CONFIDENTIAL November 5, 1935.

(DRAFT OF PRESS STATEMENT RE RAISING RESERVE REQUIREMENTS)

On November _____ the Board of Governors of the Federal Reserve System issued a regulation increasing by 25 percent, effective on ____________, the requirements as to reserves to be maintained by member banks against demand and time deposits. The Board's action in this matter was under the authority conferred by the Banking Act of 1935 which amended paragraph 6 of section 19 of the Federal Reserve Act, to provide that, upon the affirmative vote of not less than four of its members, the Board, in order to prevent injurious credit expansion or contraction, may change, within certain limits, the requirements as to reserves to be maintained against deposits by member banks.

The recent increase in member bank reserves has carried them to a level at which they exceed legal requirements by the unprecedented amount of $3,000,000,000. These excess reserves, if utilized in full, could support an amount of bank credit more than double the existing volume and far greater than can be soundly employed, even with full business recovery. Such a growth of bank credit would constitute an injurious credit expansion.

The increase in reserve requirements should not cause an advance of money rates or tighten credit conditions and should not act as a restraint on the lending policies of banks. It is not, therefore, a reversal of the System's policy of encouraging business recovery by maintaining easy conditions in the money market. After meeting the increased requirements the member banks, in the aggregate, will still have $2,300,000,000 of excess reserves, and these reserves are so widely held that all but a very few member banks are in a position to meet the increase in requirements by the use of their balances with the Reserve bank or with correspondents.

In view of the abundance of reserves in all classes of banks, the Board has made the increase in reserve requirements applicable to all member banks, including country banks as well as banks in central reserve cities and in reserve cities. A survey made by the Board shows that country banks have a larger amount of excess reserves in proportion to their deposits than have reserve city banks and have, in addition, large balances with their city correspondents on which such country banks as do not have sufficient reserves with the Reserve banks can draw for the purpose of meeting the increased requirements. A large part of the existing excess reserves is, in fact, directly or indirectly, owned by country banks which are consequently in fully as good a position as city banks to meet the increase in reserve requirements without curtailing their loans or investments.

The increase of reserve requirements prescribed by the Board will absorb the reserves created in recent months largely by an inflow of gold not arising out of ordinary transactions in international trade and finance, but caused by a movement of funds from foreign countries due to disturbed political and economic conditions. It would not be good policy to have reserves arising from this cause incorporated in our credit base. An advance of 25 percent in requirements at this time will have the effect of restoring excess reserves to the level of last spring, when the recent flight of capital from abroad began.