

1972

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ADDRESS REPLY TO
FEDERAL RESERVE BOARD

February 2, 1917.

Dear Sir:

The enclosed abstract of the Report of the Federal Reserve Board, which is to be released probably at 12 noon, on Saturday, February 3, has been prepared at the request of some members of the Press. Thinking that you might possibly have use for it, a copy is herewith forwarded to you. The abstract is not an official statement of the Board, but, as just stated, has been prepared as a matter of convenience to the press.

Very truly yours,

Enclosure:

February 3, 1917.

The Federal Reserve Board to-day sent to the Speaker of the House of Representatives its Third Annual Report covering the operations of the system for the year 1916. The outstanding feature of the document is its discussion of the existing banking situation as affected by possible conditions growing out of the present abnormal state of foreign trade, and the situation that may exist after the war is over.

To make the system an effective means of financial preparedness, able to guard against all contingencies reasonably to be expected, the Board proposes the reserve percentage amendments to the Federal Reserve Act already made known some time ago, which it estimates would result in massing in the Federal reserve banks a total sum of \$800,000,000 to \$900,000,000. Other proposed changes in the law would enable the Board to safeguard this stock, not only by varying discount rates, as at present, but also by changing reserve requirements, inclusive of those of member banks.

As a means of assisting in this process of mobilizing the gold of the country, the Board again proposes an amendment to the Act providing for the issuing of Federal reserve notes under liberalized conditions by permitting cash in the hands of Federal reserve agents to count as a part of the Federal reserve banks' own cash reserve.

This plan for an immensely powerful massed reserve is further amplified and worked out in its foreign aspects as shown by the statement that the establishment of connections with the great governmental banks abroad is under consideration, and that relationships not only with the Bank of England, as announced some time ago, but with other institutions will be authorized from time to time, such relationships to be employed as a means of regulating gold export movements. The central feature of the report is thus a highly developed and thorough-going plan for uniting and organizing the gold resources of the banks of the country under joint management, designed to render their use as effective and economical as possible, both at home and in international trade.

The report shows that the banking situation of the country taken as a whole is in some respects one of remarkable strength, because of the notable additions to the gold holdings of the banks and of the people at large, but a note of caution is sounded in the statement that there has been an even greater proportionate expansion of deposits and loans. The investment of the funds of the banks in long-term securities have been very large. Purchases of obligations other than those of the United States Governments now being more than six billion dollars, an increase as compared with the situation in June, 1914, of about \$1,300,000,000 or 27.2% of the sum then invested. According to the Board, the purchase of desirable foreign loans by American

investors has been a healthy and normal operation, and the recent statement containing a warning against undue extension of bank investments in foreign securities was intended simply as a caution to the banks that eventually the amount of securities to be taken over must depend upon the absorbing power of the investor himself.

The banking and currency situation has developed very satisfactorily during the year in a number of ways, which are fully described in the report. Interest rates have been low throughout the year, but the Board has found it unnecessary to establish any special low rates of discount as was done during 1915, and those that were already in effect have been but little availed of, owing to the satisfactory financial position of local farmers and traders. There has been a most encouraging improvement in the character of the paper circulation of the country, Federal reserve notes, practically equivalent to gold certificates and protected by 100% of gold, being issued to the extent of about \$283,000,000. At the same time the old national bank notes have fallen off to the extent of \$44,500,000, their places being taken primarily by the new gold secured notes. Coordinated with this process of strengthening and improving the circulation of the country has been that of rendering more effective the use and advisability of checks. The Board shows that there are now about 15,000 banks in and out of the Federal reserve system on which checks may be collected at par, and it predicts that further experience under the present plan of clearings and collection will at no distant date practically place the whole country on a par collection basis, inasmuch as banks will be likely to lose desirable business if checks drawn upon them are at a discount while checks drawn upon a nearby competitor circulate at par. While the clearing house system is thus moving forward toward complete success, the Board recommends amendments to the Federal Reserve Act designed to further improve and confirm it by facilitating the use of the System by State banks and trust companies. That the growing strength and efficiency of the Federal Reserve System is fully appreciated by the banks of the country is strongly set forth, the Board stating that the reserve banks have won the confidence of the public, that the system is established upon a firm and enduring foundation, and that information available shows that an increasing favorable attitude is being adopted toward it by strong State institutions. The new members gained by the System during the year 1916 numbered 130.

An interesting feature of the Report is the description of work done in the administration of the Clayton Act, and the so-called Kern Amendment. In a large number of cases directors of banks whose tenure of office was rendered unlawful under the new legislation voluntarily withdrew from one or more directorates, the result being to bring about a considerable change in the distribution of national bank directorships. The process of applying

the Kern amendment has, however, proved to be one of considerable difficulty and detail, and the Board points out that it must be regarded as a continuing operation, which can never be definitely finished, since the conditions will change, and the application of the law to individual cases will necessarily change with them.

The Board points out that practically all of the appeals for changes in Federal reserve districts have been disposed of in one way or another, and it devotes considerable attention to the question of domestic branches and agencies. No new branches have been established during the year, so that the branch at New Orleans remains the only institution of the kind in the system. It is pointed out that the experience gained from the operation of this branch makes it seem wise in every case where the establishment of a new branch is proposed, to consider with special care the question whether there is a real need for such a branch and whether it can be expected not only to increase the convenience of the member banks, but at the same time to make itself self-sustaining. In this same connection, it is further noted that the establishment of agencies or offices in various cities designed to meet the needs of the local banks is under consideration and that good success has been had with an agency of this kind at Memphis, Tenn., during the past year, the agency being established for the purpose of facilitating the handling of the cotton crop. It is, however, stated that the whole question of the establishment of branches is somewhat inadequately dealt with in existing law, so much so that the Board would welcome legislation designed to clarify its authority and duty as well as that of the Federal reserve banks themselves in this matter.

In dealing with the earning capacity of the system, the outstanding fact noted by the Report is that net profits for the past year amounted to 5% on the average for the whole system, as against an average net earning since organization of 3% of paid-up capital. The gross expenses for the year are shown to have been about \$2,200,000, while the net earnings were about \$2,750,000. A table of dividends shows that all the banks are now on a dividend basis, although none of them have provided for their fully authorized percentage up to date. This is in spite of the fact that the past year has been an unusually unfavorable period for the business of rediscounting, owing to the great plethora of funds in the vaults of banks generally and the prevailing low rates of interest.

The amendments to the Federal Reserve Act enacted by Congress in September, 1916, are commended as having added materially to the smooth working of the system, and a lengthy discussion of the detailed changes in the Act now recommended as a further improvement is furnished. Taken all in all, the Report shows a condition of greatly increased strength and capacity in the system as a whole, of favorable outlook for the future, and of expectation that with suitable legislation by Congress all probable contingencies to be expected within the near future can be amply guarded against.