The Chartered Bank has now an unnecessarily large amount of cash in relation to its deposit liabilities and, on the other hand, has suffered a reduction in earnings. After setting aside $1,000 of the cash which it has just received as a reserve against its new $10,000 of deposits it has every incentive to look about for loans which it can make or securities which it can buy with the remaining $9,000 cash. Assuming that it has disbursed the whole $9,000 in cash in this way its balance sheet would be as follows:—

5

Assets		*Liabilities*	
Cash	$ 8,500	Deposits	$85,000
(Previous $17,500 — $9,000 paid to borrowers or sellers of securities)			
Loans and Investments	79,000	Capital	5,000
(Previous $70,000 + $9,000 of new loans made or securities purchased)			
Other Assets	7,500	Other Liabilities	5,000
	$95,000		$95,000

If we assume that the holders of the $9,000 of notes just paid out do not need them for active circulation and wish to use the facilities of the Chartered Bank they will deposit the notes with the Chartered Bank and increase its cash accordingly. Its balance sheet will now be:—

6

Assets		*Liabilities*	
Cash	$ 17,500	Deposits	$ 94,000
(Previous $8,500 + $9,000 from new deposits)		(Previous $85,000 + $9,000 of notes deposited)	
Loans and Investments	79,000	Capital	5,000
Other Assets	7,500	Other Liabilities	5,000
	$104,000		$104,000

The first stage in the Chartered Bank's attempt to repair a loss in earnings through expansion on the basis of an abnormally high cash ratio may be summarized in two steps thus:—

	Step 1	*Step 2*		*Net Result*
Cash	— 9,000	+ 9,000	=	no change
Loans and Investments	+ 9,000	no change	=	+ 9,000
Deposits	no change	+ 9,000	=	+ 9,000

The Chartered Bank has the same cash as it started with (though this is only possible because no additional notes are needed for active circulation and because the people who got the notes wish to use the facilities of the bank) but has $9,000 additional loans and investments and $9,000 additional deposits.

Its balance sheet (No. 6) still shows a cash ratio much higher than the normal 10 per cent. It would presumably feel safe if it had only $9,400 in cash. It then takes the other $8,100 of the total $17,500 and uses it to make loans or buy securities. Again we assume there is no increase in active circulation and no hoarding and so again the cash comes back to the Chartered Bank, increasing its deposits by another $8,100. They will now total $102,100, loans and investments will be $87,100, and the other items in the balance sheet will be the same as in No. 6.

A surplus of cash still exists, to the extent of $7,290. The same cycle of operations will be repeated many times, each expansion of loans and investments on the asset side and deposits on the liability side being 9/10 of the last, and each cycle depending for its completion upon the willingness of the public to redeposit with the Chartered Bank the cash that has been paid out to it.