

1936-7

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SUMMARY OF BUSINESS SITUATION

by

Frank Garfield

Business conditions and prospects are not the same as last summer. Recovery has proceeded farther and its momentum appears to be great. Industrial production has increased rapidly, but has not kept pace with the demand for goods, with the consequence that a substantial volume of unfilled orders has accumulated. Shortages of equipment and skilled labor are appearing in certain lines, although there is still a large number of unemployed. There has been a rapid rise in prices for two months and a half, not only in farm products but also in industrial materials, which had shown little change in price for three years. Increased buying accompanying greater industrial activity has been supplemented by buying of a speculative nature and by foreign and domestic buying for armament purposes, with the purchasers more concerned about promptness of delivery than about price. The most important factor in the situation that may interrupt the progress of recovery is in the field of labor relations, with the possibility of extended strikes in some leading industries. In general, developments in production and prices indicate that some slowing down in the rate of advancement may be desirable from the viewpoint of sustained recovery.

EFFECT OF INCREASE IN RESERVE REQUIREMENTS
ON STOCK MARKET SPECULATION

by

Carl E. Parry

An increase in the reserve requirements at this time would affect speculation in securities in two principal ways. In the first place, because of its general implications, it would weaken the conviction and impair the influence of such brokers and other financial advisers as have long been advertising aggressively the view that inflation is absolutely inevitable and that investors and speculators should govern their policies accordingly. In the second place, because of its tightening effect on the very lowest of short-term money rates and its stiffening effect on long-term rates, it would curtail some of that demand for securities which arises from the widespread belief that prices of income-bearing securities have not yet risen far enough to bring them into line with the current level, or in any event with the prospective level, of long-term interest rates.

With the volume of stock speculation as large as it has now become, both of these effects would be in the public interest at the present time. There can be little doubt that the broad underlying trend of the stock market is still upwards, notwithstanding the fact that a very substantial advance has already occurred. The factors accounting for this trend are quite sufficiently strong without the reinforcement they have been receiving from belief in the inevitability of inflation or from expectation that money rates are destined to go even lower than they have already gone.

