Monetary Tightening and Financial Stability: Evidence from the Great Depression

Discussion for “2025 NYU Stern Workshop in Financial History”

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Federal Reserve Bank of Richmond

October 24, 2025

Disclaimer

The views expressed here are my own and do not necessarily reflect the views of the Federal Reserve Bank of Richmond.

The Paper in One Slide

Big Picture

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$\Rightarrow$ Very topical; a paper I would have loved to write. Let's dive in...

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- Paper currently uses annual balance sheets
- Can we obtain quarterly data at least for a subset of banks?

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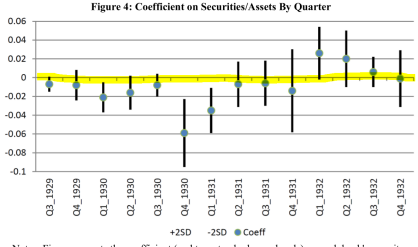

Notes: Figure presents the coefficient (and two standard error bands) on each bank's security-to-asset ratio from equation (1) but estimated separately for each quarter.

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  $\Rightarrow$ $1 =$ Cash/Assets $+$ Loans/Assets $+$ Securities/Assets

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- However: Assets = Cash + Loans + Securities
  $\Rightarrow$ 1 = Cash/Assets + Loans/Assets + Securities/Assets
- Thus, Cash/Assets is the baseline; *this matters*

Table 1: Predicting Quarterly Bank Exits Panel - July 1929-Dec 1932

	Closed During Quarter			
	(1)	(2)	(3)	(4)
LnAssets	-0.001**	-0.001	-0.001**	-0.001
	[0.000]	[0.000]	[0.000]	[0.000]
Securities/Assets	-0.008**	-0.010***	-0.096***	-0.103***
	[0.003]	[0.003]	[0.034]	[0.036]
Securities/Assets * AAA Rate in Quarter			0.019**	0.020***
			[0.007]	[0.008]
Loans/Assets	0.027***	0.025***	0.027***	0.025***
	[0.003]	[0.003]	[0.003]	[0.003]
Capital+Surplus/Assets	-0.029***	-0.029***	-0.029***	-0.029***
	[0.004]	[0.005]	[0.004]	[0.005]
Surplus/(Capital+Surplus)	-0.045***	-0.045***	-0.045***	-0.045***
	[0.002]	[0.002]	[0.002]	[0.002]
Ln(# of Banks in County)	0.001	0.000	0.001	0.000
	[0.001]	[0.001]	[0.001]	[0.001]
Fraction of County's Total Deposits	-0.056**	-0.076***	-0.056**	-0.077***
	[0.024]	[0.026]	[0.024]	[0.026]
Change in LnDeposits Previous Year		-0.003***		-0.003***
		[0.000]		[0.000]

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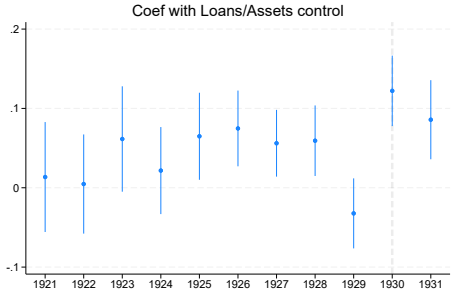

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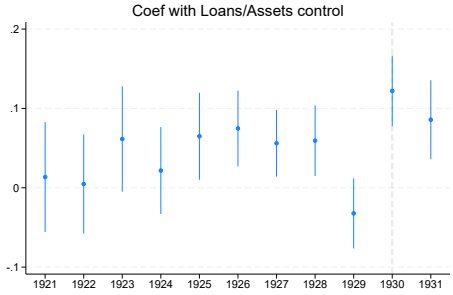

