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News Release
PR-33-76 (4-28-76)

MUTUAL SAVINGS BANK PERFORMANCE IN 1975 AND THE OUTLOOK FOR 1976

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Savings flows into mutual savings banks benefited from several factors in 1975. Inflation moderated. As general loan demand eased because of the recession, short-term interest rates dropped sharply. Rates on competing money market instruments at times during the year even fell close to rates paid on passbook savings accounts, causing significant inflows of new savings. Also, to spur the economy into recovery, the Federal Government enacted a tax reduction during the second quarter of 1975. This stimulus, coupled with a high savings rate because of consumer reluctance to spend, drew even more savings into the mutual savings banks. However, in large part because of liquidity pressures experienced in 1974 and the desire of the mutuals to be far more liquid in 1975, earnings did not improve as much as one might have expected from the large inflows of savings.

Deposits, excluding interest, increased by $4.9 billion during 1975, reversing a $2.8 billion drop in all of 1974, despite the fact that deposit outflows of $21 million and $338 million were registered in August and September.

In 1975, total operating income of FDIC-insured mutuals increased to 7.06 percent of average assets, up from 6.87 percent in 1974. This

19-basis-point rise in gross earnings on assets equaled the increase experienced in 1974, but was considerably less than those in 1972 and 1973 (see Table 1). The actual dollar increase in total operating income, on the other hand, was $696 million -- a 10.7 percent increase over 1974.

The rate of increase in operating income was slowed in 1975 also, because of the emphasis placed on strengthening liquidity relative to that of 1974. In contrast to 1974, when the small increase in assets was channeled into mortgages and corporate securities with a net decrease in U.S. Government securities, during 1975, holdings of the more liquid but lower yielding U.S. Treasury and agency issues increased $3.5 billion, accounting for almost 30 percent of the overall increase in assets. Mortgage purchases rose only 3.1 percent, while corporate securities were up 19.4 percent, U.S. Governments up 57.8 percent, and obligations of states and their political subdivisions up 65.4 percent during the year.

Total operating expenses as a percentage of assets, for FDIC-insured banks, increased by 8 basis points during 1975. Salaries and other employee expenses rose 13.7 percent in 1975, exceeding the 12.2 percent increase in average assets. Specifically, there was a $144 million rise in total operating expenses between 1974 and 1975, which included an increase of $58.7 million in salaries, pensions, and other employee benefits, $11.8 million in actual net loan losses (a 117.6 percent rise over 1974), and $54.1 million in other operating expenses.

Interest and dividends as a percentage of average assets rose 19 basis points in 1975, equaling 1974's rise. This reflects the continued shift from the regular savings deposits to higher yielding time deposits (see Table 2). However, the shift was less than we had predicted last year. It now appears that the deposit mix may soon reach about 60 percent regular savings and 40 percent time deposits. In 1975, the rate of change in total operating income equaled that in interest and dividends. This is an improvement over 1974 when interest and dividends increased by 9 basis points more than did total operating income.

Net operating income after interest and dividends for 1975, at .59 percent of average assets, was the lowest since 1970. However, because of a 10-basis-point reduction in securities losses relative to assets, net income after taxes was actually able to show a 2-basis-point rise over 1974 (see Table 1).

The rather disappointing increase in net income as a percentage of average assets in 1975 can also be explained by several factors, which were mentioned for total operating income. First, the desire of mutual savings banks' management to build liquidity was strongly evident; net operating income was up only 9.9 percent compared with the 12.2 percent increase in average assets. Second, management could not contain operating expenses, which grew 19.5 percent during 1975. Finally, the overall weakness in the economy and the depressed housing industry, particularly during the first half of the year, had an important influence on mutual savings banks' earnings.

Interest expenses on deposits should not rise as much for mutuals in 1976 as in the previous year. Short-term money market rates are likely to continue falling early in the year and to edge up toward year-end. This would suggest that banks may not find it as necessary to attract funds via higher yielding time deposits. Most of the money that had disintermediated to money market instruments in 1973 and 1974, the so-called "hot money," was returned to the mutuals in the spring of 1975, as short-term rates plummeted. Therefore, this source of funds will not be available to increase deposit flows in 1976 over those in 1975 nor will there be another savings surge like that which occurred in the second quarter of 1975 following the tax reduction. Preliminary data from the FDIC's monthly mutual savings banks survey show about $2.5 billion net deposit flows into mutuals during the first three months of 1976. This pace of inflows, however, should not be expected to hold for the rest of the year as the economy picks up and the savings rate drops. If short-term interest rates follow the pattern described and if the personal savings rate declines, as has been predicted, from 8.3 to 8.0 percent, we expect net deposit flows before interest, i.e., net new money, to grow in excess of $6 billion in 1976 -- compared with 1975's net growth of $5 billion.

