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FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D. C. 20429

Telephone: 393-8400
Br. 221

FOR RELEASE TO P.M.'S, MONDAY, APRIL 4, 1966 PR-23-66 (4-4-66)

A TIME FOR TESTING

An Address By

K. A. RANDALL, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D.C.

before the

SPRING MANAGEMENT CONFERENCE
of the
UNITED STATES SAVINGS AND LOAN LEAGUE

New York, New York
Americana Hotel

Monday, April 4, 1966
12:30 P.M.

A TIME FOR TESTING

It is a great pleasure to address your Spring Management Conference, attended by so many distinguished representatives of top management of your member associations. As head of the agency entrusted with responsibilities for insured banks, I feel somewhat of an interloper. But this feeling is lessened by the knowledge that we share many of the same goals and face some common problems. Both banks and savings and loan associations, moreover, can justifiably take pride in the contributions they have made to the economic growth of the United States--and particularly to the current balanced expansion of the economy. These contributions have not been achieved without the expenditure of a great deal of thought, imagination, and effort. And the road has not always been smooth.

As the economy has grown, however, the environment has changed. Institutions and practices have also changed. Therefore, we cannot afford to sit back and view our past accomplishments with complacency. New tasks and new challenges await us.

At the present time, the U. S. economy is operating close to capacity levels, with the requirements of the stepped-up activity in Vietnam added to already strong domestic demands. The productive capacity of our factories is being utilized at levels approaching the preferred rate of 92 percent on the average, and the overall unemployment rate has reached and surpassed the long-sought 4 percent interim target. These are goals that we have long sought--mileposts in our progress toward the future. To date, the growth of the economy has been well balanced; no major distortions have emerged. It is a balance that we do not want to endanger and a growth that we do not want to check.

Upward price pressures have occurred in a few instances, but their persistence depends on several imponderables. The jobless rate is still high for certain groups in our labor force that might be drawn into productive employment, and few industries are operating above desired levels. The additional demands on the economy that might stem from the Vietnam conflict, moreover, cannot be anticipated with any degree of certainty; the course of events there is not wholly within our control. Some of the strong expansionary forces could moderate as the Federal Reserve's credit restraint measures of last December begin to take hold and as the recently enacted tax measures and the larger Social Security deductions hold down income growth. Furthermore, new plant and new workers will contribute to a rapid growth of supply capabilities.

The margin of flexibility in the economy and the scope for freedom of action have obviously narrowed, in any event. Financial institutions are discovering that they have less leeway to respond to the credit demands of the economy. There is more intense competition for savings. Banks are finding their ability to satisfy private credit demands hampered by declining liquidity. Meanwhile, many of the specialized thrift institutions are confronted by a different problem--shrinkage of safe and profitable investment opportunities. The relative sluggishness of residential construction activity over the past two years and high vacancy rates in a number of areas, for example, have reduced mortgage financing requirements--a major area of activity for savings and loan associations. At the same time that the rise in desirable earning assets may be slowing down for some financial institutions, interest costs are continuing to rise because of the intensity of the competition in the money and capital markets between borrowers and financial intermediaries for the limited supply of funds. This is truly a time for testing--testing of management's ability to meet the challenges and solve the problems posed by the current situation.

Proof that financial management can rise to the occasion is furnished by the efficiency with which financial intermediaries directed the great flow of savings and liquidity accumulated during World War II into fulfillment of the large and diversified credit needs of an economy in transition from war to peace. The magnitude of the task is indicated by the fact that the gross savings of the economy aggregated some $834 billion in the 15-year period from 1946 through 1960, while the annual growth of savings more than doubled during this period. And liquid assets held by the public had risen almost $150 billion during World War II to a total of $232 billion by the end of 1946. Since 1960, savings growth has continued, reaching an impressive rate of $110 billion in 1965 alone. Part of this saving has been put to work directly by the saver, part has been channeled through the money and capital markets, and a significant share has flowed to financial intermediaries--commercial banks, mutual savings banks, and savings and loan associations, which in turn have made these funds available to the rest of the economy.

Share accounts of savings and loan associations consequently have grown more than twelvefold since 1946. In contrast, deposits at mutual savings banks are only slightly more than twice--and savings and time deposits at commercial banks only slightly more than three times--as large as they were in 1946.

Savings and loan association mortgage credits rose from a mere $5 billion at the end of 1945 to over $110 billion in 1965 and provided major support to the postwar housing boom. Mortgage financing by other mortgage financing institutions, on the other hand, has expanded less rapidly. By the end of last year, mortgages held by life insurance companies were only slightly more than half as large--and by commercial banks and mutual savings banks about two-fifths as great--as the dollar volume of mortgages handled by savings and loan associations.

