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A MONEY MARKET PRIMER

A
MONEY MARKET
PRIMER

AND
KEY TO THE EXCHANGES

BY
GEORGE CLARE

THIRD EDITION

REVISED BY

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INTRODUCTION

THAT the Bank of England, even in George Clare's time, had attained an unquestioned position in the money market of this country is evidenced by the fact that, although the "market" looms large in the title to his now classical work, the first seventy pages of a book of one hundred and fifty were given up to the history, constitution, functions and operations of the Bank, while the discussion of the market proper was reserved for the third and final section of the book, that on the "Open Market," covering some seventeen pages only.

When it is remembered that Clare wrote over forty years ago, it is a remarkable testimony to his reasoning that the bulk of the principle remains true to-day. Because, therefore, of the sustained strength of his work, it has been deemed desirable to retain as much as possible of the original, and merely to add so as to bring the book up to date. To speak of revising is scarcely correct, or, at least, just; for little more has been necessary than to describe the happenings of the early twentieth century (punctuated, as it was, by that devastating financial calamity, the War), and to allow for the influence which such events had upon the condition of affairs as Clare saw it.

It has been thought reasonable to retain, for their historic value, the chapters on the Paris, Berlin and New York exchanges, and to add to them a brief survey of the effect of the War on the money market and the exchanges in general.

Finally, Clare's graphs have been omitted, for the figures of the past seventeen years of artificial conditions would bear no comparison with those of the period prior to 1914.

A comparison between certain statistics of the years 1881 to 1890 and those of recent date would show that although the Bank of England is still the pivot of the money market, there have been changes of very considerable importance. Previously, the Bank stood out alone from a host of relatively small, unconnected units; nowadays it is a giant of the central banking sphere coincident with giants in the industrial and commercial spheres. It then dominated by reason of its greater strength, its monopoly and the lack of strength and of cohesion of its *confrères*. To-day it dominates purely as a control dominates the subsidiary parts of an engine, but it cannot function without them. Its earlier virtual monopoly of note issue meant the control of currency, credit and banking generally; to-day it means the control of currency and credit only.

To speak of the London Money Market of the present day is not to speak of the Bank of England alone, or even of the Bank together with the joint stock banks. The market is constituted by a number of money factors in the mercantile sense

of the term "factor." Each of these plays a part in the composite organisation. In the days which Clare reviewed, from 1850 to 1890, the organisation was much looser and the component parts less interdependent than in later years, particularly those of the twentieth century preceding 1914; but to-day, although the structure of the market is losing none of its composite nature, there is a gradual fading away of the definition between the individual components. In other words, certain constituents of the market are tending to trespass on the sphere which was once regarded as the particular preserve of other constituents. This is not to say that the latter are in danger of losing their identity, but that they tend to become less strong by reason of such encroachment.

Like the expression "foreign exchanges," the term "money market" is applied at will to any of a number of conceptions, the chief of which are, perhaps, the nebulous place where the market's transactions are effected; the members of the financial community responsible for the being and existence of the market; and lastly, and most importantly, the volume of money which constitutes the market's commodity. Fortunately, a true description of the market must cover all these conceptions, so that everyone's individual ideas are met.

The geographical conception of the market may be disposed of briefly by stating that it lies within the area bounded, roughly, by an imaginary line passing on the western side of the new Head Office

of the Midland Bank in Poultry ; north to the south side of Finsbury Square ; east, so as to include Old Broad Street, Bishopsgate and Gracechurch Street ; south along King William Street ; and back to Poultry. This area covers the Head Offices of the " Big Five " and other important clearing bankers, the Bank of England, the Stock Exchange, the bill brokers, acceptance houses, discount houses, merchant bankers, London offices of the Scottish and foreign and colonial banks, and many of the most important insurance offices, which comprise the components mentioned earlier.

From the standpoint of this Primer, the most significant factor of the market is the commodity. Curiously, perhaps, it is not all the money of the country which is held in mind when the market is discussed or considered ; in fact, it is the lesser part to which the importance of prime consideration is granted, which bears on our financial relations with the money markets of the world. It is with no little reluctance that I attempt to define this aspect of the market ; it cannot truly be defined, but simply indicated, and then only approximately.

There is a volume of money, of relatively stationary amount, supplied primarily by the clearing banks, flowing into and out of the Bank of England according to certain influences, the total of which volume depends, at the present time, upon the country's international financial and commercial relations and upon the production of gold and its sale to the Bank. These

considerations will be dealt with in later chapters; it only remains, for the present, to mention the essential characteristics of a successful international money market. These are the free and unfettered import and export of the international currency, gold ; the existence of a highly organised discount market, a market in the international credit instrument, the bill of exchange ; a central institution which can and shall control the market and act as the medium through which international transactions are ultimately effected.

Of this organisation the Bank is the pivot, the keystone, the fulcrum. It is the ultimate gold reserve of the country, and the only medium through which gold can be minted ; it is the bankers' bank and the controlling institution in the discount market ; it has a monopoly of note issue and, consequently, controls the volume of credit. For this reason, therefore, the Bank, its history, status, functions and influence can deservedly be given first place in the following pages.

I have to acknowledge particular indebtedness to the following, which are suggested as the nucleus of a bibliography—

- EINZIG, PAUL.—*The Fight for Financial Supremacy*. Macmillan, 1931.
 „ „ *International Gold Movements*. Macmillan, 1929.
GREENGRASS, H. W.—*The Discount Market in London*. Pitman, 1930.
KEMMEERER, E. W.—*The A.B.C. of the Federal Reserve System*. Princeton University Press: Humphrey Milford, 1919.

SCHACHT, H.—*The Stabilisation of the Mark*. Allen & Unwin, 1927.

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„ „ *Tate's Modern Cambist*. Effingham Wilson, 1929.

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and, for welcome advice, to Messrs. H. E. Evitt, J. Huskins, John Sangway and William F. Spalding, of Messrs. Harlow & Jones, Ltd. (Foreign Exchange Brokers), and the Ottoman, Westminster and Hong-Kong Banks respectively.

M. H. M.

5, BISHOPSGATE, E.C. 2;
July, 1931.

PREFACE TO FIRST EDITION

IN the following pages an attempt is made to present, in brief compass and in plain untechnical language, a general view of the London Money Market, and of the elements that combine to determine the value of loanable capital in this country.

As the object aimed at is simply to make the reader acquainted with those rudimentary facts and principles, a knowledge of which is essential to the right understanding of an ordinary "money article," the writer makes no pretensions to originality, but has merely endeavoured to collect and arrange such of the widely-scattered information bearing on the subject as will, he believes, render those who "inwardly digest" it able to follow and appreciate the meaning of the City Editor's pros and cons.

The scope of the work is to point out and elucidate the influences that conduce to the rise or fall, firstly, of the Bank Rate of discount, and secondly, of the Market Rate. Beginning with the former, we pass in review each item of the weekly account issued by the Bank of England, noticing how the normal variations arise, how they are affected by the state of credit, and what evidence they afford of that ebb and flow in the

demand for loanable capital, the movements of which are reflected in the ever-changing price of "money." Of these figures those which record the amount of cash held by the Banking Department are, of course, the most significant ; and as it is well known that the relative weakness or strength of this item is the main incentive to action on the part of the Bank, the Reserve has been subjected to detailed analysis, with the result of demonstrating that there exists a much closer connection than might be imagined between the Bank's gain or loss of gold on foreign account and the variations of the advertised rate.

In view of such connection gold movements themselves claim attention, and, in order to gain a clear insight into their causes and antecedent conditions, the working of the Foreign Exchanges is next investigated. It is investigated, moreover, at some length, there being reason to believe that no branch of commercial knowledge is in general more imperfectly understood. By treating it, however, in a more practical manner than is usually the case, and by associating the enunciation of principles with illustrations of their application, the writer, who has actual experience to guide him, trusts he has succeeded in bringing the intricacies of the subject within the grasp of any ordinary intelligence.

Finally, the leading features of the open market are described and explained ; what loanable capital consists of, whence it comes, how it is disposed of, and how its value is settled, being,

with other such, the questions to which it is sought to furnish a reply. . . .

From beginning to end the writer has confined himself, as far as possible, to statements of fact, and to the inferences that seem fairly deducible therefrom, leaving all matters of mere speculative theory to be dealt with by those who are better able than himself to do them justice. Moreover, he has even resisted the temptation of attempting an answer to "What is money?"—a problem which seems almost as far from satisfactory and concise solution as the famous query propounded by "jesting Pilate."

April, 1891.

CHAPTER I

THE BANK OF ENGLAND

HISTORY

THE Charter of Incorporation of the Society denominated the Governor and Company of the Bank of England—the first joint stock banking association ever established in this country and the foremost in stability, magnitude and importance of the great financial institutions of the world—dates more than two centuries back, from the 27th day of July, 1694 ; and, as “ the Bank ” is the parent of the modern banking system, a short account of the circumstances that led to its formation will not be out of place as an introduction to our subject.

In 1694 the Government of William III was in great straits for want of money to carry on the war with France. Six years previously James II had been expelled from his throne and country, on the ground that he had broken the fundamental laws of the kingdom ; but with the aid of Louis XIV, at whose court he had found refuge, had since been making strenuous endeavours to evict his Protestant son-in-law, and to re-establish his own sovereignty and the dominion of the Church

of Rome. William on his part was vigorous in defence of his crown and was freely seconded in his efforts by Parliament, which voted supplies with great liberality and had imposed taxation to an extent hitherto unheard of. But though the country already found its burden almost beyond endurance, more money was still an imperative necessity.

In these circumstances a question of principle was raised, that has since been revived on many similar occasions of extraordinary expenditure. Seeing, it was said, that posterity will reap the chief benefit of our struggle for popular rights and religious toleration, why not let posterity settle the bill? Why trouble to pay as we go? That a public loan would be both expedient and just, was, in fact, admitted by all; and the Chancellor of the Exchequer was but too willing to borrow. But an obstacle lay in the way; and an obstacle that appeared insuperable. Where were lenders to be found? Was it likely that anyone would trust his money to a revolutionary government that had only been established six years and might be overturned as a result of the next campaign?

At this conjuncture, however, the strong religious and political convictions of a part of the community came to the help of the country. In the City of London there were many wealthy men—Dissenters mostly—who were willing, rather than see the land once more delivered into bondage, to place their whole fortunes at stake; and among

these merchants a scheme now began to find favour that had been perseveringly put forward by a Scotsman, William Paterson, but to which they had hitherto turned a deaf ear. His plan was to apply the joint stock principle to the business of banking and, out of the capital raised for that purpose, to grant a loan to the Government. The proposal, on discussion, speedily took definite shape and passed in due course from the City to the Houses of Parliament, where it was settled and sanctioned.

It was proposed to raise £1,200,000 by public subscription and to *lend the whole* of it to the Government at 8 per cent. interest, the lenders to be incorporated by Royal Charter¹ and to have power to issue notes on Government security to the extent of the sum lent. The idea of putting all their eggs into one basket was probably not quite relished by intending subscribers, but the capital was nevertheless soon raised. In those days good investments were, after all, a rarity; and the new undertaking, backed up as it was by the guarantee of a government that seemed honestly bent on paying its way and supported by the best known merchants of the City of London, appealed with success to the sentiments and to the pockets of the capitalists and, by its happy combination of patriotism with interest at 8 per cent., gratified at once their love of country, their love of gain and their hatred of tyranny and Popery.

¹ The Charter granted limited liability, which was at that time a highly valued and rarely conferred privilege.

It is worthy of notice that this loan to the public of £1,200,000, besides being the foundation stone of the Bank of England, is also the starting point in the history of the Funded Debt of this country.

In its inception the Bank of England was something more than a business enterprise. Not only was it a finance company ; it was also a political organisation. The Governor and Directors were all Whigs and so were most of the subscribers, the Tories as a body having abstained from any support of the new-fangled scheme, which they viewed with suspicion and dislike.

“ During several generations ” says Macaulay, “ the Bank of England was emphatically a Whig “ body. It was Whig, not accidentally, but “ necessarily. It must have instantly stopped “ payment if it had ceased to receive the interest “ on the sum which it had advanced to the “ government ; and of that interest James would “ not have paid one farthing. . . . So closely “ was their interest bound up with the interest of “ the government that the greater the public “ danger the “ more ready were they to come to “ the rescue. In old times when the Treasury “ was empty, when the taxes came in slowly, and “ when the pay of the soldiers and sailors was in “ arrear, it had been necessary for the Chancellor “ of the Exchequer to go, hat in hand, up and “ down Cheapside and Cornhill, attended by the “ Lord Mayor and by the Aldermen, and to make “ up a sum by borrowing a hundred pounds from “ this hosier, and two hundred pounds from that

“ironmonger. Those times were over. The
“government, instead of laboriously scooping up
“supplies from numerous petty sources, could now
“draw whatever it required from an immense
“reservoir, which all those petty sources kept
“constantly replenished. It is hardly too much
“to say that, during many years, the weight of
“the Bank, which was constantly in the scale of
“the Whigs, almost counter-balanced the weight
“of the Church, which was as constantly in the
“scale of the Tories.”

The note issue of the new bank was favoured by circumstances. The coinage being both deficient and hopelessly bad, there was a real want of circulating media ; and, as no reasonable doubt could be entertained of the solvency of an institution possessing so wealthy a body of shareholders, its notes were from the very outset readily taken, and the new enterprise soon became an assured success.

CHAPTER II

THE BANK OF ENGLAND

LEGISLATION AND STATUS

THE first landmark in the history of the Bank is the Act of 1708, which made it unlawful for any association of more than six partners to carry on banking business in England and Wales and practically invested the Bank with a monopoly of joint stock banking.¹ The injurious effects of this measure, which for over a century confined banking in England to the narrow limits of private enterprise, were submitted to by the country until 1826, when it was repealed, the Bank being compensated by the reduced privilege of being the only joint stock bank of *issue* within sixty-five miles of St. Paul's. To our modern ideas this prerogative appears of little value ; but in those days, when deposits were few and notes many, the exclusive monopoly of the metropolitan circulation conferred unquestioned predominance over all other banks.

The next notable intervention of Parliament was in 1844, when the drastic measure known as the "Bank Act" was made law. This Act regulated

¹ As the Bank frequently obliged the government by lending to it when no one else would have lent, the government in return favoured the Bank by freeing it from the danger of threatened competition.

the power of issue of all banks in England and Wales, including the Bank of England. Its object was to effect the ultimate extinction of the "Country" note, to supplant it by the Bank of England note and to make the latter "as good as gold." Its provisions as regards the Bank of England are referred to more fully hereafter.

Although the next piece of legislation intimately to affect the Bank was the Gold Standard Act, 1925, there were other enactments with which the Bank was concerned, and which, in fact, led naturally to the Currency and Bank Notes Act, 1928. These statutes resulted from the War of 1914-1918, and consist of the Currency and Bank Notes Act, 1914, the Currency and Bank Notes (Amendment) Act, 1914, the Finance Act, 1915, as regards Part IV, section 27. But they are not particularly relevant in the present connection. It is common knowledge, and will be treated later at length, that the War, by reason of its vast production for destructive purposes, and by its rude interruption of international financial relations, brought this country to a condition unprecedented in its experience and unthought of in its most extravagant economic dreams. In particular, the existing volume of currency was found quite inadequate to cope with the overwhelming increase in the volume of production and, for reasons which will be examined hereafter, the gold supply and reserve were found insufficient to meet the requirements of the gold standard. These two factors

led, firstly, to the creation of a subsidiary currency (soon to become, in a sense, the primary one), and secondly, to the divorce of the bulk of the currency from gold.

From the standpoint of the Bank of England the Currency and Bank Notes Act, 1914, effected two things: firstly, the convertibility of the Treasury note in gold at the Bank and, secondly, the payment of postal orders by the Bank in gold or other legal tender coin. The Gold Standard Act, 1925, had a more practical effect. Its provisions may be summarised as follows:

- (a) the inconvertibility of the Bank of England note, but its maintenance as legal tender;
- (b) the inconvertibility of the currency note;
- (c) the prohibition of the free minting of gold bullion;
- (d) the requirement that the Bank should sell gold in 400 oz. bars only and at £3 17s. 10½d. per oz. troy of standard fineness.

The latest act is the Currency and Bank Notes Act, 1928, which may be regarded as the second piece of revolutionary legislation concerning the Bank, the first being the Bank Charter Act, 1844. It need not be emphasised that the system whereby two issues of notes circulated concurrently could be a temporary measure only and that, at a suitable time, arrangements would have to be made for combining them—assuming that the new issue could not be disposed of in any other way. This combination was envisaged almost from the inauguration of the Treasury note issue;

it was confirmed by the Cunliffe Committee in 1918 and became effective ten years later. This Act of 1928 provided, *inter alia*, for the issue by the Bank of notes for one pound and ten shillings for the transfer to the Bank of the currency note issue; for the limitation of the fiduciary issue and its cover; and for the concentration and continued concentration at the Bank of the gold holdings of the country.

From the day of its foundation down to the present time the Bank of England has discharged a double function. It is the bank of the state, as well as one of the banks for the public. It transacts the entire banking business of the government receiving its revenue from the collectors all over the country, paying all outgoings, managing the public debt, issuing Treasury Bills and advancing money on "Ways and Means" when expenditure temporarily overtakes income.

But, although the Bank is thus in intimate connection with the government, it is far from being a state bank,¹ in the sense in which the term applies to such as the State Bank of the U.S.S.R., and yet, at the same time, it is something more than a private banking corporation, like any of the "Big Five." Perhaps its position is best described as being midway between the two, partaking of the prestige of the one and of the liberty of action of the other. Yet it is definitely a private, not a government, institution.

¹ Except in so far as the management and regulation of the issue of notes and the guarding of the reserve are concerned, in which matters the Bank may be regarded as acting on behalf of the State.

It also stands in an exceptional relationship to other banks. Its unquestionable stability, "equal to that of the British Government," as Adam Smith said, has led them to entrust their reserves of cash to its guardianship, and the strange anomaly is exhibited of a bank making unrestricted use, free of interest, of millions of money belonging to its competitors in the same line of business.

Circumstances have likewise made the Bank of England the sole repository of our stock of bullion. It always held the bulk of the gold of the country, but early in the War the individual reserves of the banks were concentrated and the Bank has now power to require that all gold over a certain amount, not held for trade or export purposes, be sold to it. Until the Gold Standard Act, 1925, anyone had the right to take gold bullion to the Mint and to ask for sovereigns in exchange at the rate of 77s. 10½d. per ounce standard; since that Act, however, the free mintage of gold has been stopped and gold can be demanded from the Bank in bars of approximately 400 oz. troy only. By the Act of 1844 the Bank is compelled to buy all that may be offered to it at the rate of 77s. 9d. per standard ounce.

The Bank of England is thus the focus of the monetary system of the country and, as the repository of the Government balance, of the bullion reserve, and of the ultimate banking reserve, is invested with a certain stateliness and dignity of standing, which place it *hors de concours* and which restrain it from working, as other banks do, solely with a view to dividend earning.

CHAPTER III

THE BANK OF ENGLAND

MONEY MARKET

THE history of the relationship between the Bank of England and the London money market from the date, 1694, of the Bank's inception to the present time, is divided by its two main governing statutes, the Bank Charter Act of 1844 and the Currency and Bank Notes Act of 1928. These Acts, for a while at least, both decided the future status of the Bank, at times when experience had taught that the existing status left something to be desired from the point of view of the Bank's position as the central institution of this country. The object of the second of these statutes, unlike that of the first, was to meet a situation which had not arisen from the operation, policy or status of the Bank itself and, in all probability, such object might not have been achieved—or even much thought of—if it had not been for factors which were beyond the control of the Bank. It is true that a certain amount of criticism had been levelled against the constitution of the Bank and against its policy, but such criticism must have

taken considerably longer to materialise, if ever it were to do so, had it not been that circumstance had created a situation which broke all bounds and which, in its vast sphere of influence, called for drastic remedy sooner or later.

It might be truer to say that the history of the Bank's relations with the money market since 1844 has been cut into three periods, from 1844 to 1914 (the commencing year of the War); from 1914 to 1928, when legislation was resorted to to meet the position which had resulted from the War; and from 1928 to the present time. The Bank of England's position underwent a profound change, *vis-à-vis* the money market during the War, and again as a result of the Currency and Bank Notes Act, 1928; and it was largely the terms of this Act which set the spark to the somewhat languid criticism (of the Bank) which had existed for some time, but with insufficient strength to cope with a public opinion prepared to allow things to continue provided nothing unpleasant happened to shake its belief in the efficacy of the provisions of the Bank Charter Act, 1844. It must be remembered, however, that the general public knew practically nothing of the economics of the money market and the foreign exchanges, and it was not until the startling events of the War brought home to a much wider circle of interested people the possibilities in central banking, that the faint dissentients from the existing policy were spurred into action. As with science, the knowledge of banking and

currency matters was enlarged beyond expression, for the War "period" was replete with example and practice.

For almost a century and a half from the date of its birth the Bank of England was the undisputed monarch of the money market, but the establishment of joint stock banks in London, beginning with the London and Westminster Bank in 1834, brought powerful rivals into the field, who, by offering to pay interest on deposits—a practice which the Bank resolutely set its face against, and which, except, it seems, for foreign accounts, it yet refuses to countenance—attracted to themselves immense sums many times in excess of their capital and were thus enabled to contest its supremacy on nearly equal terms. From that time until to-day the relationship between the Bank and its joint stock rivals has gradually changed, as has also the relationship of the Bank to the government. There has been a change not only in the Bank's measure of control over the money market, but in the nature of its relation to the other factors of the market, and further in its own political and international importance. The growth of productivity in this country and the great increase in prosperity up to the early years of the twentieth century gave increased power to the whole of the constituent members of the banking industry and, perhaps, to the Bank in particular; but although there has been what economists would term an "absolute" increase, this has not been shared

equally between the Bank and its lesser *confrères*, which have progressed more rapidly. At the same time, owing to the predominance of deposits over notes, and to the freedom of the relationship between the joint stock banks and the Bank, the latter has, in a sense, lost its former very definite hold over the money market (although not its practical capacity for enforcing it) and yet has consolidated its position as the central bank of the country.

In this connection it is useful to turn to the thoughts of an observer in the last decade of the nineteenth century. In the second edition of this book (1892), the following extract from *Lombard Street*, by Walter Bagehot, was given as the reason for the Bank's "powerful hold over the market":

"At all ordinary moments there is not money enough in Lombard-street to discount all the bills in Lombard-street without taking some money from the Bank of England. As soon as the Bank rate is fixed, a great many persons who have bills to discount try how much cheaper than the Bank they can get these bills discounted. But they seldom can get them discounted very much cheaper, for, if they did, everyone would leave the Bank, and the outer market would have more bills than it could bear."

The position therein indicated had altered, however, even before the War, and it is still less true at the present time.

The Bank of England's influence in the London money market is exerted through what is known

as the "short loan fund," and is applied by means of the "Bank Rate"—although similar effect can be obtained in another manner, as will later be shown. The functions of a central bank depend upon the standard upon which the currency of the country is based. If the standard is gold, then it is the duty of the central bank to conserve the reserve of gold; the same is true of the gold bullion standard, which is now in force in this country. The gold standard means the free and unlimited minting of gold, and its free export; the gold bullion standard differs in that minting is not free (although it may be) and gold is not in circulation as money. In other words, the legal duty placed on the Bank of England is to redeem notes in gold bullion only. The gold standard was suspended in 1916, and was reinstituted in part in 1925 by the Gold Standard Act of that year. It is claimed for London that, apart from New York, it has the only absolutely free gold market in the world; that gold can be obtained in any circumstances, circumstances in which obstacles would, on the Continent, be placed in the way of withdrawal for export. This reputation was lost for a time, during the War and, in fact, up to 1925, but the *status quo ante* has now been restored and foreigners can again be certain of obtaining payment of their debts in gold, if they require it. But, as has been said, gold is not in circulation.

The currency laws of this country do not require that every note issued be covered by gold; they allow of a fiduciary issue, the cover for which

consists of government debt, securities and silver. This issue is treated fully in the next chapter. Suffice it to say that, beyond a certain figure, every note issued must be covered by an equivalent amount of gold, and it follows from this that the note circulation of the country—notes in actual circulation and held by the banks and the Banking Department of the Bank of England—depends upon the gold held in the Issue Department of the Bank. This, again, is dependent on the influx and efflux of the metal to and from the country.

It is now necessary to indicate the relationship between the note circulation and the short loan fund. In the first place, although anyone in credit with his banker is entitled to notes (and, ultimately, though not practically, to gold—the note being convertible, but gold being unobtainable owing to the conservation of gold in the hands of one authority, the Bank, whose power of sale is restricted), the turnover of cheques is far greater than that of notes, and balances withdrawable by cheque are also ultimately withdrawable in gold. Apart, however, from the fact that gold can only be obtained in bars of not less than 400 oz., gold is not specially required except for the settlement of international indebtedness; this, moreover, was the case before this law was enacted, legislation merely confirming the existing condition of affairs. The sum total of the balances held with the banks in the country represents the immediate purchasing power of the community, but it is only a proportion of this

amount which is "called" at the same moment of time. For this reason the banks do not find it necessary to keep the whole of this sum liquid and, in fact, they invest the greater part in securities, bills, advances to customers, etc. They do, nevertheless, keep a certain part in cash, known as their cash reserve. This consists of notes, silver and copper held on their tills and in reserve, with which to meet the immediate needs of their customers—requirements in ready cash, for small transactions, and in the shape of short loans. The cash reserve represents roughly 10% of the banks' liabilities to customers on current and deposit account. Short loans account for a further 8% and are loans made subject to repayment the following morning or after twenty-four hours, or at the end of any period up to fourteen days, but usually seven.

A distinction between the banks' loans to customers, which appear in the balance sheet under the heading of advances, and loans to the money market is to be found in the rate charged. It may be said to be the almost invariable rule that advances to customers are charged at $\frac{1}{2}$ % or 1% over the Bank Rate, whereas loans to the market pay 1% under Bank Rate for weekly and day-to-day money, and what they will fetch for longer fixtures and overnight money. The former are ordinarily renewable; the latter are not, and form, in a sense, a more liquid asset than the former. The security also is frequently more easily realisable.

Apart from these two, the cash reserve and the short loans, the banks maintain accounts with the Bank of England, and the "short loan" fund of the country may be said to be constituted by the total of balances with the Bank of England together with the volume of money actually loaned for the short periods indicated.

Yet these two are not independent of one another ; in fact, the actual volume of loans may depend upon the volume of balances held by the banks with the Bank of England. The tradition and practice of the banks in this country of maintaining a cash ratio precludes their lending beyond a certain proportion of their liabilities, and, to an extent, therefore, the total volume of balances with the bank is an indication of whether money is plentiful or scarce, "easy" or "tight." It will be seen, consequently, that the extent to which banks can lend is dependent on the ratios which they maintain between the various methods of investment of the funds placed at their disposal by their customers, their depositors ; that, so long as they maintain their ratio, their volume of advances can increase only with an increase in their deposits. As (excluding an increase due to inflation) a permanent increase from this source can only be gradual, arising from greater productivity, the fluctuation in the short loan fund in this respect is, within short periods at least, negligible.¹

This brings us to the third, the only remaining factor—the balances with the Bank of England.

¹ No account is here taken of the relatively modern factor, the placing and withdrawal of French short-term balances.

Even these can be increased only by an increase in deposits of the individual banks as by their allowing bills to run off and by their not permitting their loans to be renewed ; and it has been said that they maintain fairly constant ratios between the several types of "investment." The increase in deposits to which we particularly refer is, however, of a special nature, deposits resulting from the purchase by the Bank of gold. We may be permitted to reiterate that, normally, the Bank is empowered to increase the note circulation so long only as such increase is covered by gold. When, therefore, the Bank is able to acquire gold, it may pay for it either directly in notes or, which comes to the same thing, by a draft on itself. This draft is collected by the particular bank into which it is paid and thus goes to swell the volume of deposits held by the banks with the Bank of England ; the notes are presumably paid into a clearing bank, finding ultimate expression in balances with the Bank. So may the short loan fund be augmented, and so may money be made plentiful where it was scarce.

It is here necessary to digress somewhat in order to discuss the movements of gold to and from the Bank. There are, broadly, two sources from which the metal may be obtained, and one destination for which it may be lost. In the first place, the gold may be obtained in the London market, to which it has been sent by the producers ; secondly, it may be sent to this country from abroad, either in settlement of international mercantile indebtedness, or as the result of some

international financial operation. It may be withdrawn from the Bank for export as the result of either of the two considerations just given. Whether it will come to the Bank or be diverted, or whether it will be withdrawn, depends largely on the Bank Rate.

BANK RATE

“Bank Rate,” or the “Bank of England Minimum Rate of Discount,” is theoretically the lowest rate at which the Bank will discount approved bills of exchange, or make advances on mercantile securities for short periods, and up to 1878 it was the actual minimum; but the Bank then adopted the practice, which has since been adhered to, of discounting for regular customers (those who keep their regular banking account there) at market rates, in order to place them on as favourable a footing as the customers of other banks.

This indicates the fact that market rates are lower than the Bank Rate, and it follows from this that people (other than the Bank's customers) will not take bills to the Bank for discount, or borrow from the Bank, if they can get the accommodation from one of the other banks. Again it follows that they will not resort to the Bank except under pressure—in other words, unless the Bank Rate is made effective. It need hardly be emphasised that the banks use every endeavour to avoid leaving money idle and, therefore, if funds are plentiful, they will lend at lower rates

than usual rather than earn nothing at all ; so that unless they choose to answer the call of the Bank of England, or unless funds are naturally low, the raising of the Bank Rate will have no effect and can only be made effective by making money more valuable. This means decreasing the supply and the Bank achieves this by becoming a large borrower itself—by selling securities or bills. The short loan fund is thus depleted, because the purchasers of securities or bills pay for them by draft on the joint stock banks, which naturally reduces their balances with the Bank. The supply is shortened in relation to the demand and money rates rise ; if the increase in the Bank Rate is effective, they rise to a prohibitive extent or the banks refuse to lend at all and borrowers are compelled to go to the Bank—are forced into the Bank.

To appreciate the reasons for a rise or fall in the Bank Rate it is necessary to treat of the duties and functions of a central bank. Firstly, however, the relationship between Bank Rate and market rate must be shown.

BANK RATE *IN RE* MARKET RATE

The market rate of discount is, in so far as it can be precisely described, the rate at which three months' bank bills can be discounted. As there are two sources of demand for such bills, the price is governed by the operation of the two types of buyer—the joint stock banks of the country and the Continent. These two may be said to

be largely independent of one another, the English and Scottish banks carrying a large portfolio (varying naturally from time to time, but always large), whereas a Continental demand springs up only as a result of better rates being obtainable in this country than abroad. Setting aside the Continental demand, the price the English banks are prepared to pay for bills is dependent upon the price they have to pay for deposits related to the price they obtain for advances to customers. But the chief factor is the supply of bills in relation to the demand. The demand may depend on a number of factors, governed by the banks' position, but genuine trade bills cannot be manufactured, and the supply is, therefore, uncontrollable (except that, by an adjustment of the Bank Rate, it may be made cheaper to finance trade by bills rather than by overdraft).

The relationship between the Bank Rate and the market rate may be said to be fairly constant. Such variation as there is in the ratio arises from the effectiveness or lack of effectiveness of the Bank Rate. When the latter is more than usually wide of the market rate, it is said to be out of touch, this position arising when money is so plentiful as to force money rates down away from the Bank Rate; or the supply of bills so short that the discount rate cannot be maintained at its customary disparity from the Bank Rate.

On the other hand, the Bank Rate and the market rate may move close together—at such times, for example, when money is tight and bills

are plentiful, this situation giving rise to apathetic competition for the larger quantity of bills and sending the price down.

The relationship may be further illustrated by showing the interconnection between the two rates. The joint stock banks of the country vary the rate they allow on deposits according to the Bank Rate, and when the deposit rate is thus increased, loan rates are increased in proportion. This means dearer money for the bill brokers, who endeavour to reimburse themselves by charging higher rates for their bills. And so the market rate is increased. But it is clear that, at all times, the position is governed by the supply of and demand for money and bills respectively; that it is dependent upon the balance of these four forces.

At the time of writing the banks' deposit rate is 2% below the Bank of England rate and, unless an extraordinary influence arises to affect the position, will continue to be. Perhaps the exception should be noted of a probable reduction in the margin to $1\frac{1}{2}\%$,¹ in the event of the Bank Rate falling further, or of a widening to something more than 2% if the Bank Rate were to rise to a very high figure. But the fact is evident that, so long as the banks are prepared to govern (as on present lines) their deposit rate by reference to the Bank Rate, then the latter will control the former. This is a truism, but it does not carry us far enough. The deposit rate does not absolutely govern the market rate of discount; it is,

¹ As recently took place (May, 1931).

as has been shown, only a factor, and not the most important factor.

REASONS FOR CHANGES IN BANK RATE

The reasons for alterations in the Bank Rate lie in the functions of a central bank.¹ These are mainly two :

- (a) The conservation and control of the gold reserve, the ultimate reserve of the banking industry ;
- (b) the control of the note issue.

These two have been shown to be interconnected, but from the point of view of changes in the Bank Rate, the reserve is the determining factor. Inasmuch as the note issue is dependent upon gold, the credit basis of the country is so dependent ; an increase in the gold holding expanding the basis, a reduction restricting it ; so that international gold movements may have a marked effect on the short loan fund. With this the Bank is not directly concerned, but rather with the maintenance of an adequate ratio between its reserve and its liabilities. The conception of an *adequate* reserve has altered considerably in past decades, as will be shown in the chapter on the " Banking Department." This is not a question to be discussed at the present juncture ; it is sufficient to state that if the Bank deems it desirable to protect its reserve, the rate

¹ It should be stated, however, that a central bank may, if its constitution permit, undertake commercial banking—undesirable though this may be thought to be. It will be recalled that the Bank of England recently (1930) went further in its policy of conducting central banking business only by disposing of its Western (London) Branch to the Royal Bank of Scotland.

is raised, and when the need is passed, it is lowered. It is a feature of the movements in the rate that increases are usually made in stages of 1% and decreases in stages of $\frac{1}{2}$ %.

The Bank Rate is also used, although relatively rarely, for the purpose of off-setting an unduly speculative boom or of lending incentive, by making money cheaper, to a movement in the direction of better trade. In this sense, the reserve may be said to take second place, but, at the same time, it is safe to assert that unless the Reserve position is satisfactory, the central bank would not take upon itself, in the second case, the responsibility of risking a further depletion in the Reserve.

The proportion which the Reserve should at any time bear to deposit liabilities—the point, that is to say, at which it is considered that safety ends and danger begins—is determined not by any hard-and-fast rule, but by the circumstances of the moment and by contingencies within the knowledge of the directors, who are at all times in possession of a mass of information that rarely reaches the public.

Years of high average Reserve are years of low average Bank Rate, and years of high average Bank Rate are years of low average Reserve.

MOVEMENTS IN THE BANK RATE

If one were to study the movements in the annual average discount rate of the Bank of England from 1844 to 1929, one of the first points of outstanding significance that would be noted

would be that the crises of 1847, 1957 and 1866 are clearly indicated, whereas that of 1914—the fourth occasion since 1844 on which the suspension of the Bank Charter Act has been imminent (though, unlike the other three, it did not in fact, though perhaps in effect, take place)¹—shows no great divergence from the general trend. The highest average after 1866 was that of 1920.

Secondly, the narrow limits within which the average has moved since 1866 compare strikingly with the violent fluctuations which are indicated prior to that date. It would be seen that the average rate has fallen below 2% in three years only, in 1897, 1898 and 1899. The higher limit is less consistent than the lower. If we took 4% as the basis, we should find that for the years 1845–1866, this figure has been exceeded eleven times; from 1867 to 1914, it was exceeded in seven years only; from 1914 to the end of the period under discussion, the average was below 4% on three occasions only and the highest average was about 6·7%.

From 1845 to 1866 was the period of crisis, as has already been indicated. The peaks are explained by the following events or situations.

The crisis of 1847 was the result of a number of factors. It may be said to have begun with the failure of crops in the two years preceding, particularly the potato crop in Ireland. This necessitated the importation of a considerable volume of cereals, which was paid for by the

¹ Kirkaldy says that a few notes were issued in excess of the legal limit.

export of specie. In spite of such export, no steps were taken by the Bank to counteract the effect or to stop the outflow, with the result that the reserve fell to a dangerously low level. The trouble was aggravated by commercial and financial failures and the reserve was further depleted, until the Act was suspended—though, in fact, no additional issue of notes actually became necessary.

In 1854, 1855 and 1856 the Crimean War had disastrous effects in that it created a feeling of unsettledness in the business community. It was on such a foundation that fell the news of a crisis in America and, weakened by the failure of certain banks in Scotland, the position finally resulted in the suspension of 1857. On this occasion, notes were actually issued beyond the statutory limit.

In 1862, legislation provided for the formation of companies with limited liability. Like most new propositions with a very rosy prospect, the principle was abused and a great many companies were formed, 90% of which were to fail during the next three years. In 1866, the failure of Overend Gurney, a large City banking house, brought widespread confusion to the financial interests of the City and caused the third suspension of the Bank Act.

During the second period mentioned above, there are six peaks, of relatively minor dimensions, *viz.* in 1873, 1878, 1882, 1890, 1907 and 1913. The payment by France of the war indemnity

demanding by Germany caused an efflux of gold from this country in 1873. In 1878, the City of Glasgow Bank and the West of England Bank failed. In 1882, conditions were affected by the Boer War, the war in Egypt and a banking crisis in Paris. These were, however, successfully weathered and the next serious crisis did not occur until 1890, when the house of Baring Brothers found itself in difficulties. The Bank Act was not suspended, for the situation was saved by prompt action on the part of the Bank, which came to the assistance of Barings, who, in fact, were solvent. In 1900 came the South African War and in 1907 the banking crisis in America. In 1913, the Balkan War gave rise to further financial unsettledness.

The third period under review, that from 1914 to 1929, has three peaks of high average Bank Rate, those of 1916, 1920 and 1926. The first of these is accounted for by the rapid inflation which ensued as a result of the War. In 1916 England had abandoned the gold standard; our balance of trade was decidedly adverse; invisible exports fell off considerably.

The peak of 1920 was largely the result of an endeavour to stop the intense speculation, in goods of all kinds, which followed the termination of the War. That of 1926 was caused principally by the very large efflux of gold in 1925, when the Bank of England lost nearly £12 millions.

The periodicity of panics (1847, 1857 and 1866, as well as 1837 and 1825) formerly gave rise to

a notion that, owing to the action of some undiscovered economic law, five fat years in the money market were to be followed by five lean years, and that panics moved in decennial cycles ; but it is now recognised that their periodicity was a mere coincidence, and that they were due to a want of promptitude in taking steps to defend a dwindling reserve. The ratio, for instance, which the reserve bore to liabilities in 1844-6 was 50 $\frac{2}{3}$ %, and in 1847 fell to 33% ; in 1852-6 was 47%, and in 1857 fell to 30% ; and in 1861-5 was 40%, against 30% for 1866. Since 1866 the mean proportion was not until 1915 again suffered to fall so low, and has averaged about 43%. The War and post-War figure of the Reserve are indicated on p. 97 and discussed toward the end of the chapter on the " Reserve."

RETURN

By the Act of 1844 the Bank was required to transmit to the Commissioners of Stamps and Taxes for publication in the *London Gazette* " an account of the amount of Bank of England Notes issued by the issue department of the Bank of England, and of gold coin and of gold and silver bullion respectively, and of securities in the said issue department, and also an account of the capital stock, and the deposits, and of the money and securities belonging to the said governor and company in the banking department of the Bank of England."

This account, known as the "Bank Return," is laid before the directors at their weekly meeting on Thursday morning, and is afterwards made public. Its details are always interesting to men of business, and in critical times its appearance is awaited with anxious impatience, as the information it contains will either allay or aggravate apprehension of danger or difficulty. The Return also does duty as a balance sheet, which the Bank never publishes. The following is the one for the week ended December 31st, 1890 :

BANK OF ENGLAND.

AN ACCOUNT pursuant to the Act 7th and 8th Victoria, cap. 32, for the Week ended on Wednesday, December 31st, 1890.

ISSUE DEPARTMENT.

