FEDERAL RESERVE BOARD

STATEMENT FOR THE PRESS X-1789

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Following is a statement made by Governor Harding in opening the conference had by the Board today with bankers representing some 25 clearing house associations throughout the country:

"Gentlemen, during the time of war ordinary banking policies were necessarily abrogated in order to make successful the war financing. Rates were established by the various Federal Reserve Banks, not so much with reference to ordinary industrial and commercial requirements, but rather to promote the success of the various Liberty Loan campaigns. We may have departed from some well established banking precedents which had always governed in time of peace and adopted policies fully justified by war conditions which should however be modified in normal times.

As you know, the requirements of the Government during the war were exceedingly heavy. The Treasury issued in certificates and bonds a total of about twenty five billion dollars during a period of eighteen months. This amount was very greatly in excess of the normal investment capacity of the country, and in order to make a success of floating the various issues, it was necessary that the public be appealed to to subscribe to the various issues without reference to its immediate ability to pay.

The member banks and the non-member banks gave a most patriotic response to every appeal that was made by the Treasury. They opened their coffers to the public, invited subscribers to take large amounts, to make loans at the banks and in many cases agreements were entered into as to the rates of interest that would be charged for these loans over a given period of time.

The Federal Reserve Banks, with the approval of the Federal Reserve Board, established preferential rates of discount on paper secured by war obligations and everything possible was done to aid the Government in raising the financial sinews of war.

The termination of the war, from a military standpoint did not, however, synchronize with the financial end of the war. When hostilities ceased there were large liabilities of the Treasury outstanding, many of them undetermined, and it soon became evident that another large popular loan was necessary. Doubts were expressed by some as to the efficacy of the patriotic appeal that was made and had been responded to so magnificently during the time of war. But the people of America arose to the occasion.

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The Victory Loan was over-subscribed. But even then we did not reach the definite end of our war financing, for the Treasury had outstanding a floating debt in the shape of certificates of indebtedness amounting to nearly four billion dollars. This floating debt had to be arranged. The Treasury was anxious to reduce it from time to time at the quarterly periods when income taxes and excess profit taxes are paid in.

The Federal Reserve Banks and the Federal Reserve Board recognized early in the year 1919 certain dangerous tendencies toward which we were drifting, and the Board issued repeated warnings that unnecessary credits in excessive amounts should be checked. But those warnings had only a temporary effect, and as the year progressed it became evident that dangerous tendencies had developed into dangerous conditions.

Action was finally taken and a halt called. The Federal Reserve Board was subject, no doubt, to some criticism. But I believe that even some who were severe critics last November recognize now that the corrective applied was necessary and salutary.

The Secretary of the Treasury has notified the Federal Reserve Board that the financial plans of the Treasury as to the handling and ultimate retirement of the floating debt have progressed so far that as far as the Treasury is concerned, the Board might feel entirely free to exercise its statutory powers with reference to the control of credits and the regulation of discount rates.

There is no question, gentlemen, that the credit structure of this country is expanded. Such a condition is inevitable; there is no blame that should attach to anyone for such a state of affairs, for we have passed through the greatest, most destructive and most expensive war of all history. All wars are accompanied by increase of taxation. In most of the countries there has been inflation of currency, and in all countries a great expansion of credits.

During the Civil War resort was had to increased taxation, to credit expansion, as represented by bond issues; and to direct currency inflation as represented by an issue of irredeemable notes which were paid out to meet current expenses. Those notes were given the legal tender quality, so that they were receivable for all debts, public and private. The injection of irredeemable paper money into circulation drove out metallic money, gold and silver, and prices advanced; they were based upon the paper standard, and after the Civil War closed fifteen years elapsed before the paper currency was able to circulate on an absolute parity with gold, and even so late as the years 1894, 1895 and 1896 our legal tender notes proved to be a very disturbing factor, for, owing to their frequent redemptions and immediate re-issue, they constituted a serious menace by making a constant drain upon our supply of gold.

The United States was financed during the recent war partly by increased taxation and partly by bond and certificate issues, a form of credit expansion. Currency inflation did not enter into the scheme. The obligations issued by the Government were not made available by Congress to secure issues of circulating notes directly. But, as Section 13 of the Federal Reserve Act, which defines the limitations of eligible paper, and which bars investment securities of various kinds, made an exception in favor

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of paper secured by notes and bonds of the Government of the United States, it developed that, after all, Government bonds were used indirectly to some extent as a basis of circulation, by reason of paper secured by them being placed with Federal Reserve Agents as part security for Federal Reserve notes, plus the required gold reserve.

