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"Its a matter which is very surprising and "without any Example, that after the Nation has been Six "Years ingag'd in such a Chargeable War, and has been at "near Thirty Millions Expence, and such quantities of "Bullion have been Exported, besides the Loss of several "Millions which the Enemy has taken: that after all this, "instead of the Interest of Money rising, (as has been "usual in all Wars) there should now be such a fall of "Interest, which must be acknowledged to be wholly owing "to the Bank, and that it could not have been effected "without it; for till the Bank exerted itself, the "Interest of Money was rising apace, and would have con- "tinued so, and have come to a strange Exorbitancy e'r "this, if the Bank had not been Establisht."

("Short Account of the Bank of England"
Godfrey, 1697.)

"All the precautions of the Bank take time to "operate. The principal precaution is a rise in the rate "of discount, and such a rise certainly does attract money "from the Continent and from all the world much faster "than could have been anticipated. But it does not act "instantaneously; even the right rate, the ultimately "attractive rate, requires an interval for its action..."

(Bagehot's "LOMBARD STREET", Chap.XII.)

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The periods of greatest interest in connection with Bank Rate are July and August 1914 and that from the Armistice onwards; these have accordingly been dealt with in much greater detail than the years 1915/17 and the first half of 1918.

For an account of the critical days of July and August 1914 there is very little material available at the Bank, since it was not the practice of Lord Cunliffe unnecessarily to record his activities on paper. But Treasury shorthand notes* throw strong light upon the state of mind of the Bankers, the Government and the Bank of England at the time of the joint Conference of 4th - 6th August, while quotations from a Treasury Memorandum by Mr. R. G. Hawtrey and an article in the Economic Journal for September 1914 by Mr. J. M. Keynes (who was present at the Conference above-mentioned) have been of particular value in completing this portion.

Fortunately from the autumn of 1918 there is a great deal of material of the greatest value. There seems to be no reason why this material should be compressed, possibly undergoing distortion in the process. On the contrary, it is important that nothing relevant to the controversy on Bank Rate policy should be omitted which might assist in portraying the minds of those chiefly concerned in the endeavour to control a critical and swiftly

*Vide abridged version in C.C.P.120. The full notes are at the Treasury.

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changing situation. A very full picture is given from October 1918 to April 1920 in the letters addressed by the Governor, Lord Cullen (then Sir Brien Cokayne), to the Chancellor and the Treasury, and in the letters to and from Mr. Strong, the Governor of the Federal Reserve Bank of New York. The further correspondence passing between the latter and Mr. Norman (Governor from April 1920) are the chief sources for completing the story.* It must be remembered throughout, however, that the correspondence between the Bank and the Government was always largely supplemented by personal interviews of which, unless very exceptionally, there is no record: conversations between the Chancellor, Treasury Officials and the Governors took place frequently - one might say almost daily - from 1914 onwards.

During Lord Cunliffe's Governorship few letters on the subject of rates were written to the Government, while the relationship with the Federal Reserve Bank had not yet developed: these facts must be pleaded in extenuation of the rather disproportionately small amount of space given to the years 1915/17.

The treatment of this Chapter may be thought too discursive for its title. If so, the far reaching effects of Bank Rate must serve as an excuse for the occasional enlargement of this part of the History into a more general survey. Apology must also be offered for the fact that some overlapping with other Chapters is thereby caused.

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*The correspondence with the Treasury throughout the period is filed in C.C.P.71, while that with Mr.Strong will be found either in C.C.P.71 or C.C.P.166.

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The outlook at the beginning of 1914 was a moderate one. In the Stock Market there was an early but short-lived boom fostered by a rapid decline in money rates from the 5% official rate ruling on the 1st January to the 3% rate introduced on the 29th January, which continued throughout the remaining six months of the pre-war period. The reaction produced by over-speoulation occurred towards the end of February and subsequent recovery was retarded by conditions in Mexico and Brazil, in Ireland and in the Labour Market at home. The predominent feature of this period was dullness, except for the failure of the Canadian Agency and of Chaplin, Milne, Grenfell & Co. and the amalgamation of Banks, the most important being those of the Metropolitan Bank of England & Wales, Ltd., with the London City & Midland Bank, Ltd., and of Robarts, Lubbock & Co. with Coutts & Co., both in July.

With regard to gold movements, the London Market remained normal, the Bank of England receiving £6,643,000 out of £24,790,000 imported between 1st January and 31st July. The difference of some £18,000,000 appears to have been taken chiefly for the Continent, for France and Germany; France, it is alleged, having also drawn a considerable supply of gold from New York in the early part of the year.*

*Between the end of 1877 and the end of 1914 the Bank of France increased its gold holdings by £120 millions, of which £12 millions were acquired in 1913 and £16 millions in 1914.

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On the 28th June the Archduke Ferdinand and his wife were assassinated, but little effect was produced in the London Money Market until 24th July, though sales had commenced on the Vienna Bourse in the middle of that month, the pressure spreading to Berlin and Paris on the 18th and to New York on the 20th. On Friday, the 24th, the Press published the Austrian ultimatum to Serbia, but the position was not yet really abnormal.

July

The ultimatum to Serbia was at first considered little more disastrous than the prospect of the failure of the Buckingham Palace Conference on Ireland. Bank Rate stood at 3%. the figure to which it had been lowered six months before. By Saturday, the 25th, however, the ultimatum overshadowed all other events and the actual breakdown of the Irish Conference was hardly noticed.

Large selling orders came from the Continent, the Paris Bourse being particularly embarrassed. The only support London received was from Wall Street, which did not hesitate to purchase American Rails. On Monday, the 27th, the Brussels, Budapest and Vienna Bourses and the Paris Coulisse were closed and the market here was quite demoralised by heavy sales.

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Bagehot had said that the London Money Market was "by far the greatest combination of economical power and "economical delicacy that the world had ever seen". Both these qualities were demonstrated as never before at the end of July 1914. The power of London was indeed too great. Its demand for the payment forthwith of the rest of the world's indebtedness not only turned the exchanges in her favour, it soon broke them down, and the Money Market was paralysed by its own action. Not every exchange moved in London's favour. The only important exceptions however were the French and Swiss Exchanges. Paris was able to withdraw funds from London.

Tuesday, the 28th, saw the suspension of the American Exchange Market. Gold had been shipped from New York to Paris as early as the 18th July, and over $10 millions had been sent or booked for that destination by the 28th; while $15 millions were engaged for export to London on the 27th and 28th. The breakdown was of course due to the large sale of securities from Europe in New York and the endeavour to remit the proceeds to Europe.

The foreign Banks withdrew a large sum of money from the Stock Exchange and further sales resulted; later, on news of the declaration of war by Austria a further big fall took place in many quotations, especially in Canadian

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and American Rails, Wall Street now being sellers instead of buyers. On the 29th sales of securities* were accordingly concentrated on London resulting in a continued fall in all quotations.

Discount business, nearly normal on the 27th, had been on a very small scale and at firmer rates on the 28th and practically ceased on the 29th+: Banks were calling in loans from the Discount Houses who were, in turn, selling short bills to the Bank of England: Accepting Houses were in difficulties, for a general breakdown of the Exchange Market was impending and threatened their clients with default. The Accepting Houses were unwilling to undertake fresh business, hence an absence of new acceptances added intensity to the existing scarcity of the means of remittance to London. A 19 day settlement had been fixed for 27th - 29th July and was causing much anxiety, in view of the inability of brokers' foreign clients to remit sums due. The anxiety was heightened by a fear that the Banks would not support the Stock Exchange but would make difficulties about their advances and their margins. Some Banks, it was alleged, did begin to call in loans they had

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*The securities pressed on the international markets were chiefly, of course, of the kind usually most dealt in internationally such as Canadian Pacifics, Rio Tintos, &c.

+It is believed that isolated transactions took place during the next few days at rates rising to 10 or even 15%.

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already agreed to make. Still, the settlement passed off fairly satisfactorily, though seven failures occurred on the 29th and a further number on the next day. But for the Ulster crisis and general stagnation things would have been worse: as it was there were few speculative accounts open - indeed, it has been said that there had not been, for many years, so little stock being carried on borrowed money (though the total none the less came to about £80 millions sterling*).

It was on Monday, the 27th, in connection with the settlement, that the first rise in the Bank's discounts and advances took place, nearly £5,000,000 being added in respect of London alone. On Wednesday, the 29th, total discounts and advances stood at £26,423,000 as compared with £12,950,000 on Saturday, the 25th.

By the 30th all the chief Stock Exchanges had closed, except London and the Provinces, New York and the official Paris Exchange, and remittances from abroad had practically ceased.

For the ten days ended Thursday, the 30th July, the aggregate market value of 387 representative securities fell £187,992,000 or 5.6%, a record, if somewhat nominal, depreciation. The situation had become acute on Thursday

*"War & Lombard Street" H.Withers p.121.

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and the Stock Exchange did not reopen after the close of business on that day. It was expected on Thursday that the Bank Rate which was still only 3% would be raised, and a change to 4% was in fact made. So moderate a rise may have encouraged borrowers. The Bank of France simultaneously raised its rate from 3½% to 4½% and the National Banks of Sweden, Belgium and Switzerland each increased their rates by 1%.

On Friday morning, the 31st July, the announcement of the closing of the Stock Exchange produced consternation. The Banks could now neither realize their investments nor call in their Stock Exchange loans. The pressure on the Discount Market was, therefore, intensified and the Governor, who began by taking short bills at 2% above Bank Rate, soon put up the charge for bills and loans to 8% and 8½% and then to 10% and 10½%*. In these circumstances, it was decided at 2.45 in the afternoon to double at onoe the official minimum. The new figure, 8%, was a higher rate than any since November 1873.

At the close of business on the 31st Discounts and Advances stood at just over £40,000,000; the Reserve had sunk to £17,420,000 and the Proportion, 24.5, was less than half that of a week before.

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*At these high rates, loans were the more popular form of accommodation as it was hoped that after a week had elapsed conditions would be easier.

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July/August

The closing of the London Stock Exchange was followed at once by similar action in New York. Germany, Austria and Denmark raised their Bank Rates by 1%. The Paris Bourse nominally remained open, but only a few quotations were available and business was practically suspended. The French announced a one month's moratorium on bills. The closing of the London Stock Exchange ensured the insolvency of the Accepting Houses unless these could be assisted in some abnormal manner.

From the 29th July to the 1st August there were large withdrawals of gold from the Bank, the total issue of bullion falling in the four days by over £12,000,000. Of this, £4,131,000 was taken for export to the following destinations: France £1,740,000; the Continent (probably France) £847,000; Belgium £588,000; Egypt £565,000; Gibraltar £250,000; Malta £80,000 and Switzerland £61,000. The rest of the loss was to home circulation, i.e., the Banks and the Public. The demand of the latter was due almost entirely to the action of the Banks, on (and after) the 31st July, in refusing to pay their customers' cheques in gold or to pay more than a small proportion in this form, though much of the demand made on them was of the normal end-of-the-month and Bank Holiday character. The notes paid out were largely useless for wage payments, &c., and

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were consequently at once presented at the Bank of England. The Bankers' policy was both short-sighted and unfortunate in attracting a great amount of public attention to the position and aggravating the demand for gold, which began to be hoarded*.

The Banks really weakened their own position by not paying sovereigns. They should have paid out coin first, and subsequently themselves have cashed the notes at the Bank of England if the coin was exhausted. Even if an ultimate shortage of sovereigns should have occurred (a matter for the

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*One or two rather caustic references to this failure of the Banks to learn from the experience of past crises were made by Lord Cunliffe at the three day Conference (4/6 August) between the Government and the Bankers (to which further reference is made later).

5th August

"Until last week £5 notes were convertible into gold anywhere, "and so they are to-day at the Bank of England, but not at "any other Bank."

"The Banks have declined to part with £5 as against a £5 note, "that is the trouble amongst the crowd which we have to "get over if we can."

6th August (To Chancellor)

"There is one rather important thing I wish to ask you about, "and urge that you should impress on these Bankers. Our "gold is now down to 10 millions, and there is not the "slightest doubt that these Banks are making themselves "over strong, and they are hoarding gold against their "possible demands. I want you to impress upon them the "extraordinarily awkward position they will be in if we "have to suspend specie payment while they have millions "of sovereigns in their vaults."

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Bank of England's rather than the other Banks' attention), to refuse to pay sovereigns was only likely to discredit notes and create the very demand for sovereigns which it was desired to avoid. Further, the Bankers' action doubled the strain upon the Bank of England's Reserve, for the Banks required more notes but did not part with the coin received by them, whereas if gold had been paid out the loss to the tills would have been largely offset by gold receipts.

"We had heard a great deal in the times of peace," wrote Mr.Keynes (in "The Economic Journal" of September 1914) * "of the private reserves of gold which some of these banks "were said to be building up. So far from their taking "gold from the Bank at the next crisis, hopes were held out "of their actually being able to take new gold to the Bank "in replenishment of its own reserve. These hopes were not "fulfilled. The banks held on to what gold they had, and "took out from the Bank of England in the first three days "of the crisis many millions more. Our system was "endangered, not by the public running on the banks, but by "the banks running on the Bank of England." To show how little the public were alarmed he also points out that "The "Post Office Savings Bank remained open throughout the "period for which the Joint Stock Banks were closed (i.e. "Monday to Thursday, 3rd - 6th August), without suffering "seriously from withdrawals".

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*"War and the Financial System, August, 1914".

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At this point an extract from a confidential Treasury Memorandum*may be introduced:

"On . . . , the 31st July, a note was addressed to the "Bank of England by Sir F.(Felix) Schuster and Sir E.Holden, "proposing that a 'Chancellor's letter' should be applied "for, and that, as soon as the letter was obtained, the "bankers should be allowed to deposit 13 to 15 millions of "gold and 26 to 30 millions of securities and bills of "exchange to be approved by the Bank of England as "collateral security for a corresponding emergency issue "of notes.

"This proposal was based upon a suggestion made not "long before by Sir Edward Holden. It had been elaborated "in the report of a special sub-committee, composed of "Sir E.Holden himself, Sir F.Schuster and Mr.J.H.(Herbert) "Tritton, which had been appointed by the Gold Reserves "Committee of the Clearing Banks. The report had only just "been completed, and had not been published, but an advance "proof was sent by Sir F.Schuster to the Chancellor of the "Exchequer on the 30th July.

"The principle of the report was that all banks should "be required to accumulate gold reserves of their own, equal "to 5 per cent. of their deposits and that in an emergency "(on the bank rate rising to 8 per cent.) the gold should be "deposited with the Bank of England, along with double the

*By Mr.R.G.Hawtrey.

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"amount in approved securities, in exchange for notes. The "gold reserve of the Bank of England was also to be "strengthened by a gradual repayment of the Government debt.

"The underlying idea was to provide machinery within "the law for issuing an emergency currency, in place of the "old plan of breaking the law. In adapting the proposal to "the crisis then raging, the principal features of the "permanent scheme had to be sacrificed. It became nothing "more than an arrangement for allotting the accommodation to "be given by the Bank of England, after the legal limit of "the fiduciary issue was exceeded, among the banks in "proportion to the amount of gold that they could put up. "Presumably it was intended that the Bank should be precluded "from lending to anyone other than the banks handing over "the prescribed proportion of gold, for, if facilities were "freely granted to other borrowers, there would be no reason "why anyone should offer to hand over gold at all; the "scheme would be meaningless.

"The scheme does not appear to have provided against the "possibility that any bank that could secure a credit balance "at the Bank of England could draw it all out in gold, and "use the gold as the basis for a demand for emergency notes. "No doubt it was taken for granted that discretion would some-"how be reserved to prevent such an abuse. But, even so, "nothing could prevent a bank with insufficient gold paying "its customers' cheques in Bank of England notes, and

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"accumulating the gold paid in in the ordinary course of "business.

"This is precisely what the banks began to do on the "very day that their representatives proposed the adoption "of the scheme. And, inasmuch as the scheme had been "publicly advocated by Sir E. Holden, in January 1914, and by "Sir F. Schuster, on the 22nd July 1914, and had been a good "deal discussed, it is not impossible that an expectation "that the scheme would be put into operation was the cause "of the Bankers' action in holding back gold.

"Whatever the merits and defects of the scheme it could "do nothing whatever to ease matters at that time. It "might be necessary to suspend the fiduciary limit, but, if "so, what advantage could there be in restricting the freedom "of the Bank of England in making advances? The only "advantage to be gained by the transfer of the Joint Stock "Banks' gold to the Bank of England was that the Bank would "pay it out freely. But this advantage could be obtained "much more satisfactorily if the Joint Stock Banks themselves "had paid out their sovereigns direct to their customers.

. . . .

". . . late on Saturday night (1st August), it had been "decided to accept, subject to certain conditions, Sir E. "Holden's scheme for the deposit of gold and the issue of "emergency currency.

"On the Sunday accordingly a formal letter was "addressed to the Chancellor of the Exchequer on behalf of

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"the Clearing Banks asking for the adoption of the scheme "and a reply was sent by the Prime Minister and the "Chancellor of the Exchequer agreeing on the following "conditions:

"(1) The scheme was to be regarded as an emergency "expedient, without prejudice to the question of its "permanent adoption;

"(2) The primary deposit of gold was to be made in "exchange for notes in the ordinary way;

"(3) The issues of notes against securities were to be "strictly limited to the amounts which the Treasury was "satisfied were really required;

"(4) The notes were to be advanced at bank rates, with a "minimum of 10 per cent.

"Nothing was said as to the position of other borrowers. "Thus the Bank of England retained an absolutely free hand "to follow its usual practice in granting accommodation and "the only operative effect of the scheme would be to limit "the accommodation to be given to the Clearing Banks (which, "of course, under normal conditions do not borrow from the "Bank of England at all)."

Notwithstanding the statement made above, it is rather doubtful whether the Prime Minister's and Chancellor's letter, though drafted and dated, was actually despatched.

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The point is, however, of little importance since in any case the scheme was at once dropped. Sir Edward Holden, in his speech to the shareholders of the London City & Midland Bank on 29th January 1915, referred to the proposals and stated "this scheme was submitted to the Chancellor of the "Exchequer, but strong opposition to it was shown by the "Bank of England".

The following references to it are to be found in the Notes of the Government and Bankers Meetings at the Treasury:-

6th August 1914

After the Governor had pointed out that the Bankers would be very awkwardly placed if suspension of specie payments took place while they (the Bankers) had millions of sovereigns in their vaults:

THE CHANCELLOR: "What about the arrangement by which "they were to deposit 10 to 15 millions of gold with the "Bank of England?"

THE GOVERNOR: "That has gone no further, and I do not "suppose it will. This arrangement of yours (i.e. issue "of Currency Notes) will supersede the other . . . "

Later,

The Chancellor having emphasized the need to avoid suspension of specie payments:

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LORD ST.ALDWYN: "May I just say we did offer to send "£15,000,000 of gold into the Bank of England."

THE CHANCELLOR: "I have put that to the Governor. "Does that offer still hold good?"

(An interruption occurring here, no answer seems to have been given.)

The question of suspending the Bank Act was certainly discussed on Friday, the 31st July, between the Bank of England, the Clearing Bankers and the Treasury, and on Saturday, the 1st August, (the day of Germany's declaration of war on Russia) the customary formal request for permission to exceed the limit of the Fiduciary Note Issue was written, in which it was pointed out that in the previous five days upwards of £27,000,000 had been advanced in London alone, "an unprecedented sum to lend". The Governors added that the Reserve might fall below £11,000,000 before the close of business; as a matter of fact only £9,967,000 remained that evening. The reply from the Prime Minister and Chancellor bore the same date and enjoined a minimum rate of 10% during the suspension. Lord Cunliffe had gone to the Treasury in the morning and had brought the letter back to the Bank. It followed the precedents of 1857 and 1866, on which occasions a 10% rate was stipulated, but the crisis of 1847 afforded a precedent for suspension at 8%. The official

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minimum was raised to 10%* soon after Lord Cunliffe's return. The exact time has not been recorded but from the remarks in 'The Times', 'Finanoial Times', 'Financial News' and 'Morning 'Post' there is little doubt it was between 12 and 12.30. Business at the Bank in loans and discounts, suspended "by "tacit agreement" ('Morning Post'), then recommenced. 'The 'Times' of the 3rd August said that the 10% rate foreshadowed "an early suspension of the Bank Act" and this was generally expected+, but whether it had actually occurred or no was not generally known until 9th November 1915, when a statement was made in the House of Commons^x. This statement indicated that no actual suspension of the Act had taken place, though the Act had been technically violated.

The Clearing Bankers are said to

*The following extract from the Court Minutes of the 10th August may be quoted here:- "The Governor reported that on "Friday, the 31st July, after consulting several of his "Colleagues, he raised the Rate of Discount on Bills not "having more than 95 days to run from 4 to 8 per oent., and "that after a Meeting of the Directors on Saturday, the 1st "August, he further raised the Rate of Discount from 8 to 10 "per cent. That on Thursday, the 6th August,he reduced the "Rate of Discount from 10 to 6 per cent., and on Saturday "the 8th August, he further reduced the Rate of Discount to "5 per cent."

+'The Economist' of 8th August 1914 said "It became evident "that the Bank Act would have to be suspended and the country "provided with a supplementary paper currency. This has now "been done". Whether "this" refers to both supposed necessities or to the latter only is uncertain.

^xThe Hansard Report of this announcement will be found among the Appendices.

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have slightly relieved the Market on Saturday by lending again a little of the money they had called in from the Discount Houses. Meanwhile in New York it was being suggested that the Bank of England should open a Branch in that centre, and alternatively plans were being made for shipping £20 millions of gold to London.

On the rise of the rate from 3 to 10% in three days Mr. Keynes commented*"The rapid rush . . . . . was "partly due to the great volume of bills which the Joint "Stock Banks forced the Discount Houses to take to the Bank "of England; but more largely to the amount of gold and "notes taken from the Bank of England by these same Joint "Stock Banks.

. . . .

"This violent movement was a mistake, the second "jump to 10% being made, perhaps, under the influence of the "Treasury, which was probably influenced by the traditional "rule that the bank-rate must be 10 per cent. as a prior "condition to the grant of emergency assistance. The "principle that the bank-rate must be raised in a crisis is "in general sound, but it was applied in this case without "sufficient regard to the special circumstances. In "general a high bank-rate has the effect of attracting gold "from abroad or retaining it at home, while a moderate bank-"rate, on the other hand, restores confidence. Usually the

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*'Economic Journal', September 1914, "War and the Financial System, August, 1914".

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"Bank has to compromise between these opposite influences. "On this occasion a high bank-rate was useless in the "special circumstances for the first purpose, and the need "of establishing confidence became, therefore, the dominating "consideration. The 10 per cent. bank-rate caused great "alarm amongst the general public, as well as to the discount "houses to whom such a rate would be ruinous and who feared "for a moment, though baselessly, that it might be a prelude "to refusing them accommodation altogether". (This fear had been a feature of all previous panics.)

On the other hand the theory was laid down by Bagehot*, and has long been put in practice by the Bank, that although the Bank should perhaps never refuse accommodation+ in a panic a high rate should be charged, in order to deter those not urgently in need and to ensure that a return to normal conditions will follow at the earliest possible moment. And on this occasion it must be remembered that actual business had been done at 10% and more before the official rate was moved up to that figure. Whereas in 1847 the 8%

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*Sir Edward Holden did not accept this - vide his speeches during the war at some of the Annual Meetings of his Bank.

+Vide Appendix giving the Governor's evidence before the Committee on Currency & the Foreign Exchanges, when Sir Brien Cokayne said the Bank, so far as he knew, had never (but once) refused to advance on British Government Securities.

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rate though fixed as low as was considered possible, namely, about 1% above market rates abroad, was also ½% above the average rate the Bank had previously been charging*.

On the afternoon and evening of Sunday, 2nd August, there was a Meeting of Clearing Banks and Discount Houses which late at night recommended the Chancellor, among other things, to issue £1 and 10/- notes; as soon as these were available, to suspend specie payments; to extend the Bank Holiday for two more days at least; and to pass a general moratorium of one month. They also asked for a suspension of the Bank Act of 1844, the existence of the Chancellor's permissive letter (obtained on the previous day) not having been made public until much later.

Meanwhile, on Sunday a one month moratorium on bills of exchange other than cheques was proclaimed and was legalised by the Postponement of Payments Act passed on the next day. The novel expedient gave temporary relief to the Accepting Houses who were enabled to postpone for a month payment of any bill accepted before 4th August subject to interest at the Bank Rate current on the date of re-acceptance.

*Speech of the Chancellor of the Exchequer in House of Commons 30th November 1847.