Notes issued.....	£39,193,345	Government debt	£11,015,100
		Other securities	5,434,900
		Gold coin and bullion...	22,743,345
	<u>£39,193,345</u>		<u>£39,193,345</u>

BANKING DEPARTMENT.

Proprietors' capital....	14,553,000	Government securities ..	£9,806,433
Rest	3,241,083	Other securities	33,178,856
Public deposits ¹	6,824,359	Notes	14,079,175
Other deposits	32,990,230	Gold and silver coin	722,489
Seven-day and other bills	178,281		
	<u>£57,786,953</u>		<u>£57,786,953</u>

¹ Including Exchequer, Savings Banks, Commissioners of National Debt, and dividend accounts.

Dated January 1st, 1891.

F. MAY, CHIEF CASHIER.

In accordance with the above-quoted clause of the Bank Act, the items are arranged under the two heads of Issue Department and Banking

Department, the former giving particulars of the circulation and the latter of the general liabilities and assets.

It has been indicated that the Currency and Bank Notes Act of 1928 was a landmark in the history of the Bank of England. This was the statute under which the Bank assumed responsibility for that issue of notes which was formerly the responsibility of the Treasury ; owing to this Act the appearance of the Bank Return was entirely changed. It was laid down that " The form prescribed by Schedule A to the Bank Charter Act, 1844, for the account to be issued weekly by the Bank under section six of that Act may be modified to such an extent as the Treasury, with the concurrence of the Bank, consider necessary, having regard to the provisions of this Act." The following is the first return to be published after the Act came into force, that of November, 28th, 1928 :

BANK OF ENGLAND.

AN ACCOUNT for the week ended on Wednesday, November 28th, 1928.

ISSUE DEPARTMENT.

Notes issued :

In Circulation£367,001,148
In Banking Department 52,087,797

£419,088,945

Government Debt.... £11,015,100
Other Govt. Securities .233,568,550
Other Securities..... 10,176,193
Silver Coin.....5,240,157

Amount of Fiduciary

Issue 260,000,000
Gold Coin and Bullion .159,088,945

£419,088,945

Dated the 29th day of November, 1928.

C. P. MAHON, *Chief Cashier.*

BANKING DEPARTMENT.

Proprietors' Capital . . . £14,553,000	Government Securities £52,180,327
Rest 3,254,001	Other Securities :
Public Deposits (includ-	Discounts and
ing Exchequer,	Advances £13,586,293
Savings Banks, Com-	Securities 20,214,855 33,801,148
missioners of National	Notes 52,087,797
Debt and Dividend	Gold and Silver Coin 757,041
Accounts) 21,452,051	
Other Deposits :	
Bankers £62,379,409	
Other	
Accounts 37,185,203	
7-Day and Other Bills 2,649	
<u>£138,826,313</u>	<u>£138,826,313</u>

Dated the 29th day of November, 1928.

C. P. MAHON, *Chief Cashier.*

Government Debt and Other Securities are shown as before ; Other Government Securities are new, while Silver Coin takes the place of the old Silver Bullion which appeared in the early returns. These items totalled are described as the Amount of Fiduciary Issue. To this total is added Gold Coin and Bullion, the final total balancing that of Notes Issued, which, differently from heretofore, is now divided into In Circulation and In Banking Department. The statement concerning the Banking Department has not been changed, but some of the items have been amplified ; Other Deposits being broken up into Bankers and Other Accounts, Other Securities divided into Discounts and Advances, and Securities. The figures speak for themselves, but will be dealt with later.

This book is not concerned with the moral aspect of " War " finance ; suffice it to say that from 1914, the Treasury issued notes independently

—though through the medium—of the Bank of England, notes for which the Bank was not responsible. This issue, which began in 1914 and at the end of the year had not reached serious proportions, speaking relatively, had risen in 1920 to the colossal figure of nearly £370 millions gross. It was necessitated by the enormous increase in production due to the War. The output of every kind of material necessary to the prosecution of a war assumed incredible proportions and the existing currency was unable to carry the huge volume of goods and services. Unfortunately, such goods were manufactured largely to be destroyed—in other words, notes were put into circulation to meet a production which was to be wasted in short period, the consequence being the inflation of the currency. The cover for such currency was not, and could not be, gold. At first, a moderate amount of gold was held as cover, but in 1924 this was transferred to the Bank of England. Apart from a negligible amount of silver and a more appreciable amount of Bank of England notes, the reserve consisted of Government Securities. The fiduciary issue in December, 1914, was practically £20 millions ; in 1920, it had risen to almost £320 millions and at the time the issue was taken over by the Bank, it was £230 millions.

CHAPTER IV

THE BANK OF ENGLAND

ISSUE DEPARTMENT

WHEN the British public speculates and loses, it is very apt to lay the blame not so much on its own want of prudence as on the shortcomings of others. Usually the government is made the scapegoat ; but sometimes public opinion is very severe upon company promoters and financiers, at other times upon the banking system, and so on.

Such was the case prior to 1844. In the crash that followed on a speculation in corn or stocks some of the provincial bankers were generally to be found among the victims ; and the unfortunate holders of their notes, seeing themselves in possession of mere worthless pieces of paper, raised the specious cry of "Overissue," and demanded government interference. The grievance was taken up by the country. The banks, it was maintained, had been at the bottom of all the mischief ; for, by putting into circulation more paper than was required for the transaction of business, they had produced a redundant

currency, leading to high prices, speculation, and crisis. On the other side it was contended, however, that the theory of "overissue" was a mistake, and that there could be no excessive issue of paper money so long as it was convertible at will into coin; or, in other words, that it was impossible to make a man carry a ten-pound note about with him in his pocket if he only wanted £5 in paper. Only make sure, they said, that every note issued shall be paid on presentation, and the circulation may safely be left to take care of itself.

This was the commonsense view of the matter; but, nevertheless, it was upon the assumption, then entertained by business men of great experience, that excessive issues of bank notes were the main cause of the continually recurring panics, that the provisions of the Bank Act of 1844 were made law.

Up to that time every banker had the right to issue notes to any extent, the sole condition imposed by law being that he should pay them in cash on demand, or, in default, become bankrupt. But whether or not he maintained a sufficient reserve of cash to ensure convertibility was left entirely to his own judgment and sense of rectitude, the consequence being that in many instances bankers grossly abused their privilege, and, when opportunity offered, increased their issues to an unjustifiable extent.

It was accordingly determined by Sir Robert Peel to assert the broad principle that the right

of regulating the issue of currency rests with the state (on the ground that, as bank notes formed part of the national currency, and were practically irrefusable, it was proper to treat them as being not private, but public, instruments), and to overhaul the entire system of note issue, or, as the Act says, "to regulate the issue of bills or notes payable on demand." Adopting a suggestion of Lord Overstone, who was then the greatest living authority on banking, he began by ordering the Bank of England to keep its business as a bank of issue wholly distinct for the future from the general banking business, and to operate in a separate department which he entitled "The Issue Department of the Bank of England." There was to be no mixing of accounts, but, in the weekly statement rendered to the government, the liabilities and assets of the two departments were to be shown apart.

As a liability, the new department was to take over all the Bank of England notes then in circulation, and, as assets, securities to the amount of fourteen millions and precious metals for the balance. It will be appreciated that for 150 years the Bank had been at liberty to issue as many notes as it pleased against what cash it pleased, and the practical effect of the Act was to limit the profit-earning part of the issue.

The issues of other banks (of England and Wales) were treated with a view to eventual extinction. No new bank of issue was thenceforth to be established, and those then existing were forbidden,

under heavy penalties, to exceed a certain maximum, corresponding to the average amount which they were respectively able to keep in circulation in the early part of 1844. The total amount so authorised was £8,631,647, divided amongst 280 banks. It was doubtless thought that these issues would have been absorbed more quickly than has been the case; and in this respect the Act may almost be said to have failed. A bank that suspended its issue could not afterwards resume it, and the privilege was also to be forfeited by any that became bankrupt. It had already been enacted, too, that if a country joint stock bank opened an office in London it should lose its right of issue.

The elaborate care taken by Parliament to protect the interest of the note-holder, and the enormous importance attached to the convertibility of the note, as distinguished from a banker's other liabilities, mark a stage in the development of banking which has been left far behind. To understand how differently the note was then regarded, it must be borne in mind that in those days a banker's note circulation was his principal liability, and that deposits were in comparison but a very small item. In February, 1820, to give an instance, the circulation of the Bank of England amounted to £23,000,000, and the total deposits to £4,000,000; while in February, 1890, the figures were: circulation, £23,000,000; deposits, £35,000,000. In June, 1914, the circulation was in the neighbourhood of £29 millions,

deposits having mounted to £56 million. The figures for the latter part of 1914 and subsequent years cannot truly be compared with those of previous years on account of the serious inflation which took place during and after the War, and of the fact that there had come into existence a new currency, the Treasury Note, which altered the complexion of the "national" account.

From the passing of the Bank Charter Act to the Great War a vast change came over banking. The circulation of notes as a whole has declined and, at the same time, the liability of bankers on current and deposit account has increased by leaps and bounds. Thus, in 1895 the figures for the joint stock and private banks of England and Wales were: notes, £412,600; deposits, £527 millions. In 1914 the figures were £58,990 and £928 millions. In 1928 the deposits amounted to £1982 millions, while notes had ceased to exist. (It must be remembered that there are certain issues in the Isle of Man which appear in the balance sheets of some of the English joint stock banks.)

Now-a-days, therefore, we have come to consider deposits as the all-important element in banking, and the liability on notes as a matter of relative insignificance; but, when the Bank Act was passed, people thought just the reverse, and held the opinion that, while special legislation was necessary to insure the noteholder from loss, the ordinary law of bankruptcy was a sufficient protection for the banker's other creditors.

FIDUCIARY ISSUE

How Sir Robert Peel arrived at the seemingly arbitrary figure of £14,000,000 as a basis of the Bank's issue against securities does not appear ; but, as the average issue during the century had never fallen short of that sum, he probably fixed upon it as a safe minimum which the Bank might count upon keeping in circulation in all ordinary circumstances. The chief item in that amount was the debt owing to the Bank by the public, which, in the course of the 150 years that had elapsed since the date of the first loan, had been increased by sundry additional borrowings to a total of £11,015,100. This did not exist as stock, but was simply a book debt on which the Government paid the Bank interest. The difference consisted of interest-bearing securities. It was further provided in the Act that, in the event of any of the other banks forfeiting its right of issue, the Bank might be allowed on application to increase its own issue against securities to the extent of two-thirds of that which had lapsed. Since that time the issues that have from various causes been suffered to fall through, amounted (at the end of 1891) to upwards of £3,500,000, and the Bank had accordingly increased its authorised circulation against securities by £2,450,000 to £16,450,000.

From 1890 on, the Bank by this means increased its fiduciary issue to £19,750,000 and, apart from the Isle of Man and the Channel Islands, had a monopoly, no other bank in England and Wales having any circulation.

The germ of the Act is contained in the clause that directs the Issue Department to hold the equivalent, in gold coin or in gold or silver bullion, of every note created beyond the authorised issue against securities. Up to £11,015,100 the note issue was guaranteed by the government, corresponding in every way to a state issue, and for a further sum of £8,735,000 the Issue Department itself was responsible and held convertible securities thereagainst; but for every additional (£5) note that the Issue Department put forth beyond these £19,750,000, standard gold to the weight of 616·37 grains had to be deposited in the vaults. This Department was and still is, consequently, purely automatic in its functions. Like a bank of deposit it takes charge of gold for the public, issues a transferable deposit receipt thereagainst, and gives it out again as soon as the receipt is returned and cancelled.

The fiduciary issue to-day is a different matter, in composition, amount and cover, and its amount is not explained by the augmentation due to the lapsing of issues of other banks in England and Wales. In the early years of the War, it was seen that the possible issue of the Bank—under existing law—was entirely inadequate to cope with the volume of currency which had been made necessary by war production. The government might have suspended the Bank Charter Act once more and suspended it indefinitely. But the government was the great creator of the mass of material of all kinds which

was the cause of the need for a vastly increased volume of currency ;. such manufactures were largely to be paid for by the government, as were, moreover, such commodities as were rationed and purchased in bulk by the government. Therefore, the government provided the means of payment, using the Bank as a convenient medium, but assuming the responsibility itself.

Clearly, the control of the issue by the Treasury was intended to be purely a temporary measure ; it was recognised that sooner or later provision would have to be made for the centralisation of all note issues under one control. This materialised in 1928, as a result of the passing of the Currency and Bank Notes Act, 1928, which statute provided *inter alia* for :

- (a) the issue by the Bank of notes for one pound and ten shillings ;
- (b) the amount, present and future, of the fiduciary issue ;
- (c) the cover for such issue ;
- (d) the redemption of currency notes and their replacement by Bank of England notes ;
- (e) the transfer to the Bank of part of the assets of the Currency Note Redemption Account ;
- (f) the payment to the Treasury of the profits of issue and the release of the Bank from liability to stamp duty ;
- (g) the modification of the weekly account ;
- (h) the control and custody (by the Bank) of gold reserves.

The issue of notes for one pound and ten shillings meant the alteration of the effect of the Bank of England Act, 1833, under which notes of the small denominations would not have been legal tender.

The fiduciary issue was fixed at £260,000,000. The Act provides that the issue may be increased by the permission of the Treasury on representation by the Bank that such increase is expedient. Such increase must, however, be limited to a definite figure and to "such period not exceeding six months, as the Treasury think proper." The Treasury minute authorising an increase must be laid before both Houses of Parliament, and any series of renewals of the Treasury authority may be extended for a total of two years only, except as otherwise determined by Parliament.

The Bank may request the Treasury to reduce the issue; whether a reduction takes place is, however, in control of the Treasury, which is empowered to determine the period for which the reduction shall take effect.

The backing for the fiduciary issue is governed by the section which reads: "In addition to the gold coin and bullion for the time being in the issue department, the Bank shall from time to time appropriate to and hold in the issue department securities of an amount in value sufficient to cover the fiduciary note issue for the time being"; but such securities may include silver coin to an amount not exceeding five and one-half millions.

Section II of the Act of 1928 (*vide* p. 236) is an interesting commentary on the post-War gold position. While, up to 1914, there was no movement of importance to record, the position changed in that year. It is probable that the possibility of war gave rise on the Continent to a demand for gold ; at least, the fact is that a considerable amount left England during the early months of 1914. At the same time, the Continent was converting every foreign holding into gold, which action, combined with adverse conditions in New York, brought gold from that City. This situation was not, however, to last long. The outbreak of war made gold shipments difficult, hazardous even, and expensive ; moreover, with the progress of the War, this country and its allies were forced to rely more and more for material of all kinds on the United States. The means of payment were three : gold, American securities and loans from America. The net result of payment and unsettled indebtedness was that America became the gold granary of the World and that Europe was left with unprecedented debts to the United States.

The composition of the cover for the present fiduciary issue is different in two respects only from that of the issue of pre-War days. Firstly, no silver bullion was previously held ; for, though the Act of 1844 gave power to hold it to the amount of one-fourth of the gold, silver could not be legally tendered in payment of a £5 note. As has been shown above, the cover may consist of silver coin

to the extent of £5,500,000 and, in fact, an amount of over £4 millions is held. Also, the cover may comprise Other Securities, by which is meant commercial bills.

On the circulation against securities there used to be a profit of about 3%¹ (which shrank, however, after deduction of the heavy working expenses and of a certain proportion paid to the government for the privilege of issue, to a net gain of from £50,000 to £100,000 per annum), but every note issued against gold meant (and still means) an actual loss, because of the expense of printing the note and of the custody of the gold.

It is usually taken for granted that the assets of the Issue Department are specially hypothecated to the service of the issue, and, to the ordinary reader, the language of the Act sounds clear on the point :

“ The whole amount of Bank of England notes
“ then ” (31st August, 1844) “ in circulation
“ . . . shall be deemed to be issued on the
“ credit of such securities, coin, and bullion
“ so appropriated and set apart to the said
“ issue department.”

Nevertheless, it has been held on good authority that the object of the Act is not to secure the noteholder, but to place limits to the issue,² and that, if the Bank failed, all its creditors would fare alike, the noteholders having no advantage over the depositors. Though interesting in theory,

¹ See footnote on p. 54.

² Such is undoubtedly the effect of the measures passed in 1845, which dealt with the Irish and Scotch banks, and this argument is based on the assumption that the three Bank Acts were one in intent and purpose.

the question is, of course, of no practical importance. A further interesting point in this connection is the statement in a recent book dealing with the London Money Market to the effect "... that in practice the gold reserve is no longer considered as security for the internal note circulation and is available to a greater extent than ever before for the purpose of meeting international requirements."¹

The Bank Act has been suspended on three occasions, namely, in the panic years 1847, 1857 and 1866. The Banking Department, having on these occasions suffered its reserve of cash to sink too low, had to apply for permission to borrow notes from the Issue Department, and the Act was temporarily suspended in order that the latter might increase its issue against securities. In the statutes regulating the note issue of the former Imperial Bank of Germany, which was modelled somewhat on the lines of the Bank of England, this contingency was specially provided for. Like the Bank of England, the Reichsbank issued a fixed amount of notes against securities, but might at any time exceed the limit on payment to the government of a fine of 5% per annum on the excess issue. In all ordinary circumstances this tax acted as an effective check ; but the reserve of power was useful to fall back upon in an emergency.²

¹ Einzig : *The Fight for Financial Supremacy* (1930), p. 44.

² 'Clare,' Second Edition : A modification in that direction of the Act of 1844 could not fail to be beneficial in times of pressure. The mere knowledge, in fact, that the Bank possessed ability to increase the currency in case of need would remove all cause for uneasiness.

The position concerning the fiduciary issue is still very much where it was ; that is to say, the Bank is not able to act without the consent of the Treasury and then only within prescribed limits. In fact, the Currency and Bank Notes Act, 1928, did little to bring British " crisis " regulations into conformity with Continental practice, which latter has not infrequently been advocated. There would seem, however, to be no material difference between the two methods of currency issue beyond the permitted fiduciary or reserve limits. There may, nevertheless, be a certain difference in effect, so far as the public is concerned, the English method entailing a more public advertisement of the fact that the ordinary prescription has failed ; but inasmuch as the effect abroad is the more important, and as foreign countries are scarcely likely to be deceived by either method of excess currency provision, any distinction is, practically, negligible.

POSITION OF NOTE IN CREDIT SYSTEM

The Bank of England Note was made legal tender in England and Wales (not Scotland or Ireland) in 1833. Up to 1928 it might be legally tendered in payment of sums above £5 everywhere except at the Bank itself—that is to say, the Bank of England could not compel its creditors to take its own notes. Since the passing of the Currency and Bank Notes Act, 1928, however, Bank of England notes for £1 and 10s. have been legal tender to any amount and at any branch of the Bank.

The active circulation (*i.e.* the notes outside the walls of the establishment, and actually in the hands of the public) has shown no tendency to keep pace with increasing trade or increasing population, but rather the reverse. From 1876 on, the average has been :

	Notes.	Population (England and Wales).
1876-8	. £27·9 millions	. 24·7 millions
1879-81	. 27·5 „	. 25·7 „
1882-4	. 25·6 „	. 26·6 „
1885-7	. 24·6 „	. 27·5 „
1888-90	. 24·4 „	. 28·4 „
1891-3	. 25·6 „	. 29·4 „
1894-6	. 25·9 „	. 30·3 „
1897-9	. 27·5 „	. 31·3 „
1900-2	. 29·5 „	. 32·6 „
1903-5	. 28·7 „	. 33·8 „
1906-8	. 28·9 „	. 34·9 „
1909-11	. 28·7 „	. 35·8 „
1912-14	. 29·7 „	. 36·6 „

While the population has steadily increased the note circulation is very little more than in the first period under review. It would seem, therefore, that the note had become of relatively less importance as a currency medium up to 1914. From 1914 on, the note circulation of the country has been affected by two factors, both arising from the same cause. In the first place, war expenditure was met by an inflated currency which brought about a rise in the price level, and thus the circulation of the Bank of England

was increased in what might be termed an artificial manner. Secondly, a new issuing authority, the Treasury, came into existence, and for many years—until 1928 in fact—there were two issues, which, although independent, were supplementary, by reason of the fact that they served different purposes. The "Treasury" or "Currency" note would not have existed if gold could have been in circulation, and it superseded the sovereign, which disappeared from circulation during the War. The Bank of England note served, until 1928, the same purpose as it had previously served, as bankers' reserve and for payments of £5 and upwards. It was always visualised, nevertheless, that the two issues would, at a convenient time, be amalgamated, and this took place as a result of the Currency and Bank Notes Act of 1928, giving the Bank of England figures from that date a new complexion, bearing no clear relation to that of their predecessors and offering no useful comparison unless the joint figures be used.

When, therefore, it is desired to relate the present position of the Bank of England circulation to that existing in 1913, it is necessary to remember that, as a result of the inflation of the War and post-War years, the amount was swollen

(a) directly, by the absorption of the Treasury note issue ; and

(b) indirectly, through the rise in prices due to inflation, which affected the Bank's own issue (apart from the Treasury Note issue) as it affected banker's deposits.

From trade the note has been largely ousted by cheques, which, now that every trader, and an ever-increasing number of private individuals as well, have banking accounts, form the actual paper currency of the country; and for ordinary purposes the £5 note suits neither the rich man, who prefers to pay by cheque, nor the poor man, for whom the unit is too large. The difficulty of obtaining change is also an obstacle to its current use.¹

The employment of the Bank of England Note of £5 and higher denomination, is now almost restricted to two purposes. It serves, firstly, as a substitute for gold in bankers' till-money; and, secondly, as a medium for effecting payments of £5 and upwards, principally, but not largely, in circumstances in which a cheque might not be taken (*e.g.*, travelling expenses, hotel bills, etc.).

In accordance with this distinction, the circulation may be broadly divided into two portions—viz., a Residual or Fixed Issue, and a Tidal or Circulating Issue, the former of which bears a preponderating proportion to the whole. The fluctuations are mere surface ripples, and rarely exceed 5% on either side of the average. The chief features are:

1. The large proportion—nearly 95%—that the fixed issue bears to the total;
2. The higher level attained in the holiday seasons, particularly in August and at Christmas, but, although in a minor degree, in April also.

¹ 'Clare,' Second Edition: "A £1 note (the re-issue of which now "appears to be within measurable distance) would, on the contrary, be "found most useful, and doubtless have an extensive circulation."

The normal ebb and flow of the note circulation is one of the most familiar phenomena of the market, and the certainty with which its recurrence may be reckoned upon deprives it of all influence over the value of money. A fall in the Reserve of a million and a quarter in a fortnight would be regarded as a serious matter if occasioned by external demands, but is looked upon with indifference if, as at the end of July, it is seen to be nothing more than the swing of the currency pendulum. Of course, if such a movement should happen to coincide with an efflux of gold for abroad it augments the effect of the latter, and to that extent is an element of danger ; but, on the whole, the fluctuations of the Circulating Issue are too well known to affect the relations between borrower and lender.

As regards the Residual Issue the case is different. It is only rarely that this portion of the circulation betrays any signs of life ; but its movements, when they do occur, have an immediate and powerful influence over the value of money. A rise in the residual circulation, coupled with an increase in the Bank's Other Securities, is a sure sign of danger ahead. It means that bankers are converting securities into cash and increasing their reserves, and is seen at times when the course of events has been such as to throw doubts upon the soundness of the banking system, and when the least hitch might precipitate a "run."

A case in point occurred in December, 1878.

The stoppage of an important provincial bank was announced on the 9th, and by the 18th the circulation, which, in the usual course, would have shown a decrease, had risen from £29,000,000 to £32,000,000, while the price of money leaped up from $4\frac{1}{2}\%$ to 6% , but was practically unborrowable except on the finest securities. To point to more recent times, the circulation during May, June and July, 1914, had fluctuated about the £29 million mark. On July 29th it was £29,706,000; within a week, on August 5th, to be exact, an increase to £36,105,000 was shown.

GOLD COIN AND BULLION

The remaining item in the account of the Issue Department is that of "Gold Coin and Bullion," the amount of which corresponded to and regulated the balance of the issue in excess of £19,750,000—now in excess of £260,000,000.

It has already been pointed out that the Bank's profit¹ on the circulation arises from the portion that is based on securities, the remainder being in the nature of a receipt for gold deposited, which the Bank must preserve intact until the holders of its notes present them and demand it back again. The Issue Department, as such, has consequently no incentive to acquire gold or to increase its issue thereagainst, and, if it regarded only its own interest in the matter, might possibly

¹ By Section 6 (1) of the Currency and Bank Notes Act, 1928, the Bank is required to pay to the Treasury an amount equal to the profit of the Issue Department. By Section 6 (4) "the Bank shall cease to be liable to make "any payment in consideration of their exemption from stamp duty on "bank notes."

be averse to so doing, for the only advantage the Issue Department derives from the notes against gold is that the gold held against them helps to secure the convertibility of the fiduciary issue. But it is not a free agent. So far as the issue against gold is concerned, the law makes it the servant of the public, and compels it to take at a fixed price all the gold that may be offered. The Act of 1844 provided that all persons shall be entitled to demand from the Issue Department "Bank of England Notes in exchange for gold "bullion, at the rate of £3 17s. 9d. per ounce of "standard gold," the person tendering the same to be at the expense of melting and assaying it; and until 1925 not only was it the Bank's duty to give gold for notes, but also to give notes for gold whenever required. The holder of the gold was not, until 1925, bound to go to the Bank, however. The coinage of gold, being quite gratuitous in this country, he might, if he so pleased, deliver it (if of sufficient amount) direct to the Master of the Mint, who would in due time return it in the shape of sovereigns, at the rate of 1869 sovereigns for every 480 ounces metal of standard fineness ($1\frac{1}{2}$ pure gold, $1\frac{1}{2}$ alloy), equivalent to a price of £3 17s. 10½d. per ounce. This was known as the Mint price of gold, and was 1½d. per ounce higher than the Bank price; but, notwithstanding this difference, all imports of gold were, as a matter of course, lodged in the Bank,¹ the reason being that the importer in this case received his money

¹ Unless there should be a demand for export, in which case arrivals are more likely to be sold in the market for reshipment.

at once, while if he went to the Mint his gold would have to wait its turn, and an uncertain loss of interest would be incurred.¹

This margin of $1\frac{1}{2}d.$ per ounce went into the Bank's pocket, but, strictly speaking, was not profit. It was rather a compensation paid to the Bank for the trouble and expense of sending the bars to the Mint in case it should be required to convert them into coin. Naturally, no more bars were minted than was found necessary, the Bank keeping them in stock as far as possible in the shape in which they were received.

In selling gold the Bank was guided by the same consideration that would influence any other dealer. The law insisted that it should pay out sovereigns to the holders of notes when required, but beyond that left it at liberty to make its own bargain. If an exporter wished to make a shipment of gold to a foreign country, it might not answer his purpose to send sovereigns, and in that case he would ask the Bank to give him bar gold, which was more convenient for export,² and, in fact, formed an international currency, travelling backwards and forwards as a sort of makeweight to balance differences of international indebtedness.

The Bank was always prepared to cash its notes in bars instead of sovereigns, if desired, and usually treated them as being of equal value, charging

¹ The time allowance on gold taken to the Mint was said to be 20 days, and as $1\frac{1}{2}d.$ per ounce is just equal to 20 days interest at 3%, the result was much the same whether bullion be sent to the Mint or sold to the Bank. In practice, however, the gold coined at the Mint was received exclusively from the Bank of England, as no private trader ever sent any.

² Bar gold is less liable to loss by friction than specie.

the Mint price of 77s. 10½*d.* per ounce, which left 1½*d.* per ounce, or 3s. 2½*d.*%, profit; but if the demand was very pressing, the Bank took advantage of it just as another seller would, and put up the price to 77s. 11*d.* The difference appears trivial, but as the margin on bullion transactions is calculated with extreme nicety,¹ an advance of ½*d.* per ounce, or one-half per mille, frequently sufficed to hinder an inconvenient withdrawal. Beyond 77s. 11*d.* it was not safe to go, because, rather than pay more, exporters might find it advantageous to send sovereigns out of the country to be melted, and the Bank would have to replace them by minting bars.

This position was changed, as has already been shown, by the Gold Standard Act, 1925, which made the currency and bank note inconvertible, prohibited the free minting of gold and altered the provisions under which gold could be sold by the Bank. Nowadays, gold cannot be demanded for notes, except in bars of approximately 400 oz. troy (fine), the price being the same as previously, *viz.*, £3 17s. 10½*d.* per standard oz.

To the Issue Department the ebb and flow of gold from and into the country is a matter of indifference. If gold comes in, its printing presses strike off so many more notes; if gold goes out, notes return and are cancelled. In either case its account balances as before, and its position remains the same.

¹ The profits made in bullion business are smaller, because more certain, than in most other trades. Being an exceptionally transferable article, gold moves as soon as the least profit is shown.

So utterly improbable is the contingency of a "run" on this Department as to be hardly worthy of serious consideration. It might, no doubt, occur in the event of foreign invasion, and, as a matter of fact, did once happen in the eighteenth century, when the news reached London that the Highlanders, under the Pretender, had advanced as far as Derby. But, apart from this exceptional instance, public confidence in the note has never been shaken; and in time of panic even, when every other "promise to pay" is discredited, the circulation, instead of falling off, invariably increases.

Supposing, however, for the sake of argument, that some unforeseen circumstance should give rise to a "run," it may well be asked how the Issue Department could possibly pay the holders of all its notes in gold, seeing that £260 millions of the money are locked up in securities, government debt and silver.

To this it has been answered that, in an emergency, the Bank would have no difficulty in realising its Other Securities, and might then get the government debt converted into stock, and sell that, taking its own notes in payment.¹ Apparently this is the only explanation possible; but, as it is based on the assumption that buyers could be found for over £200 millions of securities at a time when the Bank of England itself was in danger, it may be taken for what it is worth.

¹ By declaring the Bank of England Note to be a legal tender, the government virtually pledges its honour to see it paid; so that it would perhaps be nearer the mark to maintain that the Issue Department, after disposing of its other securities, could call on the state to provide funds for the eleven millions of notes issued on the credit of the state.

CHAPTER V

THE BANK OF ENGLAND

BANKING DEPARTMENT

THE Banking Department of the Bank of England is simply a bank like any other, and differs in no essential particular from its neighbours.¹ Like them, it transacts ordinary banking business for the public (though to a decreasing extent) and, like them, it is carried on by the directors without government interference, for the benefit of the shareholders.

In only one respect is its management affected by special legislation. As the Bank is the custodian of vast sums of public money, it is but just that the government and the public should have opportunity of knowing how that money has been dealt with ; and the Bank Act, therefore, requires that the Banking Department, as well as the Issue Department, shall publish a weekly statement of liabilities and assets—a condition that has been imposed on no other bank.

¹ The words "exclusive privileges of *banking*" appear to have been retained in the Bank Act for the sake of conformity with previous statutes, as the Bank neither possesses nor lays claim to any exclusive privileges whatsoever, other than those which appertain to and are comprised in its function of the management of the issue on behalf of the state. At the outset it possessed the prerogatives of limited liability and of immunity from competition, but its only advantage now over other banks is that of keeping the government account and of the monopoly of note issue.

The first place in this Return is given to the items of—

PROPRIETORS' CAPITAL AND REST

The strength of the Bank and the source of the unbounded confidence that is placed in its stability, is the enormous amount of the capital, £14,553,000, which, at the end of the nineteenth century, was not only far larger than that of any other bank in the world, but even exceeded the united capital of the state banks of France and Germany. And yet, vast as this sum appears, it is not the whole extent of the resources; for, in addition, a Rest or reserve fund of undivided profits has been accumulated to the extent of upwards of three millions more,¹ so that the actual working capital is over seventeen and a half millions.

The chief object of capital to a bank is to give confidence and, in a sense, security, to depositors² and, in this respect, the security offered by the Bank of England is unparalleled. Thus, on the 2nd July, 1890, the total deposits stood at £34·3 millions, against £17·7 millions of capital and reserve, a proportion of over *fifty* %; while the balance sheet per 30th June, 1890, of the next largest English bank, the London and Westminster, showed £25 millions deposits against £4·5 millions capital and reserve, a proportion of less than 20%.

¹ It was decided long ago by the Court of Proprietors that the Rest should never be allowed to fall below three millions.

² 'Clare,' Second Edition: It is because the chief depositor is the nation itself that the Bank needs keep so large a capital. It must show the public not only that it is safe, but that it is safe beyond all question.

Considering these two banks at the present time (although the "Westminster" is no longer the "next largest" and the Bank has lost its superiority of capital), the relative positions, from the point of view of the proportion, have not altered. Absolutely, there has been a vast change. The respective figures as at 26th December, 1929, in the case of the Bank of England, and 31st December, 1929, in the case of Westminster Bank, Ltd., are as follows :

	Capital and Reserve.	Deposits.	Proportion
Bank of England	£17,943,838	115,666,738	15 + %
Westminster Bank Ltd.	£18,640,314	285,160,311	6 + %

It will be seen that, although in each case the proportion of capital and reserve to deposit liabilities has declined to about one-third of the figure for 1890, yet the relationship between the two banks in this respect is about the same.

It must be remembered that the Bank of England's deposits have increased not so much through an increase in the number of depositors or in the amounts of their deposits (as a result of the enormous increase in production), but rather through inflation. This applies equally to the other banks, but each of the present clearing banks is now a composition of several which have been absorbed or taken in amalgamation.

In one sense, however, the very magnitude of the Bank's capital is a disadvantage, for its profit, though amounting to nearly a million and a half per annum, means, when it comes to be spread over so large a sum, only the modest return of

12%, a result which compares unfavourably with the handsome dividends distributed by most of the Bank's younger rivals, who, not being burdened with a load that presses so heavily upon them, have, in this respect, been able to outstrip it in the race. Of course, if the prices of the stocks are taken into consideration, the yields fall within a much narrower range.

PUBLIC DEPOSITS

The largest and most important account in the Bank's books, and the largest probably that any bank has ever possessed, is that of the British Government.

The public income, as it is collected day by day by the Customs and Excise officers throughout the country, is paid in at the branches of the Bank of England; and, on the other hand, the enormous payments that the government has to make to the Army and Navy and to the Civil Service are all effected ultimately from balances with the Bank. It also attends to the payment of interest on the National Debt, and for this duty receives special remuneration.

To a banker's eye this is an ideal account; for all its variations can be easily calculated, a handsome balance is always kept, and there is not the least fear of the government's withdrawing its money in a panic.

Beside the Exchequer account, the Public Deposits comprise the balances standing to the credit of the Secretary of State for India, of the

National Debt Commissioners, and of other "official" accounts.

From the point of view of the money market, the most interesting feature of the fluctuations is the large increase of the balance in the March quarter. At the beginning of the year the payment of the Consols and Local Loans dividends, etc., causes a drop, but from the middle of January to the end of March the incomings exceed the outgoings to the extent of several millions.

The reason of this increase in the receipts is that the greater part of the taxes are paid in the March quarter.

The results of this temporary lock-up of money are very noticeable. The transference of so large a sum of money from the pockets of outsiders to the coffers of the Bank naturally acts upon the value of money, not only contributing to bring about the decline in the official quotation, which, prior to the disturbing influence of the War, usually took place at this time, but materially influencing the market rate, by narrowing down the margin which exists between that and Bank Rate. As a rule the outside market has no difficulty in outbidding the Bank, and the success of its competition depends on its ability to do so. Thus, while the average Bank Rate for the ten years 1881 to 1890 was £3 9s. 8d.%, that of the market for best three months' bank bills was only £2 14s.%, a difference of 15s. 8d. But between January and March the impoverishment of the market, combined with the augmentation of the Bank's

strength, has a striking effect on this margin. In December and June, owing to the large amount of dividend payments that fall due at the beginning of those months, money is very plentiful, and the average variation large, being no less than £1 3s. % ; but the revenue collection soon begins to tell on the available supply, and in January, and to a less extent in July, the margin is reduced to £0 14s. % ; while in the first three weeks of March the average difference is only 10s. 8d. %.

From 1891 to 1914 the averages were £3 7s. 7d. % and £2 16s. 4d. % respectively—giving a difference of 11s. 3d. %. The War years do not afford the same comparison, but for the ten years 1921–1930, the average Bank Rate was about £4 9s. % and the average market rate about £3 18s. %, the margin being 11s. %.

Consequent upon this tightening up of outside rates, the Bank, at this time of the year, obtains far more than usual of the current discount business.

From the end of March onward, the movements of the Public Deposits are affected appreciably by the payment in June and December of the dividend on the 5% War Loan, 1929–47. The figure rises considerably during May and November and falls to a low level after the disbursement of the funds above referred to. Should the Exchequer balance at any time be insufficient to meet these disbursements, the deficiency is met by “Ways and Means” advances or a further issue of Treasury Bills, the government repaying

the loan out of the first quarter's revenue. An increase in the item of Government Securities is consequently an almost invariable feature of the first Return of the year.

Up to 1914 the volume of Public Deposits showed no material change, nothing but a very gradual increase each year, on the average, with occasional setback. In 1914, however, the average had risen from £13 millions to £19.5 millions; in 1915, £85 millions were reached and for the next five years the averages were, in millions, £55, 50, 36, 24, 19. Since then, they have been relatively stable at £15 millions approximately. The reason for the remarkable change during the years of the War is that the government account was swollen by the receipt of funds invested in the loans floated for the purpose of financing the War, in Exchequer Bonds and Treasury Bills, and by the proceeds of income tax, the rates of which rose from 1s. 8d in the £ for 1914-15, to 3s. 1915-16, and 5s. 1916-17 and 1917-18.

OTHER DEPOSITS

The whole of the Bank's liabilities to the general public (with the exception of a small amount of Seven Day and Other Bills, which are shown separately) used to be grouped together under the head of Other Deposits. These consist of balances standing to the credit of its customers in London, Manchester, Liverpool, Birmingham, etc., and correspond to the "Current Accounts" (rather than to the "Deposit Accounts") of other banks.

In a rough sort of way, the Other Deposits may be said to be a measure of the supply of loanable capital, and to all who are conversant with the constitution of the money market every change in this item conveys a significant meaning. If they rise beyond the usual average, the augmentation is regarded, in the absence of other known causes, as an indication that the supply of money in the open market exceeds for the time being the effective demand. On the other hand, a fall below the average points to scarcity, and is the usual forerunner of an advance in outside quotations.

This connection between Other Deposits and the market rate arises from the fact that the Bank of England is the bankers' bank, and that the Other Deposits include, in addition to the balances of many great corporations and wealthy firms, the cash balances of the whole of the London clearing bankers. Each of the clearing banks, of which there are ten, keeps an account at the Bank, and the differences arising out of the daily clearings are settled by transfers from one to another in the Bank's books. Bearing in mind the magnitude of the daily clearings (average daily clearing, 1930, £142 millions), it is evident that for this purpose alone substantial balances need be kept.

But in addition the London bankers also entrust to the Bank's keeping the amount of cash that experience has taught them the necessity of holding in reserve to meet any sudden demand that may be sprung upon them. A more natural system, one would imagine, would be to look after their

money themselves ; but it is one of the peculiarities of English banking that no establishment in the country, except the Bank of England, takes charge of its own reserve. Wherever possible the responsibility is shifted on to someone else. Such cash as is necessary for daily requirements is kept on hand, but the uninvested surplus that must be set aside to provide for unexpected withdrawals is consigned to the care of some other bank. The branch banks look to the head office ; the head office relies on the balance at the Bank of England.

The Bank has therefore the responsibility of looking after what is really the ultimate banking-reserve of the whole country, and the Other Deposits or, at any rate, that part of them belonging to bankers, are as far as actual cash goes the only source from which a supply can be obtained to satisfy any immediate need. In whatever part of the country an urgent demand for cash should spring up, it can only be met by trenching on the one central fund.

If the bankers' balances were reducible into nothing more than the provision for clearing differences and a reserve, they would, from their very nature, be all but free from fluctuation. The total under the former head would not vary, as the whole of the debits on any given day's transactions equal the whole of the credits, leaving the difference the same ; and the reserve also would, when business and credit were in normal condition, be liable to little change.