So, while we have turned our backs now upon the period of war financing and have directed our steps toward a more normal banking policy, we can not expect this year, nor next, nor in the immediate future, to regain a banking position which would be regarded as normal, when judged by pre-war standards. We can only reach such a position when, as the result of increased production, and reduced expenditure on the part of the people and of the Government, outstanding

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obligations of the Government have been very greatly reduced and the remainder has been absorbed by the investing public. The process is one which will require time and patience. But we can formulate our policies now. We must have a definite policy to which we must adhere in order to bring about, in the course of time, the result which I think all thinking men agree should be attained.

The banks of the country, the commercial banks in the large and medium sized cities, and in the country towns, have an important part to play in bringing about this result. I hope you gentlemen who are here today will impress upon your neighbors and upon your country bank clientele the importance of pursuing a definite, sound policy.

Non-essential loans should be discouraged and the rediscount facilities of the Federal Reserve Banks ought not to be used for the sake of profits. The Federal Reserve System should be brought back as rapidly as possible to the basis that the authors of the Act had in mind when the law was enacted. Federal Reserve Banks should be kept in a liquid condition. They should be in a position to expand or contract their loans according to the industrial and commercial requirements of the country. They should be kept in a position to respond to any unexpected emergency and to all seasonal requirements. They should be able to furnish to the business of the country a sound and elastic currency. And when I say elastic, I mean a currency which is capable, not only of expanding, but also of contracting, in order that it may expand again when occasion requires.

If the Federal Reserve Banks, as a reflection of the condition of the member banks of the country whose reserves are kept entirely with the Federal Reserve Banks, are permitted to expand to the very limit of their resources, and then the country should be confronted with an emergency, we would be obliged to meet that emergency just as though there were no Federal Reserve System.

The Federal Reserve Board is directly concerned with the subject of rates, In ordinary times the natural corrective of an expanded condition is an advance in rates. Of course, with the world out of joint as it is at present, with the United States having the only free gold market, with the embargoes which exist, necessarily, in foreign countries upon the export of gold we can not merely by raising rates add to our gold holdings; and in raising rates we must be careful not to do anything to discourage production or add to the costs and difficulties of production. We would prefer not to do that, because the ordinary profits of every-day business are small as compared with the larger profits which may be gained from successful speculative operations; and the average business man is more sensitive to increased costs in his supply of money and credit than is the speculative individual. The latter's expectation of large profits often renders him indifferent to rates. If money is cheap, so much the better for him, but if it is high and it is obtainable, he will take it anyway.

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But we believe, gentlemen, that by calling the attention of the banks of the country to the fact that, after all, the resources of the Federal Reserve Banks are not infinite; and that not only is there a check provided upon rediscounting in the way of advancing rates, but a direct check, as outlined in Section 4 of the Federal Reserve Act, which, in defining the duties of the Board of Directors of a Federal Reserve Bank, requires them, in granting their loans and discounts and accommodations, subject to the orders of the Federal Reserve Board, to pay due regard to the wants and requirements of every other member bank, to administer the affairs of their bank fairly and impartially, keeping in view the possible requirements of all members; and it follows that should three or four member banks, or a group of a dozen or so member banks be permitted, through very large discounts, to absorb all the loanable funds of a Federal Reserve Bank, it would be impossible to grant reasonable accommodations to all member banks.

But it is going to be necessary, perhaps, to raise rates beyond their present level. I am not here to make a prophecy nor to outline future policies; but you should all bear in mind that a further rate increase is a contingency which must be reckoned with.

Now, we are coming to a subject which affects you bankers very closely. That is the effect of further advances in discount rates of Federal Reserve Banks upon your relations with other banks, and upon your relations with your own mercantile and individual customers.

About two years ago, when the war was at its height, when no one knew how long it would continue, when we had a certificate issue every week and a bond issue every few months, the banks of the country began to be restive and they commenced bidding up for deposits. The Federal Reserve Banks and the Federal Reserve Board looked with concern upon the new developments, and the Board sent one of its members to New York to confer with the Clearing House Committee. That conference was followed by a conference with the entire Clearing House Association. There were a good many things to be considered. Many of the bankers in New York were engaged in a nation wide business. They came into competition to some extent with banks who carried accounts with them. Finally, as the result of various conferences, the New York Clearing House adopted a rule governing the rates of interest to be paid on deposits and bank balances, a sliding scale being adopted for the rate on bank balances, between a minimum of one per cent and a maximum of three per cent based upon the ninety day discount rate for commercial paper at the Federal Reserve Bank.