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Sunday had been spent at the Bank in sending out invitations to a Meeting of Bankers and Accepting Houses, which took place in the Court Room on Monday. The Meeting was presided over by Lord Cunliffe, who, it may be said at once, was advising the Government throughout the crisis, though very little written record exists of his activities at this time. Discussion turned on the precise effect of the Bills of Exchange Moratorium Proclamation &c. but soon centred upon the question whether the Banks should open on the following day. Speakers (amongst whom Mr. Henry Bell, the General Manager of Lloyds Bank, was prominent) evinced very great anxiety concerning the banking situation. Eventually at the instance of Lord Revelstoke a Bankers' Memorial to the Chancellor was drawn up asking for three extra Bank Holidays. This recommendation had, as mentioned above, already been made by the Meeting of Bankers &c. on Sunday. A Bank Holiday Bill was passed on the evening of Monday.

On Tuesday, the 4th*, Great Britain entered the war and on this day also a Conference, lasting three days, began between the Chancellor of the Exchequer (Mr. Lloyd George), Members of the Cabinet and Representative Bankers and Traders. This Conference was chiefly occupied with the proposed general moratorium and the provisions for supplying

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*By 4th August Paris, Berlin, Amsterdam, Zurich, St. Petersburg all had a 6% Bank Rate, while Christiania was 6½% and Copenhagen and Brussels 7%.

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the Bankers with Currency Notes by Friday, the 7th, when they were to re-open to the Public and when it was feared considerable demands might be made upon them. Among the Bankers the most prominent were Viscount St.Aldwyn (who was elected Chairman of a small Advisory Committee) and Sir Edward Holden.

One of the most important points to be settled was whether specie payments should be suspended when the Currency Notes were available. As has been mentioned above suspension had already been advocated by the Bankers at their Meeting on 2nd August. The Traders' Representatives also supported this view on the 4th. One of the Bankers present said "I understand one of the difficulties to-day "is that the Bank of England cannot help us, because they "are afraid of a run on the gold supply. It is really a "question for the Governor of the Bank of England whether he "wants people to come and ask for specie and not get it". The Governor then interposed "It is not true that if the "Bank were open to-day I could not pay my way in gold. And "if you could see the accounts of the Bank, which the "Chancellor of the Exchequer has seen, you would be surprised "that there is so much fuss".

That settled the matter. Indeed but for the action of the Banks themselves in refusing to pay out gold the situation could not justify any such extreme measure.

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Large amounts of gold were on their way to Great Britain from America and the exchanges made it unprofitable to export gold to almost every country. As regards home circulation it is true that at the close of business on 1st August 'London Sovereigns' had dropped to their minimum of £9,294,000; but the Mint was turning out £500,000 to £1,000,000 a week. "Even if," wrote Mr. Keynes,* "the Bank "of England had been exposed to a foreign drain of gold, or "to the risk of it, it would have been a shameful abandon-"ment of the Bank's traditions to have refused to pay out "gold so long as any substantial quantity of it was still "available. A suspension of specie payments, the English "have been taught to believe, is a last, and not a first, "resort. On an unshaken belief in the tenacity of this "tradition the international position of the City of London "largely depends; and weakness on this point in the early "days of the crisis, however great the danger, might have "preluded a vast loss of future prestige.

"In the actual circumstances, however, a belief "in any serious danger of the loss of gold abroad showed a "great misconception of the financial situation of this "country. It would have been ridiculous to have risked our "prestige by refusing to meet our immediate foreign obli-"gations in cash at a time when the rest of the world, so far "from being able to demand money from us, was utterly unable "to pay what was immediately due <u>to</u> us from them.

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*'Economic Journal', September 1914, "War and the Financial System, August, 1914".

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"The staunchness of the Bank of England, the "authorities of which never wavered in their determination "to meet immediately in gold all possible claims upon them, "and the good sense of the Treasury and the Government "fortunately deprived of influence counsels of so great "folly."

As it happened, the gold held by the Bank steadily mounted until by 26th August more was held than at the same time in 1913.

On the 5th and 6th August the Bankers urged that the Currency Notes should be supplied to them by the Government at the Bankers' Deposit Rate (for 7 days with minimum of 3%). If the charge were above the Deposit Rate, their depositors would in turn expect a better yield. The Bankers had a very strong objection to 6%, a figure which it was proposed should be adopted as Bank Rate after the Bank Holidays. Their advances to Trade would have to be made at or above this figure*, and Sir Edward Holden in particular maintained that Traders would resent the rate and would regard the situation as being one in which the Government was making a profit at their expense.

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*"When the Banks re-opened in August they charged 6% on "outstanding loans. The rate was reduced on September 17th "to 5%, at which figure it remained until the end of the "year".

('The Economist' 2nd Jan. 1915)

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Lord Cunliffe contended that the only possible rate chargeable for this accommodation was Bank Rate. The Bankers were made to realize that if a lower rate were conceded it would be possible for the Market to borrow from them in order to repay the Bank of England, so that the Currency Note Rate would, in practice, control the situation instead of the Bank Rate doing so; Sir Felix Schuster, however, proposed to deal with this difficulty by giving the Bank an assurance that no action would be taken by the Bankers in the Money Market which would interfere in the slightest degree with the effectiveness of the Bank Rate. This suggestion, however, was not taken up and, as the Chancellor of the Exchequer (Mr.Lloyd George), Mr.Austen Chamberlain and others agreed with the Governor, the question became one of what the Bank Rate should be.

This rate was not to be announced until the 6th August, but it had been discussed in Conference on the 4th and 6% had been decided upon and announced in the House of Commons on the 5th*. According to the notes of the Conference+, the Bank's share in the decision (as communicated by Mr.Austen Chamberlain to a late comer) had

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*Mr.Lloyd George also spoke in the House on the iniquity of hoarding gold.

+Shorthand notes were taken and are held at the Treasury. A somewhat compressed version is filed in C.C.P.120.

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been indioated as follows -

". . . the third point the Chancellor announced, to "which the Governor concurred - in fact proposed it - is "that the Bank Rate should be reduced to 6%".

During a temporary absence of the Bankers from the Conference on the 6th, Mr.Austen Chamberlain referred to the disadvantages of again altering the rate, which would give an appearance of weakness, but it was at last decided that, if matters went well on Friday, the 7th, a reduction to 5% should be made, and on the Bankers' return they were informed accordingly. This concession partly satisfied them.

On the 6th the Currency & Bank Notes Act was passed and a Proclamation issued postponing other payments besides bills of exchange, with certain exoeptions. So general a moratorium was chiefly desired by the Bankers who feared the demands of their depositors at a time when their assets were frozen - securities by the closing of the Stock Exchange, bills by the Accepting Houses. (This moratorium was extended from time to time until the 4th November.) The Banks received discretionary power to refuse the encashment of cheques. The general moratorium did not receive support from Lord Cunliffe, who considered it unnecessary and damaging to the credit of the Country*. It is true

*This is in accordance both with Lord Cullen's recollection and with Lord Cunliffe's speech to the Bank Proprietors on his retirement from the Governorship in 1918 (see Appendix).

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that at the three days' Conference he spoke in favour of extending the moratorium to include India and the Colonies, but there is nothing to indicate approval of the measure in itself. The enormous amount of legal tender (20% of deposits) which could be drawn under the Treasury Memorandum issued in connection with the Currency & Bank Notes Act should have been quite sufficient to restore confidence to the Banks. As for the Public as a whole, they had never lost it.

When the Banks opened on Friday, the 7th, there was very little excitement. Indeed the Public is said to have paid in rather than withdrawn funds from the Banks. At the Bank of England an actual decrease in discounts occurred but advances again mounted by over £5 millions and the Reserve was depleted by £8 millions, a somewhat larger loss than on the 31st July and 1st August: much of this had gone out for Government requirements during the holidays*. The Reserve now stood at £1,928,000 only and the Proportion at 2.7%+. The lowest point, however, had been reached.

*3rd August		£255,000
4th	"	155,000
5th	"	2,123,000
6th	"	1,090,000
		£3,623,000

+If the Bank's accounts be reconstructed to show the technical excess issue of notes on the 7th and 8th August (see chapter 'Bank Notes & Currency Notes'); and if in such reconstruction (vide end of Accounts Book 1914/15) it be assumed that the gold in the Reserve would have been transferred to the Issue Department and the Banking Notes returned to Store, in order that the amount of the Excess Issue should

(See next page)

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On the following day the rate was reduced to 5%, as promised to the Bankers.

Meanwhile the endeavour to remit from the United States had forced up the Exchange Rate by the 28th July to 4.94, after which it became 'nominal', leading to gold shipments to London and to deposits of gold for the Bank's account at Ottawa. Large amounts of gold from America were now beginning to appear in the Bank's figures: over £9½ millions arrived from this source in August, mostly at Ottawa, and similar movements continued throughout the autumn. About the end of the month the exchange again began to function, at near $5 to the £.

The first and most important step taken to remove the difficulties that had led to the moratorium came on the 13th August, the Government announcing that the Bank of England would discount, under Government guarantee, at Bank Rate, and without recourse to the holders, all approved bills accepted before the 4th August. The Market is said (by "The "Bankers' Magazine") to have been "staggered" by the comprehensive nature of this pronouncement.

As the discounting was without recourse the Banks and Discount Houses were relieved of the most formidable of their possible losses. Their loans to the Stock Exchange

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be reduced as much as possible, the proportion (of silver coin remaining) to deposits would have been .42. (The silver could of course have been transferred to Issue only if valued as bullion.)

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were much less embarrassing, being, at the worst, largely covered by the securities held. Out of the sums obtained under the new facility previous borrowings from the Bank were repaid.

Later, the scheme was attacked because of its inflationary effect, Mr.Keynes (one of the earliest to point out to the Public the dangers of cheap money) contending that while the bills should have been made marketable they should not have been actually marketed at the Bank of England*.

It was alleged however that the Banks still showed excessive caution. Mr.Lloyd George, speaking in the House of Commons on the 24th August, pointed out that the Government had taken risks and that the Bankers must do so as well. He referred to complaints that had reached him that Traders were not receiving their usual amount of accommodation. He had been obliged to tell the Bankers that the House of Commons might have to take action. The Banks were also attacked by Mr.Keynes in the article already quoted. He alleged that not only had their influence been cast throughout "on the side of panic measures" but that "their action "suggested that considerations of their own immediate safety, "and even, it should be added of their own pecuniary profit, "overshadowed those of the general interest and of the more

*'Economic Journal', December 1914, "The Prospects of Money, November, 1914".

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"remote future. They showed too little of that steadfast "and honourable regard for the good name and future position "of the City of London which the authorities of the Bank of "England, on the other hand, never forgot".

It is but fair to add first, that in reply to a circular sent out by Somerset House to over 8,000 persons on the 19th August, 6,341 returns contained the opinion that banking facilities were, at that time, "reasonably "comparable" to those available before the war, and only 969 expressed the opposite view. (The phrase "reasonably "comparable" was not perhaps the clearest that could have been used in this connection.) But it is curious to note that of the Bankers themselves making a return no less than 33 out of a London group of 75 considered that facilities <u>had</u> been contracted. On the other hand, of provincial Banks only 2 out of 34 held this opinion. From this and other figures in the return it appears that the provinces were more fully accommodated than was London. In the second place, money was already too plentiful, and there would have been some real justification for a hesitation on the Bankers' part to create further credit without cogent reasons.

The Discount Market also remained lifeless. Foreign trade suffered because the Accepting Houses continued to be protected only by a moratorium and were in no position to take any new business. New bills were not forthcoming

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and the liability on all old bills remained except as concerned the last holders. On the 5th September therefore the Government arranged for the Bank to advance to acceptors the money required to pay off all approved pre-moratorium bills at maturity, and the acceptors were not to be forced to repay such advances* in full until a year after the end of the war. Thus new bills could once more safely be accepted, as they would mature before the liability to the Bank became operative. Meanwhile the moratorium was prolonged, by the Proclamation of 3rd September, until 4th October. The opinions of some 8,000 business men had been taken on this step+ and the large number of votes for extension received from Bankers, Stockbrokers, Discount Brokers and Export Merchants carried the day, notwithstanding the fact that debtors had been further relieved by the Courts (Emergency Powers) Act passed on 31st August.

On 30th September the moratorium was again continued for another month (4th October - 4th November), though bills re-accepted before the 4th October only received 14 days' extension.

Next came the scheme for dealing with Stock Exchange loans, announced on the 31st October. (See Chapter II)

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*These loans were a second, not a first, claim on the firms concerned.

+Vide Somerset House Circular of 19th August, 1914.

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By this time most of the foreign exchanges were in working order again, but of course the war had made a large number of debts irrecoverable, quite apart from the exchange difficulty. Exporters and others were not yet relieved as regards these debts, except by the Courts (Emergency Powers) Act. On 3rd November a scheme was published which enabled them to obtain advances from their Bankers (in the form of bills guaranteed by the Government to the extent of three quarters of any eventual loss).

Finally some assistance was given by the Government to the Liverpool Cotton Exchange and Parliamentary authority for the various liabilities was obtained by the War Obligations Act of 27th November.

The Bank's discount of pre-moratorium bills had created a large increase in Other Securities and in Total Deposits, the latter of which rose from £68,249,000 on 5th August to £162,496,000 by the 2nd September. But the Discount Market remained idle until the announcement on 5th September of the scheme for Bank of England advances to pay off pre-moratorium bills; hence until after this date the market rates remained at nominal figures between 4 and 5%. By 9th September, however, Three Months' Bills were quoted at 3¼ to 3½ and a week later at 3%. Still lower quotations followed. The average short loan rate for the seoond half

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of 1914 was only £2: 5:11 which was actually lower than that of the Bankers' Deposit Rate, 2½%.

The plethora of money was increased by other causes in addition to the transactions in pre-moratorium bills. The Bank's total bullion had increased from £26,420,000 on 7th August to £73,474,000 on 15th December. On the same dates the Reserve was £1,928,000 and £56,364,000 respectively. (In both cases these were minimum and maximum totals for 1914.) Another £13½ millions of gold had been set aside for the Currency Notes Reserve. The Government's temporary borrowings from the Bank on Ways and Means Advances and Treasury Bills, prior to the issue of the 3½% War Loan, though together never exceeding £30 millions, and generally much less, had a similar tendency*. To a trifling extent only this was offset by Bank Borrowings, these did not even reach £5 millions until just before Christmas and the figure increased but little until the end of February 1915.

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*That the Court of Directors were quite alive to this and to the existence at the end of November of a state of inflation is shown by a resolution passed 26th November 1914 requesting the Governor "in view of the adverse effect of inflation of "credit on Foreign Exchanges, to ask the Chancellor to "consider that rate (i.e. 2½% for current Ways and Means "Advances) as variable and to consent to its being raised at "short notice should the necessity arise". (The Chancellor agreed.)

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Critics have held that a 5% rate was insufficient and that it should have been kept at 6% or 7% in order to counteract the inflation which became inevitable as a result of the volume of credit created by the Bank of England's advances to acceptors of pre-moratorium bills. Very possibly, however, the 5% rate would have been adequate if made effective. It is at least probable that the Bank desired it should be made effective*. But the Government wished to raise a large loan almost at once+; and apart from the temptation to borrow cheaply, it may have been felt inadvisable that the British Government should appear before the Public and the Enemy offering terms that might be construed as an admission that their credit had already suffered. Moreover the Public, anxious to convince themselves that the war would cause but little disturbance, were clamouring for 'business as usual', and would as usual no doubt have resented dear money. The ill success of the 3½% War Loan is, however, in itself an argument that it would

*This statement is in accordance with Lord Cullen's recollection (in 1924). (In 1914 Lord Cullen was Mr.Brien Cokayne, a Director; he became Deputy Governor in 1915 and Governor in 1918.)

+From 19th August to 4th November, the date of the War Loan, the Government had borrowed from the Public by the issue of £90 million Treasury Bills, nearly all of six months' currency (v.Chapter II).

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have been better to tighten control and offer a higher rate with the Loan. Lord Cunliffe had strongly opposed so low a yield*. If he had had his way money would probably have been diverted into the Government's pocket that was instead spent on the production of goods not needed for the war. It is true that so far as the Investment Market was concerned the employment of funds in new issues for purposes unconnected with war requirements was stopped or checked by the establishment of the Capital Issues Committee on the 27th January, 1915. Subsequent to this date such issues as were made were doubtless in the main justifiable; in any case their total fell away from an amount in excess of £152,000,000 in the first six months to £27,673,000 in the second half of 1914, while in 1915 the figures were £42,756,000 and £28,335,000 for the first and second half years, respectively. But surplus profits if not invested in other people's trade were no doubt attracted back into traders' own businesses, rather than lent to the Government, and the period of cheap money antecedent to the Loan doubtless contributed to this process.

The curtailment of demand for non-essentials could scarcely have produced unemployment, since a scarcity of man-power for the Fighting Services and for making munitions soon

*There appears to be no written evidence of this, but Lord Cullen stated his certainty on this point. (Verbal 5/12/1924)

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developed; on the other hand, the wasteful public consumption produced by plentiful credit at cheap rates forced up wages and prices against the Government.

The War Loan was itself a further cause of expansion due to the Bank of England's and the other Bankers' large subscriptions (vide Chapters II and III) though here a considerable deduction must be made owing to the large amount of money accumulated and kept on the Exchequer Account, during the first nine months of 1915. This balance was variable but was often as much as £70 or £80 millions and ran up occasionally to as much as £120 millions.

It is not surprising that with all these influences at work prices should have risen by the end of the year to about 9% above the level of the previous July, and in the one month of January 1915 more than another 8% rise occurred.

On the 4th November the moratorium ended; the 3½% War Loan was issued on the 17th and in this month also the Federal Reserve System of America was inaugurated*.

There was no occasion to borrow from the Bank over the year end. Three Months' Bill rates were $2\frac{7}{16}$%.

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*Owing to the Aldrich-Vreeland Bill of 1908 additional currency was available on the outbreak of the European War and was issued temporarily to the amount of $370 or $380 millions. The Federal Reserve System was an outcome of the Aldrich Monetary Commission established under the same Act. A Central Bank closely modelled on European lines had first been planned; the draft of 1911 contemplated a Bank with a capital of $300 millions and 15 Branches. The final constitution took shape under the influence of President Wilson.

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On January 4th the Stock Exchange re-opened with minimum prices imposed on all dealings, and by February it was estimated that 40% or 50% of the speculative positions open at the outbreak of war had probably been covered. On 19th January came announcement of Treasury control of fresh capital issues.

The financial history of 1915 is very largely the history of the American Exchange. The movement towards restoration of the exchanges had begun in the second week of September, 1914, and by the end of the year the exchanges were near parity, New York being the last to move adversely to this country. It became unfavourable, however, at the beginning of 1915.

The exchange was 4.84$\frac{7}{8}$ at the end of January, 4.80$\frac{1}{2}$ at the end of February, and it gradually fell until September. It was 4.76 on 1st August; and later in the month 4.60 was touched, while early in September a decline to 4.47 took place. Constantly rising prices here with stationary prices in America was doubtless one cause of the fall in this and, later, in other exchanges. The price rise here was partly due to factors already existing, and partly to fresh large creations of credit under certain financial agreements made in February, whereby Great Britain undertook to assist Russia and France. The downward movement in sterling, however, was

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much accelerated by the necessity which arose for making large purchases in the United States.

These considerations were quite sufficient to account for the adverse exchange; indeed, it was only the strength of Great Britain's position before the war as the greatest lending nation that delayed for about a year the appearance of any serious fall in sterling.

The Bank's total bullion reached its maximum for the year on the 19th January, when the Reserve was also at a figure only exceeded towards the end of August and the beginning of September. The Proportion was not again in 1915 as high as in the first three weeks of January when it was 32.7. By the end of June it had fallen to 16.2 and the Reserve to under £36 millions. The improvement in the Bank's figures in August and September was chiefly owing to the receipt (under 'Certain Agreements' v. Chapter IV) of £3,000,000 from France on 1st September, £2,000,000 from Italy in July and August, and a net inflow in those two months of £10¾ millions* from Home Circulation, the Public having been urged to take Currency Notes in exchange for gold+, but in spite of a further gain of £4 millions from the same source between October and the year end, the Bank's position was not maintained.

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*This is separate from the £20,823,000 collected in August from the Bankers and shipped to the U.S.A. (v. Chapter V).

+Treasury Notice dated 6th August, 1915.

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The probability of a drain of bullion in the autumn to America had been foreseen by the Bank (and by others) at the beginning of the year, and from September onwards, large transfers of gold were made to the United States. Gold was also withdrawn for Spain and Japan.

The American Exchange position was attracting a good deal of public comment by April*, and, as related elsewhere, efforts to deal with the situation by supporting the exchange began to be made through the Bank of England as early as the 18th February. The purchase of securities however did not begin until July. At the end of September a joint Anglo-French Mission arranged an Anglo-French 5 year loan of £100,000,000 in the United States, but at a high cost, over 5¾% tax free. Yet the exchange showed renewed weakness in October and November, dropping at times to 4.62½. It was not until after the end of the year that the newly formed London Exchange Committee and the American Dollar Securities Committee provided really adequate measures to peg the exchange, though an improvement to 4.70 had been secured towards the end of November, and in December further steps had been taken towards the mobilisation of American and Canadian securities.

The exchanges of other neutral countries, especially Holland and Scandinavia, also moved against Great Britain in the late autumn and in November the Bank lost by "exports"

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*Vide 'The Economist' for April, 1915.

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over £12 millions, making an aggregate of £77 millions "exported" for the year to the end of that month, the net loss for the 11 months being £19 millions*.

To revert to the more internal aspect of the situation, by the middle of February the London Three Months' Bill Rate was as low as $1\frac{5}{8}$% and at one time during the month it touched $1\frac{1}{4}$%. Meanwhile, however, the Bankers were said to be charging $\frac{1}{2}$% or 1% above Bank Rate for their advances which gave rise to some complaints. Early in the month the Chancellor expressed the desire that Russia should "draw from "the Joint Stock Exchange Banks and elsewhere" cash which the Government could not borrow "because the rate of interest we "could offer was not sufficiently attractive". (He was, however, equally anxious that Great Britain should not take advantage of Russia to make a profit out of her needs.)

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*Extract from the Minutes of the Court of Directors Thursday, 18th November, 1915.

The following Resolution was moved, vizt:-

"That the Court view with grave concern the present "adverse state of the Exchanges with all neutral Countries, a "continuance of which must result in such a drain of gold "from the United Kingdom as will, in their opinion, imperil "the maintenance of the gold standard of this Country.

"That the Court appreciate that this question has been "engaging the serious attention of His Majesty's Government, "but would urge upon them the necessity of the adoption with-"out delay of a definite policy, with a view to remedial "measures being taken, which should more especially include "curtailment of imports and arrangements by which neutral "Securities may be made available for National purposes.

"That the Court would finally point out that the "effective maintenance of British credit abroad would greatly "assist in a solution of the gold and exchange problems.

"And the same was Carried".

The Chancellor replied on the 2nd December assuring the Bank that the matter should receive his attention.

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A slight improvement in the Three Months' Bill Rate took place in March, doubtless due to an upward movement in Bank Borrowings. In mid-February these had been about £5½ millions; on 1st March they were £13½ millions; on 11th, £22 millions; 12th over £41¼ millions and by 31st some £49½ millions. (During the next few months, until the beginning of August, as much as £60 or £80 millions were borrowed.) By the middle of March a rise of 1 point in the market rate had been secured, but the rate soon fell away again to 2%.

"Under ordinary circumstances" (said the Bankers' Magazine for March 1915) "our purchases of commodities from "New York would have been financed by Bills drawn on London, "and these, coming into the market, would, in their turn, "have had a hardening effect upon Bill Rates, while they "would have given a distinct warning to the market of the "trend of events. Now, however, ... these purchases "have been conducted on a cash basis, so that the effect has "been to instantly supply America with enormous cash "balances, while the supply of Bills in the market has been "diminished rather than increased."

A much more effective measure came on 14th April, when the issue of Treasury Bills at fixed rates began. The rates for these were at first low - viz. 2¾% to 3¾% according to maturity, but they prevented market rates falling below

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these figures. The rates were later raised, in August, October and November (when all maturities became 5%). Owing to the scarcity of ordinary commercial paper the Treasury Bills were readily absorbed, some £160,000,000 net being thus obtained by the Government from April to October; much of the money obtained by means of tender and fixed rate bills was retained in the Exchequer, its balance rising in April to £100 millions; these expedients, accompanied by Bank Borrowings at rates slightly below those of the Treasury Bills went a long way towards securing the Government's command of the Money Market. Gold withdrawals in June for the United States of America followed by the issue of the $4\frac{1}{2}$% War Loan raised bill rates rapidly and considerably, Three Months' Bills moving from $2\frac{7}{8}$ to $4\frac{1}{8}$, though money for the day and for the week remained at $1\frac{1}{2}$ to $2\frac{1}{4}$ only. The large repayment by the Government on account of their indebtedness to the Bank* further tightened up the Market and by mid-July Bank Rate was for the first time quite effective; Three Months' Bills being not infrequently as high as $5\frac{1}{4}$%. On 21st July the Bankers' Deposit Rate was raised from 2% to 3% and on 2nd September by another $\frac{1}{2}$%. In August bill rates again slackened to under 5%, and in September the Bank endeavoured to get all Banks to adopt $4\frac{1}{2}$% as the minimum rate for advances. This arrangement was made rather ineffectual

*v. Chapter II

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owing to offering of American and other foreign money at lower rates by institutions outside this agreement; Government disbursements also made money easier*, though the Treasury Bill Rate, now 4½%, kept the Market from dropping away too completely. The Anglo-French Loan in New York had practically no effect on the Market here.