FLOATING MONEY

As a matter of fact, however, the bankers' balances do vary very considerably, and the disturbing cause is to be found in a third element, that of floating money. There are times when a banker literally has more money to dispose of than he knows what to do with. When dividends are paid, for instance, the market often becomes full to overflowing, and the ordinary outlets are insufficient to carry off the supply. All the bills that can be found are eagerly bought up, and loans tend to increase, but there still remains a margin awaiting investment, and it is this margin of idle money which swells the Other Deposits until suitable employment can be found for it. The same thing occurs in periods of business stagnation, and in fact whenever the demand is slack, or the supply excessive. At all such times the Other Deposits are sure to increase, and the increase is ordinarily attended by lower rates.

Other Deposits, at the present time, stand at something over £100 millions, having increased from an average of, say, £25 millions in the years 1881-1900, to £37 millions in the years 1891-1900 ; to £42 millions 1901-1913, to £111 millions 1914-1919 and to £114 millions in the years 1920-1927.

How much of this belongs to bankers, and how much to the other customers of the bank, has not, until recently, been known by the public since 1877. A return was formerly made to the government in which the bankers' balances were shown apart, but its publication was

discontinued after 1877. With the Return for the 28th November, 1928, however, the proportion is once again shown. In 1877, the balances of other customers amounted approximately to £11 millions, the difference being bankers' balances—roughly one half. Nowadays, the proportion of bankers', to other, deposits is approximately as 2 : 1.

The most marked feature in the regular movements of this item is a large and sudden increase at the turn of the half-year. On the 30th June and 31st December, the banks are in the habit of calling in money from the discount houses in order that the item of "Cash" may make a good show in the published balance sheet and this money finds its way into the Bank to swell the Other Deposits, thus causing an abnormal increase. After the accumulation has served its purpose it is rapidly dispersed again. In illustration of this might be mentioned the fact that in recent times the balance of one of the clearing banks doubled itself over the turn of the year and fell to about its original figure within a week.

Another rise is caused by the dividend payments at the same times of the year; in the first three months of the year, and in July (but to a lesser degree), Other Deposits are decreased by payments to the government on account of taxes.

These fluctuations are all such as recur with regularity year after year, but there are also others of less frequent occurrence which call for notice. Times of difficulty and crisis have in recent years always been accompanied by a great and rapid

advance under this head. At such conjunctures bankers immediately set about strengthening their reserves.

The year 1875, which was made memorable by the failure of the Manchester firm of Collie, and by other mercantile disasters, will serve as an example, and the more so as the changes that then took place in the bankers' balances are known with certainty :

On the		Other deposits. Millions.	Bankers' balance. Millions.
19th May		£17	£7·3
	22nd May. Crisis at Rio. Suspension of large bank. Reported embarrassments in London		
26th May		19·4	10
	31st May. Large failures		
2nd June		21·6	11·9
	3rd to 8th June. No further failures. Confidence partially restored		
9th June		20·1	10·5
	15th to 19th June. Failure of A. Collie and Co., followed by others		
23rd June		22·8	12·4
	24th to 29th June. More failures		
30th June		25·3	14·2

In this instance we see that in six weeks the Other Deposits registered an increase of £8½ millions, and that of this sum no less than £7 millions were paid in by bankers, who nearly doubled their balances. The remaining £1¼ millions may possibly have been money that was transferred by its owners from the custody of other banks to that of the Bank of England, as it is probable that the panic feeling which drives depositors away from other banks, drives them to the Bank of England as the last refuge.

Another example is found in 1878, the year of the City of Glasgow Bank collapse, but here the action of the banks can only be a matter of surmise, as for 1878 the distinguishing figures were not published.

On the		Millions.
25th Sept.	The Other Deposits stood at.....	£20·1
	26th to 30th September. Rumours of difficulties in Scotland	
2nd Oct.	2nd October. Stoppage of City of Glasgow Bank...	21·9
9th Oct.	10th to 15th October. Other failures.....	26
16th Oct.		27·3

This is an increase of £7½ millions in three weeks.

Finally, in November, 1890, when it became known that the Barings were in difficulties, the Other Deposits ran up in seven days from the already high figure of £30·3 millions to £36·4 millions, which up to that time was the highest point recorded.

War rumours produce much the same effect. In the early part of 1885 a dispute with Russia, in connection with the delimitation of the Afghan frontier, gave rise to considerable uneasiness, and the Other Deposits, which in February stood at less than £24 millions, had risen by July to as much as £34½ millions. Business had meanwhile come almost to a standstill, and the large cash reserves that bankers had gathered together hung on their hands for want of employment long after all danger of war had passed away. Money was in consequence "a drug in the market," and for

six months, from the middle of May, could be borrowed from day to day at an average price of less than 10s. % per annum.

The year 1914 provides us with yet another example of an increase in Other Deposits as a result of crisis. The average for 1913 was £41·5 millions; in 1914 they had risen to £80 millions, and in 1915 to £103 millions. But it must not be imagined that such increases were solely due to the strengthening, by bankers, of their reserves. A period of inflation had commenced, which raised the figures artificially beyond what they would otherwise have been.

One other point in connection with the bankers' balances remains to be mentioned.

OTHER DEPOSITS AND GOLD MOVEMENTS

When gold is moving from this country, say, to the Continent, the only practical way in which the Bank can counteract the outflow is to raise the value of money above the general Continental level. This not only tends to make the export unprofitable, but at the same time induced bankers in other countries to buy up London paper for temporary investment, thus turning the exchanges in our favour, and, eventually bringing gold from other quarters to replace that which has been lost.

The success of this measure always depends, however, on the extent to which it is seconded by the open market. Continental bankers who have floating funds to invest care nothing for the rate

that the Bank of England is supposed to charge. In bidding for bills their competitors are not the Bank of England, but the dealers in the open market, and it is the market rate alone that affects their calculations. If the London market is above their home market, other things being equal, they will buy freely, but a high Bank Rate alone will produce no effect.

For the Bank, then, to declare that money, for which 4% was asked yesterday, shall to-day be worth 5%, is of no avail unless other big dealers concur, and fix their charge accordingly. It is of course to the advantage of other lenders to raise their price, if feasible, and, to a certain extent, they are almost forced to follow the Bank, because, as we have already seen, the interest they pay to their depositors is regulated by the official rate, and, as they have to give more when the rate advances, they must also charge more, or be out of pocket—though it should be borne in mind that bankers do not allow interest on all the money lodged with them; and that they lend only a proportion of such moneys. But the price of money in the open market does not depend on this or similar considerations; it is like that of other commodities, adjusted by the equation of supply to demand.

With demand we have here nothing to do; but, so far as supply goes, a ready test of strength is afforded by the amount of the Other Deposits. If the Other Deposits stand at a low figure, the supply is short, and the market will as a general

rule keep well up to the Bank, responding readily to the latter's initiative. If, on the other hand, the Other Deposits are high, indicating a supply in excess of requirements, then the pressure of this margin of unlent money will cause lenders to beat down rates in their anxiety to use up the funds under their control, and the Bank will be powerless to influence outside quotations without taking steps to deplete the supply in the market. The larger the margin of idle money in such cases the larger will be the disparity between official and unofficial quotations.

CONTROL OF MONEY MARKET

BANK RATE.

The efficiency, therefore, of a high Bank Rate in putting a stop to an efflux of gold varies inversely with the amount of surplus funds at the disposal of the market, being greatest when the Other Deposits are at their lowest, and *vice versa* ; and although, generally speaking, an export tends naturally to bring about an advance in rates, because every million sent out of the country, besides reducing the gold reserve, also causes a contraction of the available stock of market money, yet it may, and sometimes does, happen, when supply is excessive, that the market could afford to let two or three millions go without feeling the loss. In such circumstances a high Bank Rate is comparatively useless, and the reserve would soon fall to a dangerously low point unless other means could be found to protect it.

Repeated advances of the rate would no doubt have the effect, in the end, of screwing the market up to the desired level, but there is a limit to the Bank's powers in this direction, because an unusually high rate would, unless justified by a crisis, cause an outcry throughout the country ; and as this would be distasteful to the Bank, the movements are generally confined within narrow limits, 5% being, as a general rule, the maximum. If 5% fails to arrest the export, other measures may have to be resorted to. The Reichsbank, in such a case, would possibly give exporters to understand that they must be prepared to incur the consequences of its displeasure if the withdrawals were persisted in. This the Bank cannot do ; nor can it put a premium on its gold, like the Bank of France did before the law of June, 1928, made France a free gold country, after the disorganisation of the War. And yet the outflow must be stopped somehow.

OPEN MARKET POLICY.

Whenever, then, it becomes evident that the market is hindered from following the Bank by the pressure of a margin of money for which no suitable employment can be found, the Bank goes straight to the root of the difficulty, and gets rid of the incubus by the simple but peculiar expedient of borrowing the surplus herself. This was formerly effected by selling Consols for " cash," and buying them back for the " account." The " account " price, at which they were bought

back, was of course higher than the "cash price," at which they were sold (because it included a larger proportion of the accruing dividend), and the difference between the two prices represented the interest paid for the loan.

As the buyers "for cash" gave cheques on their bankers in payment, the bankers' balances at the Bank were to that extent reduced in the next clearing; consequently the Other Deposits fell, and, as the owners of those deposits had less to lend than they had before, the market at once hardened, and the Bank succeeded in its object of raising the price of money above the Continental level, and of tempting foreign capital over.

Since 1914 this method has not been possible, because Consols could not be bought for the account. As an alternative, the Bank achieves the same effect as previously either by buying outright or by so arranging its tenders for Treasury Bills as to govern the volume of funds in the market.

MARKET RATE.

For the past year or two, the Bank has exercised control through this means, described by the financial press as the "hidden hand." In addition, she has been known, when occasion demanded it, to indicate to the market her desire for, say, a certain stiffening of rates, as an alternative to the use of the discount rate. The following extract from "Lombard Street" in the *Financial News* of the 12th March, 1931, is of interest in this connection :

" The Bill Market has been allowed a good deal
" more latitude during the past ten days or so,
" and, . . . towards the end of last week rates
" began to slip away quite sharply . . . the rate
" has not fallen below $2\frac{5}{8}\%$. . . This seems to
" be the level now regarded as desirable by the
" authorities, for they have taken no steps to
" enforce a higher rate." This would have, for
example, the effect of making the money market
attractive to the foreigner, without imposing any
burden on the industry of this country. Such an
exercise of control or persuasion might occur if the
raising of a foreign market rate tended to lessen
the advantageousness of London in comparison
with the foreign centre. An interesting commen-
tary on this aspect of the subject is provided by
the remarks of Dr. Benjamin M. Anderson before
the Commercial Club of Chicago on 18th February,
1931, as follows :

" The difficulty grows out of the British reluc-
" tance to make use of the old orthodox measure
" which would have been employed without hesi-
" tation in pre-War days—namely the raising of
" the Bank Rate and the tightening of credit in
" London. Both political opinion and business
" opinion have been strongly opposed to the
" employment of this measure in London because
" of the widespread belief, despite years of dis-
" appointment, that low discount rates make good
" business, and because of a reluctance to go
" through with liquidation which firmer money
" would involve."

In illustration of the attraction of funds to London, without a rise in the Bank Rate, through the market rate of discount, the following "City Notes" comment from *The Times* of 27th January, 1931, may be given :

" A further substantial withdrawal of gold from
" the Bank of England for shipment to France,
" the knowledge that more will be taken to-day,
" and the realization that the persistent drain on the
" gold reserves of the country cannot continue indefinitely without something unpleasant happening,
" caused the Money Market to tackle seriously the
" question of rates yesterday. The rate for three
" months bills was put up to $2\frac{7}{16}$ to $2\frac{1}{2}$ per cent.
" Although this is not high enough—with the
" official rate at 3 per cent.—it sufficed to tempt a
" certain amount of American buying of bills and to
" move the New York exchange in our favour
" slightly. The Paris exchange also moved in
" favour of sterling, the closing rate being 123·89f.
" with francs rather offered. Thus once again the
" effectiveness of the rate as a weapon to influence
" the exchanges has been demonstrated."

Another way of controlling the market has been often suggested. The Bank, it is said, could easily make herself mistress of the situation by offering to pay interest on deposits. As a great part of the money lying with other banks is deposited as much for the sake of security as of profit, there is no doubt that a very low rate of interest would suffice, when backed by the name and prestige of the Bank of England, to tempt

much of it over. There would then be no difficulty in making the Bank Rate effective, for whenever the market fell away, the Bank could always pull it up again by advancing the deposit rate, and thus exhausting external supplies.

To this course there are, however, some obvious objections. In the first place it would be a reversal of the Bank's traditional policy, which subordinates profit to perfect safety. But perfect safety, it is clear, is not compatible with the possession of a vast sum of money, repayable at a day or two's notice, and if the Bank is already able to obtain the loan of over £100 millions of money without paying a shilling for it, what would the deposits amount to if interest were offered? The Bank, it must be remembered, is the repository of the nation's balance, and cannot afford to expose itself to the risk of a "run" in the event of a crisis. As matters stand at present, there is no such risk if ordinary precautions are taken, for, as we have already seen, the deposits *increase* in time of panic; but whether such would still be the case when the depositors were a large and mixed body is another question.

Then again, the Bank, by competing with its neighbours for deposits, and thus robbing them of a lucrative part of their business, would not only give dire offence to its best customers, but would probably add little to its own earnings. Other banks make deposits pay because they invest the greater part of the money in interest-bearing securities, and retain only a small proportion to meet withdrawals; but the Bank,

prior to the War, at any rate, made a practice of keeping about 40% in reserve, and would thus, while giving interest on all it received, be earning on only about a half; besides which, a large portion of the £100 millions, of which the Bank now enjoys the use free of interest, would no doubt be at once transferred from Current Account to Deposit Account, swelling the total on which interest would have to be paid.

Apart, however, from all considerations of safety or profit, the great difficulty would be to obtain, and above all, to keep up a sufficient Reserve. In view of the existing shortage (and the probable increasing shortage in the future) of gold, the position under the gold standard would become impossible to maintain. There is no certainty that high rates would bring the required influx, even if high rates were desirable.

Practically, therefore, the Bank is just able, by the exercise of constant care, to preserve the balance between imports and exports, and it is clear that the price it would have to pay for a large and permanent addition to its stock would be all but prohibitive; so that, however peculiar the system may appear of forcing up outside rates by borrowing and paying interest for money which it does not want, it nevertheless seems to compare favourably with the alternative proposal of allowing interest on deposits, and, until a better mechanism can be devised, we are likely to see the Bank continuing to use the bankers' balances as a lever by which to lift the market.

CHAPTER VI
THE BANK OF ENGLAND
BANKING DEPARTMENT (*contd.*)

GOVERNMENT SECURITIES. OTHER SECURITIES

UNDER these headings the Bank states the total values of its investments.

GOVERNMENT SECURITIES comprise, as their name sufficiently indicates, all those (such as Consols, etc., Treasury Bonds, Treasury Bills [excluding those bought from discount houses, which bills are included in Other Securities, Discounts and Advances], etc.), which yield an income guaranteed by the British Government.

Little importance attaches to changes in this item, but as they sometimes throw a side-light on the state of the market it is well to know their meaning.

At times, for instance, there is often a sudden increase, which represents the security given by the Treasury to cover temporary advances obtained from the Bank. As the balance standing to the credit of the government is usually insufficient to meet the dividend and other payments

then falling due, the deficiency is borrowed from the Bank and is afterwards paid off out of the revenue collected in the course of the few following weeks.

A movement in the Government Securities on the occasion of a fresh issue of Treasury Bills, points to changes in the Bank's investments, and sometimes produces a passing effect on outside rates. If the Bank, for example, allows a parcel of its Treasury Bills to run off without renewing them, the new allotment will fall to be paid for by the market and, so far as it goes, will tend to make money scarcer and, consequently, dearer.

Further, Government Securities may be affected indirectly by gold movements through the policy of the Bank in supporting the market by the purchase of securities at times of heavy withdrawals of gold. An example of this is to be found in the figures for June, July, August and September, 1929, the period of the huge withdrawals of gold by France. From the middle of June to the commencement of October, over £35 millions were withdrawn and in that period, Government Securities rose from £35 millions to £76 millions.

The sale and re-purchase of Government Securities has been already referred to as a chief means of exhausting external supplies.

OTHER SECURITIES

The general investments of the Bank in Indian, Colonial and Corporation Stocks, and in Railway Debenture Stocks, etc., its stock of bills of exchange

held under discount, and the sums due by bill-brokers and others for advances made to them against security, together make up, with other miscellaneous assets,¹ the large total that figures on the credit side of the Return as Other Securities. Since 1880 the item has not fallen below £17·9 millions, and the average (1881-90) was £21½ millions. For 1891 the average was £29·7 millions, the increase being explained by the advance of £7½ millions made by the Bank in the matter of the Baring liquidation. There would appear to be no ready explanation of the next noticeable increase—from about £23 millions to £30 millions in 1890-91, but the enormous rise from an average of £33 millions in 1913 to an average of £68 millions in 1914 is easily ascribed to the commencement of the European War. For 1915 the average was £126 millions.

The particulars in detail were not published until November, 1928. Formerly a return was made to Parliament in which the loans and discounts were distinguished from other assets, but this information was not supplied after 1875. So far as discounts go, the Bank's business appeared at that time to be falling off. They reached their peak (nearly £10 millions) in 1866 and gradually fell off to £4 millions in 1875. The averages for 1874-75 were about the same and were £3 millions less than that for 1873. In 1890, conjecture estimated the average contents of the bill case at a comparatively low figure. In 1929

¹ The value of the branch premises is included in this item.

the amount varied between something over £3 millions and over £52 millions, peaks of £52 millions and £42 millions being reached at the end of June, 1929 and on January 1st, 1930. These huge increases are attributable to "window dressing" calls by the banks forcing the brokers to the Bank of England. The present figures, however, bear no true relation to those prior to 1875, because of the enormous increase in productivity since the earlier date and the considerable inflation during and subsequent to the War. The market is almost invariably able to underbid the Bank, and in the competition for bills the lowest bidder is usually successful. It may be laid down as a general rule that buyers and sellers of bills only apply at Threadneedle Street in exceptional circumstances, such, for instance, as when the market is bare, and an advance of the official rate anticipated. Dealers may then be unwilling to increase their commitments except with the proviso "subject to Thursday's rate," and those in search of accommodation may prefer to take their chance at the Bank.

The bulk of the Bank's ordinary business with borrowers takes the shape—not of discounts, but—of short loans against the deposit of the best class of stock exchange securities or of bills of exchange. Money is not lent from day to day (but for periods of not less than seven days), nor on the security of documents representing produce. Whenever there is a pressure for money in the

open market, whenever demand exceeds supply, the Other Securities are increased by transactions of this class, showing that the Bank has been called upon to fill up the void.

In addition to the rise caused by the window-dressing of the banks, the lock-up of money caused by the collection of taxes also makes its mark on the Other Securities, and produces a rise in the first and third quarters of the year which is followed by a rapid fall as soon as the Treasury lets the money out again in the second and fourth quarters.

These movements call for remark not on account of the mere fact that dealers are at intervals compelled to resort to the Bank for aid, but because they show how ill adapted the market is to bear a slight extra strain. Though its liabilities and resources are of vast proportions, yet so delicate is the adjustment, and so small the unused margin kept as provision against contingencies, that the removal of two or three millions tends to destroy the equipoise, and to leave it dependent on the support of the Bank for the means to pay as it goes.

A simultaneous increase of both Other Securities and Other Deposits is sometimes seen, and is taken to indicate (unless preparation is being made for dividend payments, etc.) that bankers are calling in funds and strengthening their balances as a precautionary measure. This is a feature of the Return whenever any uneasiness is felt in the market, and the gravity of the impending danger may always be gauged by the extent of the movement.

In 1866, on the failure of Overend Gurney & Co. the Other Securities rose from

£20·8 millions on 9th May,

to £30·9 „ 16th „

being an increase of £10 millions in seven days ;
in 1875, when A. Collie & Co. failed, from

£18·3 millions on 16th June,

to £25·5 „ 30th June ;

in 1878, on the suspension of the City of Glasgow Bank, from

£17·3 millions on 25th Sept.,

to £23 „ 16th Oct.,

and in November, 1890, (the Baring difficulties),
from £21·5 millions on the 12th,

to £32·1 „ „ 19th.

The Bank, it will be seen, lends with the greatest freedom on such occasions, this being the best way of allaying the feeling of panic ; but as the borrowers are only actuated by a desire to be “ on the safe side,” the money is not really wanted, and the greater part of it is usually left in the hands of the Bank, explaining the advance of the Other Deposits.

In 1914, when War was declared between this country and Germany, Other Securities rose as follows :

July	15th	£33,623,000
„	22nd	£33,633,000
„	29th	£47,308,000
August	5th	£65,352,000
„	12th	£70,787,000
„	19th	£94,726,000

August	26th	£109,905,000
September	2nd	£121,821,000
„	9th	£116,923,000
„	16th	£113,792,000
„	23rd	£110,733,000

CHAPTER VII

THE BANK OF ENGLAND

THE RESERVE

THE total amount of Notes and Coin, or cash in hand, held by the Banking Department, constitutes what is known as the " Reserve."

These are the vital figures of the Return. On the maintenance of a sufficient store of actual cash to satisfy the claims of depositors depends the very existence of the Bank, for the whole of the deposits are practically debts payable in gold on demand and the Bank must either fulfil its obligation to repay when called upon, or the note must be declared inconvertible. Between the proportionate strength of the Reserve and the price that the Bank charges for loans there exists, too, an intimate connection, and the Reserve is in fact both the basis of the Bank's credit and the key to the Bank Rate.

As the idea sometimes crops up that the Reserve secures the note-holder as well as the depositor, and that an export of gold is bad for the country, because it must impair the ability of the Bank to cash its notes on presentation, it may be well to point out before going further that the convertibility of the note has nothing whatever to do with

the Banking Department, and the " Reserve " is a *banking* reserve, maintained solely for the purpose of cashing depositors' cheques. The misconception arises from confounding the functions of two distinct funds—namely, the Banking Department's cash reserve against deposits, which the note holder cannot touch ; and the Issue Department's stock of gold appropriated to the service of the note, which the depositor cannot touch. Perhaps the fact that the Reserve is habitually spoken of as gold, while the Bank's entire stock of metal (with the exception of a small proportion of coin required for till money) is held by the Issue Department against notes issued, may partially account for the confusion. It is obvious, too, on examining the Return, that a withdrawal of bullion must diminish the stock in the Issue Department, but why at the same time it should also affect the cash in the Banking Department does not at first sight appear at all clear.

The difficulty disappears, however, on considering the means employed to take gold from the Bank. Theoretically, the usual course is to obtain credit with a London banker by discounting bills, or selling securities, etc., to make use of that credit by asking for Bank of England notes, and to convert the notes into gold at the Issue Department. In fact, gold is rarely taken from the Bank nowadays except by a clearing bank which maintains a balance with the Bank. The banks act as agents for exporters or export on their own account. The gold, it is true, is actually paid

out by the Issue Department, but the notes which give power to demand that gold are bound to come out of the Reserve of the Banking Department. The reason is that London bankers keep comparatively little cash on hand, but rely on their balance at the Bank to meet any exceptional demand. Consequently, the banker who is called upon to furnish the notes required for a large gold withdrawal will draw on his balance at the Bank, the transaction taking the form of a debit to his account, a debit to Notes, in the Banking Department, a reduction of the Issue Department item Notes in Banking Department, and an equivalent reduction in Gold Coin and Bullion.

For the sake of illustration we will take a Return, that of February 19th, 1930, and, assuming a gold export of, say, five millions to take place, and the bankers to have made up their balances at the Bank by calling in money from the brokers (who have provided it by borrowing at the Bank, causing a corresponding increase in the Other Securities), will see what change is thereby produced.

The Return was as follows :

ISSUE DEPARTMENT.			
Notes issued :	£	Govt. Debt.....	£11,015,100
In Circulation	345,580,773	Other Government	
In Banking Depart-		Securities	233,599,941
ment	65,390,738	Other Securities	10,924,483
		Silver Coin.....	4,460,476
		Amount of Fiduciary	
		Issue	260,000,000
		Gold Coin and Bullion	150,971,511
	<u>£410,971,511</u>		<u>£410,971,511</u>

BANKING DEPARTMENT.			
Capital	14,553,000	Government Securities	38,581,563
Rest.....	3,653,974	Other Securities:	
Public Deposits ¹	13,871,221	Discounts and	
Other Deposits:		Advances	4,732,768
Bankers	59,167,021	Securities	16,293,348
Other Accounts.....	34,416,671	Notes.....	65,390,738
7-Day and Other Bills	3,519	Gold and Silver Coin .	666,989
	<u>125,665,406</u>		<u>125,665,406</u>

¹ Including Exchequer, Savings Banks, Commissioners of National Debt and Dividend Accounts.

and after the imaginary withdrawal would appear (in abbreviation) thus:—

ISSUE DEPARTMENT.			
Notes issued	406 millions.	Securities	260 millions.
		Gold	146 millions.
	<u>406</u> ..		<u>406</u> ..

BANKING DEPARTMENT.			
Capital and Rest	£18 millions.	Securities	£65 millions
Deposits	108 ..	Notes.....	60 ..
		Coin	1 ..
	<u>126</u> ..		<u>126</u> ..

It is evident that the means possessed by the Banking Department to pay its creditors in *cash* on demand have been reduced from $\frac{66}{108}$ or 61% to $\frac{61}{108}$ or 55% ; but the Issue Department is no worse off for the withdrawal, having simply performed the mechanical function of giving up against return of its receipts a portion of the gold which it was taking charge of on behalf of the public.

The result of an export of gold is thus shown to be a reduction of the Reserve, and a consequent falling-off in the power of the Bank to pay its debts ; and to this fact is due the great importance that is attributed to the movements of the metal.

RESERVE THE BASIS OF CREDIT

While it will be readily admitted, seeing that the solvency of the Bank depends on the maintenance of an adequate cash balance, that the strength of the till is a matter that intimately concerns its creditors and stockholders, it may seem, to the business community generally, that the question of a greater or less Reserve, except in so far as it affects the value of money, can present little direct interest.

As a matter of fact, however, the stability of the Bank of England concerns every banker and merchant in the Kingdom.

The explanation turns on the law of legal tender. According to law a tender of payment (of any sum above forty shillings) is not valid unless made in the current gold coin of the realm, or—what is much the same thing—in Bank of England notes. Every creditor, therefore, has the right, limited somewhat by the Act of 1925, to insist on payment in gold.

In all ordinary circumstances trade payments are effected by cheque, and this dormant right is all but lost sight of ; nevertheless, all our buying and selling, all our borrowing and lending, is based on the principle that debts are payable in gold.

Now, the class of debts that exercises the greatest influence over the state of credit is that owing by bankers to their customers, and these alone (to say nothing of the indebtedness of merchants one to another) exceed by hundreds of millions sterling

the whole stock of gold that the country possesses. The sum due on the 31st December, 1929, by the Clearing Banks alone, under the head of Deposit and Current Accounts was practically £1800 millions, on the basis of balance sheets published, while the total gold holding of the Bank of England was roughly £150 millions.

This cannot truly be called a Reserve. The meaning of "reserve" is a fund set apart for use in an emergency—an extraordinary fund for extraordinary occasions—but the cash held by bankers is their till money, the stock in trade necessary for their every-day transactions. What they regard as a reserve is something very different. Their actual reserve consists not of a store of cash locked up in their strong-rooms, but of money at call, and a balance at the Bank.

So long as the central fund holds out, these reserves are of course just as good as cash, and are more easily managed than an accumulation of notes and coin; but the point is that they are not actually cash, and that though the banks have borrowed unheard-of sums, which they promise to repay in gold or notes on demand, they hold practically no gold or notes wherewith to pay, but depend on obtaining their supply, when wanted, from someone else.

All of them without exception rely, directly or indirectly, on the Bank, and not one is able to meet an unusual demand for cash out of its own resources. Whenever or wherever such a demand may spring up it must fall on the Reserve. But

the stock of cash kept by the London offices is adapted only to known requirements and is not meant to meet unforeseen demands; consequently the balance at the Bank is drawn upon.

In America, if a federal reserve bank accepts deposits, the national banking law insists that for every \$100 lodged in its hands it shall set aside \$35 in gold or lawful money; but in this country the law takes no cognisance of a banker's duty in that respect, and leaves him at liberty to keep as much, or as little, legal tender as he pleases. It forbids him to issue a single note, but is silent on the subject of deposits, the uncontrolled liability on current and deposit account amounting, in the case of the clearing banks—as has been said—to £1800 millions.

Practically the whole of this vast sum is payable in gold on demand, but on the assumption that only a very small proportion will be asked for at any one time, bankers have locked up over 90% of it in bills of exchange, securities, loans, etc., and only the Bank of England pretends to keep a large store of legal tender money.

The £66 millions of notes and gold lying (February, 1930) in its vaults are therefore the ultimate and sole cash reserve of the whole country, and, if the Bank lost that reserve, neither the banks which depend upon it, nor the customers which depend on the banks, would be able to keep their engagements.

On it, in short, reposes the entire fabric of English credit.

DISINTERESTED ATTITUDE OF BANK

One of the most remarkable features of our banking system is the fact that the Bank of England—the guardian of our only store of gold—while allowing that its business differs from that of other banks, and that it would be injudicious to let the Reserve sink below what the directors consider a safe point, holds nevertheless that the danger limit depends solely on the character and extent of its own liabilities (quite apart from those of the bankers who have claims upon it), and has on no occasion either expressed the intention of keeping up a reserve of specie for the whole country or acknowledged a sense of duty on that score. But, though unwilling actually to avow responsibility, the Bank, at the same time, is unable to disavow it, and the promptitude with which it has always defended the Reserve from foreign assault, even at times when by so doing it was putting itself out of the market, proves that it tacitly accepts the situation.

The task that the Bank has to perform is no grateful one, however. The interests involved are in direct conflict. On the one hand are its stock holders, always ready to point out that if less money were kept lying idle a larger dividend might be earned, and on the other hand the public equally ready to maintain that, as the Bank pays no interest on deposits, it could very well afford to lay aside a larger proportion even than at present.

On paper, this arrangement—or want of arrangement, rather—looks anything but satisfactory, but in practice it works smoothly and well, and the business world has learnt to place great confidence in the Bank's management of the national gold reserve.

It has often been suggested that the clearing bankers, instead of lending their spare money to the Bank of England, might form a mutual association, appoint a committee of management, keep their own joint cash reserve, and share among themselves the profit now accruing to the Bank. But bankers appear to view such schemes with indifference, and are quite satisfied to leave matters as they are. They have a motive for their disapproval. In addition to knowing that their money is absolutely safe in the Bank's hands, and that the feeling of responsibility (which though unconfessed is none the less felt) will always restrain it from unduly economising in the Reserve, they feel convinced—and this is the real inducement—that if events should ever again occur of a nature to imperil the Bank's safety the government would intervene to save it. They believe that, if another crisis ever happens, the government, if need be, will help the Bank, and, what is more to the point, that the Bank, if need be, will help them ; while, if they kept their own reserves, there would be less reason why either the one or the other should come to their assistance.

The government, they consider, would have no choice but to help the Bank. As its balance is

kept in Threadneedle Street, and a large part of its business transacted there, the stoppage of the Bank would throw the machinery of the state into utter confusion ; besides which, the Bank is the sheet anchor of our national credit, and no ministry dare face the consequences of its failure, which would be almost as calamitous to the country as those of a civil war. Past experience, too, sides with their view. Thrice since 1844 has the Bank been on the point of closing its doors, and thrice has the government stepped in to avert the catastrophe. On a fourth occasion, in 1914, the government gave its promise but action took another form.

Bankers conclude, therefore, that, whatever else may happen at a future crisis, the Bank of England will weather the storm and, by presenting it with their surplus in time of ease, they expect to establish a claim to its good offices in time of stress.

PROPORTION

The figures of the Reserve, taken by themselves, offer no indication of the position at any particular time and variations in the amount are not necessarily any proof of an improvement or worsening of that position. To judge fairly of its strength it must always be related to the varying liabilities against which it is held, the abstract figures alone being no criterion.

On comparison of the Reserve with the total deposits and 7-day bills we find that up to 1913 the proportion rarely fell so low as 30%, which

was considered the minimum, or exceeded 50%, and that the average was about 43%. From 1914, on however, the position weakens materially, the average proportion for the years 1914 to 1927 being 34, 23, 26, 19, 17, 18, 14, 14, 18, 18, 18, 22, 23, 29%. From 1927 the proportion has increased considerably, the figures for 1928 (47 weeks) and 1929 being respectively 42 and 40; in February, 1930, it had risen to 65 $\frac{7}{8}$ %, the highest point since 1896.

The influences that act on the Reserve divide naturally into home and foreign—into demands connected with the internal circulation of currency, and demands connected with the working of the foreign exchanges.

Home requirements affect it because, as we have seen, it is the sole resource in the country of unemployed legal tender money, so that if more currency is at any time required by the country to carry on its business it must of necessity come from the Reserve.

Gold is now no longer in circulation. Notes take the place of gold :—

- (a) in cases where large sums must be held in cash—bankers' till money, for instance;
- (b) for payments to the non-banking classes;
- (c) in circumstances in which, generally speaking, a cheque would not be taken.
- (d) for all cash transactions.

The demand for currency is liable to large expansion. More notes will be wanted if trade improves, if wages rise, and more people find

employment ; and also for holiday and festival (*e.g.*, Christmas) expenditure, because then bankers naturally increase their till money. The result in any case is the same : the Reserve falls and, if it is depleted to such an extent that the position is regarded as dangerous, the Bank may raise its rate to attract fresh supplies of gold from abroad. It will accordingly be found that the Bank Rate, in those years in which business has been good, exceeds the average.

MOVEMENTS IN RESERVE

As indicated above, there are certain clearly defined influences on the Reserve, at periods, for example, when the demand for cash, as opposed to credit, is greater. Such periods are the holiday and festive times of the year, Easter, Whitsun, August and Christmas. At these times the notes in circulation increase appreciably, the increase running off as soon as the particular holiday period is over. The reserve is in this way depleted. It is increased, naturally, on those occasions on which cash is less required and the tendency is for notes to return to the Bank.

This is what may be termed the "home" or "domestic" drain. The "foreign" influence, in the direct form of the receipt or loss of gold, is dependent upon several factors, dealt with in a later chapter, chief among them being, perhaps, relative discount rates in different monetary centres.

Mention must be made, however, of the general relationship between the reserve and the money

market. Money may be described as "tight" or "easy," as when it is hard or easy to obtain, when supply is low or good. It naturally follows that when money is "easy" there is a tendency for its price to fall, and *vice versa*. Although money may be "tight" or "easy," both at times of industrial depression, such as the present, and at times of prosperity, the terms are relative and, broadly, one may say that if trade is booming, money tends to become "tight," and the reserve to fall. If conditions are dull and money cannot be used with profit, the reserve tends to show a high figure. At the present time (July, 1931), for example, conditions are too easy, by reason of the severe depression from which the country is suffering, and the reserve is very high, at 57%.

Before the War there was a fairly constant relationship between the Reserve and the Bank Rate, the latter being used regularly and inevitably to counteract movements in the former. Nowadays, the relationship is not so clear, as has been shown on page 77 in the reference to the remarks of Dr. Anderson, the American economist. This is because other methods of attracting gold are employed. On the other hand, there are times when a rise in the Bank Rate fails to have its normal effect, as, for example, on the occasion, in 1929, of the serious export to France.

CRISES AND BORROWING FROM BANK

From what we have seen it is evident that but little weight attaches to the periodical rise and

fall in connection with the every-day work performed by the currency, and that such ordinary demands may be left to take care of themselves, their nature and extent being too well understood to afford ground for uneasiness, or to call for corrective measures.

With extraordinary demands the case is different. When credit is good, experience shows that the country will use no more currency than is necessary for its wants, and that notes taken for temporary purposes will return as soon as the need for them is passed. When credit is bad, on the other hand, there is no knowing how much additional currency the country may suddenly ask for, or how long it may keep it. If it asks for too much there may be something approaching a panic, because the constitution of the Bank is not adapted to bear an abrupt demand, and the Reserve may melt away before the measures taken to relieve it have had time to act. In any case there is sure to be a sharp rise in the discount rate, as the Bank on such occasions takes vigorous measures to defend the reserve, and to gain delay until gold can be attracted from abroad.

The Currency and Bank Notes Act (and, formerly, the Bank Act) assigns a limit to the note issue against securities, and prescribes that for every note issued beyond the limit gold must be held.¹

¹ 'Clare,' Second Edition: In one all-important particular the Act (the Bank Act, 1844) is defective, however. It makes no provision for a *sudden* expansion of those requirements. A gradual expansion may be met by importing gold from other countries (the only method, since 1844, of increasing the currency), but the contingency of a sudden demand does not appear to have been foreseen when the Act was framed.

When "credit" is good our stock proves sufficient, because, in practice, it is supplemented to an indefinite extent by the use of cheques. But "credit" means belief—the general belief that he who promises to pay is able to pay, or, in other words, that the drawer of the average cheque has enough money at his banker's to meet it—and if events occurred of a nature to weaken that belief the efficiency of instruments of credit would be impaired. Cheques would then no longer pass current, or, at any rate, not to the same extent as before, and business men would revert for a time to the more primitive system of payment by note.

The failure of some great firm, or well known bank, might, for example, cause merchants to become all at once suspicious of their neighbour's solvency. Each one would ask himself who had been involved in the failure, and whether this man or that man was still safe, and until his doubts could be set at rest, determine that, as far as possible, he would avoid the risk of taking cheques, or, if he must take a cheque, that he would at least collect it at once. Bankers might accordingly find that a great number of cheques, instead of coming forward through the Clearing House as usual, were being presented across the counter. Consequently they would have to increase their tills very largely, making heavy inroads on the Bank's reserve.

But perhaps the most striking effect of "discredit" is the sudden scarcity of "market money"

that ensues. Bankers, by virtue of their calling, are at all times prone to a certain slight degree of mistrust, but the disturbance of credit caused by a great and unforeseen failure renders them suspicious, or, at least, dubious, and they look askance upon every application for money, however legitimate. Besides, until they know what is going to happen, they naturally deem it prudent to husband their resources, and the result is that they tend to restrict their usual loans and discounts. In addition, too, they demand repayment of much of the money lying "at call" with the brokers, and as the brokers can only repay by borrowing elsewhere, a rush to the Bank of England begins. This took place, for example, in 1914.

The Bank being virtually the only lender that remains, all who have obligations to meet apply there for money, and in most cases ask for more than they really want at the moment, for fear of not being able to obtain it when they do want it. In such circumstances the magnitude of the Bank's advances is almost incredible. During the five days up to the 1st August, 1914, the Bank lent over £25 millions.

A high rate appears to have scarcely any effect in checking applications, and naturally so, for a merchant who has acceptances falling due in the morning must have the money to meet them, no matter what he pays for it.

This heavy borrowing at famine prices has been a characteristic feature of every panic, and enables

the Bank to do good business. But while swelling the Bank's profits it also endangers its safety, for a large proportion of the sum borrowed is carried off in cash, producing that rapid and alarming diminution of the Reserve, which is the actual proximate cause of a crisis.

This is not a case of a "run," such as other banks are subject to. The deposits instead of decreasing actually increase, and it is because the public mistrust each other that they demand notes, not because they mistrust the Banking Department.

As the fall of the Reserve is thus directly attributable to withdrawals in connection with these fresh loans, it may perhaps be thought that if the Bank refused to grant applications it could keep its Reserve, and prevent a panic. But the Bank must lend; it has no choice. If it refused to do so, the brokers, who are the chief borrowers, could not possibly repay the bankers, and the latter would be compelled in self-defence to draw out their balances; a measure the effect of which would be to bring on an immediate crash.¹

Since 1928, however, an increase beyond the amount of the fiduciary issue can be obtained with the consent of the Treasury, for a total period of two years (Section 8 of the Currency & Bank Notes Act, 1928).

¹ 'Clare,' Second Edition: When it becomes known in the City that the Reserve is running low, and that the Bank may soon be perforce compelled to stop lending; when merchants realize that unless more money can be found to-morrow they will be ruined; and when bankers, in an agony of dread lest their customers should take fright, are praying for closing-time; then the height of the panic is reached, and the general anxiety culminates in a few hours of mental suffering that are long afterwards remembered as the "crisis."

(See overleaf.)

