

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 1684]
July 16, 1936

Statement by the Board of Governors of the Federal Reserve System
Relating to Reserves Required to Be Maintained by Member Banks
With Federal Reserve Banks

*To all Member Banks in the
Second Federal Reserve District:*

At the request of the Board of Governors of the Federal Reserve System we transmit to you herewith, printed on the following pages, a copy of the Board's statement made public on July 15, 1936, with respect to the action taken by the Board on July 14, 1936, increasing the reserve requirements for member banks after the close of business August 15, 1936.

A copy of the supplement to Regulation D adopted by the Board of Governors of the Federal Reserve System, effective as to each member bank after the close of business August 15, 1936, relating to the reserves required to be maintained by member banks with Federal Reserve banks, will be mailed to each member bank in the Second Federal Reserve District at an early date.

GEORGE L. HARRISON,

President.

Statement by the Board of Governors of the Federal Reserve System
Relating to Reserves Required to Be Maintained by Member Banks
With Federal Reserve Banks

July 14, 1936.

The Board of Governors of the Federal Reserve System today increased the reserve requirements for member banks as follows: on demand deposits at banks in central reserve cities, from 13 percent to 19½ percent; at banks in reserve cities, from 10 percent to 15 percent; and at "country" banks, from 7 percent to 10½ percent; on time deposits at all banks, from 3 percent to 4½ percent. These increases, which amount to 50 percent of present reserve requirements, will become effective after the close of business on August 15, 1936.

This action eliminates as a basis of possible injurious credit expansion a part of the excess reserves, amounting at present to approximately \$3,000,000,000 and expected to increase to nearly three and a half billions by the time this action takes effect. These excess reserves have resulted almost entirely from the inflow of gold from abroad and not from the System's policy of encouraging full recovery through the creation and maintenance of easy money conditions. This easy money policy remains unchanged and will be continued.

The part of the excess reserves thus eliminated is superfluous for all present or prospective needs of commerce, industry, and agriculture and can be absorbed at this time without affecting money rates and without restrictive influence upon member banks, practically all of which now have far more than sufficient reserves and balances with other banks to meet the increases. Furthermore, by this action the remaining volume of excess reserves, which will still be larger than at any time in the System's history prior to the recent large inflow of gold, is brought within the scope of control by the Federal Open Market Committee which, as constituted by the Banking Act of 1935, consists of the members of the Board of Governors and five representatives elected regionally by the Federal Reserve banks.

Excess reserves are the funds held by member banks on deposit with the Federal Reserve banks in excess of the amounts required by law. Total reserve deposits of member banks at the present time are \$5,900,000,000, of which \$2,900,000,000 are required reserves and \$3,000,000,000, excess reserves. According to present indications it is estimated that total reserves are likely to increase by as much as \$400,000,000 before the increase in reserve requirements goes into effect on August 15, bringing the estimated total of reserves at that time to approximately \$6,300,000,000. By the present action required reserves will be increased by \$1,450,000,000, or from \$2,900,000,000 to \$4,350,000,000. This will leave excess reserves of approximately \$1,900,000,000. Therefore, even after the increase in reserve requirements has gone into effect, member banks will still have a larger volume of excess reserves than at any time prior to the recent large gold imports.

Present excess reserves of approximately \$3,000,000,000 are likely to increase to a new peak of nearly three and a half billions by the time the increase in reserve requirements becomes effective because of an expected reduction in Treasury balances and a decrease in money in circulation, which at the present time is exceptionally high owing to the large disbursements in connection with the cashing of veterans' service bonds.

The portion of existing excess reserves, which will be absorbed by the Board's action, if permitted to become the basis of a tenfold or even larger expansion of bank credit, would create an injurious credit expansion. It is for this reason that the Board decided to lock up this part of the present volume of member bank reserves as a measure of prevention on the one hand and of further encouragement to sound business recovery and confidence in the long-term investment market on the other hand.

The present is an opportune time for the adoption of such a measure. While there is now no excessive credit expansion, since the excess reserves have not been utilized, later action when some member banks may have expanded their loans and investments and utilized their excess reserves might involve the risk of bringing about a severe liquidation and of starting a deflationary cycle. It is far better to sterilize a part of these superfluous reserves while they are still unused than to permit a credit structure to be erected upon them and then to withdraw the foundation of the structure.

Thorough surveys made by the Board show that the reserves are so well distributed that practically all member banks are in a position to meet the increased requirements either by utilizing their excess balances with the Reserve banks or by drawing upon their excess balances with correspondent banks.

In the light of recent experience and in view of the fact that after the increase in requirements goes into effect member banks will still have approximately \$1,900,000,000 of excess reserves, the Board is convinced that this action will not affect easy money conditions now prevailing. It does not constitute a reversal of the easy money policy which has been pursued by the System since the beginning of the depression. Rather it is an adjustment to a changed reserve situation brought about through the extraordinary inflow of gold from abroad.

The prevailing level of long-time interest rates, which has been an important factor in the revival of the capital market, has been due principally to the large accumulations of idle funds in the hands of individual and institutional investors. The supply of investment funds is in excess of the demand. The increase in reserve requirements of member banks will not diminish the volume of deposits held by these banks for their customers and will, therefore, not diminish the volume of funds available for investment. The maintenance of an adequate supply of funds at favorable rates for capital purposes, including mortgages, is an important factor in bringing about and sustaining a lasting recovery.

The reduction of excess reserves to an estimated level of approximately \$1,900,000,000 brings them within the scope of control through the System's open-market portfolio which consists of \$2,430,000,000 of United States Government securities. Frequent changes in reserve requirements of member banks should be avoided because they affect all banks regardless of their reserve position. At this time an increase can be made equitably because reserves are widely distributed. Unless large additional increases in reserves occur through gold imports or otherwise, no occasion for further adjustments in reserve requirements is likely to arise in the near future.

For current adjustments of the reserve position of member banks to changes in the credit situation the Reserve System should continue to rely on the traditional methods of credit control through discount policy and particularly through open-market operations. By the present action excess reserves will be reduced to within the amount that could be absorbed through open-market operations, should such action become desirable. Conversely, should conditions develop requiring expansion of reserves, they could be increased through open-market operations.

The Board of Governors believes that the action taken at this time will give assurance for the continued encouragement of full recovery.

The following table gives estimates as of August 15 of the reserves of member banks by classes before and after the increase in reserve requirements.

ESTIMATED RESERVE POSITION OF MEMBER BANKS ON AUGUST 15, 1936

(In millions of dollars)

	Total reserves	Before increase in requirements		After increase in requirements	
		Required reserves	Excess reserves	Required reserves	Excess reserves
Central reserve city banks	3,000	1,500	1,500	2,250	750
Reserve city banks	2,200	950	1,250	1,400	800
"Country" banks	1,100	450	650	700	400
All member banks	6,300	2,900	3,400	4,350	1,950