, I happened to be in the Stock Exchange, and on that day, between 10 and 1 o'clock, we saw Northern Pacific stock advance to $1,000 a share and money lending at about 100 per cent. There had been previously no such complete collapse of values in Wall Street as had occurred that day up to 1 o'clock. Towards the middle of the day they sent word very frankly that their boxes were empty and they could not send in more margins. Our loans got so low that if we had attempted to liquidate them the proceeds of the collateral would have been insufficient to pay the face of the loan. In other words, if very many of the loans had matured and the sale of the collateral took place, it would have resulted in the complete collapse of Wall Steeet. Later a plan had resulted in the sale of Northern Pacific stock and Mr. Morgan and his associates sent out word that they would not be unduly severe in the sending out of margins, and later prices had risen to a point where the loans could be made good and money was practically unlendable.

"The point I am trying tobring out, in telling this story, is that it presents a picture of a complete collapse of values which resulted in a condition that meant insolvency. Money was over, and money got back to normal rates all in a period of about five hours. In similar fashion, that is what happened in the United States, and in fact the whole world in commodity values. Speculation and extravagance worked out their own natural conclusion. There are those who say that some design of man or men, or possibly the reserve banks, by advancing rates, had brought about this state of affairs. I do not believe it for a minute, and I do not think most people do. In general, I would say that no man or men had the power to stop that great wave of speculation, and no man or men had the power to stop the break which took place. On the other hand, I would say that certain policies might have been adopted so that it should not have reached its extreme limits.

"Everyone now is satisfied that something must be done to stabilize the values of goods, and they will be stabilized to some level. Certain houses that retail goods, or certain houses that wholesale goods, or certain houses that manufacture goods, by reason of foresight or some other circumstances that gave them a more favorable position than other competitors, may be out of debt and not have large inventories, and are able now to buy and stock up with goods that are coming along from producers, manufactured out of cheaper raw materials and by cheaper labor than the goods and existing stocks which are being carried upon borrowed money. The tendency among retail stores at present is to keep new goods and cheaper goods in competition with high prices. It is forcing down the selling prices of the old ones and there are some new levels taking place from it. The same thing is happening in bank credit. Put yourself in the position of any bank officer in this city and see what happens in the daily trend of your business. At the end of the day he may find that he has a surplus of reserves on deposit at the Federal Reserve Bank. That surplus is the result of a great variety of transactions in the member banks. The member banks may have made some new loans. I may have loans out. The net results of all these movements may have had some bearing on his reserves. That is going on every day. It goes on both sides of the account. The bank which is short in its reserves willcome here to borrow. In fact, the number of banks that are borrowing from us now is, I think, more than 100. As soon as a bank gets in that position where it has a credit balance at the clearing house, then it has a choice of what to do with that credit balance; then it goes out to seek an investment, and, under the conditions that exist to-day, it seeks the very best and safest investments it can get.

"The banker is a little timid just now and he is willing to debit his competitor for good commercial paper only. The influence of the lending bankers that are out of debt is the influence that will bring the market rate for money down to or below our rate. That process continued indefinitely would, of course, liquidate all of our loans. If the traditional policy of fixing the rates of the Federal Reserve Banks should prevail, I should presume we should always have our rate a little bit above the market rate. Of course, we should always provide for seasonal movements, or crop making, or withdrawals of gold from the United States, or heavy borrowings. This process I describe is what is liquidating the loan accounts in the reserve banks to a great extent. I want to come up to the point of describing, or prognostigating, if you please, a little bit about the future. Before referring to the future, I want to refer to another important influence on our rates and an important rate consideration in the Reserve bank.

"You know that every time the Treasury of the United States puts out a loan and places that loan, as it does, through the reserve banks and the member banks, the first transaction is for the member bank to buy the certificate, to make payment by credit, and then, if they can do so, to sell the certificate to a customer and to the public and make a profit on the deposit. You can see that if the member bank can't sell the certificate of indebtedness they can't make this profit. It is the thing that did the damage in 1918-1920, and the policy of the reserve banks and Treasury Department together should be designed to get the largest amount of money that can be obtained for the Treasury's notes at the lowest rates of interest and at the largest security to the public. You may say that the rate allowed by the Treasury must be sufficiently attractive to the public to enable the public to buy them, but sufficiently unattractive to the banks to make it unwise for the banks to retain them, and have every stimulus existing to sell these certificates to the public just as promptly as possible.

"It has been necessary for the past three years to determine rates between the Treasury and the Reserve banks which will enable the Treasury to successfully float its certificates, and at the same time to relieve the reserve banks and its members of any chance of loss. On the whole it is working now and the certificate issues are almost immediately distributed to the public when they are offered.