1847, 1857, 1866 AND 1914

Since the passing of the Bank Act in 1844 there have been four "crises," those of 1847, 1857, 1866, and 1914, and on each occasion the directors of the Bank received on application a Letter of License from the government of the day, authorising them to increase their issue of notes against securities. In 1857 the Bank at once availed itself of the authorisation, but in 1847 and 1869 it was not found necessary to do so, the knowledge on the part of the public that the limit had been removed having the effect of quieting the feeling of panic. In 1914, the position was met by the issue of Treasury notes.

The crisis of 1857 was brought about by a demand for gold for Scotland, where the failure

There is but one remedy, and that an obvious one. The Bank Act must be suspended. As it is evident that more notes are urgently wanted to replenish the Reserve, and as more notes cannot legally be created, except against a deposit of gold—which it is impossible to obtain at a few hours' notice—the strict letter of the law must be disregarded until the gold has had time to reach us. The spirit of the law is that the issue shall adapt itself to the wants of the country, and, if those wants suddenly and without warning expand, there is no sense in retaining the fixed limit.

The Directors of the Bank accordingly lay a statement of the facts before Government, and the Ministers (who, of course, have no more power than anyone else to override an Act of Parliament) undertake in response to promote a Bill of Indemnity if it should be found necessary to break the law.

It may be asked why, if this step is sure to be taken, and everyone feels convinced that it will be taken before matters come to the worst—why there is ever a crisis at all, and why people should lose their self-possession. The reason is, firstly, that merchants who are in imminent danger of stopping payment cannot possibly keep cool; and, secondly, that there is always some amount of uncertainty as to the delay that may precede the suspension of the Act. It is uncertain whether the Directors will take action in time, uncertain whether red-tapeism may not cause a hitch somewhere, uncertain whether the Reserve will hold out until relief is given, and so on, and it is this leaven of uncertainty that does all the mischief. It was even asserted after the last crisis that, if the responsibility of overstepping the limit had rested with the Directors, conditionally upon their applying afterwards (instead of beforehand) for an indemnity, people's minds would have been at ease, and everything would have passed off quietly.

of two large banks had led to a run on others. Unfortunately, the drain fell on a Reserve that had been suffered to run down to the low figure of £2½ millions, though the average of the five previous years had been kept up to £8½ millions. On the night of the 11th November it had fallen to £1,462,000, and on the following night to £581,000. The directors then appealed to the government for aid, and at midnight a letter was addressed to them by the First Lord of the Treasury and the Chancellor of the Exchequer, stating that "if they should be unable in the present emergency to meet the demands for discounts and advances upon approved securities without exceeding the limits of their circulation prescribed by the Act of 1844, the Government will be prepared to propose to Parliament, upon its meeting, a bill of indemnity for any excess so issued." Within twenty-four hours the Reserve was gone, and the law had been broken.

The effect of the letter being to remove the arbitrary limit placed by the Act on the fiduciary issue, which at that time amounted to £14,475,000, all that the Bank had to do was to transfer a parcel of Government Securities from the credit of the Banking Department to that of the Issue Department, to issue notes against the same, and to pass the notes into the Reserve.

The next Return that appeared, that of Wednesday, 18th November, 1857, is interesting as being the only one that shows an actual infringement of the Act; for, though the excess

issue of two millions was retained for some time afterwards as a precautionary measure, the Reserve in the following week had risen to £2½ millions, and the Banking Department was therefore in a position to cancel the loan. The Return was as follows:—

ISSUE DEPARTMENT.

Notes issued.....	£22,554,595	Government Debt.....	£11,015,100
N.B.—Of which two millions are issued under the authority of the letter from the First Lord of the Treasury and the Chancellor of the Exchequer.		Other Securities.....	5,459,900
		Gold Coin and Bullion	6,079,595
		Silver Bullion.....	..
	£22,554,595		£22,554,595

BANKING DEPARTMENT.

Proprietors' Capital.....	£14,553,000	Government Securities	£6,407,134
Rest	3,433,500	Other Securities	30,299,270
Public Deposits	5,483,881	Notes	1,148,185
Other Deposits	13,959,165	Gold and Silver Coin ..	404,501
Seven Day & Other Bills	829,544		
	£38,259,090		£38,259,090

As soon as it became known that the restriction had been removed, matters began to mend. Discount houses being able to obtain a plentiful supply of money from the Bank, at once began to grant liberal accommodation to their customers, and the crisis of 1857 was at an end.

The suspension of the Act, it is to be observed, in no way interfered with the principle of convertibility, and the Bank remained under precisely the same obligation as before to pay its notes in gold on presentation.

The panic of 1866 was precipitated, if not caused, by the downfall of Overend, Gurney and Co., a great firm of bill and discount brokers,

whose name was almost as well known throughout England and, indeed, throughout Europe, as that of the Bank itself. To be "as rich as a Gurney" denoted fabulous wealth, and the announcement of the failure created universal consternation. Country bankers, fearing the effect that the news might have on the minds of their customers, telegraphed at once to their London agents for notes, or ran up themselves by the next express to fetch them. In many instances these fears were only too well justified, and the safety of numerous banks was imperilled by the large withdrawals that took place.

Again, as ill-luck would have it, the Reserve stood at an exceptionally low point. Trouble had been brewing between Austria and Italy, and there had been an export of gold to the latter country. The usual Scotch¹ withdrawals had also taken effect. On the evening of the 9th May the Reserve amounted to £5,800,000, against an average for the five previous years of over eight millions. On the 11th ("Black Friday"), the day of the failure, £2½ millions were drawn out in notes, and at the close of business the directors estimated that the available stock of cash in London and all the branches was down to £3 millions, a sum which, it was believed, would be wholly swallowed up in the morning. It was therefore deemed advisable to submit the facts without further delay to the consideration of ministers.

¹ 'Clare,' Second Edition: In May and November, for the customary half-yearly payments, such as rent, interest on loans and mortgages, farm servants' wages.

At once a reply was returned, signed by Earl Russell and Mr. Gladstone, saying that if "the Directors of the Bank of England, proceeding upon the prudent rules of action by which their administration is usually governed, shall find that, in order to meet the wants of legitimate commerce it be requisite to extend their discounts and advances upon approved securities, so as to require issues of notes beyond the limits fixed by law, Her Majesty's Government recommend that this necessity should be met immediately upon its occurrence, and in that event they will not fail to make application to Parliament for its sanction. No such discount or advance, however, should be granted at a rate of interest of less than ten per cent."

All fear of an actual collapse was now removed, but it was long before the country recovered from the fright. Bank Rate had to be maintained at 10% until the middle of August—a period of three months—and it was not until the end of the year that the circulation contracted to its normal level.

The leading items in the Bank returns varied as follows :

1866.	Circulation.	Other Deposits.	Other Securities.	Reserve.
9th May	£22·3 millions	£13·5 millions	£20·8 millions	£5·81 millions.
16th "	26·1 "	18·6 "	30·9 "	1·20 "
23rd "	25·5 "	18·8 "	31 "	1·39 "
30th "	26 "	20·5 "	33·4 "	·86 "
6th June	25·5 "	20·2 "	31·8 "	2·83 "

The lesson taught by the events of 1866 speedily bore fruit. Recognising the fact that a substantial

Reserve is the one great safeguard against a recurrence of panic, the Bank increased its till from eight to twelve millions, and further raised it to an average, for the ten years ending December, 1890, of above £13 millions.

In some respects the course of events in 1914 was similar to those of previous years of crisis. For the first seven months of the year, the Reserve had fluctuated between £22 and £34 millions. On July 29th, it stood at £26,875,000 but in the Return of August 5th, it showed a reduction to £9,966,000. The extent of this reduction is appreciated only when the figures of the Returns for the last week in July and the four weeks of August, 1914, are compared.

	Notes.	Other Deposits.	Other Securities.	Reserve.
	£	£	£	£
July 29	29,706,000	54,419,000	47,308,000	26,875,000
Aug. 5	36,105,000	56,750,000	65,352,000	9,966,000
„ 12	35,934,000	83,326,000	70,787,000	15,530,000
„ 19	37,186,000	108,094,000	94,726,000	19,223,000
„ 26	35,571,000	123,893,000	109,905,000	26,352,000

As is usual on such occasions, the panic led to a rapid increase in the note issue.

After a failure of credit comes the sequel, namely: stagnation of trade, and cheap money. As merchants will no longer trust each other so far as before, they give smaller credits and transact less business. Capital goes "on strike," as it were. Consequently, fewer bills are created and, as bankers distrust bills generally and will take none but the best, the supply of money quickly overtakes the effective demand, and rates fall away.

After the disaster of 1866, the Bank Rate dropped steadily from 10% to 2%, and remained at its minimum for the protracted period of sixteen months. The minor catastrophes of 1875 and 1878 were also followed by low rates, and, in fact, the lowest averages of the twenty years, 1869-88, are those of 1876 and 1879, whilst the average of 1868 is the lowest since the date of the Bank Act. In 1914, the commencing year of the Great War, the Bank Rate which, in the months January to July, had gradually fallen from 5% to 3%, was on July 30th, raised to 4% ; on July 31st raised further to 8% and on August 1st, still further to 10%. On August 6th, it was lowered to 6% and on August 8th to 5%, at which figure it remained until July, 1916.

RESERVE AND INTERNATIONAL GOLD MOVEMENTS

If our internal requirements for currency purposes were the only consideration that need weigh with the Bank in determining the price of its loans, it is probable that in normal times the advertised rate could be maintained at an almost permanent figure, and that changes would occur only rarely and in exceptional circumstances.

But the Reserve has to fulfil a double function. In addition to being the only stock of currency that is available for home use in an emergency, it is also the most readily accessible store of gold to be found in Europe, and is peculiarly exposed to foreign demands.

Whenever a foreign nation happens to want gold, whether to strengthen bank reserves, for coinage purposes, as backing to a note issue, or for any other purpose, usually the quickest and least troublesome way of obtaining it is to buy bills on London, remit them here for discount, and, in theory, turn the proceeds into Bank of England notes and cash the notes at the Issue Department.

Hoardings of gold have also been accumulated by the state banks of France, Germany, and other countries, but these banks have no mind to surrender without a struggle and, with the present-day exception of the Banque de France, they usually succeed in opposing such obstacles to an export demand as to turn it effectually aside.

Here it is different. Our reserve is open, without let or hindrance, to all the world : and no item of the "money article" is more familiar than the announcement that gold to such and such a value has been taken out of the Bank for shipment to France, Belgium, Germany, and so on.

These movements are of the greatest importance, as their influence on the Reserve is direct and immediate. Every export diminishes the power of the Bank to pay its debts ; and if the outflow reduces, or threatens to reduce, the Reserve below safety point, the rate will have to be raised in order to check the efflux and to attract gold from other quarters. To a great extent, therefore, the Bank is guided by the general tendency of these movements in the adjustment of its rate of discount ; and, as other dealers anticipate its

probable action by advancing their quotations when a gold efflux is likely, and lowering them when inward shipments are arranged, the price of money may in many cases be said to depend on the ability and will of other nations to deprive us of our stock of gold.

The Bank's transactions in bullion are so large and so frequent as to constitute an important part of its business, and the gold held by the Issue Department to provide for the payment of its notes is largely made up of bars and foreign coin, which are in constant demand for export purposes.

Foreign coin is dealt in on the same principle, though the price at which it buys and sells is a question of negotiation, fluctuating, of course, within limits prescribed by the statutory buying and selling price of gold as moderated by the advantage, if any, enjoyed by coin in relation to bullion. As English standard gold is 22 carats fine, that is to say, contains 22 parts pure gold in 24, while the standard of French, German, American, and most other gold coin is nine-tenths fine, the equivalent buying price for the latter should be 76s. 4*d.* per ounce ($\frac{22}{24} : \frac{9}{10} :: 77s. 9d. : 76s. 4d.$). This assumes that the foreign mints work with absolute exactness, but allowing one-half per mille for possible short-comings in this respect, we get 76s. 3½*d.*, which is the rate the Bank usually pays. If the coin bought at this price had actually to be melted and re-minted, the purchases would show a loss; but there is no necessity to send it to the Mint, as it is sure, sooner

or later, to be wanted again for export, and the Bank need only lock it up until it is asked for. The selling price is 3*d.* or 3½*d.* per ounce higher, equal to a profit of about ⅓%. If a run is made on any particular coin, such as Napoleons, or American Eagles, the Bank can stay the outflow for a time by putting another penny on the price. Thus, supposing that it just covers expenses to take Napoleons from the Bank when the French exchange stands at 124·17½, and the price at 76*s.* 6½*d.*, then an advance of a penny would stop the export until the exchange had receded to about 124·04.

Though a change is now and then made in the selling price of coin, the rate at which the Bank buys is practically fixed. It has been pointed out, however, that if a little more could be offered at times when it was desirable to attract gold hither, the advance in price would produce a more certain and more direct effect than that of an advance in the Bank Rate, which is, at best, but a roundabout way of inducing imports. As it is probable that the Bank never has to melt its foreign coin, it would cause no actual loss to pay 1*d.* or 2*d.* more per ounce, though of course it would reduce profits. On the other hand, there is no article in the world that responds so readily to a paying demand as gold, and, frequently, a slight rise in price would make all the difference between profit or no profit on an import.

In the spring our commercial and banking transactions with the rest of the world in normal

times left a balance in our favour, which was remitted to us in gold, but in the autumn, when we were importing and paying for our share in the world's harvest, the balance turned against us, and the gold ebbed away. A reference to the figures of the average Bank Rate would show how closely the latter sympathised with these movements. The year opened with gold at its lowest, and the rate at its highest. As the metal flowed in, the rate gave way ; the peak was reached about Midsummer, and then came the reflux, which was held in check by a further raising of the rate.

This was the position up to 1914, but from that year there is no clearly defined seasonal fluctuation of the Reserve. The latter was affected by artificial factors which provide comparison with pre-War figures only with difficulty. Briefly, conditions of artificiality prevailed from the time when gold exports to America in payment for war material so depleted our Reserve as to enforce a break-away from the gold standard, until the reinstitution of the gold standard in 1925—a decade altogether. The Reserve during this period was affected by purely domestic influences only, except to the extent to which gold export was permitted by Treasury authority, a relatively negligible factor.

It may be taken for granted, then, that the statistics of the Bank's gain or loss of strength from the gold sent into or out of the country form the best ground-work on which to base a forecast of the future course of the market ; but at the

same time it must not be assumed that the connection is always so close and clear as in the instance given. Due allowance must also be made for other influences, such as the general condition of the markets, the state of trade, the political outlook, etc., all of which are considerations that the directors, doubtless, take into account before deciding on a change of rate.

But, on the whole, the broad principle to be kept in view is this, that if the country is losing gold, the necessity of defending the Reserve will compel the Bank to raise its rate ; while, on the other hand, the necessity of earning a dividend for its stockholders will induce it to lower it again as soon as practicable, in order the better to compete with its rivals in the loan market.

CHAPTER VIII

THE FOREIGN EXCHANGES

AN enquiry into the diverse influences that tend to the enhancement or to the depression of the loan value of capital would be wanting in completeness unless it included some attempt to investigate the cause of those movements to and fro of gold, which prove, as we have seen, to be the most potent factor in the determination of its price, or, at any rate, of its price as indicated by the advertised discount rate of the Bank of England. When speaking of gold movements, we mean, of course, such movements as are caused by currency transactions and include such gold, sold to the Bank of England, as is allowed to have free influence on the internal credit position of the country; for it must be understood that gold imports may be sterilised or offset by central bank action, as will hereafter be shown. In other words, we refer, for the present, to movements of gold arising as a result of international trade and finance. To this end we now turn to the subject of Foreign Exchanges, under which general but indefinite designation are classed all those transactions which have for their object the transmission of capital from one country to another.

In its elementary form international trade consists simply of an exchange of commodities. To facilitate settlement, however, each country expresses the value of its exports in gold or silver—"the common denominators of exchange"—and liquidates its foreign dealings by means of bills of exchange.

Just as the payments to be made and received in the course of our home trade are balanced against each other by an interchange of cheques in the clearing house, so the payments that have to pass between different countries in settlement of foreign transactions are balanced against each other by an interchange of bills in the various money markets, or international clearing houses. Those who have exported goods to other countries go there, in effect, to sell their drafts, and thus obtain payment, and those who have imported goods from other countries go there, in effect, to buy remittances, and thus make payment. Until 1921, business in foreign bills of exchange was transacted in the Royal Exchange, dealers meeting there twice a week. An importer to this country, wishing to settle his indebtedness, might do so by remitting foreign bills bought on 'Change but, generally speaking, such bills were purchased for investment by those having funds available for temporary placement at a profit. With the course of time, however, such a method of settlement became incompatible with the requirements of an ever increasing volume of business. Nor was it likely in earlier days that a bill could be purchased for

exactly the amount required. The process of evolution not only changed the "locale" of the market but, in a sense, its nature also. The business of providing foreign remittances is now in the hands of the banks and, in so far as the settlement takes the form of the remittance of a bill of exchange, the bill is frequently a cheque or "sight" draft, not a "time" bill.

PAR OF EXCHANGE

Now, if the dream of an international currency should ever be realised, and if on a given day the demand for bills on, let us say, Germany, was just equal to the supply, then 100 units of currency would buy a bill for 100 units, and exchange would be at par.

The expression Par of Exchange means an equipoise of the exchanges, and indicates a condition of affairs in which the demand for and supply of bills balance each other. Whenever they so balanced, exchange would be visibly at par; and conversely, whenever the exchange between any two countries stood at par, we should know for certain that, at that moment, their claims (in the form of active demands) on each other were equal. This suggests the existence of an international currency; but, as different countries assert their independence by employing different systems, the exchange does not in practice take so simple a form. Nevertheless, it is still true that if the supply of bills on, say, Germany fits the demand, the exchange (which in this

instance is expressed as the number of Reichsmark that are given for £1 sterling) must be at par.

However, we have no means of ascertaining whether and when demand and supply do so balance.

MINT PAR

As a substitute for this ideal par, cambists have adopted what is known as the Mint Par of Exchange. This is obtained by establishing a comparison between the currencies of the countries concerned, based on the weight and fineness of precious metal contained in their respective standard coins. The relationship, for instance, existing between the English sovereign and the French franc depends on the mint regulations of the two countries, which ordain that :—

(a) 1 sovereign shall contain 7·322382 grammes fine gold ;

(b) 1 gold franc = ·05895 gramme fine gold,

$$\text{so that } \text{£}1 = \frac{7\cdot322382}{\cdot05895} \text{ fcs.}$$

$$= 124\cdot2134 \text{ fcs.,}$$

meaning that the same quantity of pure gold is contained in one sovereign fresh from the Mint as in 124·21 francs (basing their value on that of the golden Napoleon). The mint par between England and France is therefore

$$124\cdot21 \text{ francs to the } \text{£}1.$$

A mint par can only be established between countries that employ the same standard of value. It cannot be fixed between a country with a gold

standard and one with a silver standard, because there is no fixed ratio between gold and silver. The value in England of a Shanghai tael, or of a Hongkong dollar, is determined by the price of silver in the London market ; and the value of a sovereign in China, by the fixed price for gold exchange in the open market.

The mint par, again, is not affected by deficiencies of weight or fineness in the standard coin, or by the charges made for coinage, etc. It is pretty certain that 1550 average Napoleons would not lift the scale at ten kilogrammes or 1869 sovereigns at 480 ounces, but the difference does not affect the mint par, which, being purely arbitrary, is concerned only with the statutory weight and fineness, and is therefore unalterable.

VARIATION FROM MINT PAR

When our claims on another country about equal theirs on us, the ones pay for the others, and exchange should be at par.

But it can only very rarely happen that there exists anything like an equivalence of claims. Almost invariably the bills "cleared" must, and do, leave a balance against one country or the other ; and it is this fluctuating balance that affects the exchange, and produces the constant oscillations of the rate.

If, on a given day, the balance of indebtedness between England and France should be against England ; that is to say, if we attempt to pay more to France than France to us, there will be

competition for the bills on offer, and the price will naturally rise. Those who have to make remittances to France will have either to pay more for bills than their par value, or go without. The intrinsic value of 100 sovereigns is 12421·34 francs; but buyers will have to pay more than £100 for a bill of 12421·34 francs, and, if France had the same currency that we have, would have to pay more than £100 for a bill of £100. In other words, bills on France would be at a premium.

To beginners, the question of a premium on the exchange usually appears to be a stumbling-block. They readily understand that a bill may be worth less than its face value, but how it can ever be worth more, they fail to see. And yet the principle is quite familiar in every day life, though it presents itself in a different aspect. Suppose, for instance, you wish to send a sovereign to your young brother at school, how will you manage it? Probably either by buying a Postal Order, for which you will have to pay 2*d.*, or by sending the coin itself, or a note, and paying 3*d.* registration fee. Such being the case, what is the charge of 2*d.* but a premium on the exchange? Because it would cost 3*d.* to send the coin, you prefer to give 20*s.* 2*d.* for a bill of 20*s.*; and, on the same principle, a merchant who has to remit £1000 to Paris will pay more than £1000 for a bill, rather than go to the expense of sending gold. Of course, if it cost 10*s.*% to transmit gold to Paris, he will not pay more than 10*s.*% premium on the bill. Nor would you give more than 3*d.*

for the Postal Order. In the one case as in the other the premium cannot rise beyond the cost of remitting coin.

Assuming, then, that the balance be against us, bills on the other country concerned will be in request here, and will go to a premium. In the days of the Royal Exchange market, this would have meant a shortage in supply, but because the quantity of paper tendered for sale on 'Change fell short of the demand, it by no means followed that some of the intending buyers had to return empty-handed, or that the exchange at once leapt to the gold-moving point. Bills, like most other things, were always to be had at a price, and, if the amount on offer was inadequate, the broker who had buying orders to execute would apply to one of the foreign bankers, or bill merchants, who were always ready to draw on their Continental correspondents to any amount that was required. Nowadays, there is rarely any question of a shortage in the supply of exchange, for all banks are prepared (as were the old foreign bankers or bill merchants) to "manufacture" remittances in the shape of drafts on their correspondents in the centre to which the remittance is to be made. The cost of such drafts is dependent in the first place on the ratio of demand to supply, but the rate of interest paid by foreign banks on London bankers' funds held abroad and the cost of replenishing such balances must also be taken into consideration. The banker will draw at a rate that covers all expenses together

with his correspondent's commission (if any) and some remuneration for himself. The actual extent of the variation from mint par will depend on the equation of two forces ; the strength of demand on one hand, and the competition of other bankers on the other.

Although the indebtedness of the individual is discharged by the remittance of a banker's draft, that of the country as a whole will remain as it was until the banker covers his correspondent. Either gold, or securities, or bills on other countries will serve this purpose, but in all ordinary circumstances the T.T. forms the cheapest and most convenient mode of covering. These are purchased from other, London and foreign, bankers who have surplus funds in the currencies required. Formerly, when bills were the medium in this connection, covering was often an arbitrage transaction. If he had drawn on Germany, for instance, he might remit bills on Amsterdam or Vienna ; if on France, bills on other, adjacent, countries, and so on. This explains the tendency of the exchanges to rise or fall in groups, and shows why an important advance in the price of bills on France was generally (in the absence of special influences) accompanied or followed by a secondary advance in the prices of those on, say, Belgium, Luxembourg and Italy.

Ultimately, therefore, an adverse balance was, and is, discharged, for the time being, by transferring to the creditor country a portion of the balance due to us by other nations.

But such a balance might last for weeks together, and every day bring with it a demand for currency which can only be met by recourse to the banks, who continue issuing drafts, and buying up other transfers for cover. Of course, the longer this goes on the scarcer and dearer will these transfers become, and in proportion as the banker pays more for his remittances so he will have to charge more for his drafts. In the end even—if the adverse balance is large enough, or lasts long enough—other means of remittance may become so expensive that it will pay him better to cover his drafts by buying gold from the Bank of England at the Bank's selling price (tariff price), and shipping it to his correspondent, who will sell it to the Bank of France or to the Reichsbank, as the case may be, at their buying rate (tariff price), and credit him for the proceeds. The price of currency is now said to have reached "Specie" or "Gold" point, and can go no higher (save in very exceptional cases, such as the outbreak of war).

GOLD POINTS

"Specie" or "Gold" Point, which demands particular attention, is the rate of exchange produced by buying gold in one country and selling it in another. If this operation could be carried out without expense, gold point would be identical with the mint par, which, as we know, is the value of a given quantity of gold expressed in different currencies. But an export involves charges. The metal must be packed, insured, and shipped, and,

in addition, brokerage and commission may have to be paid. Deduct these charges from the mint par, and you have the rate at which gold goes out ; add them, and you have the rate at which gold comes in. For instance, gold of the value of £1000 is worth 124213·4 francs ; but if we assume the inclusive cost of transmission to be $\frac{1}{2}\%$, then the outlay necessary to produce 124213·4 francs will be £1000 + $\frac{1}{2}\%$, or £1005. This is equivalent to an exchange of 123·59, so that, if bills on France should rise in value to such an extent that £1000 will only purchase Fcs. 123·59, exchange will have touched the outgoing gold point.

It is obvious that the price of bills cannot ordinarily rise beyond this point, for, rather than pay more, merchants would ship bullion themselves ; and gold, it must be remembered, can always be had at one fixed price of £3 17s. 10½*d.* per oz. English Standard.

Unlike the mint par of exchange, gold point cannot be fixed with exactness. All depends on the charges that have to be paid. One banker may be so situated as to have no brokerage or commission to pay, and, perhaps, by undertaking the operation on a large scale, may also effect a saving on the freight and insurance, and so be able to snatch a profit in cases where another banker, selling drafts at the same price, would not get his money back. The most we can say, therefore, is that gold will generally (though, owing to the presence of other factors, not inevitably) be

shipped when the exchange attains a certain level, that level at which it becomes profitable to export the metal.

BILL MARKET—FOREIGN EXCHANGE QUOTATIONS

At one time all business in foreign bills in this country centred on the Royal Exchange, where days

CORRECTION—PAGE 126.

Line 12 should read: "£1,000 will only stately
purchase Fcs. 123,590'00." se of
the

following is a type:—

COURSE OF EXCHANGE,
London, 8th March, 1888.

On	Usance.	Prices.	
Paris .	Cheque	25·28½ - 25·33½	= Francs and Centimes for £1.
France .	3 mos.	25·45 - 25·50	= " " "
Belgium .	"	25·46½ - 25·51½	= " " "
Germany .	Short	20·36 - 20·40	= Reichsmarks and pfennigs for £1.
"	3 mos.	20·49 - 20·53	= " " "
Holland .	Short	12·1½ - 12·1½	= Florins and stivers for £1.
"	3 mos.	12·2½ - 12·3½	= " " "
Italy .	"	26·10 - 26·15	= Lire and Centesimi for £1.
Switzerland	"	25·52½ - 25·57½	= Francs and centimes for £1.
Petersburg .	"	18½ - 18½	= Pence for 1 Rouble.
Vienna .	"	12·85 - 12·90	= Florins and Kreutzers for £1.
Trieste .	"		
Madrid, etc.	"	46 - 46½	= Pence for 1 Peso.
Lisbon and	"	-	
Oporto .	"	52½ - 52½	= Pence for 1 Milreis.
Copenhagen	"	18·33 - 18·37	= Kronors and öre for £1.
Stockholm .	"	18·35 - 18·39	= " " "
New York .	Short	49½ - 49½	= Pence for 1 Dollar.

The London rates of exchange divided into two groups. In the one was stated the amount of foreign money that exchanged for one pound

sterling; in the other, the amount of sterling that exchanged for one unit of the foreign currency. Most of the extra-European exchanges, for instance, New York, Calcutta, China, Rio de Janeiro, Buenos Aires, Mexico, etc., fell into the latter division, being quoted in shillings and pence, but all the Continental rates, with the exception of Russia, Spain, and Portugal, were rendered in foreign money.

The table published at the present time is of an entirely different nature. It differs from the old "On 'Change" table not only in its construction as a table but in the significance of its constituent factors. The following are taken from *The Times* and *The Financial Times* of July 28th, 1931:—

The Times.

The following table gives the range of telegraphic exchange quotations within which business was reported yesterday:—

Place.	Method of quoting.	Par of exchange.	July 27.	July 28.
New York . .	\$ to £	4·8666	4·85½-4·85½	4·85-4·85½
Montreal . .	\$ to £	4·8666	4·87-4·88	4·87-4·87½
Paris . .	Fr. to £	124·21	123·80-123·98	123·50-124·00
Brussels . .	Bel. to £	35·00	34·75-34·83	34·75-34·82
Milan . .	Lire to £	92·46	92·70-92·85	92·60-92·80
Switzerland . .	Fr. to £	25·2215	24·87-24·92	24·87-24·92
Athens . .	Dr. to £	375	374½-375½	374½-375½
Helsingfors . .	M. to £	193·23	192½-193½	192½-193½
Madrid . .	Pts. to £	25·2215	53·20-54·25	53·75-54·30
Lisbon . .	Escu. to £	—	109½-110½	109½-110½
Amsterdam . .	Fl. to £	12·107	12·03-12·05½	12·03-12·05
Berlin . .	M. to £	20·43	20·25-21·00	20·00-21·00
Vienna . .	Sch. to £	34·58½	34·50-34·60	34·50-34·65
Budapest . .	Pen. to £	27·82	27·70-28·00	27·70-28·00
Prague . .	Kc. to £	164·2527	163½-164½	163½-164
Warsaw . .	Zloty to £	43·38	43½-43½	43-43½
Riga . .	Lats to £	25·2215	25·10-25·40	25·10-25·40
Bucharest . .	Lei to £	813·6	816-818	816-818
Constantinople . .	Pst. to £	110	1,025½	1,025½

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The Times—(continued).

Place.	Method of quoting.	Par of exchange.	July 27.	July 25.
Belgrade . . .	Din. to £	25·22 15	273½-274½	273-275
Kovno . . .	Lit. to £	48·66	48-49	48-49
Sofia . . .	Lev. to £	673·659	667-673	667-675
Reval . . .	E.Kr. to £	18·159	18·20-18·27	18·20-18·30
Oslo . . .	Kr. to £	18·159	18·16-18·17	18·16-18·17
Stockholm . .	Kr. to £	18·159	18·14½-18·16	18·14-18·15½
Copenhagen . .	Kr. to £	18·159	18·16-18·17½	18·16-18·17
Alexandria . .	Pst. to £	97½	97½-97½	97½-97½
Bombay . . .	Per rup.	18d.	1/5½-5½	1/5½-5½
Calcutta . . .	Per rup.	18d.	1/5½-5½	1/5½-5½
Madras . . .	Per rup.	18d.	1/5½-5½	1/5½-5½
Kong-kong . .	Per dol.	—	11½d.-1/0½	11½d.-1/0½
Kobe . . .	Per yen	24·58d.	2/3½-2/0½	2/0½-2/0½
Shanghai . . .	Per tael	—	1/2½-1/3½	1/2½-1/3½
Singapore . . .	Per dol.	2/4	2/3½-3½	2/3½-3½
Batavia . . .	Fl. to £	12·107	12·03-12·05½	12·03-12·05
Manila . . .	Per peso	24·666d.	2/0½	2/0½
Rio de Janeiro	Per mil.	5·899d.	3½-3½	3½-3½
Buenos Aires .	Per dol.	47·619d.	32½-33½	33½-33½
Valparaiso† . .	\$ to £	40	40·00	39·93
Monte Video . .	Per dol.	51d.	25-26½	25-26½
Lima† . . .	Soles to £	17·38	17·12½	17·12½
Mexico . . .	Pesos to £	9·76	9·85-9·90	9·85-9·90

† 90 days. ‡ Nominal.

EMPIRE EXCHANGE RATES.

Buying Rates per £100.

	Demand.	30 days' sight.	60 days' sight.	90 days' sight.
On—	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Australia* . .	131 10 0	132 5 0	133 0 0	133 15 0
New Zealand* .	111 2 6	111 15 0	112 7 6	113 0 0
Africa and Rhodesia	98 15 0	98 3 9	97 12 6	97 1 3

Selling Rates.

	Cable transfers.	Demand.
On—	£ s. d.	£ s. d.
Australia* . .	130 0 0	130 7 6
New Zealand* .	109 12 6	110 0 0
South Africa . .	99 15 0	99 12 6
Rhodesia . . .	99 16 3	99 13 9

* Rates per 100 London pounds.

The Financial Times.

	Quoted.	Par.	July 27.	July 28.
N.Y. (T.T. 1½%) .	Dol. to £	4·86½	4·85½-85½	4·85½-85½
Montreal (T.T.) .	Dol. to £	4·86½	4·87½-87½	4·87½-87½
Amsterdam (2%) .	Fl. to £	12·107	12·04-04½	12·04-04½
Berlin (10%) .	Mks. to £	20·43	20½-20½	20½-20½
Brussels (2½%) .	Belga to £	435	34·79-34·80	34·78-34·80
Madrid (6%) .	Ptas. to £	25·22½	53·55-53·65	53·95-54·05
Milan (5½%) .	Lire to £	92·46	92·77-92·82	92·70-92·80
Paris (2%) .	Fr. to £	124·21	123·85-123·95	123·90-124
Zurich (2%) .	Fr. to £	25·2215	24·88-24·90	24·89-24·91
Copenhagen (3½%) .	Kr. to £	18·159	18·15½-17	18·16-18·17
Helsingfors (6%) .	Mks. to £	193·23	192½-193½	192½-193½
Kovno (7%) .	Litas to £	48·66	48½-48½	48½-48½
Oslo (4%) .	Kr. to £	18·159	18·16½-16½	18·16-18·17
Reval (7%) .	E. Kr. to £	18·159	18·20-18·27	18·20-18·27
Riga (6%) .	Lats. to £	25·22½	25·10-25·40	25·20-25·30
Stockholm (3%) .	Kr. to £	18·159	18·15-15½	18·14½-15½
Alexandria .	Pstrs. to £	97½	97½-97½	97½-97½
Athens (9%) .	Drch. to £	375	374½-375½	374½-375½
Belgrade (7½%) .	Din. to £	25·22½	273½-274	273½-275
Bucharest (8%) .	Lei to £	813·6	816-818	816-818
Budapest (9%) .	Pen. to £	27·82	27·90-28·00†	27·85-27·95†
Constantinople .	Pstrs. to £	110	1,025-35	1,025-35
Durazzo (8%) .	Fr. to £	25·22	25·24-25·36	25·24-25·36
Lisbon (7½%) .	Esc. to £	110	109½-110½	109½-110½
Moscow (8%) .	Rbls. to £	9·458	9·407-9·486	9·407-9·486
Prague (4%) .	Kr. to £	164·25	163½-164½	163½-164
Sofia (8½%) .	Levas to £	673·659	665-675	665-675
Vienna (10%) .	Sch. to £	34·58½	34·50-34·60	34·50-34·60
Warsaw (7½%) .	Zloty to £	43·38	43½-43½	43½-43½
Bangkok .	d. to baht.	21·82d.	21½d.	21½d.
Batavia (4½%) .	Fl. to £	12·107	12·10	12·10
aBombay (6%) .	d. to rupee	18d.	17½-17½d.	17½-17½d.
aCalcutta (6%) .	d. to rupee	18d.	17½-17½d.	17½-17½d.
aHong Kong .	d. to dol.	..	12-12½d.	12-12½d.
aKobe (5·11%) .	d. to yen	24·57d.	24½-24½d.	24½-24½d.
Manila .	d. to peso	24·06d.	2/0½d.	2/0½d.
aSaigon .	d. to pst.	..	19½d.	19½d.
aShanghai .	d. to tael	..	15-15½d.	14½-15½d.
aSingapore .	d. to dol.	..	27½-27½d.	27½-27½d.
aBuenos Aires .	d. to peso	47·58d.	33-33½d.	33½-33½d.
aRio de Janeiro .	d. to Mil.	25·89d.	3½-3½d.	3½-3½d.
cLima (7%) .	Sols. to £	17·38	17·12½	17·12½
aMonte Video .	d. to dol.	51d.	25½-26d.	25½-26d.
Mexico .	Pesos to £	9·76	9·85-9·90	9·85-9·90
cValparaiso .	Dol. to £	40	40·00	39·93

g. Telegraphic transfer. c. Ninety days. d. 1 belga=5 francs.

e. De facto parity. † Nominal.

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The following approximate rates were quoted for forward business:—

	1 month.	2 months.	3 months.
Amsterdam . . .	½c.-par	½c.-par	½c.-par
Berlin . . .	nominal market		
Brussels (a) . . .	around par	par-2c.	1-3c.
Madrid (a) . . .	½-¼c.	½-¾c.	¾-1¼c.
Milan (a) . . .	5-15c.	20-30c.	30-40c.
New York (b) . . .	½-¼c.	1½-¼c.	1½-1¾c.
Paris (b) . . .	12-6c.	20-10c.	25-15c.
Zurich (a) . . .	par-¼c.	par-1c.	par-1c.

(a) Over "spot," i.e., discount. (b) Under "spot," i.e., premium.

DOMINION RATES.

Usance.	Union of S. Africa.		Australia.*		New Zealand.*	
	Buying.	Selling.	Buying.	Selling.	Buying.	Selling.
T. T. . .	%	%	%	%	%	%
Sight . . .	99½	99½	..	130/-/-	..	109/12/6
30 days . . .	98½	99½	131/10/-	130 7/6	111/2/6	110/-/-
60 days . . .	98½	99½	132/5/-	..	111/15/-	..
90 days . . .	97½	99½	133/-/-	..	112/7/6	..
90 days . . .	97½	99½	133/15/-	..	113/-/-	..

* Rates in London per £100 sterling.

CENTRAL AND SOUTH AMERICAN EXCHANGES.

The following are some of the latest Central and South American exchange rates as supplied by the Anglo-South American Bank:—

Place.	Method of quoting.	Par of exchange.	Previous rate.	Latest rate.
Ecuador . . .	Sucres to £1	24.3325	24.61	24.62
Venezuela . . .	Bolivares to £1	25.25	29.40	28.37
Colombia (Bogota) . . .	Pesos to £1	5	5.03½	5.04
Nicaragua . . .	Cordobas to £1	4.8665	4.92	4.96
Salvador . . .	Colones to £1	9.73	9.90	9.92
Bolivia . . .	Bolivianos to £	13.33	13.46½	13.48½

Quotations may now be regarded in three classes: the European, to which may be added New York, Montreal, Alexandria, Batavia and Teheran, in the form of currency to the £; the

Eastern, to which Batavia and Teheran are exceptions, in the form of pence to currency ; and the South American, half of which—Buenos Aires, Rio de Janeiro and Monte Video—are indicated in the form of pence to the local unit, and half—Lima, Mexico and Valparaiso—in terms of the local unit to the £. Generally speaking, newspaper quotations, with the sole exceptions of Valparaiso and Lima, are for telegraphic 'transfer, the exceptions' referred to being for 90 days. In addition, a cheque rate is given for New York and Montreal. It needs only a cursory comparison of the present day table with the old Course of Exchange to appreciate the growth of business between London and South America and the East. Nowadays, most of the Central and South American exchanges are given ; those not included in the above table are of insufficient importance to warrant classing with the major ones.

One or two points regarding the modern table require explanation. Firstly, it will be seen that there are double quotations for each centre ; this may mean that the range for the day is given, as in the case of *The Times*, or that the figures represent the buying and selling rates in the respective currencies. There is no indication as to the precise significance of the double quotation in *The Financial Times*.

The expression " nominal " means that business in the currency referred to is negligible and the quotation is really no guide to the rate which

would be charged or given in regard to a transaction in that currency.

"De facto" parity is the rate at which an exchange is kept, by artificial manipulation, by the government responsible for the currency in question, before the rate is given the force of law. For example, the de facto parity of the franc, prior to stabilisation, was 124·00-·02.

A glance at the two tables will reveal that the Australian and New Zealand exchanges which used to be indicated as a premium or discount in relation to the £ sterling are now quoted in the form of colonial currency for £100 sterling. The South African exchange is quoted sterling to £100 (S.A.).

