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Volume Title: A Program of Financial Research Vol 1: Report of the Exploratory Committee on Financial Research

Volume Author/Editor: Exploratory Committee on Financial Research

Volume Publisher: UMI

Volume ISBN: 0-870-14458-8

Volume URL: http://www.nber.org/books/expl37-1

Publication Date: 1937

Chapter Title: Major Factors in Fluctuations in Bank Deposits, 1929-1936

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Chapter URL: http://www.nber.org/chapters/c0626

Chapter pages in book: (p. 47 - 50)

MAJOR FACTORS IN FLUCTUATIONS IN BANK DEPOSITS, 1929–1936

General Background

Between 1929 and 1933 the volume of bank deposits belonging to the people of the country declined about 30 per cent. Simultaneously, prices of securities, including high grade bonds, collapsed. The factors responsible for this unparalleled collapse would under any circumstances merit the most careful evaluation. In this particular case, however, investigation must be especially painstaking, since the attendant circumstances were quite other than those which would be expected under ordinary banking and credit theory. Insufficiency of reserves, for example, which theoretically is considered by far the most important factor in deposit liquidation, was not important during this period.

Viewed from the assets side of the bank balance sheet, furthermore, the liquidation of security loans was the largest single factor in this decline, although both call and time loans on securities were freely available at exceptionally low rates throughout the period. The magnitude of the problem posed for theorists in money and banking is illustrated by contrasting the situation in the crisis of 1919–22 with that in 1929–33. In the former, a 6 per cent discount rate, maintained by the Federal Reserve banks over an exceptionally long period, and applicable to a volume of member bank borrowing equal to 150 per cent of their required reserves, resulted in an aggregate decline in deposits of about 10 per cent. During 1929–33, despite a quick drop in discount rates, a negligible volume of member bank borrowing, and a wide availability of excess reserves, the decrease in deposits amounted to 30 per cent.

Equally as challenging as the decline in available bank deposits from 1929 to 1933 is their subsequent rise of more than one-half from 1933 to 1936. Paralleling this rise, there occurred: (a) an unprecedented increase in banking reserves; (b) a sharp decline in interest rates; (c) a bond market boom; (d) a doubling of stock prices; (e) a relatively modest increase in commodity prices; (f) a gradual recovery in production and trade. Granting that extraordinary forces, precipitated by the emergencies of 1932–33 and leading to gigantic fiscal operations on the part of the Treasury as well as far reaching innovations in monetary organization and policy, dominated this rapid change in financial conditions, it still presents many significant angles for inquiry. Theoretically, this rapid growth of deposits should have induced simultaneously a veritable boom in production and trade, a rapid expansion of money incomes, a marked stimulation of capital formation from savings and from bank expansion, and a sharp and extended rise in commodity prices. Indeed, this presumably should have happened on the basis of orthodox theories as well as on those of more modern schools. Under classical theory, the sheer impact of a larger quantity of credit on the economic system should have had irresistible accelerating effects; under modern analysis, the primary and secondary impact of funds introduced into trade by governmental relief and public works expenditure should have found prompt expression in like effects.

This projected investigation can readily be divided into three parts. [1] The specific factors in the decline in deposits from 1929 to 1933 will be studied in the order of their relative importance, which appears to be: (a) bank failures, which account for about one-half of the total decline; (b) security loan liquidation, which accounts for perhaps a fourth more of the total decline; (c) contraction in other banking assets. With both the aggregate magnitude of these factors and their incidence in time from the final quarter of 1929 through the first quarter of 1933 determined, the inquiry would be directed to the specific factors to which bank failures are attributable. In this phase the work of the Federal Reserve Committee on Branch, Group, and Chain Banking would be helpful. In addition, however, three aspects of the problem not adequately covered in those reports should be analyzed carefully: (a) the extent to which failures were due to assets regarded as substandard, (b) the extent to which pressure on banks arose from regional deficiencies of funds reflecting deficiencies in the balance of payments, (c) the incidence of hoarding and the importance of transfers of 'smart money' from banks in difficulty to more solvent institutions. Finally, the extent to which pressure on the bond market arose from sales of securities by open banks should be compared with the liquidation of bonds by receivers of closed banks.

[2] In a similar way the basing point for the second part of the project would be the relative importance of specific factors in the increase in deposits subsequent to 1933: (a) the reorganization of banking facilities and the rehabilitation of banking capital with the aid of the Reconstruction Finance Corporation; (b) dishoarding of currency by the public with the reestablishment of financial confidence; (c) the inflow of gold from abroad following dollar devaluation and concomitant foreign political disturbance; (d) the expansion of Treasury currency in consequence of the silver purchase program; (e) the growth of the Federal debt and its considerable absorp-

tion into bank assets; (f) the divergent movements of other elements of bank assets. With these data assembled, investigation would concentrate on the financial aspects of the Federal recovery and relief program and the Treasury operations necessitated by it. Borrowing operations of the Treasury and the movement of its balances would be studied intensively. The disbursement of funds in connection with various phases of the recovery and relief program, and the activities of various Federal agencies, would be carefully traced and related to the movement and activity of deposits in different economic areas and for different classes of banks. Deposit data collected by the Board of Governors of the Federal Reserve System in connection with its study of bank reserves from 1924 to 1935 would prove of immense value for this part of the project, and some use might be made of the large deposit survey, recently concluded.

[3] These two parts of the project completed, it should be possible to trace effectively the sequence of events from 1929 through 1935 with greater detail and authority and to evaluate: (a) the relative efficiency of the almost innumerable measures taken to combat the crisis and promote recovery; (b) the extent to which our financial system should be reorganized further to stabilize bank deposits or bring them under better control. An indication of the limitations to which much of prevailing banking and credit theory is subject when viewed against an adequate factual setting should also be possible.

Procedure

This study could be made only with the thorough cooperation of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Reconstruction Finance Corporation and the Federal