Since the mutuals' need for liquidity appears to have been satisfied in 1975, we expect net deposit flows to be channeled mostly into further debt payoffs and mortgages, rather than into lower yielding U.S. Governments. We expect that about $3.6 billion, or 60 percent, of the new deposit inflows will go into mortgages with the remainder probably going mostly into the slightly less rewarding corporates and tax-free municipals. Borrowing should decrease further in 1976 as steady deposit inflows reduce the need for borrowed funds. We predict that borrowings will drop to about $350 million in 1976 from the $535 million average in 1975, with a corresponding shrinkage in costs.

Our forecast for mutual savings banks' net earnings on assets in 1976 is for an improvement of 6 basis points over 1975 (see Table 1). Total operating income should benefit from greater emphasis on mortgage investments and other higher yielding assets as the asset mix tends toward higher yields. The rise should be about 20 basis points to 7.26 percent of average assets. This rate is comparable to the 19- to 30-basis-point increases experienced since 1970.

In 1976, rises in total operating expenses should slacken with a declining rate of inflation. Wage demands and pension costs should moderate and other expenses should increase at a slower rate. We predict, therefore, that expenses will rise by only about 4 basis points to 1.11 percent of average assets, compared with the 8- to 9-basis-point rises experienced between 1972 and 1975.

With interest rates reaching their maximums and the deposit mix stabilizing, total interest and dividends as a percentage of assets should rise by only about 11 basis points, down from the 19-basis-point rise between 1974 and 1975.

Because interest rates also are expected to rise somewhat, sales of securities should result in a net capital loss of about .02 percent of average assets in 1976. Therefore, assuming a 32 percent tax rate, net income should increase 6 basis points to .42 in 1976. This net rate of return on assets for 1976 is in line with the rate mutuals earned in 1971, but well below the high earning years of 1972 and 1973.

TABLE 1

Selected Income and Expense Items for FDIC-Insured Mutual Savings Banks

(percent of average assets)

	1970	1971	1972	1973	1974	1975	1976 Forecast
Total operating income	5.87	6.15	6.38	6.68	6.87	7.06	7.26
Total operating expense	.79	.79	.81	.90	.99	1.07	1.11
Net operating income before interest & dividends	5.08	5.36	5.57	5.78	5.87	5.99	6.15
Total interest & dividends on deposits	4.52	4.64	4.75	4.93	5.21	5.40	5.51
Net operating income after interest & dividends	.56	.72	.82	.85	.67	.59	.64
Net realized gains or losses	-.19	-.08	-.02	-.10	-.16	-.06	-.02
Net income before taxes	.37	.64	.80	.75	.51	.53	.62
Franchise & income taxes-total	.12	.17	.22	.22	.17	.17	.20
Net income	.25	.47	.58	.53	.34	.36	.42
Total operating income less interest & dividends	1.35	1.51	1.63	1.75	1.66	1.65	1.75

SOURCE: Federal Deposit Insurance Corporation Reports of Condition and Income for FDIC-insured mutual savings banks.

TABLE 2

Time and Savings Deposits of Insured Mutual Savings Banks
April 1973 - January 1976
(in percent)

	1973			1974				1975				1976
Type of Deposit	Apr	Jul*	Oct	Jan	Apr	Jul	Oct	Jan+	Apr	Jul	Oct	Jan
Regular	73.3	71.6	68.7	67.4	66.8	66.3	65.9	65.3	65.2	64.9	64.1	63.5
Time	26.1	27.5	30.5	31.9	32.4	32.7	33.1	33.5	33.7	34.0	34.9	35.6
Under 4 years	26.1	24.6	23.6	22.7	20.8	19.1	18.0	16.8	15.5	14.7	15.3	15.2
Over 4 years		2.9	6.9	9.2	11.6	13.7	15.0	16.7	18.2	19.3	19.6	20.4
Other (incl. accts. over $100,000)	.6	.9	.7	.7	.8	.9	1.1	1.2	1.1	1.1	1.0	.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Introduction of the Wild-Card Account, July 1.

\+ Introduction of the 6-year, 7-3/4% Certificate, January 1.

SOURCE: Federal Deposit Insurance Corporation Survey of Time and Savings Deposits.