The table of *The Financial Times* refers to an interesting feature which was never present in the Course of Exchange table, that of "forward" rates. This matter is treated in some detail later.¹

On the Continent generally the rule obtains of stating all rates in the home currency, like ordinary prices. This is the natural and more simple method; but the London system, although somewhat perplexing on first acquaintance, possesses the advantage of enabling easy comparison to be made between the rates current here and abroad. Paris, for example, quotes London in francs and centimes, and, as we quote Paris in the same way, it is seen at a glance whether and to what extent the rates differ. On the other hand, if it were the custom here to

¹ It will be noted that the complaint, made in Clare's Second Edition, that the table did not show the discount rates ruling in foreign centres has been partly met; the figures given are mostly central bank rates.

quote the Continent in sterling, and if, while Paris gave the price of cheques on London as, say, 124·27, we priced Paris cheques at 1·9½*d.* per franc, it is obvious that the identity of the two quotations could not be established without calculation. It has accordingly become the usage to state the exchange here as it is stated abroad ; and as Paris and Zurich quote London in francs, London quotes them in francs ; Brussels in belgas ; Lisbon quotes and is quoted in escudos, and Leningrad (though quotations are not often seen in the papers) is quoted chervonetz to the £10.

No difficulty need be experienced in dealing with a rate expressed in foreign money, if only the bearing of the rise and fall be clearly kept in view. In this case a rise of the rate is of course equivalent to a fall in price, and a rise in price to a fall of the rate. The following report :—" Continued weakness was displayed by Swiss francs and pesetas . . . on the other hand, belgas improved to 34·83," means that the Belgian rate fell, while the Swiss and Spanish rates rose. If you have Belgian currency to sell you try to obtain as low a rate as possible, and, if you are buying, to buy as high as you can. Heavy sales cause the exchange to advance ; heavy purchases cause it to recede.

When a rate in foreign money rises above par, the currency is at a discount, and when it falls below, at a premium ; but these terms are in practice avoided except in the case of rates between this country and Australia and South

Africa, and we say instead that the exchange has moved for or against us, or, simply, that it is higher or lower.

The expressions "favourable" and "unfavourable" are also constantly met with. A favourable exchange is one that tends towards the incoming gold point, and is so styled because an inflow of gold produces an increased Reserve, and cheaper money. An unfavourable exchange, on the other hand, points to an export of gold, and dearer money. It will be found useful to bear in mind that all the Continental exchanges are favourable when above par, and unfavourable when below, or, in other words, that *high rates are for us, and low rates against us*. Yet these expressions must be used guardedly, for a low rate (in foreign currency) is favourable to the exporter from this country, but unfavourable to the importer into this country; again, a low rate, in pence to the foreign unit, means an advantage to the British importer, but a disadvantage to the British exporter. The terms must therefore be regarded from the standpoint of the individual or class concerned in the particular transaction.

The meetings in the Royal Exchange ceased in February, 1921, when the "On 'Change" table disappeared. The business which was then transacted is now carried on in the "City" and large provincial offices of the banks, the discount houses and so on. The market is not a bi-weekly market, dealings between brokers and bankers now being a daily affair.

Apart from this change in the type and nature of the bill market, the twentieth century has seen two others, both of immeasurable importance, of which the effect may be said to have changed the entire face of the market. Both are due to the War. They are, firstly, the domination of the bill market by the Treasury Bill and the establishment of a market in "futures."

TREASURY BILLS

Treasury Bills are a government obligation in the shape of bills issued by, and payable with, the Bank of England at three, six, nine and twelve months after date. They came into existence before the War, but it was the unprecedented increase in government expenditure as a result of the War which changed the Treasury Bill from a relatively unimportant factor in the market to one which virtually controlled bill rates generally. It will be remembered that not only was government expenditure for war material on a colossal scale, but the government found it necessary to control certain commodities and bought itself the nation's requirements in these respects. Its ordinary income was manifestly unequal to the task, with the result that borrowing was resorted to in a degree hitherto unheard of. The Treasury Bill was one method of raising money temporarily and the volume issued at one time reached a figure of over a thousand million pounds. At a time when foreign trade was more or less at a standstill and the banks had practically lost their

principal liquid investment, the Treasury Bill filled the gap. Moreover, it had the quality of unquestionable security, and it followed, therefore, that where the Treasury Bill could be obtained (and there was of necessity no dearth), no one (except the Continent, whose central banks' discount regulations often prohibit their taking "one-name" bills), would prefer to take commercial, or even bank, bills at a higher price—which meant that there could be no market in trade bills, except on a price basis dictated by the price of Treasury Bills or else for foreign investment. From the point of view of government borrowing, the Treasury Bill has the advantage of being a short-dated security, enabling the government to obtain the benefit of cheaper money. There is the disadvantage at the present time (though this is not a disadvantage inherent in the Treasury Bill) that the National Debt is of such magnitude that the government is almost forced to borrow by means of the Bill whether it likes it or not, and whatever the price of money. It is true that in recent years a large part of the floating debt has been funded, but nevertheless the volume of Treasury Bills current is still sufficiently large to make them a considerable influence.

FORWARD EXCHANGE

The second revolutionary feature of the existing market in foreign exchange compared with that of pre-War years is the creation of a market in forward exchange. It has already been explained

that the price of bills could not rise above what were known as the specie or gold export points, for the reason that anyone desiring to settle indebtedness to a foreign creditor would choose the cheapest method, and that if the charges for packing, insurance, transport, commission and brokerage in connection with the shipment of gold were less than the cost of bills, coupons or securities, gold would be sent. This applied necessarily to exchange with such countries as were on a gold standard. The War interrupted intercourse with enemy countries entirely and with the majority also of the others, whether allied or neutral, by reason of the extreme difficulty of transacting business. The cost of the transport of gold and other valuables became prohibitive ; the bill, long or short, lost ground as a means of settlement because of the departure of most nations from the gold standard, and of the depreciation of their currency owing to inflation. It was found necessary to work either on a " cash " basis by means of the telegraphic transfer or else to cover one's self against depreciation in the foreign currency by a forward transaction.

Let it be supposed that an English merchant sells to a Spanish buyer, when the peseta is falling to such an extent that to be paid in pesetas entails serious risk of loss. Unless the Spanish buyer agrees to pay in sterling, the Englishman cannot know within an appreciable margin what amount of sterling his pesetas will realise. This means that he cannot fix his price with any

certainty. The Spanish buyer would not agree to pay in sterling, also because of the uncertainty of his own currency ; he too buys on a certain basis, on which his price to the retailer depends. He is willing to pay in pesetas. There is a deadlock which has to be overcome, but how ? Neither is willing to take the risk and therefore the risk must be borne by someone else, but by whom ? The problem has been solved by resorting to a middleman, or rather, to more than one middleman, the banker and the foreign exchange broker. Let it be supposed also that the Spaniard demands three months' credit as a condition of his doing business. He is willing to give a three months' bill in pesetas, the right to pesetas in three months' time, but the Englishman is dubious as to the course of the peseta in the meantime. If he can persuade his banker to buy from him the right to the pesetas, but on the basis of the present price of the peseta, he would be willing to sacrifice a little to avoid carrying the risk. It may be that he is under contract with the Spaniard to supply material or commodities, for which he has to purchase the raw material. He knows that he will receive so much in pesetas at a definite future time but he does not know how the course of the peseta may run between now and then. He contracts accordingly with his banker to buy from him so many pesetas at the time when he will be in a position to deliver and the price is fixed on the basis of the existing price of the peseta. His raw materials may also have been purchased from a country

whose currency is fluctuating, *e.g.*, from Germany. He knows that in three months' he will be liable to pay his German supplier so many marks, but, in order to be able to fix his price to the Spanish purchaser of the manufactured article, he must know what his manufacturing costs, which include the costs of the material and of the marks, will amount to. He therefore contracts with his banker to sell to him the marks he will require at the time he will require them, and he will be willing to pay something for being relieved of the risk of exchange fluctuations in this currency also.

SHORT AND LONG RATES

In explaining the theory of the exchanges it is conducive to simplicity to disregard at the outset the element of time, and to assume that an ordinary transaction takes the shape of an immediate payment in one country in order to receive the immediate equivalent in another, or, what amounts to the same thing, to assume that cheques are in all cases dealt in.

A glance at the exchange table, which reflects the business that actually takes place, will however dispel this idea. The great majority of the quotations apply to cable or telegraphic transfers¹, the only exceptions being Valparaiso and Lima, for

¹ Formerly, when foreign bill business was transacted in the Royal Exchange, the predominant quotation was that for three months' bills, as the following extract from 'Clare,' Second Edition, shows: "As a matter of fact, the great majority of the quotations apply to bills of three months' currency, and the only Continental 'cheque-rate' that we quote is Paris, though Germany and Holland are also given 'short' (sight to eight days). The sight exchanges often referred to in the Money Article are not London rates, but the quotations current abroad."

which the 90 day rate is given, New York and Montreal. Nevertheless, we are not saying that cheques on other countries are not to be had here. A banker will, if desired, draw "at sight" on Palermo, or Prague, or Cadiz, or almost any other town of importance, but as there is no recognised quotation for cheques, the transaction is out of the ordinary course, and the banker "makes a price."

In practice then we read very little in London of the sight or mail transfer rate to which such prominence is given in theory,¹ and the average exchange transaction consists of an immediate payment on this side in order to receive the equivalent abroad the same day. There would appear to be some difference of opinion as to whether the T.T. (telegraphic transfer) rate governs the sight or cheque rate or *vice versa*. The difference between the two must, however, rest on the interest lost or gained, as the case may be, according to which method is employed. The banker who draws at sight on New York has anything up to a week's use of the money which he receives for his cheque, and the rate must be higher (\$ to £) in consequence. Theoretically, the rate for telegraphic transfer is dependent on the cost to the banker of providing or replenishing balances in the centre on which he is operating. In practice, these can bear no close relationship to one another, by reason of the multiplicity of transactions, of all kinds, in currencies. The T.T. rate is probably more

¹ It should here be noted that the British overseas banks do an appreciable business in sight, or demand, and mail transfers.

closely allied to the rate at which the banker can obtain immediate currency, in a particular centre, as quoted by a foreign exchange broker. It must not be assumed from the above statement that the relationships referred to are not close—they are minutely so, but it is the *basis* of calculation which we wish to stress. It will now clear the ground if we show, in the first place, how the long rate is arrived at, and what relationship exists between the price of a bill at three months, and the price of a cheque. To state a case, say that I have made purchases in France and, the time having arrived for payment, have the choice between remitting a cheque, or a three months' bill; if the cheque would cost me 124·30 per £1, what ought I to pay for the bill? Obviously the difference in price will mainly depend on the rate of interest ruling in France—not on the English rate—for either my correspondent will credit me for my remittance in three months' time, charging interest meanwhile at French bank rate on the balance due to him, or, as is more likely, he will discount the bill with his banker, and credit me at once for the proceeds. If bank rate is 4% in France, the charge on a three months' bill will be 1% cheaper than the cheque, or at 125·54. The price I pay must also cover the expense of the foreign bill stamp ($\frac{1}{2}$ per mille), which brings the rate up to 125·605.

Another consideration will also influence me. I shall be under liability on my endorsement until the bill is actually paid, and the longer it runs the

greater will be the risk. In three months' time the drawer and acceptor may have failed, or war may have broken out. For this risk I must also be compensated by some allowance in price, which is of the nature of an insurance premium, and will be greater or less according to the standing of the other parties to the bill, and to the general state of credit. If I tax my chance of loss on that score at $\frac{1}{4}$ per mille, the result will be that I shall consider 125'636 for a three months' bill as the equivalent price to 124'30 for a cheque.

The long rate, therefore, is, generally speaking, based upon the sight rate, rising and falling in agreement with it, and the amount of its deviation depends on the rate of discount ruling in the country upon which the bill is drawn, and on the state of credit. In other words, broadly speaking, demand versus supply produces the short rate, and demand versus supply, plus interest at the foreign rate, produces the long rate.

It hence follows that while the short exchange cannot move independently of the long, the long exchange can and does move independently of the short ; unless, of course, a movement in the long rate (due to a fall or rise in the rate of interest in the foreign centre) is offset by a change in the relation between the supply of and demand for the currency, creating an equivalent change in the short rate—which is probably rare and unlikely, though possible.

Mention has been made of " the general state of credit " as a factor in the long rate. To a certain

extent this consideration must always influence the buyer of a bill, but it is only in rare cases that we can lay our finger on a movement of the exchange that is distinctly due to disturbance of credit. The following instance will, however, illustrate what is meant. In January, 1882, there was a crisis in Paris, brought on by over-speculation, and many failures occurred. The London exchange on Paris moved as follows :—

1882.	Cheques.	3 months.	Difference.	Discount in Paris.
12th January .	25·25	25·57½	32½c.	5%
19th „ .	25·20	25·55	35c.	„
26th „ .	25·13½	25·50	36½c.	„
2nd February .	25·15	25·53½	38½c.	„

The margin between short and long increased, it is seen, from 32½c. to 38½c., although discount in Paris remained at the same figure.

To quote another case, in April, 1885, news was received in London of an affray between Russian and Afghan outposts at Penj-deh, and it was believed for a time that England would be drawn into war with Russia. The movements of the 3 months' rate on St. Petersburg were :

2nd April .	24½ pence	Dis. 6%
7th „ .	23¾ „	„
9th „ .	21½ „	„

and speak for themselves.

CHAPTER IX

THE FOREIGN EXCHANGES

BILL RATES AND THE PRICE OF MONEY

THE foreign exchanges, it has been well said, are the barometer of the money market.

Between the price of London bills, as expressed in the current rate of discount, and the price of foreign bills, as expressed in the current rates of exchange, there exists at times a close sympathy, —a fact of which we are frequently reminded in the money article, where, as in the following instances :

“ Uncertainty in many foreign centres regard-
“ ing Bank' Rate prospects again caused
“ nervousness in the foreign exchange
“ market.”

“ Until Thursday's reduction in Bank Rate,
“ sterling displayed strength against nearly
“ all currencies, but after the change all
“ rates reacted.”

reference to the position of the one constantly serves to explain a rise or fall or the other.

Before discussing the causes and import of this connection it will be well to make sure that we

understand what is meant by saying that the exchanges have risen or fallen. Suppose, for example, the following movements in the Swiss exchange :—

	3 months.	Cheques.	Discount.
12th Jan. . . .	25·50 .	25·31½ .	2·6%
19th „	25·45 .	25·26½ .	2·6%
	<u>—5</u>	<u>—5</u>	<u>..</u>

Here the sight rate dropped 5c., and as the discount rate in Geneva remained unchanged, the long rate was also marked five points down. Clearly this was a fall of the exchange.

At the beginning of May is a similar instance of a rise :

	3 months.	Cheques.	Discount.
3rd May	25·47½ .	25·28½ .	2·2%
10th „	25·53½ .	25·35 .	2·2%
	<u>+6½c.</u>	<u>+6½c.</u>	<u>..</u>

But now notice the following :—

	3 months.	Cheques.	Discount.
6th Sept. . . .	25·57½ .	25·42½ .	2·0%
4th Oct.	25·70 .	25·42½ .	3·8%
	<u>+12½c.</u>	<u>..</u>	<u>+1·8%</u>

At first sight one might mistake this movement of the 3 months' rate for a rise of the exchange ; but, as a matter of fact, there was neither rise nor fall, the advance in the long quotation being simply a widening of the difference between short and long, caused by the upward movement of discount.

Here again is a case where the long rate, taken by itself, might lead us astray :—

	3 months.	Cheques.	Discount.
2nd Feb.	25·45 .	25·25 .	2·6%
16th Feb. . . .	25·45 .	25·27½ .	2·2%
	<u>..</u>	<u>+2½c.</u>	<u>—·4%</u>

As the cheque gained one per mille, there was a rise in the exchange, which ought to have carried up the long rate as well; but a simultaneous decline in the discount rate also occurred, and as the two influences happened to balance each other exactly, the 3 months' price remained unaltered.

It is plain, therefore, that a rise or fall of the exchange affects both short and long rates alike, but that while in the former case its force is always manifest, in the latter it may be obscured by the action of other influences to which the time rate is subject. Consequently, if only the long rate is available for reference, these other influences must be eliminated before we can safely say that a particular movement is due to changes in the ratio between demand and supply. But as the rate now quoted is for T.T., this point is of academic interest only.

The relationship that has been referred to as existing between the fluctuations of the exchanges and those of the price of money is of the nature of cause and effect, and the link that brings them into connection—the agency that transmutes a rise or fall in the price of foreign bills into a like movement of discount rates—is gold, the ebb and flow of which, while regulating the action of the Bank of England and, through the Bank, that of the market, is itself regulated by the demand for and supply of means of remittance. As might be expected, it is when gold point is within measurable distance that this connection is most apparent, but at all times some semblance of agreement is

traceable between the respective price waves, and it may be laid down as a general rule that discount tends to harden on a decline of the exchanges, and to weaken on an advance. Rising exchanges (those quoted as currency to the £) have thus come to be associated with the idea of cheaper money, while falling exchanges are regarded with disfavour as being the forerunner of a possible bullion drain and of its inevitable accompaniment—dear money.

The principles that underlie a rise or fall form in these circumstances the next subject that suggests itself for enquiry. It is necessary, however, to premise at the outset that as the international dealings of which the exchanges represent the settlement are too varied and too complex almost to be known as a whole to anyone, it is difficult to assign every fluctuation to its specific cause; and that, though a knowledge of the principles that determine such fluctuations is of great value as a guidance, it is capable only of general application and cannot be relied upon to solve the meaning of each particular rise or fall.

Accepted, of course, that they serve as a means of remittance, for what purpose, let us first ask, are bills purchased, and why are there more buyers in the market at one time than at another? The demand for foreign bills is a demand for means of remittance to foreign countries. Other vehicles for the transfer of capital are also procurable, but none so suitable. Gold, or silver, or securities, might serve the same purpose but their use is

impeded by the cost of carriage and insurance, as well as by other drawbacks, and common sense tells us that the least troublesome and least expensive mode of sending money abroad is to buy and remit a bill of exchange.

Such being the reason why bills are sought after, it follows that the greater the stream of outward flowing capital, *i. e.*, the greater the volume of indebtedness to be discharged at any particular moment of time, the stronger will be the demand for bills, and the higher their price. On the other hand, if the inflow of capital exceeds the outflow, the price of London bills will be high abroad, and the price of foreign bills low in London. The position of the exchange is therefore an "outward and visible sign" of the relative strength of two opposing streams of capital, which are incessantly flowing to and from the countries concerned, and it is necessarily in favour of the country that is receiving on balance. Thus, if the exchange on Germany is against us—or below par—*i. e.*, in favour of Germany—that fact is a fairly sure indication that we are remitting more to Germany than Germany to us; if in our favour, or above par, it tends to demonstrate the contrary. It is necessary here, however, to point out that political influences may be strong enough to affect the position. In fact, the exchange between the two countries may be entirely divorced from the question of their relative indebtednesses. Political influence, in the form of lack of confidence in a country's affairs, will readily show itself in the

anxiety to translate its currency into that of the country which holds it. Apart from this, moreover, speculation in the currencies of countries adversely or favourably affected by political considerations will sway exchanges to an appreciable degree, quite irrespective of the ratio of indebtedness between the two.

Why people should wish to make remittances to other countries admits of course of various explanations, but the most natural reason—the reason that first presents itself to the mind—is that of settling a debt ; and it is accordingly usual to assign the place of honour as a regulator of the exchanges to international indebtedness. This, it need hardly be said, arises principally out of trade. The bulk of the bills drawn by one nation on another are created in connection with business transactions, and if we could analyse the contents of a banker's portfolio we should be pretty sure to find that, so far as foreign bills were concerned, trade bills preponderated in numbers, if not in amount. Likely enough they would include most of the smaller bills, and most of those for odd sums.

That the trade demand for bills exercises great influence over their price there can be no question, but it is an influence of which there exists no certain criterion. The Board of Trade, it is true, publishes the declared values of our national imports and exports, and, as we must undoubtedly pay for the one and be paid for the other, this information might be expected to be valuable as a

basis of enquiry. It is obtained, however, in too loose a manner to be of much help, and to infer, because the returns of a given month showed an increase in our imports from Germany, or a falling off in exports, that the German exchange was about to turn against us would, to a practical man, seem an absurdity.

Even if the Board of Trade returns were strictly accurate, they would still need to be accepted with many reservations. In the first place there is considerable diversity in the terms on which mercantile transactions are based. Values may be given on a "C.I.F.," or an "F.O.B.," basis. Again, the practice of "dating forward" may have for effect that goods exported in January only fall to be paid for some months later. Other exports, again, are made "on consignment," and are paid for only as sales are effected.

Secondly, vast sums are drawn on London for goods which never touch our shores at all. As bills on London are in universal demand, and as the names and standing of the great London accepting bankers are universally known, a bill on London will, as a rule, command a proportionately higher price than one drawn on a Continental banker, and if an importer in Germany orders coffee from Rio, or cotton from New Orleans, he will, frequently, and because it pays him better to do so (or because the exporter demands it), open a "reimbursement credit," in favour of the shipper, with a London banker. The consequence will be that, though the produce appears neither

in our imports nor exports, London will pay the exporting country for it and Germany will pay London, so that the Brazilian or American exchanges will, to that extent, be influenced against us and the German for us.

Then again, prior to the War, the interest due to us on the hundreds of millions that we lent to other countries had to be taken into account as a set off in part payment for the commodities they sent us ; and we had, and still have, moreover, a heavy bill against them for services rendered in carrying their wares across the seas. But since the War, and as a result of its incomprehensibly extravagant and futile expenditure, our holdings of foreign securities have considerably diminished, a great proportion having been utilised to meet current indebtedness to America for material supplied for war purposes. Instead, - we are faced with what, before 1914, would have been regarded as a fantastic figure of indebtedness to the United States, the annual service of which demands some £50 millions. The purchase of dollars is, however, so managed by the Government as to have the least influence on the dollar exchange, and the sterling is found by reparations payments by Germany and War debt payments from our allies.

Lastly, poor countries are constantly borrowing from their richer neighbours. Year after year millions of English money find their way to every quarter of the globe, for investment in railways, mines, public works, armaments, etc., and every

new issue helps to sway the exchanges, every interest payment or repayment of capital tends to sway them in the opposite direction.

On the whole, therefore, we are forced to the conclusion that, owing to the many elements of uncertainty, and to the lack of information on essential points, the balance of actual indebtedness between this and other countries must remain an unknown quantity, and that, as we cannot correctly estimate its cause, we cannot hope to predict its effect.

CONTINENTAL INVESTMENT DEMAND

Though the relative strength of the London demand for bills on other countries, and the volume of drawings on London, to pay for purchases of produce and securities, as compared with the demand in those countries for bills on London to pay us for our manufactures, for interest, and for freight, etc., is the natural and original cause of variations in the course of the respective exchanges, there are cases in which the influence of relative indebtedness is dwarfed and even neutralised by another circumstance, which, so far as European countries are concerned, frequently plays the leading part in regulating rates. It is, in fact, almost possible to classify the exchanges on the basis of the influences by which they are mainly governed ; and, if an attempt were made to carry out this arrangement, we should have them fall into two groups, the distinguishing feature between which is what is known as the "investment "

demand, to which more detailed reference is made later in this chapter. The group containing those countries which purchase the London bill as an investment may be said to be comprised, in order of importance, roughly, of France, Holland, Belgium, Germany, the United States, and, less markedly, Italy and Spain. Other countries participate in the demand only intermittently.

It will be seen that the principal European bourses—those of the countries with which we have the most extensive relations, and with which we are most in touch—form a group by themselves, and are characterised by the fact that their variations are dependent not so much on relative indebtedness as on the relative value of money in the respective centres. This, being a new factor in the problem, will require some preliminary explanation.

In all countries where banking and credit are highly developed and where the accumulation of savings constantly tends to outgrow the approved modes of investment, one of the distinctive functions of a banker is to take charge of his customers' spare money until they can find a profitable use for it ; and the first principle of his business or, rather, of this branch of it, is to keep the bulk of such money in a readily available form. The resources must never be far out of reach. In this country in particular, but to a rather less extent on the Continent, convertibility into cash, without difficulty, without loss and without delay, is regarded as the essential qualification of

a suitable outlet for a banker's funds, and to lock up in mortgages, ground rents, and other long-term investments, money that might have to be repaid at short warning, would be to imperil his safety and almost to invite disaster.

In the whole range of interest-bearing securities there is but one class, however, that can be held to possess this qualification in all points, and that is bills of exchange, which, if carefully selected, are as safe as any other investment, and are endowed, moreover, with the excellent property of turning themselves into cash automatically, and at par. A banker who has plenty of good bills to depend upon can, except in times of world upheaval, such as August, 1914, speedily gather together a large reserve of ready money in time of danger, by simply letting his portfolio run down without renewal. Accordingly, they are in general favour as a banker's investment, and in most cases form the backbone of the assets. This is true not only of bankers in these Islands, but of those on the Continent as well, though with this difference, that, whereas the British banker confines himself solely to British paper, his neighbour on the other side of the Channel stocks his bill case with an assortment of foreign, in addition to home, acceptances.

Foreign bills as an investment are strangely neglected by the English joint stock banks. Whether it be that the technicalities that have to be mastered in connection with the business are the deterrent, or whether it be that insular prejudice regards them as unsafe, it is hard to say ;

but there is certainly good reason to doubt whether any of the clearing banks in Great Britain, or the Scotch and Irish, keep a single Continental acceptance in their bill cases; such stock as is kept being mostly, if not entirely, in the hands of the foreign bankers, bill brokers and discount houses.

On the Continent the case is very different. Not only in the capitals, but in all the principal towns, bankers buy and hold bills on other countries, both for the sake of the interest they yield and as part of the regular stock-in-trade, and, other things being equal, naturally lay out most money in those which, for the time being, produce the highest return. The consequences are of the utmost importance, for if interest in this country rises above the Continental level, bankers and other dealers in money in France, Germany, Belgium, Holland, etc., will at once begin to reduce their holding of home and other bills, by selling them, or allowing them to run off, and will replace them by London paper, producing a demand that may amount in the aggregate to many millions, and which almost invariably carries the exchange with it. In a like manner, if interest here falls below that level the exchange will recede as rapidly as it rose, because bankers abroad will get rid of their London bills in order to buy something more remunerative.

It will perhaps help to render this investment demand more intelligible if, at this point we make ourselves acquainted with the exact manner in

which interest is earned on a foreign bill, and also notice how the movements of the exchange affect the yield. Taking the quotations of the Paris-London exchange on, say, the 1st March—when Bank Rate in London stood at 3% and in Paris at $2\frac{1}{2}\%$ and the market rates at $2\frac{1}{2}\%$ and 2% respectively—at 123·086 long and 123·86 sight, a Parisian banker laid out fcs. 100.000 in a three months' bill on London for

Fcs. 100,000 @ 123·086 = £812·44, due 1st June
and had sold on the 31st May at sight rate, which happens to have been again 123·86, as before.
For fcs. 100,000 he would receive back

$$£812·44 @ 123·86 = \text{fcs. } 100,628·80$$

which is equal (leaving stamps, etc., out of consideration), to a little over $2\frac{1}{2}\%$ per annum, and is the exact return that was in prospect when the operation was initiated.

Now suppose the purchase to have taken place on, say,

5th Jan.	London bank-rate	3%	Long exchange	123·521
	„ market-rate	2%	Sight „	124·337

fcs. 100,000 @ 123·521 = £809·58 due 5th April
and the sale at the beginning of April, sight exchange being 123·863,

$$£809·58 @ 123·863 = \text{fcs. } 100,277·00$$

In this case the exchange rose so that, although 81·60 centimes per pound were received for interest, there was a loss of 47·40 centimes on the rate, making a net yield of 34·20 centimes for each pound invested, or nearly 1·1% p.a.

Finally, consider the following purchase :—

28th June .	London bank-rate	2½%	.	Long exchange	123·537
	„ market-rate	2½%	.	Sight „	124·275

fcs. 100,000 @ 123·537 = £809·47 due 28th Sept.

which, sold on 27th Sept., sight exchange being 124·438 :

£809·47 @ 124·438 = fcs. 100,728·82

Here a fall of the exchange from 124·275 to 124·438 added 16·30 centimes to the 73·80 receivable for interest, giving a total return of 90·10 centimes per £1 which is over 2·9% p.a.

These instances are sufficient to explain that, in order to earn interest by way of an investment in foreign bills, three months' paper is bought at the long or cheap price, and sold when due at the short or dearer price (if sold before maturity, the price is proportionate), the margin between the two rates giving the return on each pound invested. They make it clear, too, that until the resale has been effected, the outturn of the investment is never certain ; for, though the difference between short and long at the time of the purchase is the presumptive yield, the actual yield will of course be the difference between the long rate at the time of purchase, and the short rate at the time of the sale. There is thus a savour of speculation about the business, which may partly account for the disesteem in which foreign bills are held by English bankers, though on the other side of the question it may be noted that they are usually only bought for investment when the presumptive yield is

greater than the discount obtainable on home bills, that they can be turned into cash whenever desired, and that the fluctuations range within comparatively narrow limits, besides having a constant tendency to right themselves.

The Continental buying of London paper for the portfolio, though it may be said to commence as soon as the interest obtainable thereon shows a profit over home rates, does not manifest itself in its full strength until the discount ruling here for the best bank bills exceeds the market price of corresponding paper ("haute banque") abroad. The great banks of Paris, Berlin, etc., want first class paper, and are willing to pay the first class price. Hence the real investment demand—the demand for sums large enough to sway the course of the exchange—is governed by the London market rate for the best bank paper, and, in proportion as this rises above the corresponding rate abroad, so buying increases and the exchange advances. Finally, even, if the attraction of capital is sustained by the continuance of a high discount rate, exchange may be forced up to gold point, and gold will then begin to flow in.

In detail, the rise of the exchange in such circumstances is occasioned as much by sales of Continental drafts as by the purchase of London on the foreign bourses, for, as the supply abroad of choice bank bills on this country is limited, the buyers in Paris, etc., take the natural course of satisfying their requirements in the best stocked market, and, to that end, instruct their London

agents to buy for them from the discount brokers here, and to draw for the amount of their purchases. The offer of these drafts for sale here has, of course, the same effect on the exchange as would be produced by the demand for an equal amount of London bills in Paris; that is to say, while London is growing dearer in Paris, Paris is growing cheaper in London, the movements on each side being practically simultaneous and identical. It is hardly necessary to mention that the London price of Paris never sensibly differs from the Paris price of London, and that—the two sides being kept in constant touch by telephone and telegraph—it is immaterial which leads, as the other will at once follow suit. If this were not so, an easy profit could be made by taking advantage of the difference.

Thus, supposing Paris quoted London at 124·23, and London, Paris at 124·20, an operator would instantly sell London in Paris (by telegraphing or telephoning his correspondent to draw upon him) and Paris in London, the result of the transaction being that for his own draft of say fcs. 124,200 he would receive £1000 here, and be charged fcs. 124,200 in Paris, and for his agent's draft of say £1000 would pay £1000 here, and be credited with fcs. 124,230 in Paris, thus finishing with fcs. 30 to the good. As, in such a case, the sales of London in Paris would tend to depress the quotation there, while the sales of Paris in London would tend to raise it here, it is clear that the difference would be speedily levelled by the action of these so-called "arbitrage" operations.

INTEREST RATES AND THE EXCHANGES

In illustration of the economic law that high interest attracts capital from abroad, and as evidence of the influence thereby brought to bear on the course of the exchange, reference may be had to a quotation from *The Times* in February, 1931, which treats of two exchanges in this connection. It is as follows :

"INFLUX OF AMERICAN FUNDS.

" The policy of the Bank of England in checking
" the fall in the pound sterling by reducing the
" redundancy of bank credit has already borne
" fruit. Besides making purchases of sterling
" bills, American banks have offered large sums
" for fixed deposits with London banks, and still
" more would be forthcoming if the open market
" discount rate were advanced a little further.
" This influx of American money has brought
" about a material improvement in the dollar
" value of sterling, and yesterday the New York
" exchange was the best feature among the foreign
" exchanges. A fortnight ago the rate was only
" \$4·85 $\frac{9}{32}$; yesterday it touched \$4·85 $\frac{7}{8}$. The
" movement of funds from America to London is
" the more interesting since American bankers
" have lately called in funds from certain countries
" where they had been earning a better return
" than can be obtained in London. Apparently
" they prefer the lower rates that can be earned in
" London because the risk is less. Of course, if

“ London called in funds as readily as some other
“ countries the economic troubles of the world
“ would be gravely accentuated. The new creditor
“ countries have yet to learn that to call in foreign
“ credits is a serious matter, especially in times
“ like the present. Such action should only be
“ resorted to in case of real emergency. The Paris
“ exchange was also firmer yesterday, closing at
“ 123'91½ fcs. against 123'89 fcs. on Monday. At
“ the present figure gold withdrawals from the
“ Bank are not profitable. This exchange, how-
“ ever, is very erratic in its movements, and no
“ confidence can yet be felt regarding the cessation
“ of the gold flow to Paris.”

It is here necessary to draw attention to another factor, one which has been much in evidence in the past two years and which did not exist prior to the War period. The factor in question is the existence in one centre of abnormal amounts of the balances of another. We refer, in particular, to French balances transferred to London not as a result of higher interest rates, but as a safeguard against the fall of the franc. In explanation of this it is necessary to digress for a moment.

The War brought with it abnormal production and expenditure—largely unprofitable, inasmuch as the material produced was destined for rapid destruction. The credit systems of the belligerent nations were unable to withstand the strain and, in consequence, they resorted to inconvertible paper in order to meet the huge demand for

currency; they "watered" the wealth of the country. The result was that currency was created to carry goods and services which were, in the main, immediately destroyed, and, inevitably, the quantity theory of money began to function. Prices rose and the value of gold fell. Internal price levels being reflected in the external values of the currencies, the foreign exchanges swang away from mint pars; gold points went by the board, as did the gold standard and, when the War was over, the belligerent countries found themselves possessed of currencies having an exchange value far below that of 1914. Great Britain extricated itself in 1925 by a return to the gold standard; other countries had to "stabilise" at a point approximate to that to which the currency had fallen, in order to avoid the extreme hardship which a rigid deflation to pre-War figures would have entailed. Germany was compelled to make a fresh start with a new unit. Foreign nationals had, in the meantime, become frightened of their own currencies and had endeavoured to save themselves from the serious loss with which they were threatened by transferring balances to more stable centres, largely London and New York. This naturally led to a weakening in the exchange value of the currency, which weakening became so serious that, for a time, restrictions were placed by the governments concerned on the export of the currency.

When the currencies were stabilised, the balances were repatriated, in spite of the fact that London

rates were higher than those on the Continent, because they were needed in their own countries. A gold efflux ensued, reaching, in 1929, serious proportions and finally forcing the Bank of England to raise the Bank Rate to $6\frac{1}{2}\%$, the highest figure for nine years. This ultimately stemmed the drain, though it brought no fresh gold to this country. It is interesting to note that in the following weeks the movements of the Bank Rate and gold were as shown :

	%	Millions.		%	Millions.
July 24 .	$5\frac{1}{2}$	£5 + out	Oct. 9 .	$6\frac{1}{2}$	1.6 + in.
„ 31 .	$5\frac{1}{2}$	8 + out	„ 16 .	$6\frac{1}{2}$	.9 + in.
Aug. 7 .	$5\frac{1}{2}$	1.7 + out	„ 23 .	$6\frac{1}{2}$	.07 + in.
„ 14 .	$5\frac{1}{2}$	.7 + out	„ 30 .	$6\frac{1}{2}$	.8 + out.
„ 21 .	$5\frac{1}{2}$	2.6 + out	Nov. 6 .	6	.2 + in.
„ 28 .	$5\frac{1}{2}$	.6 + out	„ 13 .	6	.6 + in.
Sept. 4 .	$5\frac{1}{2}$	.1 + out	„ 20 .	6	.1 + in.
„ 11 .	$5\frac{1}{2}$	.2 + out	„ 27 .	$5\frac{1}{2}$	2.5 + in.
„ 18 .	$5\frac{1}{2}$	.5 + out	Dec. 4 .	$5\frac{1}{2}$	.9 + in.
„ 25 .	$5\frac{1}{2}$	3.6 + out	„ 11 .	$5\frac{1}{2}$	3.2 + in.
Oct. 2 .	$6\frac{1}{2}$	2.8 + out	„ 18 .	5	3.4 + in.

The gold “in” does not necessarily mean imported as a direct result of exchanges due to the raising of the Bank Rate, but that the Bank was able to acquire gold in the market.

Admittedly the circumstances were entirely exceptional, but they serve to illustrate that gold movements are by no means the result of comparative interest rates only.

To invite the temporary loan of foreign floating capital by bidding high for its use is of little avail, unless its owners can feel assured of employing their money with safety as well as with profit, and to ensure the success of the operation it is no less essential to offer absolute security than to offer

remunerative interest. It is, in fact, only because English credit ranks as it does that an advance in discount rates operates so effectually on the exchange, and though it requires a stretch of imagination to suppose that the best class of London bills could in any circumstances fall into discredit, it is, nevertheless, quite within the range of possibility that a shock to confidence, such as a great failure is liable to occasion, might, by rendering foreign capitalists chary for the time being of trusting us with their spare funds, rob a high Bank Rate of all magnetic virtue.¹ The Bank, as we know, depends for the replenishment of a falling Reserve on its ability to attract gold from abroad, but high rates have failed to influence the exchanges before when general credit was bad, and they might fail again.

Quite apart, too, from the question of credit, it is to be observed that the extent to which the exchanges may be affected by a given margin between discount rates is not reducible to rules, but varies in each case according to the attendant circumstances. There exists no necessary relation, no definite ratio, between the two sets of fluctuations. If the London market quotation gains, say, one per cent. on that ruling in Paris, the exchange is pretty sure to exhibit some sign of the consequent investment demand; but what the actual rise will be no one can foretell, for other influences are always at work, which may either hasten or retard the upward movement. The investment buying

¹ Cf. the position in August, 1931.

itself is also not of uniform strength, but will be greater or less according to the condition of the continental markets, and to the opportunities that offer for the advantageous use of spare money at home.

GOLD MOVEMENTS

To sum up the result of our investigation into the influences that control the course of the chief European exchanges, we find that, excluding the political factor and the possible effect of shocks affecting confidence, the amount of their deviation from par is a measure of the strength, either united or counteractive, of two distinct forces—relative indebtedness and the relative value of money ; and that the latter, unlike the former, is the outcome of conditions that are known, and that are susceptible of artificial regulation.

Why an advance of the official minimum should be regarded as a means to the attraction of gold is now apparent. It is argued that if Bank Rate goes up the market will follow, or can be made to follow ; that if the market rate for best three months' bills rises above the corresponding charge in Paris and Berlin, etc., Continental capitalists will probably invest much of their floating funds in London paper ; and that, if the supply of remittances on this country can thereby be so largely reduced as to fall short of the effective demand, some part of the balance due to us may have to be sent in gold. It is assumed, in short, that the Bank of England, by acting on the relative

value of money, will be able to turn the exchanges in our favour, and, ultimately, to force them up to gold point.

In the working out of this process little difficulty is experienced until the final stage is reached. So long as credit is good here, high interest almost invariably leads to a rise of the exchanges, but it is noticeable that, when on the very verge of gold point, the upward movement almost as invariably receives a check. This is explainable to some extent by the existence, in addition to bills of exchange and the precious metals, of a third means of remittance, consisting of the so-called "international" securities. Certain bonds of the Italian, Egyptian, Austrian, Argentine and other governments, being quoted and dealt in on the principal foreign bourses, as well as on the London Stock Exchange, can be bought in one country, and sold in another, at practically equivalent prices, and are hence available in case of need as a medium for the transmission of capital ; but as the operation involves the expense of insurance and brokerages, as well as loss of the margin between buying and selling prices, it can only be resorted to with advantage when bills are exceptionally dear, and, in the matter of expense, there is probably little to choose between a shipment of bullion and a shipment of securities. When, however, an advance of the exchange is suddenly arrested just below gold point, it may mean that the "arbitrage" of bonds is beginning to yield a profit.

Another reason is that a high exchange invites speculation for the fall. When cheques on Germany, let us say, stand as high as 20·50 (long being 20·50 plus interest), there is plenty of room for a fall, but very little for an advance, and a speculative purchase of bills may be thought to offer good prospects of profit on the eventual re-sale. If so, a demand for German paper is likely to spring up in London, which will go towards neutralising the effect of the demand for London paper in Germany.

