X-1427

The following recommendation was made by the Federal Advisory Council to the Federal Reserve Board:
(Meeting of February 17 and 18, 1919.)

Topic 9.

You have asked our advice as to the discount rates current at the Federal Reserve Banks, particularly as they are affected by the amount of Government issues remaining undigested as evidenced by the fact that the larger part of the invested assets of the Federal Reserve Banks consists of member banks' 15-day notes secured by Liberty bonds and Treasury certificates and of customers' notes maturing within 90 days secured in like manner.

The Board would like the opinion of the Council as to the merits of differential rates. Assuming the differentials have been necessary to aid the Treasury in floating its securities, does the Council feel that differentials with respect to the character of paper and not to time of maturity should be continued as a permanent policy?

Recommendation: Until the Liberty bonds already issued and the Victory bonds to be issued are distributed among permanent investors and paid for by them and until the banks are relieved of the obligation they are under to carry such large lines of them for their patriotic customers who have gone in debt for them, and until our Government gets through with its temporary financing on short-time certificates, the discount rates at the Federal Reserve Banks should continue to show some preference on loans covered by Government securities. The rates might well be continued as they now are until after the next bond issue has been placed, but there will come a time when such preference should not be continued, otherwise loans on Government securities will continue to form too large a proportion of the Federal Reserve Bank loans to the disadvantage of commercial paper and therefore to the disadvantage of industrial and commercial enterprise. The financial necessities of the Government for the payment of its war debts will however have to be met and provided for before such discrimination in favor of loans covered by Government securities as will induce people to borrow to pay for them in anticipation of their future earnings and incomes can be discontinued.

X-1427

The following recommendation was made by the Federal Advisory Council to the Federal Reserve Board:
(Meeting of February 17 and 18, 1919.)

Topic 10.

You have asked for the views of the Council, as to whether it will be necessary for some time to come in order to develop an acceptance market in this country to stimulate it by a low rate at the Federal Reserve Banks, and you have drawn our attention to the lower rates prevailing in London for bankers' acceptances than those current here.

Recommendation: In the opinion of the Council the acceptance market in this country is developing as well as could be expected. The market for bankers' acceptances is now and has been materially interfered with by our Government's financing on certificates of indebtedness. This interference will continue as long as the Government continues its short-time financing. In the meantime the acceptance rates at the Federal Reserve Banks should be maintained just about as they have been. When conditions again settle down on a peace basis supply and demand combined with competition in foreign markets will govern such rates. In comparing discount rates for bankers' acceptances current here with those current in London it should be remembered that during recent years much of Europe's foreign business, particularly that of England, has been financed through loans made by our Government. In this connection it is of interest to note that the acceptance business of the London banks and banks domiciled in London, on December 31,1912, amounted to approximately £ 117,000,000 sterling, while on December 31,1917, the same had fallen to approximately £ 82,000,000. On August 31,1918, it had advanced to £ 86,000,000. This decrease of from 25 per cent to 30 per cent in the volume of the London acceptance business, together with the fact that our loans to the British Government had the effect of largely relieving the London banks of responsibility for financing their Government on short-time obligations while it threw exactly that burden on the banks of this country, largely accounts for the low discount rates for acceptances prevailing there and for the higher rates prevailing here. When England again resumes the financing of her imports and exports through the ordinary banking channels and the present artificial restrictions are withdrawn by both Governments in connection with their imports and exports, and our Government restrictions on all foreign exchange transactions are removed a better equilibrium of the two discount markets is likely to be established. In other words, foreign exchange markets during the war have been in quite an abnormal condition and are likely to continue so until Government war debts between the nations are finally and permanently adjusted and international business transactions return to their normal and natural course free from the governmental restrictions and impediments placed on them during the war. Until then existing conditions do not afford an equitable basis on which a comparison of current rates existing in London and New York can be made.

The following recommendation was made by the Federal Advisory Council to the Federal Reserve Board:
(Meeting of February 17 and 18, 1919.)

Topic 11.

The Council would draw the attention of the Federal Reserve Board to the following:

Under the provisions of section 5202 of the national bank act the liabilities incurred by a national bank directly and indirectly can not exceed the amount of its capital stock except for certain purposes named.

It would seem that the amount of bills of exchange which a national bank may discount in London and other foreign centers comes under the prohibition of this section.

The rate at which 60 or 90 days bills of exchange on London are sold in this country is based upon the sterling cable rate less certain deductions, principally an interest charge at the open market rate in London for discounting bills. This rate, which to-day is 3-7/16 per cent rules much below market rates for money in this country.

In purchasing export sterling bills a national bank must discount the bill in London immediately upon its arrival if it is to engage in a profitable transaction. If it does not discount the bill it carries a 3-7/16 per cent investment to maturity when money in this country is worth more. This no bank will do.

But to engage in this class of business to the extent required by the demands of American exporters and to discount the bills purchased upon their arrival in London the contingent liability created by the bank by the indorsement of bills will quickly exceed the amount of its capital.

As it is the desire of the Federal Government and the Federal Reserve Board to encourage as far as possible the development of bankers' acceptances and the financing of foreign commerce by American banks to meet the competition of London banks, it is suggested that section 5202 be amended so as to exclude from its prohibitions the liability created by national banks as an indorser on accepted bills of exchange actually owned by the bank and rediscounted at home or abroad, or if this object can be accomplished by a ruling of the Federal Reserve Board it would be more desirable than to attempt an amendment to the act.

There is no limit to the amount of bills drawn against actually existing values which a bank may purchase and hold, hence it would seem logical that there should be no limit upon the amount which a bank might negotiate by indorsement.