F E D E R A L   R E S E R V E   B O A R D

STATEMENT FOR THE PRESS

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The Review of the Month for the October Federal Reserve Bulletin, says:

PUBLIC FINANCE IN SEPTEMBER.. Fiscal operations of the Government during September were unusually large and included issues on September 2 of \$573,841,500 of five months' $4\frac{1}{2}$ loan certificates, and on September 15 of two series of tax certificates, of which one, for six months, and bearing interest at the rate of $4\frac{1}{2}\%$, yielded \$101,131,500 and the other, for twelve months, and bearing interest at the rate of $4\frac{1}{2}\%$, yielded \$657,469,000. An analysis of the amounts taken in each Federal Reserve district of each of the three series is given in the following exhibit:

Federal Reserve District.	Series C-1920	Series T 9	Series T 10	All three series.
Boston	\$45,765,500	\$5,704,000	\$31,752,000	\$83,221,500
New York	252,679,000	25,582,500	412,319,000	690,580,500
Philadelphia	27,155,000	5,563,000	54,586,500	87,304,500
Cleveland	39,088,500	8,788,000	53,802,000	101,678,500
Richmond	10,493,500	2,999,500	10,339,500	23,832,500
Atlanta	19,312,000	3,706,000	5,618,000	28,636,000
Chicago	63,193,500	24,097,500	35,172,000	122,463,000
St. Louis	17,975,500	3,614,500	12,232,500	33,822,500
Minneapolis	16,000,000	4,750,000	7,750,000	28,500,000
Kansas City	16,000,000	2,835,000	4,165,000	23,000,000
Dallas	23,179,000	3,491,500	8,232,500	34,903,000
San Francisco	43,000,000	10,000,000	21,500,000	74,500,000
Total	\$ 573,841,500	\$101,131,500	\$657,469,000	1,332,442,000

Redemptions of outstanding Treasury certificates were considerably larger and included:

1. The redemption on September 9 (when a 20% installment on the Victory Loan was due) of outstanding balances of the last two series of certificates issued in anticipation of the Victory Loan and due September 9 and October 7 respectively.

2. The redemption on September 15 (when the third installment of the Income and War profit taxes was payable) of the outstanding balances of two series of tax certificates.

At the beginning of the month it was calculated that the aggregate amount of certificates maturing or called for redemption during the month was in the neighborhood of 1800 millions, and that this amount, somewhat reduced by exchanges and cash redemptions, would be fully covered from the cash in bank, and payments on account of Victory Loan subscriptions, also income and profit taxes due on September 9 and 15 respectively. In his circular of September 8, the Secretary of the Treasury announced that there remained no other maturities of certificates to provide for prior to 1920, as the certificates maturing December 15, of which over 750 millions had been issued, were more than covered by the income and profit tax installment due on that date. The total amount of Treasury certificates outstanding at the end of September is slightly over 3.5 billions (as against $6\frac{1}{4}$ billions on April 30) of which only about 1.6 billions are loan certificates requiring to be refunded.

In view of the success attaining the most recent tax certificate issues, which realized 757.5 millions in the three days during which subscriptions were taken, and the very large cash balance of the Treasury it is expected that no new certificate issues will have to be resorted to during the month of October.

OUTLOOK FOR LIQUIDATION. More than this, material improvement in the financial position of the Treasury and the favorable conditions on which recent issues of loan certificates have been placed carry confirmation of the views expressed by the Secretary of the Treasury in his letter of July 25 and repeated in his letter of September 8 that the borrowing operations incident to the financing of the war would be carried to completion without another great funding loan. So far as long-term government war financing is concerned, it may be said to have come to a close with the Victory Loan. Such financing as is still to be provided can clearly be carried through by short-term issues maturing on tax dates.