In spite, however, of all counteractive agencies, experience proves that, in the long run, a high Bank Rate rarely fails to draw gold hither from one point or another. There may be protracted delay, but it is almost sure to come at last.

Now, as an increase of the Reserve must, sooner or later, be followed by a reduction of the official minimum, it is very natural that the bill brokers and discount houses should bestow great attention on the signs of an inflow, and that, when gold point is close at hand, the further movements of the exchange should be reflected in the fluctuations of the market rate. If the exchange continues to gain, we find that discount weakens, because dealers, in their anxiety to secure as many bills as possible before the anticipated fall, begin to outbid each other; if it relapses, discount hardens, because it is feared that the Bank may be forced to give the screw another turn. So intimate, sometimes, is this connection that it is difficult to

distinguish between effect and counter-effect, or to say whether the exchange controls the discount rate, or the rate the exchange.

Immediately it becomes known that gold has actually arrived,¹ the market quotation gives way—the fall being greater or less in proportion to the quantity of money seeking employment, and to the magnitude of the receipts—and the exchanges follow ; for as London bills now yield a lower return than before, the Continental investment demand ceases, and the price declines for want of support. The fall is hastened also by sales on the part of those who, having bought on the basis of the higher discount charge, take advantage of the relapse to realise at a profit. Thus, if discount here is at 4%, and Berlin quotes London 20·50 cheque and 20·30 for three months' (leaving stamps, etc., out of consideration), it is evident that a drop to 3% must reduce the margin between short and long by five points to 20·50–20·35, so that those who had previously bought long at 20·30 could in theory gain about $\frac{1}{4}$ % either by re-selling at 20·35, or by the more usual course or remitting the bill to London for discount and drawing against it. The competition of sellers would, however, force them to accept a lower price—say, 20·47 $\frac{1}{2}$ –20·32 $\frac{1}{2}$; and if discount, while going down here, were going up in Berlin they might perhaps be willing to relinquish the whole

¹ In fact, on the completion of arrangements for a gold shipment, the bullion arbitragist sells the foreign currency which the shipments will produce, because if he waited till the arrival of the metal, the exchange might go against him and deprive him of his profit.

profit, making the rate 20'45-20'30 ; while, finally, if money were now worth more at home than here they might even sell at a loss.

The following fall of the German rate will illustrate the foregoing explanation :

Date.	Gold movements during week.	Bank rate.	London market-rate.	Berlin market-rate.	London cheque in Berlin.	3 mos. London in Berlin.
3rd Oct.	£339,000 out	Raised to 5%	4½%	3½%	20'48½	20'25½
10th „	764,000 in	„	3½ „	3½ „	20'45½	20'26
17th „	393,000 „	„	3½ „	3½ „	20'42½	20'24
24th „	22,000 „	„	3 „	3½ „	20'36½	20'22½

As the effect of an advance of Bank Rate to 5% the stock of bullion soon registered a large gain, and the market, believing pressure to be over, competed so eagerly for bills, that within three weeks the rate had broken away to 3%, although the official minimum remained unchanged. The German exchange, it will be seen, followed the downward course of the market, but it is noticeable that whereas a fall in discount from 4½% to 3½%, when London was above Berlin, only brought the exchange down three points, a fall from 3½% to 3%, when London was below Berlin, brought it down six points.

Although the property of influencing discount quotations has, for the sake of brevity, been ascribed to the " exchanges " in general, it is to be observed that only those rates affect the market, the rise or fall of which is attended by the possibility of an eventual gold movement, and that this condition is fulfilled by very few. Gold, it is evident, can only be had from countries that

have it to give, and are willing to give it. Unless they possess mines, it must be taken either from the circulation (if there is one) or from the central reserve ; so that, in the case of a country that has no mines, that has little or no gold in circulation, and that refuses to trench on its central reserve for export purposes, gold point is completely inoperative.

As an instance we may cite the exchange with Spain. The monetary system of Spain being in theory identical with that of France prior to stabilisation, the mint par with England is 25·22, and the nominal gold point may be taken at perhaps 1% higher ; but as there is a forced currency of depreciated paper, and as the country hesitates to use its more than adequate gold reserve the exchange is at a figure showing the peseta to be worth less than half what it should be worth. From Italy, too, at the present time, gold cannot be obtained. The Italian currency consists almost entirely of notes, which are redeemable in gold or silver on presentation, and though the National Bank might pay out small sums in gold it would certainly refuse it if demanded to a large amount for export. In such cases as these the exchange is subject to very wide fluctuations, the value of paper money being at the mercy of the issuing government's political, as well as financial, troubles.

To come to the point, the exchanges that bring gold to the Bank of England are practically reducible to three, namely : those of France,

Germany and the United States. These are all wealthy nations, are all holders of large stocks of metal, and are all able to bear a withdrawal of one or two millions without, as a rule, seriously feeling the loss. France, we may add, is to be understood as including Belgium and Switzerland, the rates of which, though often more in our favour than the Paris quotation, never differ relatively by more than the cost of sending specie across the frontier. The Dutch and Scandinavian exchanges are also omitted, because they are prevented from attaining gold point by the arbitrage operations of Berlin bankers, and are, therefore, to a great extent subordinate to the German rate. Supplies also reach us from Australia and South Africa, but these imports stand on a different footing. Being gold-producing countries,¹ Australia and South Africa ship the produce of their mines as an article of merchandise, and in payment for goods received, just as they send copper or fruit.

Turning to the other side of the question, that of exports, we again find that France, Germany, and America take the lead. Before the War the rest of the world bought and borrowed so largely from us that there was rarely any question of the exchanges being against London. In exceptional circumstances, such as the issue of a new loan, they might on occasions swing round to gold point, but their normal condition was favourable.²

¹ The United States is now the second largest producer of gold.

² It will be seen from the tables given on pp. 128-131 that the exchanges were in the main against us.

How, then, one might ask, were the numerous withdrawals from the Bank of England for various destinations to be accounted for? The explanation is simple. Many withdrawals are not exchange operations at all, but are shipments "to order." This or that foreign government happening, let us suppose, to be in want of gold for some purpose or another—for example, for political reasons—instructs its banker to buy a certain quantity as cheaply as possible, and to debit it with the cost; and as London is the most accessible of the gold markets, the banker sends the order to his agent here, who executes it by taking bars from the Bank. A good exchange may help a transaction of this nature, for if the rate is favourable to the foreign government so much the better; but a bad one cannot hinder, for whether favourable or not the bullion will be taken if there is actual need of it. A further illustration of the movement of gold not attributable directly to the exchanges is that of France during the past eighteen months.

The Bank's losses of gold, therefore, cannot all be put down to the working of the exchanges; but, on the other hand, neither can all its gains. Large imports are occasionally made in connection with the financing of foreign loans. It is almost essential to the success of such operations that money should be plentiful and cheap, and, though the big finance houses, who undertake to carry them through, cannot increase the quantity of loanable capital, they can do much to make and

keep the market easy by bringing gold here, as required, to maintain the Reserve. Consequently it is no unusual occurrence for the announcement of a conversion or of a group of new issues to be accompanied by an artificial inflow of bullion, which is intended to smooth the way.

Notwithstanding the possibility of these casual interferences, the ebb and flow of gold is determined in the main by the action of the exchanges, and we now proceed to an examination of the three principal rates, those of Paris, Berlin and New York.

CHAPTER X

THE FOREIGN EXCHANGES

PARIS

THE mint par of exchange between England and France before the War was 25·2215, but for convenience was commonly called 25·22½.

To transmit bullion from London to Paris cost about 10 centimes per £, and the outgoing gold-point lay between 25·10 and 25·15. At the higher of these rates there was said to be a profit on buying light French gold from the Bank by weight, and setting it in circulation in France, and at the lower it would probably pay to export sovereigns. The result of such operations, it has already been pointed out, was determined by the charges that had to be borne, and, as these varied according to the position of the exporter and the magnitude of the operation, only approximate figures could be given.

The incoming gold point, or the exchange at which we ought to have drawn gold from France, was nominally about 25·32½; but as the rate sometimes stood above this figure for appreciable periods, it would appear that there existed some obstacle to the outflow. Such was in fact the case, and the obstruction was a premium on gold, imposed by the Bank of France.

Unlike the Bank of England, which is a private corporation, existing solely for the benefit of its stockholders, the Bank of France was (and is) regarded as a semi-independent department of the state, and as such was expected to adapt its policy to the views of the government, as well as to private ends. In endeavouring to hinder an export of the precious metal it fulfilled a public function. The contingency of war, be it remembered, has never for a moment been absent from the minds of those who have the direction of Continental finances, and the gold lying in the vaults of the Bank of France is looked upon as the national war treasure, to part with which for mere trade considerations would be want of patriotism.

Then, again, while the metallic reserve of the Bank of England consisted almost exclusively of gold, that of its neighbour was about half silver. It also happened that the balance of indebtedness between England and France was usually in our favour, and there can be little doubt that, if the Bank of France had always been ready to accede to demands for export, the result would have been to absorb much of her stock, and to fill its place with the cheaper substitute. For these reasons the Banque has almost invariably shown herself disinclined to let gold leave the country.

When Napoleons were asked for against notes, the request was treated according to circumstances. If the exchanges were favourable, and gold was wanted by a customer for trade purposes within

the country, it would be given out as a matter of course to any reasonable amount ; though, even in this case, it was said that the applicant was expected to pay for the gold by discounting first-class bills at the French bank rate, by which means the Banque was enabled to make an indirect profit on its coin, as the paper would otherwise have gone into the market. If, however, the exchanges were against the country, the Banque protected itself by paying out small coin, which, like our own half-sovereigns, were so worn as to be useless for export, and eventually could exercise its right to pay in 5-franc silver pieces, which, under the monetary system of the country, were legal tender to any amount.

Applications for large withdrawals avowedly for export had to be submitted to the directors, who fixed the premium at which they were willing to sell bars and foreign coin. This premium varied with the intensity of the demand, and has been as high as 9 per mille. In most cases it was prohibitive, and was meant to be understood as a refusal.

As soon as a premium came into operation, the nominal gold point was superseded, and had to be modified in conformity. At 4 per mille, for instance, the exchange would have had to advance to 25'42½ before it would have paid to take gold from the Banque.

Now, if the only means of obtaining gold from France were by the encashment of notes, as is the case with us, a persistent refusal to let it go, when the balance of indebtedness was adverse, would

have amounted to much the same thing as retrogression to the silver standard, and the exchange would have risen in proportion.

Why this did not occur in practice is because gold could always be extracted from the circulation. The banking system of the United Kingdom is so elaborate, and credit on the whole so good, that our currency consists mainly of cheques ; but in France the cheque system was almost (and is still relatively) unknown, and trade was carried on entirely on a gold basis. The bankers of Paris and other large cities issued cheques, but the latter were looked upon in much the same light as we in London regard a banker's payment. Payments were everywhere effected in gold or notes, and of the two the former were preferred, as notes had more than once engaged the attention of forgers. The quantity of gold coin in use was consequently very large, and, though estimates differ widely as to the actual amount, it was no doubt much larger than the circulation of this country, and there was no difficulty in collecting a considerable sum for export. Gold point being $25\cdot32\frac{1}{2}$, it followed that if the price of cheques on London rose higher it became cheaper to remit full weight Napoleons than to buy and remit a sight draft. What happened then in such a case was that full weight coins were sorted out and sent away ; at a step or two higher the heavy coins followed, and lastly, if the exchange went a point or two beyond $25\cdot40$, ordinary coin, taken as it came, would yield a profit.

The effective limits to the range of the French

exchange might, therefore, be laid down at that time as 25·10 on the one side, and, on the other, such point beyond 25·32½ as might be determined by the average loss of weight on the best coin available, together with the cost of collection.

The policy of restricting withdrawals by means of a premium appears at best to be of very doubtful wisdom. In the first place it could never actually prevent gold from leaving the country; for if there was a balance owing to us from France, and we refused to accept payment in kind or in securities, no other medium of liquidation would remain but gold, and a premium would serve only to dam up the outflow until the exchange reached a higher level. Secondly, it would inflict a fine on those who had to remit to England; for if 25·32½ were the effective gold point, it would also be the limit to the price of cheques, while a merchant might be compelled to pay ¼% or so more for his remittance than would otherwise be the case. Lastly, it is open to question whether in the end it really prevents diminution of the Banque's stock, which was its only justification. When an export of gold was in progress the customers of the Bank of France could hardly expect to be freely paid in gold, but, as soon as the drain was over, they saw no reason for not asking for what they wanted, and would have been much incensed if their legitimate requirements had been refused; consequently, if the export had caused any deficiency to be felt in the circulation, the vacuum was gradually filled up at the Banque's expense.

The question inevitably suggests itself why the Bank of France should not have copied the example of its neighbours, and have tried the effect of an increased discount rate. Apparently the reason was that the French had a liking for cheap money, which they believe to be good for trade, and that the Banque yielded to the pressure of public opinion.

The history of the French exchange subsequent to the War is related in brief in the final chapter of this book. Apart from the fact the French franc has been stabilised at a different figure from those at which the exchanges of other countries have been stabilised, the factors which determine the gold points apply much the same in each case. It may be of interest, however, to indicate how the French gold import and export points are arrived at at the present time. Permission has kindly been given, by the author of *International Gold Movements*, Dr. Paul Einzig, to quote from the first Appendix to his book :—

32,150·725 oz. fine gold at 84s. 11·45455d.	£136,567 10 0
Freight, 10½d. per £100	52 15 3
Insurance, 6d. per £100	34 3 0
Interest, 2 days, 5%	37 8 6
Packing, 20 boxes	5 0 0
	£136,703 16 9
1000 kilos fine gold at 16,963·50	Frs. 16,963,500
Minting costs 2·20 per kilo of ·9 fineness	22,222
Gold export point : Frs. 123·93	Frs. 16,941,278
1000 kilos of fine gold	Frs. 16,963,500
Freight, 10½d. per £100	7,382
Insurance, 6d. per £100	4,241
Interest, 2 days, 5%	4,179
Incidental cost	400
	Frs. 16,979,702
32,150·725 oz. fine gold at 84s. 9·81818d.	£136,348 6 0½
Gold import point : Frs. 124·5541.	

BERLIN

Turning to Germany, we find a system in operation which is nearly on all fours with our own. Not only do both countries enjoy the luxury of a gold standard, and both central banks pay out gold to any amount on presentation of their notes, but both also adopt the same plan of correcting adverse exchanges by an advance of the official discount charge, and frequently raise or lower their rates almost simultaneously.

According to German mint law the Reichsmark must contain 37^1_{90} kilogramme of fine gold, and the par with the United Kingdom is therefore about 20·429, as follows :

1 RM.	=	£1
if £1	=	7·98805 grammes standard
and grammes standard 12	=	11 grammes fine
and grammes fine 1000	=	2790 RM.
$7·98805 \times 11 \times 2790$	=	20·429 RM.
12×1000		

The gold points are approximately 20·33 against us, and 20·53 for us. The latter is the rate at which the Bank of England gains gold at the expense of the Reichsbank, and is always effective. Though the Reichsbank is for several reasons very loth to see its reserves of metal drawn upon for the benefit of other countries, it has in no instance ever refused to pay out full-weighted gold at the head office in Berlin ; nor, of course, has it the power to refuse. At the same time, there is a general impression that, while always saying " Yes," it usually means " No " ; and it is said to have occasionally visited its resentment upon exporters who have had the temerity to ask for gold at

inconvenient seasons. Whatever the nature of the pressure may be that the Reichsbank is able to exert on the Berlin bankers, it appears to be effectual in hindering them from acting counter to its wishes.

To illustrate how gold points are arrived at we give the theoretical calculation¹ of a shipment of gold from London to Berlin and Bremen.

	Shipment to	
	Berlin.	Bremen.
32,150·725 oz. at 84s. 11·45455d. . .	£136,567 10 3	£136,567 10 3
Transport (1s. 9d. per £100 for Berlin, 1s. 4d. for Bremen) . . .	119 10 6	91 1 3
Insurance (1s. 0d. for Berlin, 9d. for Bremen) . . .	68 10 0	51 7 6
Interest, 5% (3 days for Berlin, 2 days for Bremen) . . .	56 3 6	37 8 10
Packing and Boxes . . .	5 0 0	5 0 0
	£136,816 14 3	£136,752 7 10
1000 kilos fine gold at RM. 2784 . . .	RM. 2,784,000	
Gold export point . . .	RM. 20·3484	RM. 20·3580

The policy pursued by the Reichsbank in the struggle for gold is far more enterprising than that of the Bank of England, and any legitimate expedient that will tend to smooth the way for imports is adopted without hesitation. Its assay of foreign coin, for instance, is said to be more favourable to the seller than that of the Bank of England, and it is even willing to bear the small loss of interest that is incurred on a shipment from this country, having to that end offered to make advances for six days, free of interest, on condition of the loan being repaid in gold.

The pre-War mark has disappeared. The persistent and ever accelerated increase in the quantity of the unit resulted inevitably in the progressive decrease in its value, until the unit

¹ Einzig, *International Gold Movements*, p. 97.

was finally refused acceptance both in Germany and outside. New units took its place and the present position is that Germany is again on the same basis of currency as before the War, with a unit answering in much the same way as the pre-War mark to the conditions which have been outlined above. Germany's adherence to the gold standard has not been made easier by the reparations for which the country is responsible, but that is another story.

NEW YORK

The money market of New York, to which we next direct attention, is governed by conditions and forces that are in some respects unique.

Until 1913 there existed in the United States no central institution holding a commanding position similar to that occupied by the central banks of Europe. There were, in the main, two types of bank, the national bank and the state bank ; the former registered under the National Banking Act of 1863 and the latter under the law of the state in which they operated. The manner in which they were linked together was useless, as the crash of 1907 showed. There were three central reserve cities, New York, Chicago and St. Louis, the national banks in which were known as " central reserve city " banks ; national banks in a number of other important cities being styled " reserve city " banks, all others being called " country " banks.

The system was supposed to be held together by the reserve requirements of the governing

statute, the ratios being 15% by country banks with banks of either of the two remaining classes, and 25% by reserve city banks with central reserve city banks. With regard to the state banks, the statutory restrictions of the states varied considerably, but were rarely very stringent. The national banks were given the right of note issue against government bonds, with the result that there were endless varieties of notes current.

The strength of a reserve lies in its being concentrated in one place, but that of the American banking system was split up into innumerable parts. Firstly, only a percentage—and a small one—was required to be kept with other banks; the remainder was maintained in the strong-rooms of the individual banks. Again, there was no means of mobilising the reserve in times of need. The fact of the reserves with other banks being invested in securities meant that they were reserves only so long as there was a market in securities, which is not always the case in times of crisis. The reserves were, therefore, practically negligible as an effective defence.

The power of currency to meet the requirements of trade, and to maintain its parity with the currencies of foreign countries, is to be found in soundness with which it can be regulated and in the facility with which it can be made available wherever it is required. The currency of the United States was a composite one, consisting of a variety of notes and coins. The issue of notes was a cumbersome and not very prompt procedure ;

moreover the bonds against which they could be issued were frequently to be obtained only at a premium, which lessened the attractiveness of the proposition, for 100 dollars worth of bonds could be the basis of 100 dollars worth only of notes, no matter what their market worth. The currency position was complicated, further, by the fact that the Treasury kept its funds obtained as a result of revenue collection, not in one depository, but in several. The money was collected and released according to the dictates of the government and tended to flood and deplete the market at inconvenient times, causing currency stringency and plenitude when freedom and scarcity respectively would, according to the requirements of trade and the condition of the money position generally, have been preferable.

The lack of a discount market assisted further to disperse the market, sending much foreign exchange business to London which New York would otherwise have obtained. There existed no re-discounting facilities, such as it is the function of a central bank to offer.

RESERVE

A drain on the reserve was produced by one or both of two very different causes, namely: a flow of currency from New York to the interior, or an absorption by the Treasury. Owing to the fact that the law permitted national banks to include in their reserves the balances kept at central reserve cities, and that money could

generally be employed to better advantage in New York than elsewhere, the spare cash of the provinces gravitated towards the one central point, and the stock of ready money at the commercial metropolis was virtually the foundation upon which the transactions of the whole country were based. The result was that whenever the volume of trade increased to such an extent as to necessitate the use of a greater quantity of currency the "country" bankers provided the additional currency by calling in their balances, and the whole strain was thrown on New York.

Such a movement, resulting from wages payment at harvest time and crop transport requirements, could not, if unexpected, fail to entail serious consequences; but its regularity enabled New York to make ready for it in advance, and thus render it almost harmless. Nevertheless, it was always possible that the provision made might fall short of actual requirements, and in that case the reserve could only be replenished by drawing gold from Europe in payment for exports. This, coming at a time when the requirements of the home harvest had to be met, meant a most unwelcome addition to the burdens of the European banks, and resulted in that "fight for gold," which has been aptly compared to the situation of three men struggling to cover themselves with a blanket only big enough for two.

The second cause of a drain on the reserve, and the most salient characteristic of the New York market, was the incessant absorption of currency

produced by the collection of the government revenue. In England, France, and most other countries, the proceeds of taxation are entrusted to a central bank, which employs the greater part of the money in loans and discounts, and thus at once returns it to the channels of trade ; but in the United States, the Secretary of the Treasury—corresponding to our Chancellor of the Exchequer—acted as his own banker, and for safety's sake, kept the government balance under his own control in the Treasury vaults. This circumstance alone would have made little difference to the market if the Secretary had had power to set free his holdings after the ordinary banking fashion, but as he was forbidden by law to use government funds for any purpose other than disbursements on account of the state, such surplus as might at any time remain in his hands was as dead to the market as the buried hoard of a miser. As all taxes, too, were payable in currency, the Treasury balance consisted solely of notes and coin ; so that an accumulation of government funds not only diminished the available supply of loanable capital, but, if allowed to go on unchecked, speedily swallowed up the marginal reserve of legal tender which kept the Associated Banks above the 25% limit, and thus brought about a dangerous crisis.

To ward off this catastrophe, constant official care and watchfulness was needed. The task incumbent on the Treasury was to preserve equilibrium between receipts and disbursements; so as to

keep the outflow of currency equal to the inflow. But this was no easy matter. Even in England there are times when the one temporarily overlaps the other to a large extent, as is seen from the wide fluctuations in the Public Deposits at the Bank of England, and, if such is the case in a country where income is annually adjusted to balance expenditure, how great must have been the difficulty of preventing a lock-up in the United States, where the public income—and herein lies the crux of the problem—exceeded the outgoings by many millions sterling per annum.

This was the position until 1907, which year saw the greatest financial and banking crisis¹ the United States has ever experienced, a crisis which was responsible for the ultimate establishment of American banking on a system which would compare with the systems of the older world. In the words of Benjamin Strong, LL.D., then Governor of the Federal Reserve Bank of New York (Preface to Kemmerer's *The A.B.C. of the Federal Reserve System*): "The federal reserve banks came into being in the month of November, 1914. The passage of the legislation by which they were created had been preceded by five years of discussion, following the financial

¹ 'Clare, Second Edition: To all appearance, therefore, the existing system must sooner or later end in a deadlock; and so long as it endures, business has to be carried on under conditions that are wholly artificial. The New York market is in fact at the mercy of an autocrat, who, having full power to loose or to bind large masses of currency at his absolute discretion, decides for himself whether and when money shall be cheap, and whether and when it shall be dear.

“ upheaval of the fall of 1907, such as might have “ been expected to prepare the way for the “ considerable changes in banking methods contemplated by the new law.” This legislation was the Federal Reserve Act, which was passed in 1914, and which entirely reorganised the banking system of the country, tightened up the loosenesses of the previous state of affairs and, incidentally, laid the foundation of the means whereby America was later to bear the brunt of European war finance.

The deficiencies of the system which accelerated the crisis of 1907 were met in the following manner. The present organisation may be compared with a pyramid, having as apex the Federal Reserve Board, and as base the banks, known as “ member” banks, the intermediate stage being represented by the twelve federal reserve banks. All national banks are compulsorily members of the system, but for the state banks membership is optional. Under the new régime the federal reserve banks hold the entire reserves of the member banks, so that the reserve of the country is concentrated in twelve points, as against the thousands under the old order. The reserve cities are not all stock market centres and thus the funds of the country are not all diverted to centres where they can be employed in stock market finance.

The federal reserve banks are now required to offer re-discount facilities to the member banks. The right, possessed by the federal reserve banks, to deal in the open market, provides a further

method of the transfer of funds from one area to another and tends to lessen difficulties due to the tying up of funds in certain areas to the exclusion of others. With regard to the currency, the majority of the old national bank notes have been withdrawn and their place taken by notes issued by the federal reserve banks against a 100% cover in—

(a) “. . . notes, drafts and bills of exchange arising out of commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial or commercial purposes . . . ;”

(b) “Bills of exchange indorsed by a member bank of any Federal reserve district . . . or bankers’ acceptances purchased under the provisions of the said section fourteen ” (*i.e.*, in open market);

(c) gold and gold certificates.

The reserve against these notes must consist of 40% in gold, save as permitted by the federal reserve board and against payment of a tax. Moreover, a reserve of 35% in legal tender money or gold must be kept by the federal reserve banks against deposits. It will be seen, therefore, that provided the necessary reserves are maintained, there is no limit to the extent to which credit, in the form of deposits or notes, can be provided. In other words, such credit is directly dependent upon the requirements of industry, as indicated by the means possessed by the members banks for discounting.

Discount facilities must be granted to the member banks against—

(a) the notes, drafts and bills of exchange mentioned above;

(b) notes, drafts and bills of exchange endorsed by member banks and drawn for the purpose of carrying on trading in bonds and notes of the United States Government.

The par of exchange between the sovereign and the gold dollar is $4.86\frac{2}{3}$, arrived at as follows:

$$\begin{array}{rcl}
 1 \text{ } \$ & = & £1 \\
 \text{If } £1 & = & 123.274 \text{ grains standard gold.} \\
 \text{grains standard } 12 & = & 11 \text{ grains fine} \\
 \text{grains fine } 232.2 & = & \$10 \\
 123.274 \times 11 \times 10 & = & \$4.866. \\
 12 \times 232.2 & = &
 \end{array}$$

In illustration of the gold points we give calculations¹ of shipments of specie to and from New York:

100,000 fine oz. at 84s. 11.45455d.	£424,772 14 7
Freight, 3s. per £100	637 0 0
Insurance, 9d. per £100	160 10 0
Interest, 5% for 8 days	465 10 5
Boxes and Packing	16 0 0
	<u>£426,052 4 2</u>
Gold export point	\$4.8515
100,000 fine ozs. at \$20.67183	\$2,067,183.00
Freight, 3s. per £100	3,100.50
Insurance, 9d. per £100	778.15
Interest, 5% for 8 days	<u>2,046.00</u>
	\$2,073,107.65
100,000 fine oz. at 84s. 9.81818d.	£424,090 18 2
Gold import point	\$4.8884

It will be observed that the claims of the United States on us being principally for agricultural produce, must fall mainly into the autumn and early winter months, but that our counterclaims being such as appertain to no one season of the year in particular, are presumably distributed

¹ Einzig, *International Gold Movements*, p. 95.

pretty evenly over the whole twelvemonth ; and it will be found, as a consequence, that on an average of years the exchange from August to December is against us, but during the other months is in our favour. An export of gold from this side—if it is to take place at all—may generally be expected about the end of the harvest season.

A withdrawal of bullion from the Bank for New York is always made more of in the market than a shipment to the Continent. The effect on the Reserve is in both cases the same, but in the one the gold is not so likely to return, whilst in the other it is only at two or three day's remove, and can more easily be had back again if we are willing to bid high enough for it. Considering, however, the magnitude of our trade with the States, the amount of bullion that actually passes between the two countries is much smaller than might be supposed, owing to the effect of securities arbitrage, *i.e.*, transfer, by sale, of international securities, arising out of price differences between the two countries. It does not follow, therefore, because the balance of trade at a given time happens to be against us, that we shall have to liquidate it in gold. If bank reserves be low in New York and money dear, as much hard cash as is wanted is likely to be demanded from us ; but if the surplus be satisfactory, and money cheap, America will probably adjust accounts by taking back some of her own securities and the exchange will not be allowed to relapse to gold point.

CHAPTER XI

THE OPEN MARKET

OF all the articles bought and sold in the London markets it would be difficult to name any one the price of which is subject to greater and more sudden changes, or is liable to be influenced by circumstances more numerous and complicated, than is that of loanable capital or market money.

From day to day, and sometimes almost from hour to hour, market rate is constantly varying; and its movements are remarkable not only in point of frequency, but also for their width of range. To-day, for instance, the current charge for discounting a three months' bank bill of £1000 may be £5, and a month hence may have fallen 40% to £3, or have risen 100% to £10; in other words, 2%, 1·2% and 4% respectively.

This price, like that of other commodities, is dependent in the main on the equation of supply to demand or, to be more exact, on the ratio between the amount of floating capital that lenders have available for immediate employment, and the amount that borrowers, who have satisfactory security to offer, are in immediate want of (*i. e.*, the effective demand). But to render this

definition intelligible it is necessary that we should first know, on the side of supply, what loanable capital consists of, how it is generally employed, and in what manner it becomes available for immediate use.

Market money, roughly speaking, is other people's money. The general loan fund of the country is held by the banks, and is made up of customers' deposits, on which low interest is paid, and of current account balances, on which, as a rule, no interest at all is paid. If it were their own money that bankers lent out, the low rates that borrowers are accustomed to would be altogether out of the question. But the money so used is what has been lodged with the banker by his customers, and for the greater part of it—probably two-thirds or more—he pays nothing. Consequently the banker can afford, if "deposits" are large in proportion to capital, to lend very cheaply (it must be remembered that "lending" is a banker's primary function), and yet be able to secure a satisfactory profit. Some banks, indeed—the clearing banks—hold customers' money to as much as twenty or thirty times the amount of their paid-up capital, and could thus pay a fair dividend if that money returned them no more than 1% net.

From the published accounts of the joint stock and private banks of England and Wales (exclusive of the Bank of England) it appears that at the end of 1929 the total deposits amounted to something in the neighbourhood of £1900 millions.

All this borrowed capital, with the exception of the varying proportion (usually about 10%) reserved to meet withdrawals, has to be made use of somehow; and from its very nature—being repayable on demand, or at short notice—must necessarily be laid out in securities that are realisable without difficulty or loss.

Now, of all such securities first-class bills of exchange are, as there has been occasion to point out before, indisputably the safest and best. From the fact that they are self-convertible, turning into cash automatically and at par, they constitute next to actual money a first line of defence, and a strong portfolio is so indispensable to the safety of banking business that in every case a due proportion of bills (varying between 10% and 13%, in the case of the "Big Five") forms a leading feature of the interest-bearing assets.

After bills, the next best outlet is to be found in advances for short fixed periods on good security; and in these two directions—bills and short loans—a banker generally employs about 15% to 25% of his customers' money.

SHORT LOAN FUND—SUPPLY

The exact amount of money which constitutes the total sum lent by the banks to the market, which is called the short loan fund, is difficult to estimate. Taking the figures of the ten clearing banks for March, 1930, it will be found that the average for the month totals £184 millions, in the case of Bills Discounted, and £135 millions in the

case of Money at Call and Short Notice. To these figures must be added those of the other banks, non-clearing, foreign and colonial. Possibly the most recent published estimate is that of Mr. H. W. Greengrass, in his *Discount Market in London*, who puts the figure at little less than £900 millions.

Supply is not limited, however, to the steady inflow of "old" money seeking re-investment. A pressure of "new" money frequently makes itself felt. The country in ordinary times earns more than it spends, and the accretion of savings, unless carried off by an expansion of trade, aided by home and foreign loans, etc., flows into the banks, and from the banks into the market, until some approved opening can be found for it. In that case supply becomes redundant, and rates are forced down to a low level; but watchful company promoters quickly bestir themselves to improve the opportunity, and there are always foreign states ready, whenever money is plentiful, to invite our assistance in the exploitation of their undeveloped resources, or, since the War, for purposes of reconstruction, until, by one means or another, the surplus is absorbed into permanent investments and the equipoise of supply and demand is re-established.

DEMAND

So much for the question of supply. As regards the general demand for loanable capital, it consists, as was said, of the immediate requirements of those who have acceptable security to offer;

and by discount demand, to which branch we for the present confine our attention, is to be understood the needs of the discount market, which can be translated as the quantity of *good* bills that borrowers are desirous of converting into cash. Those borrowers (or, to be more precise, sellers) are the merchants and manufacturers of the country, and the extent of their requirements varies with, and is dependent upon, the state of trade; for as the settlement of business transactions (especially those with foreign countries) is chiefly effected by means of bills, it follows that the greater the volume of trade the greater will be the number of bills drawn, and the greater also the quantity tendered for discount.

Because of the intervention of the bill broker, it is scarcely correct to speak of a money market demand by the merchants and manufacturers of the country. The transactions of the latter, in so far as they are conducted with bill brokers and not with their own bankers, result in an appreciable proportion of the supply of the bill broker's trading commodity. The real demand is by the brokers and is only indirectly dependent upon the supply of bills arising from the commerce of the country. It by no means follows that a bill drawn by a manufacturer or merchant sets up a "short loan" demand by a broker; nor does it follow that a broker's demand is dependent on the supply of bills from such producers.

The broker's stock-in-trade, in other words, comprises not only such bills as come forward in

this manner, but also, and to a very great degree, Treasury Bills ; and, one must not lose sight of the fact that Treasury Bills have intruded in the "market" to an increasing extent, to an extent unheard-of before the War, seriously disturbing the market's equilibrium. The subject is dealt with more fully in the chapter on the War and post-War influences on the market and the exchanges.

To revert, creation of more paper is not the only effect of better business. It also implies that the number of bills brought to market will bear a higher proportion than hitherto to the total in existence. Seeing that, when orders are coming in freely, traders are always anxious to turn over their capital as fast as possible, and to discount every remittance as soon as received, in order to employ the money in fresh purchases, and that, on the other hand, they try, when there is "nothing doing," to avoid the accumulation of an idle cash balance by discounting no more than is necessary to meet previous engagements (unless they are working on an overdraft, in which case it may be more profitable to discount in order to reduce the debit balance), it is evident that improvement of trade signifies a relative as well as an actual increase of demand.

More trade, therefore, means more bills, larger calls on supply, and higher rates ; less trade means fewer bills, a falling off in demand, and lower rates.

The demand for money is thus the summary and product of all the complex influences that affect

the present conditions or the future prospects of commercial industry, either as a whole or in any of its branches, and, as such, is incessantly fluctuating,¹ and with it the discount rate. From its nature it can only be treated in the abstract. No figures are available that will enable us to gauge more than very approximately the quantity of bills that are likely to come forward next week or next month. If the Board of Trade Returns, the Clearing House Returns, the Railway Returns, etc., all tell the same story of an increase, we can be fairly sure that trade is improving, and that next week or next month the demand will have grown; but what the growth will be, or just when it will begin to be felt, is what we cannot know for certain. And besides, the conditions under which business is carried on are gradually changing. There is reason to believe that each year more and more transactions are conducted on a cash or sight basis, and that the number of "time" bills now created bears a steadily diminishing ratio to the volume of commerce. Instead of settlement by bill, a growing preference appears to be shown for settlement by cheque, cable transfer, or "sight" draft drawn under a credit—means of payment that avoid the uncertainties of a fluctuating discount rate, save the *ad valorem* cost of bill stamp, and reduce the risk of loss to a minimum. Scarcity of bills (partly comparative, owing to the growth of the loan fund) is indeed a long-standing

¹ It is almost entirely to the variations in the demand for loanable capital that the constant changes of rate are due. Supply may, by comparison, be regarded as an almost constant quantity.

grievance with lenders, and is substantiated by the fact that bankers generally now hold fewer trade bills in proportion to other assets than was the case in former years.

VARIATION IN THE BANK RATE

Next to the interaction of supply and demand, the chief influence that governs market rate is the rise and fall of the official minimum. As we already know, there is a necessary connection between the two, inasmuch as bankers regulate their allowance on deposits by Bank Rate. If Bank Rate is raised, the deposit rate has to be raised, and it stands to reason that if the banker pays more for what he borrows he will try to obtain more for what he lends.¹

When the Bank Rate goes up, therefore, the market follows and, further, if there should exist good ground for anticipating an upward movement, the outside rate will take the lead. Why the market

¹ 'Clare,' Second Edition : " It does not follow, though, that he will be compelled to raise his charge *pari passu* with his allowance, for he pays interest only on part of his borrowed capital, not on all, and if out of every £100 that he holds he pays interest on £40 and lends £80 thus :

LIABILITIES.		ASSETS.	
Interest-bearing deposits	£40	Interest-bearing loans and discounts	£80
Current-account balances	60	Cash, etc.	20
	£100		£100

then an advance of 1% in his allowance on the £40 will be made up to him by an advance of $\frac{1}{2}$ % in his charge on the £80."

This, however, is now a practically obsolete argument. It is fast becoming the rule to quote, both for deposits and advances, rates varying from Bank Rate, but the banker protects himself from abnormally low rates by quoting a minimum rate at which he will lend and (frequently), from abnormally high rates, by stipulating a maximum at which he will borrow.

grows firmer when gold goes out, for instance, is not so much because the removal of a million makes any appreciable difference in supply, but rather because the possible consequence of a reduction in the Reserve has the effect of making lenders more cautious, and borrowers more eager to borrow before the rise takes place.

As a matter of course, a fall of the official minimum is usually attended by a fall of market rate ; but, as regards the advance, it is necessary to distinguish between a movement due to real, and one due to artificial, causes. Bank Rate may be raised in consequence of an increased demand, which is a real cause, or it may be raised quite irrespective of the actual value of money, simply to check a drain of gold, and protect the Reserve. In the former case the Bank and the market rise in unison, because the same cause acts on both ; but in the latter the Bank alone is really concerned, and though other dealers may endeavour, on the strength of the official announcement, to exact a higher charge, supply may prove too much for them, and they are forced to moderate their pretensions. On such occasions there is frequently a very wide disparity between the two quotations, and if it were not for the dependence of deposit rate on the Bank the difference would be even wider. Where, again, the demand for bills is keen and money is cheap, the discount rate may fall away until there is an appreciable disparity between it and Bank Rate. In that event a fall in the latter may be anticipated and its arrival

frequently has little influence on the market quotation.

THE RISK FACTOR IN RATES

There is one other factor that enters into the composition of discount rates, and that is credit, or the standing of the parties to the particular bill. In every loan operation the lender, before fixing a rate, has to decide for himself whether there is reasonable certainty of repayment at the stipulated time, and of repayment in full. If quite satisfied on both points, he charges only for the use of the money and for his trouble, but, if there is any room for doubt in the matter, he also charges for his risk, and thus makes the borrower pay an insurance premium in addition.

This variable element is usually absent from "bank" or "fine trade" bills, only making its appearance in times of disturbance, when the general disinclination to lend on any security whatsoever causes an all round advance, but its effects are distinctly visible in the great diversities of charge that are always in co-existence side by side; for loanable capital has as many different values as there are degrees of credit, and between the 60% charged by the moneylender, the $\frac{1}{2}$ % or 1% over Bank Rate charged by the joint stock banks, and the 2% charged by Lombard Street for short money, there are innumerable gradations, all dependent upon the supposed solvency of the borrower, and on the lender's appraisal of the danger that he incurs in parting with his money.

BILL BROKING

No detailed reference has yet been made to the very important part performed in the economy of the discount market by the middleman, through whom, in practice, much of the better class of business is transacted.

At first sight, the need of an intermediary may not be apparent ; and, from the fact that every banker discounts for customers as part of his regular business, it would be natural to infer that the stock of bills shown in his balance sheet had been acquired at first hand. Generally speaking, however, it is not so. Inferior paper may and does go direct to the banker, especially in the provinces, but the bulk of the superior sort, of the bank and best trade bills, passes through the hands of the London " bill brokers " (or bill merchants, as it would be more correct to designate the majority of them) and discount houses, which include six joint stock companies with large capital and many private firms.

The broker's business is to buy from merchants and to resell to bankers ; and, as his turnover is usually on a considerable scale, a very small difference in the rate is sufficient to remunerate him.