1. Coef. of Securities/Assets spikes in 1930 ✓

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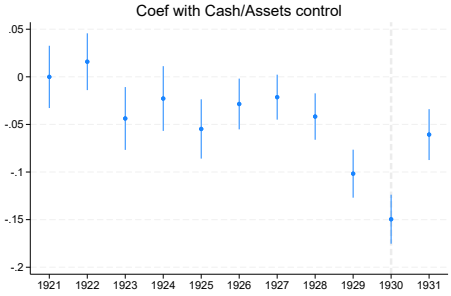

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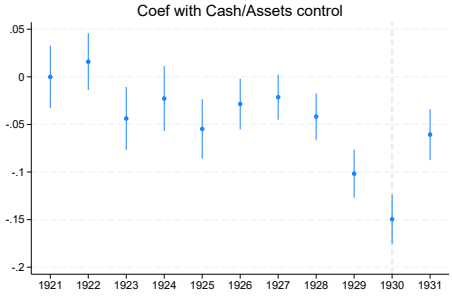

- The choice of baseline matters!

Suggestion 3: Economic Losses vs Accounting Losses

- 2023 SVB Crisis: most losses were unrealized
- How was it in this case? What was the accounting treatment?

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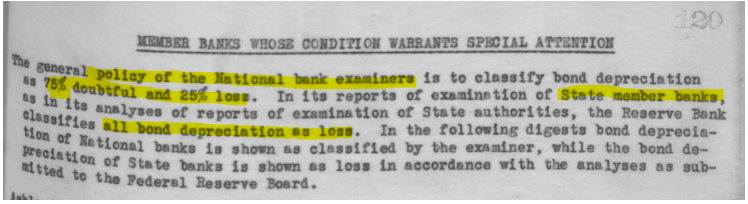

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MEMBER BANKS WHOSE CONDITION WARRANTS SPECIAL ATTENTION

The general policy of the National bank examiners is to classify bond depreciation as 75% doubtful and 25% loss. In its reports of examination of State member banks, as in its analyses of reports of examination of State authorities, the Reserve Bank classifies all bond depreciation as loss. In the following digests bond depreciation of National banks is shown as classified by the examiner, while the bond depreciation of State banks is shown as loss in accordance with the analyses as submitted to the Federal Reserve Board.

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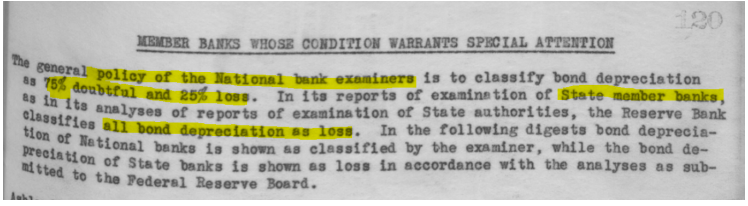

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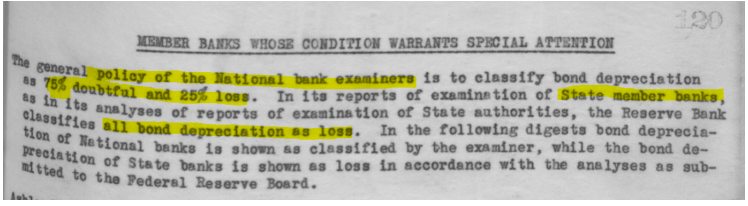

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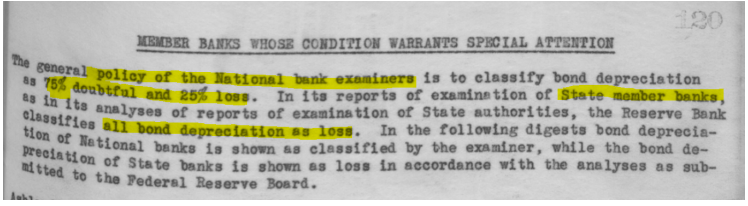