The outlook is distinctly encouraging, therefore, for an improvement in the investment status of the outstanding funded securities of the Government and, with it, for an improvement in the loan and investment accounts of the banks. The extent to which the banks of the country subscribed to war bonds of the different issues which they did not intend as a matter of policy to carry permanently as a part of their long-term investments, can not be accurately determined. Neither can the volume of loans made by the banks to customers on account of their subscriptions to government war issues and still outstanding be accurately determined. Details of an estimate made for this purpose and elsewhere presented in the Bulletin indicate that the volume of unabsorbed war securities is undoubtedly large. Liquidation of these war finance investments and loans is clearly a necessary preliminary to any large and genuine improvement in the banking and credit situation. Such liquidation means the purchase of war securities by actual investors. That such liquidation will be stimulated through improvement in the market for government bonds is clear. The recent improvement in the government bond market, fore-shadowing as it probably does a progressive improvement because of increased realization that government long-term financing is over, is, therefore, of good augury for the general banking situation.

Liquidation, in the natural course, of war loan accounts seems likely before long to become a characteristic of the banking trend. Whether such liquidation, however, will result in a lasting decline in the total volume of outstanding bank credits will depend upon the state of industry and trade and upon the movement of prices.

DISCOUNT POLICY. As the period of war financing begins to approach its end, the Federal Reserve Banks will again be in a position to shape their policies without being under the necessity of giving first consideration to the interests or needs of the Treasury. Since the entry of the United States into the great war, the Federal Reserve Banks have from the necessities of the situation utilized their resources in every legitimate way in support of war finance. Their discount policy, in particular, has been shaped, first with a view of facilitating the placement of the great issues of both long-term and short-term obligations brought out by the Treasury, and secondly with a view of stabilizing the market for Liberty Bonds. With these objects in view, differential rates (details of which are elsewhere presented in the Bulletin) have been maintained at Reserve Banks in favor of borrowings by member banks either on their own or their customers' notes, when secured by war obligations.

The effect of this policy of differential rates has reflected itself in the successful placement of five great loans aggregating $21,500,000,000 and many issues of tax and loan certificates. The preferential treatment thus extended to borrowers on government finance account has justified itself not only by the results achieved but, also, was justified by the unquestionable fact that, during the war and until the financial operations incident to the war were completed, the main business of the nation was the efficient prosecution of the war and the first duty of its financial and credit system, therefore, the constant support of the Government's financial program.

The disappearance of the Treasury from the long-term loan market and the rapid reduction in its requirements for short-term accommodation fore-shadows the approach of the time when the differential rate as an agency for furthering the financial operations of the Government may be expected to disappear and Federal Reserve Bank rates once more be fixed solely "with a view of accommodating commerce and business."

EXPANSION AND DISCOUNT RATES. The extent to which Federal Reserve Bank rates may normally be expected to be "effective", in the sense in which that term is used in England and Continental Europe, still remains to be determined. Our experience under the Federal Reserve System is too brief to enable definite conclusions to be drawn with reference to this matter. It seems doubtful, however, whether, for a long time to come and taking the country as a whole, there will be any such close connection of Reserve Bank rates with the volume of credit in use as was to be noted for example in England, the home of central banking, in pre-war days. Our nearest approach to an effective Reserve Bank rate was reached in the closing months of the year 1916.

The habitual temper of the American business community is sanguine and American business is, for the most part, done on liberal margins. The bulk of the requirements for credit facilities comes from industry and trade mainly domestic in its origin and character. Such a condition does not make for sensitiveness to the influence of changing rates such as was the case in England where much business is done on a narrow margin of profit and where banking resources were normally largely employed in the international loan market.

At any rate it seems fairly clear that little desirable restraining influence could have been exercised by Reserve Bank rates in recent months. While repeated tendencies toward speculation of one kind or another have manifested themselves and, at times, given rise to an undesirable situation, there is no reason to believe that an advance of rates would have held these tendencies in check, at any rate no such advances as could have been undertaken without serious injury to legitimate business and desirable enterprise which was entitled to encouragement and support. There is no ready method in reserve banking by which the use of reserve facilities can be withheld from use in undesirable lines of activity without, also, being withheld from use in desirable lines.

