

FEDERAL RESERVE BOARD.

Statement for the Press:

X-1374

Release simultaneously with
release of Annual Report to
be submitted to Congress 12
o'clock noon, February 8, 1919.

The Annual Report of the Federal Reserve Board for the calendar year 1918, as submitted to Congress today, has been prepared in much greater detail than heretofore and gives a most complete story of the national financing during the last and most important year of the Great War.

In submitting the report the Board says:

"In meeting the emergencies occasioned by the war, Governments everywhere have been compelled to make unprecedented drafts upon their national incomes and resources. With the great nations engaged in a death grapple, preservation of national life has been the supreme object. Most difficult questions of financial expediency have been presented to finance ministers in deciding upon the most available and effective means of mobilizing national resources. The decision once made, it became the duty of all separate administrative agencies concerned with fiscal or banking functions to cooperate in giving effect to policies adopted, and it was in this spirit of cooperation that the Federal Reserve Board felt it to be its duty to assist in making effective the policies determined upon by the Secretary of the Treasury, however inconsistent some of the steps necessary to be taken might be with principles which usually govern in normal times. The demands of war are imperative and must be met without delay, and in financing the titanic struggle happily ended by the armistice last November, first consideration could not always be given to what was theoretically desirable, or convenient from the standpoint of banking practice.

The financial obligations of the Government are being met, the war has been won, hostilities have been ended, and representatives of the United States and the allied powers are now in conference regarding terms of peace. The country is confronted, it is true, with the problems incident to the demobilization of troops, the readjustment of prices, and the diversion of industry from war activities to the employments of peace. We are approaching an era of general readjustment and resumption of construction at home, and of reconstruction abroad, but the termination of the war at a time far in advance of popular expectation has minimized instead of magnified our national problems. We should have been

confronted with them in any event whenever the war terminated and the Government has not been required to withdraw from their ordinary employment the 2,000,000 or more of men it was preparing to withdraw in September last, nor is the country faced with the necessity of equipping them, and of maintaining overseas military and naval forces for a year or more of 4,000,000 to 5,000,000 men. The expenditures of \$25,000,000,000 to \$30,000,000,000 which had been anticipated for the year 1919 will be greatly reduced, and instead of sending new men to the front the Government is bringing back a large portion of the forces which it had been maintaining abroad.

country'

"Within a few months the war financing will have been completed, and the Board can then deal with the problems incident to bringing our credit structure and our banking operations back to a commercial basis. Our banking situation is strong and inherently sound, and is much stronger than would have been the case had the war continued for another year.

"On December 31 the Federal Reserve Banks held a reserve of about 50 per cent against their combined liability for deposits and note issues, and if the reserve against deposits be computed on the basis of the legal requirement of 35 per cent, the reserve against Federal Reserve notes would be 60 per cent. The ability of the country to absorb investments has proved to be far greater than had been anticipated, and our credit structure, although expanded, is unshaken. We have no currency problems, and conditions are not comparable with those which existed at the close of the Civil War, and while the volume of circulation is larger than it has been at any period in our history, there has been no depreciation in the gold value of our currency, every form of which is on an absolute parity with gold. True, the purchasing power of money has declined, but this is due to the abnormal and urgent demands for goods and services and the accompanying expansion of credit and currency. The quality of our currency has been maintained; there is a single standard of prices which is based upon the dollar, and not a double standard, one based upon the gold dollar, and the other upon the paper dollar, as was the case during and after the Civil War. The increased volume of Federal Reserve notes has been an incident or an effect of expansion of credits, rather than the cause of such expansion, and the conditions which resulted in additions to the country's gold stock of more than \$1,000,000,000 during the years 1915 and 1916 have changed.