In September Mr. McKenna, the new Chancellor, introduced his first Budget. Taxation was increased, a measure Mr. Lloyd George had avoided in the previous May; the tax revenue, including imposts levied by Mr. Lloyd George in the autumn of 1914, was raised to about £170 millions above the pre-war figure. Economy now began to be urged both on the Government and private individuals.

During November and December Bank Borrowings were increased by 30 or 40 millions; on the 12th November Treasury Bill Rates were put up to 5% and the Bank "took the "extreme course of intimating"+ that they would not discount bills under 5½%. For a few days, as a result of these measures, the Market Rate for Three Months' Bills was nearly 5½%, but (as previously experienced) the supply of bills was insufficient to maintain rates: more especially as the Bank's

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*v. Chapter III. Arrangement under which some £12½ millions were deposited with the Bankers in connection with payments in full on the 4½% War Loan.

+"Bankers' Magazine", January 1916.

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action necessarily had the effect of lessening the volume of applications for Treasury Bills. The Bank did not have occasion to carry out their decision, except on the 29th December when a small amount of bills, about £150,000, was discounted at 5½%.

In view of the heavy exports of gold and the other considerations indicated, the question of a change in the Bank Rate arose, but on the 9th November the Governor agreed with the Chancellor that, instead of putting up Bank Rate to 6%, the Treasury Bill Rate for all currencies but one month should be altered to 5%. This change might have been made earlier had it not been that the last instalment of the 4½% War Loan was not out of the way until the 26th October. It was thought possible that, as Bankers had the right to borrow on their holdings of 4½% War Loan at ½% under Bank Rate, they would as a result of the alteration take such advances for the purpose of investing in 5% Treasury Bills. Should this be the case, the Treasury were to pay the Bank the extra ½% on any such additional advances (i.e. in excess of the existing figure of £6,681,000). If therefore Bankers were to act as suggested to any large extent, the Exchequer would raise a considerable sum, virtually at 5½%, which would be the rate at which Treasury Bills would have to be sold with Bank Rate at 6%. The efficacy of this measure would determine to a large degree the possibility of avoiding the

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higher rate*. The Treasury Bill Rate was raised to 5% on the 12th November, but on balance the Bankers seem to have reduced their borrowings on War Loan in the next five months, instead of increasing them. On 25th November the minimum prices were removed from Consols, 2¾% and 2½% Annuities, and Consols fell from 65 to 60½.

Though money rates were not affected, a rather firmer tone was produced in the Discount Market in mid-December by an issue of Exchequer Bonds, and for the second half of 1915 the margin between Bank Rate and the average Market Discount Rate practically disappeared. The situation was never exactly stringent, but the Market had to borrow from the Bank on more than one occasion. As has been shown, this was in marked contrast to the first half of the year, when money was so plentiful that the Bankers' Deposit Rate (2%) was actually above the Short Loan Rate, which was only £1:12:11.

Exchange uncertainties probably prevented Neutrals from taking advantage of the cheap money conditions here to borrow to any great extent in this Market during the period that money was dangerously easy. Moreover, at that time, New York had only just begun to develop a Discount Market.

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*Lord Cunliffe's letter to the Chancellor of 10.11.15.

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The tendency of London rates to be lower than those of New York often recurred during the war period. But the great trade prosperity of the United States, the establishment of the Federal Reserve System and the large influx of gold in the autumn made the year 1915 one of remarkable ease in that Market, and at its close the United States had begun to occupy a leading place in financing international trade, Bankers' acceptances then outstanding being estimated at over $100,000,000. The official rate of the Federal Reserve Bank of New York was 6% on the 16th November, 1914, but on the 23rd December it had been reduced to 5% and after February 1915 the rates of the Reserve Banks remained for the most part at 4½% or 4% during the whole of 1915. These rates continued in force through 1916 and 1917 also.

By the end of 1915 the figure of total purchasing media* had risen to 132 (December 1913, 100). On the 1913 basis 'The Economist' Index Figure was 134.9, as compared with 100.2 in August 1914, and 123.5 in April and May, 1915. Retail prices in December 1915 were 44% above the level of July, 1914, according to 'The Board of Trade Labour Gazette'. The Currency Note Issue had risen from £21½ millions (19th August, 1914) to £103 millions.

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*Bank of England's Index for the United Kingdom.

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During this year the Market became fully accommodated to the control exercised by the Government and the Bank by means of Treasury Bill offerings* and Bank borrowings. A state of stability was the result. On the one hand surplus funds were absorbed, while on the other hand, money never became tight, because Treasury Bills could be allowed to run off or loans to the Bank called in. The average Market Rate for the whole year was only ¼% below Bank Rate.

Efforts were largely directed to the maintenance of the foreign exchanges and rates were therefore kept high in order to attract and keep the balances of neutral countries. The position of the exchanges by the beginning of February is indicated in the following table+ :-

Exchange	Feb.5 1915	Feb.5 1916	Percentage for or against London on basis of pre-war parities	
Paris	25.10½	27.99	10.9	for London
Amsterdam	11.95	11.40	5.78	against "
Christiania	19.42½	17.35	4.46	" "
Switzerland	25.70	25.05	.67	" "
Madrid	25.12½	25.07½	.57	" "
Rome	26.37½	32.25	27.87	for "
Petrograd	110½	161	71.28	" "
New York	4.84	4.76½ ‡	2.07	against "

*Treasury Bills increased from £380 millions to £1,148 millions during the year.

+From 'The Economist', 12th February 1916.

‡This was about "War Parity". The exchange remained between 4.76 and 4.77 from 6th January 1916 to 20th March 1919.

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The exchanges against France, Italy and Russia were adverse largely because those countries were averse from using their gold reserves to support a position weakened by increased imports from, and decreased exports to, this country. Those against London were so for similar reasons as regards imports and exports in spite of a comparative willingness to ship gold, because the gold stock held was relatively inadequate to meet the enormous demands made and was reserved for use in America. The maintenance of the sterling-dollar exchange was "the pivot of our whole "financial policy and the foundation of our credit in all "parts of the world" (v. Anglo-French Committee, October 1916, Chapter XII).

Up to about the middle of March the rate for best Three Months' Bills was over 5%. On the 24th March the rates for Treasury Bills were reduced, the Three Months' Bills from 5 to $4\frac{1}{2}$, Six and Nine Months' Bills from 5 to $4\frac{3}{4}$%. The proposal of reduction came from Lord Cunliffe, but was put forward with a hesitation which was shared by the Treasury and was regarded as a temporary and experimental step to be withdrawn should the Bank find a difficulty in maintaining the 5% Bank Rate. It was understood in the Market that the Bank was still charging $5\frac{1}{2}$% for loans or discounts and did not propose to make any change. Only three or four small discounts in fact took place before the Bank Rate rose to 6% in July, and most of these were done at $5\frac{1}{2}$%.

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The change in the Treasury Bill Rate did not affect the money rate, which for the first three months of 1916 was from 4% to 4¼%. The steadiness of this rate, in spite of a huge turnover of money during the period, called forth some commendation of the manner in which the Bank's and the Government's control was exercised. Bill rates, however, fell from 5% to 4½%.

During the next two months, rates in New York showed a tendency to harden, and it was thought advisable, on the 16th June, to restore the previous uniform rate of 5% for all maturities of Treasury Bills (Three to Twelve Months), following which the Bill Rate became firmer at about 5⅛%. Foreign purchases of Bank Paper and Treasury Bills increased. In New York the Call Money Rate had seldom been over 2% for eighteen months, and the stability of the American Exchange induced American and Canadian Banks to take advantage of the high rates obtainable here. It was said to be the opinion of some authorities at this time that there had never before been so much foreign money employed in London.

A sharp, if temporary, upward movement in New York money rates was caused in July*, the excess reserve of the Clearing House Members being reduced on the 8th of that month to a low figure+.

*The Market was said to have been temporarily affected by large payments of taxes (v. Mr.Strong's letter 8.8.16).

+$53,546,000.

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Two days later call loans advanced to 6% (the highest rate for the time of year since 1907) and a fall in Stock Exchange securities occurred. Renewals were granted at 4½% and 5% for a few days. This quickly attracted funds, and rates in New York fell to the unexpectedly low level of 2½%. Gold was pouring in, excess reserves increased by $41,000,000 during the following week, and an easy Money Market was restored. Here the Market Rate was already above Bank Rate; the opinion was held that conditions throughout the United States, with the crops to finance, would become much less easy; while Great Britain's purchases from Neutrals continued large and would be specially heavy from America in the autumn*. Accordingly, to counteract the probable tendency of money to flow thither and depress the exchange, the Bank, on the 13th July, raised the rate to 6%, Treasury Bill Rates for Three, Six and Twelve Months' Bills being adjusted to 5½%, 5¾% and 6% respectively on the following day, and 5% being offered for Bankers' surplus funds. At the time of the change, the Reserve had fallen £3 millions in three weeks,-and was to drop another £5 millions by the end of the month.

These rates were expected to make London a more attractive centre than New York for the employment of foreign capital. It was indeed believed that at this time foreign

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*For a brief expression of Lord Cunliffe's views v. L.12.7.16 to Governor of Bank of France. (C.C.0.493/50 France fo.87)

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countries were lending rather less here, partly perhaps owing to misgivings as to the probable outcome of the war, still more, no doubt, for fear of adverse exchange movements.

The rate movement was considerably criticised either as precipitant and over-cautious or as increasing the cost of Government borrowing, while affording a very doubtful support to the foreign exchanges. Nevertheless an increased demand for bills on the Continental and American account, beginning towards the end of July, demonstrated the immediate efficacy of the change in attracting funds to London, and practically all the neutral, and some other, exchanges gradually moved in favour of this country. The French Exchange was an exception, benefiting by fresh credits raised here and gold shipments. The Russian Exchange also received assistance from the entry of Roumania into the war. The exchanges were, in general, now showing greater steadiness than at any time previously during the war, in spite of the autumn strain.

While the good effect temporarily produced on the exchanges was acknowledged, it was next suggested that the same result might have been obtained by offering to borrow foreign capital at a preferential rate. This course, adopted in November, 1917, was resisted earlier on the ground of the difficulty believed to exist in practice of excluding

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all funds but those of foreign provenance. The Bank indeed always remained sceptical as to this expedient*.

In August, the scheme for mobilisation of American &c. securities, to which the imposition of an extra 2/-s Income Tax on such securities had given an impetus, enabled the Government to arrange a two years' loan of $250,000,000 in the United States. During the autumn the problem of further dollar borrowings was regarded with considerable anxiety, as may be seen from the Report of the Anglo-French Committee (Chapter XII). A further $300,000,000 in three and five year Notes was placed on 1st November, but at the end of the month the most difficult stage of all was reached with the publication of a warning to American Banks by the Federal Reserve Board against lending money to foreign Governments.

As showing the predominant influence of the American position on the English Bank Rate, it should be noted that Lord Cunliffe, writing to the Chancellor of the Exchequer, Mr. McKenna, on 15th August 1916, expressed the opinion that had the British Government succeeded in getting France+ to ship their quota of gold to the United States of America in 1915, as the Bank had desired should be done

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*Vide letter to Chancellor - 25th September, 1919, quoted below.

+In December, 1915, the Bank of France held no less than £200,600,000 in gold. A further £160,700,000 was held by the Russian State Bank.

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". . . . . the Bank Rate would almost certainly be still "standing at 5% and might have remained there throughout the "year and the country would thus have been saved many "millions". The Chancellor, it must be added, did not accept the blame for the failure to secure the French gold and indeed sought to place the responsibility on the Bank.+

On the 27th September, the Treasury Bill Rates for all maturities were fixed at 5½%, a modification which produced no change upon discount quotations, as the Three Months' Rate remained unaltered.

At the beginning of October, the Government were borrowing at 6% for three years by means of Exchequer Bonds, and about the same time the exchanges began to weaken again. This Exchequer Bond issue was very adversely criticised. It was the Bankers, headed by Sir Edward Holden, who were chiefly responsible for the issue; so high a yield was not favoured by the Bank of England*.

While the stringency in Wall Street in July was of brief duration there was a recurrence of uncomfortable conditions towards the end of the year which helped to justify the early imposition of the 6% rate.

The Bank's total bullion showed a net gain on the year of rather less than £2,000,000, but the Reserve was on a weekly average nearly £5,000,000 lower than in 1915.

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*Oral - Lord Cullen 1924.

+C.C.P.71a, fo.59 and 61.

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Total deposits also showed an average decrease of £36 millions, chiefly owing to a reduction in the exceptional Government balances previously maintained.

The index number of total purchasing media rose during the year nearly 19 points to 150.9, and 'The Economist' price index showed a much larger upward movement, from 134.9 to 182.2, these figures indicating an acceleration in the rate of "velocity of circulation".

In America, while the Federal Reserve System's Discount Rates were, as before stated, $4\frac{1}{2}\%$ and 4% throughout the year, the New York Market Rate for Three Months' Bank Bills averaged no more than 2% to 3%, as compared with $4\frac{9}{16}\%$ to $5\frac{3}{4}\%$ in London and $4\frac{3}{8}\%$ to 5% in Paris. The condition of affairs in the United States was due to the fact that the growing prosperity of farmers and manufacturers relieved them temporarily from dependence on the Banks for accommodation. America gained £136 millions of gold during 1916, making, since the beginning of the war, about £232 millions, of which about £212 millions had been furnished by the Allies*.

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*Figures given by Sir Edward Holden 26.1.17 (London City & Midland Bank Meeting).

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This was the year of the Russian and Italian disasters, the intensive submarine campaign and the entry of America into the war.

For the first fortnight of 1917 easy rates were experienced in New York, owing to a return flow of money from the Western States, and also to large gold arrivals from Europe. Great Britain was successful in floating another loan of \$250 millions in one and two year Notes. In these circumstances, and on the day of the issue of the loan in question (18th January), the Bank Rate was lowered, but only by $\frac{1}{2}$% - an unusually, but by no means unprecedentedly, small reduction in a 6% Bank Rate. A week previously the subscription lists of the big 5% and 4% War Loans had been opened, and these were also expected to benefit by the change. "Tap" Treasury Bills were withdrawn at the beginning of January, and the repayment of maturing bills by Ways & Means Advances and the proceeds of the loan (a considerable amount of which was paid up in full) prevented any stringency occurring except on the last two days of the subscription, the 15th and 16th February, when some money was borrowed from the Bank. Market Rates tended slightly upwards, being $5\frac{1}{8}$ to $5\frac{1}{4}$ on the 20th February. A month later they had fallen to $4\frac{1}{2}$ to $4\frac{5}{8}$%.

The $5\frac{1}{2}$% rate was not destined to remain in force for long. The probability of America's joining the Allies

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began to be seen, and the British loan in New York was over-subscribed. On the 3rd February, President Wilson broke off diplomatic relations with Germany. The immediate effect of this was some withdrawal of balances from Europe by American Bankers who wished to strengthen their position in view of the likelihood of war. But a revised version of the Federal Reserve Board's warning to Banks was published on the 8th March, intimating that the circular of the 28th November had been misinterpreted, and that good foreign securities might be purchased with advantage to the foreign and domestic situation. On the 5th April, the day of America's declaration of war, Bank Rate was reduced to 5%*, a somewhat nominal alteration as the rate of Bank Borrowings remained at 4½% and in consequence the Bankers' Deposit Rate was also left unchanged. Indeed, in spite of the Bank Rate reduction, Discount Rates hardened about ¼%. This was because of the re-introduction of tender Treasury Bills as from the 23rd March, and the offer at first of large amounts, £50 millions weekly, causing the Market to begin raising rates against the Treasury.

Early in April a mission, headed by Mr.Balfour+ and Lord Cunliffe, arrived in the United States and, as a result of their consultations with the American Government, large

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*The 5% Bank Rate continued until 6th November 1919, a period of 945 days. Although a 2% rate between 1894/96 lasted nearly as long, no rate had actually exceeded this in duration since July 1836, previous to which date 4% ruled unbroken for nine years.

+Afterwards Earl of Balfour.

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financial support was placed at the Allies' disposal, £600 millions being shortly authorised by Congress and repayment not being exacted under thirty years.

Exchequer Bonds were placed 'on tap' again about the middle of April, and to stimulate the sale of these it was urged that money should be made cheaper. After a few weeks the Treasury had reduced the amount of bills offered weekly and made supplementary sales of intermediates; but on the 19th June the further step was taken of reducing from 4½% to 4% the rate allowed on the Clearing Banks' surplus balances. On the same day 'tap' Treasury Bills were reinstated at the fixed rate of 4½% for three and six months' maturities, yearlings being suspended. The Bankers, however, after some hesitation, decided to keep their Deposit Rate at 4%, partly because of the reduction in deposits owing to the War Loans, and the large advances* they had made to assist their customers in the same connection. This Deposit Rate remained unchanged throughout the year and, as during the last six months the Bank were paying no more for surplus funds, conditions tended to be less favourable to the Bankers than in previous years. On the other hand, securities, with the exception of American securities which fell heavily+, did not depreciate much and in some cases even showed a gain.

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*The War Loan advances of the London City & Midland Bank outstanding on 30th June 1917 were £22,978,581. (v."Bankers' "Magazine" August 1917).

+Owing to the big Liberty Loan issues.

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On the 4th July, the Treasury again raised the selling rates of Three and Six Months' Bills, this time to $4\frac{3}{4}\%$, a movement which was soon followed by a hardening of the Market Rate to a point equal to or slightly in advance of this figure. To some extent this was attributed to the fact that the neutral exchanges continued to become more adverse to this country; it was also noted that the Bank of England had lost £$4\frac{1}{4}$ millions in the three weeks ending 18th July.

As the autumn progressed the exchanges continued to fall, a fact which was partly explained by the tightening of the blockade with its curtailment of exports. The position at the end of October may be indicated by the following paragraphs taken from a letter addressed to Mr. Strong by Lord Cunliffe -

"We have been much interested in your various "telegrams about money rates &c. and are most anxious to "reciprocate freely in the matter of such information, but "to tell the truth there is very little to be said just "now from this side. We have for the time being settled "down into a sort of humdrum state with little to ruffle "the surface of our money market. The new National War "Bonds* create hardly any displacement of cash, as the "money goes round continuously and is disbursed by the

*Issued 2nd October 1917.

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"Government as fast as it is collected. If only these "Bonds could be placed in sufficient daily quantity to "meet the needs of the Government there would be no "necessity for further heroic measures. It is true that "at the beginning of December Government will have to pay "out some 50 million sterling for interest on loans, but "probably a fair proportion of this amount will be "invested in War Bonds and the balance does not frighten "me. I am, however, somewhat apprehensive that the "issues of War Bonds may not suffice for daily require- "ments. A campaign to push them, through the 'War "'Savings Committee', was inaugurated the other day, as "you will probably have heard, by a big Meeting in the "Albert Hall, and I sincerely hope that it may prove "successful, but it is easier to work up enthusiasm for a "special operation than to keep it alive for a continuous "effort.

"The amount of the short debt (Treasury Bills and "'Ways and Means' advances) is of course pretty heavy*, "but if the War Bonds care for the daily expenditure we "might hope for a reduction in the short debt when the "Revenue receipts become heavier in February to April, and "in that case I do not see why the internal situation "should demand any special measures or occasion any "disturbance in the money market meanwhile.

*Floating Debt was now over £1,100 millions.

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"The external situation is far from pleasant. It is "true that, thanks to your splendid co-operation, the "American position is no longer the bugbear that it used "to be, but we continue to import from most of the world "while our exports are greatly restricted, and, as a "result, not only are the exchanges in a pretty bad state "but we have been compelled to part with some gold to meet "liabilities."

This letter was followed by a cablegram on the 6th November -

"With a view to encouraging applications for National War "Bonds, there is an inclination towards lower rates and "discussion regarding reducing Bankers' Deposit Rates, "but lowering Bank of England Rate is not even "discussed."

The cheap money policy was adopted and the first step towards putting it into operation was taken on the 15th November, when a preferential rate for foreign money was introduced*. The next came on the 21st December, when regulations were published in the Gazette placing obstacles in the way of the export of capital from this country+. In most respects this order merely regularised restrictions which had largely been in unofficial operation previously. A further move was made on the 27th December when the Treasury Bill Rates for Three and Six Months' Bills were reduced to 4% - a drop of ¾%.

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*Bankers were henceforward obliged to make a weekly return of foreign balances lent to the Bank of England.

+D.O.R.A. Regulation 41.D. The London Exchange Committee took a large share in this arrangement, the whole question having been raised by them on 4th October previous.
A Proclamation was published on the same day prohibiting the importation of securities except matured bonds and coupons falling due for payment in the United Kingdom. These are given as an Appendix.

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These changes were followed early in 1918 by further adjustments. On the 2nd January the Clearing Bankers reduced their Deposit Rate from 4% to 3½%, thus re-establishing the usual difference of 1½% between this rate and Bank Rate. The Bank of England also brought down the rate for funds deposited by the Banks from 4% to 3½%, keeping the rate for foreign balances at 1% above the new figure. At the same time the number of institutions from which such balances were receivable was increased. (It was, however, decided that balances held by Banks domiciled in overseas parts of the British Empire could not be treated as foreign holdings.)

Before considering the effect of these various measures a few words may be added to conclude the review of the year 1917.

In America, notwithstanding her entry into the war, rates were not on an average high during this year. There was a rise to 5% and 6% in June and this was touched again, for a time, in the autumn. The Commercial Paper Rate ranged from 3½% at the beginning of the year to round about 6% at the end. The Discount Rate of the New York Reserve Bank remained at 4% until the 21st December, when it was increased to 4½%, while, until December, 3½% was charged on paper secured by Government Certificates of Indebtedness

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and Liberty Loan Bonds. Two Liberty Loans were issued, for £400,000,000 and £760,000,000 respectively.

Early in September America placed an embargo on gold exports, a similar regulation being made in Japan.

The year was an uneventful one for the London Discount Market. Borrowings from the Clearing Banks began at 5% and were reduced to 4½% on the 26th February and to 4% on the 19th June. These reductions, combined with the raising of Treasury Bill Rates in July, made the position profitable for Bill Brokers in the second six months. The average Bill Rate for the year was £4:16: 2, and the Short Loan Rate £4: 8: 3.

The Bank's total bullion remained fairly steady, showing a net gain of about £3½ millions. The average proportion of the Reserve, however, declined from 25.9 to 18.9. The index figures of total purchasing media and wholesale prices ('Economist') again rose, to 176.8 and 215 respectively, a larger increase of purchasing media than in 1916, but a smaller price rise.

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The Chancellor desired a weekly absorption of £25 millions of National War Bonds and stated in Parliament that he hoped to finance the war without another War Loan. In the last week of 1917 less than £1 million Bonds had been taken up. The first effects of cheap money on the subscriptions were remarkable, the weeks ending the 5th and 12th January producing sales of £23,881,809 and £33,174,946 respectively*. These satisfactory totals were, it is true, partly owing to a 'Tank Campaign', particularly successful in the north of England and in Scotland. For a few weeks more an average of about £20 millions was maintained. These results were evidently felt to be sufficiently encouraging to warrant a further cheapening of money, for on the 14th February (following some market stringency due to tax collection) the Treasury Bill Rate was again reduced, from 4% to 3½%. The Bankers' Deposit Rate followed with a reduction to 3%, this being also the rate now allowed by the Bank for Clearing Bankers' Deposits subject to three days' notice. National War Bonds now gave a yield of 1½% more than Treasury Bills and at least 2% more than the Bankers' Deposit Rate.

On the 23rd May the Clearing Banks consented to the proposal that henceforward 3% should not only be their published rate but should actually be the best terms

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*"Bankers' Magazine", February 1918.

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obtainable by depositors. The Bank arranged with the Discount Houses that the latter should not compete for the Bankers' deposits by paying more than 3%, except to the Bankers themselves, who from now usually charged the Market 3¼%.

The Foreign Money Rate was kept at 4½% throughout the year. At first withdrawals were feared but, in fact, the amount borrowed began slowly but steadily to grow.

In one respect the cheap money policy (which was not without critics in the financial Press) seems to have made the Treasury and Bank of England control of the Market more complete than before for, owing to the attraction of foreign money to the Bank of England, certain funds were absorbed which it was alleged had previously been available for Market employment. Moreover, the increased sums invested in National War Bonds were, it was said, not disbursed by the Government quite so quickly as when placed in Treasury Bills.