DEPOSITS AND LOANS AND INVESTMENTS OF BANKS

by

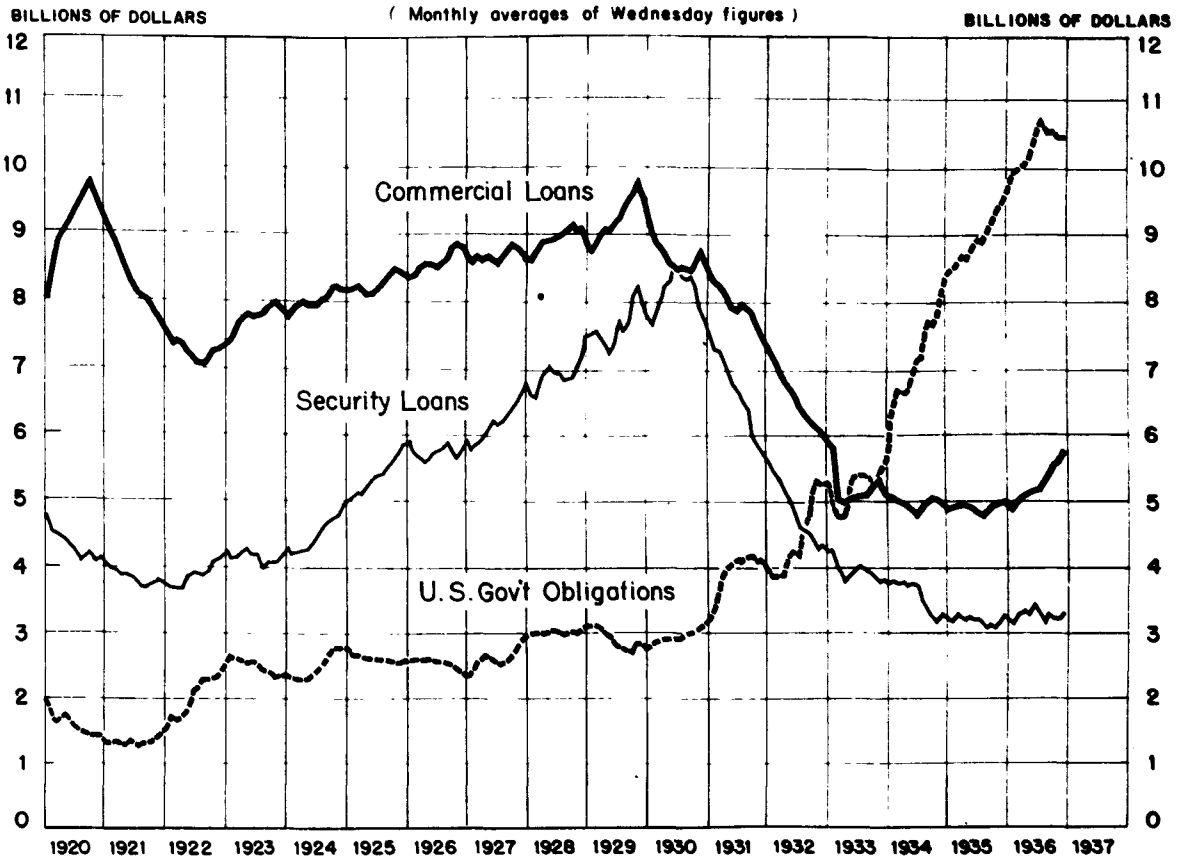
Victor M. Longstreet

Since the raising of reserve requirements of member banks in the middle of August there has been a marked growth in loans to customers of weekly reporting member banks in 101 leading cities. As a consequence total loans and investments of these banks have continued to expand, notwithstanding some reduction in their holdings of Government securities. There appears also to have been a continued growth in loans and investments of other member banks. Bank deposits have also increased further, reflecting the increases in total bank loans and investments, as well as gold imports and a reduction in Treasury balances with the Reserve banks. The amount of money in circulation has also increased and by more than the usual seasonal amount. As a consequence, the total amount of bank deposits and currency held by the general public was about \$2,-300,000,000 larger at the end of 1936 than in the middle of the year and about \$1,300,000,000 larger than at the end of 1929.

Increase in bank loans

The following table shows for the central reserve cities of New York and Chicago and for each Federal Reserve district the increase in so-called "other" loans to customers of reporting member banks since August 12, 1936, just before the raising of reserve requirements, and for the year 1936 as a whole.

LOANS AND U.S. GOVERNMENT OBLIGATIONS of Member Banks in Leading Cities



"OTHER" LOANS OF REPORTING MEMBER BANKS

	December 30, 1936 (Million dollars)	Change since:			
		August 12, 1936		December 31, 1935	
		Million dollars	Percent	Million dollars	Percent
Total.....	4,290	+607	+16	+889	+26
New York City.....	1,556	+318	+26	+395	+34
City of Chicago.....	405	+57	+16	+148	+58
Federal Reserve district:					
Boston.....	307	--	--	+33	+12
New York <u>1/</u>	157	+8	+5	+19	+14
Philadelphia.....	191	+4	+2	+21	+12
Cleveland.....	239	+31	+14	+61	+34
Richmond.....	119	+19	+19	+10	+9
Atlanta.....	176	+44	+33	+31	+21
Chicago <u>1/</u>	162	+20	+14	+62	+62
St. Louis.....	144	+26	+22	+29	+25
Minneapolis.....	123	+15	+14	-4	-3
Kansas City.....	151	+9	+6	+19	+14
Dallas.....	159	+23	+17	+26	+20
San Francisco.....	401	+33	+9	+39	+11

1/Excludes central reserve city banks.

These loans include all loans other than loans on securities, loans to banks, loans on real estate, and acceptances and commercial paper bought. They cover, therefore, loans for agricultural, commercial, and industrial purposes, as well as instalment loans, personal loans, etc. As shown by the table, these loans at reporting member banks increased by nearly \$900,000,000, or by 25 percent, during 1936 and the increases occurred in all Federal Reserve districts outside Minneapolis, where there was a slight decline. Increases have been especially marked since the raising of reserve requirements last August, and since that time the Minneapolis district has shared in the general increase. A part of the recent increases is undoubtedly attributable to some seasonal demand for credit in the late summer, but during

December there was further marked growth, contrary to the usual seasonal movement. Some of the growth in these loans as compared with a year ago is also a result of special transactions, such as the purchase last July of Commodity Credit Corporation notes, chiefly by banks in the city of Chicago, and the granting of loans to receivers of closed banks, which was important in Detroit last spring. It is believed, however, that perhaps the bulk of the increase reflects a demand for additional funds by producers and distributors of goods.

No statement of condition for all member banks is available since June 30, 1936. The above figures for weekly reporting member banks, however, are fairly indicative of what has taken place at central reserve and reserve city member banks. Latest figures for country member banks, set forth in the table below, show that there was also an increase of about \$100,000,000 in "other" loans at these banks between March 4 and June 30, 1936. Again, increases were in each Reserve district outside Minneapolis. It is likely that as much as one-half of the growth in "other" loans of country banks during this period might have been of a seasonal character. As explained later, there appears to have been a further substantial increase in total loans and investments of country member banks in the last half of the year, although there is no way of telling what part of this might have been in "other" loans.

Loans on real estate, loans to banks, acceptances and commercial paper bought, and loans on securities to customers have shown no significant change at weekly reporting member banks for some time. Loans to brokers and dealers, although they have fluctuated widely, have exhibited no definite tendency to increase or decrease during 1936.

"OTHER" LOANS OF COUNTRY MEMBER BANKS

	June 30, 1936 (Million dollars)	Change since March 4, 1936	
		Million dollars	Percent
Total.....	1,893	+101	+6
Federal Reserve district:			
Boston.....	195	+15	+8
New York.....	346	+11	+3
Philadelphia.....	238	+3	+1
Cleveland.....	154	+13	+9
Richmond.....	160	+12	+8
Atlanta.....	105	+5	+6
Chicago.....	140	+10	+8
St. Louis.....	88	+5	+6
Minneapolis.....	88	-1	-1
Kansas City.....	130	+6	+5
Dallas.....	130	+8	+7
San Francisco.....	119	+12	+12

Holdings of United States Government obligations

In the last half of 1936 United States Government direct and fully guaranteed obligations, which had theretofore been the principal factor accounting for the growth in member bank credit, declined from \$10,800,000,000 to \$10,500,000,000 at reporting member banks, reflecting a reduction of \$500,000,000 in holdings of New York City banks and an increase of \$200,000,000 at reporting banks in other leading cities. In the first half of 1936 Government direct and fully guaranteed securities held by reporting member banks had increased by \$1,200,000,000. The recent reduction in holdings of Government securities at New York City banks appears to have been due in part to the fact that the Treasury has been issuing fewer short-term obligations, of which New York banks usually take a large share, and in part to the desire to maintain large reserve balances in anticipation of a further increase in reserve requirements. An additional consideration

might be the expectation that an increase in reserve requirements may possibly result in a rise in short-term money rates and a fall in the prices of shorter-term Government issues.