"With the development of our foreign trade, with increased shipping facilities, and with the granting of credits to other nations to aid them in their work of reconstruction and to enable us to sell them goods, a new influence will be felt in due course, which will work towards the restoration of more normal levels. Banking credits, which are not extended beyond our power to sustain them, but which are at present concentrated in this country, will become more widely diffused throughout the world and the elastic quality of our currency, the main constituent of which is now the Federal Reserve

- 3 -

note, will soon be manifest, as indeed it has already been evidenced in some degree by the retirement of approximately \$200,000,000 of notes since the close of the year."

In this connection, attention is called to the fact that, while the minimum reserve against Federal Reserve notes required by law is 40%, as a matter of fact, this reserve has not fallen below 60%, and that, while the maximum of Federal reserve notes in circulation during the year was \$2,701,956,000, the 60% gold reserve (which otherwise would have been in circulation) held against such notes was \$1,621,173,000, so that the actual increase of circulation due to Federal Reserve notes amounted to but \$1,080,783,000.

"An obligation", says the report, "rests upon the American people to assist the Government in the completion of its financial program and to absorb the securities which have been and are yet to be issued. This absorption can be accomplished by reasonable economies and by persistent saving for some time to come, and it will be the duty of the Federal Reserve Board and of the banks in the meanwhile to aid in the extension of credit facilities, necessary in the processes of production and distribution."

That the Board is not unmindful of the many elements of danger lurking in forced and premature contraction of credit and currency is shown by the following extract from its remarks:

"Drastic contraction would be followed by results no less disastrous than those which would attend undue expansion, and the processes of deflation must therefore be permitted to work themselves out in a gradual and orderly manner. Discount rates, which for the past 18 months have been based upon the rates borne by Government issues, must for the time being continue to be fixed with regard to Treasury requirements, but when the war obligations of the Government have been digested, and the invested assets of the Federal Reserve Banks have been restored to a commercial basis, rates can be established with reference to the commercial requirements of the country."

"The Board is profoundly conscious of the responsibilities imposed upon it by the Federal Reserve Act, and during the period of readjustment and afterwards as progress is made in the re-establishment of peace conditions, its purpose will be to exercise its control of our credit structure in such manner as best to promote the national welfare, the agricultural, industrial, and commercial interests of the country, and the development of our foreign trade."

X-1374

- 4 -

Some conception may be had of the great service rendered by the Federal Reserve System to the Government in its war financing in noting the following statement of the fiscal agency operations of the Federal Reserve Banks:

"A total of \$11,113,816,250 of bonds of the third and fourth Liberty loans, and \$10,659,743,000 of Treasury certificates of indebtedness issued in anticipation of these loans, of the forthcoming fifth loan, and of 1918 and 1919 tax receipts have been subscribed, allotted and collected through the 12 Federal Reserve Banks.

"Including operations in 1917, certificates of indebtedness and Liberty bonds subscribed for and collected through the Federal Reserve Banks have amounted to \$31,452,290,250, composed of \$14,529,708,000 of certificates and \$16,922,582,250 of Liberty bonds."

In an interesting chapter dealing with the development of the market for bankers acceptances the Board gives a full explanation of the reasons for the variance between the London and New York market rates, pointing out that while the London market rate has been lower than that in New York the official (Federal Reserve Bank) rate has been 4-1/2 % as against an official (Bank of England) rate of 5%.

Opening the chapter relating to its discount policy, the Board says:

"The discount policy of the Board has necessarily been coordinated throughout the year with Treasury requirements and policies, which in turn have been governed by demands made upon the Treasury for war purposes. All lines of business activity have been subordinated to war necessities; more than two million men have been under arms in France, another million at stations and training camps in this country, half a million more were in the Navy, making more than three and a half million men actually under arms; and it is estimated that the labor of fifteen million more has been devoted to the production, manufacture and distribution of commodities and material required in the conduct of the war. The Government has been the principal purchaser and consumer of goods, as well as the chief employer of labor, and the financing of the Government therefore has been of ~~paramount~~ importance from a commercial as well as a patriotic point of view.

The rates of interest borne by the Treasury certificates of indebtedness and by the Liberty loan bonds have been determined by the Secretary of the Treasury within the limits fixed by Congress, and the Board has felt it to be its duty to adjust its discount rates in such manner as to assist the distribution of the various Treasury issues.

