At a meeting of the Federal Reserve Board with The Advisory Council, held in the Assembly Hall, Metropolitan National Bank Building, at 11:15 A. M., on Tuesday, September 18, 1917.

Present:

Governor Harding, presiding, Mr. Warburg, Mr. Williams, Mr. Delano, Mr. Hamlin, Mr. Allen, Assistant Secretary, all the members of the Advisory Council, and Secretary Grim.

President Forgan read to the meeting recommendations of the Council as follows:

RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL TO THE FEDERAL RESERVE BOARD.

September 18, 1917.

TOPIC NO. 1.

The effect of the pending bond issue upon our general financial situation, the policy that the Federal reserve banks should pursue as to reserves against deposits and note issues, discount rates.

Recommendation:

The temporary effect of the pending Government bond issue upon the general financial situation will be to dislocate bank deposits. The effort to be made to place the bonds with small investors will also to a considerable extent encroach on savings deposits. As this loan will come on the market at the season when, in connection with the movement of crops, the greatest expansion of bank credit usually takes place, the banks, especially at the centers, will need the assistance of the Federal reserve banks in the shape of short loans or rediscounts to a greater extent than they did in connection with the former issue.

As the money received by the government for the bonds is redisbursed and returns to the banks through the channels of commerce the financial situation will gradually adjust itself to the new conditions created by the flotation of such a large issue of bonds.

Bank credits will likely be still further expanded, resulting in increased deposits and loans.

In anticipation of these conditions the Federal Reserve Banks should pursue a policy of conservation of their reserves against deposits and note issues. For this prupose, while they should meet liberally the temporary requirements of member banks for the prupose of putting through the government bond issue, any undue expansion thereafter of a more or less permanent nature should be curbed and controlled by the Federal Reserve Banks' discount rates; for the protection of their reserves the Federal Reserve Banks should raise their discount rates whenever occasion calls for such action. These banks should be kept in a strong position not only in the interests of further government financing but to prevent any undue expansion of credit by their member banks through the discount facilities afforded them.

TOPIC NO. 2

General discussion of the Foreign Exchange situation:
To what extent can this country continue to give credits to the nations with which it is associated in the war which normally send us gold in settlement of trade balances due us, and continue to ship gold to those nuetral nations to which we may be indebted. What restrictions, if any, are necessary upon our imports to offset the embargoes on exports?

Recommendation:

The Council has nothing on which to base a definite opinion as to what extent this country can continue shipments of gold to to neutral countries while itself advancing money to meet the requirements of the countries associated with us in the war. It seems to us the shipments of gold are a part of the contribution which we are making to these countries, being part of our advances to them, for the prosecution of the war. To what extent this can be continued without unduly impairing our resources it is difficult to tell, but there is no question that if such action tends to shorten the war or to enable the associated nations to win it, this country should not hesitate even to impair its resources for the purpose of accomplishing that object. As the war may be prolonged it may be necessary in conjunctuon with the other nations associated with us to endeavor to prevent the arbitrage of exchange as far as possible. In that connection we have read with great interest the report of the informal committee made to the Secretary of the Treasury on September 13, 1917, and heartily approve of their suggestions.

The Council views with great satisfaction the increase of the gold resources of the Federal Reserve system and hopes that no steps will be ommitted to increase and hasten the mobilization of the gold of the country in the Federal Reserve Banks. Great discretion however, must be used in the methods applied so as not to create alarm which may lead to the hoarding of gold and its consequent demobilization. We note with satisfaction that the President by proclamation has placed with your Board the control of gold exports. This will insure the handling of such transactions with the discretion so necessary to avoid public alarm.

TOPIC NO. 3.

Loss on Gold Abrasion (Suggested by Governor Harding)

Recommendation:

Inasmuch as it is of paramount importance that the gold now in circulation should be mobilized in the Federal Reserve Banks which to some extent is prevented because of the existence of light weight gold in circulation we think the Federal Reserve Banks would be justified in assuming the loss by abrasion on such of this gold as is offered to them on deposit within a reasonable, specified time.

Additional Recommendation:

Whereas, under section Four of H. R. 5901 (In the Senate of the United States, Calendar No. 121, September 13, 1917, Pages 7 and 8) the following language occurs:

"In any case of the issue of a series of convertible bonds, if a subsequent series of bonds (not including United States certificates of indebtedness, war savings certificates, and other obligations maturing not more than five years from the issue of such obligations, respectively) bearing interest at a higher rate shall, under the authority of this or any other Act, be issued by the United States before the termination of the war between the United States and the Imperial German Government, then the holders of such convertible bonds shall have the privilege, at the option of the several holders, at any time within such period, after the public offering of bonds of such subsequent series, and under such rules and regulations as the Secretary of the Treasury shall have prescribed, of converting their bonds, at par, into bonds bearing such higher rate of interest at such price not less than par as the Secretary of the Treasury shall have prescribed," -

Resolved that this Coucil is of the opinion that prior to the issue of these bonds it is essential that the Secretary of the Treasury should state definitely all the terms connected with them, including the price, at which any future issues bearing a higher rate of interest will be exchanged for them.