The problem of controlling the volume and uses of credit in a country with so much diversity of business interests and business temper as the United States is far from simple and far from certain of solution. Experience alone can determine whether and in what manner a technique of control through rates can be developed which will secure the desired results. The objects to be obtained are however clear and vastly important. They are to regulate the volume and uses of credit so as to give at all times to productive industry the beneficial effects of credit stimulus and support without, however, opening the way to the costly evils of credit and price inflation.

CREDIT AND PRICES: The dependence of prices on credit has had convincing examplification in the past few years. Credit expansion has admittedly been one of the major influences in bringing prices to their present levels. The way in which credit affects prices nevertheless requires discriminating analysis. Of itself and alone, credit can not be said to determine prices. Credit affects prices only as it is used in the purchase and payment of things. It can affect prices, therefore, only when acting in conjunction with other favoring conditions.

There are times when the banking organization has large reserves of credit power and yet industry and trade being "slow" there is little demand for additional credit and consequently little credit is added to the volume of credit in use and consequently little effect is exerted by credit in changing prices. A bank may offer a customer credit but it can not make him take it. It is the credit which is taken and used, not the credit which is offered, that counts in the movement of prices. There are other times when the reserves of credit power are low and yet the demand for credit, because of buoyancy in industry and trade, is large and the volume of credit in use consequently large and its influence on prices unmistakable. The volume of credit in use depends, therefore, quite as much upon the state of trade as it does upon the state of credit. The limits within which the use of credit can be forced by the banks are pretty narrow. Credit, as such, can not, therefore, be said to be the cause of price changes. By enabling and facilitating transactions in the purchase and sale of materials and goods and labor, which require the use of a large volume of purchasing media, credit nevertheless is a decisive factor in the price situation. It is the business of the banking organization to create and supply purchasing media. Thus, at times, when trade is brisk and the spirit of industrial enterprise runs high, the increased volume of credit supplied by the banks sustains and facilitates, if it does not indeed induce, the purchasing movement and thus supports the rise in price levels. Without such an enlargement in the volume of circulating credit or purchasing media in other suitable forms, the accommodation of prices to changing conditions in a period of activity would be impeded. While credit, therefore, can not create a situation which results in high prices, it is equally true that a situation which results in high prices can not eventuate without the assistance and mediation of credit. While there must be a desire for the use of credit before credit can expand, once under way an expansion of trade gets so much encouragement, stimulus and support from an expansion of credit that it is at times difficult to say which is more cause and which is more effect, so closely interdependent and interwoven are the two. Questions of theoretical formulation apart, however, the close connection of credit and prices, or of prices and credit, does not admit of reasonable doubt. What is still to be tested is the kind and measure of control at once effective and beneficial in its effects that can be exercised on credit through the instrumentality of Reserve Bank rates and operations - that is the extent to which the volume and character of Reserve Bank operations will be sensitively responsible to changes of rate.

FEDERAL RESERVE NOTES: The responsiveness of the volume of Federal Reserve note circulation to fluctuating requirements is again in process of proof. A year ago attention was called in the Bulletin to the increase of Federal Reserve notes in the months synchronizing with the crop-moving period. The same phenomenon is now being repeated.

While seasonal requirements thus appear to be the principal cause of short-period changes in the volume of outstanding Federal Reserve notes, the fundamental influence determining their normal volume is the movement of general prices and the volume of outstanding bank credit. No mathematically definite and quantitative relationship between the volume of bank credit and the volume of circulating notes can be specified, but a close connection between the two exists. The connection is indeed so close that an increase in the volume of circulating notes may ordinarily be expected to follow closely upon an increase in the volume of circulating bank credit. This is particularly true in times when a close connection is observed between changes in the volume of bank credit in use and general prices. At such times and generally in times of increasing trade activity, prices at wholesale rise first. In their wake there follows of necessity a rise of retail prices and in consequence a need for increase of circulation. It may be stated as a general proposition, therefore, that changes in the volume of currency in times of expansion follow price changes. They do not precede them. There is, therefore, no foundation in present American experience for the view still sometimes urged that changes in the volume of currency are responsible for changes in prices.