Securities other than Government obligations held by reporting member banks, after increasing by about \$300,000,000 in the first four months of 1936, declined somewhat in the last quarter. At the end of the year they amounted to \$3,250,000,000, representing an increase of about \$200,000,000 during the year.

Increase in total loans and investments

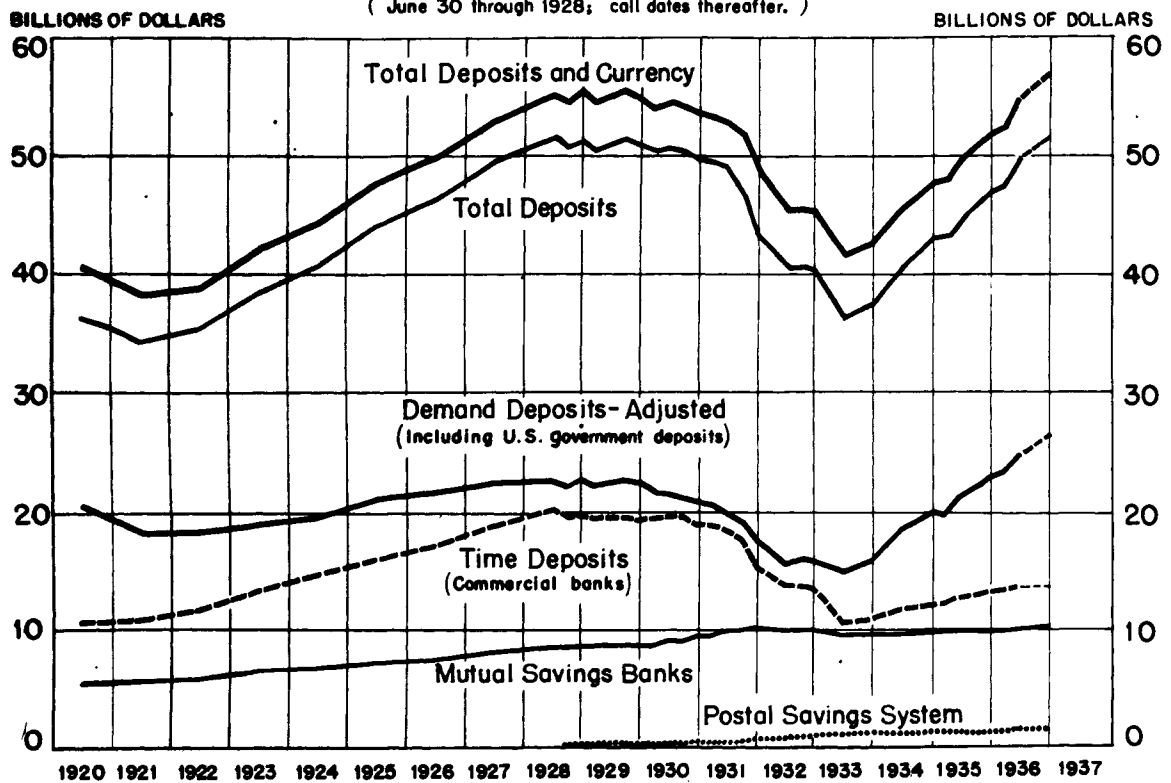
Total loans and investments of all member banks probably increased during the last half of the year by roughly \$500,000,000, as compared with an increase of \$2,300,000,000 in the first half. Total loans and investments of reporting member banks, which are representative of central reserve and reserve city banks, increased by about \$350,000,000 in the last half of 1936, and loans and investments of country member banks are estimated to have increased by about half of that amount. Although figures on loans and investments of country banks are not available since June 30 last, a rough indication of the increase in their total is afforded by the difference between the increase in deposits of country banks and the increase in the total of their reserve balances and estimated due from banks. The greater increase in loans and investments of member banks during the first half of the year was due principally to acquisition of United States Government obligations by weekly reporting member banks in leading cities.

Increase in member bank deposits

Expansion in loans of banks, further gold imports, and expenditures by the Treasury from balances previously accumulated have resulted in continued

DEPOSITS AND CURRENCY

(June 30 through 1928; call dates thereafter.)



growth of bank deposits during the last half of 1936, notwithstanding the flow of additional currency into circulation.

It is estimated that deposits of banks in central reserve and reserve cities are now \$3,700,000,000 greater than they were at the end of 1929, an increase of 21 percent. As shown by the following table, deposits at country banks, however, are somewhat smaller than in 1929. This is due partly to the fact that failures among country banks were relatively more numerous than among city banks, so that losses to depositors were also greater. There has also been a greater increase in Postal Savings deposits in smaller cities, where country banks are located, than in the larger cities. Another important factor has been the movement of idle funds, especially in the early stages of depression, to the money markets of the financial centers in order to seek profitable employment. Since the middle of the year the percentage increase in deposits has been half again as large at country banks as at city banks and deposits at banks in New York City and Chicago have shown much smaller increases than in other parts of the country. There is evidence, therefore, that a redistribution of deposits more in accordance with the pre-depression pattern is under way.