By May a tendency of foreigners to withdraw funds from Treasury Bills in order to take advantage of the Bank of England 4½% Rate was noticed. The total of Treasury Bills however still continued very high in May, partly because money was easy and there was talk of still lower rates being introduced, but throughout the year because

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expenditure on the war was so great that receipts from War Bonds could make but little impression on the Floating Debt.

By the third week in May the Bank were beginning to feel a little disturbed at the situation and in particular at the continued increase in the active note circulation; while it seemed that the new policy was not going to be successful in promoting an average weekly sale of £25 millions of National War Bonds. Applications were now falling off; in spite of occasional spurts owing to the "Tank" campaigns, a successful "Business Men's Week", the re-investment of dividends, &c., the weekly average of War Bonds sold for some time had been considerably below the level aimed at.

Government expenditure had risen to about £55 millions weekly by the middle of 1918, of which sum about £34 millions had to be raised internally by means other than taxation. Consequently the Floating Debt continued to rise alarmingly, being between £1,300 and £1,400 millions in June, a total higher than had hitherto been touched.

In July War Bond subscriptions improved temporarily to the stipulated figure of £25 millions a week and on the 15th August (the date of the Interim Report of the Committee on Currency & Foreign Exchanges) it was announced that a grand total of £1,000 millions had been attained.

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During the third week in September (when sales of War Bonds were again declining) it seems that the Chancellor must have asked the Bank to take yet further steps towards producing easier monetary conditions - probably a reduction of Bank Rate.

At this time the active circulation of Bank Notes had risen about £19 millions in a year, while the corresponding Currency Note figure showed an increase of over £95 millions. The Proportion stood at a little over 17; 'The 'Economist' index number as measured from 1913 was 232, a rise of 20 points in a year; while total purchasing media, according to the Bank's index*, was 186 in June, (from which level it was rapidly to increase to 216 by the close of the year).

The end of the war was now in sight, a consideration which warranted (or demanded) a change of attitude on the part of the Bank: the new Governor, Sir Brien Cokayne (Lord Cullen), had given evidence in favour of "dear money" before the Cunliffe Committee on the 8th July (v.Appendices) and the Report of that Committee tended to strengthen the Bank's hands.

The Governor's reply to the Chancellor was the prelude to a long fight on rate policy. For from this time

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*Not available at the time.

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onward until April 1920 (and indeed later) the Bank were engaged in an unceasing endeavour to secure adherence to their view that "dear money" was essential, as the letters given below in this chapter very sufficiently prove. After reading this correspondence it would scarcely be maintained by anyone that responsibility rests upon the Bank for the very disastrous effects of the long delay which occurred before the "dear money" policy was established - or rather re-established.

The following is a quotation from the Governor's letter to the Chancellor dated the 18th September 1918* -

"I have been thinking about what you said "yesterday on the subject of cheaper money and do not feel "any more reconciled to it. I still believe, although as "you say I cannot prove it, that a further reduction would "have little or no effect in increasing the subscriptions "to War Bonds, and I am convinced that the temptation to "employ money abroad is already too great and that there "are innumerable ways of doing it without risking prose- "cution. I also feel very strongly that it will be "impossible to preserve our international credit unless we "have comparatively dear money after the war and that the "more we artificially cheapen it now, the more difficult

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*v. C.C.P. 71^{c} fo.1.

"it will be to revert to normal conditions. In fact, as "you know, my own feeling is that money is too cheap here "already".

On the 16th October the Governor wrote again to the Chancellor urging him to attempt a funding operation at once. One of the arguments adduced in favour of this course was that after the war "if the foreign exchanges are "to be controlled, our position as a Debtor instead of a "Creditor nation will require high money rates. Although "these will not actually govern the rate at which a long "Loan could be issued, they would obviously interfere with "its issue at the now current rates for Government Loans".

On the following day the Governor expressed some alarm as to the possibility that a French loan about to be issued in London might, if unlimited in amount or payable in instalments, appear "so attractive to the public as to "invite a dangerous position".

"The artificial lowering of money rates, of which "as you know we here have always been so much afraid, has "not only encouraged the present fever of speculation but "has also made it almost impossible to apply the usual "preventative to such dangers as I fear. But in the event "of an unlimited issue of the new loan being contemplated I "should like to feel that you would not disapprove of the "Bank exercising what little influence it can still, in the

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"present artificial circumstances, bring to bear in the "direction of raising rates for loans and advances to such a "level as may seem advisable, if possible without appearing "to jeopardise the adequate success of an issue which is to "be made by the Bank on behalf of an Ally".

During the year there was but little net change in the Bank's figures, except for an increase in the total bullion of £20 millions, with a corresponding growth in the note circulation. The average Market Rate for Three Months' Bills was barely over 3½% and, with the Clearing Bankers lending at 3¼%, the margin left for the Discount Market was small. On the other hand there was an extensive jobbing business in Treasury Bills which, combined with an ability to employ balances freely and a rise in short-dated securities, doubtless made the year a profitable one to Bill Brokers. For the first time for many years there was a net appreciation (viz., 7.7%) in the 387 representative securities selected by "The Bankers' Magazine". In the United States Market Rates during the greater part of the year were fully ¾% higher than in London. Two more Liberty Loans were floated.

At the beginning of 1918 neutral exchanges, with the exception of Spain, showed a tendency to move in favour of Great Britain, but from March until August the value of

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sterling again declined. The exchanges with Spain, Switzerland and Holland touched the lowest points hitherto reached in April, May and August respectively. The success of the Allies in the field from this month onwards produced a marked recovery in the neutral exchanges though some reaction occurred in the last month or so of the year.

The British War Bond campaign continued during the autumn with slightly greater success than in the summer.

The account of the year may be concluded by an extract from a letter* from the Deputy Governor, Mr.Norman, to Mr.Strong, dated the 11th December, -

"Our domestic conditions give us more "misgivings on the financial side than yours need give you, "and for such reasons as the following:- Our business has "been much more disorganised by the War than yours and will "therefore come round more slowly: our floating and "unfunded debt is large and may be difficult to handle: "our need of raw materials is great and immediate: our "foreign debtors (as a whole) are good only in the long "run, if at all: our debts abroad are large and do not "tend to ease the exchange position. Meanwhile the need "for fresh money both at home and abroad for enterprise "and imports is growing insistent and will tend to compete "with the Government's need, so that each is apt to force "the pace against the other and to hamper the other's "legitimate requirements."

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*C.C.P. 71^{c}., fo.82.

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With the close of hostilities had also come the termination of the period during which the Bank had felt it inevitable that their own opinion should be subordinated to the views of the Government. A change of attitude appears in the Bank's subsequent correspondence with the Chancellor. But the Bank remained as powerless as before to move effectively without the Government's assistance.

A letter to the new Chancellor, Mr. Austen Chamberlain, from the Governor dated the 30th January again shows the Bank's anxiety to reverse the cheap money policy. It had been on the whole insufficiently successful as regarded National War Bonds sales. The point however that the Governor now urged was that if the gold standard were to be preserved after the Peace Treaty, when it was anticipated Great Britain might return to a free gold market, an endeavour must be made to improve the foreign exchanges before (official) peace came and this could only be effected by raising the value of money here, a process which could and should be gradually applied. He added -

". . . . unfortunately in the present abnormal "circumstances the Bank of England will be unable, without "the co-operation of H.M. Government, to raise the level of "money rates. The Government has created such a volume of "short debt that were the Bank to endeavour to make even

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"their present moderate rate of 5% really effective they "would, for instance, have to borrow the greater part of the "more than £1,000,000,000 at present employed in 3½% "Treasury Bills, which would obviously be impossible.

"It is very important, not only from the international "point of view which I am here considering, but also from "the domestic point of view, that the earliest possible "steps should be taken to reduce by some funding operation* "the present enormous amount of Government floating debt. "Until that is done it will not be possible for the Bank to "control the Exchanges and protect the gold standard by "raising money rates before Peace is declared unless the "Government will also raise the rate for Treasury Bills.

"But before any steps in the direction of dearer money "can be considered, it will be necessary to release the "Bankers and others from the agreement to limit their "Deposit Rates to 3% and 3¼%.

"So long as this restriction remains it will not be "possible, or indeed fair to the community, to raise the "value of money, and as I think it would be well after "releasing the Banks from this agreement to allow time for "matters to settle down, I hope you will see your way to put

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*For Lord Cullen's views on Funding, October 1918, vide Appendices.

According to Mr.Norman's recollection, the Bank's desire that a large funding loan should be issued at the beginning of 1919 was frustrated by the opposition of the Bankers (Sir E.Holden and others) who feared its effect upon their deposits.

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"an end to the agreement at an early opportunity. "Unfortunately the majority of the Bankers will probably "prefer to remain bound by the agreement which must have "been very profitable to them, but at least they cannot "complain of the removal of a restraint on their liberty of "action. And now that restrictions are being removed in "many directions*, the traders and other depositors through- "out the country will feel it very hard that the Government "are still preventing the Bankers from paying even such "deposit rates as they please."+

On the 12th February the Governor expressed concern at the increase in "Ways & Means" Advances despite the period being that when Revenue collection is almost at its maximum:

"I am sure you will believe that the Bank are not less "anxious to be of use to the Government than at any time "during the War, but I am equally sure that you agree with "me in thinking that such pure creation of credit as the "Bank's advances to the Government, though it may have been "inevitable during the strain of War, should not be per- "mitted to continue, and still less to increase, now that "the fighting is over; and indeed that in the public "interest it ought to be reduced as rapidly as possible.

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*On 8th January, the exchanges of France, Belgium and Italy being in our favour, the special rate for the money of all Allied Countries was discontinued; this was the first move towards decontrol of the Market.

+Vide C.C.P. 71c fo.101.

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"I trust therefore that you will see your way to raise "sufficient funds from the public not only to prevent the "increase but to effect a rapid decrease in the amount of "the Bank's advances to the Government which are already "very excessive and constitute probably the most potent of "all factors in creating the 'inflation' from which the "country is suffering in so many ways".

On the 28th February the Governor again pointed out that "Ways & Means" Advances were quickly increasing, 54½ millions having been added thereto in 24 days. With the money so borrowed the Government were reducing Treasury Bills whereas the reverse process should be adopted. This letter was shown to Sir John Bradbury*but was not sent to the Chancellor as, in the former's opinion, it was premature, the effects of the War Bond campaign having not yet been eliminated.

A further remonstrance on the lines of previous letters and stating that it was "of the utmost importance "that steps should be taken, i.e. before restrictions on "gold movements were released, to restore to the Bank the "requisite power to exercise effective control of the "situation" was addressed to the Chancellor by the Governors, as expressing the Court's opinion, on the 6th March.

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*Sir John Bradbury, afterwards Lord Bradbury, was Joint Permanent Secretary to the Treasury from 1913-1919.

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In this letter the Court showed themselves fully aware of the danger of a oonvulsive contraction of credit - such as however became the more difficult to avoid as the need for restraint increased and was ignored.

". . . . . . the Directors are convinced that it is "essential to avoid as far as possible the need for any "sudden and violent increase of rates and that the action "which they deem to be necessary should be taken in advance "by gradual steps in order to avoid the disturbance which "might otherwise ensue."

The Chancellor replied on the 15th February and the 18th March to the Governor's last two letters but in somewhat general terms of reassurance and seemed to think that the Bank were unduly alarmed by the amount of the "Ways & Means" Advances. (These stood at £234 millions on 18th March.)

On the 21st March the Governor rejoined -

"My Court thoroughly appreciate the Government's need "for fresh borrowing especially with a view to the repayment "of floating debt, but they hold that any loss to the "Exchequer through the payment of a somewhat higher rate on "money still to be raised internally is of relative insig- "nificance to the country as a whole compared with the evils "produced by the maintenance of money rates far below those "of other centres, evils which will be intensified as war "restrictions are removed.

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"The Bank are powerless to control the rate of money "while Treasury Bills renewable at 3½% are constantly "maturing in enormous quantities, and they therefore recom- "mend that the Government's promised co-operation should "take the form of at once releasing the Bankers' Deposit "Rate and promptly but gradually raising the rate for 3 "Months' Treasury Bills and offering 6 Months' and 12 "Months' Bills at sufficiently higher rates to effect some "spreading of the maturities over the year. The recent "withdrawal of support from the American Exchange appears "to me to afford a very suitable occasion for the adoption "of this policy and to render it all the more necessary.

"The Court also view with grave apprehension the rapid "growth of their Ways & Means Advances to the Government at "a period of the maximum revenue collection and are "seriously alarmed at the prospect of a still further "increase in those advances during the ensuing months.

"The Directors therefore feel bound respectfully but "earnestly to suggest that for this reason also, unless "prompt steps are taken to repay or, at any rate, largely "reduce their said advances by a long funding loan or by "other methods, the Government should tempt the public to "renew Treasury Bills, by offering these at more attractive "rates, rather than take steadily increasing advances from "the Bank wherewith to repay money borrowed from the public."

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The arguments in these first letters, being coupled with the expectation of a speedy return to the gold standard, had eventually perhaps for that very reason the less weight with the Chancellor. For there was no return to the gold standard after the Peace Treaty: on the contrary, many weeks before that, the prohibition of gold exports lost its informal character being imposed, at the beginning of April, by Proclamation, following the "unpegging" of the American Exchange on the 19th March.

The Governor was still of opinion in April that the prohibition was unwise, but the Clearing Bankers were unanimous in its favour.

He had also again repeated to the Chancellor his "regular and persistent advice" to allow freedom of deposit rates and an increase in the discount on Treasury Bills "a "change which if gradually effected would have the support "of the Clearing Bankers and follow the Currency Committee's "Report." (v. Committee of Treasury Minutes 26/3/19 and 2/4/19.)

The Chancellor however remained unwilling to make any rate alterations, and it was felt that nothing more could be done until after the new big loans, issued at last in June, (the Victory and Funding Loans) were out of the way.

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The lists of these Loans closed on the 12th July, and two days before that date the Governor wrote once more to the Chancellor urging that the short borrowing of the Government should now take the form of the issue of Treasury Bills and not of "Ways & Means" Advances.

". . . . . . I ought here to refer once more to the "question of money rates. My colleagues and I have as you "know long held that higher rates were demanded by the "financial situation of this country, but owing to the "enormous volume of the floating debt and the extent to "which the Bank had suffered themselves during the latter "years of the War to come under advance to the Government, "they have been unable without the Government's co-operation "to exercise their traditional control of the money market, "and although I have repeatedly begged you to help us in "lifting rates you have hitherto felt that the immediate "interests of the taxpayer precluded you from helping to "make money dearer while the Government still require to "borrow so largely.

"Now, however, that the Government has, for the moment "at least, completed its long-term borrowing and reduced its "liability on Treasury Bills, I feel confident that you will "agree that the permanent interest of the taxpayer lies in "the speedy restoration of sounder financial conditions to

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"which the establishment of a rate of interest more in "harmony with that ruling in other countries will in our "opinion so greatly contribute.

"We regard it as urgent in the public interest that "power to control the market should at once be restored to "the Bank, and it may become absolutely necessary to raise "the market rate for money in the near future if we are to "avoid such a break in the Exchanges as might produce a "dangerous situation.

"The first step necessary is that the Banks should be "released from their undertaking to limit their deposit rate "to 3%: and the conclusion of the Loan campaign would seem "a very fitting time for their release."

Following this letter the Banks were freed from the undertaking in question*; the issue of Treasury Bills was resumed with an additional ½% allowance in favour of six months' maturities; and at the end of the month the Bank announced the cessation of the borrowing of home funds.

In August the restrictions on the export of capital (other than gold) were removed, so that the only protection to the Bank now remaining was that of the prohibition of gold exports.

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*The 3% rate (fixed by agreement 23rd May 1918) applied only to domestic deposits; as regards the Allied balances affected by the Bank of England's withdrawal of the Special Rate a few days earlier a rate of 3½% was permissible according to a decision taken by the Clearing Banks on 13th January 1919.

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The small increase made in the Six Months' Treasury Bill Rate proved inadequate to attract sufficient funds and "Ways & Means" Advances rose fast during the second half of August. This led to a further protest from the Governor on the 1st September and, on this occasion and a few days later, he urged that either Treasury Bill Rates should be raised - the more desirable course - or that the Bank should borrow from the Market the amounts required to provide for advances to the Government, charging for the latter the rate paid for the former.

On the 3rd September the Reserve fell below £26 millions (and thereafter decreased steadily to £17,693,000 on the 24th December).

Various suggestions were made to deal with the situation, one being to invite tenders for a greater amount of bills than those maturing - a proposal made by Lord Cunliffe. It was argued that the Market, through the Bank, were lending the Government some £170 millions of foreign money at 4½% and that the best way to find out at what rate they would prefer to lend the money on bills instead would be to ascertain this through the tender system. On the other hand, it was urged that it was cheaper to continue borrowing £170 millions at 4½% if it enabled the Government to borrow £850 millions at low rates on Treasury Bills.

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The objection to this policy was, of course, the impropriety of the large "Ways & Means" Advances it involved.

Another criticism which the Governor considered to be entirely just was that, if the Chancellor merely wished to convert the bulk of "Ways & Means" Advances into Treasury Bills, all that was necessary was to stop paying a high rate for foreign money: in which case all the money so deposited would go into Treasury Bills even if the rate remained at $3\frac{1}{2}\%$. The Governor also considered that the fact of the situation requiring higher rates for numerous reasons was no argument for permitting the Market to fix such high rates as it might choose; though it was an argument for imposing on the Market such higher rates as might be thought advisable. Moreover having once converted "Ways & Means" Advances into Treasury Bills by permitting the rates for the latter to be forced up, what would there be to prevent the rates once more from declining to the existing level?

On the 22nd September the Bank took the opportunity of the formal correspondence with the Chancellor concerning the usual quarterly advances - a correspondence always published - to protest again regarding the amount and duration of the outstanding accommodation afforded.

On the 25th the whole position was dealt with in a long letter (written by agreement with the Chancellor) in which emphasis was chiefly laid upon the state of the foreign exchanges.

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Before giving this letter it may be well to review the rise in prices that had occurred since the Armistice.

After the Armistice the gradual removal of controls and the release of buying power which had been under restraint during the war had begun to affect prices. Goods were demanded and price was a secondary consideration. Total purchasing media had increased by £400 millions during 1918, an unprecedented rise: and a further £250 millions were added in the first half of 1919.

Yet, while the increase of purchasing media encouraged spending, at first prices did not rise proportionately, because the extent of the increase in purchasing power is in general made known to traders only through the increase in the consumers' demand. Later, with prices constantly rising, the experience of traders leads them to expect that the rate of the upward movement in the immediate future will be much the same as it was in the near past, and this estimate may incline them to put up prices more quickly than the real increase in demand will justify; for over any given short period the wants of many people tend not to keep pace with the increase in their purchasing power. Hence, towards the peak some traders are likely to overreach themselves and to produce a buyers' strike. Meanwhile, in other and more prudent traders a hesitancy to hold large stocks will develop.

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When the hesitancy of these traders and the disinclination of the Public to buy have proceeded so far as to infect the general production and sale of commodities the peak will have been reached and passed. Usually the more rapid the rise in prices the quicker the change over from confidence to fear.

In any case, with inflation on a large scale, the public demand for goods would not at first be kept in check by the raising of prices, for traders are for some time too much afraid of a buyers' strike to raise prices adequately; instead of this they hope to increase production. To the extent to which fresh plant is installed and production is actually increased, a policy of inflation is justified. But whereas a slight inflation, if other circumstances be favourable, may increase production pari passu, in most cases inflation proceeds much more rapidly than production. Traders are thereupon tempted to compete for existing supplies by duplicating their orders, so that the percentage of goodsallotted to them may be sufficient. The manu-facturer is deceived by this as to the extent of the real demand and actual over-production may result, thus further increasing the panic when supply overtakes demand. The rise in prices and subsequent fall is also accelerated by the action of speculators, to whom all such disturbances afford a favourable field of operations.

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The contention that prices first lag behind and then outstrip the rate of increase in purchasing media is borne out by the facts in 1919, for in the first half of that year wholesale prices* rose only 4 points although purchasing media rose 24 points; while in the second half of 1919 the relationship was reversed, prices rising no less than 53 points while purchasing media increased $3\frac{1}{2}$ points+.

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*"Economist" Index.

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		Total Purchasing Media[x] (000's omitted)	Total Purchasing Media Index	Economist Index of Wholesale Prices
December	1913	£1,035,874	100	119
"	1914	£1,210,646	116.9	127.3
"	1915	£1,368,164	132.1	165.1
"	1916	£1,562,724	150.9	223
"	1917	£1,831,236	176.8	263.2
"	1918	£2,236,266	215.9	277
June	1919	£2,483,115	239.7	281.3
December	1919	£2,519,679	243.2	334.7
"	1920	£2,633,240	254.2	269.3
August	1921	£2,567,621	247.9	193.5

N.B. The Total Purchasing Media increase in 1917 took place entirely in the second half of that year.

[x]The figures of Total Purchasing Media are taken from Statistics prepared for the Chief Cashier.

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The rise might and doubtless would have been kept in check by Bank Rate had the Government consented. "That .. "the obviously far too low discount rate of the Bank of "England during 1919 proved exceptionally effective, first "by restraining the tendency of prices to fall, and then as "a powerful factor in causing a rise in prices, is as indis- "putable a fact as it is instructive" wrote Professor Cassel ("Money & Foreign Exchange after 1914").

The continued rise in prices at length produced a fall in sterling such as had been foreseen by the Bank.

The letter dated 25th September 1919 follows -

"The Court of Directors of the Bank have "again discussed the gravity of the present financial situa- "tion and wish me to address you at some length on the "matter. I am therefore troubling you with this letter "which the Court have approved at their meeting to-day.

"The Foreign Exchanges

"The pound sterling is now quoted at a "discount in all the most important centres, the discount "being about 15% in the United States, Great Britain's "principal creditor and supplier. With the approach of the "autumn demands, it is probable that unless remedial "measures are quickly taken the Exchanges will further "depreciate until the prices of imports necessary for the

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"life of the nation rise to alarming figures, and possibly "until sterling exchange becomes unsaleable in many foreign "countries.

"It is true that an adverse Exchange tends to "discourage imports and to encourage exports: and if on the "one hand this Country were an importer mainly of unnecessary "luxuries and on the other hand were content to remain in a "state of international suspension of payment in gold until "the Exchanges correct themselves there would perhaps be some "argument for leaving the situation to provide its own remedy. "But it is surely worth a temporary effort to recover the "magnificent credit which the Country has so long enjoyed and "which once lost could but slowly if ever be recovered: and "in the meanwhile it would be impossible without widespread "distress to dispense with the vast majority of her imports.

"The raising, if that were possible, of "further large loans in America would provide for our "immediate needs, but only at the expense of the future: and "it is the opinion of my Court that, although the devastated "Countries of Europe are more than justified in borrowing "money in America in order to re-establish their industries, "there is nothing to justify this Country, which is merely "impoverished and in no sense devastated by the War, in "continuing to borrow without making so much as an effort to "restore the Exchanges and the balance of trade by normal "means.

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"Still less will Great Britain be in a "position to finance other Countries until she is again a "creditor of the world with the Exchanges in her favour. "Yet at the present moment owing to the relatively low rate "of discount in London compared with the United States she "is financing a large amount of American business: and "efforts - too often successful - are constantly being made "by foreigners to raise loans in this Country by means of "drawing-credits rather than borrow in America on less "favourable terms.

"If the Bank had been free to exercise their "proper functions they would long ago have taken steps to "raise the value of money in this Country in order to protect "the Exchanges. But while the present large floating debt "of the Government exists the Bank are powerless to control "the money market without the co-operation of the Treasury. "For if the Bank were to attempt to-day to make their Rate "effective by borrowing from the market any surplus funds up "to say 4½% per annum, the whole of the Treasury Bills, "renewable at only 3½%, would be allowed to run off, and the "Bank would require to borrow and to re-lend to the "Government on "Ways & Means Advances" an amount far too "large for them to handle. In fact the Lombard Street "money rate, which in particular affects the foreign "Exchanges, is now controlled by the rate for Treasury Bills.

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"The Court fully understand that a Chancellor "of the Exchequer should hesitate to raise the rate at which "he is borrowing. Yet this is what the Bank have habitually "done, often at great expense to themselves, when the good of "the State appeared to demand higher rates for money: and I "submit with all deference that, so long as Treasury opera- "tions prevent the Bank from performing this duty to the "State, the Treasury becomes responsible for its performance "and is justified in incurring expense to enable it to be "performed.