While it may be true as a theoretical proposition that prices at retail could not rise without an increase in the volume of currency and that refusal to supply currency might impede an upward movement of retail prices ((though it is much more likely that refusal to supply currency would lead the community to adopt devices such as due-bills or bearer checks, etc. of small denominations to meet the demand for currency substitutes), it is also true that such a method of controlling prices, if successful, would be at the cost of business disaster.

Prices at wholesale are not appreciably affected by the volume of pocket money. It is the volume of circulating bank credit that influences the trend of wholesale prices. Restriction of bank note issues would not, therefore, act as a direct restraint upon the movement of wholesale prices. Such effects as might conceivably be exerted from this source would at best be indirect and would effectuate itself by what would be tantamount to a breakdown in the organization of trade by making it difficult for retail prices to adjust themselves to changes, proceeding from more or less fundamental influences, in the movement of wholesale prices. The pocket currency of the country is a function of the general money volume of the country's business. To attempt to turn it into an instrument of credit control would be a perversion of the currency function of the banking system.

The correction of the price situation will come in a more natural and economic manner. Prices at retail will fall to more normal levels as prices at wholesale do. Prices at wholesale will fall as savings accumulate and liquidation of the war loan accounts of the banks ensue and reduction advances to the point where it more nearly matches the great increase in the volume of circulating or purchasing media which have been called forth during the successive emergencies of recent years.

The manner in which liquidation of the war loan business of the banks will operate a reduction of currency may be explained. It should also be noted that such liquidation will be most effective if those who are now debtors to the banks on account of Liberty Loan subscriptions take up their obligations out of their own savings. Repayments of funds borrowed from the banks may take the form either of bank deposit credit or of Federal Reserve notes. In the latter case, Federal Reserve notes would begin to accumulate in the hands of the member banks. They would take them to the Reserve Banks for credit to their reserve accounts. Since the reserve accounts of most of the member banks have been brought to their present levels through extensive rediscounting, the return of the Reserve notes to the Reserve Bank would be in effect a reduction of the member bank's liability to its Reserve Bank and a retirement of the Reserve note through such process of redemption. There would thus be a direct reduction in the volume of Federal Reserve notes in circulation and a corresponding reduction of rediscounts. In the former case, where the debtor of the member bank made payment by credit, there would take place a reduction in the first instance of the volume of the member bank's liabilities and in the second instance of the Reserve Bank's deposit liabilities--and, it may be added, on the asset side of the statement a reduction of its discounts. The whole volume of outstanding bank credit would thus contract itself and the same causes that brought about the contraction would result in a lowering of prices which would necessitate a smaller volume of pocket currency and a return flow of redundant currency to the banks and eventually to the Reserve Banks.

Taking things as they are, the bulk of outstanding Federal Reserve notes may properly be regarded as supplied to the borrowing member banks against rediscounts. Expense in the shape of a discount charge is, therefore, entailed to member banks in obtaining increased supplies of notes. While Reserve notes are freely issued to the banks in the sense that no limits have been imposed upon the amount, they are not issued without cost. As increases in the volume of Federal Reserve note currency, particularly in times of expansion, will be obtained against rediscounts or bills payable of member banks, the Federal Reserve note, as long as it is out, involves serious cost to the bank that takes it. The member bank, therefore, has every inducement, as notes accumulate in its hands, to use them in reducing its borrowings from the Reserve Bank. Thus has an automatic machinery been provided, operating by the method of profit and loss, for sending into retirement and redemption such part of the Federal Reserve note circulation of the community as may at any time be in excess of requirements.

The main condition, as already observed, determining currency requirements is the level of prices. The reduction of the volume of the currency is, therefore, a price problem far more than the reduction of prices is a currency problem.

COST OF LIVING PROBLEM. That the high price levels which have been attained in the United States present a grave situation is clear from the attention which current discussion of the causes of industrial unrest is directing to the cost of living problem. It presents the most urgent and immediate phase of the problem of post-war business and industrial readjustment. It promises to remain a persistent phase of post-war conditions unless its nature and cause are understood and a rational economic attitude toward it is developed.