The Board has therefore continued the policy, as explained in the last annual report, of giving a preferential rate of discount to notes made or offered by member banks secured by the Government's war obligations, and has continued to ~~permit~~ the Federal Reserve Banks to discount for nonmember banks, upon the indorsement of a member bank, notes secured in this manner."

The following statement is quoted as illustrating the manner in which the System has fulfilled its mission in making funds available as needed throughout the country by means of rediscounts and sales of paper between Federal Reserve Banks:

"Transactions of this character between the Federal Reserve Banks have been unusually heavy during the past year, due to three causes named in the order of their importance; First, transfers of Government funds; second, joint purchases of bankers' acceptances; and third, seasonal requirements incident to crop moving.

The Board's policy has been to equalize, in an approximate degree, the reserves of the 12 Federal Reserve Banks with the purpose of avoiding undue variations in their reserve position. Discount transactions between the banks have not, as a rule, been negotiated by the banks themselves, but through the medium of the Federal Reserve Board, instructions being given by telegraph, and transfers incident to the operations were effected in the same way.

Open-market purchases of bankers acceptances have shown a very substantial growth. Investments in paper of this class reached a maximum of \$388,383,000 on October 25. The principal market for acceptances is New York, although an open market for them has been established in Boston under the auspices of the Federal Reserve Bank there. The Federal Reserve Banks of other districts have found it more convenient to participate in the purchases of acceptances made by the Federal Reserve Bank of New York, and some of the banks have undertaken to take care of the acceptances originating in their own districts which are sold in the New York market. Voluntary transactions between the banks in acceptances have been permitted without the indorsement of the Federal Reserve Bank selling them, but in all cases where the Board has required rediscount operations the indorsement of the bank disposing of the paper has been given.

Rediscounting because of seasonal or crop-moving requirements has been confined to five banks- the Federal Reserve Banks of Kansas City, Minneapolis, Dallas, Atlanta, and Richmond- but it is probable that none of these banks would have had occasion to rediscount except for the fact that they were discounting heavily for member banks paper secured by Government obligations. Transactions in paper of this class have been so heavy and transfers of balances from one district to another so constant that the process of rediscounting between banks has been continuous through the greater part of the year.

All of the banks have disposed of paper except the Federal Reserve Banks of Cleveland and San Francisco. Rediscount operations between the Federal Reserve Banks, including voluntary purchases of bankers' acceptances, during the year, have aggregated \$655,638,000, as shown in detail in the following table:

INTERDISTRICT MOVEMENT OF BILLS DISCOUNTED OR PURCHASED BY FEDERAL RESERVE BANKS
DURING THE PERIOD FROM JAN. 1 TO DEC. 31, 1918.
(In thousands of dollars)

Federal Reserve Bank.	Rediscounts and sales between Federal Reserve Banks.			Acceptances purchased for account of other Federal Reserve Banks.		Direct purchases of acceptances in other Federal Reserve districts.		Interdistrict movement of discounted and purchased paper.	
	Rediscounted or sold by -	Discounted or purchased by -	Excess of rediscounts and sales.	Excess of discounts and purchases.	Amount purchased by -	Market in which purchased.	Purchased by bank.	Excess movement from -	Excess movement to -
Boston	120,297	19,898	100,399		1,907	2,057	2,503	92,046	
New York	180,901	67,681	113,220		174,860	41,634		329,714	
Philadelphia	50,149	66,365		16,216	18,949		21,397		56,562
Cleveland		137,115		137,115	65,628		5,014		207,757
Richmond	69,063	331	68,732					68,732	
Atlanta	75,293	2,514	72,779		57			72,722	
Chicago	9,984	195,398		185,414	1,093		3,685		190,192
St. Louis	12,500	9,051	3,449				2,770	679	
Minneapolis	24,996	99,462		74,466	6,384		2,057		82,907
Kansas City	8,530	25,047		16,517	11,047				27,564
Dallas	103,925	3,242	95,683		1,283		265	94,135	
San Francisco		24,534		24,534	68,512				93,046
Total	655,638	655,638	454,262	454,262	174,860	174,860	43,691	43,691	658,028

X-1374

- 7 -

The following brief table quoted in the Report gives a graphic picture of the effect of two years of war financing upon the Federal Reserve System. It will be seen that the enormous needs of the country, both for military and commercial purposes, have been provided for, while the System's surplus over required reserves has been lowered only by \$17,400,000.