"The best solution, were it possible, would "undoubtedly be that the volume of Treasury Bills and 'Ways "'& Means Advances' should come to an end and the Bank be "left free to perform their traditional functions. But that "would demand a huge funding operation which would certainly "be impracticable in the near future. It is indeed probable "that the Bank will not regain complete control of the money "market until part at least of the Government's floating debt "has been absorbed by administrative economies or increased "taxation or both. Meanwhile in the opinion of the Court "the raising of money rates is urgent.

"The Treasury has already to some extent "recognised its responsibility for the foreign Exchanges by "instructing the Bank to pay for its account 4½% per annum on

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"foreign balances. But this measure, which was of doubtful "efficacy during the War, has now become even less satis- "factory: for there is nothing to prevent foreigners from "providing, without risk of Exchange, a large amount of "'foreign money' by discounting bills at 3½% in this market "and depositing it at 4½%. It is clear therefore that the "'foreign money rate' should be dropped, which would lead to "the extinction of the bulk of 'Ways & Means' Advances "(probably the most vicious form of inflation) about which "we addressed you separately on the 22nd instant. The "question that remains is whether the Treasury Bill rate "should be raised or a fresh blow be dealt at the foreign "Exchanges by leaving the foreign money to find its way into "3½% Treasury Bills. As to that I may say that if the sole "object of the Treasury were to borrow internal money as "cheaply as possible without regard to the interests of the "State as a whole, the Treasury Bill rate might as well have "been fixed at 2½% or even lower and the Exchanges allowed "to fall still further.

"Since I wrote to you in July on the subject "of money rates another powerful reason for bringing the "value of money in London up to the international level has "arisen, namely the removal of restrictions on remitting "money abroad for investment. To-day there is nothing to

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"deter any who hold 3½% Treasury Bills here as an investment "from exchanging them for 5½% British Government Treasury "Bills in America except the fear that something will surely "soon be done towards equalising money rates and thus "rectifying the Exchanges. And the probability that many "of our countrymen have already made considerable investments "abroad at higher rates than could be obtained here gives "cause for hope that when the conditions are reversed the "improvement in the foreign exchanges will be all the greater.

"The internal situation

"Turning now to the internal situation of the "Country we find virtual abandonment of the gold standard: "the Bank's Reserve lower than it has been since the first "fortnight of the War: an expansion of credit* which has "inevitably led, or at least contributed largely, to a "general rise in prices, to a great increase in the currency "and to extravagant living. These symptoms are not indeed "by any means confined to this Country but they are none the "less evils which should be kept in check by means inter alia "of comparatively dear money.

"The rise in prices, more pronounced here than "in America, must clearly be checked and to some extent "corrected before the Country's trade can be re-established "on sound lines and enabled to hold its own against "competitors in the export markets.

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*The Bankers' deposits had risen from £1,070 millions at the close of 1913 to £2,033 millions at the close of 1918.

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"The general private extravagance is an "obvious evil when the Country has overspent its resources, "and it would seem fitting that at a time when the Government "is wisely bent on retrenchment in its own expenditure the "people should also be induced to economise.

"To produce a drastic reduction in prices and "check on extravagant habits it might be necessary to raise "the value of money above the present Bank Rate of 5%. But "my Court fully realise the danger and inconvenience of too "sudden a contraction of credit and lowering of prices and "confine themselves for the moment to a request that the "Government will enable them to make their present moderate "rate of 5% effective.

"The currency expansion is regarded by my "Court as merely a symptom of the general condition of "credit. Nevertheless, or rather on that account, they "welcome the steps which you have taken to keep the "Currency Note circulation within bounds by setting aside "Bank Notes against expansion in the circulation*. They "believe it to be most fitting that when the circulation of

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*This measure, recommended by the Currency Committee, had been adopted by the Government in August. The arrangement was designed, by coupling Currency Notes to Bank Notes, to curb the issues of the former by the mechanism existing in Bank Rate for restricting the issue of the latter. Incidentally a foundation was laid such as might enable the Bank eventually to take over the Currency Note issue when such notes were sufficiently covered.

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"the Country expands unduly the strain of such expansion "should be thrown upon the institution which under our "monetary system is designed to bear that strain, namely the "Bank. But they beg respectfully to point out that the "means by which they are habitually enabled to bear and "relieve that strain consist in the control of the money "market which is now shared - if not monopolized - by the "Treasury, and they therefore beg your help in the use of "that control.

"The Bank's Reserve: The setting aside of "Bank Notes for the Currency Note Account is in some degree "responsible for the fact that the Bank's Reserve is now "lower than it has been since August 1914. But the deple-"tion of the Reserve is mainly due to the increase in the "Bank Note circulation* which is chiefly a result of the "general expansion of credit, the Bankers requiring more "cash against their increased deposits and the higher prices "and wages demanding more currency of high denominations.

"The Bank's Reserve cannot in present "circumstances be replenished by an influx of gold, and the "only means of improving it is to contract the active Note "circulation and with this object to raise the value of "money: but the process in any case takes time to operate

*This circulation has risen from £34,622,000 to £80,902,000 during the past five years.

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"and with the autumn demands in sight there is no time to be "lost in making a beginning if the Reserve is to be kept "from falling to a point at which it might create alarm.

"Should you not see your way to co-operate "with the Bank in raising the level of money rates the "Reserve will probably continue to fall until the Bank is "compelled either to force Currency Notes on an applicant "for Bank Notes (which might give rise to a premium on the "latter) or to apply to the Treasury, under the Currency & "Bank Notes Act, for permission (the modern equivalent of a "'Chancellor's letter') to issue Bank Notes against "Securities in excess of the fiduciary issue allowed by law. "This permission, in accordance with the precedent always "observed on similar occasions, would presumably be given "only on condition that the Bank raised their rate of "discount to a high figure in order that the circulation "might by this means be contracted and the necessity for the "excess issue quickly overcome. But so long as the opera- "tions of the Treasury render the Bank Rate ineffective a "sharp rise in Bank Rate would either be without effect or "would merely penalize legitimate borrowers without "contracting the expansion.

"Lastly, I must refer to the virtual "abandonment of the gold standard. The absence of gold as

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"a circulating medium within the Country causes but little "inconvenience and may well be allowed to continue. Any "failure to cash Notes in gold is only of importance in the "relations of this Country to others, as it implies a "refusal to honour a foreign debt in the form which the "foreigner has been accustomed to expect: and the prohibi- "tion of gold shipments has set the seal on that refusal. "The credit of Great Britain, although no doubt it has "already suffered, has so far been wonderfully sustained "throughout the general re-shuffling of peace negotiations, "partly no doubt through world-wide confidence that the "failure to meet her debts in gold will be temporary. But "a large part of the world is now in process of returning to "peaceful conditions and it is difficult to believe that "this Country can regain its former credit while failing to "honour its obligations in gold. The Court regard the "restoration of the gold standard and the resumption of free "gold exports at the earliest possible moment as of vital "importance to the Country as a whole and consider that it "is well worth a temporary sacrifice to secure that end.

"It is possible that with the foreign "Exchanges in their present state and without any steps "being taken to protect them, the shipment of the whole of "the available stock of gold in the Country would only

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"suffice to meet the inevitable drain on our resources for "a short time. But, assuming a satisfactory state of "industry, the Court see no reason why Great Britain should "not before long resume payment in gold of her current debts "abroad provided that she is prepared to lose a moderate "amount of gold and that steps be taken to keep money rates "at an adequate level compared with those ruling in other "important centres.

"In conclusion, my Court are of opinion that "for the various reasons enumerated in this letter, money "rates in this Country are unduly low and that higher rates "are required by the present situation. They find that the "only way to obtain them is to raise the Treasury Bill rate "and they therefore respectfully urge you to increase the 3 "months rate for Treasury Bills to 4½% and the 6 months rate "to 5% and to discontinue paying a special rate on so-called "'foreign money'".

This appeal was successful in so far as the immediate steps recommended in the last paragraph of the letter were concerned. The Treasury Bill Rates were raised to the desired level on 6th October and on the 21st came the abolition of the special rate for foreign money.

These changes were received with approval by the Federal Reserve Bank of New York, and the Governor took

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occasion to show to the Chancellor the letter in which their opinions were conveyed. From the same letter it is clear that by the middle of October Mr.Strong was becoming alarmed as to the speculative tendencies apparent in the United States. In New York there was great activity in the Stock Market and call money had been as high as 15%. By the third week American financial opinion outside the Reserve Banks began to favour an increase in discount rates. Mr.Strong thought, however, that no change was likely to occur before the 12th November, when a Conference of Reserve Bank Governors was to be held in Washington. At this time both in England and in America strikes were in progress, the usual outcome of rising prices.

The Bank of England's views in the interval between 6th October and 6th November are briefly indicated in a letter from the Governor to Mr.Strong dated 20th October -

> "It is evident that we shall have to raise rates
> "further to protect our position and even our reputation
> "for sanity. The idea that we should, in our present
> "situation, undercut the United States in lending money
> "to Europe is preposterous".

(Belgium was then threatening to borrow here, as being cheaper than in the United States.)

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On the 3rd November the Reserve Bank made some rate adjustments, the chief effect of which was to increase by about ½% the rate applied to loans based on Government securities, and on the 6th November various discount rates were raised by ¼% to ¾%. On the 6th also the Bank of England Rate was raised from 5% to 6% and on the next day Treasury Bill Rates for Three and Six Months' Bills were raised to 5½%.

The change in New York was "made necessary by an "unbridled speculative mania in securities, land and com- "modities which was getting beyond control, and materially "reduced Bank resources and our reserves. We are applying "direct pressure on the Bankers to curtail it".

Mr. Strong explained (letter 6th November) that the Market for commercial borrowings and borrowings against Government securities had, by then, been divorced from the speculative Call Money Market -

". . . . . our banks seem to have been "educated not to use the Reserve Bank very extensively in "order to make profit on the stock exchange rate. Those "that give evidence of doing so we admonish, but, in the "long run, nothing will be so effective, as you realize, as "a rate which is unprofitable, and, notwithstanding that "money is loaned at times at 10% and above on the stock "exchange, our minimum rate of 4-1/2%, with expenses and

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"taxes added, comes very close to the gross return realized "on all invested funds by the banks in this city. If this "turn of the screw is not enough, then we must give it "another, but we are determined to stop this mad march of "speculation and expansion, whether it be in securities, "real estate, commodities, or what not.

"The rate of 4-1/4% which you will observe "simply applies to about $100,000,000 of Treasury "Certificates outstanding was made in order to help the "position for the Treasury in case circumstances justify "their attempting later in the year to borrow at that rate. "I have never felt quite so satisfied with myself as just "now in feeling that the first and most important step has "been taken in freeing the Reserve Bank rate policy from the "overshadowing influence of the Government's borrowing, but, "privately, I must admit that it was not brought about "without a grand struggle."

In London the concurrence of the Treasury to the rise in the Bank Rate was at last secured chiefly because of the steady increase in the note circulation. The rise in Treasury Bill Rates in October had been sufficient to absorb slowly the Ways & Means Advances, but no general mastery of the situation had been gained.

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In spite of this hard-won success, on the 6th November Mr.Norman wrote to Mr.Strong giving reasons for his not regarding the "certainty of sound money as definitely "settled".

Owing no doubt to the rise in England being offset to some extent by the rise in New York, the American Exchange failed to respond to the 6% rate and continued to fall steadily. This was a disappointment to the Bank of England, but it was felt that this country was, to some extent, suffering for the misfortunes of France, the French Exchange having moved equally heavily in Great Britain's favour. The rate became thoroughly effective as regards the Bill Market. But the rise in the circulation received only a momentary check. In a letter to Mr.Strong, dated the 19th November, the Governor referred to the trade position -

". . . . . so far as I can learn our imports "and exports (visible and invisible) are even now about "equal, but while we are paying cash for all we receive I "fear we are giving a good deal of credit for our exports. "You know how we at the Bank have been setting our faces "against long credits masquerading as 90 days' sight Bills, "but I suspect that many traders are themselves exporting on "credit and I should not be surprised if the large demands

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"on our Banks for Trade advances are partly accounted for by "the traders having failed to receive cash for their previous "sales: though of course the principal reason for the "unusual volume of such advances is the high level of prices. "In so far as it is true that we are exporting on credit, the "recovery in our Exchanges should be all the more rapid when "the world gets on its legs again which it does not at "present show much sign of doing".

The Bank of England soon recognised that their new rate would be insufficient.

Industrial issues continued on an excessive scale* and, towards the end of November, there was an abnormal withdrawal of large denomination Bank Notes which the Bank conjectured was due to fears of a Capital Levy. The Governor urged a definite settlement of this proposal on the Chancellor at the same time indicating that a rise in rates might be required before long.

The Federal Reserve Bank was equally, or even more, anxious to make a further effort at control. Mr. Strong's views are contained in two letters dated the 4th and 10th December -

". . . . . as you have observed, we were "successful in starting rate advances in the Federal Reserve

*In 1919 new capital subscriptions in the United Kingdom were £238 millions, as compared with £65 millions in the previous year. ("The Bankers' Magazine", February 1920.)

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"System early in November, but our efforts to bring about "further changes, which I, personally, strongly believe "should be done, have so far not met with favour in "Washington and it now looks as though no further increase "will be possible until after the turn of the year. This I "greatly deplore, because the country seems to be absorbed "in a riot of extravagance and speculation such as I have "never before witnessed, and I know of nothing which will "check it quite so effectually as a strong rate policy by "the Reserve Banks. The difficulty, as you may surmise, "still rests with the Treasury, whose officers feel that "much higher rates will force severe declines in the "Government's war bonds and necessitate paying much higher "rates for their present short borrowings. We shall hope "in due course, however, to reconcile our views and policies "and the Treasury's, and, if we do not succeed in doing so, "I fear that we will not succeed in checking further price "advances, a recurrence of the speculation which was tem- "porarily checked by our previous action, and, of course, a "further reduction in our reserve percentages. I may say "to you quite confidentially that this Bank submitted higher "rates for approval by the Federal Reserve Board a little "over a week ago and they were disapproved, although this "was never announced.

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"There is much discussion of the position of "the foreign exchanges and people are wondering whether "there is any bottom. I, personally, cannot see any improve-"ment in present conditions, in fact, believe they may grow "worse unless steps are taken to restrict purchases in this "country which are not of an essential character; this will "make financing of food stuffs, raw materials and necessities "much easier for you and us . . . . .

" . . . . .What has transpired in our money "market is rather curious and significant. The speculation "in stocks assumed dangerous proportions, and, following the "slight advance in our rates made in November, we undertook "to caution the bankers in the city that our facilities must "not be employed for furnishing credit for these speculative "operations. They have shut down rather sharply on the "stock exchange borrowings with the result that we had a "considerable liquidation and a rather panicky collapse in "stock values, but, after all, the difficulty is only in "small part the stock exchange loan account. The demand "for every kind of goods, and particularly those of a luxury "character, with the accompanying advances in prices of all "kinds, has caused constant expansion of the loan account of "all the banks of the country. This is supported, of "course, by increasing demands upon the Reserve Banks and is

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"reflected in the gradual decline in our reserves. So long "as this extravagance continues, we are building up a "structure of credit which some day will have to come down, "and I deplore delay in sound measures to check it. There "seems to be the feeling also that our tax laws operate to "prevent liquidation of accounts in which large book profits "are carried but which cannot be realised without incurring "liability for heavy excess profit payments, and, on the "other hand, an insistent selling of those securities where "losses, if realised, will reduce tax payments, such, for "instance, as some of our war bonds. Our Treasury is alive "to the danger of this situation and Secretary Glass's "recommendations just submitted to Congress for changes in "the tax law are aimed to remedy the difficulty.

" . . . . Our situation is very similar to "your own, but, of course, you have been able to advance "your rates to a level which has given you a control of the "market somewhat beyond anything which we can claim here, "our rates for advances upon Treasury certificates of "indebtedness remaining at 4-1/4% and 4-1/2%. There is a "great bulk of borrowing from our bank in the form of short "advances secured by these obligations (of which there is "over three and one-half billions outstanding) so that it "will require still further rate advances by both the Bank "and the Treasury to enable us to obtain control.

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"My own feeling is that while your higher "rates would ordinarily help the exchanges, and, in the long "run will do so, much difficulty will, nevertheless, persist "so long as unregulated imports continue by Europe and so "long as our own money markets must remain as high as now, "or even higher. The reports of our export trade indicate "where the difficulty lies and it may require even lower "rates for sterling and francs to erect the barrier that is "required against luxuries. What I, personally, deplore is "the possibility that your importers may be entering into "contracts, no one possibly for a very large amount, but the "aggregate being considerable, without having exchange cover "in hand, and, when pay day comes, dollars must be had at any "price on your side, or sterling sold at any price on this "side, with a constantly lower quotation for sterling "resulting. If your importers are buying for cash and "selling on credit, the situation is by so much the worse.

"Your policy in regard to long credits "masquerading as 90 day bills is quite similar to our own, "and, of course, causes some complaint among our bankers and "exporters.

" . . . . I have been confronted here with the "insistent argument that rates alone will not check our "constant expansion. My own position is that without rate

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"advances we cannot check it. If we do advance rates, "which is the first and fundamental step, then other steps "can be successively taken, such as remonstrance with our "banks, education, etc; all, however, supplementary to the "operation of the rate and wholly ineffective to check "expansion unless the rate advance is first made.

"To be sure rate advances here will not only "not attract gold, but, I fear, will not check gold exports "to the East and South America, but I feel very confident "that as it becomes unprofitable to borrow from the Reserve "Banks, member banks will find it necessary to make it "unprofitable for their customers to borrow from them, and "gradually the loan and deposit account will come down, "together with lower prices induced by the liquidation "required in order to pay loans.

"While we had a sharp liquidation in "speculative stocks, I must say that new issues of stocks of "various industrial enterprises, which are making phenomenal "profits in this period of extravagance, have sold literally "like 'hot cakes' whenever offered. Much of this, I fear, "is capitalizing earnings which will not be permanent, or, "possibly, I might say capitalizing enhanced values of "productive industries, brought about by our expanded "condition, which some day must contract.

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"Our Government's revenues and expenditures "are, in my opinion, now in such shape that we will be "justified in addressing ourselves aggressively to this "problem of expansion, but, as I wrote to you recently, it "looks unlikely at the moment of writing that we will do so "by any important further rate changes until next January at "the earliest."

In December Sir Brien Cokayne was becoming alarmed at the possible effect on the Bank's Advances and on the Floating Debt by the repayment of the 6% Exchequer Bonds falling due in February 1920, and his views were put before the Chancellor in a letter dated Christmas Eve -

" . . . . .I realise that there is some "argument for repaying the 6% Exchequers by Ways and Means "Advances and Treasury Bills if you believe that you will "shortly afterwards be able to borrow on more favourable "terms than in January. But even if this were certain I "believe that the impression created by an apparent policy "of drift and further expansion of the floating debt would "create such a bad moral effect that it would be worth "paying more in January to avoid it.

"It must however be very doubtful whether you "<u>will</u> be able later on to borrow more cheaply than in January

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"and I hope you will not risk creating such a bad effect on "the mere chance of borrowing a little cheaper.

"I devoutly hope that the heavy collection of "revenue during the early months of next year will enable "you to make some real reduction of debt and I agree with "you in thinking that when that reduction is shewn it will "have a marked effect on Government credit. But this effect "will be enormously greater if it is found that the strictly "floating debt (Ways and Means Advances and Treasury Bills) "has been really reduced than if the net result is merely "that the floating debt has not increased so much as might "have been expected. I consider that to ensure that any "such reduction of debt should be applied to the floating "debt it is well worth making some small sacrifice in rate "for a few years on the £150,000,000 required to meet the "6% Exchequers.

"Probably if any such repayment of debt out "of revenue is accomplished it will then be possible to do "some real funding of short debt on more favourable terms "than would otherwise be possible, as the public will be "more inclined to believe that the funding will be permanent "and will take a more hopeful view of the future of the "Country's finances.

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"But the mere fact that repayment of debt has "begun will in itself, especially at a period of maximum "revenue collection, tend to tighten money rates and thus "not only make the issue of short-dated securities even more "expensive but also diminish the amount which it would be "possible to raise by a longer loan. So that it will be "all the more desirable not to increase the floating debt, "in order that the funding operation may effect a substantial "reduction in that form of debt.

"In January on the other hand money should be "fairly plentiful as the Banks will be 'un-window dressing' "and the tax gatherer will not have made his full force felt.

"Then again it is necessary to contemplate "the possibility of no reduction of debt being effected by "next spring. In that case your floating debt will have "been increased by the total amount of the February maturity "and the position will appear worse than ever without any "effort having been made to amend it.

"I earnestly hope therefore that you will "make up your mind to have an issue of some sort as early as "possible in January (to enable the 6% Exchequer holders to "convert into it) at whatever rate may then be practicable. "I am not at all bigoted about the form of loan that should "be issued but on the whole I would suggest a 5% 5 year "Exchequer Bond 'on tap' at the appropriate discount.

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"I am very anxious that you should try to "avoid 1920 and 1921 maturities so that during those two "years you may be as free as possible to get the finances of "the country into order and the gold standard re-established "which will do more than anything to improve the credit of "the country. In the following two years (1922 and 1923) "large blocks of War Bonds fall due for payment, and an "investment for a longer period such as 10 or 20 years will "not appeal to the majority of the present holders of the "6% Exchequers, while your objection to borrowing at present "rates for any but a very short period would apply more "forcibly to such an issue than to a 5 year Bond. There "may also be some slight objection to borrowing for more "than 5 years at a higher yield than that of the 5% War Loan, "though Mr.Bonar Law's pledge cannot possibly bind for all "time."

For the year 1919 the average Market Discount Rate for Three Months' Bills was 1½% below Bank Rate for the first six months and nearly 1% below thereafter. The November Rate did not become very effective until January 1920.

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On the 3rd January 1920, the Governor answered Mr.Strong's letters of the 10th November and 4th and 10th December -

". . . . . I have been greatly interested in "all you tell me about your money rate policy and the "points of similarity with our position add to its interest. "The Government's reluctance to pay more for its borrowing - "the irritation of Bankers and others at the depreciation in "their securities - and the taunts that the poor silly old "Bank seems to think it can attract gold - are all part of "our daily bread. Your remark that while dear money may "not by itself effect a cure no cure is possible without it, "puts the whole question in a nutshell. I see you have now "fixed an all round rate and see your way to making it "effective, so that I hope you may not need to raise rates "further. There is no doubt that if your rate were to come "up to ours and remain there we should be forced to go up "again and we are anxious to avoid as long as possible "exceeding a 6% Bank Rate as anything above that bears hardly "on legitimate borrowers. But I agree with you that credit "is likely to be a costly commodity for some time to come.

"Just at present the plethora of money created "by the ridiculous 'window dressing' of our Banks at the end "of the year has rendered our rate completely ineffective and

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"the Banks are eager buyers of January bills at 4½%.' But I "think this ease, though it may last a few weeks, is only "temporary and the activities of the tax-gatherer will be on "our side before long."

The story is continued in a letter from Mr.Norman of the 15th January -

". . . . . On the whole things look rather "brighter than they did a couple of months ago. First, the "cost of living, which was confidently expected to rise, was "stationary during November and December; but it is thought "doubtful whether it can remain where it is owing to the "increasing competition of the former enemy countries for "limited supplies of food.

"Second, the American Exchange, which might "have been expected to become demoralised, has fallen - as it "was bound to do - but has never been demoralised.

"Third, the Government indebtedness as a whole "has perhaps now reached its apex. Next year it may be "expected that extraordinary receipts from stores, &c., will "more than cover extraordinary expenditure and that ordinary "and increased receipts from taxation will more than cover "normal expenditure: thus one may hope for some reduction of "debt*. For the rest of the year - I mean financial year -

*Mr. McKenna had told the Governor that he intended to say in his annual speech that it was no use putting up money rates until the Government had ceased to borrow on Revenue Account. The Governor accordingly got the Treasury to write him a letter (dated 8th January) to be shown in confidence to Mr.McKenna, giving detailed estimates demonstrating that revenue would exceed expenditure for the year 1920/21.

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"heavy taxation will be coming in which is expected to more "than cover outgoings and somewhat to reduce Ways & Means "advances and Treasury Bills. An issue of $5\frac{3}{4}\%$ Exchequer "Bills (sic) is to be made next week, but this is solely for "the purpose of extending for a few years similar Bonds* "falling due this year and to avoid money for their repayment "being provided by our book credits.

"Fourth, the labour position has been obscure "and uneasy all along and although the railway men seem at "this moment to have come to terms with the Government there "are threatenings in other quarters. Somehow I do not "believe there is going to be real trouble, but it is "difficult to give any reason.

"Fifth, the rise in our rate which took place "early in November is now becoming effective. Hitherto the "Banks have been preaching cheap money as well as practising "it in their rates (mostly in order to cut one another's "throats). No doubt the demand for commercial advances has "been enormous and the result on the Banks is that now they "are loaned up to the hilt and in self defence almost bound "to put the rates up as well as to scale down their "customers' requirements - all of which is healthy enough.

