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ADDRESS REPLY TO
FEDERAL RESERVE BOARD

December 17, 1919.
X-1758

Subject: Construction of Term "non-essential".

Dear Sir:-

There is enclosed for your information a copy of a circular which has been sent to all banks and trust companies in Federal Reserve District Number 9 by the Governor of the Federal Reserve Bank of Minneapolis. The Board feels that this is a timely circular and that it is a good plan to explain not only to the member banks but to the non-member banks the policies of the Federal Reserve System.

The Board would not, however, go so far as to say that "borrowing for non-essentials should be vigorously discouraged." The term "non-essential" does not have the same significance now as it did during the war. Were the Federal Reserve Banks to undertake to pass judgment upon the essential need for a given credit regardless of the eligibility of the paper offered, they would find it necessary, if they wish to avoid the charge of being unduly censorious and dictatorial, to exercise a very delicate discretion in their construction of the term "non-essential".

Very truly yours,

Enclosure.

Governor.

Letter to Chairmen of all F.R. Banks except Minneapolis

FEDERAL RESERVE BANK OF MINNEAPOLIS

X-1758 a

TO ALL BANKS & TRUST COMPANIES
IN FEDERAL RESERVE DISTRICT NO. 9:-

The advance in the discount rates of the Federal Reserve Bank of Minneapolis is another warning to bankers and the general public that the resources of the Federal Reserve System are not unlimited. It is my sincere hope that the significance of this action will be understood and that it will not be necessary to again advance the rates at a later date.

The first warning was issued in October, 1915, and has been repeated at various intervals since that date, but the action taken by the Federal Reserve Bank has not been given sufficient attention or possibly it has not been properly understood.

The resources of the Federal Reserve System were intended for the benefit of commerce and industry. It was not the purpose that they be used to stimulate the investment market or to encourage and support speculative movements. To this date commerce and industry have received extensive benefits, both direct and indirect, from the Federal Reserve Banks, which will, of course, continue their established policy and take care of all the legitimate and reasonable requirements of business, including agriculture.

It is quite evident, that through the extravagances of individuals and the indiscriminate extension of credits by certain banks for investments and speculative purposes, the reserves held by the Federal Reserve Banks have been used through an indirect process for purposes other than those intended and authorized by law. The extension of credit for speculative purposes is not confined to stocks and bonds alone, but substantial advances have been made to encourage the movement of land, and for speculation in commodities. The Federal Reserve Bank of Minneapolis, in common with other Reserve Banks, has used every precaution to eliminate such use of its facilities, but indirectly these credits have been extended, with the result that an unwarranted over-extension of credit exists at this time over the country as a whole. If this condition is permitted to continue it will in time work a severe hardship upon everyone.

Experienced bankers are cognizant of the real situation and are confining their advances in accordance with sound and prudent banking judgment. Certain banks have not exercised proper discrimination and are accumulating loans that do not help the general situation. Such banks are depending on sources other than the Federal Reserve Bank for assistance in the event of an emergency. Such assistance is, of course, secured indirectly through the Federal Reserve Bank and this warning is issued particularly to banks that are following this course as a reminder to them of the unwisdom of depending upon the Federal Reserve Bank for indirect support that it would not be permitted by law to extend directly to its own members.

The Federal Reserve Bank will thoroughly investigate all applications from member banks. If the proceeds of such rediscounts are to be used, either directly or indirectly, for purposes other than those intended by law, such applications will not receive favorable action.

The Federal Reserve Bank is compelled to consider not alone whether paper offered for rediscount is eligible, but whether the purposes behind the application for rediscount are in conformity with the law and with its publicly announced policy. It is very desirable that all banks, both member and nonmember, carefully analyze their loans and discriminate in the extension of credit, discouraging borrowing for non-essentials and requesting their customers to clean up their old indebtedness before incurring new obligations. Many loans which are not in themselves objectionable will be found upon analysis to be unnecessary at this time, and while the strain upon credit continues, borrowing for such non-essentials should be vigorously discouraged.

A failure to follow this policy is very likely to result in placing the bank involved in the embarrassing position of being compelled to explain to borrowers who desire funds for necessary commercial and industrial purposes that it is unable to afford them reasonable support because of the fact that its deposits have been loaned in too large a measure for speculative purposes.

The rigid restriction of loans to those which are actually necessary in order to properly support commercial business, industry and agriculture of the Ninth District, can in no wise harm any except those who by reckless expenditure of both their funds and their credit, have encouraged inflation. Such a policy is essential and necessary if the present strain on credit is to be checked before it results in wide-spread injury to all business and to individuals.

The Federal Reserve Bank is convinced of the absolute necessity of prudence, caution and wise discrimination in both the extension and the use of credit.

Yours respectfully,

(signed) R.A. YOUNG.

Governor.

December 13, 1919.
Circular No. 189