Fractional Reserve Banking Example

In order for a bank to make new loans i.e., create new money, a new deposit must occur which then triggers the "Reserves" process. Let's assume Bank 1 receives a new deposit of $1,000. The $1,000 deposit instantly becomes part of Bank 1's Reserves, as all deposits do.

	Amount Deposited	***Bank 1's Additional Reserves***		***Expanded Money Supply***
Bank 1	$1,000	$1,000		$1,000

Using 10% as the Federal Reserve's reserve requirement, Bank 1 has to put $100 in their Bank Reserve stored at the Federal Reserve, and the other $900 is considered "Excess Reserves" and can be used as the basis for new loans.

Now, it would be logical to assume that this $900 would come out of the existing $1,000 deposit but that is not the case. What really happens is that the $900 is simply created out of thin air on top of the existing $1,000 deposit for a $1,900 total increase to the money supply. In other words, the $900 can be created out of nothing, simply because there is demand for such a loan and there is a $1,000 deposit to satisfy the reserve requirements.

	Amount Deposited	***Minus 10% Reserves held at the Fed***	***Excess Reserves (New $$ Lent Out)***	***Expanded Money Supply***
Bank 1	$1,000			$1,000
Bank 1	$1,000	$100	$900	$1,900

Now, let's assume that somebody walks into Bank 1 and borrows the available $900. Most likely they will deposit it into their own bank account at Bank 2. The fractional reserve process then repeats. The new deposit becomes part of Bank 2's reserves, 10% is isolated and in turn 90% of the $900 or $810 is now available as newly created money for more loans. Of course, that $810 can be loaned out and re-deposited creating an additional $729 etc.

	Amount Deposited	***Minus 10% Reserves held at the Fed***	***Excess Reserves (New $$ to Lend Out)***	***Expanded Money Supply***
Bank 1	$1,000			$1,000
Bank 1	$1,000	$100	$900	$1,900
Bank 2	$900	$90	$810	$2,710
Bank 3	$810	$81	$729	$3,439
Bank 4	$729	$72.90	$656.10	$4,095.10
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		$1,000	$9,000	$10,000

This deposit-money creation-loan cycle can technically go on to infinity, however, the average mathematical result is that about $9,000 can be created on top of the original $1,000. In other words, ***for every deposit in the banking system, about 9 times that amount can be created as new money out of thin air***. This new money can only come into existence if there is someone desiring a new loan. The fractional reserve banking system is based 100% on increasing debt.