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*The 6% Exchequer Bonds.

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"Sixth, the Currency Note circulation is "contracting as well as could be expected and the Bank Note "circulation inclines to do the same: but the latter "position is obscured by the gradual addition to our figures "of the Gold hitherto held by the Banks.

"The French Government's credit has gone to "pieces in London, and when they offered £8,000,000 of their "Treasury Bills for sale the other day the applications did "not reach £1,500,000. I cannot see how they are going to "get along and there is some danger that owing to political "pressure credits may have to be opened for them and for "other of the European countries which are simply going to "lead to further inflation with you and with us just as "conditions are beginning to show a glimmer of improvement."

Meanwhile the Treasury had put into force some more of the Currency Committee's recommendations, and one of these is referred to in the letter just given, it having been decided that the Bankers' gold, say, £40 millions, should be paid into the Bank's vaults. A maximum Currency Note Fiduciary Issue (£320,600,000) had also been fixed for 1920*, thus ensuring that any inflation bringing the issue above that figure must directly deplete the Bank's Reserve and give the Bank control.

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*Treasury Minute of 15th December 1919.

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*Treasury Minute of 15th December 1919.

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On the 22nd January the further rise in United States rates which the Governor feared took place, the New York, Boston and Philadelphia Reserve Banks putting up their rate for commercial paper to 6%, and rates against Government securities being also adjusted.

On this subject Mr. Strong wrote on the 6th February

". . . . . our rate changes were not at all "what I would have recommended nor, indeed, confidentially, "did they meet the advice of my associates in the Bank. "They were a compromise between differing views of our own "with differing views in the Federal Reserve Board itself "and, finally, radically different views held by the officers "of the Treasury. When this is all past history I shall "give you the story in detail, but one thing may be said in "justification of the rate increases, namely, that were we to "permit such developments as we have witnessed during the "past few months to proceed to their logical conclusion, I "might say, their inevitable conclusion, we would put it "beyond our own power to render any sort of aid to Europe, "consuming our resources in the meantime in extravagant "living and wasteful expenditure. I fully realised that "these higher rates in New York would make it more difficult "for you, but I hope you bear in mind that the rates last "established in New York are not as high as they look, the

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"effective rate, of course, being the one which remains "unchanged, namely, 4¾% for advances upon treasury "certificates of indebtedness. The very high rates quoted "for stock market money are inevitable and would have "developed irrespective of any rate made by the Bank, "because we have insisted with the bankers in New York that "they must curtail the advances they were making for the "support of a dangerous speculation in industrial stocks, "particularly oils and automobiles.

". . . . . rates so far have done little more "than check the stock market speculation but have not "reached those who are speculating in their own products. "I have preached until I am black in the face, particularly "to our bankers, that the test of a good credit is the "period of time required to accomplish the purpose for which "the credit is granted and they do not seem to grasp the "idea that loaning money to an industrial concern which is "making profits on contracts to deliver goods a year hence "or longer are dangerous loans to make, and personally I "dread the day, which will surely come if we don't look out, "when a lot of these unfilled orders will be represented by "unliquidated inventories."

The position in England at the beginning of February is shown by the Governor's letter of the 2nd February to Mr.Strong -

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". . . . . It is extremely difficult to see "even a short way ahead in these days, but we are hoping "that our present rates will prove more efficacious at this "time of year when revenue collections are heaviest than "they could possibly have proved in the autumn. But there "are several evils which no reasonable increase in money "rates will cure. Thus the profits obtainable (on paper) "by exporting on credit are such as to be merely 'shaded' by "interest at 10% per annum.

"I do not believe there is any very serious "amount of speculation here on borrowed money. But the "anxiety to avoid the present heavy taxation by investing "for a chance of appreciation rather than for a certainty of "income, is so strong as to create an unwholesome demand for "speculative securities. Indeed this is carried to such a "pitch that large blocks of 'Shell' shares are believed to "have been placed here recently both by Dutch and American "sellers.

"Can we wonder that, with this sort of "aggravation to the demands that we have to meet, both for "ourselves and for our Allies, on the American Exchange, the "dollar should continue to appreciate in sterling? I am not "unduly disturbed by the fall in the American Exchange, and "only hope that we may continue to be spared an actual "breakdown in the Exchange until it reaches a level at which

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"it will provide its own remedy. We are anxious, as I have "already said, to give present money rates a fair trial, but "one thing which would to my mind necessitate a further rise "would be that your rates should overtake ours. Hence our "anxiety for some guidance as to your rate policy."

Further demands upon the Bank in February for accommodation, however, made it imperative in their opinion to take action without waiting on America.

In this month the Chancellor had asked the Bank to put in writing a justification of "dear money". The defence was despatched on 25th February, at a time when the Bank were anxious for a further 1% increase. The memorandum and covering letter are given in full.

"25th February, 1920.

"Dear Mr. Chancellor,

"Early in the month you asked me to prepare a "memorandum shewing the effects of the higher money rates "established a few months ago and shewing cause why they "should not be lowered.

"I do not know whether the enclosed memorandum "which we then prepared will still be of any use to you as I "imagine that nobody would now suggest that rates should be "reduced. Indeed everything points to dearer money in the "very near future and yesterday the Markets were thoroughly "expecting a rise of 1% in the official rates to-morrow.

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"The Bank have already been obliged to grant "many millions of accommodation on Government Stocks and "Bills in the last two weeks, and are in fact being called "upon to create further inflation to fill the gap caused by "the deflation occasioned by the Government's recent "repayment of debt.

"But there are obviously limits to the "accommodation which the Bank can continue to grant without "applying the proper corrective of higher rates and I should "probably have asked your concurrence in a rise of rates to-"morrow if it were not that I am particularly anxious not to "raise the value of money directly after the present issue "of Exchequer Bonds.

"Apart from these domestic conditions we must "remember too that from all accounts everything points to a "very difficult position in America and to higher money "rates there.

"I am afraid therefore that I shall very soon "have to ask you again to support a rise of 1% in the Bank "Rate by varying your Treasury Bill rate correspondingly.

"Yours sincerely,

(Sd.) "BRIEN COKAYNE.

"The Right Honourable

"The Chancellor of the Exchequer."

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"MEMORANDUM AS TO MONEY RATES

"I. General effect of the increase in rates

"The rise in rates has inflicted no hardship or "restraint on the development of legitimate industry "which with present profits could well afford even higher "rates.

"It has discouraged the holding up of stocks of "goods* and has promoted their quick turnover, thus "rendering production and distribution more immediately "effective in meeting demand.

"It has tended to check the increase in prices "and in the cost of living and thereby to lessen the "extent of the constant demand for higher wages.

"It has afforded an obvious inducement to sell "abroad to cash buyers rather than to credit buyers.

"It has checked borrowing as well as speculation "both in commodities and in securities and by depressing "prices of the latter has tended to discourage the sale "of securities from abroad to this country which cannot "at present afford to take securities in payment for her "exports.

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*Lord Cullen is of opinion that, if rates had been allowed to rise, overstocking might have been prevented altogether. As it was, not only did Stocks accumulate, but probably their extent was considerably greater than Bankers suspected. (If a reliable Index of Stocks in hand could have been compiled by the Government a great deal of trouble might perhaps have been avoided between 1919 and 1921. But the agitation for Indices of Production and Stocks in hand did not come till later.)

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"It has retarded the inevitable fall in the "American Exchange and, in spite of that fall, has "throughout facilitated free dealings; in fact it is "only since the internal situation in the United States "has created for that country difficulties in financing "her exports that trouble has been experienced in selling "sterling in New York. It must also be remembered that "the operations of our late Allies whose Exchanges have "been moving more and more in our favour have been largely "instrumental in causing the existing depreciation of our "Exchange with the United States.

"It has helped to attract foreign capital to "London and to retain British capital here.

"It has checked the tendency of foreigners - "including even Americans - to finance themselves in this "market.

"It has arrested the currency and credit "expansion.

"It has shown the intention of this country to "face facts and has thus helped to improve our standing "in foreign countries.

"It has had all the advantages which long "experience has rightly attached to a rise in rates - "though in a less degree than heretofore owing to this "country having ceased to be a large creditor.

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"II. Probable need for even higher rates

"It is true that all these effects would be, "and probably will eventually have to be, enhanced by a "still further rise in rates. In October it looked as "though a 5¾% effective rate, although unlikely to "achieve great results at the time, would perhaps be "sufficient if maintained during the present year. But "since then the Federal Reserve Board have raised their "official rates to such an extent that it is very "probable that a further rise will be necessary here.

"It is not true as has been alleged that until "the Government has virtually extinguished its floating "debt there is no use in paying a high rate for "Treasuries. In fact the reverse is the case. For "once the floating debt has become sufficiently reduced, "the Bank of England will be restored to its position as "regulator of money rates in accordance with the needs of "the country and the Treasury's only concern will be to "obtain the best possible rate for the negligible balance "of floating debt then outstanding.

"III. Steps necessary for a return to normal conditions

"Generally speaking it will be agreed that steps "should gradually be taken to appreciate the currency, to "bring about a fall in the prices of commodities, to "increase the purchasing power of 'money' and to get back

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"to the gold standard; or, in a word, to prevent the "continuance of the present inflation.

"These steps are necessary to enable the "manufacturer to improve the export trade, to stabilise "internal conditions, and to restore the balance between "(1) commodities of all kinds and (2) money and credit.

"The depreciation of the currency is two-fold: "first, a general depreciation of say 150% as measured by "the rise in prices; second, a specific depreciation as "measured by the premium of nearly 50% on the price of "gold as bullion, or, what comes to the same thing, by the "fall in the foreign exchanges.

"The first and most urgent task before the "country is to get back to the gold standard by getting "rid of this specific depreciation of the currency.

"This end can only be achieved by a reversal of "the process by which the specific depreciation was "produced, the artificial creation of currency and credit, "and for this the appropriate instrument is the rate of "interest. The rate of interest is the price of loanable "capital and, whatever may be the theoretical advantages "of discrimination by the Banks, no other practical means "for limiting advances and the concomitant creation of "credit and rise in prices has been suggested than the "old and well-tried plan of a rise in the Bank rate.

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"'The existing expansion' - in the words of the "Currency Committee's final report - 'is not merely the "'legacy of the stress of War finance . . . . . but also "'in part the result of maintaining rates for money in "'London below those ruling in other important financial "'centres.'

"Economic reconstruction after the War involves "a high demand for capital, and the normal effect of "demand is to raise the price of the thing demanded. "The operation of this economic law was suspended during "the War by the artificial creation of credit and currency. "Now that this has ceased the law again comes into play, "with the result that as a preliminary step the Bank of "England rate has been raised to 6%. This is not to make "money artificially dear, it is to set the rate for money "free to find its natural level by the equation of supply "and demand. It is to strip the market of the artificial "conditions of control in which the rate of interest had "ceased to be the measure of the demand for loanable "capital.

"The validity of this step is not impaired by "the circumstance that the export of gold is still pro- "hibited. It is true that in normal conditions the "undue expansion of credit would be indicated by the drain

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"or the fear of a drain on the gold reserves of the Bank "of England, and that at present this is not possible. "It is not, however, the drain on the gold which serves "to check the undue expansion of credit but the conse- "quent rise in the rate of interest, and this holds true "whether in point of fact the gold be exportable or not. "It is the rate of interest that counts.

"The process of deflation of prices which may "be expected to follow on the check to the expansion of "credit must necessarily be a painful one to some classes "of the community, but this is unavoidable. It is small "comfort to the holders of gilt-edged Bonds to be told "that it is only the price and not the value of their "Securities which is depressed by a rise in the rate of "interest. Per contra, people with fixed incomes and "the great body of the working classes will be greatly "relieved by a decrease in the cost of living. The "Government will have to pay more for their loans but the "increased cost to the Nation is as dust in the balance "compared with the restoration of free trade and the "removal of social unrest and political discontent.

"IV. Imprudence of reverting to cheap money

"If rates were now lowered the holders of "existing Treasury Bills would indeed secure a profit; "the many holders of other Government Securities would be

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"enabled for the moment to write back some of the "depreciation already suffered and possibly in some cases "to unload holdings at higher than present prices on an "unsuspecting public; and Bankers without raising their "present Deposit Rates would be able to attract increased "deposits from present holders of Treasury Bills and thus "further to enlarge their loans and with them the general "conditions of expansion. But none of these gains to "individuals can be advantageous to the country as a "whole, and all the beneficent effects of dearer money on "the general financial condition of the country, both "internal and external, would be lost.

"It is true that with lower rates for Loans and "Treasury Bills the Exchequer would have less money to "raise for service of the Debt; i.e., the taxpayers, who "consist to a highly disproportionate extent of the "moneyed classes, would have less to pay for the use of "money borrowed from those same classes by the Government.

"But it may be doubted whether the reduced cost "to the Exchequer would not be more than outweighed by "the increased cost to the Nation of practically all "commodities and ultimately by the increase in wages "(which would inevitably be brought about by such "expansion as would follow lower rates) and in any case "the injustice, if any, of the high rate is merely a

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"question between one class and another inside the "country and should not be allowed to interfere with the "permanent interests of the country as a whole.

"The Federal Reserve Bank's rate for commercial "Bills is already 6%, and in the other principal creditor "country, Japan, rates are already much higher than ours. "Indeed even now London is to some extent financing "American business and any slight reduction in our money "rates would intensify this anomaly.

"The inevitable expansion of credit which would "follow a reduction in rates, would include an increase in "the issue of Currency Notes, and once their legal maximum "was reached or during the process of reaching it the "Bank's Reserve would be so depleted as to demand penal "rates.

"It is therefore submitted that no fall in rates "at the present time (even ignoring the foreign demand for "accommodation here, as shown, e.g., by conditions in "America) could last beyond a few months; while during "that period the financial condition of the State could "only be worsened.

"It may be debated whether last November was the "best moment for an increase in rates: some think that it "should have come six weeks later, others that it should "have come six months earlier, when the export of gold was "prohibited.

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"But no long-sighted person oould doubt but "that to reverse the general polioy then deliberately "adopted, after a partial trial and without reaching the "logical and ultimate levels, would be to invite a crisis.

"10th February, 1920."

No written answer appears to have been returned to the Bank's letter of the 25th February and nothing was done to meet its request. On the following day the forecast of probable movement in America received marked justification, the New York Federal Reserve Bank Rate on paper secured on Treasury Certificates being increased by ¼% to 5%. This rise would, it was hoped, at least impress Bankers and Traders with the need for caution, if not immediately effecting contraction.

In March the problem of the repayment of the Anglo-French Loan of $500 millions, due the 15th October, arose and the Treasury proposed a shipment to America of gold amounting to £27,200,000, made up of £22,200,000 gold held by the Bank under agreements made between the British and Italian Governments, dated the 8th July and the 9th November, 1915, and £5,000,000 gold from the Bank's Reserve. The Governor consented; but wrote to the Treasury on the 8th March that, in view of this loss of gold and of the recent

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increase in the circulation and in "Other Securities", he anticipated a need for the early increase of 1% in the Bank Rate. Before setting aside the £5 millions in question, he would be glad to hear that the Chancellor agreed to make the rate effective by ordering a similar and simultaneous increase in the Treasury Bill Rate. This the Chancellor refused to do (16th March) being apparently hopeful that a gradual deflation might be effected by the Banks taking concerted action to reduce accommodation. The Banks had recently been asked to ration credit, but the Bank of England (and the Federal Reserve Bank) held that rationing is extremely difficult - almost impossible - except to the extent of avoiding loans for pure speculation, and considered discrimination against particular trades unsound banking.

On the 8th April even the Bank of France raised its Discount and Advance Rates to 6% and 6½% respectively, a flat rate of 5% having previously ruled throughout the war.

On the 12th April, the Bank remonstrated with the Treasury once more, pointing out the alarming changes in the Bank's figures which had taken place in a few weeks. The Proportion was now under 15% and the fiduciary issue of Currency Notes was less than 15 millions below the legal limit. The Bank's Ways & Means Advances had risen to £55 millions on Saturday, the 10th, an increase of £40 millions since 17th March*.

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*Total Ways & Means Advances outstanding had increased by £87,907,000 since 17th March.

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According to Mr.Norman's recollection, it was the last named consideration that turned the scale and at last secured Mr.Austen Chamberlain's unwilling consent to the 7% rate. The change (which the Market had expected in the middle of March) was made on Thursday, 15th April, and the Treasury Bill Rate was advanced to 6½%.

On 20th April the aggregate value of the "Bankers' "Magazine's" 387 representative Stocks revealed a drop of £147 millions, no department showing an improvement on the month.

From the beginning of April American credit and prices seemed once more to be moving up. But by the third week there were signs of a "buyers' strike" and at the end of April the "30,000 independent and competitive Banks" in the United States were at last beginning to resist the pressure put upon them for accommodation.

During this month a Committee of the New York State Chamber of Commerce also reported and included among their recommendations "That Bankers and business men should "co-operate in a strong effort to combat further expansion "of bank credits or additional issue of currency".

By May the advance in the English Bank Rate had not brought about any very apparent check, but, nevertheless, there were indications that an end of the boom was approaching. The Bank's cable to New York of the 4th May said:-

"Demand for accommodation continues beyond the amount

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"Bankers are able or willing to grant. But as demands "for higher wages continue circulations tend to increase "and our position to worsen. We note indications that "certain commodities are less saleable at recent or some-"what lower prices, which may perhaps be attributed to "continuing pressure of high rates."

The Bank's feeling perhaps was rather that a change had become inevitable before the 7% rate was imposed: hence any fall in prices might be 'post hoc non ergo propter 'hoc', though not necessarily uninfluenced by the previous rise in November. It will of course never be possible to ascertain whether the "buyers' strike", a psychological phenomenon, originated in America quite independently of the rise in rates. But it is important to record that it was Mr. Strong's belief that it would have occurred in any case*.

According to the Board of Trade and "Economist" index numbers of wholesale prices, the 'peak' here was reached at the end of March, though according to the indices of "The Times" and "Statist", in April. In the United States the highest point was touched late in May according to the New York Reserve Bank and the United States Bureau of Labour Statistics, but at various dates from the 1st February to the end of May according to other authorities. It is

*Opinion confirmed by Mr. Strong at the Bank of England, April, 1924.

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therefore difficult to say definitely which of these countries preceded the other in this respect. It was in Japan that the first fall in prices took place, perhaps brought about by the rises in the Bank of Japan's Rate from 6.57% to 7.30% on the 6th October and to 8.03% on the 19th November 1919. But in Governor Strong's opinion the first signs of a break in Japan appeared in March and April 1920 and might be attributed to a Chinese boycott of Japanese goods (Commission of Agricultural Inquiry Report, Part 13, page 496)*.

Governor Strong had now left for a tour in the East and in his absence a letter, dated 11th May, arrived from Mr. Pierre Jay, the Chairman and Federal Reserve Agent of the New York Federal Reserve Bank, which showed a slight disbelief in the power of high rates by themselves to secure command over the situation. This drew a rejoinder from Sir Brien Cokayne (who had just become Lord Cullen and had also recently ceased to be Governor) expressing his belief that money rates were sufficient in themselves although that remedy unassisted by education might have to be very drastic. He pointed out that apart from education or compulsion the only method of inducing people to save was to make it profitable to do so, and that was achieved by dear money.

*It was the general opinion in Japan at the time, and of the Bank of Japan itself, that the Chinese boycott was the real and decisive cause. (Mr. Strong, April 1924, verbal at Bank of England.)

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Although the level of inflation was higher here than in America the amount of speculation carried on with borrowed money was much greater in the United States. Accordingly, while the Bank of England at the beginning of June were hoping to avoid further rate increases, the Federal Reserve Bank of New York considered it advisable to adopt them; their new rates, effective from the 1st June, varied from 5½% on advances against Treasury Certificates to 7% on the discount of commercial paper. In communicating these rates to the Bank of England the Federal Reserve Bank stated that they had been adopted in order to "reflect existing "credit conditions", to "impress borrowers and the public "with the necessity for postponing less necessary business", and to "assist Bankers in checking, or even reducing, credit "expansion in order to prepare for autumn requirements".

It must be remembered that the 7% rate was only adopted by three Banks, New York being followed by Chicago and Boston; and that the effective rate was that allowed on Treasury Certificates and other Government securities. This was only 5½% or 6% when the Trade Acceptance Rates ranged from 7% to 6%*.

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*For the three months ending 31st August the average rate at which acceptances were purchased, even by New York, Boston and Chicago, was no more than 6.04, 6.12 and 6.11% respectively, and the amount discounted at 7% (or above) by New York in these months was little over $44 millions, not much more than one-tenth of the total discounted by New York (which accounted for more than half of the Reserve Banks' total re-discounts in the period).v.F.R.Bulletin, 1920, p.1104.

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Between this date and the end of July the development of affairs in the United States may be summarised briefly as follows -

At first there was no check in the loans of the New York Reserve and other Banks, the former still re-discounting largely for other Reserve Banks.+ The Commercial Paper Market became firm and rates varied from $7\frac{3}{4}\%$ to $8\frac{1}{4}\%$. The Stock Exchange became inactive and remained dull. By the middle of June the volume of loans and re-discounts was decreasing; the chief feature of this month, however, was an excessive cancellation of orders, though this was attributed to transportation difficulties rather than to a contraction of credit. At the end of June a check on the demand for labour was evident, and by the third week in July there was a general feeling among Bankers that prices had reached their highest, while merchants and manufacturers were becoming aware of a strained credit situation. By the end of July deflation was being felt in ever-widening circles*.

In England, anxiety regarding the Bank Rate continued for, though prices were slowly falling, wages were not yet affected and the Currency Note fiduciary limit was rapidly being approached owing to holiday demands. The position became so serious that on the 12th July the Bank,

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*Though Bank Deposits continued to increase until the end of 1921.

+For figures and a chart of U.S.A. Interdistrict Accommodation 1920 and 1921 v. E.A. Goldenweiser's "Federal Reserve System in Operation", pp.36/7.

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in order to protect their Reserve, felt it necessary to urge that the Bank and Treasury Bill Rates should be raised.

Writing to Mr.Niemeyer of the Treasury on the 12th July the Governor said -

". . . . . In our opinion the time has already "come when the report of the Currency Committee regarding the "maximum Fiduciary Issue should be made effective - indeed we "think that this step should have been taken before the "Bank's Reserve fell below £20,000,000* - retaining (if you "will) the £5,000,000 margin which I have long understood it "to be the Treasury's determination to maintain.

"For some weeks past I have yielded to the "desire for delay expressed by Mr.Blackett and the Treasury "for reasons of policy connected with the state of business "in the House of Commons, and in order to ease the situation "I have suggested (almost against our better judgment) that -

"(1) a temporary addition should be made to the "Fiduciary Issue of Currency Notes to offset the "amount of gold estimated to have been withdrawn "from circulation early in the year and used to "meet foreign indebtedness, and

"(2) a loan as it were of gold should be made from "India.

*The Reserve fell from £21,025,000 on 23rd June to £16,274,000 on 30th June and did not rise above £17,355,000 during the rest of the year. On 22nd December it was no more than £11,629,000.

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"Failing the adoption of either or both of "the above, we seem to have arrived last week at a point "when a decision must be taken one way or the other unless, "as you suggest, the £5,000,000 margin is to be trenched "upon to meet any expansion shown by this or a later week's "figures. I can have no objection to this course though if "it is to be adopted I think it should have been taken "before the Bank's Reserve was allowed to fall below "£20,000,000. In any event, however, I hope you will not "ask that the Bank's Reserve shall be depleted below last "week's figures.

"To sum up, we think that in these "circumstances the Fiduciary maximum should be taken to have "been reached, that the Bank and Treasury Bill rates should "be raised by steps if and when the circulations continue to "rise, and that further expansion should fall on the Issue "Department of the Bank if need be under the Currency and "Bank Notes Act of 1914."

About this time the Governor also considered that the 7% rate was perhaps losing its power owing to a new cause: "people are holding commodities rather than sell at "present prices, in the hope of being able to write them "down lower still later on, and so reduce their Excess "Profits Duty". He also considered that even if 7% was

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enough for purely internal purposes danger might arise from America and Japan whose effective rates were above those here.

At first deflation in the United Kingdom (as measured by the fall in prices*) was not unduly rapid. Just as prices had been slow to begin to rise so their decline did not yet keep pace with the diminution in Velocity of Circulation. The conviction that the process had begun in earnest was, however, entertained by the Bank by the third week in June and, as we have seen, by the New York Reserve Bank about a month later. Failures began to increase in the United States at the beginning of August. The difficulty here regarding the Currency Note limit was evaded by the expedient of writing off two series of Notes which had already been called in. The expansion caused by holidays also ceased about this time and, with the fall in prices and the slackening of trade, Notes began to return from circulation.