Additional Recommendation:

In our opinion it may be necessary for the successful administration of the Food Administration Grain Corporation that the limit placed on loans by the by National banks by Section 5200 U.S.R.S. should not apply to loans to this Corporation. This Corporation being own3d by the United States Government loans to it may properly be classified as loans to the United States Government and therefore not subject to the limitation of the law. We would recommend that an early ruling to this effect should be made and promulgated by the proper authorities. If this is not possible under existing law we recommend that the law should be amended.

General discussion ensued in which various ones took part. -

Mr. Fleishhacker called attention to the fact that one of the large savings banks in District No. 12 had lost $4,000,000 of its deposits through subscriptions to the last Liberty Loan, and suggested this as a subject which might well have the consideration of the Board, perhaps with a view to the recommendation of an amendment to the Federal Reserve Act permitting loans by Federal Reserve banks to savings on approved securities.

Governor Harding directed attention to the fact that such an amendment had been recommended by the Board in 1916 but failed of approval by Congress and also referred to a conference which he had recently had with the State Superintendents of Banking for Maine and New Hampshire and the conditions in those States.

Mr. Williams suggested an amendment which would permit savings banks to come into the System and obtain issues of Federal Reserve notes against certain classes of their securities actually owned and in the hands of offering banks six months prior to the date of offering.

Mr. Wing expressed himself as opposed to having savings banks brought into the Reserve system on the ground that this would be a source of weakness rather than of strength, and expressed the opinion that there was no particular danger in connection with the contemplated loan but that there probably would be difficulty should other large loans follow it. The savings banks, he said, must ultimately have some help.

There was further discussion of the matter, in connection with which Mr. Rue raise the question as to the method through which a mutual savings bank could subscribe to stock, and Mr. Mitchell favored steps to enable Federal reserve banks to loan to savings banks through member banks. The situation of English savings banks as the result of loans floated by England was discussed by Mr. Forgan, who said that in the central west he believed the savings bank operations were so combined with commercial banking that there would be a sufficient amount of commercial paper for rediscount to care for the situation at present. He said that in Chicago, with one or two exceptions, all of the savings banks had sufficient commercial paper for rediscount.

The New York situation was covered by Mr. Morgan, who said that the savings banks did not represent so large a share of the financial structure that the commercial banks could not readily take care of them in connection with this loan. He thought this also true of New England, and in reply to an inquiry from Mr. Warburg, who raised a question as to the willingness of commercial banks to care for the needs of savings banks, Mr. Morgan said it sould be necessary for them to do it, and that this was conceded pretty generally.

In summing up the discussion, Governor Harding expressed the opinion that the Federal reserve system should not be weakened in any way, that savings banks should have aid, and that ultimately the best source from which to obtain this aid was through the Government itself.

Each member of the Advisory Council was asked to state conditions in his district for the information of the Board, with special reference to (1) the relations of clearing operations to Federal reserve banks, (2) business conditions, and (3) prospects for the sale of the new issue of Liberty Bonds:

Mr. Wing, Boston. Boston's banks are using the Federal reserve clearing system with satisfaction, and the tendency is for banks to come into the System. There should be great care exercised in admitting smaller trust companies, as it is quite possible that they may be an element of weakness rather than of strength. The First National Bank, of which Mr. Wing is President, finds it necessary to carry a reserve with the Federal Reserve Bank of approximately $10,000,000 but finds that it is carrying in addition a float of $15,000,000 to $20,000,000 representing collections due from other banks, to rid itself of which it has found no adequate plan. Large savings banks are accumulating money, and there will probably be no trouble among them by reason of the next flotation of Government bonds for they can get help from commercial banks. In his opinion New England would take only about one-half the total of its last subscription to Liberty Bonds. This estimate Mr. Wing based upon the following:

1. Many corporations already hold substantial purchases of bonds.

2. The corporation tax.

3. The difficulty among corporations doing business with the Government in obtaining prompt payment, together with the need for all of their capital in the business in which they are engaged.

General business, Mr. Wing said, was falling off, but Government work is holding up the situation. There is a considerable scarcity of labor.

Mr. Morgan, New York. The Federal Reserve Bank is growing stronger every minute. It has the cooperation of member banks and others who want to enter the system. The recent opinion of the Attorney General as to the application of the Clayton Act to State bank directors was helpful. The savings bank situation in New York is not so large a part of conditions as to make it vital during the next loan. Business is diminishing, people being frightened by proposed and possible legislation. There is a tendency not to lend money. The sale of bonds is going to be difficult. Many small holders have not yet paid for their previous purchases. The real difficulty is the uncertainty as to taxes to be imposed. Mr. Morgan said New York, if it had to do so, wouldprobably take up 40% of the whole issue of bonds, say $1,500,000,000, but to do this it would have to draw upon other parts of the country. Mr. Williams interjected the statement that national banks now held less than $100,000,000 of the last issue of Liberty Bonds, and in reply to a question Mr. Morgan stated that he thought the interest rate on the new bonds should be 5% and that they should be fully taxable. Mr. Watts, of St. Louis, suggested that this was really the personal preference of the Secretary of the Treasury, but he was bound to recognize the exemption granted to state and municipal bonds.