DEPOSITS OF MEMBER BANKS
(In millions of dollars)

	Dec. 31, 1929	June 30, 1933	June 30, 1936	Dec. 31, 1936 (est.)
Central reserve city banks:				
New York City	5,900	5,000	7,400	7,600
Chicago	1,400	1,300	2,000	2,000
Reserve city banks	10,000	6,900	10,800	11,400
Country banks	12,200	7,000	10,600	11,300
All member banks	29,500	20,200	30,800	32,300

Note: Deposits, other than United States Government deposits, interbank deposits, and Postal Savings redeposited in banks, and less cash items in process of collection.

The estimated volume of deposits and currency in the hands of the general public at the end of 1936 is compared in the following table with the volume at the end of June 1933, the low point of recent years, and at the end of 1929, before the decline of the early 30's. The figures are estimates covering total deposits in all banks, except private banks for which comparable data are not available, and they are adjusted to exclude items in process of collection, interbank deposits, and United States Government deposits. Deposits in the Postal Savings System, whether or not they are redeposited in banks, are included in the figures for time deposits. Vault cash of banks has been excluded in obtaining the amount of currency held outside banks.

DEPOSITS AND CURRENCY HELD BY PUBLIC
(In millions of dollars)
Partly estimated

	Dec. 31, 1929	June 30, 1933	June 30, 1936	Dec. 31, 1936
Demand deposits--adjusted	22,400	14,100	23,600	25,300
Time deposits	28,500	21,600	24,700	25,100
Mutual savings banks	8,900	9,700	10,100	10,200
Postal Savings System	200	1,200	1,200	1,300
Commercial banks	19,400	10,700	13,400	13,600
Currency outside banks	3,600	4,800	5,200	5,400
Total deposits and currency	54,500	40,500	53,500	55,800

Note: Total includes currency in circulation outside banks, deposits at all banks in the United States, and deposits with the Postal Savings System. Demand deposits are adjusted to exclude interbank and United States Government deposits and cash items in process of collection. Private banks are excluded.

By the middle of 1936, prior to the raising of reserve requirements, total deposits and currency held by the public had increased to \$53,500,000,000,

which was about \$1,000,000,000 below the 1929 figure. In the last half of 1936 further increases brought the total to \$55,800,000,000, about \$1,300,000,000 or over 2 percent more than in 1929. The recent increase, as well as the increase since the low point of 1933, has been largely in demand deposits, which are now at an all-time peak of \$25,300,000,000 and are about 13 percent larger than in 1929.

Velocity of bank deposits

The volume of checks drawn against bank deposits is currently below the volume of pre-depression years, and accordingly the rate of turnover of deposits is also smaller, reflecting the fact that although the volume of bank deposits and currency held by the public is above the pre-depression level, there is a large amount of idle funds awaiting investment or other use. The rate of turnover of deposits in all banks, excluding mutual savings banks, as measured by the ratio of check payments to deposits, has been at about 15 times per annum since 1933, as compared with about 20 times per annum in the period 1922-1926, prior to the speculative boom that culminated in 1929.

In view of the increase in population and the consequent likelihood of an increase in the volume of business -- when prosperity is restored -- the volume of funds in the hands of the public does not appear to be excessive. The volume, however, is sufficiently large so that an increase in turnover to the level of 1922-1926 would carry total transactions to a level where inflationary tendencies might develop. It is clear that no further increase in deposits should be encouraged by the Federal Reserve System.

VOLUME AND DISTRIBUTION OF EXCESS RESERVES

by

L. M. Piser and Woodlief Thomas

Excess reserves in November and the early part of December averaged about \$2,200,000,000. As a result of a seasonal increase in currency in circulation and additions to Treasury balances in the second and third weeks of December, excess reserves declined to about \$1,900,000,000, but with the return flow of currency and disbursements by the Treasury from accumulated balances member banks in February will probably have excess reserves of \$2,200,000,000, about the same as in November.

Distribution by classes of banks

It is difficult to estimate what shifts may take place by February in the distribution of excess reserves among the individual banks and classes of banks. The likelihood of withdrawals of bankers' balances in case of an increase in reserve requirements makes such estimates even more difficult. Assuming that the distribution will be approximately the same as in November, the following table shows probable excess reserves of the various classes of member banks after an increase of $33 \frac{1}{3}$ percent in reserve requirements.

DISTRIBUTION OF EXCESS RESERVES

(Amounts in millions of dollars)

	Actual Nov. 16-30, 1936	Probable Feb. 1937	Percent excess over required (Feb.)
		After increase of 33 1/3% in requirements	
Central reserve city banks			
New York City	768	110	4.2
Chicago	225	80	13.7
Reserve city banks	728	240	12.1
Country banks	516	270	27.2
All member banks	2,237	700	11.3

It is expected that after an increase in requirements all member banks in the aggregate would have about \$700,000,000 of excess reserves -- approximately 11 percent over the enlarged requirements. Total reserves of country banks would be about one-fourth larger than requirements and their excess reserves in dollars would be about the same as in the early part of 1934. Reserves of banks in Chicago and in reserve cities would be in excess of requirements by about one-eighth, while those of central reserve city banks in New York would be only 4 percent in excess of requirements.

