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FEDERAL RESERVE BANK OF SAN FRANCISCO

December 11, 1915.

The Honorable Charles S. Hamlin, Governor,
Federal Reserve Board,
Washington, D. C.

My dear Governor:

I have your letter of December 4th.

As it happens, a few days previous to its receipt, I had sent out about 20 or 25 letters to the principal cities of the district to secure certain information for use in my annual report. Among the questions asked in these letters was one covering substantially the same ground as your two queries. Consequently, I have a recent expression from representative bankers in a number of cities. This I have supplemented by personal interviews with the leading bankers of this city, and have also made investigation of copies of reports sent in by member banks in response to Comptroller's calls.

There seems very little tangible evidence that the establishment and operation of the Federal reserve bank has influenced rates in any important way. Most of the replies to queries have been definitely that rates have not been affected. No evidence could be found in the information given in the bank reports that rates had been affected by this cause, or even by the condition of unparalleled excess bank reserves.

In spite of all this, and while it is not capable of any convincing demonstration, it is nevertheless my personal conviction that the existence of the Federal reserve bank has influenced rates in this district to a considerable extent. It is a current which I am inclined to judge by the straws.

A number of banks for whom we have rediscounted have stated that they have thereby been enabled to accommodate their communities in a way not possible hitherto. With such an outlet for loans in excess of a bank's own means it cannot be otherwise than that a bank would be inclined to maintain a more reasonable level of rates than it would feel justified in charging if its means were inadequate to meet reasonably the demands made upon it.

A bank in Idaho wrote us that it was making an 8% rate upon eligible paper, while charging 10% on other loans. It was not specifically stated, but I inferred that 10% had been its regular minimum for all classes of loans prior to the establishment of the Federal reserve bank.

A leading San Francisco bank during the year has said to its member bank correspondents that it would not be necessary for them to rediscount with the Federal reserve bank to obtain the rates published; that they would meet the Federal reserve bank's rediscount rates for eligible paper. I was told that advantage of this offer had not been taken by a single bank, it being preferred to borrow after the methods previously followed even though at higher rates; nevertheless, it is clear that no such lending rates were offered by San Francisco banks prior to the establishment of the Federal reserve bank. It was also stated that this offer was not made to non-member banks.

Summing up, it is my conviction that the rates extended by banks in reserve cities to their correspondents, and particularly to member banks have been, although perhaps insensibly, influenced to lower levels then would have been the case if the Federal reserve bank had not been in existence to stabilize the situation and give the lending banks the full measure of confidence which they seem to have had.

I do not feel at all so sure that there has been as much influence in reducing rates made by member banks to individuals. It has, however, not infrequently happened that the notes of individual borrowers have appeared to be executed for the direct purpose of being sent in for rediscount. It is open to inference that such accommodation could not or would not have been extended if the Federal reserve bank had not stood ready to rediscount, and it is perhaps a reasonable inference that somewhat more favorable rates would be made on such loans because of our low rediscount rates than would have been made if to make such loans involved either reduction of the rediscounting banks reserves, or the payment by it of higher rates to correspondent banks.

It must be recognized that the rediscount facilities offered by the Federal reserve bank tend to increase the power of a small bank in competing with a large one. A bank with large deposit liabilities would, on the average, not rediscount to so large a proportion of its total assets as would a bank with small deposit liabilities. Because of the rediscount facility the smaller bank would be more inclined to strive to obtain the patronage of those whose borrowing requirements it could not otherwise meet. It would seem natural that a larger bank having previously had this patronage would be inclined to make moderate rates to retain the customer. The possibility of such competition would seem to be a constant influence to prevent unusually high rates.

It is my conviction that the establishment of the Federal reserve bank has tended to keep rates at more moderate levels, but it must be admitted that the major influence for this has been the unparalleled excess reserves. It would seem very reasonable to expect that the Federal reserve bank's influence making for moderate rates would assert itself in a much more pronounced way when the excess reserves have been more nearly absorbed in general business, and when a larger proportion of banks are more nearly loaned to the extent of their means.

Respectfully,
John Perrin,
Chairman of the Board.