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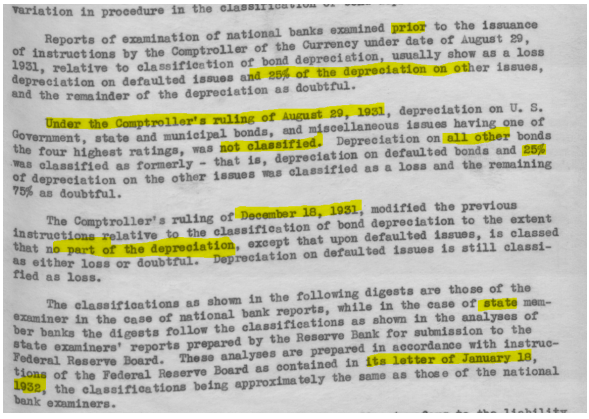
- Mostly mark-to-market
- 1931: deposits rushed out; banks liquidated govt bonds; bond prices crashed.
- Fed didn't step in (Friedman & Schwartz p319)

Suggestion 3: Economic Losses vs Accounting Losses

- Maybe also study differences between state and national banks?
- Until 1932, SBs booked all losses while NBs only booked 25%



Variation in procedure in the classification

Reports of examination of national banks examined prior to the issuance of instructions by the Comptroller of the Currency under date of August 29, 1931, relative to classification of bond depreciation, usually show as a loss depreciation on defaulted issues and 25% of the depreciation on other issues, and the remainder of the depreciation as doubtful.

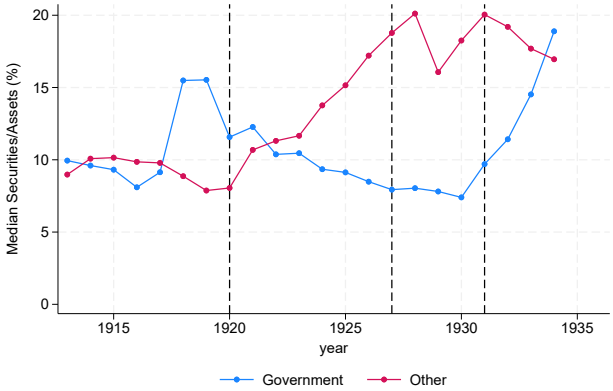
Under the Comptroller's ruling of August 29, 1931, depreciation on U. S. Government, state and municipal bonds, and miscellaneous issues having one of the four highest ratings, was not classified. Depreciation on all other bonds was classified as formerly - that is, depreciation on defaulted bonds and 25% of depreciation on the other issues was classified as a loss and the remaining 75% as doubtful.

The Comptroller's ruling of December 18, 1931, modified the previous instructions relative to the classification of bond depreciation to the extent that no part of the depreciation, except that upon defaulted issues, is classed as either loss or doubtful. Depreciation on defaulted issues is still classified as loss.

The classifications as shown in the following digests are those of the examiner in the case of national bank reports, while in the case of state member banks the digests follow the classifications as shown in the analyses of state examiners' reports prepared by the Reserve Bank for submission to the Federal Reserve Board. These analyses are prepared in accordance with instructions of the Federal Reserve Board as contained in its letter of January 18, 1932, the classifications being approximately the same as those of the national bank examiners.

Suggestion 4: Wasn't This an Issue Earlier?

- Non-government securities had been increasing since the 1920-21 recession



Securities held by national banks (% of Assets)

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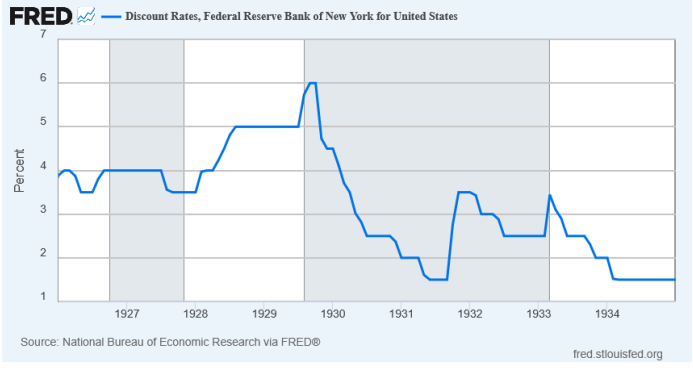
- Discount window series: Perhaps we should also look at 1929?