While no allowance has been made in estimating these figures for shifts in bankers' balances, which might involve withdrawals of some \$200,000,000 from New York City and Chicago banks, it is likely that a number of banks in those cities would continue to have excess reserves, and that the aggregates of these holdings would be little if any less than the amounts given in the

table. As shown later 15 New York City banks, on the basis of their November reserve position, would continue to have excess reserves of \$200,000,000 after the increase in requirements. Some of the withdrawals of bankers' balances would come from these banks and, moreover, banks deficient in reserves would make up their shortages by borrowing or by selling assets to banks with excess reserves both in New York and outside.

Distribution by districts

Detailed tables attached show the effect of an increase in reserve requirements upon the various classes of banks in different districts. It would appear that in November reserve city banks as a whole in the New York, Atlanta, Dallas, and San Francisco districts did not have quite sufficient reserves to meet a one-third increase in requirements. The largest ratios of remaining excess reserves to increased requirements among reserve city banks would be held by those in Boston and Philadelphia. Country banks in the aggregate in all districts would still possess substantial amounts of excess reserves, with the smallest excess over requirements in the San Francisco district and the largest in the Chicago, Kansas City, and Dallas districts.

Distribution by individual banks

The survey, recently completed by the Division of Bank Operations, of the reserve position of individual member banks in the first half of November indicates that there was a substantial number of banks, 2,600 out of 6,400, which did not have reserves sufficient to meet an increase of $33 \frac{1}{3}$ percent in requirements. The amount by which the reserves of these 2,600 banks fell short of the requisite volume was \$350,000,000. All but 165 of these, however,

could meet the increase by drawing upon not more than half of their balances with correspondents. These 165 banks would still have lacked \$120,000,000 of having sufficient reserves. The following table shows the number of banks of each class that would have had insufficient reserves to meet the increase.

Classes of banks	Number of banks		
	Total	With insufficient reserves	With shortage after using 1/2 of bankers' balances
Central reserve city banks			
New York City	37	22	13
Chicago	17	5	-
Reserve city banks	336	181	17
Country banks	5,998	2,408	130
Total	6,388	2,616	165

That banks can dispense with one-half of the balances they now hold with correspondents is a reasonable assumption, since balances now carried by banks outside of New York City with correspondents are about twice as large as those carried prior to the last few years, when excess reserves have become abundant and widespread. The amounts formerly carried are no doubt sufficient to cover needs for secondary reserves and for clearing purposes. On June 30, 1936, all member banks held demand balances with other domestic banks amounting to \$3,300,000,000, whereas from 1922 to 1929 they held an average of \$1,900,000,000, which may be considered as more nearly normal working levels. From June to November there was a further increase of fully

\$200,000,000 in bankers' balances. It may be said, therefore, that about one-half of outstanding bankers' balances represent excess secondary reserves.

The following table summarizes the amount of the shortage by classes of banks, with and without using their excess bankers' balances.

Classes of banks	Additional reserves required to meet 33 1/3% increase in requirements		
	Total	Obtainable from bankers' balances	Required after use of 1/2 of bankers' balances
(In millions of dollars)			
Central reserve city banks			
New York City	122	18	104
Chicago	3	3	--
Reserve city banks	163	147	16
Country banks	67	65	2
Total	355	233	122

Of the 163 banks that would have been short after using half of their bankers' balances about 130 were country banks, but the amount of the deficiency for country banks would have been very small, only \$2,350,000. Reserve city banks would have been able to supply all but \$15,500,000 of their needs from excess bankers' balances; over half of this remaining shortage would have been at two banks in the San Francisco district. Most of the deficiency would have been in New York City, where 22 banks, holding about two-fifths of the deposits at all banks in the city, would have been short by \$122,000,000. For these banks no allowance can be made for the use of balances due from banks since New York City banks hold only small

working balances with other banks which have not been increased in recent years. New York City banks would lose additional reserves through withdrawals from them of balances held for country banks and reserve city banks.

A similar study made prior to the time reserve requirements were increased last August indicated that 2,100 member banks would have needed \$215,000,000 of additional reserves to meet an increase of 50 percent in reserve requirements, but that by using one-half of their bankers' balances they would have reduced their needs by \$133,000,000, leaving only \$82,000,000, mostly at New York City banks, to be obtained by the sale of open-market material and by borrowing.

Actually, \$110,000,000 of bankers' balances were withdrawn from New York City banks in the week in which the previous increase in requirements became effective. Outside of New York City \$100,000,000 of bankers' balances were withdrawn from reporting banks, but these banks apparently adjusted their position in the aggregate by withdrawing balances from other banks, so that as a group they showed no net change in their position. Only a few scattered banks borrowed from the Reserve banks, and the total amount of borrowing was negligible, amounting to about \$2,000,000. There was apparently no interbank borrowing or trading in Federal funds. Shifts of earning assets among banks apparently were small. After all of the adjustments were completed reserves were still ample and widely distributed among all classes of banks in all parts of the country and among individual member banks. The increase in reserve requirements consequently had no perceptible effect upon the money market.