The fall in wholesale prices was accelerated during the last three months of 1920; in England partly owing to a coal strike and the increased unemployment resulting therefrom. Important retail prices, however, were still on the upward grade, and in November the "Cost of "Living" figure reached its highest point (176) but

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*The best indication under a definition of Inflation and Deflation to include the factor of Velocity of Circulation.

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thereafter declined quickly. In the United States the "Cost of Living" peak had been reached in July.

Lower wages were beginning to be accepted in the United States in October, towards the end of which, Bank Credit, steady for the seven previous months, increased to a new high point. This expansion was partly seasonal, but chiefly to provide for the needs of industry and agriculture, to avoid too drastic liquidation. The American Banks had failed to check expansion but were now acting with great moderation; they were carrying heavy loans for the farmers, who were withholding their crops from the market, the drop in staples, such as wheat and other cereals, cotton, and sugar, having occasioned very great difficulties. In Cuba a serious situation was caused by the fall in sugar, but more fundamentally by the over-extension of certain Banks. Industry was hampered by the cancellation of a large number of orders. In November unemployment had increased 13% above the May level and numerous plans for artificial credit support were being put forward in the Press and worked into Bills for Congress. The prices of basic commodities had now fallen over 30% in six months, but retail prices lagged far behind.

In England, although the Currency Note danger was now likely to be out of the way for a long time, the Bank

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remained, at any rate until early in November, an advocate of higher rates*. The Governor, on general grounds, had the support of the Brussels' Conference and was further possessed of evidence that America, whose Commercial Paper Rate in November was still as high as 8%, was, to some extent at least, financing herself in this Market. Moreover, several countries were attempting to borrow in London, although neutrals met with opposition from the Bank in this endeavour.

Just before Christmas, Mr.Strong arrived in London and conferred with the Governor. It was agreed that the dear money policy had been successful, although the position in both countries would doubtless have been better had it been possible to take action six months earlier. There was

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*On 4th August the Governor proposed to the Committee of Treasury an 8% Bank Rate provided the Chancellor would authorise a concurrent increase in Treasury Bill Rates.

On the 11th the Governor informed the Committee -

"That, as arranged last week, he had a long conversation "with the Chancellor on the 4th instant, when having called "attention, inter alia, to the fall in the U.S.Exchange, to "the increase in the Economist index of Commodity prices, in "the circulations and in the Bank's Ways and Means Advances, "along with the decrease in the outstanding Treasury Bills, "in the Reserve and in the Proportion, he urged an increase "in the Rate for Treasury Bills concurrently with the Bank "Rate. In spite of support to the Governor's proposal from "the Treasury Officials who were present, the Chancellor was "from the outset determined to make no change in Rates and "said in effect that it was politically impossible for him "to do so, or to state under what future conditions he would "be able to do so".

(Minutes of Committee)

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also a concurrence that deflation should be gradual. It was alleged to be now proceeding too rapidly, and, the cost of living being about to turn downwards, both the Governor and Mr.Strong were in favour of a small reduction in both Bank Rates.

Mr.Strong cabled to the Federal Reserve Bank in the following terms:-

"The Bank of England perplexed by outlook over next "few months. They consider general rate policy has so "far been wonderfully successful although the position "here might be better to-day had they been more drastic "6 months earlier. The fact remains that world defla- "tion has been started and while this bound to continue "they as we wish it to operate slowly rather than quickly. "They do not believe such deflation can now be stopped "but think possibly its rate of progress might with "advantage be slowed. If you share these views I would "be glad to learn your intentions as to rate policy for "discussion here. Your letters September 17th November "26th indicate no intention to change present policy but "rather possible increase of rates. Are you still of "this view."

The Reserve Bank replied:

"First as to commodity deflation. Our index of 12 "basic commodities namely cotton hides hogs rubber copper

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"sugar wheat corn iron lead lumber and petroleum shows "following decline from peak expressed in per cent. May 1 "June 2 July 3 August 4 September 6 October 14 November 13 "first three weeks of December 4. First 6 commodities "near or below pre-war prices. The slowing up in December "indicates deflation of group raw materials fairly well "accomplished but not yet appreciably reflected in whole- "sale prices of manufactured goods and still less in retail "prices. Speculation in commodities is greatly reduced. "Apparently we are reaching end of first phase of deflation "in which basic commodities fall acutely and entering into "a second slower phase in which unemployment increases and "wage reduction becomes effective thus permitting lower "prices for consumers' goods. New England textiles mills "have generally instituted 22½% wages reductions which are "being accepted with but few strikes by employees. "Movement gradually spreading to other industries but as "yet only very small percentage of wage earners affected. "From observations British indices we conclude our acute "raw materials deflation is somewhat ahead of England. "Second as to credit deflation. While American price "indices have fallen 25% to 35% since May the volume "commercial Bank loans has decreased about 5% and currency "none. Various elements have kept credit volume high.

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"Anticipate some January liquidation due to drawing on us "business and post holiday reduction of currency. In 13 "months volume of call loans declined one-third and prices "of 30 industrials 43%. But in spite of high rates credit "has always been kept elastic. Third as to Rate policy. "Our present view is that we should not consider reducing "rates at least until Market rates have fallen below ours "and appear likely to remain lower. Under present "inflated conditions should we now reduce our rate and "later be obliged by more active business or speculation "to raise it again the effect would be more discouraging "than if we maintained present rates but kept credit "elastic. Only motives for reducing rates in January "would seem to be to deflect natural course of prices or "encourage resumption business. This seems somewhat akin "to various schemes proposed in Congress to raise agri- "cultural prices or stimulate exports. Purchasing power "in agricultural sections is badly damaged but that of "wage earners is but little affected yet. People will "probably begin buying again when retail prices are "substantially reduced. Statistical history of post-war "readjustments show rebounds after acute declines and "though there are no precedents for present world-wide "inflation already many lines of merchandise stocks here "are low and enquiries are slightly improving. It may

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"possibly be that at some point a decrease in our rates if "entirely justified by credit conditions would be just the "thing needed to complete the resumption normal purchasing "and production but at present we think it would be "unjustified premature and ineffective. Foregoing refers "of course only to conditions here."

Mr.Norman remembers that he and Mr.Strong somewhat reluctantly acquiesced in these views, considering it on the whole of greater advantage that the two Institutions should not part company at that juncture than that the London rate should be lowered without the co-operation of New York.

It will be of interest to introduce here a quotation from the Report of the United States Commission of Agricultural Enquiry*, a body which examined the wartime financial policy of America in great detail.

Dealing with the period referred to above and the few months immediately following the Commission state their belief -

"that a policy of lower discount rates and greater "liberality in extending credits could have been adopted in "the latter part of 1920 and the early months of 1921, and "that such a policy would have retarded the process of "liquidation and thus spread the losses incident to the "inevitable decline of prices to a lower level over a longer "period."

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*Appointed in 1921, chiefly, as its title indicates, to examine the farmers' grievances.

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Although the Commission recognised the extreme difficulties with which the Federal Reserve System was at that time faced, and enlarged upon them, they added that the adoption of such a policy at that time would, in their opinion, have been advisable.

During 1920 the margin between Market Rate and Bank Rate narrowed very considerably, in marked contrast to 1919 and still more so to 1918. The total British Debt was reduced by £250 millions in spite of an increase in the floating debt of £58 millions (of which Ways & Means Advances accounted for £31¼ millions). The Bank received the gold holdings of the other Banks to the amount of about £42 millions. Sterling exchange rose in every country but the United States, where the quotation at the end of 1920 was $3.54 as compared with $3.76 a year before; but continental purchases via London had aggravated this decline.

The total number of failures in Great Britain and Ireland for the year 1920 was 2,288 as compared with 1,072 in 1919; nevertheless in 1913 there were 7,191 failures, while that was the smallest figure since 1890 at least*.

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*"Bankers' Magazine", February 1921.

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In the first few months of 1921 several factors contributed to sustain the Federal Reserve Bank's reluctance (now evidently shared by Mr. Strong*) to lower rates, of which the most important were: a slowing up of price declines with accompanying improvement in sentiment; the uncertainty caused by a new Administration; an unusual drain of gold to the Interior; and the fact that the Banks had borrowed from the Reserve System over 3,000 million dollars at from 6% to 7%. The Banks would therefore be more inclined to liquidate their own borrowings than to make fresh advances to their customers at lower rates.

Mr. Strong wrote on the 3rd February -

". . . . . As to the rate situation, - what I "last wrote you is emphasized by recent developments. The "loan account at this bank does not go down to any consider- "able extent, I believe, because strong pressure is being "exerted by interior banks to liquidate bank loans, "particularly borrowings from the local reserve banks, which "results on the one hand in withdrawals of deposits from New "York, and, on the other hand in some increased borrowings "from the Reserve Bank. A particular thing which we notice "is the constant drain upon our reserves to the interior,

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*Mr. Strong, however, when asked on the occasion of his visit to the Bank of England in April 1924, adhered to the opinion he expressed in December 1920.

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"which would amount to $50,000,000 a week or more were it "not that our reserve position is readjusted every week by "various special transactions of the Treasury, is partly "relieved by regular imports of gold coming from abroad, "and whenever deficiencies below the legal minimum remain "after these transactions, the reserve position is from time "to time readjusted by our transferring a portion of our "portfolio to other reserve banks which are growing stronger. "You will observe that this movement of funds away from New "York is contrary to the movement to be expected at this time "of the year in normal years before the war.

"It is safe to say that considerably lower "money rates cannot be anticipated here for the present, and "it is difficult to say how soon they may be expected. My "personal disposition would be at the moment to leave rates "unchanged except, of course, were we obliged to make some "slight increase in the special rates allowed for borrowings "by bankers upon Treasury Certificates of Indebtedness.

"I am beginning to have a feeling, although "still not very definite until developments more fully "justify it, that we are not through with the pressure for "liquidation of commodities. There was a general return "of better feeling after the first of January, but with the "least indication of tightening money, such as we have had

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"this week and late last week, a cold chill seems to go "through the air, which is at once reflected in the stock "market and elsewhere."

Meanwhile, in England, although currency was contracting satisfactorily, wholesale prices had not fallen as quickly as in the United States and the response of retail prices to wholesale was still inadequate. The total amount of wages was being considerably reduced by unemployment, but the rate of wages still being paid showed little sign of yielding. There was, however, a growing agitation for cheaper money, with a newspaper campaign against "Waste", under which heading high rates for Government borrowing was sometimes included; and it was generally considered that the continuance of high rates was unjustifiably retarding or preventing a trade revival. This view was held by most of the Bankers, led by Mr.McKenna, now Chairman of the London Joint City & Midland Bank Ltd.

The Bank of England were now less disposed than at Christmas to view a reduction in rates favourably. On the 3rd February the Governor cabled to Mr.Strong -

"It would seem that fears of trouble and mentality of "Bankers which we discussed at Christmas were due chiefly "to pressure of end of year liquidation of Commodities and "Securities rather than as seemed just possible to too

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"rapid pace of commodity deflation. Although fall in "wholesale commodity prices continues somewhat rapidly "security prices generally improved last month while in "some commodity markets sales have taken place which were "impossible during Autumn. We anticipate public clamour "for lower rates which we should attribute more to desire "for business and profits than to actual fears of trouble "and owing to unemployment we expect political pressure in "same direction. But at present consider neither "financial conditions nor mentality are adequate reason or "excuse for lower rates which would undo good already "accomplished cause false sense of security and prevent "fall in retail prices which must eventually precede fall "in wages. We should therefore like if possible to "maintain present Bank rate for indefinite period even if "Treasury Bill rate cannot likewise be maintained. "Should be glad to learn your views and if they include "plans for drastic rates to induce repayment of your loans "we should not expect to be adversely affected thereby."

This cable was followed up by a letter, dated the 17th February, from which the following is an extract -

"Our confidential cable of the 4th told you "briefly just what our position was and what (on re-reading "it) our position appears to be to-day. There has been and

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"is a real drive at us the whole time, but my own feeling is "that the danger of having our hands forced is less to-day "than a week ago. I think our opponents have overdone "their case - they have protested too much. After a time "reiteration and even ridicule lose their effect, and though "one cannot see far ahead I can say nothing more on that "score; but meanwhile owing to the collection of taxes "money is dear and likely to remain so for another six weeks. "The rate for all Bills up to 60 days is up to 7% and day by "day we are making advances at 7½%. I notice also an "increased demand for accommodation from outside customers, "Railway and Manufacturing Companies, which would usually be "supplied by the other Banks but which is beginning to come "direct to us owing to this (normal) pressure of taxation.

"We will keep you informed by cable if any "definite change seems probable, but you will understand "that the ground of attack among our banking friends here "has somewhat changed since the end of December: then it "was a question of 'cold feet', but they were cured when the "liquidation at the end of the year had subsided; now it is "more a question of the increasing unemployment growing out "of the shutting down of plants and of the added stagnation "of the frozen loans which the Bankers are already carrying. "Our wholesale commodity index is now 115 or 120 above the

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"pre-War level, and my idea is that we ought not properly to "be asked for lower rates until the retail commodity index "and likewise the cost of living have reached an equally low "level - they are now 40 or 50 points higher. With things "as they are the banking position is admitted to be sound "and sounder than it was when you were here."

Towards the end of February the Prime Minister attacked the Bankers in the House of Commons on the ground that they were unreasonably unwilling to risk their depositors' money in the countries of Eastern Europe (under a Government Exports Credit Scheme). On this point the Governor wrote to Mr. Strong -

"The Banks had unofficially taken up the line "that while they could shoulder the risk of the exporter "here and the importer there for a longish period, they "could not assume the risk of exchange and of political "uncertainties. I think they were right.

"Be that as it may, the Bankers were nettled, "and one or two of them who are well-known to you got up a "meeting among themselves. Realising that the essence of "defence is offence, they not only formally denied the "allegations in the Prime Minister's speech but they made a "deliberate assault on the dear money position by means of a "formal demand for the policy to be reversed; by means of a "Press campaign; and by means of intrigue in various "directions.",

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Political pressure for lower Treasury Bill and Bank Rates now inoreased and, on the 26th February, the Governor cabled to Mr. Strong as follows -

"In the near future our rates are likely to be "changed to one of two following levels: either three "months' Treasury Bills 6% and twelve months' Treasury "Bills 6½%, Bank Rate remaining 7%, or three months' "Treasury Bills 6% and Bank Rate 6½%. For reasons stated "in earlier cable this anticipation will not surprise you "but please state first whether your borrowers likely to "shift loans to London and second whether our changes "likely to affect your plans. While these changes seem "unavoidable you know we desire to suit your convenience "as to details."

The Reserve Bank replied that the proposed reduction might cause some shifting of New York Stock Exchange loans to London, but not to any great extent owing to the Exchange risk involved. With regard to their own policy they added that their views of the future were "some "what obscured at present owing to imminence of new Secretary "of Treasury whose fiscal policies are not known to us".

On the 12th March, Treasury Bill Rates were lowered to 6% and the Governor wrote to Mr. Strong two days later -

". . . . . You will have received my cable of "the 10th indicating the decision of our Government to reduce

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"the rates for Treasury Bills. As you know from my earlier "letter this was clearly inevitable, although at the last "moment it came unexpectedly . . . . It is too early as "yet to speak of the effect of this reduction, nor can I say "whether it will be followed by further reductions in "Treasury Bill rates or in the Bank Rate. I fear it will "produce too good a sentiment and this will do more harm in "the Stock Markets than in the Commodity Markets: but, "while from the purely financial point of view one would far "rather have continued as we were, it is evident, even to an "outsider, that politically it was almost necessary to make a "reduction."

Rumours now began to appear in the Press that it was the intention of the United States Treasury to reverse the policy of the Federal Reserve Board and to reduce rates. On the other hand, the Statistician of the New York Bank had, a little before this, prepared a memorandum which led to the conclusion that, after a period of dulness, the general trend of prices would again be upwards*, and although Mr. Strong did not quite agree with that view, he held the opinion that the Reserve Banks' rates should remain unchanged, which would extend liquidation into retail trade, and produce a reduction in wages and after that a reduction in Bank loans and currency.

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*This opinion was also shared by Authorities in Great Britain.

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In a further letter of the 21st March Mr. Strong wrote -

". . . . . I was greatly interested in the "comments . . . on general subjects we discussed so fully "in London: that is, the drive for lower rates, easy money, "and a more liberal discount policy, etc. All of this we "have read of in the press despatches, and we have heard a "great deal of it from various quarters here, where the "pressure of liquidation has developed weak spots. One of "the officers of our Government, who has just retired from "office*, has been an urgent advocate of such a policy. It "has originated in various parts of the country, where "distress is felt due to the sharp decline in the value of "agricultural and farm produce, such as cotton, wool and "meat, but so far I have been unable to determine the "slightest indication among my own associates in this bank, "with the Federal Reserve Board (with the exception of one "member, recently retired) nor in fact with the Secretary of "the Treasury, that any such policy is justified by con- "ditions. Only yesterday I learned definitely and "authoritatively that the remark attributed to the Secretary "in regard to rates, which was cabled to your side, was "never made by him at all. The newspaper note to that "effect may have been what we call 'flying a kite'. In

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*Probably Mr. McAdoo, former Secretary to the Treasury.

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"other words, an attempt to draw a statement in denial. We "do see, however, that you have been subjected to insistent "pressure and almost every day I am asked by banking or "newspaper friends whether your rates are not likely to come "down, and whether that will not necessitate a reduction in "our rates, or whether we may not reduce our rates and so "necessitate a reduction in yours. The question is pro- "pounded directly, indirectly, by innuendo, subterfuge, and "in every form which might be likely to disclose our policy "and position. So far, we have managed successfully to "avoid any disclosure of what we believe the future policy "of this institution should be. It is more than likely, "however, that we will be subjected to pressure of the same "character as we encountered last fall, and as you apparently "are encountering now, for lower rates. This may be of "political as well as general origin, and we do not look "forward to such a development with much pleasure. It "likely will not arise until after Congress meets in special "session on April 11th . . . . . "

On the 28th March, Mr.Strong added -

". . . . . What was quoted incorrectly about "Mr.Mellon was unfortunate. My meetings with him recently "have failed to disclose the slightest inclination on his "part to bring about a reversal of policy, and I gather that

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"he is a man who will be very much influenced by the "counsels of his associates; in fact, is one of the last "men to attempt to dominate the policy of the System, as "might have been indicated by the quotations in the "newspapers."

The three months' Coal Strike of 1921 began in this country on 31st March and ended on 4th July, and its effect on Trade and Finance was of course enormous. Several references to it will be found in the correspondence that follows.

On the 2nd April, the Governor wrote to Mr. Strong -

". . . . . We have virtually been without a "Chancellor for three weeks: it is extremely inconvenient "and all our plans are hung up. From what I have seen of "Sir Robert Horne* I do not think that his policy will differ "materially from Chamberlain's, but as a man and a brother "the latter will be very hard to beat.

"So far as we have any plans they are as "follows:-

"An Indian Loan next week <u>if</u> the coal strike permits but at "present the strike makes the future <u>very dark indeed</u>.

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*Mr. Austen Chamberlain had been elected Leader of the Party and of the House of Commons on the 21st March and Sir Robert Horne was not appointed Chancellor until April 5th.

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"Towards the end of the month sales of Treasury Bills by "weekly tender instead of by 'tap' at a fixed rate, but "perhaps continuing the 'tap' for awhile at a rate of "discount below the (varying) accepted weekly tenders. "Of course this is more or less experimental and you will "realise that the object primarily is to remove from the "Treasury the need of fixing money rates.

"Subsequently, a long Loan for the conversion of the "National War Bonds maturing within, say, five years, of "which there are about £700,000,000 outstanding. If we "could get these out of the way the future of our domestic "finance would begin to look very different.

"I do not think the reduction in Treasury "Bill rates has done any harm but the result cannot be seen "for six months. I fear the tendency of any reduction in "money rates is to stiffen the price of wholesale commodities "and the cost of living. (The relatively high price of the "cost of living is, I believe, one of the main difficulties "facing the coal miners . . . . . The proposed reduction in "their wages is in many cases out of all proportion to the "reduction which has so far taken place in the cost of "living.) But whether the Treasury were right or wrong in "reducing their rate last month, it is essential that the "Bank and the Treasury should work together. Rather than

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"one do what is absolutely right and the other what is "perhaps wrong, we had both better stand together and "together do what is perhaps wrong. On this reasoning I "should not be averse to putting down our rate by one- "half per cent. towards the end of the month: but I admit "that financially such a change can hardly be justified."

Mr. Strong writing on the 5th April still showed little indication of any change of opinion as to the probability of political influence being applied:

". . . . . So far as I can now see, the only "possibilities of a changed policy here are those which "would result: first, from indications that we might suffer "a credit breakdown, with many insolvencies, because of the "decline in commodity values, and which I now regard as an "unlikely development, and the other, political pressure "upon the reserve system, which is always a possibility with "us, as with you. Of course, when I say political pressure, "I mean pressure from political sources as distinguished "from influences confined to the system itself."

A Conference of Federal Reserve Banks took place at Washington in the middle of April, after the close of which Mr. Strong wrote, on the 18th April, -

". . . . . The Conference at Washington was a "rather strenuous affair, lasting all of last week. The

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"Boston Reserve Bank developed a keen appetite for lower "rates, which they have been threatening for some time, and "finally last week reduced their commercial paper rate to 6%, "which is the same as the rate charged for advances on "government collateral. Other than Boston, I discovered no "sympathy with the idea of lower rates in the minds of any of "my colleagues, and believe that the general disposition was "to maintain the present level all round until,

"First, retail prices, and the general cost of living is "somewhat more reduced,

"Second, money rates in the market are somewhat lower,

"Third, a clearer insight into the labor situation has "developed.

"The fact is, that very considerable distress "was reported to exist throughout the agricultural sections "in the west and south, due to the sudden and extensive "decline in the values of almost all farm commodities. "Many of the small country banks are carrying large amounts "of farmers' paper with no hope of liquidation without heavy "losses, unless prices advance, or until a new crop is "produced at very much less cost to the farmer than was the "old crop. I urgently advocated liberality in making fresh "advances to these banks, but maintenance of at least the "present level of rates, that all direct pressure upon member

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"banks to liquidate their borrowings be discontinued except "in cases where it appeared that the member banks were "abusing our facilities. My suggestion was met with a good "deal of enthusiastic approval by the Class B directors of "reserve banks which are located in the west and south, and "I believe was helpful in crystallizing opinion that in this "period we should advance liberally, but not lower rates, "which might revive the activity of the speculator both in "stock and commodities. It remains to be seen whether this "policy will be observed. I think it will here in New York.

". . . . . . My fear about the reduction in "rates by your treasury did not arise from the mere fact "that a reduction had been made, but rather that it indicated "the possibility of a reversal of the old problem which would "mean that you would need to reduce whenever the treasury "reduced and vice versa, with the possibility of getting out "of line with true market conditions so that your ways and "means advance account would again begin to roll up just "because the public would not take the current issues of "treasury bills. Putting it the other way around, if the "public did take treasury bills under these conditions, it "would really be as the result of an inflated condition.

"In conclusion, I do not see the possibility "for the moment, of important rate reductions by the reserve "banks, and especially not here in New York, so long as rates "in the market are still considerably above ours."

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But on the 26th April Governor Strong wrote:

"Not at all to my surprise, the pressure for "reduction of rates, to which I referred in a recent letter, "has crystallized in Washington, and even gone so far as to "result in the introduction of bills in Congress providing "that the rates of discount to be established by the reserve "banks shall be limited, in the case of one bill to 6% and "in the case of another to 5%. Our difficulty at the "Capitol largely originates with the agricultural interests "of the country. The farmers have been hard hit by the "decline in the value of almost everything that they produce. "Many of them failed to sell last year's crop promptly and "they are consequently heavily in debt still, and at a time "when they need to borrow money for the purpose of making "the new planting. There is much real distress due, I fear, "in a large number of cases, to their own unwisdom in "speculating in their own produce. On the other hand, they "feel the pressure resulting from this condition seriously. "We are beginning to feel it, and I was only yesterday "advised of a very determined effort, originating I regret "to say, with some members of the present administration, to "bring about a reduction in the rate of discount of this "bank, and of some of the other reserve banks, if not all of "those which have rates above 6%.

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"Knowing that you would have an important "decision to make this week, it seemed best to keep you "posted by sending you a cable . . . . . I still have "some hope that action can be deferred until conditions more "justify it than at present. Our chief difficulty undoubt- "edly lies with Congress which, even with the best intentions, "may be led into unwise legislation, if our resistance is too "determined to meet their extreme views. Another week or "ten days will probably disclose just what has to be done to "avoid the possibility of some extreme or unwise action. "It may be that we can hold our present position indefinitely, "but I am beginning to doubt it.

"This comes as an unpleasant surprise after "our Conference in Washington, where, with one or two "exceptions, everybody agreed that lowering the discount "rates was unwise at the present time.

"You see, we suffer from somewhat the same "difficulties that you do."