So far as the profiteering practices, which current discussions assume have developed widely and rapidly since the armistice, are responsible for the price aggravations which have been experienced in recent months, some considerable mitigation of the cost of living situation may be expected and, indeed, is already in sight. The activity of "fair price" committees in different parts of the country, local action by the States, investigations and publicity by the Federal Trade Commission and prosecution by the Department of Justice, under Federal law, which, as elsewhere noted, is in process of amendment, are/producing results.
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The problem of reducing the cost of living is, however, mainly that of restoring the purchasing power of the dollar. The dollar has lost purchasing power because expansion of credit, under the necessities of war financing, proceeded at a rate more rapid than the production and saving of goods. The return to a sound economic condition and one which will involve as little further disturbance of normal economic relationships as possible will be a reversal of the process which has brought the country to its present pass. In other words, the way in must be the way out. As the way in was expansion of credit at a rate more rapid than expansion of production and saving, so the way out must be an increase in production and in saving. The effect of increased production will be to place a larger volume of goods against the greatly enlarged volume of our purchasing media and thus to reduce prices. The effect of increased saving will be a reduction in the volume of purchasing media in use and, by consequence, a reduction of prices also.

> "What is needed is the restoration of a proper balance between the volume of credit and the volume of goods" said Governor Harding, speaking before the Annual Convention of the American Bankers Association at St. Louis, September 30th. "Because of the war financing of the Government it is not practicable to reduce the volume of credit except gradually, and the best and probably the only remedy for the present unrest is to increase the volume of goods, and the facilities for their distribution. Shorter hours and higher wages do not tend to increase production, but rather the reverse, and strikes and walkouts are doubly harmful in that they stop production without materially reducing consumption."

The cost of living problem on its financial side is misconceived unless it is conceived as the problem of restoring the value of the dollar. To accept the depreciation worked in the dollar by war conditions and to standardize the dollar of the future on this basis would be to ratify the inflation wrought by the war and the injustices it produced. No artificial solution for an economic situation of this kind is likely to commend itself to the better judgment and the sense of equity of the country, even could some artificial method of dealing with the question of monetary depreciation be devised which would not bring in its train a crop of new difficulties and and problems.

COST OF LIVING INDEX AND WAGE ADJUSTMENT. So far as the main incidence of the high cost of living is to be found in the ranks of labor, its correction presents an industrial problem rather than a monetary problem - a problem to be met not by a change in the monetary standard but by a change in the machinery of industrial remuneration. The successful handling of the cost of living situation, so far as concerns labor, is in first instance a matter of determining the extent to which the actual cost of living to different grades of labor in different parts of the country has been increased by rising prices, and secondly, of devising some effective method of adjusting money wages to changes in the money cost of living. The former is a technical statistical problem and is having the attention of the Bureau of Labor Statistics, which is accumulating data on the basis of which can be constructed a cost of living index number that will show variations in total expense of families dependent upon wages because of price changes. The latter is the practical problem of improving the status of labor by the establishment of new working principles governing the relations of employers and employed.

Speaking on this subject at the Annual Meeting of the American Association of the Baking Industry in Chicago September 24th, Mr. Miller of the Federal Reserve Board said:

> "There has been no general policy, either public or private, governing the action of industry in the matter of wage adjustment to changed living conditions. All sorts of influences have been at work in determining the outcome; the maintenance of the standard of living has not been the controlling consideration. The state of the labor market in different industries has, at times, resulted in increase of wages more than the increase in the cost of living, and at other times wages have lagged. **** * It must be said that there has been on the whole a lack of close correspondence of changes of wages with changes in the cost of living.
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> "The facts and indications, fragmentary as they are, reveal a situation which from every reasonable point of view must be regarded as unsatisfactory. Much as was achieved in certain industries during the war through the action of public or private agency, the maintenance of the standard of living does not occupy the decisive place it should in the determination of wages. Chance and circumstance play too large a role, and principle too little. Wages must be regarded as the first charge on industry, and the maintenance of at least those living standards which were customary before the war must be made secure. The first duty of the nation is to preserve the health and strength of its workers. The standard of living is, therefore a matter of public and national concern as well as of individual concern. The Nation can not afford, industry can not afford, to run the risk of impairing its working forces through lack of some effective method of adjusting wages to the cost of living. This is, in an immediate