By comparing the actual results of last August with those indicated in the previous study, it may be possible to estimate the effect of a further increase in requirements. Member banks outside of New York City would need to raise about \$230,000,000 of additional reserve funds, as compared with about \$125,000,000 last summer. Most of this amount would probably be obtained, as before, by withdrawals from bankers' balances. Less than half of these balances are held with New York City banks, and some of the withdrawals will be absorbed by reserve city banks with adequate excess reserves, but a substantial portion of the withdrawals from reserve city banks will be met in turn by withdrawals from New York. As a consequence a large part of the additional reserve funds obtained from bankers' balances will in the end come from New York. These withdrawals may be as much as \$200,000,000. Outside of New York City, borrowings should be negligible and sales of assets unimportant in amount.

New York City banks would be subjected not only to an increase of one-third in their present reserve requirements but also to a further loss of perhaps \$200,000,000 of reserves through the withdrawal of bankers' balances. Probably half of the withdrawals would come from the 15 New York City banks which, after the increase in requirements, would still have excess reserves of more than \$200,000,000. Excess reserves of New York City banks would probably not be entirely absorbed. Individual New York City banks that would be short of reserves could adjust their position temporarily by purchasing Federal funds from banks that still had an excess or more permanently by the sale of assets to such banks. In view of the public discussion of the possibility of an increase in requirements, it is likely that many of the banks that would have been deficient in November will by February have taken steps to build up their reserves. These adjustments would probably have some effect on money rates, a matter which is discussed in another memorandum.

EFFECT OF SPECIFIED INCREASES IN RESERVE REQUIREMENTS
(In millions of dollars)

	Present excess reserves (Nov. av.)	Amount that would be absorbed by			Amount that would be left after			Percent excess over required reserves that would be left after		
		Full increase of 33 1/3 percent	Increase outside of country banks	Increase in demand deposits alone	Full increase of 33 1/3 percent	Increase outside of country banks	Increase in demand deposits alone	Full increase of 33 1/3 percent	Increase outside of country banks	Increase in demand deposits alone
All member banks	2,219	1,522	1,278	1,359	697	940	860	11.4	16.1	14.5
Central reserve city banks:										
New York City	751	648	648	638	103	103	113	4.0	4.0	4.4
Chicago.....	221	143	143	137	78	78	84	13.6	13.6	14.8
Reserve city banks:										
Boston.....	106	48	48	46	58	58	60	30.2	30.2	31.6
New York.....	2	11	11	9	-9	-9	-7	-20.9	-20.9	-17.1
Philadelphia..	111	52	52	48	59	59	63	28.4	28.4	30.9
Cleveland....	120	70	70	59	50	50	61	17.9	17.9	22.8
Richmond.....	59	28	28	25	31	31	34	27.9	27.9	31.5
Atlanta.....	12	24	24	22	-12	-12	-10	-12.4	-12.4	-10.5
Chicago.....	91	48	48	41	43	43	50	22.5	22.5	27.2
St. Louis....	38	30	30	27	8	8	11	6.6	6.6	9.3
Minneapolis..	15	16	16	15	-1	-1	--	-1.6	-1.6	--
Kansas City..	48	36	36	34	12	12	14	8.4	8.4	9.9
Dallas.....	23	23	23	21	--	0	2	--	--	2.2
San Francisco.	98	102	102	74	-4	-4	24	-1.0	-1.0	6.3
Total....	724	487	487	421	237	237	303	12.2	12.2	16.1
Country banks:										
Boston.....	50	30	--	21	20	50	29	16.8	56.2	26.4
New York.....	96	53	--	33	43	96	63	20.3	60.4	32.8
Philadelphia..	46	28	--	14	18	46	32	16.1	54.8	32.7
Cleveland....	48	23	--	14	25	48	34	27.5	70.6	41.5
Richmond.....	27	16	--	11	11	27	16	17.2	56.2	27.1
Atlanta.....	23	13	--	10	10	23	13	19.6	60.5	27.1
Chicago.....	88	26	--	18	62	88	70	59.6	112.8	72.9
St. Louis....	22	11	--	8	11	22	14	25.6	68.7	35.0
Minneapolis..	31	11	--	7	20	31	24	45.5	93.9	60.0
Kansas City..	37	11	--	9	26	37	28	57.8	108.8	65.1
Dallas.....	38	11	--	10	27	38	28	61.4	115.2	65.1
San Francisco	17	12	--	8	5	17	9	10.6	48.6	20.9
Total....	523	244	--	163	279	523	360	28.6	71.5	40.3

BANKS HAVING INSUFFICIENT FUNDS TO MEET INCREASE
OF 33 1/3 PERCENT IN RESERVE REQUIREMENTS
(Based on daily average figures for first half of November 1936)