Continuing, Mr. Morgan said that Government loans would have to come to a 5% basis, and that there was practically not a railroad in the country which was in condition to take any of the new issue of bonds because of the fact that notes were coming due and that money is being taken away from them.

Mr. Rue, Philadelphia, reported that banks in Philadelphia were practically all using the Federal Reserve Bank in one way or another in connection with their clearing operations. Some non-member banks operated through member banks. In reply to an inquiry from Mr. Warburg, Mr. Rue stated that in Philadelphia banks were, however, still settling clearing house balances in gold. The Staff of the Federal Reserve Bank is totally inadequate to handle all the collections, and cannot absorb all the float. Business is letting up, except where manufacturers are doing Government work. These corporations are heavy borrowers. It will be difficult to arouse enthusiasm for the new issue of bonds. People thought they could convert the first issue at the new rate and with the same conditions and privileges. Railroads have a serious problem before them and are not in a condition to subscribe. Trust companies are well loaned up. Mr. Rue would not prognosticate how much of the new issue of bonds the Philadelphia district would take.

Called upon out of order, Mr. Watts, St. Louis, reported that now only five clearing house banks in St. Louis were not members of the Federal Reserve System. Not very long ago a majority of all the local banks were not members, and in twelve months he thought all the rest would join. This membership covers 80% of the banks holding savings deposits, and in each case, the commercial operations of the banks having savings deposits predominate. The St. Louis district will come fairly well up in its previous allotment on the next Liberty Loan. The farmers were not reached in the last campaign but would be this time. More bonds will be sold to the moderate investor.

Mr. Mitchell, Minneapolis, also called upon out of order, reported that clearing house banks in the Twin Cities were practically all members of the system. Business conditions are normal. Crops are good. In Minnesota the wheat crop will be seventy million bushels, in North Dakota 65,000,000 bushels, but in Montana it will not be so good. He believed the farmers would sell their wheat at the price fixed by the Government and that the volume of bond sales in the Northwest would be less than at the previous offering unless banks subscribe heavily for their own accounts. The savings bank situation is not a large factor in the Northwest. State banks have not felt the necessity for joining the system to any great extent thus far.

Mr. Rowe, of Cincinnati, said the use of acceptances in that district was growing, especially in the vicinity of Pittsburgh. Depositors in the savings banks had accounts averaging $200 to $300 each, and he did not think they would be largely withdrawn on account of their moderate size and the interest rate of 3% to 4%. There is an active demand for money, and he thought issues of Treasury certificates were being purchased by corporations in anticipation of heavy taxes to be levied upon the corporations and for the payment of these taxes.

Mr. Norwood, Richmond, said the banks in the smaller places in that district were using the Federal Reserve Bank more and more, but that he was not familiar with the situation in Richmond. Business is active, crops good, and bonds will be sold to about the same extent as before.

Mr. Lyerly, Chattanooga, said the Federal reserve system was growing in favor and strength and that the savings bank situation in the Atlanta district could be cared for. There is an abundance of money, and it has been necessary to guard against expansion. Seventy-five per cent of the farmers have better crops than ever before. There are 125,000 in three cantonments in the district, bringing an expenditure of from $6,000,000 to $8,000,000 per month. If one-third the amount of bonds sold in the last campaign were taken by the Atlanta district in the next campaign he thought it would have done well. Their sale will be retarded by the changed conditions as to taxation.

Mr. Forgan, Chicago, said that all the clearing house banks were now settling their entire balances by drafts drawn on the Federal Reserve Bank, and all are delighted with the results. There are many small State banks which would like to come in, but which hold that they cannot afford to do so because they would be required, as central reserve city banks, to carry 13% reserves. The banks in his district have few of the bonds left, and are, therefore, ready for the next campaign. Business is very active, the demand for money heavy, and banks are lending large amounts.

Mr. Swinney, Kansas City, reported that a strike, now settled, had made havoc with business in Kansas City. The Kansas corn crop was very large. The district would do the very best it could in connection with the new issue of Liberty Bonds. It was hampered at the time of the last issue by the fact that its banks were borrowing considerable money. There will be no difficulty by reason of the savings bank situation in the 10th district. Conditions are generally good.

Mr. Swinney called attention to the need for subsidiary silver coin and small bills.

Mr. Record, Dallas, stated that crops were pretty good and that that district would probably absorb as many bonds as before.

Mr. Fleishhacker, San Francisco, said that the clearing house bank situation was working out in San Francisco and that the establishment of branches of the bank had been helpful. Business conditions are quite satisfactory, but the situation of the savings banks in connection with withdrawals for purchase of liberty bonds is not good. Labor is short, and there is much labor trouble. This district is much interested in the licensing of gold for shipment abroad, and Mr. Fleishhacker expressed the hope that the situation would be handled with care. The sale of the second issue of Liberty Bonds will take more time and be more difficult than the sale of the first issue because of the changed conditions.

At 1:15, the meeting adjourned.

APPROVED:

Chairman.

Secretary.