Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 19, 1936

To Chairman Eccles

Subject:

From Mr. Goldenweiser

I attach a copy of Mr. Longstreet's report of the meeting of the Board with the economic staff on May 11, 1936.

CONFIDENTIAL
Notes on meeting May 11, 1936

GENERAL CREDIT CONDITIONS

Credit conditions in this country since 1933 have been characterized by (1) a large growth in monetary gold stock and in excess reserves of member banks, (2) extensive Government borrowing and spending, (3) rapid increase in volume of bank deposits, and (4) limited use of the available supply of funds.

Summary of developments prior to 1933

The collapse of the speculative boom in the fall of 1929 ushered in a period of monetary ease that lasted until the international financial crisis of September 1931. During this period monetary developments, i.e., those developments affecting member bank reserves and borrowings, were in no way restrictive and may be considered as relatively unimportant among the factors causing continued business recession. Bank loans to customers declined, but the total of bank loans and investments and bank deposits showed little decline until the end of 1930. The volume of business activity was sharply reduced, and with the contraction in payrolls and retail trade, money returned from circulation. Monetary gold stock also increased and the Federal Reserve banks purchased securities in the open market. Funds obtained by banks through gold imports, through return of currency from circulation, and through open-market purchases were used to repay indebtedness to the Federal Reserve banks. During this period, member bank reserve balances showed little change.

In September 1933, with England's departure from the gold standard and the accompanying international financial crisis, monetary factors assumed a new importance. Foreigners withdrew large amounts of their funds from New York and the previous inflow of gold was reversed into an outflow. At the same time the weakness of individual bank situations and the reduction in the value of bank assets resulted in runs upon banks and large currency hoarding. Member banks drew upon their reserve balances and borrowings at the Federal Reserve banks rose almost to the 1929 level. Deposits and loans and investments of member banks declined sharply during this period.

After the passage of the Glass-Steagall Act on February 27, 1932, the Federal Reserve System bought a large volume of securities, indebtedness at the Reserve banks was sharply reduced, and member bank reserve balances were restored by the end of 1932 to the 1928-1930 level. Gold also began to move into this country. It was during this period that excess reserves first appeared. Although the general reserve position of banks was improved by open-market purchases and gold inflow, currency continued in hoards, bank loans and holdings of corporate securities continued to be liquidated, and the condition of many banks remained weak. Numerous bank failures at the turn of the year brought wholesale runs upon banks, culminating in March 1933 with the closing of all banks in the country.

Developments since 1933

The year 1933 was one of transition. With the reopening of banks on a sound basis, monetary factors again became relatively unimportant. Return of currency from hoards and heavy open-market purchases by the Reserve banks enabled member banks to reduce borrowings and accumulate excess reserves. The decline in loans of banks was checked and, toward the close of 1933, their investments began to increase sharply, as banks continued to purchase Government securities in even larger volume than in 1931 and 1932 and as the decline in bank holdings of corporate securities was halted.

Heavy gold imports following revaluation of gold on January 31, 1934, further built up excess reserves of member banks and permitted them to repay all of their indebtedness to the Reserve banks. Banks bought more heavily of Government obligations in 1934 and 1935 and also increased somewhat their holdings of other securities. Government spending of the proceeds from the sale of securities to banks, together with gold imports, caused a sharp increase in bank deposits.

By the end of 1935, the total volume of deposits and currency held by the public had increased to $51,800,000,000 as compared with $40,700,000,000 in June 1933 and $54,500,000,000 at the end of 1929. Most of the increase occurred in demand deposits, which have recovered to about the 1929 level, as shown by the following table:

TOTAL CURRENCY AND DEPOSITS AT ALL BANKS HELD BY THE GENERAL PUBLIC
(In millions of dollars)

	Dec. 31, 1929	June 30, 1933	Dec. 31, 1935
Demand deposits 1/	22,400	14,300	22,000
Time deposits	28,500	21,600	24,800
Mutual savings	8,900	9,700	10,000
Postal savings	200	1,200	1,200
Other	19,400	10,700	13,600
Total deposits	50,900	35,900	46,800
Currency outside banks	3,600	4,800	5,000
Total deposits and currency	54,500	40,700	51,800

1/ Adjusted to exclude interbank and United States Government deposits and certain collection items.

Although the volume of bank deposits and currency held by the public is only about 5 percent less than in 1929, business activity has not yet returned to so high a level and the volume of payments has continued relatively small, reflecting the hesitancy of holders of funds to spend or invest them. A considerable amount of currency continues in hoards and the rate of turnover of bank deposits has remained near the low level reached in 1932. The total volume of check payments has increased about in accordance with the growth in deposits, but the rate of turnover of deposits in all banks excluding mutual savings banks, was about 15 times per annum in the years 1933-1935, as compared with 20 times per annum in the years 1921-1926, and a peak of 27 times a year in 1929, reflecting principally stock market activity. At New York City banks, where deposits are now almost as large as in the pre-depression period, the rate of turnover is much smaller--26 times a year in 1935 compared with 57 in 1926; whereas at other banks, where deposits are still much smaller, the rate of turnover has shown a relatively small decline--from 13 to 11.