

offset this particular influence of business on money, but at least prior to the creation of the Federal Reserve System it may have been of considerable significance.

Second, business conditions may influence the money stock through an influence on the volume of member bank borrowings at the Federal Reserve. While the size of such borrowings is, of course, importantly conditioned by the terms under which loans to member banks are made, including the level of the discount rate, it may also be significantly affected by the strength of loan demand and by the yields that banks can obtain on earning assets. These matters, in turn, are clearly related in part to the state of business activity.

A third influence of business on money operates through the effects of business on the ratio of the public's holdings of coin and currency to its holdings of bank deposits. A rise in this ratio, for example, tends to drain reserves from banks as the public withdraws coin and currency. Since one dollar of reserves supports several dollars of deposits, the loss of reserves leads to a multiple contraction of deposits which depresses the total money supply by more than it is increased through the rise in the public's holdings of cash. While no one is very sure as to just what determines the cyclical pattern of the currency ratio, a pattern does seem to exist which in some way reflects shifts in the composition of payments over the business cycle as well as, in the historically important case of banking panics, fluctuations in the public's confidence in the banks themselves.⁸

A final avenue of influence of business on money is through the influence of business conditions on the ratio of bank excess reserves to deposits. When the ratio of excess reserves to deposits is relatively high, other things equal, the money supply will be relatively low since banks will not be fully utilizing the deposit-creating potential of the supply of reserves available to them. Business conditions can affect the reserve ratio in various ways. Thus they can influence bank desires to hold excess reserves through variations in the strength of current and prospective loan demand, through variations in the yields on the earning assets of banks, and through variations in banker expectations. When business is rising, loan demand is apt to be strengthening, yields on earning assets are apt to be

⁸ It might be noted that while the Federal Reserve has for many years routinely offset the reserve effects of short-term movements in coin and currency, such as occur around holidays, for example, the ratio of coin and currency in the hands of the public to deposits has apparently continued to show some mild fluctuations of a cyclical nature.