The explanation of the practice of banks in buying from brokers rather than from the actual suppliers (the first holders in this country) is that it is simply a question of division of labour. Bill discounting is really a trade by itself, and

a trade that requires extensive knowledge of a very special kind. The discounter must have the financial and moral standing of hundreds of commercial houses at his fingers' ends. He has to find out, if possible, who X is, and what his antecedents are ; whether he speculates, or accepts too much ; whether he was involved in any recent failure, or has lost by the fall in copper or silver or whatever commodity he trades in ; and, according to the mental estimate which he thus forms of the state of X's affairs, he is guided as to the amount of X's acceptances that it is safe to hold. In a word, he must know men and their means, in order that he may be able to tell a good bill from a bad one. And further, unless his mental estimate is kept posted up to date it soon becomes useless, so that he must always be on the alert for fresh information. Knowledge of this sort, it is evident, can only be acquired by long experience and the exercise of great judgment ; and the broker, to whom it is of vital importance, gives his whole mind to it. But a banker has no time to devote to its intricacies. He has quite enough to do to look after his own customers without having to make exhaustive and intimate enquiries about the acceptor of every bill that he holds ; and so, for the sake of a fractional difference in the rate, he is only too glad to save trouble by buying from a broker, who takes the risk upon himself, and whose standing guarantees immunity from loss by bad debts. This only applies, however, to the larger brokers and to the companies. If the

banker buys from the small men he practically takes the risk himself. There is also what is known as a "runner" or a "running broker," an intermediary between banker and broker, who sells to the banker without recourse.

The other party to the bargain—the holder of the bill—also derives benefit from the arrangement, as the broker, under the stimulus of competition, gives him a better rate than he could obtain from his own banker; and as the merchants of Manchester, Liverpool, etc., as well as those in London offer the pick of their remittances in the London market, the result is that all the best paper in the country comes to that market.

The brokers are also dealers in floating money. A banker keeps a certain amount of till money, which varies little, and a certain balance at the Bank of England which also varies little, but his fluctuating surplus of cash he lends to a broker, who deposits collateral security¹ and undertakes to pay at a moment's notice.

This "call money" the broker employs in the discount of bills, and, as it pays interest, it must likewise earn interest or bring a loss. Consequently, he cannot afford to keep much of a reserve; and as a matter of fact, he makes no serious provision for withdrawals, but relies on being able to repay by letting his bills run off, or, in case of need, by borrowing at the Bank.

¹ The practice of requiring security for money lent to the bill brokers is said to date from the failure of the Overends, who held millions against their mere acknowledgment.

It is of course evident that, under ordinary circumstances, the incomings of the brokers as a body on any particular day must about balance the outgoings, as the amount "called" by those bankers who are "short," makes those to whom it is transferred "over," and is lent out again by the latter. But it also frequently happens that money is taken clean out of the market. When, for instance, bankers are preparing for dividend and coupon payments, etc., they find it necessary to strengthen their balances, and the money "called" for that purpose has to remain locked up for a day or two. The brokers are then compelled to seek assistance at the Bank, which, if the applications are heavy, sometimes takes advantage of the situation by raising the charge for loans to perhaps 1% over Bank Rate, so that the broker then stands in the peculiar position of having to borrow at perhaps 5% with one hand, while at the same time taking in bills from his customers at $3\frac{1}{2}\%$ or 4% with the other, for it must be remembered that whatever the broker may be paying for money, he cannot possibly refuse to discount for regular customers, and he is always expected to quote below Bank Rate. It may be mentioned in passing, that in 1858, as a direct consequence of the panic of the previous year, the Bank refused to help the brokers by re-discounting for them, but has recently relaxed the rule and now takes bills that have only a few days to run.¹

¹ Even in August, 1914, the Bank intimated that it would not be prepared to grant accommodation to bill brokers; but the decision was rescinded the same morning as it was made.

An increase of the Other Securities, showing that recourse has been had to the Bank, sometimes affords a good clue to the course of the market, as it proves that the outside supply of money has run short.

In addition to day-to-day money, discount houses and broking firms hold large deposits at short notice ; and, like the banks, base their deposit rate on the Bank Rate, borrowing, in fact at a slightly higher rate than that allowed by the clearing banks on deposits. Unlike the banks, however, they have not the good fortune to get any part of their money for nothing ; and, as they make their profit out of the difference between the rate at which they borrow and the rate at which they lend—that is to say, out of the difference between deposit rate and market rate—they have to submit to a reduction of profit, if not to actual loss, whenever the disparity between market rate and Bank Rate is wider than usual. An accusation that has been levelled at the bill brokers as a body is that of “ beating down ” rates and thus rendering the Bank Rate inoperative ; but it is obvious from the foregoing that the interest of the chief houses, which hold large deposits, lies in just the opposite direction. The real culprits, it is far more likely, are the banks themselves, who, rather than keep money lying idle, offer it at constantly decreasing prices through the small brokers. These have not the capital to hold more than a mere fraction of the bills they purchase, and act largely as agents, collecting

for their principals and paying themselves by an infinitesimal difference in the rate.

LOANS TO STOCK EXCHANGE

However suitable bills may be as an investment for loanable capital, the outlet thereby provided is totally inadequate to carry off even a moiety of the millions for which employment has to be found; and the banker, being forced to look elsewhere for means to mobilise the greater part of his customers' money, resorts to loans and advances, which, in point of magnitude, constitute his principal assets. These are divisible into two classes :—

- (a) trade and personal advances, by way of loan and overdraft ;
- (b) loans to the London Stock Exchange.

The first mentioned, although of considerable bulk may be dismissed in a few words. Being transactions of a special nature, each application is dealt with on its merits, and the rate charged by the banker for the accommodation varies according to the circumstances of the case, but is usually based upon Bank Rate.

As regards the second class, there still remains, after every legitimate demand of commerce has been duly met, a very large surplus to place out, and part of this the greater part is lent to bill brokers and locked up in a long-term investment) is disposed of in loans from day to day or fortnight to fortnight on the London Stock Exchange.

The attraction presented by this mode of employment lies in the fact that, while involving little risk or trouble, it yields a relatively high return, anything from $\frac{1}{2}\%$ below Bank Rate to, say, 2% above being charged—the rate depending, naturally, on the security offered, apart from the question of the relative tightness or easiness of money conditions in general.

From the banker's point of view a loan to the House is a very simple and easily managed affair. On account day, the broker ascertains how much he wants to carry him over and calls on his banker to learn how much the latter is prepared to lend and at what price. The securities are deposited, giving a margin dependent upon the nature and type of the securities, and the credit is received. Securities are usually valued at the so-called "making-up" price, which is officially fixed for each stock at every settlement. The loans run from one settling or account day to the next, and a renewal is treated in every respect as a fresh transaction, the securities being revalued at the new making-up price, and additional cover given if the value has fallen below the limit. As the banker holds the stock simply as pledgee, the property in it remains with the borrower, who is entitled to all dividends and redemption moneys.

The ultimate destination of this borrowed money is to pay for stock that has been bought by speculators for the rise. In a certain sense, every buyer of stock is a speculator for the rise, inasmuch as no one buys a stock that he thinks

will fall, but the term is usually applied to those only who cannot go on holding what they have bought unless they can continue to borrow; in other words, to those who buy what they cannot pay for. As is well known, the bulk of the transactions that take place on the Stock Exchange are of this nature, the bona fide investment business having been estimated by competent judges at a small percentage of the whole.

If then the speculative buyer, or "bull," whom we will assume to be one of the outside public, does not intend to pay for and take delivery of his purchase on settling day, he tells his broker to "carry over" the bargain until the next account. The broker is not bound to do so, however. He has the right to insist on payment if he pleases, or in default to re-sell the stock and charge his client with the difference; but the right is rarely exercised (unless he is prepared to lose his customer), and, if instructed to "carry over," he does so as a matter of course.¹ Anyone unacquainted with the practice of the Stock Exchange might suppose that the broker would now proceed to ascertain for the information of the buyer whether and on what terms the inside dealer (or "jobber," as he is called), who had sold the stock, was willing to put off delivery for a fortnight, till the next settling day. But this procedure, though it appears the natural and proper method of arranging the postponement, would give rise to endless trouble and delay; and what actually

¹ The £1 % stamp duty on transfers has greatly reduced contango business. Operators on the market are more inclined to cut their loss.

occurs is that the broker, instead of opening up negotiations with the seller, simply pays for the stock himself on delivery, and raises the money by pledging the same or other securities with a banker.

The bankers, therefore, ultimately pay for and hold the stock bought by the "bull."

If the speculator, instead of being an outsider, is a member of the House, he buys direct from the jobber, and it is then the latter who has to carry over. This is effected either out of his own resources or, as before, by pledging the stock. In the latter case he may borrow direct from his banker, or he may employ the agency of one of the large brokers, who in this respect act, as it were, as intermediary between the jobber and the banks, and charge the jobber a trifle more than they pay themselves—the jobber finding the margin.

The charge (technically known as the "contango") made to the speculator by the broker or jobber for carrying over is dependent on several considerations; for, though ruled to a great extent by the value of money—interest being its elemental factor—it also varies according to the volume of speculation open for the rise, according to the more or less risky character of the security sought to be "continued," and according to the supposed ability of the speculator to meet an eventual loss. As it must be taken, too, to include the broker's remuneration for pledging his credit, as well as for the use of the 10% margin that

he provides, and for his time and trouble, it is naturally always more than the banker receives.

Besides speculation for the rise, there is another purpose for which money is borrowed by the Stock Exchange. Whenever it can be had cheaply, very large sums are laid out in dividend-paying securities, with a view to realising the margin between the interest they yield and the rate charged for the loan. Thus, if a dealer can borrow at say $2\frac{1}{2}\%$, it may pay him to buy a 4% stock at par, and to pledge it on a 10% margin, the operation working out as follows :—

On £1100 stock he receives at the rate of	.	.	£44 per annum.
and on £1000 borrowed thereagainst pays	.	.	25 „

Showing a profit at the rate of	.	.	.	.	£19 per annum.

on each £100 of net outlay. This example does not take into consideration the income tax factor, but it serves to illustrate the point in question ; nor does it make allowance for the fact that the full interest on a stock may not be accounted for in the price. Until the rate begins to rise, this is very satisfactory, but immediately it approaches 4%, he must either face a loss or sell out ; and it is on the realisation that the actual result depends, for, if the stock should have declined in value since he bought, the prospective profit may be curtailed or may even disappear altogether.

Why the price of money should exert influence over the stock markets, as everyone knows it does, is now easily perceived. Securities rise when money is cheap, not only because the low return obtainable on capital employed in the

outer market induces purchases for investment, but also because those yielding a fixed rate of interest are largely bought on borrowed funds in order to secure the margin of profit, as just explained ; and also because light contangoes are in themselves an incentive to speculation for the rise. When money grows dear, on the other hand, prices give way from the opposite causes : that is to say, because capital can then be employed so advantageously in other directions that investment buying falls off, and because those who previously bought on borrowed money—whether for the sake of the interest difference or as a “ bull ” speculation—are forced into realisation by the onerous charges. In securities of the class favoured by speculators it consequently happens that important fluctuations are sometimes assigned to causes that appear singularly far-fetched and irrelevant (a fall in securities which are dealt in in several leading money markets may perhaps be ascribed to a decline of the Paris cheque rate, or or an advance of the Berlin bank rate), but that are quite intelligible if the principle of this relationship is borne in mind, and if it is remembered that the missing link in the connection is the effect that operators expect to see produced in the value of loanable capital.

CHAPTER XII.

1914—1918

THE WAR AND ITS EFFECTS ON THE MONEY MARKET AND THE EXCHANGES

This chapter is not to be construed as an attempt to cover the post-War monetary history of Europe—it would not bear the burden ; nor is it intended as a summary of those cataclysmic events which have each formed the subject of libraries of their own. It is, on the contrary, merely a guide to the events above referred to, an indication as to the possible evolution from a straightforward and peaceful monetary existence to the jungle of monetary nightmares, such as inflation, demonetisation, exchange collapse, etc. ; such explanation as is necessary to prepare the student of this Primer for the wealth of search and research awaiting him—as is necessary moreover to maintain the balance between the rudiments of the subject and its practical application in normal and abnormal times.

The money and exchange history of the period 1914 to date has been punctuated by statutes and radical changes in custom. The most important of such statutes and other documents are accordingly here given in full.

It has been mentioned in earlier chapters that the War has been responsible for drastic changes in the money and foreign exchange markets. The Treasury Bill has, temporarily, at least, outgrown the trade bill as the dominant factor in the discount market ; exchanges have given way, under pressure of an overwhelming flood of paper money, until they have ceased to exist ; the gold standard went everywhere by the board ; the English changed from a creditor, to a debtor, nation ; and a new vocabulary became necessary for the description of the new phases through which the money economy of several nations passed—we now speak of “inflation” and “deflation,” “stabilisation” and “demonetisation” as if we had known them all our lives ; we discuss the “shortage” of gold as we previously thought of decreasing coal supplies. Competitive money markets and new units of currency have appeared. International indebtedness has given rise to reparations, which, in turn, have resulted in an international bank with pretensions far above the mere functions of a reparations clearing house. Above all (but a point with which this book is little concerned), prices have risen enormously and fallen less, and wages likewise ; and world conditions have, in the decade which has passed since the War ended, gradually become as depressing as most people believe to be possible.

England commenced its financial history of the War, in August, 1914, with the threatened suspension of the Bank Act. The crisis was

overcome by a moratorium and the issue of an emergency currency. Without any warning worthy of mention, our relations with the greater part of Europe were cut off ; goods could not be delivered or obtained ; bills could not be collected or paid ; and this not only so far as combatant countries were concerned, but as regards neutrals also, because of the risk of making shipment. It needs no imagination to picture the intense uncertainty which prevailed, nor the serious risk of collapse which threatened those firms and businesses dependent upon foreign connections. This position was met by the government in several ways. Firstly, a moratorium of one month was granted to the accepting houses ; secondly, loans were made by the government to acceptors, and, in addition, the Bank of England was given authority to depart from its previous attitude of rigid refusal to accept for discount bills accepted by the London offices of foreign banks, commonly known as " foreign agencies."

The financial history of the War really commences, as far as this country is concerned, with the closing days of July, 1914, and is well illustrated in the letter, dated the 1st August, 1914, from the Bank of England to the Chancellor of the Exchequer. The letter is given below in full, as portraying the feelings and misgivings of the directors of the Bank.

" We consider it to be our duty to lay before the Government the facts relating to the extraordinary demands for assistance which have been

“made upon the Bank of England in consequence
“of the threatened outbreak of hostilities between
“two or more of the Great Powers of Europe.

“We have advanced to the Bankers, Bill
“Brokers and Merchants in London during the
“last five days upwards of Twenty-seven Millions
“Sterling, upon the security of Government
“Stock, Bills of Exchange, etc., an unprecedented
“sum to lend, and which, therefore, we supposed
“would be sufficient to meet all their require-
“ments; although the proportion of this sum
“which may have been sent to the country must
“materially affect the question.

“We commenced this morning with a reserve
“of 17,420,000 l., which has been drawn upon so
“largely that we cannot calculate upon having
“so much as 11,000,000 l. this evening, making a
“fair allowance for what may be remaining at the
“Branches.

“We have not up to the present refused any
“legitimate application for assistance, but having
“regard to the depletion of the reserve, we fear
“that unless we obtain authority to issue Notes
“against Securities in excess of the amount
“permitted by law it will shortly become necessary
“to curtail the facilities which under present
“conditions we regarded as essential to offer to
“the trade and commerce of the country.”

In response to this letter, the Bank was advised
that, if necessity called for such action, it
should “extend its discounts and advances upon
“approved securities” and that the Prime

Minister and Chancellor of the Exchequer would not "fail to make application to Parliament for "its sanction," the Bank to deduct a fair charge for risk, expense and trouble, and the profits, after this had been done, to accrue to the public.

The widening of the Bank of England category of discountable bills was the next important step. From an official point of view, the matter is put in the enclosure to a letter addressed by the Chancellor of the Exchequer to the Bank of England on 12th August, 1914, as follows :

" . . . We are now able to announce that
" the Chancellor of the Exchequer has completed
" arrangements with the Bank of England for
" terminating the present deadlock in the money
" market and for enabling the trade and commerce
" of the country to resume its normal course.
" The greatest difficulty arose from the stoppage
" of remittances to London both from the provinces
" and from other countries not only in Europe
" but in all parts of the world. This caused a
" breakdown in the foreign exchanges and deterred
" bankers from discounting bills in the normal
" way. To overcome this difficulty as well as
" that of providing traders in this country with
" all the banking facilities they need, the Govern-
" ment have now agreed to guarantee the Bank of
" England from any loss it may incur in discounting
" bills of exchange either home or foreign, bank or
" trade, accepted prior to August 4th, 1914.
" Accordingly we are authorised to make the
" following announcement :

“ The Bank of England are prepared on the
“ application of the holder of any approved bill
“ of exchange accepted before the 4th day of
“ August, 1914, to discount at any time before its
“ due date at Bank Rate without recourse to
“ such holder, and upon its maturity the Bank of
“ England will in order to assist the resumption
“ of normal business operations give the acceptor
“ the opportunity until further notice of post-
“ poning payment, interest being payable in the
“ meantime at 2% over Bank Rate varying.
“ Arrangements will be made to carry this
“ scheme into effect so as to preserve all existing
“ obligations.

“ The Bank of England will be prepared for
“ this purpose to approve such bills of exchange
“ as are customarily discounted by them and
“ also good trade bills and the acceptances of such
“ foreign and colonial firms and bank agencies
“ as are established in Great Britain.”

The enclosure was published the next day and tended greatly to the restoration of confidence.

CURRENCY AND TREASURY NOTES

The magnitude of the scale on which the War was conducted soon carried production of war materials to a stage hitherto undreamed of, but such production brought no lasting benefit, for the reason that materials and food were manufactured and grown purely to be destroyed. The necessity for producing on a huge scale and in the shortest possible time meant throwing to the winds all

ideas of economic manufacture or of economic purchase, which meant production and purchase without regard to cost. Those who had anything to sell which was required for the promotion of the War demanded their price, usually forthcoming without argument. Those goods in particular, and food, which had to be obtained from abroad were acquired at famine prices, for the sellers realised that the buyers were in a cleft stick ; moreover, shipping became an unprecedentedly costly business, the cost of transport increasing with the decrease in the tonnage due to war destruction and with the increase in the danger.

Again, those of the population who were engaged in munitions manufacture were in a position to command wages on a scale out of all proportion to what would ordinarily have been regarded as the value of their services. This condition arose as a result of the combination of several factors. In the first place must be considered the extreme necessity of providing a continuous and ever-increasing flow of munitions ; secondly, the labour obtainable for such production was limited by the enrollment of men for the fighting services and by the fact of there being a transition period during which had to be taught a new class of labour—a class which had hitherto had no connection with that type of industry. The effect of these two factors, combined with the existence of a government determined to provide for the fighting services all that was required for a successful

and, if possible, rapid termination of the War, led, as has been indicated, to a class of wage-earner who began the movement for higher wages throughout the country.

Finally, the situation was made worse by a psychological change in the attitude of the nation in general. Those whose business kept them in this country, having much more to spend than ever before, acted in what can only, in the circumstances, be regarded as a normal manner; they spent more, and obtained luxuries where before they had been able to purchase necessities only. Those whose fortunes took them into more dangerous areas decided to avail themselves of every opportunity to make the most of life, in case it did not last. They, too, therefore, spent liberally on the all too few occasions which were granted them. In fact, the whole nation became prepared to pay almost any price for anything, and shopkeepers and, to a less extent, manufacturers also, benefited accordingly—but relatively, not absolutely, because the combination of circumstances served to raise prices generally, so that every apparent profit was less real than it appeared.

This augmentation in the total production of goods in the country, this ability to command higher wages and this willingness to spend to a previously unknown degree soon resulted in a serious shortage in currency, and again the government stepped in, becoming, for the first time in the history of this country, a note issuing body.

The need had been foreseen, for, as a preliminary to the suspension of the Bank Act, the Bank Rate was raised to 10% on August 1st, to which figure it had been raised from 8%, the rate of the previous day. The 10% rate reigned for five days only, there then being a reduction to 6%—on the 6th August—and to 5% on the 8th, there being no further change until the 13th July, 1916.

The issue by the government took the form of notes (a) in which Bank of England balances could be cashed or (b) which could be borrowed by the banks up to an amount not exceeding 20% of their deposit and current account liabilities, bearing interest at Bank Rate. By August 26th, 1914, the sum taken in this way amounted to over £21 millions; this rose to £38 millions by the end of the year and the figures thereafter were :

End of 1915 £103 millions.			End of 1922 £301 millions.		
„	1916	150 „	„	1923	299 „
„	1917	213 „	„	1924	296 „
„	1918	323 „	„	1925	297 „
„	1919	356 „	„	1926	296 „
„	1920	368 „	„	1927	300 „
„	1921	326 „	(Nov. 21) 1928	287	„

Not only, however, was recourse had to Treasury note issues because of the additional volume of currency required, but because also of the need for the conservation of gold. Again, the action was taken to provide the means of assisting the banks who, by reason of their being cut off from a liquidation of their resources, were unable to meet their liabilities.

It was obvious that sooner or later, the Treasury issue would have to be dealt with toward a

permanent basis and the matter was delegated by the government to what is known as the "Cunliffe" Committee, whose first interim report was made in August, 1918. The following is the summary of its conclusions :—

SUMMARY OF CONCLUSIONS.

Before the war the country possessed a complete and effective gold standard. The provisions of the Bank Act, 1844, operated automatically to correct unfavourable exchanges and to check undue expansions of credit.

During the war the conditions necessary to the maintenance of that standard have ceased to exist. The main cause has been the growth of credit due to Government borrowing from the Bank of England and other banks for war needs. The unlimited issue of Currency Notes has been both an inevitable consequence and a necessary condition of this growth of credit.

In our opinion it is imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be grave danger of a progressive credit expansion which will result in a foreign drain of gold menacing the convertibility of our note issue and so jeopardising the international trade position of the country.

The pre-requisites for the restoration of an effective gold standard are :—

- (a) The cessation of Government borrowing as soon as possible after the war. We recommend that at the earliest possible moment an adequate sinking fund should be provided out of revenue, so that there may be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt.

- (b) The recognised machinery, namely, the raising and making effective of the Bank of England discount rate, which before the war operated to check a foreign drain of gold and the speculative expansion of credit in this country, must be kept in working order. This necessity cannot, and should not, be evaded by any attempt to continue differential rates for home and foreign money after the war.
- (c) The issue of fiduciary notes should, as soon as practicable, once more be limited by law, and the present arrangements under which deposits at the Bank of England may be exchanged for legal tender currency without affecting the reserve of the Banking Department should be terminated at the earliest possible moment. Subject to transitional arrangements as regards Currency Notes and to any special arrangements in regard to Scotland and Ireland which we may have to propose when we come to deal with the questions affecting those parts of the United Kingdom, we recommend that the Note Issue (except as regards existing private issues) should be entirely in the hands of the Bank of England. The Notes should be payable in London only and should be legal tender throughout the United Kingdom.

As regards the control of the Note Issue, we make the following observations :—

- (1) While the obligation to pay both Bank of England Notes and Currency Notes in gold on demand should be maintained, it is not necessary or desirable that there should be any early resumption of the internal circulation of gold coin.
- (2) While the import of gold should be free from all restrictions it is convenient that the Bank of England should have cognizance of all gold exports, and we recommend that the export of gold coin or bullion should be subject to the condition that such coin and bullion has been obtained from the Bank for the purpose. The Bank should be under obligation to supply gold for export in exchange for its notes.
- (3) In view of the withdrawal of gold from circulation we recommend that the gold reserves of the country

should be held by one central institution and that all banks should transfer any gold now held by them to the Bank of England.

Having carefully considered the various proposals which have been placed before us as regards the basis of the fiduciary note issue, we recommend that the principle of the Bank Charter Act, 1844, should be maintained, namely, that there should be a fixed fiduciary issue beyond which notes should only be issued in exchange for gold. The separation of the Issue and Banking Departments of the Bank of England should be maintained, and the Weekly Return should continue to be published in its present form.

We recommend, however, that provision for an emergency be made by the continuance in force, subject to the stringent safeguards recommended in the body of the Report, of section 3 of the Currency and Bank Notes Act, 1914, under which the Bank of England may, with the consent of the Treasury, temporarily issue notes in excess of the legal limit.

We advocate the publication by the banks of a monthly statement in a prescribed form.

We have come to the conclusion that it is not practicable to fix any precise figure for the fiduciary Note Issue immediately after the war.

We think it desirable, therefore, to fix the amount which should be aimed at as the central gold reserve, leaving the fiduciary issue to be settled ultimately at such amount as can be kept in circulation without causing the central gold reserve to fall below the amount so fixed.* We recommend that the normal minimum of the central gold reserve to be aimed at should be, in the first instance, £150 millions. Until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for at least a year, the policy of cautiously reducing the uncovered Note Issue should be followed. When reductions have been effected, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements previously recommended. When the exchanges are working normally on the basis of a minimum reserve of £150,000,000, the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists.

We do not recommend the transfer of the existing Currency Note Issue to the Bank of England until the future dimensions of the Fiduciary Issue have been ascertained. During the transitional period the issue should remain a Government issue, but new notes should be issued, not against Government securities, but against Bank of England Notes, and, furthermore, when opportunity arises for providing cover for existing uncovered notes, Bank of England Notes should be used for this purpose also. Demands for new currency would then fall in the normal way on the Banking Department of the Bank of England.

When the fiduciary portion of the issue has been reduced to an amount which experience shows to be consistent with the maintenance of a central gold reserve of £150 millions, the outstanding Currency Notes should be retired and replaced by Bank of England Notes of low denomination in accordance with the detailed procedure which we describe.

The final report was presented in December, 1919, which report is also given below :

CURRENCY AND FOREIGN EXCHANGES

2. *Foreign Exchanges.*—We stated in the introduction to our Interim Report our opinion that a sound system of currency would in itself secure equilibrium in the Foreign Exchanges. We have reviewed the criticisms which have been made upon this part of our Report, but we see no reason to modify our opinion. We have found nothing in the experiences of the war to falsify the lessons of previous experience that the adoption of a currency not convertible at will into gold or other exportable coin is likely in practice to lead to overissue and so to destroy the measure of exchangeable value and cause a general rise in all prices and an adverse movement in the foreign exchanges.

3. The nominal convertibility of the currency note which has been sustained by the prohibition of the export of gold is of little value. The weakness of the exchanges is in a measure due to trade conditions, but an important cause of the depreciation in sterling in New York and other financial centres is, in our opinion, to be found in the expanded state of credit in this country. The existing expansion is not merely

the legacy of the stress of war finance and Government borrowings, which even now have not ceased, but also, in part the result of maintaining rates for money in London below those ruling in other important financial centres. The difficulties of the Foreign Exchanges' position are aggravated by the grant of long term loans and credits, whether directly or under guarantee or otherwise by the Government or by private lenders, to enable foreign States or their nationals to pay for exports from this country. Few of these loans and credits will be liquidated at an early date. The large payments which we have to make to America, North and South, for necessary imports of foodstuffs and raw materials from those countries make it essential that we, in our turn, should secure payment in cash for as large a proportion as possible of our exports visible and invisible. We recommend therefore that preference should be given to exports to countries which are able to make payment in the ordinary course of trade.

Increased production, cessation of Government borrowings and decreased expenditure both by the Government and by each individual member of the nation are the first essentials to recovery. These must be associated with the restoration of the pre-war methods of controlling the currency and credit system of the country for the purpose of re-establishing at an early date a free market for gold in London. •

4. *Bank of England.*—The principles of the Bank Charter Act of 1844 were fully considered by us in our Interim Report. We have examined with care the opinions there expressed in the light of certain criticisms which have been made with regard to them. We see, however, no reason to alter our conclusions. We have again considered the principles governing the banking systems of the principal foreign countries and we are satisfied that they are not so well adapted to the needs of this country as those contained in the Act of 1844. Certain important alterations which experience suggested to be desirable have been made in the constitution and management of the Bank during the war, and we do not now think it necessary to make any further recommendation.

5. *Government Borrowings on Ways and Means Advances from the Bank of England.*—We desire to draw attention to the extensive use made during the war of the system of Ways

and Means Advances from the Bank of England. We referred to this matter in paragraph 16 of our Interim Report and explained its effect in causing credit and currency expansion. The powers given to the Government by Parliament to borrow from the Bank of England in the form of an overdraft on the credit of Ways and Means were, as the name implies, intended to enable the Government to anticipate receipts from Revenue or permanent borrowings for a brief period only. Indeed Parliament by expressly providing that all such advances should be repaid in the quarter following that in which they were obtained showed that it had no intention of bestowing upon the Government the power of securing an overdraft of indefinite duration and amount. Under the exigencies of war finance the Government found it necessary to re-borrow in each quarter on the credit of Ways and Means the amount needed to enable them to comply with the statutory requirement that the previous quarter's Ways and Means Advances should be repaid, with the result that the total outstanding advances remained for a long time at a high figure. We are glad to see that efforts are now being made to reduce this overdraft to more moderate dimensions.

We, therefore, hope, now that conditions are less abnormal, that the Government will confine its use of Ways and Means and Advances from the Bank of England to providing for purely temporary necessities. Such advances afford a legitimate method of tiding over a few weeks' shortage, but are entirely unsuitable for borrowings over a longer period.

6. *Foreign Banks*.—Several of our witnesses have called attention to the conditions under which it is open to foreign banks to establish themselves in this country. We suggest that this is a matter which should receive the early attention of His Majesty's Government.

7. *Scottish and Irish Banks*.—We have now taken evidence in regard to the application of the recommendations in our Interim Report to Scotland and Ireland. The status of legal tender was given to the notes of the Scottish and Irish Banks of Issue as an emergency measure to tide over the period at the outbreak of war when a serious shortage of currency was threatened, a condition of affairs which no longer obtains. Some of the witnesses on behalf of the Scottish and Irish Banks showed a marked desire to retain the privilege of legal

tender status for their notes. In our opinion the grant of legal tender status could not be given permanently to the notes of Scottish and Irish Banks except under statutory conditions similar to those embodied in the Bank Act of 1844. The evidence before us indicates that rather than be subjected to such conditions the banks would prefer the restoration of the pre-war status. We accordingly recommend that the pre-war status be restored. We further recommend that when the position which we contemplate in our Interim Report is ultimately reached the cover held by the Scottish and Irish Banks for their excess issue shall take the form of any legal tender at that time in existence.

8. *Currency Note Issue*.—We have considered whether steps should not be taken at an early date to impose limitations upon the fiduciary portion of the currency note issue with a view to the restoration of the normal arrangements under which demands for new currency operate to reduce the reserve in the Banking Department of the Bank of England. In view of the fact that demobilisation is approaching completion and that as we hope fresh Government borrowing will shortly cease, we consider that effect should now be given to the recommendation made in our Interim Report that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements which we proposed in paragraph 33 of our Interim Report. The policy of placing Bank of England notes in the Currency Note Reserve as cover for the fiduciary portion of the issue as opportunity arises should, of course, be continued. We recommend further that the Treasury Minute made under Section 2 of the Currency and Bank Notes Act, 1914, providing for the issue of currency notes to Joint Stock Banks, which is in fact inoperative, should now be withdrawn.

In particular, it was advocated that the recommendation of the interim report, that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, should be put into effect. This (which had for its object the gradual reduction of the degree

of inflation and of making it less difficult, when the time should come, to return to pre-War conditions) was done until the passing of the Currency and Bank Notes Act, 1928, which provided for the amalgamation of the currency note issue with that of the Bank of England and for a fixed fiduciary issue. The text of the Act is given below.

THE CURRENCY AND BANK NOTES ACT, 1928.

[18 & 19 Geo. 5. Ch. 13]

An Act to amend the law relating to the issue of bank notes A.D. 1928.
by the Bank of England and by banks in Scotland and Northern Ireland, and to provide for the transfer to the Bank of England of the currency notes issue and of the assets appropriated for the redemption thereof, and to make certain provisions with respect to gold reserves and otherwise in connection with the matters aforesaid and to prevent the defacement of bank notes. (2nd July, 1928.)

1.—(1) Notwithstanding anything in any Act—

- (a) the Bank may issue bank notes for one pound and for ten shillings ;
- (b) any such bank notes may be issued at any place out of London without being made payable at that place, and wherever issued shall be payable only at the head office of the Bank ;
- (c) any such bank notes may be put into circulation in Scotland and Northern Ireland, and shall be current and legal tender in Scotland and Northern Ireland as in England.

Amendment
with respect
to powers
Bank of
England to
issue bank
notes.

(2) Section six of the Bank of England Act, 1833 (which 3 & 4 Will.
c. 98. provides that Bank notes shall be legal tender), shall have effect as if for the words " shall be a legal tender to the amount " expressed in such note or notes and shall be taken to be " valid as a tender to such amount for all sums above five " pounds on all occasions on which any tender of money may " be legally made " there were substituted the words " shall " be legal tender for the payment of any amount."

5 & 16
1860. 5. c. 29. (3) The following provisions shall have effect so long as subsection (1) of section one of the Gold Standard Act, 1925, remains in force—

(a) notwithstanding anything in the proviso to section six of the Bank of England Act, 1833, bank notes for one pound or ten shillings shall be deemed a legal tender of payment by the Bank or any branch of the Bank, including payment of bank notes :

(b) the holders of bank notes for five pounds and upwards shall be entitled, on a demand made at any time during office hours at the head office of the Bank or, in the case of notes payable at a branch of the Bank, either at the head office or at that branch, to require in exchange for the said bank notes for five pounds and upwards bank notes for one pound or ten shillings.

(4) The Bank shall have power, on giving not less than three months' notice in the London, Edinburgh and Belfast *Gazettes*, to call in the bank notes for one pound or ten shillings of any series on exchanging them for bank notes of the same value of a new series.

& 2 Will. 4.
37. (5) Notwithstanding anything in section eight of the Truck Act, 1831, the payment of wages in bank notes of one pound or ten shillings shall be valid, whether the workman does or does not consent thereto. • •

amount of
bank of
England
note issue.
2.—(1) Subject to the provisions of this Act the Bank shall issue bank notes up to the amount representing the gold coin and gold bullion for the time being in the issue department, and shall in addition issue bank notes to the amount of two hundred and sixty million pounds in excess of the amount first mentioned in this section, and the issue of notes which the Bank are by or under this Act required or authorised to make in excess of the said first mentioned amount is in this Act referred to as " the fiduciary note issue."

(2) The Treasury may at any time on being requested by the Bank, direct that the amount of the fiduciary note issue shall for such period as may be determined by the Treasury, after consultation with the Bank, be reduced by such amount as may be so determined.

3.—(1) In addition to the gold coin and bullion for the time being in the issue department, the Bank shall from time to time appropriate to and hold in the issue department securities of an amount in value sufficient to cover the fiduciary note issue for the time being. Securities note issued to be held in the issue department.

(2) The securities to be held as aforesaid may include silver coin to an amount not exceeding five and one-half million pounds.

(3) The Bank shall from time to time give to the Treasury such information as the Treasury may require with respect to the securities held in the issue department, but shall not be required to include any of the said securities in the account to be taken pursuant to section five of the Bank of England Act, 1819. 59 Geo. 3 c. 76.

4.—(1) As from the appointed day all currency notes issued under the Currency and Bank Notes Act, 1914, certified by the Treasury to be outstanding on that date (including currency notes covered by certificates issued to any persons under section two of the Currency and Bank Notes (Amendment) Act, 1914, but not including currency notes called in but not cancelled) shall, for the purpose of the enactments relating to bank notes and the issue thereof (including this Act) be deemed to be bank notes, and the Bank shall be liable in respect thereof accordingly. Transfer of currency notes issued to Bank of England. 4 & 5 Geo. 5 c. 14. 4 & 5 Geo. 5 c. 72.

(2) The currency notes to which subsection (1) of this section applies are in this Act referred to as "the transferred currency notes."

(3) At any time after the appointed day, the Bank shall have power, on giving not less than three months' notice in the London, Edinburgh and Belfast *Gazettes*, to call in the transferred currency notes on exchanging them for bank notes of the same value.

(4) Any currency notes called in but not cancelled before the appointed day may be exchanged for bank notes of the same value.

5.—(1) On the appointed day, in consideration of the Bank undertaking liability in respect of the transferred currency notes, all the assets of the Currency Note Redemption Account other than Government securities shall be transferred to the issue department, and there shall also be transferred to the issue department out of the said assets Government securities Transfer of Bank of certain parts of assets to Currency Note Redemption Account.

of such an amount in value as will together with the other assets to be transferred as aforesaid represent in the aggregate the amount of the transferred currency notes.

For the purpose of this subsection the value of any marketable Government securities shall be taken to be their market price as on the appointed day less the accrued interest, if any, included in that price.

(2) Any bank notes transferred to the Bank under this section shall be cancelled.

(3) Such of the said Government securities as are not transferred to the Bank under the foregoing provisions of this section shall be realised and the amount realised shall be paid into the Exchequer at such time and in such manner as the Treasury direct.

profits of
the issue to
be paid to
the Treasury.
& 56 Vict.
18.

6.—(1) The Bank shall, at such times and in such manner as may be agreed between the Treasury and the Bank, pay to the Treasury an amount equal to the profits arising in respect of each year in the issue department, including the amount of any bank notes written off under section six of the Bank Act, 1892, as amended by this Act, but less the amount of any bank notes so written off which have been presented for payment during the year and the amount of any currency notes called in but not cancelled before the appointed day which have been so presented.

(2) For the purposes of this section the amount of the profits arising in any year in the issue department shall, subject as aforesaid, be ascertained in such manner as may be agreed between the Bank and Treasury.

(3) For the purposes of the Income Tax Acts, any income of, or attributable to, the issue department shall be deemed to be income of the Exchequer, and any expenses of, or attributable to, the issue department shall be deemed not to be expenses of the Bank.

(4) The Bank shall cease to be liable to make any payment in consideration of their exemption from stamp duty on bank notes.

amendment
s. 6 of 55
56 Vict.
18.

7.—Section six of the Bank Act, 1892 (which authorises the writing off of bank notes which are not presented for payment within forty years of the date of issue), shall have effect as if, in the case of notes for one pound or ten shillings, twenty years were substituted for forty years, and as if, in

the case of any such notes being transferred currency notes, they had been issued on the appointed day and, in the case of any such notes not being transferred currency notes, they had been issued on the last day on which notes of the particular series of which they formed part were issued by the Bank.

8.—(1) If the Bank at any time represent to the Treasury that it is expedient that the amount of the fiduciary note issue shall be increased to some specified amount above two hundred and sixty million pounds, the Treasury may authorise the Bank to issue bank notes to such an increased amount, not exceeding the amount specified as aforesaid, and for such period, not exceeding six months, as the Treasury think proper.

Power to
increase
amount of
fiduciary
note issue

(2) Any authority so given may be renewed or varied from time to time on the like representation and in like manner :

Provided that, notwithstanding the foregoing provision, no such authority shall be renewed so as to remain in force (whether with or without variation) after the expiration of a period of two years from the date on which it was originally given, unless Parliament otherwise determines.

(3) Any minute of the Treasury authorising an increase of the fiduciary note issue under this section shall be laid forthwith before both Houses of Parliament.

9.—(1) For the purpose of any enactment which in the case of a bank in Scotland or Northern Ireland limits by reference to the amount of gold and silver coin held by any such bank the amount of the notes which that bank may have in circulation, bank notes held by that bank or by the Bank on account of that bank, shall be treated as being gold coin held by that bank.

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(2) A bank in Scotland or Northern Ireland may hold the coin and bank notes by reference to which the amount of the bank notes which it is entitled to have in circulation is limited at such of its offices in Scotland or Northern Ireland, respectively, not exceeding two, as may from time to time be approved by the Treasury.

10.—The form prescribed by Schedule A to the Bank Charter Act, 1844, for the account to be issued weekly by the Bank under section six of that Act may be modified to such an extent as the Treasury, with the concurrence of the Bank, consider necessary, having regard to the provisions of this Act.

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11.—(1) With a view to the concentration of the gold reserves and to the securing of economy in the use of gold, the following provisions of this section shall have effect so long as subsection (1) of section one of the Gold Standard Act, 1925, remains in force.