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The schedule of maximum rates follows:

When the 90-day rate for commercial paper at the Federal Reserve Bank of New York is:	Maximum rate to be paid on the above accounts is:
2% or over but less than 2½%	1%
2½% " " " " 3%	1¼%
3% " " " " 3½%	1½%
3½% " " " " 4%	1¾%
4% " " " " 4½%	2%
4½% " " " " 5%	2¼%
5% " " " " 5½%	2½%
5½% " " " " 6%	2¾%
6% or above	3%

The Board has no criticism to make of this schedule. It accepted the arrangement when made with the realization that it was not exactly the kind of an arrangement it had sought to bring about, but it was the best to be had under the circumstances. The same schedule was adopted also by the clearing house banks of Boston, St. Louis, Chicago, St. Paul, Minneapolis and New Orleans. But what the Board wishes to have thoroughly understood by the bankers throughout the country is that it can not be hampered in its approval of discount rates for Federal Reserve Banks by any arrangement made by banks or any association of banks, as to rates of interest which are made dependent upon Federal Reserve Bank discount rates. In other words, the Board will exercise its statutory rights, and will be absolutely and entirely free to approve such rates as in its opinion the interest of the country demands, without reference to any competition which may spring up as the result thereof among bankers for deposits. It is well that you should understand this.

Now, I will pass to the next phase of the question, as viewed by the Board. We are exceedingly anxious that there should be no scramble for deposits. We see no occasion why an advance in a Federal Reserve Bank rate should bring about such a condition because these advances, after all, are not permanent, they are temporary; whereas, the relationship between a depositor and his bank, or between one bank and another bank, is supposed to be more or less permanent. It is pretty hard sometimes, even in the face of greater inducements offered by other institutions, to break up an established relationship of many years standing.

We have no suggestions to offer as to the wisdom of the policy of paying interest on deposits. We know, of course, that fifty or seventy-five years ago the practice was looked upon with suspicion by many of the most conservative banks. We know that in the panic of 1873 in New York seven banks in that city which at the time were engaged more particularly in building up a business with interior banks throughout the country, and which paid interest on such balances, were the banks which stood more in need of assistance; and that they had to call on the banks which did not pay interest on deposits, to assist them by means of advances through the clearing house.

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But times have changed. The world has progressed. One by one the banks which stood out against the practice of paying interest on bank balances, have yielded, looking for remuneration in greater volume of business. So we may recognize the fact that the payment of interest on deposits is an established practice among American banks and there is no need to criticize it. But there is reason in all things. There ought to be moderation in all banking methods. The Federal Reserve Board wishes you to keep in mind this thought which, in its opinion, if heeded will prevent any dangerous tendencies or unsound practices. All deposits in banks are of a temporary and transitory character. Banks are conducted with due regard to the law of averages. A man may have a large deposit with a bank subject to check. To-morrow it may all be checked out. But it is going into somebody else's hands. As long as there is no hoarding of funds, and credits move from one individual to another on the books of a bank there is no change in the position of the bank, or the position of the associated banks of the city if there should be a transfer from one bank to another.

But keep in mind, gentlemen, the temporary character of deposits,-both demand and time deposits. There may be an agreement that, in consideration of a higher rate paid a time depositor the banker may have assurance that the funds will not be used by the depositor for a given period of time - but no banker should look upon deposits as a permanent asset. They are a liability.

No customer of a bank should be educated to believe that his deposit in bank is an investment. In other words, your rates should not be put up so high that they will attract deposits on an investment basis, because a deposit in bank is temporary; it is merely a fund awaiting use or investment and not an investment itself. If you get your customers educated to the idea, by paying them high rates, that their deposits with you are real investments that they have made, you may wake up sometime to the very unpleasant realization of the fact that after all these are investments which you must buy back at their face value whenever the owner of the deposit desires you to do so.

This year there are going to be very heavy demands of various kinds made upon the investment markets of this country. The railroads are soon to be returned to their owners. We are confronted now with the problem of financing our exports to Europe. We have financed [illegible], or exports amounting to four billion dollars during 1919, just how we do not know, but we have a suspicion that the American banks have borne most of the burden, directly or indirectly.

While there is no occasion to doubt the soundness of your loans - because there is an abundance of good collateral exclusive of the twenty billion dollars or so of Government bonds - we feel that it is important in financing our permanent requirements and long time loans to appeal, not to the commercial banks but to the investment market.

This reasoning applies more particularly to the smaller banks, which very naturally like to see their deposits continue to increase, and many of them have the feeling that any decline in their total footings is a reflection upon them, although it may very greatly strengthen their reserve position if their loans, and deposits are reduced in equal proportion.