"I want to refer a little bit to the future, as to where we might land if all of our loans were paid off and we had a huge bank building and a payroll, and doing all sorts of things for nothing, with a great big expense account and nothing coming in. I do not think that is going to happen right away, however, as we have two billion dollars going to the reserve banks now. Let us assume that the day is coming when the banks of the United States are not going to find it necessary to borrow from usthe way they do. No banks like to borrow money. There is not very much profit to them when they are paying 6 or 7 per cent.

"We deal principally in the Federal Reserve Banks with three kinds of credit instruments. One is commercial paper, another government securities (the government's long loans and certificates of indebtedness) and the third acceptances, which principally are drawn to represent importations of goods from Europe.

"When all the commercial paper gets out and a considerable part of the borrowings on government securities are repaid, we will be able to put our rates down. From personal observations while I was abroad, and a comparison of banking methods generally, unless I am mistaken, through the influence of the Federal Reserve System, we could use this great reservois in financing great commodities throughout the world.

"For the first time in the history of the United States, we are in the position of being a lending nation, instead of a borrowing nation. Europe for years is going to be pressed for capital to rebuild her industries and to re-establish France, and they are going to be burdened with enormous debts, and this country has, in proportion to its wealth, a much smaller public debt than the European nations. It has a great mass of fluid capital, which can be employed, I hope, and for the first time can compete with the commerce of the world in doing a real banking business. I should suppose we now have $500,000,000 or $600,000,000 of bills representing international transactions and commodities. If we had $2,500,000,000 the rate could be changed. I do not think I could do better than read you a paragraph from a very able document that appears on that very matter, a paragraph from the so-called "Cunliffe's Report." It is from a select committee appointed to make a report on foreign exchanges after the war, in London:

> (At this point Gov. Strong read the paragraph referred to, beginning with "The adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances pointing to ...." and ending with the sentence: "New enterprises were therefore postponed and the demand for constructive materials and other goods was lessened.")

"The point is this: that the Federal Reserve System, up to date, has been engaged in a purely domestic, local war operation. We have been financing the war for ourselves, to a great extent. You can trace almost the entire borrowings of the Federal reserve bank directly to the war. The time is coming when the American people will gradually repay this debt and the Federal Reserve System will be free of government borrowing and then we have got to take our position in the world, and, unless I am very much mistaken, that will come as the result of converting a very large amount of the paper which we now have in our vault into this paper which old Rothschild described as "salt water paper," because it had crossed the ocean and represented the payment for international goods. But there is one thing that we must bear in mind in connection with this,- and Mr. Snyder has notified me that he has three reservations - in connection with this prognostigation. The reasons for this are these: I put the first reason beyond all others. The general feeling that I have observed throughout various parts of the world is that the English banks are safe banks to do business with. The second great reason is that they have built up the facilities to do the business well, carefully, intelligently and promptly, and the third influence is that London has had a great reservoir of fluid capital to employ in this business. Now our condition at present comprises just those three fundamental influences. We have our integrity, our character, and our ability, just as good as that which is produced in the British Isles or elsewhere. I think, in other words, that the character test can be met by American bankers just as much as by any other bankers. Next we have got, or we should have in the near future, that great surplus, fluid banking capital to employ in this kind of business. One thing we have not got in the machinery. We have not got that great net-work of pipes connecting this reservoir. It takes years to create that. The British bankers have been at it for some generations. We can, however, do it promptly enough to place our reserves at the service of the world, and we have got to try and do it the way the British have done it. We have got to try and establish agencies here of any foreign banks that can come here and also abroad, and to do business in our market and borrow money. A bank would not be worth a dent if it just received money and did not lend it out. We should encourage the lending of money abroad and we should employ any agency we can get here to help us along this line.

"Mr. Snyder, I guaranteed to tire this enthusiastic audience in half an hour. I have no talked for nearly 45 minutes. Have you any points to make in connection with this matter?

\- - - - - -

Mr. Snyder remarked, in reply: "I am sure that, now that we have the Governor here, we would like to ask him some questions."

\- - - - - -

Mr. Case was called upon by Mr. Snyder, and remarked; "Why do you pick on me? I do my picking with the Governor down-stairs. I am going to leave him alone for the present. How about picking on Mr. Snyder?"

- - - - - - -

(Mr. Snyder)

"How can we become world bankers if we do not make money interest rates? Is not that the great obstacle now to this country becoming world bankers? England's rates are always better than ours. That is the source of their great strength.