(In millions of dollars)			
	Apr. 5-6 1917	Dec. 27, 1918	Increase.
Total cash reserve	952.7	2,146.2	1,183.5
Total net deposit and Federal Reserve (note liabilities)	1,136.8	4,238.1	3,101.3
Total required reserve	416.7	1,617.6	1,200.9
Reserve percentage	84.7	50.6	34.1
Total earning assets	225.6	2,318.2	2,092.6
Free Gold	546.0	528.6	17.4
Federal reserve notes outstanding. . .	400.7	2,855.6	2,454.9
Collateral:			
Required paper (a) 22.3 (b) 1,567.3			1,545.0
Gold (c) 373.4 (d) 1,288.3			849.9
Note issue power	1,365.0	1,321.5	43.5
(a) 6 per cent (b) 55 per cent (c) 94 per cent (d) 45 per cent			

The material changes in the items comprising resources and liabilities of the Federal Reserve Banks from March 30, 1917 (which date was prior to the declaration of war and also before the act was amended on June 21, 1917, which changed reserve requirements by providing that all reserves of member banks be carried with the Federal Reserve Banks), to December 27, 1918, were:

(In millions of dollars)			
Resources	Increase	Liabilities	Increase
1. Cash:		Capital	25
Gold	1,152	Surplus	1
Legals and silver	47	Deposits:	
	1,199	Government	43
2. Bill holdings:		Member bank	867
Discounts-		Foreign Government. .	
War paper.	1,400	(and other credits	107
Other discounts	283		1,017
Acceptances.	219	Federal Reserve notes	2,328
	1,902	Federal Reserve bank notes	117
3. Government securities		All other liabilities, net	
Long term		including 1918 net earnings	55
Short term	264		
4. Warrants. (a) 16		Total	3,543
5. Float	171		
6. 5 per cent redemption fund against Federal Reserve bank notes.	6		
7. All other resources, net	17		
Total	3,543		
(a) Decrease			

Figures showing the earnings and expenses of the several Federal Reserve Banks for 1918 have already been made public. The aggregate net earnings were \$55,446,979, while the average rate of earnings for the year, based on total invested assets, was 4.12%. It is interesting to study the table of changes during the year in the several classes of earning assets held by the banks, viz:

(In thousands of dollars)

	Jan. 4, 1918.	Dec. 27, 1918.	Increase.
Bills discounted:			
Secured by Government war obligations:			
Customers' paper	145,208	363,025	217,817
Member banks' collateral notes.....	140,711	1,037,346	896,635
Total	285,919	1,400,371	1,114,452
Otherwise secured and unsecured -			
Agricultural paper.....	7,901	29,384	21,483
Livestock paper.....	8,601	27,334	18,733
Member banks' collateral notes.....	61,110	21,616	(i)39,494
Trade acceptances -			
In the foreign trade.....)		(27)	
In the domestic trade.....)	14,769	(15,959)	1,217
All other, n. s.....	247,513	208,247	(i)39,266
Total	339,894	302,567	(i)37,327
Total discounted bills.	625,813	1,702,938	1,077,125
Bills bought in open market:			
Bankers' acceptances -			
In the foreign trade	180,609	129,162	(i)51,447
In the domestic trade.....	82,867	166,493	83,626
Dollar exchange bills.....	1,850	796	(i) 1,054
Total	265,326	296,451	31,125
Trade acceptances -			
In the foreign trade.....	5,516	3,843	(i) 1,673
In the domestic trade.....	496	3,379	2,883
Total	6,012	7,222	1,210
Total bills bought in open market .	271,338	303,673	32,335
United States Government long-term securities.....			
United States Government short-term securities.....	51,167	28,869	(i)22,298
All other earning assets.....	92,058	282,677	190,619
	5,167	13	(i) 5,154
Total earning assets.	1,045,543	2,318,170	1,272,627

(i) Decrease.