(2) Any person in the United Kingdom owning any gold coin or bullion to an amount exceeding ten thousand pounds in value shall, on being required so to do by notice in writing from the Bank, forthwith furnish to the Bank in writing particulars of the gold coin and bullion owned by that person, and shall, if so required by the Bank, sell to the Bank the whole or any part of the said coin or bullion, other than any part thereof which is *bona fide* held for immediate export or any which is *bona fide* required for industrial purposes, on payment therefor by the Bank, in the case of coin, of the nominal value thereof, and in the case of bullion, at the rate fixed in section four of the Bank Charter Act, 1844.

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12.—If any person prints, or stamps, or by any like means impresses, on any bank note any words, letters or figures, he shall, in respect of each offence, be liable on summary conviction to a penalty not exceeding one pound.

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13.—(1) This act may be cited as the Currency and Bank Notes Act, 1928.

(2) This Act shall come into operation on the appointed day, and the appointed day shall be such day as His Majesty may by Order in Council appoint, and different days may be appointed for different purposes and for different provisions of this Act.

(3) In this Act, unless the context otherwise requires—

The expression " the Bank " means the Bank of England :

The expression " issue department " means the issue department of the Bank :

The expression " bank note " means a note of the Bank :

The expression " coin " means coin which is current and legal tender in the United Kingdom :

The expression " bullion " includes any coin which is not current and legal tender in the United Kingdom.

(4) The enactments set out in the Schedule to this Act are hereby repealed to the extent specified in the third column of that Schedule.

INFLATION

Inflation may be said to be a War creation, for, at least, the War brought into prominence a condition of affairs which, if it had existed previously, had not been generally recognised for the same thing as it is now understood to be. It is a condition of affairs in which the volume of currency is expanded to a degree greater than is necessary to meet the requirements of the volume of goods and services it is intended to serve. Inasmuch as the price level of a country is dependent upon the amount of currency in circulation, or more truly, on the volume of credit, it is clear that in a condition of inflation, prices must rise. This is what happened in this and most other countries during and after the War, with, in certain cases, dire results. The extent of the inflation in this country can be gauged very roughly from the price level figures given below :—

MINISTRY OF LABOUR
Cost-of-Living Index Numbers

Percentage Increase over Cost of Living in July, 1914.

Jan., 1915	.	.	10-15	July, 1918	.	.	100-105
July, 1915	.	.	25	Jan., 1919	.	.	120
Jan., 1916	.	.	35	July, 1919	.	.	105-110
July, 1916	.	.	45-50	Jan., 1920	.	.	125
Jan., 1917	.	.	65	July, 1920	.	.	152
July, 1917	.	.	80	Jan., 1921	.	.	165
Jan., 1918	.	.	85-90	July, 1921	.	.	119

The indication is approximate only, because other factors, as is shown on p. 222, tended to raise the price level.

It is a generally accepted theorem in foreign exchange that, setting aside any influences such as the interference in trade between two countries

or international influences on them, the exchanges between them would reflect the relative price levels. At any rate, it needs no great effort to appreciate that any serious alteration in the price level of a country will have an effect on the exchanges between it and other countries. Elementally, a country with a relatively high price level is a good country to export to and a bad one to purchase from ; and *vice versa*. It follows, therefore, that inflation must have an effect on the exchanges; the greater the degree of inflation, the greater the " fall " in the country's currency value, as reflected by the exchanges. If we take P and P' as the price levels of two countries, and the exchange as $A = B$, then if P is trebled, the original hypothesis:

$$P : P' :: A : B$$

becomes

$$3P : P' :: 3A : B$$

which means that the currency of the country with the inflated currency is worth only a third of what it was, and, consequently, that three times as much is now necessary to purchase the same unit of the currency of the other country. It will be realized that this statement is very rough as it takes no account of extraneous factors.

Although it does not affect the statement, it is necessary here to point out that in considering the effect of money on prices, regard has to be had to another factor, that of the rapidity of circulation. This is not a subject to be discussed here, but it may be added that the influence of inflation on the monetary condition of this and other countries

during the War was increased by the fact that money circulated much more rapidly than in "normal" or pre-War times. It is not difficult to see that the effect of a given volume of money doing twice the normal amount of work is, broadly speaking, the same as that which would arise from double the volume. Introducing this factor to the equation given earlier, on the basis that the velocity of circulation in country A is twice that in country B, we find the following :—

$$3P : 2P' :: 3A : 2B$$

or
$$3P \times 2B = 2P' \times 3A$$

This and much more is what happened after 1914 to most of the countries of Europe. Some countries responsible for inflating their currencies succeeded in staying the "rot"; it is said of others that they deliberately fostered the canker until their currency was entirely valueless. All were in some measure or other affected by the disease and one only, Great Britain, was able to revert to the pre-War state of affairs, so far as currency value was concerned. It was achieved by what is known as deflation—a deliberate reduction of the amount of currency in relation to the quantity of goods and services which the currency had to finance.

DEFLATION

Deflation is the opposite of inflation and has the opposite effect. Where an inflation of the currency means an increase in the price level, deflation

means a reduction ; and such reduction signifies, in terms of figures, an increase in the value abroad of the country's currency. That country becomes a good one to buy in, a bad one to sell in.

The possibilities in both deflation and inflation have given rise everywhere since the War to intense argument. Not only did the War leave most countries with depreciated currencies ; it left them with overcapitalised industries ; with a far greater capacity for production than a peace-time régime demanded or could demand ; it meant, therefore, a serious reduction in the incomes of those in receipt of fixed and unearned incomes, such as are obtained from stocks and shares ; it meant a level of wages higher than post-War conditions warranted ; it meant serious unemployment, unprecedented and harsh adjustment from a war, to a peace, basis ; and, finally, a higher price level than the currency position seemed to justify. In other words, adjustment was bad and difficult, and each difficult factor operated adversely on each other in a kind of vicious circle. Needless to say, suggestions as to remedial measures were not few. The form they actually took depended largely upon the degree to which the particular country had fallen from its 1914 estate. To the one which succeeded in returning to its pre-War currency status, there remained the industrial and financial difficulties. Those who were not so fortunate (or so unfortunate, as we are sometimes persuaded to believe), had first to give attention to their currencies and,

subsequently, to their industrial and financial positions. Their currencies, they had first to stabilise, incidentally aiding their industry and finances.

STABILISATION

Stabilisation may be described as that monetary condition where the currency has become stable, through the adjustment of the country's economic state to those existing abroad, as reflected in the foreign exchanges. That point it is, where, between two countries on the same standard, equilibrium has been reached and, by the regulations governing that standard, the currency which was unstable by reason of the internal dislocation of the country's economy, now fluctuates within narrow limits about a central point. Stabilisation may be either *de facto* or *de jure*. *De facto* stabilisation may be either natural, as where it is the result of the unfettered influence of economic forces on the one side as related to those on the other; or artificial, as where a currency, as indicated by the exchanges, is maintained at a given figure by governmental or central bank action—otherwise known as "pegging." *De jure* stabilisation takes place where the stabilisation is given the force of law. This has now become the fact in most of the countries which at some time or other found themselves forced off the gold standard.

"Pegging" an exchange is the artificial maintenance of the rate at a desired level and is achieved

by the purchase and sale of exchange on the country or countries with which it is desired to have stable exchanges. To take, for instance, the example of America and England during the War, the rate of $\$4.76\frac{1}{2}$ approx. was maintained in spite of the fact that economic forces were tending to force the rate down against this country. Dollars, in the shape of American securities held by English nationals, were sold to such an extent as to counteract the effect of natural economic forces, until—in 1919—restriction was removed and the exchange fell to its proper level. Again, before the War, India—through the gold exchange standard—maintained the value of the rupee by selling Council Bills and Reverse Councils, in London and India respectively. This meant the maintenance, in London, of a (gold) reserve which could be drawn upon as occasion required.

Obviously, “pegging” means an adequate reserve, which would normally be acquired as the result of the purchase, by the government or other exchange controlling body, of bills drawn upon the other country, or other rights to the exchange of the other country, as the outcome of trade or voluntary or compulsory sale by holders of securities expressed in the desired currency. In the case of the American example during the War, the extent to which this artificial maintenance could be sustained was bound to come to an end before much longer, for a huge proportion of our rights to dollars had been exhausted and

we had little to sell which the Americans desired ; the system would, then, have broken down sooner or later, unless America was prepared to continue indefinitely her loans and credits to this country. But so long as the reserve can be fed, so long can the exchange be " pegged."

REPUDIATION

One other method was resorted to as a means of overcoming currency difficulties during the War. This was what has been called repudiation, but in fact, is only an extreme form of inflation. If the process is carried far enough the currency becomes of no worth at all. This is what happened in Germany, whose position was made more difficult by the action of foreign nationals in speculating in the mark. The extreme degree to which inflation in Germany was carried soon had not only the direct effect expected, of currency depreciation ; but also the indirect one, of further depreciation, due to the fact that the value of the mark fell so rapidly that it was dangerous to hold marks. Those held or acquired one day were, the next, worth only a fraction of their worth the previous day. The mark became discredited abroad and in Germany itself. It was a case of all sellers and no buyers, until finally, German citizens refused to accept mark notes. It is no exaggeration that certain eccentric people used them as wall paper.

The currency had gone. Those who held marks had lost all that they represented—the notes were

so much waste paper. Germany found several expedients, among them the renten-mark, issued against charges on property. A new gold mark was created, for which the old Reichsmark was exchangeable at a fantastic figure, and was tied to gold.

POST-WAR INDUSTRIAL DIFFICULTIES

In the paragraph dealing with inflation, it has been said that remedial measures for the existing industrial depression after the War were not few. One of the most strongly advocated, however, was inflation itself, in carefully regulated doses. We were, and still are, asked to "manage" our currency, in the sense of increasing its volume with the purpose of so increasing prices as to give a fillip to trade. Briefly, it is held that rising prices mean increasing business; that there is the incentive to increased production to take advantage of the rising prices, to turn over stocks more quickly—and it is said that this increase in business must permeate the whole industry and trade of the country, by reason of its psychological effect.

This is true up to a point, but there must come a setback which will be all the more serious because of the greater extent of the boom, and which will take the longer to overcome. Perhaps it may be said that this doctrine is advocated by a relative few, and that few, extremists. There is, however, another remedy deserving of serious consideration—though the writer does not belong

to the 'school which advocates it. It is the remedy of a stable price level and, because it entails the management of the volume of currency in circulation, bears a definite kinship to that of the inflationists.

The exponents of this view consider that the all-important factor in trade and industry is a stable price level. It is held by one of the leading economists of this country at the present moment and is propounded from time to time through one of the large banking institutions of London. The achievement of a stable price level is to be obtained by the alteration of the amount of currency in circulation, according to a carefully compiled and revised index number of prices, so that business men may know always within a little that prices will not be liable to fluctuate against them. They will make no speculative profit, but, on the other hand are safeguarded from unforeseen loss. The arguments for and against could be elaborated *ad libitum*, but this Primer is scarcely the place. Yet the student of the money market and the exchanges should know of the existence of these suggestions and of their possible effect.

With regard to the exchanges under a managed currency, it is clear that unless other countries follow the example of managing the currency, the exchanges must fluctuate much more widely than they do at present. It is said that the gold standard would be reduced largely to nothing, because in order to maintain the stable price level, incoming gold might not be allowed to

affect the credit position as it does now. It would be sterilised. The opponents of this solution seem to forget that our currency is even now "managed" by the deliberate counteraction of gold movements by the "open market" policy of the central bank. Besides, it is argued, under a managed system gold would be superfluous; an important argument, perhaps, in view of the possibilities of a gold shortage.

The fallacy in the argument for a managed currency would seem to lie principally in the factor of control. Much can be said for the system in theory, but would it, in practice, prove as efficacious as, in theory, it appears? The danger is in the possible failure to restrict the inflationary and deflationary movements to the strict requirements of trade and industry; in other words, in the reliance upon human, instead of automatic, control.

GOLD

The War was not without its effect on gold; in fact, the influence of the War in this respect has had very far-reaching results. In the first place, pre-War ideas as to gold reserves had to be revised. The pressure of increased currencies and international debts meant the throwing over of the gold standard by all the combatant (with the exception of America), and a few non-combatant, countries.

It was in August of 1916 that this country relinquished its position of a free gold market by

prohibiting the export of gold. This was due to the sheer impossibility of paying in gold for the enormous indebtedness, to America, which had grown up in respect of huge purchases of war materials from that country, purchases increasing in amount every day. It has to be remembered that not only was this country spending to a entirely abnormal extent—on materials destined to almost immediate destruction—but we were not earning anything like our normal income. It will be remembered, too, that our position as a creditor nation before the War was due to the fact that for years, decades, in fact, we had conducted a great part of the world's business in the spheres of banking, insurance and carrying, which gave us an enormous surplus income, which was invested in enterprises throughout the world. This earning capacity was cut off. Not only was the country's shipping seriously depleted by the ravages of German war craft, but it was employed, not in earning an income from other countries, but in serving the British government in bringing war material from those countries, principally America, to which we were compelled to have recourse.

The sudden reduction of much of our overseas trade meant the concurrent reduction in the means of making invisible exports. Less banking and insurance services were required, and fewer claims by this country on foreign countries were consequently acquired by us, resulting in a reduction in our national income, and in our foreign lending capacity.

MOBILISATION OF DOLLAR SECURITIES

The position was met partly by the mobilisation of dollar securities. Before the War, our holding of such securities was estimated at something over £1,200 millions; holders of them were now given the opportunity to make them over to the government, either for cash or in exchange for securities of the British government. Later, the sale to the government was made compulsory. These securities were utilised for the settlement of indebtedness in America, either directly—or indirectly, as by borrowing against them.

Our exchange with America was thus maintained at a time when it was vital that it should not depreciate, but it meant the loss of our former income from foreign securities and the accretion of a colossal indebtedness, to be met, or otherwise dealt with, at the end of the War.

Thus was gold conserved up to a point. But yet another step was taken with this object in view. Before the War, all the banks of the country held gold reserves of their own, apart from their balances with the Bank of England. By arrangement with the Bank, these domestic reserves were transferred to the Bank with the object of concentrating the total gold stock. This was achieved early in the War, the banks receiving Treasury notes in exchange.

It will be remembered that the Interim Report of the "Cunliffe" Committee recommended that

"after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay." That this was not possible until 1925 was due to two reasons. Firstly, sufficient gold had to be acquired to give the country an adequate reserve against the very much increased circulation. Secondly, unless we were to stabilise our currency at the then existing level, it was necessary to resort to deflation in order to bring the pound sterling back to pre-War parity—in other words, to remove the discount on the paper pound. The size of our debt to America and the fact that it was unfunded made the first of these difficult of achievement; any gold produced and shipped to this country was automatically taken to swell the coffers of the U.S. Treasury. For this purpose, licences were granted by the Treasury in London. The result of this trans-Atlantic movement of gold was a serious shortage in this and the other countries of Europe, and a serious plethora in America. The effect of inward gold movements being to increase the basis of credit and, consequently, to raise the price level, America found herself obliged to sterilise the metal. It was, therefore, simply vaulted and not allowed to become the basis of credit, which meant that it had no utility and, into the bargain, cost the government of the United States something for its safe custody.

The gold standard was restored in this country in 1925, but not without much criticism at the

time and since. It is still maintained that, when other countries were making no effort to restore their currencies to their pre-War level—on the contrary were thinking deliberately of stabilising at a figure far below it, it was the height of stupidity for us to deflate and thus lower our price level, depress our trade and place us at a definite disadvantage, compared with other nations, in the post-War endeavour to regain trade and prosperity.

The arguments against this course have already been given. It was not that the opponents of the move were not sensible of the advantages which a return to the gold standard would bring, if there had been no other factors to take into consideration. The need for regaining our supremacy as the leading money market of the world was obvious, for it was to our pre-eminence in this direction that our pre-War status as a creditor nation was in no small measure due. It was to be borne in mind also that we were threatened in our standing as an international money market by both New York and Paris. For a time, America seriously threatened us in this connection because, from a purely financial and commercial point of view, she had been placed by the War in the shoes which this country wore before 1914. But she had not the technique. Paris, too, is said to have had (and still to have) designs, with the advantage of being, in a European sense, better placed geographically.

But it was thought that the inevitable difficulties which would follow as a result of the required course of deflation would express themselves in such a dislocation and depression of our industries that we should find it impossible to avail ourselves of the ordinary benefits of the gold standard. Nevertheless, the step was taken, for better or worse, and the position must now be considered in the light of the existing status, not in that which might have been, for there should be no going back.

GOLD STANDARD ACT, 1925

The text of the Act is given below. In order to smooth the difficulty which it was thought would naturally be met with in the attempt to return to the gold standard, a credit was arranged for the Bank of England in New York, to be in force for two years. But no use was made of it, for the effect, abroad, of the decision to return was so productive of confidence that the matter went through and the changeover was made as if its effect had been allowed for long before.

Although the enactment is described as enabling a return to the gold standard, the condition of affairs which it prescribed was different in many respects from that which existed before 1914, so different, in fact, that we are told that the country is not on a gold standard, but on a gold bullion standard.

THE GOLD STANDARD ACT, 1925

A.D. 1925. An Act to facilitate the return to a gold standard and for purposes connected therewith. (13th May, 1925.)

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1.—(1) Unless and until His Majesty by Proclamation otherwise directs—

issue of gold
coin sus-
pended and
right to
purchase
gold bullion.

1 & 4 Will. 4.
c. 98.

1 & 5 Geo. 5.
c. 14.

13 & 34 Vict.
c. 10.

(a) The Bank of England, notwithstanding anything in any Act, shall not be bound to pay any note of the Bank (in this Act referred to as "a bank note") in legal coin within the meaning of section six of the Bank of England Act, 1833, and bank notes shall not cease to be legal tender by reason that the Bank do not continue to pay bank notes in such legal coin:

(b) Subsection (3) of section one of the Currency and Bank Notes Act, 1914 (which provides that the holder of a currency note shall be entitled to obtain payment for the note at its face value in gold coin) shall cease to have effect:

(c) Section eight of the Coinage Act, 1870 (which entitles any person bringing gold bullion to the Mint to have it assayed, coined and delivered to him) shall, except as respects gold bullion brought to the Mint by the Bank of England, cease to have effect.

(2) So long as the preceding subsection remains in force, the Bank of England shall be bound to sell to any person who makes a demand in that behalf at the head office of the Bank during the office hours of the Bank, and pays the purchase price in any legal tender, gold bullion at the price of three pounds, seventeen shillings and tenpence halfpenny per ounce troy of gold of the standard fineness prescribed for gold coin by the Coinage Act, 1870, but only in the form of bars containing approximately four hundred ounces troy of fine gold.

power for
Treasury to
borrow for
exchange
operations.

2.—(1) Any money required for the purpose of exchange operations in connection with the return to a gold standard may be raised within two years after the passing of this Act in such manner as the Treasury think fit, and for that purpose

they may create and issue, either within or without the United Kingdom and either in British or in any other currency such securities bearing such rate of interest and subject to such conditions as to repayment, redemption or otherwise as they think fit, and may guarantee in such manner and on such terms and conditions as they think proper the payment of interest and principal of any loan which may be raised for such purpose as aforesaid :

Provided that any securities created or issued under this section shall be redeemed within two years of the date of their issue, and no guarantee shall be given under this section so as to be in force after two years from the date upon which it is given.

(2) The principal and interest of any money raised under this Act, and any sums payable by the Treasury in fulfilling any guarantee given under this Act, together with any expenses incurred by the Treasury in connection with, or with a view to the exercise of, their powers under this section shall be charged on the Consolidated Fund of the United Kingdom or the growing produce thereof.

(3) Where by any Appropriation Act passed after the commencement of this Act power is conferred on the Treasury to borrow money up to a specified amount, any sums which may at the time of the passing of that Act have been borrowed or guaranteed by the Treasury in pursuance of this section and are then outstanding shall be treated as having been raised in exercise of the power conferred by the said Appropriation Act and the amount which may be borrowed under that Act shall be reduced accordingly.

3. This Act may be cited as the Gold Standard Act, 1925. Short titl

DISCOUNT MARKET

The effect of the War on the discount market was evidenced in two ways. The volume of commercial bills fell enormously until some time after the War; the balance between the commercial and the Treasury bill was radically altered.

The commencement of hostilities meant the immediate cutting off of commercial intercourse between this country and a large part of Europe, the absolute cessation of trade. The risk attaching to transport, and the scarcity of shipping, meant a serious decrease in the trade with other parts of the world. The temporary "nationalisation" of industry in this country entailed a marked reduction in the number of trade bills drawn; finally, government borrowing was responsible for the enormous growth of the Treasury Bill, the serious competitor of the commercial bill.

The bill broker was, consequently, forced over to a commodity which had previously comprised only a small part of his stock-in-trade, and one which called for no great degree of technique or knowledge, as did the commercial bill. In other words, the bill broker's business became automatic.

This, in turn, operated on the money market. When it is realised that the function of a central bank is, *inter alia*, to conserve the nation's gold holding and that it does so through its discount rate, it will be appreciated that the Bank Rate had lost its power, because there could be no question of the loss of gold. As for the central bank's function of the retarding of speculative movements, again, the reason for this function had disappeared. The only speculation—if such it can be called—which was present was indulged in by the government and no raising of the Bank Rate would have stopped it. Further, central bank action for the control of the basis of credit was

entirely neutralised by the fact that such control had passed from the central bank to the Treasury.

Moreover, the predominance of the Treasury Bill in the market meant that rates became subsidiary to the Treasury Bill rate ; and it is evident, therefore, that the nature of the money market had altered beyond comparison. Instead of being a free market, dependent upon the supply of and demand for commercial bills, and on the demand for and supply of gold, as permitted to affect the main policy of the central bank, it became quite artificial, with the government as the arbiter of prices, rates, commodity and effect.

In addition, the position was made still more artificial by the fact that the dollar exchange, the most potent of all, was "pegged" ; that the free interplay of international price levels was obstructed ; that the Continental exchanges, such as there were, were operated through London, on New York ; and that gold in New York was sterilised so as to have no effect on the price level and, therefore, on the dollar exchange. Artificiality was rife and it was always a question of safeguarding until the end of the War should make it clear what efforts would be required, and in what directions, for a return to normality within the shortest possible time and with the minimum of cost and trouble.

FOREIGN EXCHANGES

When War broke out in 1914, England, France, Germany and the United States were on the gold

standard. Many countries were indebted to Great Britain. During the early months of 1914, there had been a general gold exodus from this country and America to the Continent, principally France and Germany, pointing rather to war preparations. The money position in this country had been easy for the thirteen years of the twentieth century, except in 1907, the occasion of the American banking crisis, when the average Bank Rate, which had moved between 3% and 4%, was 5%, the highest point touched being 7%.

July and August, 1914, saw an almost frantic endeavour on the part of most countries to repatriate the capital they had invested abroad. In the case of Great Britain and America, the calling in of credits forced the dollar rate up to 7. The French selling of London bills sent the franc against us. Germany seemed to have dealt with the situation before the War commenced; the exchange was in fact rather in our favour until it ceased altogether to exist.

The position in America was that that country was indebted to Europe in a very considerable sum, which after the outbreak of War, was demanded by its creditors, but which, nevertheless, could not be immediately repaid owing to the fact that the normal shipments of U.S. produce could not be made. It has to be remembered that America was dependent for her transport very largely on Great Britain and that such transport was otherwise engaged; that countries to which commodities of all kinds would normally have

been exported were unable to accept them. The difficulty was overcome by passing gold into Canada to be held on behalf of the British Government and of earmarking it in New York on behalf of France. Gradually, the position righted itself, helped very considerably by the purchases of combatant countries in America. At the end of 1914, the dollar had fallen to a little less than 4'86; at the end of 1915, to some 13 cents below par and after the War the exchange stood at over a dollar below par, *i. e.* at a substantial premium in favour of America.

It was almost a year after the commencement of hostilities that steps were taken to prevent the exchange going still further in favour of America and, as has already been explained, the support given took the form of the purchase in London of dollar securities for sale in New York. The efforts of the Treasury resulted in the "pegging" of the rate round about 4'76½, until early in 1919—the 21st March to be exact—when the official purchase of sterling in New York ceased and the exchange was permitted to move free from artificial control.

This meant an immediate fall to \$4'55-61, for the government was heavily in the debt of America still. Until the funding of this debt, the exchange (average of daily rates)—

fell to \$3'803 in December, 1919,
to \$3'378 in February, 1920;
rose to \$4'174 in December, 1921,
to \$4'617 in December, 1922,

and thereafter fluctuated between \$4.261 and \$4.696 until 1925 when it returned to the neighbourhood of gold parity; but the maintenance of the pound sterling at about 4.86 has meant a serious increase in the taxation of the population. In order not to interfere with the exchange, dollars are bought throughout the year, in respect of the interest and repayment of principal. Since a settlement of the German reparations question has been arrived at, this country has been the medium through which continental indebtedness to America has been met. With regard to our own debt, we receive from Germany and the Continent in general just what we have to pay.

EUROPE

For purposes of this Primer, the countries of Europe may be taken together. We are concerned principally with France and Germany, but much the same, in another degree, may be said of Belgium and Italy.

Without going into figures, it may be said that the exchanges of both France and Germany fell away from par as a result of the inflation which took place in those countries. The situation was most severe in Germany, which probably accounts for the fact that the degree of inflation there was considerably greater than in France. Germany was isolated in a very real sense. By the time the end of the War came, Germany was reduced to the use of shoddy as a substitute for cotton and wool, and the analogy can be carried into other

spheres besides that of textiles. Germany was left with no raw material worthy the mention and no means of obtaining any. Food had become less deserving of the name. By reason of its isolation, Germany had to use every means of obtaining the wherewithal to continue the War ; and such wherewithal became more and more difficult to acquire and constantly more expensive. The country's ordinary financial resources were rapidly exhausted, but internal purchases had still to be paid for ; and thus Germany, like all the belligerents, with the exception of the U.S.A., came to inflation. The greater the need, the greater the extent to which this panacea was resorted to, until finally, the currency was carried to such a point that it was valueless—refused acceptance even in Germany. It was a liability.

While inflation, wherever it was found, was due to, and an index to, the condition of the particular country, yet, in spite of that condition, it need not have become so virulent as it did. The situation, so far as the post-War economic state was to be concerned, was aggravated or relieved according to the method of war finance adopted. According to Schact—*The Stabilisation of the Mark*, p. 14—Dr. Knauss is stated to have calculated that in England 20% of the cost of the War was financed by direct taxation ; in Germany, 6% only ; in France, none. To quote Schact, speaking of Germany : " The inflation, which thus originated " in the War, could undoubtedly have been kept

“within narrower limits by heavier taxation of the population.”

Although the case of Belgium is little different from that of France, she returned to the gold standard before France. In doing so, she stabilised at a higher rate, 175 francs to the £, but instituted a new exchange unit, the belga, which was to be equal to fcs. 5. We thus have quotations in belgas, at a par of 35'00—although the franc is still used internally.

POST-WAR REVIEW

Subsequent to the establishment of currencies on a gold basis, the exchanges have been affected by little of note. Mint parities, which disappeared with the currencies' divorce from gold have been again instituted. Gold points have again become effective. The serious problem, it is said, has been the shortage of gold and its mal-distribution.

The world, for many years—but to a less extent in some countries than in others—has suffered from inability to buy. There has been a world industrial depression which is now at its worst and there is depression in the mental sense as well. The seriousness of the position is increased by the fact of a gold shortage and the possibility of a more serious shortage in times to come. It is argued that a further fall in world prices is inevitable, if we are to remain attached to gold, and that such fall must react on industry and make it still more difficult to improve the condition of affairs. It is thus

only natural that remedial measures are suggested. Estimates of gold production and the appropriation of the metal have enabled economists and bankers to appreciate the position and the need for some means of meeting it. One can scarcely pick up a newspaper or journal nowadays without realising how large the question looms in the minds of people.

Two methods are put forward, but it is not the purpose of this book to discuss them. They must, however, be mentioned ; firstly, and it has already been mentioned, to throw over the gold standard and "manage" our currency by reference to an index number so as to stabilise our price level. Gold would then become unnecessary, it is asserted. Clearly, this could not be effected, except in a country dependent on no other country, or, in other words, self-contained, unless other nations followed the same course. And even if they did, how would surplus indebtedness of one to the other be met if the international currency, gold, were to be devaluated ? It would seem that the scheme presupposes not only the acquiescence of all, or, at least, the majority, of the leading nations but the existence of an international committee with supreme powers to regulate the flow of trade so that international indebtedness, so far as there may be an excess between any two countries, is not permitted to exist beyond a certain point. Secondly, it is suggested that there be created a new international currency, based, shall we say, on two metals—one to be gold, the other a metal

of which there is plenty and no likelihood of a shortage. Whether it is the conservatism of humanity or the inherent difficulty in either of the two schemes which will prevent their materialisation, cannot be said, but it is hard to see that they can be accepted.

The position has been ameliorated somewhat by inter-central bank action and also, more recently, it may be, by the Bank for International Settlements. The essence of the matter lies in the avoidance of the unnecessary transfer of gold from one centre to another and the avoidance, consequently, of dislocation of the exchanges. Through the International Bank transfers may now be made by mere book entry, and it is not hard to visualise the situation where all the gold in the world is concentrated in the hands of one authority, one custodian, the Bank in question or some other international body. This again, nevertheless, presupposes the investment of that body with super-national authority, an authority which can in no circumstances be interfered with by any member. It would be churlish perhaps to suggest that this is a Utopian condition, but it would be true to say that many people view the possibility with scepticism and refuse to allow it to assume the importance of a probability.

The Bank for International Settlements was originated with the object of dealing with reparation payments by Germany ; in other words, it was to be an international clearing house of War debts between Germany and other countries.

Nevertheless, those responsible for it are believed to see in it a solution to many of the currency ills which have beset the world as a result of the War. That the Bank can function as a clearing house requires no imagination, but whether it can also be the means of sinking national currency prejudices remains to be seen.

THE COMMITTEE ON FINANCE AND INDUSTRY

This book was practically ready for final delivery to the printers when the "Macmillan" Report appeared. The Committee was appointed

- "to inquire into banking, finance and credit,
- "paying regard to the factors both internal
- "and international which govern their
- "operation, and to make recommendations
- "calculated to enable these agencies to
- "promote the development of trade and
- "commerce and the employment of labour,"

and a glance at the Table of Contents will show to what extent the subject matter of 'Clare' has entered into the Committee's deliberations. While an exhaustive analysis of the findings and recommendations would be out of place, a brief liaison of 'Clare' with the Report may give that fillip which the practical and topical application of one's reading always provides.

The Report is divided into two Parts, the first historical and descriptive, the second giving the conclusions and recommendations. It should be understood that almost every page contains

something for the student of the rudiments of the money market or for the advanced inquirer, but these notes are the concern only of the former.

The first point of interest is the description of the Bank of England and the past and present positions of the note issue. Under the heading of "The Banking Department" is given a full statement of the composition of the assets of the Bank. Then follows a statistical treatise on the joint stock banks, ending with a statement by Sir Ernest Harvey that the banks are the guide to the Bank of England as to the needs of industry for an increased volume of credit. "The barometer to which we look is the volume of money that is seeking investment in the short market." The remainder of the chapter (IV) is given up to a description of the position of the accepting houses in the money market, and the discount market in general.

Chapter VIII comprises the story of international events since 1925, the year of Great Britain's return to the gold standard. The first Part closes with a consideration of "The Influence of Monetary Policy on the Price Level" and includes eight paragraphs on the functions of Bank Rate.

Incidentally, it is to be remarked that "There is only one real prohibition that is imposed upon the Bank, and that is in the Tonnage Act of 1694, which says that in order not to oppress His Majesty's subjects the Bank is to be debarred

" for all time from using any of its funds in dealing
" in merchandise or wares of any description."

It is the second Part, however, which is of more importance and, therefore, of greater interest. Choosing those conclusions and recommendations which have definite relation rather to the money market as an organisation than to the present economic situation, one meets the statement that

" our objective should be . . . first of
" all to raise prices a long way above the
" present level and then maintain them at the
" level thus reached with as much stability as
" can be managed."

This means that the monetary system of this country must be a managed system and the Bank of England is entrusted with the task of managing. This view has been advocated for many years past, but it is doubtful whether anyone anticipated that a government commission, of such composition, at least, would, with only one dissident, have put forward such a proposition.

Chapter II of the second Part opens with a reiteration of the recommendation that this country should adhere to the gold standard; and closes with the Committee's conception of the proper policy of Central Banks:

" The aim of the Central Banks¹ should be to
" maintain the stability of international prices both
" over long periods and over short periods.

" The Central Banks should confer together at
" frequent intervals to decide whether the general
" tendency of their individual policies should be

¹ *The Financial News*, Special Supplement, 14th July, 1931.

" towards a relaxation or a tightening of the conditions of credit.

" This form of joint policy should be consistent with a full measure of autonomy for each national institution.

" Each Central Bank should undertake to do its best to avoid the importation of unwanted and unnecessary gold merely as a result of leaving natural forces to work themselves out unchecked.

" Central Banks should consider the rate of long-term investment as well as short-term investment as falling within their purview, and should take whatever steps may lie within their power, and are suited to their local circumstances, to counteract any tendency which their own nationals may show either to keep their investible resources excessively liquid or to undertake excessive long-term commitments."

The criticism of the principle of the fiduciary note issue is the next point to note. The Committee is of opinion that " the principle of the fixed fiduciary issue is wrong in that it associates the amount of the gold which the Bank of England should hold immobilised and unavailable for export with the amount of the active note circulation." It points out that, with the exclusion of gold from circulation, gold need no longer be held to meet an internal drain and that, therefore, it should be used for the one purpose for which it is held, *i. e.*, to meet a foreign drain. The principle of the fiduciary issue prevents this and it is suggested—

- (a) that the amount of the issue should be fixed at, say, £20 millions beyond the amount of the seasonal maximum, and the sum of £400 millions is mentioned ;

(b) that the Bank should be prohibited from allowing its gold reserve to fall below £75 millions, except with the permission of the Treasury and then temporarily only.

The next outstanding feature of the Report is the recommendation that the Issue and Banking Departments of the Bank should be amalgamated, their separation being meaningless, leading to unnecessary confusion and offering no advantage. This would entail the amalgamation of the statements of the two Departments, the consolidated Return (taking for illustration round figures for April 29th, 1931)¹ would appear as follows :

	£		£
Proprietors' Capital	14,500,000	Government Securities	274,000,000
Rest	3,500,000	Discounts and Advances	7,000,000
Public Deposits ..	17,000,000	Other Securities	39,000,000
Bankers' Deposits .	49,000,000	Silver Coin	4,000,000
Other Deposits ...	37,000,000	Gold	147,000,000
Notes in Circulation	350,000,000		
	£471,000,000		£471,000,000

In the words of the Committee, " We also attach " great importance to it as a first step towards " dissociating in the world at large the question " of the right level of a country's gold reserve " from the question of regulating the note issue."

Paragraph No. 356 gives an interesting summary of the means by which the Bank can manage the monetary system. These have probably never been so frankly stated in print as they are in the Report, though the several methods have been known to all concerned with the practical operations of the money market.

¹ *The Financial News*, Special Supplement, 14th July, 1931.

The only other point of importance in the present connection is the relationship between the Bank and the joint stock banks. To begin with, the Committee criticises the monthly and half-yearly "window-dressing," being the practice designed to make a "brave show" of deposits at the Bank of England. It is urged that this practice be given up. The further recommendation is made that the joint stock banks should reduce their holdings of notes so as to increase their balances with the Bank and lessen their power over the Bank's "reserve."

It is hoped that this short historical survey of the events of the War and post-War periods may enable the student to picture the effects of the War on money markets and exchanges, and that it may serve as a natural continuation to the preceding chapters, especially those dealing with the exchanges of Paris, Berlin and New York.

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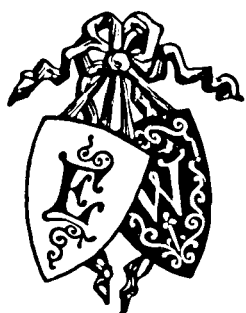
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THE GOLD STANDARD

Text of the Amending Act, 1931.

Great Britain abandoned the gold standard on Monday, September 21st, 1931. This act was preceded by the formation of a National Government pledged to balance the Budget, the unbalancing of which had led to a condition of affairs which had caused the foreigner to look askance at the pound sterling.

The position had been difficult for some time past and the Bank of England and the Treasury had found it necessary, in defence of sterling, to obtain considerable credits for its support. First France and the United States of America granted £25,000,000 each and this was followed later by a further £80,000,000 from America. Such was the uneasiness, however, with which the foreign observer regarded the finances of this country, that these did not suffice and, as *The Times* put it, we were forced off the gold standard when our gold reserve was just sufficient to cover the £130,000,000 recently borrowed.

The text of the Act providing for the suspension is given below :—

CHAPTER 46.

An Act to suspend the operation of subsection (2) of section A.D. :
one of the Gold Standard Act, 1925, and for purposes
connected therewith. [21st September, 1931.]

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows :—

1.—(1) Unless and until His Majesty by Proclamation otherwise directs, subsection (2) of section one of the Gold Standard Act, 1925, shall cease to have effect, notwithstanding that subsection (1) of the said section remains in force.

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(2) The Bank of England are hereby discharged from all liabilities in respect of anything done by the Bank in contravention of the provision of the said subsection (2) at any time after the eighteenth day of September, nineteen hundred and thirty-one, and no proceedings whatsoever shall be instituted against the Bank or any other person in respect of anything so done as aforesaid.

(3) It shall be lawful for the Treasury to make, and from time to time vary, orders authorising the taking of such measures in relation to the exchanges and otherwise as they may consider expedient for meeting difficulties arising in connection with the suspension of the gold standard.

This subsection shall continue in force for a period of six months from the passing of this Act.

2. This Act may be cited as the Gold Standard (Amendment) Act, 1931.

The Treasury Order made under Section 1 of the Act was as follows:—

Order made by the Treasury under Section 1 of the Gold Standard Amendment Act, 1931.

THE Lords Commissioners of His Majesty's Treasury in pursuance of Section 1 of Gold Standard Act, hereby order that until further notice purchases of Foreign Exchange or Transfers of Funds with the object of acquiring such exchange directly or indirectly by British subjects or persons resident in the United Kingdom shall be prohibited except for the purpose of financing normal trading requirements—contracts existing before September 21st—reasonable travelling facilities or other personal purposes.

(Signed) PHILIP SNOWDEN.

September 22nd, 1931.

The abandonment of gold has had many consequences. Firstly and, perhaps, foremost, the exchanges of most countries have gone seriously against the pound, the dollar and the franc standing (1-10-1931) at 3.98 and 100½ to the £ respectively after having touched 3.78½ and 96. Other countries have

become vastly mistrustful of sterling and have thrown sterling securities wholesale on to the market, the 5% War Loan dropping to 90½. The London Stock Exchange was closed for two days and Continental exchanges followed suit. The Government which took the step now proposes to go to the country for a clearer mandate, one which would permit it to introduce tariffs in the endeavour to bring some measure of prosperity to British industries. Meanwhile, the Continent anxiously awaits the result and the pound remains hopelessly undervalued in terms of other currencies. Denmark, Norway and Sweden have followed the example of this country and have prohibited the export of gold. India and Ireland have decided to remain attached to sterling.

The ultimate effect of the step is yet to be seen, but conjecture is rife as to the possibility of sterling's being devaluated and stabilised at something below par and as to the ultimate departure of all countries from gold.

NOTE.—The steps taken by the English Parliament following the suspension of the Gold Standard during the war are described in Clare's "Money Market Primer," page 246, *et seq.*

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(Reprinted from 'The Bankers Magazine,' New York)

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In 1929, just one hundred years later, the centenary edition of this same volume, now known as 'Tate's Modern Cambist,' has come from the press.

During the intervening years, twenty-six editions of the book have been compiled and published, each being revised and brought up-to-date by its editor. The latest, and twenty-eighth edition of the volume, thus contains more than 700 pages, in contrast to the 100 of the original volume.

William Tate himself edited the first twelve editions of the book and from that time on his work has been carried on by various editors, all financial experts of their day. The new edition, which has taken four years to compile, is the work of William F. Spalding, Fellow of the Institute of Bankers and Royal Economic Society and the author of a number of other works on financial subjects, among which are 'Foreign Exchange and Foreign Bills,' 'Eastern Exchange Currency and Finance,' 'A Primer of Exchange,' 'Bankers' Credits,' and the 'London Money Market.'

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