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Here is the crux of the proposition. If bankers through high rates of interest compete for funds with the investment market and attract large deposits to themselves, they are bound to utilize these deposits. High interest payments for deposits tend to promote unsound banking, for the reason that many a a bank which has a large volume of deposits at high rates of interest will make a loan in order to keep the money in use that it would not think of touching if the deposit bore no interest.

If all commercial banks should undertake to treat their deposits as funds available for long investments, and should accumulate deposits by paying high rates in competition with the investment market, they would naturally be called upon to purchase all kinds of investment securities which should more properly be taken by their depositors.

To sum up: There is not and can not be any arrangement to consider rates of interest paid by member banks for deposits, in establishing discount rates at Federal Reserve Banks. Member banks may, however, base their interest rates on Federal Reserve Bank discount rates if they wish. It may be the scientific way to do it, but such a rule should be as uniform as possible. But if adopted generally it ought to be with the distinct understanding that there is no obligation resting on the Federal Reserve Banks to refrain from establishing or upon the Federal Reserve Board not to approve necessary advances in discount rates

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merely because such action might precipitate a fight between member banks for deposits.

I have here telegrams and letters from clearing houses that were unable to have representatives here; and they all take the position that there ought not to be any scramble for deposits or any change in the present interest rates on deposits should the Federal Reserve discount rates be advanced further.

These telegrams and letters will be on the desk so that your own presiding officer can bring them to your attention in the proper way. I will read, however, --- without giving the name of the clearing house from which it comes -- extracts from one letter. This is a very large and important commercial center, which is not represented here today. Its clearing house committee goes on to say:

"It may be said that this Clearing House Association has no agreements of any kind between its members, as such, in regard to rates or conditions in their business. They have no rules as to charges, nor is there any provision in their organization other than voluntary acquiescence in making or enforcing such rules. However, the Association has never found any difficulty in presenting before its members matters of common interest and securing voluntary support to what has been deemed proper policy.

"The committee unanimously expressed the opinion that relation between interest paid to depositors and the current interest rates (which are perhaps best indicated by the Federal Reserve Bank's Rate) is theoretically a proper relation. It has no opinion to express at this time as to the spread which should exist or how quickly the changes of rates of interest paid to depositors should follow an increase in the discount rate. The rates now prevailing in this city were brought into being by the voluntary increase of rates on the part of other bankers competing in a sense with us for certain of our deposit lines, and were not inspired by any original idea of the bankers in this city.

"As it was at first announced that the New York banks were to pay 2-1/2 per cent on bank balances, that rate was adopted by some of our leading banks, and followed by all of the others. When the rate in New York was finally fixed at 2-1/4 per cent, no action was taken to change the 2-1/2 per cent rate here."

That condition existed in several cities. I think there is one important city that has a 3 per cent rate in effect now, in the face of the 2-1/4 per cent rate in effect in New York.

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To continue with this letter:

"The committee feels sure that there is no intent, that there will be no action on the part of any **** bank to increase rates paid for deposits, except as a matter of protecting their situation against banks in other centers competing for the same business, and should the rates in other centers be fixed at 2-1/4 per cent, we feel sure that no change would be necessary by our bankers. Should, however, the rates paid in competing centers be increased above 2-1/2 per cent, it is quite likely that the banks of this city would find it necessary to meet whatever rate was fixed by competing banks within the limits of proper business practice.

"It may be, therefore, best to assure the other members of the Conference in the absence of our representative that we will not initiate any change in rates in response to a change in discount rates made by the Federal Reserve Banks, but will be compelled, in self-protection, to follow the rates agreed upon by competing centers to the limits of proper practice as above outlined."

It was suggested by the Board when the New York arrangement went into effect that instead of having an automatic change in rate with every change in the Federal Reserve discount rate, a change in the bank rate be made a basis for a change in the deposit rate, but that the matter be considered and voted upon separately by the Clearing House Association.

It seems to the Board that it would be well for you to consider this whole question with a view, if possible, of preventing any disturbance of your own business, or increased offerings of discounts to the Federal Reserve Banks, which would inevitably result if you were to put your own deposit rates upon an investment basis and were called upon to make long investments yourselves, instead of passing them along to your customers.

The press were notified that as long as the Federal Reserve Board were in charge of this meeting they were welcome, but when the bankers themselves took charge of the meeting they might be asked to withdraw.

We are indebted to the Secretary of the Interior for the use of this room, which you can have until 4:30 o'clock this afternoon. As far as the Board knows, there is no occasion for you to stay over until tomorrow. I think you can complete your deliberations in one day. You have an opportunity to exchange views and you can hear from all sections of the country and you can appoint, such committees as you may deem advisable; but the important thing for you to do at the moment is to elect a chairman for your meeting."

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