

BANKS HAVE STOOD THE TEST

Federal Reserve System of the United States and War Conditions

How the Federal reserve system, created four years ago, has stood the test of nearly three years of war, four months of which time the United States itself has been engaged in the great conflict, is outlined in a statement prepared by Governor Harding, of the Federal reserve board. Governor Harding shows that the Federal reserve banks met the exigencies of the \$2,000,000,000 liberty loan transactions without a strain upon their resources, without an advance in discount rates, and that their total resources now aggregate more than \$2,000,000,000. Governor Harding's statement follows:—

Governor Harding's Statement.

During the month prior to the entry of the United States into the European war the Federal reserve board, recognizing the unsettled and disturbed condition of foreign affairs and the unusual influences to which domestic and financial conditions were subject, devoted special attention to the problem of immediately placing and of maintaining the Federal reserve banks in a strong and liquid condition. To this end the reserve banks were encouraged to refrain from making more than very moderate investments in securities. Even with respect to the purchase of commercial paper they were counseled to observe a policy of conservatism. As a result of the adoption of this plan of action the entry of the United States into the war as an active participant found the Federal reserve banks and, in consequence, the banking system of the whole country in an extremely satisfactory and strong position. On the 30th of March the reserve banks held against deposits a reserve of 82.1 per cent., while the combined national banks of the country held, on March 5th, \$813,028,000 of vault reserve, an excess of reserves over legal requirements of \$227,861,000.

Bank Act Amended.

The power of the Federal reserve system to render financial aid has been increased by recent legislation. The President on June 21st signed the bill amending the Federal reserve act, which in its original form had already passed the house of representatives on May 5th and the senate on May 9th. The broad purpose of the amendments is that of strengthening the gold reserves of the Federal reserve banks, and this end is accomplished in two principal ways. Arrangements are made for transferring to the Federal reserve banks the vault cash heretofore carried at the option of the banks either in their own vaults or with the reserve institutions. At the same time the non-member banks are encouraged to deposit their reserves with the Federal reserve banks by the making of liberal provisions which will enable them to exchange their gold for Federal reserve notes and to carry accounts with the Federal reserve banks for the clearing and collection of their checks. The other method chiefly relied upon to effect the purpose of the amendments is that of rendering the system more attractive to State institutions in the belief that they will become members of it.

The total resources of the reserve banks now aggregate over \$2,000,000,000, their cash reserves being over \$1,400,000,000.

Supply of Notes Increased.

In another way the Federal reserve system has endeavored to make exceptionally careful preparation for any possible demands that might be brought to bear upon it. The opening of the year had found it with a large stock of Federal reserve notes on hand, but it was deemed a measure of prudence almost to treble the available supply, \$761,000,000 of new notes being ordered. Moreover, in order to render these notes easily available they were distributed throughout the country at the various mints and sub-treasuries, where they were held subject to release by telegraph from Washington upon application of the Federal reserve bank nearest situated. Not only a note currency, but a ready means of distributing that currency without delay to the points where it was most needed was thus provided for.

Since January 1, 1915, the Federal reserve banks have been exercising the functions of fiscal agents, holding the funds of the treasury department in the 12 Federal reserve cities, other deposits being held in national banks outside

those cities. In providing for the exercise of this function of "fiscal agent," the Federal reserve act, however, contemplated the possibility of powers much broader than those involved in the holding of public deposits.

Not long after the declaration of war upon Germany the offering of the liberty loan was decided upon by the secretary of the treasury, and the question of organization and method for the placing and distribution of the loan at once presented itself. The secretary of the treasury determined to employ each Federal reserve bank as the head of a district organization designed for the distribution of the new bonds, and in each Federal reserve district such an organization was quickly developed about the local reserve bank as a centre.

Local bankers and financiers freely gave of their time and assistance to the furtherance of the work, and in each case the Federal reserve bank proved an efficient basis of organization. The several banks have, under instructions issued by the secretary of the treasury, received subscriptions to the loan and carried on the immense work of detail resulting therefrom, besides taking charge of the deposits in banks and general banking relationships growing out of the operation.

Sought to Aid Banks.

The Federal reserve board itself, besides co-operating closely with the authorities of the treasury department in efficiently conducting the loan operations of the Federal reserve banks, further sought to develop a general policy that would support and aid the banking community at large in taking and distributing the new issue of bonds. For this purpose it first established a special rate of 3 per cent. per annum for the discount at Federal reserve banks of the direct 15-day obligations of member banks secured by the temporary certificates of indebtedness which were issued in order to anticipate the proceeds of the sale of the new bonds.

Carrying further this same policy, it later established a 3½ per cent. rate of discount at Federal reserve banks intended for the 90-day paper of ordinary bank borrowers, thereby enabling the member banks of the system to extend accommodation to bond buyers in the assurance that they would be able to obtain accommodation from the Federal reserve banks by rediscounting these notes. In order to aid the customers of banks not members of the Federal reserve system, it further authorized the member banks to act as agents for non-member institutions by rediscounting the notes of bond buyers who desired to obtain assistance from their own banks without being obliged to transfer their business to member banks. Savings banks and trust companies were assured that the board would in every way co-operate with them in avoiding shock or disturbance to existing conditions, and that the Federal reserve system stood ready to extend to them reasonable accommodation in the event of necessity resulting from withdrawals made by depositors in order to purchase or invest in government bonds.

Confidence is Established.

In various other ways also rulings were put into effect with the purpose of easing the general monetary and financial situation, the result of which was to establish a general feeling of confidence throughout the country, the banks making loans to their customers at the 3½ per cent. rate, paid by the liberty bonds themselves, and obtaining aid from the Federal reserve banks as they needed it at the same rate.

Disturbance to the money market was avoided by permitting funds subscribed by customers of banks to remain on deposit in those banks until such time as they were needed for government disbursement. Rates on commercial paper remained stable and moderate throughout the whole operation, notwithstanding that it represented a greater transfer and shifting of funds than had ever before been attempted in any like operation in the history of the United States.

The whole process of selling the bonds, receiving subscriptions, transferring them to the credit of the treasury, and disbursing them upon government requisition has been carried through with remarkable ease, and constitutes a service to the country at large which would have been out of the question had it not been for the efficient organization and operation of the Federal reserve system.

Service Performed by System.

The general service performed by the reserve system can best be understood when the financial ease and quiet that have prevailed throughout the country ever since the opening of the war three years ago are contrasted with the disturbances and uncertainties which have been felt in former