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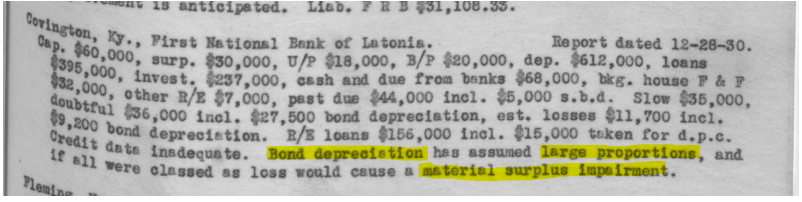
- Contemporaneous examiner reports suggested this was an issue much earlier



...ment is anticipated. Liab. F R B $31,108.33.

Covington, Ky., First National Bank of Latonia. Report dated 12-28-30.
Cap. $60,000, surp. $30,000, U/P $18,000, B/P $20,000, dep. $612,000, loans $395,000, invest. $237,000, cash and due from banks $68,000, bkg. house F & F $32,000, other R/E $7,000, past due $44,000 incl. $5,000 s.b.d. Slow $35,000, doubtful $36,000 incl. $27,500 bond depreciation, est. losses $11,700 incl. $9,200 bond depreciation. R/E loans $156,000 incl. $15,000 taken for d.p.c. Credit data inadequate. Bond depreciation has assumed large proportions, and if all were classed as loss would cause a materisl surplus impairment.

Fleming

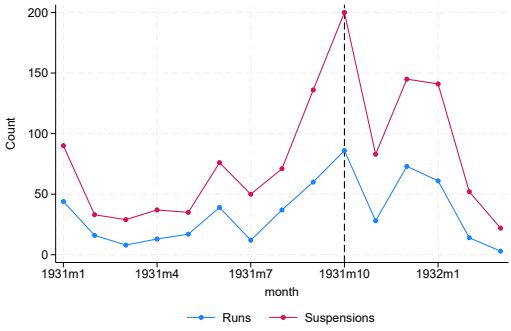
Conclusion

- Really interesting paper; has much potential.
- High-frequency data or additional sources might enrich it
- Would like to understand some institutional settings better
  - 1928-29 rate increases
  - Accounting treatments

Thank you!

Appendix

Runs, suspensions, and exits peaked in Oct. ’33



Bank Runs and Suspensions

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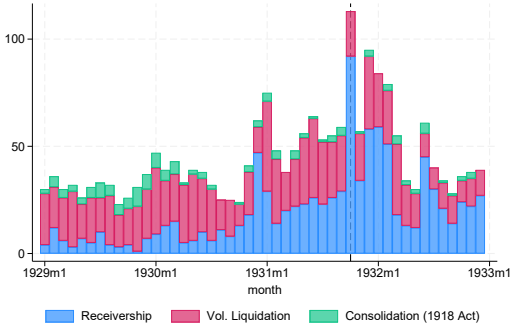

Permanent Bank Exits

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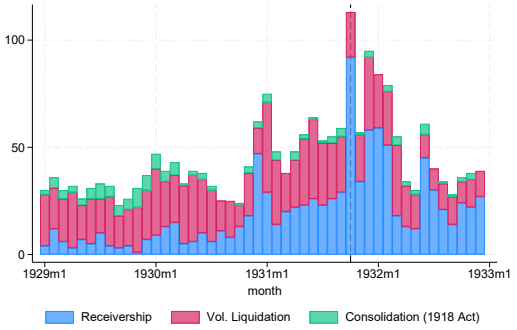
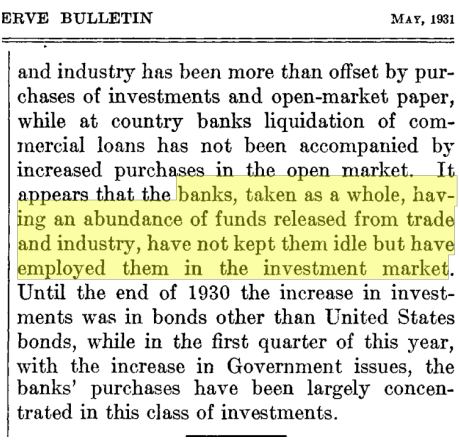


Permanent Bank Exits

? Maybe just focus on receiverships?