(Governor Strong)

"When I was in London I always used to say, with perfect good faith, that I did not think there was very great danger of their losing their business so long as the opportunity for the employment of capital in this country was as great. I really think conditions have changed. I think they have changed because they are going to be put to it for capital for a time. I think so and I guess you think so. Where they are going to lose is in the enormous demand upon them to pay debts, and it is going to tax their reserves to the utmost to pay debts - to pay debts to this country and to pay the interest due this country. They willtake some of our investment money, if we are willing to let them have it, at pretty high rates, and I frankly believe that this Federal Reserve System, by a capable adjustment of rates, will have plenty of reserves to compete with them, to a reasonable degree, in financing at least our own important trade. I have real confidence that, with the resources we have here, we can get our share of any foreign trade we go after."

- - - - -

(Mr. Snyder)

"How can we get our rates down, so as to meet this competition and still not have another big wave of inflation? Do you see any practical means, considering politics and everything else, of meeting just that thing?"

(Governor Strong)

"What I think I do see, Mr. Snyder, is this: that the development to which I referred is not going to take place over night, nor in a year, nor even five years possibly - nor even a longer period. I would be afraid of it if it did. But I can see gradually creeping into our market here those conditions which would be most conveniently drawn for geographical reasons, because they represent our import trade. Where it becomes a convenience, at a competing rate, to do business in this market, I do not see any prospect of easier money in Europe, do you? Think about that!"

(Mr. Case)

"Well, Governor, London was the world's banking center before the war, and all these bills, import and export bills, were largely financed by London. Isn't it a fact that the world war has upset that to such an extent that she does not seek, at the present time, to do more than to look after her own import and export financing, and is very glad to have diverted to this market any import and export transaction that properly belongs here? She is in no position to continually finance the world's business. She did before the war. We are getting our machinery up to the point where we can compete for it now.

(Governor Strong)

"What happened is this: they took increasing control of all the imports and no one could properly import anything without a license and the great bulk of the imports were for account of British companies. All supplies and all things, in fact, were required for the army and navy, as well as the civic population. Now the British Government paid cash, and the British treasury borrowings took place in advance, in London, of this mass of bills that otherwise would have been drawn to represent the imports of the civic population. The facilities to do business still existed - like the Bank of Shanghai, and so on. The standards of civilization are increasing ~~thus~~ in the east. There is a greater consumption of goods. There is a greater amount of business to go around. We will do still more than we do now through the foreign institutions of the world. Certainly, if it is possible to develop some hundreds of millions of bills at the present time, we will continue to do it in the future."

- - - - -

(Mr. Morgan)

"Do you think it would be in order to tell us what effect you think the change in the discount rates in this country will have upon the movement of gold? Do you think conditions are sufficiently normal now?"

(Governor Strong)

"Your question is a little bit like the question where the State asked the witness whether he is still beating his wife. I am assuming that the interest rates will decline. We have reduced one of our rates a little bit. I do not believe it is possible to answer that question, Mr. Morgan, except speculatively. — Turning to Mr. Snyder —) Did you put him up to ask that?" (Laughter)

- - - - -

(Question)

"Mr. Snyder has possibly lost sight of the fact that we have two facilities. We have a rediscount rate which is offered to various lines of business which do not necessarily have to do with our foreign trade. We have our open market purchase rate. We might keep our rediscount rate up to within a point where it is now and this would enable us to advance the business and still keep in with other lines of domestic business?

(Governor Strong)

"That opens up a field of discussion. It enables me, first, to sidestep Shepard Morgan's questions. I think it is a mistake to assume that a special rate on import bills is going tp be any check to inflation or expansion in this country, because, after all, you can't identify these dollars and insure that they are just below that type of transaction, and, even if you did, it would release other dollars for employment in other directions. The fact is that, according to my theory, what we dispense at the Reserve bank is credit. It is not one kind of credit, because it is exchanged for a commercial bill, or a commercial note, or a banker's acceptance, or a government bond, but it is just credit, and unless you meet that credit through this bank, it does not perform its function, and it does not make any difference whether you get it out with a rake, or a hoe, or a spade, - it does its business just the same. You can get at these reserves of ours with any kind of an instrument you please. By establishing this preferential rate we are able to compete in a certain line of business, it is true.

"Well, Mr. Snyder, I have doubled my promised time and now everybody expects to leave at 5 o'clock, as they have a dance on."

- - - - -

(Mr. Snyder)

"I am sure we are extremely indebted to the Governor for coming here and let us ask him questions and giving us such an illuminating prospect of this country entering the world war. Our best thanks Governor!"

Meeting Adjourned.