Attention is directed to the fact that "of the total of \$897,151,000 bills discounted and bought, as shown by the statement of January 4, 1918, \$285,919,000, or 31.9% thereof, consisted of paper secured by Government war obligations, the balance being other notes and bills rediscounted for member banks, \$339,894,000, and bills and acceptances purchased in the open market \$271,338,000. The total of paper secured by Government war obligations held by the Federal Reserve Banks on December 27, was \$1,400,371,000."

The report deals in detail with the operations of the various divisions of the Board's work. That bearing on the work of the Division of Foreign Exchange, under the administration of Director F.I. Kent, is particularly interesting. This division, acting in co-operation with all other interested departments and bureaus of the Government and through its close relations with the postal and cable ownerships, has served the twofold purpose of stopping transactions that would have benefited enemies or allies of enemies and of accumulating a vast store of valuable statistical material bearing on the trend of business throughout the world.

The Report reviews at length the successful working of a plan of daily settlements through the Gold Settlement Fund, maintained at Washington. It says that

"Combined clearings and transfers through the fund during the year 1918 aggregated \$50,242,592,000, as compared with \$27,154,704,000 in 1917, \$5,533,966,000 in 1916, and \$1,052,649,000 in 1915, making a grand total of \$83,983,911,000 since the operation of the fund was begun May 20, 1915. A comparison of the amounts of the average weekly settlements shows clearly the growth of the volume of transactions.

Average weekly volume of clearings and transfers:	
1918, July 1 to Dec. 31	\$1,064,596,000
1918, Jan. 1 to June 30	966,203,000
1917	522,206,000
1916	106,422,000
1915	31,898,000

Analysis of the principal transactions growing out of the Government's financial program, and of the transactions through the gold settlement fund since the declaration of war, April 6, 1917, shows the important part the fund has played in fiscal agency operations, for through it the Treasury has been enabled to transfer, without the actual handling of cash, vast sums from districts where they had accumulated to other districts where funds were needed to meet disbursements, the time consumed in transfers being measured in minutes instead of days."

The efficacy of this up to date method of settling balances between various sections of the country has led the Board to suggest the possibility of an international gold fund, based upon a similar principle. The Board says:

"The successful operation of the gold settlement fund has suggested the possibility of avoiding shipments of gold from one country to another in settlement of balances arising out of ordinary commercial transactions, and the Board is ready, if authorized to do so, to undertake negotiations looking to the establishment of an international gold exchange fund, or to assist in any way in its power in negotiations which may be begun by a Government department looking to that end. The Board realizes that the successful operation of a plan of this kind is dependent upon the stability of the governments concerned, and believes that definite plans can not perhaps be worked out until a stable peace has been assured. The Board would point out the importance of excluding all transactions arising from the adjustment of war obligations and of limiting the work of the fund to current commercial and exchange transactions. The gold deposited in a government bank or banks should be in the nature of a special or trust fund, and all nations participating should deposit their proper proportions of gold. Assuming that the leading nations of the world will be at peace for a long period of years, there seems to be no reason why an international arrangement of this kind should not operate as efficiently as our own gold settlement fund, which has cleared enormous transactions between distant sections of a country of vast area. The saving of loss and expense incident to abrasion and transportation charges and interest on gold transferred will be enormous, and the advantage to the commerce of the world will be incalculable. It will probably be necessary in the beginning to limit participation in the fund to the United States and the entente allies, and to a few of the leading neutral nations, but it is conceivable that all civilized countries may eventually be participants."