Class of bank	Number of banks unable to meet increase from			Amount by which increase for these banks would exceed		
	Reserve balances alone	Reserve balances plus one-half bankers' balances	Reserve balances plus total bankers' balances	Reserve balances alone	Reserve balances plus one-half bankers' balances	Reserve balances plus total bankers' balances
				(In thousands of dollars)		
Central reserve city banks:						
New York City.....	22	18	11	122,240	103,871	89,459
Chicago.....	5	--	--	2,642	--	--
Reserve city banks:						
Boston.....	4	1	1	5,249	263	202
New York.....	9	5	1	8,574	1,684	45
Philadelphia.....	14	3	--	6,646	256	--
Cleveland.....	13	1	--	20,345	3,322	--
Richmond.....	11	--	--	7,968	--	--
Atlanta.....	16	--	--	14,789	--	--
Chicago.....	30	1	--	12,833	1	--
St. Louis.....	13	2	1	4,131	170	66
Minneapolis.....	4	--	--	3,926	--	--
Kansas City.....	29	2	1	16,880	1,349	253
Dallas.....	18	--	--	6,121	--	--
San Francisco.....	20	2	--	55,756	8,407	--
Total.....	181	17	4	163,218	15,452	566
Country banks:						
Boston.....	155	17	6	9,041	422	34
New York.....	290	48	25	14,256	1,290	530
Philadelphia.....	337	19	--	9,356	209	--
Cleveland.....	263	13	4	6,151	87	31
Richmond.....	128	3	2	5,310	42	4
Atlanta.....	132	3	--	4,106	33	--
Chicago.....	186	6	1	4,791	43	1
St. Louis.....	160	12	6	2,882	146	74
Minneapolis.....	185	4	--	2,519	9	--
Kansas City.....	237	2	--	1,889	3	--
Dallas.....	161	--	--	2,143	--	--
San Francisco.....	174	3	2	4,103	72	61
Total.....	2,408	130	46	66,547	2,356	735
All member banks.....	2,616	165	61	354,647	121,679	90,760

PROBABLE EFFECT OF AN INCREASE IN RESERVE
REQUIREMENTS ON MONEY RATES

by

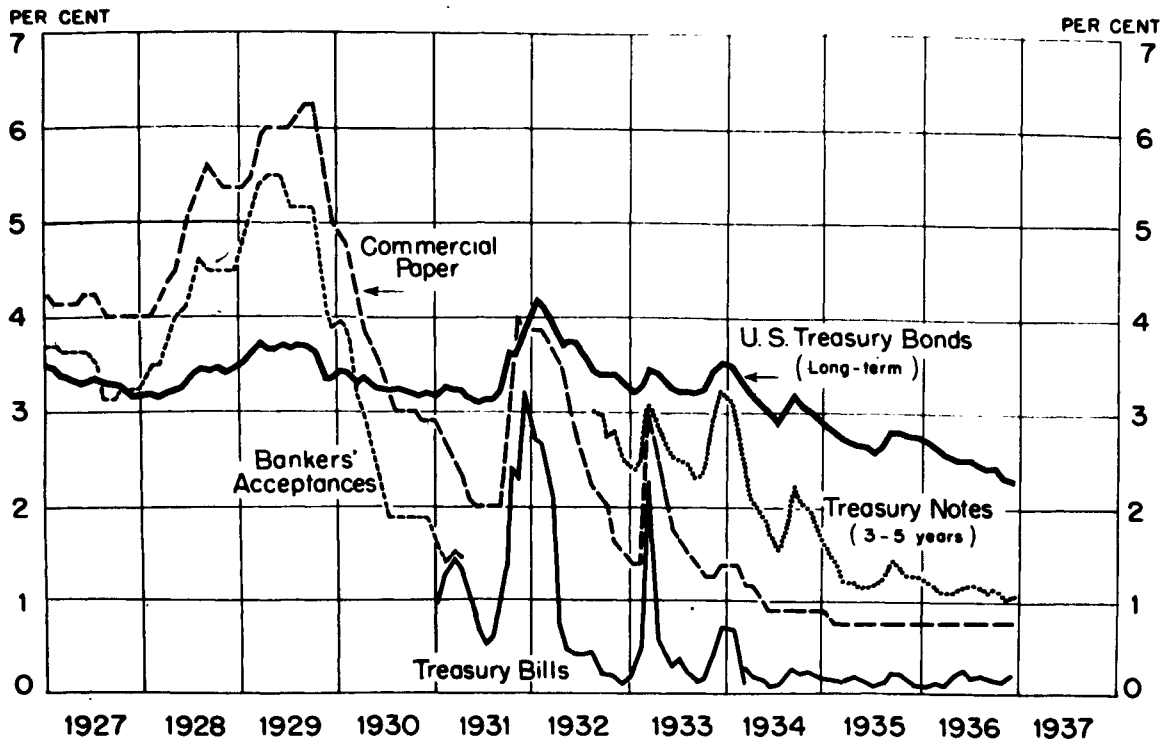
Woodlief Thomas

Analysis of the reserve position of individual member banks indicates that an increase of $33 \frac{1}{3}$ percent in reserve requirements will necessitate the sale of a not inconsiderable amount of marketable assets as well as probably some borrowing on the part of a number of New York City banks. There will also be some readjustment by banks outside of New York but, except for withdrawals of balances carried with correspondents, which in the end will be drawn mostly from New York banks, the amounts will not be large.

The adjustment of the reserve positions of New York City banks may be large enough to be reflected at least temporarily in an advance in short-term open-market money rates. In view of the remaining excess reserves, however, and the large volume of idle funds held by corporations and others awaiting profitable use, it is not likely that the rise in money rates will be considerable. Some open-market rates, which have been exceptionally low, may become established at a slightly higher level than at present. Rates on customers' loans and long-time rates are not likely to be much affected.

There appear to be definite limits on the probable rise in money rates. These limits are set by two entirely different considerations -- (1) the level of rates at which idle funds would be attracted from banks outside of New York and from non-banking lenders, and (2) the bill-buying rate of the Federal Reserve Bank of New York.