Increase particularly notable during the summer of '33

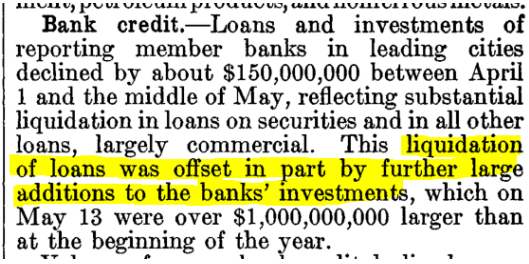


ERVE BULLETIN MAY, 1931

and industry has been more than offset by purchases of investments and open-market paper, while at country banks liquidation of commercial loans has not been accompanied by increased purchases in the open market. It appears that the banks, taken as a whole, having an abundance of funds released from trade and industry, have not kept them idle but have employed them in the investment market. Until the end of 1930 the increase in investments was in bonds other than United States bonds, while in the first quarter of this year, with the increase in Government issues, the banks' purchases have been largely concentrated in this class of investments.

FRB Bulletin (May 1931)

Increase particularly notable during the summer of ’33



Bank credit.—Loans and investments of reporting member banks in leading cities declined by about $150,000,000 between April 1 and the middle of May, reflecting substantial liquidation in loans on securities and in all other loans, largely commercial. This liquidation of loans was offset in part by further large additions to the banks' investments, which on May 13 were over $1,000,000,000 larger than at the beginning of the year.

FRB Bulletin (June 1931)

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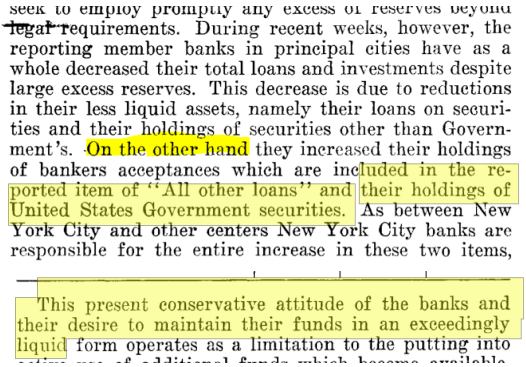

seek to employ promptly any excess of reserves beyond legal requirements. During recent weeks, however, the reporting member banks in principal cities have as a whole decreased their total loans and investments despite large excess reserves. This decrease is due to reductions in their less liquid assets, namely their loans on securities and their holdings of securities other than Government's. On the other hand they increased their holdings of bankers acceptances which are included in the reported item of "All other loans" and their holdings of United States Government securities. As between New York City and other centers New York City banks are responsible for the entire increase in these two items,

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NY Fed Monthly Review (Aug. 1931)

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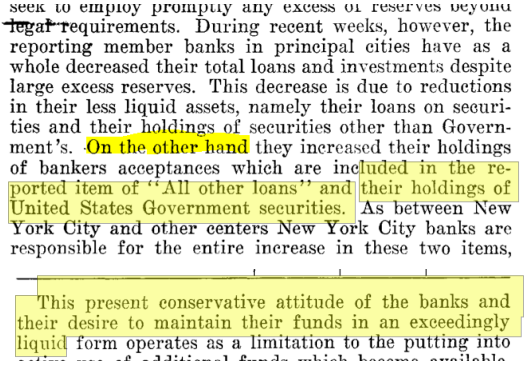

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- Looks more like flight-to-safety (liquidity, de-risk) than reach for yield