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The effect of an increase in
bank loans on holdings of Government
securities.

Enclosed is a brief listing of the main factors bearing on the future movements of bank loans and holdings of Government securities. On balance the probabilities appear to be that the demand for accommodation by customers will not entail much liquidation of Governments, especially if the Treasury does not fund very much of the short-term debt. The most important consideration that points in the opposite direction is the expansion of "All other loans" of reporting member banks that has occurred in the past year. I am wondering whether you think it worthwhile to try to get more information on this expansion. Without making an elaborate statistical study you could pick up some information by asking reserve banks in those districts in which the major expansion occurred to inquire of a few large member banks what, in general, had been the nature of the increase; how far it arose from refinancing operations and the taking over of existing debt; and how far from financing an actual increase in production and inventories, and how far from financing installment sales. The examiners might also be directed to keep their eyes open and to make inquiries along the same lines.

It would be helpful if in the call reports we could get more information on the classification of loans by purpose rather than by form.

LBC:em

THE EFFECT OF AN INCREASE IN BANK LOANS ON HOLDINGS OF GOVERNMENT SECURITIES

The expansion in "All Other Loans" of member banks which has taken place in the past year raises the question whether increasing demands for accommodation by customers may not result in liquidation of Government securities and pressure on the Government bond market from this source.

At present excess reserves are large enough to permit demands for loans to be met without entailing the necessity of liquidating other assets. It is to be expected, however, that we will eventually return to what was the normal situation of no excess reserves that prevailed up to 1932. In this case increased accommodation of customers will entail either a total expansion of assets or a liquidation of Government obligations. If it is thought inadvisable to permit an expansion of circulating deposits it would still be possible for total bank assets to increase through an increase in savings deposits and the capital and surplus of banks. Whether such expansion will be sufficient to supply the requirements of local borrowers depends upon the magnitude of such requirements. While a definite answer cannot be given, the following observations are pertinent to this question:

1. The cash reserves of American business as a whole are probably in excess of 1929.
2. The repugnance of the larger and financially strong corporations to bank indebtedness noticeable in the '20's was probably intensified by the depression.

3. Higher margin requirements will act as a check on the expansion of security loans.

4. While real estate loans will increase it is to be expected that the bulk of this business will, as heretofore, be handled by non-bank lenders.

5. With a lower level of call loans than in the '20's it is to be expected that banks will rely more heavily on Governments to satisfy their requirements for liquidity.

6. If "All Other Loans" of member banks regain the level of 1929 this would mean an expansion of \$6,263 million over the present level.

7. Previous experience in this country. From June 1921 to June 1923 the index of production rose from 65 to 106. In the same period national bank loans other than on securities and real estate declined \$607 million, and holdings of Government bonds increased \$370 million.

From June 1923 to June 1929 the Index of Production rose from 106 to 125. "All Other Loans" of reporting member banks increased by \$1,401 million. Member bank holdings of United States Government securities increased by \$320 million. In the same period the Government debt outstanding decreased by \$5,369 million.

In the past year "All Other Loans" of reporting member banks have shown a net increase of \$701 million.

8. Experience in other countries.

Holdings of Loans and Investments by Commercial
Banks in Foreign Countries

	<u>1929</u> Dec. 31	<u>1931</u> Dec. 31	<u>1935</u> Dec. 31	<u>1936</u>
<u>Canada</u> (millions of dollars)				
Loans	2,283	1,680		989 1/
Investments	448	694		1,357 1/
<u>England</u> (millions of pounds)				
Loans	962	905		850 2/
Investments	267	297		612 2/
<u>Sweden</u> (millions of kronor)				
Loans	3,203	3,392	2,762	
Investments	395	411	648	

1/ July
2/ August

9. Other factors bearing upon the future movements of bank holdings of Governments include the policy of the Government in retiring the debt and in funding the short-term issues. In general the larger the proportion of short-term issues the larger will be the proportion of the total debt held by commercial banks.