OPEN MARKET MONEY RATES



Rates most likely to be affected are those on readily saleable open-market paper. The following table shows the level of the principal money rates and Reserve bank rates in New York during December, together with corresponding rates in January 1934. After a further increase in requirements excess reserves would be no larger than in January 1934. It does not follow that money rates should return to or above the level then prevailing, but that level may indicate an approximate maximum. At that time complete adjustment had not been made in some of the rates to the comparatively new easy money situation. This was especially true of Treasury bonds and notes and rates on customers' loans, which are slower in reflecting changed conditions.

MONEY RATES IN NEW YORK CITY

	December 1936	January 1934
Bills, 90-day unendorsed	3/16	1/2
Prime commercial paper, 4-6 months	3/4	1 1/4 - 1 1/2
Stock exchange call loans	1	1
Federal Reserve funds (interbank loans)	1/8	1/8
U. S. Government obligations - yields		
Treasury bills	0.21	0.67
Treasury notes, 3-5 years	1.04	3.11
Treasury bonds, long-term	2.27	3.50
Customers' loans	2.43	3.58
Federal Reserve bank		
Rediscount rate	1 1/2	2
Buying rate for 90-day endorsed bankers' bills	1/2	1/2

Banks and bill dealers might take advantage of the opportunity, as they did last summer, to raise rates on bankers' acceptances another fraction.

The rate is now $3/16$ of one percent on 90-day bills. The present ceiling on this rate is $1/2$ of one percent, which is the buying rate of the Federal Reserve bank. Rates cannot advance beyond that limit so long as the Reserve banks stand ready to purchase all eligible bills offered.

The rate on open-market commercial paper -- now $3/4$ of one percent -- might rise to one percent or $1\ 1/4$ percent, which is almost back to the level of late 1933. In view of the fact that such paper is largely purchased by country banks, which will continue to have substantial excess reserves, a greater rise in this rate is not likely.

The call money rate is now fixed by New York City banks at one percent and they charge correspondents $1/2$ of one percent for making loans for them, which effectively keeps outside banks from this market. The ceiling on this rate is the level at which outside banks would come into the market; this is probably not over $1\ 1/2$ percent, which would give the banks a net return of one percent. The inflow of money from the interior would keep the rate from rising above that level.

Treasury bills, which now provide the most important medium for liquid investment in the money market, are largely held by New York City banks. The rate on these bills might be expected to rise above the recent extremely low level; in fact there has been a slight increase in recent weeks, reflecting in part increased offerings by the Treasury, but perhaps in part adjustment of reserve position of New York banks in anticipation of increased reserve requirements. Since, however, several New York City banks would still have substantial excess reserves, and since these bills are also popular investments for institutions and others seeking short-term uses for funds, much

of a rise would bring a substantial amount of funds into this market. It is to be doubted that Treasury bills would rise above $3/4$ of one percent, especially in view of the fact that bankers' bills cannot go above $1/2$ of one percent. Treasury bills have a maturity of nine months, while the rate quoted on bankers' bills is for 90-day paper, which might justify a difference in rates.

Some increase in yields on Treasury notes has already occurred in recent weeks, partly because of the likelihood that exchange rights on future issues will be smaller in coming years than they have been in the past and perhaps partly because of adjustments of reserve positions. The shorter-term Treasury bonds, which have been selling on a yield basis of about one percent, have also been affected somewhat, but in view of the large amount of liquid funds that would still be held by banks outside of New York and by others than banks, no substantial rise in these rates would be anticipated.

The long-term bond market might be somewhat affected by the readjustment of the reserve position of a few banks, but this effect would probably be temporary. A change in reserve requirements by itself should not have a lasting effect upon the bond market, since the large supply of available investment funds outside banks is an important factor in this market.

Rates charged customers by banks should not be in the least affected by increased reserve requirements. These rates have been slow in coming down and may continue to show a downward tendency, notwithstanding increased borrowing by customers.

Reserve System action to check increase in rates

Federal Reserve authorities could limit the effect of the increase in reserve requirements on money rates, if the maintenance of present extremely low short-term rates should be desired. Since the bill-buying rate of the New York Reserve Bank establishes an effective ceiling on the open-market rate for bankers' bills and probably also on that for Treasury bills, increases in these rates could be checked by a reduction in the New York Bank's buying rate from $1/2$ of one percent on bills maturing in 90 days or less to $3/8$ or $1/4$ of one percent, with corresponding reductions for the longer maturities. Reduction in the New York Bank's rate on Government securities bought under repurchase agreement and of its discount rate from $1\ 1/2$ percent to one percent or $1/2$ of one percent might also assist in keeping money rates down. Although banks might not borrow from the Reserve banks, there would probably be an increase in interbank borrowing, and the rate charged by banks on interbank loans --- now $1/8$ of one percent among New York City banks --- would not rise above the Reserve bank rediscount rate. Other Reserve banks might reduce discount rates to one percent, although in most cases such action would be merely a gesture.

The effect of the adjustment upon the money market might be further reduced if the Open Market Committee should authorize any Federal Reserve bank to purchase Government securities from member banks needing to sell them in order to obtain sufficient funds to meet the increase in requirements. Such securities might also be bought from banks or dealers under repurchase agreements. The System's holdings can, of course, be readjusted, if it is not desired to increase the total.