sense, the most pressing aspect of the cost of living problem with which we are confronted. Close study should, therefore, be given by different industries in every section of the country to methods of handling the problem in an effective and equitable way. Beginnings have been made in some business and industrial enterprises, but the problem should be taken hold of on a systematic and national scale in order that the needed results shall be achieved. Some mechanism by which wages may promptly be adjusted to changes in the cost of living must be accepted as an essential part of the American wage system. *** Such action is particularly urgent in view of the extremely uncertain and disrupted course which prices and the cost of living seem likely to follow for a good many years to come, or until the affairs of the world are once more in a state of settled equilibrium. It will not do to leave the adjustment of wages to changes in the cost of living, either to the slow and uncertain action of the forces of competition, or to the costly and disruptive action of industrial warfare. So far as the strike is a method of securing an adjustment of wages to rising prices, it should become an obsolete feature of the American industrial system."

THE EXPORT SITUATION. Little change is reflected in the recent volume of our foreign trade shown by the latest statement of the Department of Commerce covering the month of August. Exports for August were $646,259,000 as compared with $570,083,000 for July, the first month in the fiscal year 1920, and $602,090,000, the average for the fiscal year 1919. Largely increased exports, as compared with July, are shown for unprepared foodstuffs, partial manufactures, and manufactures ready for consumption, while smaller exports for the month are shown for prepared foodstuffs, mainly meat and dairy products. Raw cotton exports show a further decline for the month, while exports of mineral oil, cotton goods and automobiles show considerable gains. August imports were $307,331,000 as compared with $344,000,000 for the month of July and $257,990,000, the average for the fiscal year 1919. Excess exports for August were $338,928,000 compared with $226,083,000 for July and $344,100,000, the average for the fiscal year 1919.

The first two months of the current fiscal year are, therefore, characterized by a very marked diminution in the outward movement of goods. It is clear that the large American credits at the disposal of foreign governments and their disposition to draw heavily on American supplies for the purpose of "stabilizing" the first steps in the process of after-war readjustment, were mainly responsible for the heavy outflow of goods during the last fiscal year. It has not yet been determined, nor is it clear, how much must be done nor how little will suffice in further financial and economic support of Europe in the further process of her readjustment. Nor is it clear what should be done in support of certain of our industries which attained conspicuous importance as export industries under the pressure of the artificial situation produced by the war.

It seems highly probable, however, that new outlets for the excess products of these industries will have to be found if anything approaching their volume of production during the war is to be sustained.

In the meantime it should be noted that some improvement in our cost of living situation is likely to result from the diminished outflow of goods to countries not in a position to make payment by return shipments of goods. Elsewhere in the Bulletin are given the results of an attempt to estimate the growth of the physical volume of our export trade in recent years after eliminating the price factor - in other words, an attempt to estimate the growth in physical volume. While the data available for such an estimate are not as comprehensive as might be desired and the results are, therefore, not to be taken as conclusive, they are believed, nevertheless, to be of very great value as giving a more faithful picture of changes in our export situation than can be derived from totals stated in terms of money value. Taking the pre-war five-year period 1910-14 as a base for purposes of comparison and noting the increase for each of the succeeding five years as compared with the pre-war average, the following index numbers are reached:

1910 - 1914	-	100
1915	-	125
1916-17	-	120
1918	-	109
1919	-	135

It is noteworthy that the fiscal year 1919 shows the greatest increase over the pre-war average - an increase of 35 per cent, - a rate of increase more than fourfold that shown for the preceding fiscal year 1918. Such a gain in the rate of increase suggests that heavy exports (effectuated for the most part by credit advances) to Europe have been a very considerable factory in our cost of living situation. It is also noteworthy that an estimated 35 per cent of the physical volume of exports in the last fiscal year consisted of foodstuffs.