On the 20th April the Governor had cabled to New York stating that if there were "no trouble over Reparation "questions", the Bank Rate would be lowered to 6½% on the 28th, a change which in fact took place on that date. On 22nd April New York replied "We anticipate no immediate "change in our Bank Rate policy. We hope and believe to "cause you no difficulty".

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On the 3rd May a letter from the Governor shows that here, too, the Government was too strong for the Bank.

". . . . . You seem confident of maintaining "your rates and I should think you would be right to do so, "but since the 18th April, when your letter was written, I "have had your confidential cable No. 19 and am therefore "uncertain at the moment just how you stand.

"Our position is of course different from "yours, not only because we are owed very little money by "the public but also because the Treasury Bill Rate has "really dominated the short money market, and ever since the "late Chancellor put his rate down early in March the "eventual necessity of our conforming thereto has been "staring me in the face. It seemed better for the Treasury "and the Bank to work together, even if in so doing the best "may be sacrificed to the good, rather than that one should "adhere to what seems intrinsically the soundest policy and "so part company from the other. Of course this question "of Bank Rate and Treasury Bill Rate has lately been some-"what modified by the introduction of the weekly tender "system, but only time will show how that is going to work "and whether it can be maintained indefinitely as I hope it "may. It is liable of course to be too much affected by the "sudden abundance or shortage of money due to special and

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"temporary causes, but on the whole I hope it will go some "way towards making the Bank Rate as effective as it used to "be in the old days."

The change of rate, though not concerted with New York, preceded similar action there by six days only, for on the 4th May the Reserve Bank's Rate came down to 6½% and the next day Mr. Strong wrote:

". . . . . The effect of the great price "liquidation which we have suffered in this country has been "more felt by the agricultural and live stock classes than "any other. They are themselves partly to blame, but some "responsibility also rests with agitators and polititians, "who started an organised propaganda last year, and to some "extent the year before, to induce the farmers to withhold "their crop from the market. It was the same old talk of "50 cent cotton, and $3.00 wheat. The result was that many "of them were caught carrying their own crops, in which they "were in fact speculating. But, I firmly believe that as "to the great mass of these people they were the victims of "circumstances over which they had no control. Our crops "are made very largely on borrowed money, and the sudden "decline left the farmers literally unable to dispose of "their product for sufficient amounts to liquidate the loans "incurred to make the crop.

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"With this situation in the West and South, "enormous pressure has been felt in Washington from the "agricultural sections of the country that measures be taken "to ease up credit conditions. So far as I can discover, "the demand came from no other class than those engaged in "agriculture. They made an impressive showing and their "complaints reached all classes of Congressmen and Executive "officers of the Government right up to the President.

"This was all put up to me most earnestly by "my friends and associates in Washington, and the feeling "generally prevailed that the New York bank was causing the "dead-lock. My own belief is that the principle followed "so long by your institution, and as I recall, first "enunciated by Bagehot, that in such times as these, money "should be loaned freely, but at high rates, is the "principle which should now govern our operation. On the "other hand, a bullheaded resistance in this situation is "always liable to invite political retaliation, and I "finally concluded that the wisest course was to meet, in "part at least, the demand for lower rates. The last week "of this discussion witnessed developments which made it "rather easy to do this, as our Treasury Certificates of "Indebtedness are now selling on a $5\frac{1}{2}$% basis, or better, "prime bankers bills at $5\frac{5}{8}$ and $5\frac{7}{8}$%, and even the best grades "of commercial paper are now squarely at 7%, and to a "limited extent sales are made even below that.

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"I think we have done a wise thing, although "I would have preferred to wait a few weeks longer. Our "rate change follows the completion of the important C.B.& Q. "financing, and on the other hand, precedes the first step "in the Treasury's program of dealing with the Victory loan "maturity of something over $4 billions, which falls due in "May 1923."

By the 18th May all the Reserve Banks had made a reduction in rates, but the loans of Reserve and Member Banks continued to decline throughout the System.

In England the Coal Strike still remained unsettled. On the 14th May, the Governor had written to Mr. Strong -

". . . . . Had we known how prolonged the "Strike would be I doubt if a month or so ago we should have "attempted to carry out our plans as we have done.",

and on the 23rd he continued:-

". . . . . As long as our coal strike "situation is as far from definite settlement as it appears "to-day, we shall not be disposed to make any further "alteration in the rate. If we could get the coal strike "settled I should like to go down to 6 per cent. with the "definite expectation of having to go back to 7 in three or "four months. But all of this is purely hypothetical."

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The following extract is from a letter dated the 2nd June from Mr. Strong -

". . . . . It is, at the moment, difficult to "give any forecast of what may be done as to our general "policy on rates. There is a widespread propaganda to bring "pressure upon Congress and the Administration to make money "easy, particularly in the agricultural sections. A great "variety of impossible and foolish schemes of legislation are "proposed in Congress, and I cannot help but sympathise with "the difficulties with which President Harding and his "Cabinet are faced in dealing with the great variety of cases "of real distress, especially among the cattle and cotton "people, caused by the immense reduction in the value of "their products, much of which is still in their hands. "Being unable to write anything very certain, I fear the "effect of writing anything at all lest you be misled. My "own position with the members of the Cabinet and the members "of the Federal Reserve Board has not changed, and I see no "prospect of changing it, except as a concession to a situa-"tion which might result in dangerous legislation affecting "possibly even the fundamentals of our system. I have "maintained that all pressure for liquidation should be "removed, except that exerted by the reasonably high rates "which we still maintain, but that, on the other hand, at

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"these rates the Reserve Banks should extend credit liberally "in those sections of the country where it is needed and to "those member banks which show a disposition to stand loyally "by their customers and see them through this period of "depression, especially those who are in need of credit to "make new crops and to continue as producers and earners. "I would rely upon fairly high rates to check speculation and "inflationary developments, and upon a generous credit policy "to take care of cases of distress. But now and then I feel "rather lonely in my position, especially when I am in "Washington. The last sentence of the second page of your "letter of May 3 expresses very much my own view - a "classical policy, sound in theory, might be practically "unsound because of social and political consequences more "serious than a little inflation."

On the 10th June the Governor cabled that a settlement of the Coal Strike was expected in a week or two and that he anticipated there would then be a reduction in the Bank Rate to 6%, and on the 13th June Mr. Strong replied that it was not impossible that the Reserve Bank would adopt this figure themselves in a few days.

". . . . . Our reserve is now over 66%, "computed upon combined deposits and note liabilities, where, "looking at it as you would, deducting the 35% reserve "required upon deposits from our total reserves, our note "issue would be almost 100% covered. I would not hesitate

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"to make a recommendation were I as confident as you seem to "be, of increasing our rate later on should necessity arise."

On the 15th June the reduction was made in New York, but the Bank of England did not follow until the 23rd, and even then the Coal Strike had not formally come to an end although there was little doubt as to the outcome.

In July Government pressure for further reduction affected both Institutions and on the 20th July the Reserve Bank accepted a reduction to 5½%, the Bank of England following suit on the next day. On this occasion the Bank had the advantage of consultations on the spot with Mr. Jay, who was visiting England.

Early in August the Governor and Sir Charles Addis sailed for New York and, in consultation with the Federal Reserve Bank Authorities there and in Washington, decided to endeavour to keep the English Rate at ½% or even 1% above that of the Reserve Banks, with the object of inducing the American investing public to make loans to foreign countries and thus place at the world's disposal a part of the huge gold reserves which were accumulating in the United States.

By the end of August wholesale prices in England ('Economist' Index) had fallen from 287.5, the figure for August 1920, to 178.9 (the peak of March 1920 having been 310.2).

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It was alleged early in 1921, and has often been asserted since, that the history of penal rates shows it to be unnecessary that they should be applied over any long period. Once they have begun to contract credit, the throwing of stocks on the Market will produce a rapid fall in prices, and losses and failures will be so great that it will soon be found advisable to lower rates in order to restore confidence and start trade again. While it may be impossible to feel certain that speculators and traders had not learnt their lesson after a few months of the 7% rate retail prices and wages, as already stated, had lagged behind.

So far as America is concerned we have already seen that the Commission of Agricultural Enquiry considered that rates ought to have been lowered earlier (end of 1920 or beginning of 1921). Further quotations from their Report (Part II) may here be given -

"In the early part of 1919, following a short period "of price deflation and business contraction, the question "of increasing the discount rates of the Federal Reserve "Banks in the direction of the sounder policy of maintaining "these rates above the going rates for commercial paper and "above rates on Government bonds and certificates of "indebtedness arose. At this time the Government was

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"considering the flotation of the Victory loan which it was "then thought would involve $6,000,000,000. The Treasury "Department was unwilling to undertake the flotation of the "Victory loan at a rate of interest comparable with commer- "cial rates on account of the possible effect which that "action would have upon existing issues of private securities "and its possible effect in requiring the refunding of the "issue of Government bonds already floated. The discount "policy of the Federal Reserve Banks was again subordinated "to the Treasury policy in securing its credit requirements, "although at this time the tendency towards expansion, "speculation and extravagance was beginning to be apparent. "This was clearly the time for a policy of advancing the "discount rates of the Federal Reserve Banks with a view of "curtailing the expansion, speculation and extravagance which "was then beginning. It is the opinion of the Commission "that a policy of restriction of loans and discounts by "advances in the discount rates of the Federal Reserve Banks "could and should have been adopted in the early part of 1919*, "notwithstanding the difficulties which the Treasury "Department anticipated in floating the Victory loan if such

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*"I believe, if it had been possible, it would have been "desirable for the Federal Reserve System to have advanced "its rates at some point in the period between January and "March 1919". Governor Strong - before Commission of Agricultural Enquiry (Report, Part 13 p.763).

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"a policy were adopted. It is also the opinion of the "Commission that had this policy been adopted in the early "part of 1919 much of the expansion, speculation and "extravagance which characterized the post-war period could "have been avoided. The Commission also believes that had "such a policy been adopted in 1919 the difficulties, hard-"ships and losses which occurred in 1920-21 as a result of "the process of deflation and liquidation would have been "diminished.

. . . .

"As the pressure of liquidation developed, there began "to be demands on the part of the public for amelioration of "the policy of the Federal Reserve Banks with respect to "discount rates, based upon the assumption that lower discount "rates and freer money would arrest the tide of liquidation "and reduce the hardships of those who are compelled to sell "in a declining market.

. . . .

"About one-third of the banks at this period were greatly "over-extended, and it was the position of the Federal Reserve "Board that a policy of cheap money at this time, coupled "with an invitation to them to further extend themselves and "the ratio of loans and discounts to capital, might have "resulted in bank failure involving the industrial and "commercial institutions and that the Federal Reserve Board

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"and the Federal Reserve Banks were confronted with a choice "between continuing the high discount rates and the "consequent pressure and hardship upon the commercial and "agricultural industries of the country on the one hand and "a policy of lower discount rates involving a possible "financial crisis in the midst of an industrial crisis. "The Federal Reserve Banks, with the approval of the Federal "Reserve Board, took the first choice, and discount rates "were continued upon practically the same level as before. "It seems probable that a change in the policy of the "Federal Reserve system with reference to discount rates "would have accomplished a reversal in part of psychological "and economic factors which at this time were moving in the "direction of the lower prices, and at the same time would "have tended to induce on the part of banks a more liberal "attitude towards furnishing additional credit.

. . . .

"During all of the period following the armistice, the "position of the Federal Reserve Board and the Federal "Reserve Banks was exceedingly difficult. On the one hand "it was the duty of the Board and Banks to see that the "essential credit requirements of the commercial, manufac-"turing and agricultural industry of the country were met as "far as they could be. On the other hand, it was necessary

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"that credit for non-essential and speculative purposes "would be limited as much as possible, and that the Banks "were not allowed to extend themselves so that failure would "precipitate a financial crash. In other words, it was the "job of the Federal Reserve system to extend credit without "encouraging dangerous expansion of banking liabilities.

"The balance between these two positions was extremely "delicate, and it is probable that the Board and some of the "Federal Reserve Banks, having in mind the preservation of "the integrity of the banking system and the prevention of a "financial panic, imposed excessive pressure in the direction "of reduction, or at least the prevention of expansion of "loans and discounts of the member banks. The policy "inaugurated during all of this period, and increasingly "during the latter half of 1920, was one of restriction of "credit.

"The alternative of such a policy was the extension of "all the credit desired for any purposes. Such a policy "would have involved the following dangers: First, the "extension of loans and discounts by banks to a point which "might result in a large number of failures: Second, the "reduction of the reserves of the Federal Reserve Banks "below, what Bagehot so expressively calls, the 'apprehension "'point': Third, excessive currency issues resulting in

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"depreciated currency: and, Fourth, the loss of public "confidence in the banking system, runs on the Banks, and "demands for the redemption of Federal Reserve notes in gold."

The Report, in a word, upheld the opinion that rates should have been raised earlier and lowered earlier, though the difficulties of both courses were fully admitted. Since the Federal Reserve Board has Government Representatives upon it, the judgment amounted in part to a censure of the Government, but of course the Bankers were not expressly exonerated*.

Returning to the Bank of England, it may be claimed in conclusion that the evidence given shows that throughout the period they possessed the courage, if not always the opportunity, to apply to the financial difficulties of the time the remedies which current theory and past experience showed to be appropriate. If, as has been alleged, scepticism as to the adequacy of Bank Rate as a weapon in so great emergencies developed upon the outbreak

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*In this connection it is to be noted that Mr.Strong's evidence was not always quite as incisive as it would have been had he not been hampered by two considerations. In the first place, Mr.Carter Glass, who had been Secretary of the Treasury in 1919 and an advocate of cheap money, was by Aug 1921 fully converted to Mr.Strong's views and an influential friend of the system in the Senate: secondly, Mr.J.S.Williams, who had attacked the Reserve Banks' policy to cover his own misdeeds as Comptroller of the Currency could not be fought as vigorously as Mr.Strong would have wished because of the possible repercussion of such action on certain New York financial houses which were at the time in a somewhat dangerous position. (Verbal from Mr.Strong - April 1924.)

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of and during the war, it was not in the Bank that such disbelief arose or was encouraged*.

On the whole, the Bank may be said to have been only fairly successful in getting their own way. Since Bank Rate could only be effective during this period when both Government and Bank combined to make it so, the Bank were unable to enforce their policy except when they could carry the Government with them. It was hardly to be expected that they should never fail to do this. The Bank had to defer to views with which they did not agree, probably in the latter months of 1914, certainly in 1918, 1919 and the first three months at least of 1920, and again in the Spring of 1921. It seems probable too that, during the period when foreign money received preferential treatment (1918 and part of 1919), the cheap money policy imposed by the Treasury produced benefits to the Government which were more than offset by the additional inflation which this policy caused.

The occasion when the overruling of the Bank by the Government produced the most serious results was in the

*"What has already been accomplished . . . would appear to "confirm the faith of the Cunliffe Committee that in the Bank "Rate, whether for a rise or a fall, we have an instrument of "which the action has indeed been obstructed by the adverse "circumstances of the Peace, but whose efficiency, for "ultimately producing the financial result desired, remains "unimpaired by anything that has happened during or since the "war. They are not without grounds for their belief who "hold more strongly than ever that in the suppleness of the "Bank Rate lies its chief virtue and that its efficacy, "especially in the way of prevention, would be increased to "the great advantage of the community if it were more "frequently and above all more promptly applied."
(Sir Charles Addis - Presidential Address to the Institute of Bankers 8.11.21)

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BANK RATE

1921

spring of 1919. As has been shown, the Bank were not allowed to raise rates until fully six months after they wished to do so. In America there was a similar fatal delay: rates there should have been raised possibly as early as January*, certainly not later than June, 1919.

Had high rates been permitted to exercise their effect earlier, it would have been possible earlier to relax the pressure. The Governments and Central Banks concerned might then have escaped the widespread criticism that they were accentuating the difficulty of restoring trade at a time when borrowing for legitimate trade purposes should be encouraged.

Probably some measure of inflation was inevitable during the war, though it is safe to say that a more drastic finanoial policy on the part of the British Government would have been far from enoountering opposition in the Bank. Possibly after the war, even combined aotion by the Bank of England and the Federal Reserve Banks, unrestrained by their respective Governments, might have failed to stop the rapid rise in prices occurring at that time. However this may be,

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*Governor Strong, giving evidence in 1921 before the Commission of Agricultural Enquiry (Report, Part 13 p.503) said that leaving Treasury requirements out of consideration "an increase in discount rates . . . from January to March "1919 . . . would have been as close to an ideal 100% policy "of perfection as could have been adopted". (On the other hand, in April 1919, he had written to the Governor giving reasons for feeling "justified in maintaining our rates "unchanged at their present level". L.16.4.19)

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BANK RATE

1921

the Bank of England and New York Reserve Bank, as we have seen, were in accord in thinking that "while dear money may "not effect a cure, no cure is possible without it".

There is usually a tendency to opposition between a country's immediate and ultimate economic interests, and, while Central Banks may be expected chiefly to further the latter, the electorate directs the attention of its Government almost exclusively to the former. The difficulties of arriving at a concerted and consistent financial policy, very likely serious in any case, may for this reason be much aggravated. Unfortunately Central Banks cannot count on support from other Bankers in the advocacy of a course that is sound but unpopular. Indeed, the reluctance of a Treasury to adopt a "dear money" policy may be strengthened by open or veiled opposition from the other Banks: these dislike seeing their securities depreciate under the influence of high rates. Increases in Bank Rate are necessarily unpopular - especially if they accomplish their purpose.

Such considerations form a powerful argument in favour of autonomy being granted to Central Banks; but previous to the establishment of some sort of international federation it is to be feared that such autonomy as may be achieved by Banks (beyond the measure of freedom accorded to, say, the Bank of England) may have little more than an academic value.

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BANK RATE

BANK RATE CHANGES

Bank of England

				Duration in Days
1914	January	8	4½	14
		22	4	7
		29	3	182
	July	30	4	1
		31	8	1
	August	1	10	5
		6	6	2
		8	5	705
1915			No change	
1916	July	13	6	189
1917	January	18	5½	77
	April	5	5	945
1918			No change	
1919	November	6	6	161
1920	April	15	7	378
1921	April	28	6½	56
	June	23	6	28
	July	21	5½	-

Bank of France

1914	January	29	3½	
	July	30	4½	
	August	1	6	Average £4: 4: 5
		20	5	
1915/1919			No change	" £5: -: -
1920	April	8	6	" £5:14: 7
1921	July	28	5½	

Imperial Bank of Germany

1914	January	22	4½	
	February	5	4	
	July	31	5	Average £4:17:10
	August	1	6	
	December	23	5	
1915/31 August 1921			No change	" £5: -: -

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BANK RATE

BANK RATE CHANGES

Netherlands Bank

1914	February	17	4½	
		24	4	
	March	23	3½	
	July	29	4½	Average £4: 8: 8
	August	1	6	
		19	5	
1915	July	1	4½	" £4:15: -
1916/31 August 1921			No change	" £4:10: -

National Bank of Belgium

1914	January	22	4½	
		30	4	
	July	30	5	Average £4:11: 8
	August	3	7	
		27	5	
1915/1918			No change	" £5: -: -
1919	June	4	4	" £4: 8:10
1920	April	1	4½	" £5: -:11
		29	5½	
1921	May	19	5	

Bank of Japan

	From		
1912	November	14	
	to		6.57
1914	January	1	
	July	6	7.30
1915			No change
1916	April	17	6.57
	July	5	5.84
1917	March	16	5.11
1918	September	15	5.84
	November	25	6.57
1919	October	6	7.30
	November	19	8.03

No further change by 31 August 1921.

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BANK RATE

BANK RATE CHANGES

Federal Reserve Bank of New York

1914	November	16	6
	December	23	5
1915	February	3	4½
		17	4
1916			No change
1917	December	21	4½
1918	April	11	4¾
1919			No change
1920	January	22	6
	May	29	7
1921	May	4	6½
	June	15	6
	July	20	5½

N.B. From several different rates it is difficult to select that whioh most nearly corresponds to the Bank Rate of the Bank of England, especially as the classification was frequently changed. Thus:-

The rates quoted above do not refer throughout to the same class of paper.

From the beginning until June 1919 the rate is that of "Maturities of over 60 days to 90 days inclusive".

From June to December 1919 the rate is that of "Discounts "other than Trade Acceptances secured otherwise than by "United States Government War obligations: also"unsecured".

From December 1919 to August 1920 the rates are for paper of the same class "maturing within 90 days (and including "Member Banks' Collateral Notes)".

Between August and December 1920 the designation becomes: "All paper maturing within 90 days other than Government "secured, Trade Acceptances or Bankers' Acceptances".

From December 1920 to August 1921 the heading is: "Commeroial paper n.e.s. maturing within 90 days".

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FEDERAL RESERVE BANK OF NEW YORK

Discount Rates on Government Securities maturing within 16 – 90 days

Date of Change		Certificates of Indebtedness	Liberty Bonds & Victory Notes
1917	May 22nd	3½%	
	December 21st	4%	
1918	April 3rd	4¼%	
1919	January 1st		4¼%
	November 4th	Rate discontinued	4½%
	December 12th		4¾%
	" 30th	4¾%	
1920	January 23rd		5½%
	February 26th	5%	
	June 1st	5½%	6%
1921	February 5th	6%	
	July 21st	5½%	5½%
	September 22nd	5%	5%
	November 3rd	4½%	4½%

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BANK RATE

ENGLAND

AVERAGE BANK RATE, &c.

FOR EACH YEAR FROM 1914 - 1920

Bank Rate
(Figures supplied by Discount Office)

1914	£4: -:11	1918	£5: -: -
1915	£5: -: -	1919	£5: 3: -½
1916	£5: 9: 4½	1920	£6:14: 3
1917	£5: 3: -¾		

*Discount Rate (3 Months' Bills)

1914	£2:17: 8	1918	£3:11: 9
1915	£3:14: 1	1919	£3:18:10
1916	£5: 4: 3	1920	£6: 7:11
1917	£4:16: 2		

*Bankers' Deposit Rate

1914	£2: 2: 4	1918	£3: 1: 3
1915	£2:12: -	1919	£3: 3:10
1916	£3:14: 4	1920	£4:14: 4
1917	£4: -: -		

*Short Loan Rate

1914	£2: 4: 3	1918	£3: 5: 6
1915	£2:18: 4	1919	£3: 9: 7
1916	£4:12: 8	1920	£5: 3: 7
1917	£4: 8: 3		

*Figures from "The Economist".

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ENGLAND

AVERAGE BANK RATE, &c.

FOR EACH HALF-YEAR FROM 1914 TO JULY 1921

*Bank Rate

	1st Half	2nd Half		1st Half	2nd Half
1914	£3: 4: 7	£4:16:10	1918	£5: -: -	£5: -: -
1915	£5: -: -	£5: -: -	1919	£5: -: -	£5: 6: -
1916	£5: -: -	£5:18: 6	1920	£6: 8: 7	£7: -: -
1917	£5: 6: -	£5: -: -	1921	£6:16: -	

*Market Discount Rate for 3 Months' Bills

	1st Half	2nd Half		1st Half	2nd Half
1914	£2:10: 2	£3: 5: 3	1918	£3:13: -	£3:10: 5
1915	£2: 9: -	£4:19: 3	1919	£3:10: -	£4: 7: 9
1916	£4:17: 6	£5:11: -	1920	£6: 2: 2	£6:13: 8
1917	£4:16: 7	£4:15: 9	1921	£6: 2: 7	

*Bankers' Deposit Rate

	1st Half	2nd Half		1st Half	2nd Half
1914	£1:14: 7	£2:10: -	1918	£3: 2: 6	£3: -: -
1915	£2: -: -	£3: 4: 1	1919	£3: -: -	£3: 7: 9
1916	£3:10: -	£3:18: 9	1920	£4: 8: 7	£5: -: -
1917	£4: -: -	£4: -: -	1921	£4:16: -	

*Short Loan Rate

	1st Half	2nd Half		1st Half	2nd Half
1914	£2: 2: 7	£2: 5:11	1918	£3: 6: 2	£3: 4:11
1915	£1:12:11	£4: 3: 9	1919	£3: 4: 7	£3:14: 7
1916	£4: 5:11	£4:19: 6	1920	£4:16: -	£5:11: 2
1917	£4:11: -	£4: 5: 6	1921	£5: 7: 2	

*Figures from the "Economist".

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CHANCELLORS OF H.M.EXCHEQUER
FROM
JULY, 1914, TO 31ST AUGUST, 1921.

Mr.Lloyd George	July 1914 - 26th May 1915
Mr.McKenna	27th May 1915 - 10th Dec.1916
Mr.Bonar Law	11th Dec. 1916 - 13th Jan.1919
Mr.Austen Chamberlain	14th Jan. 1919 - 4th Apl.1921
Sir Robert S.Horne	5th Apl. 1921 - end of period.