In recent years, savings and loan associations have been encountering significantly more competition from other financial institutions. Competition from commercial banks, in particular, intensified following liberalization of the interest rate ceilings in 1957 and in subsequent years. Nevertheless, by remaining competitive in interest rates, by broadening the range of available services, and by a highly effective performance in general, the competitive position of savings and loan associations has been well maintained. Without the aid of the specialized thrift institutions, the economy would not have been able to chalk up the records of which it is so rightfully proud today. Your industry passed all tests with "highest honors."

The present environment provides another challenge--a new and intriguing challenge. It is a challenge faced today by other financial intermediaries as well. The success with which we meet this challenge will provide a major test of the viability of our financial institutions and of the sustainability of balanced economic expansion at high levels of activity.

The smaller margin of error that can be tolerated in management decisions today, because our resource use is pressing close to capacity limits, has already been mentioned. It is against this background that every action must be weighed. Greater responsibility than ever before is therefore placed on management--on its ability, its understanding, and its imagination. But the results should be well worth the extra effort required or the extra care called for, and the benefits will be commensurate with the results.

Three areas in particular might be pinpointed as critical for financial institutions in adjusting to changing circumstances--areas still in a state of flux. The first that I shall discuss is the change in the nature of funds classified as "savings." This change has important implications for financial intermediaries, which rely on savings as its principal "raw material" resource. No longer do "savings" consist only of the traditional funds accumulated by firms and individuals as protection against unforeseen contingencies or as a source of future financing for major capital expenditures. "Savings" now often include a significant volume of funds that were formerly held as working balances in the form of inactive demand balances.

Corporations have been a major source of this "new" type of savings as corporate treasurers have become more conscious of the earnings potential of these previously idle and essentially short-term balances. As a result, savings funds at financial institutions have become more volatile as they have become more responsive to interest rate differentials--shifting between various short-term liquid assets in search of the highest yields.

Banks have attracted a major share of this inflow of corporate short-term balances through the use of the large-denomination negotiable certificate of deposit. Other financial intermediaries have shared in the mobilization of these corporate funds, although to a lesser extent. But all financial intermediaries now must adapt to the slower growth in corporate idle balances, as corporations increasingly draw on these balances to meet their own sizable credit requirements, and to the increased mobility of these funds.

Credit and investment policies based on a continuing inflow of corporate balances should be reevaluated in light of these changes. The liquidity position of financial intermediaries may need to be strengthened to weather more easily variations in savings inflows without disruption of lending and investment policies. Dependence on these inflows, which have constituted an important source of growth for financial intermediaries in the recent past, also might profitably be reduced as a longer range policy. Other alternatives might be usefully explored.

A second area of critical concern is the greater sensitivity of savers (including households as well as corporate holders) to interest rate levels and differentials. Interest rates have attracted increasing attention in the past several years, initially because of the nation's concern with its balance of payments deficit. The mix of fiscal and monetary policy actions devised to deal simultaneously with a payments deficit and domestic underemployment of plant and manpower resources established an interest-rate structure characterized by higher short-term rates relative to long-term rates.

The subsequent rise in all rates accompaning the domestic expansion further intensified the rate consciousness of savers--and spread to the smaller saver. Thus there has emerged yet another group of savers responsive to interest-rate spreads. But the actual magnitude of response of these small savers to changes in interest rates has yet to be determined. It may be less than we think. There is obviously more awareness of rates, but little evidence so far that this awareness has triggered sizable shifts of funds. Until more is known about the elasticity of the supply of savings to changes in rates and about the interest-rate mobility of savings, the wisest course of action might be not to boost rates indiscriminately without some assurance of concrete results. Higher rates that fail to attract additional savings and higher rates in the absence of profitable and productive investment outlets only add to costs.

The third area calling for adaptability on the part of financial institutions is the situation created by the shift in credit demands from one group of credit suppliers to another as sector requirements change. Economic upswings have often been supported first by rising demands for consumer goods or capital goods or housing or exports. As the expansion progressed, the emphasis frequently shifted from one sector to another. The impact of these shifting demands tends to be reflected in the demands on financial intermediaries. Savings and loan associations, for example, grew rapidly in the immediate postwar period as postwar housing demands converged on them. Banks lagged behind in both overall growth and volume of mortgage financing. As the worst of the housing shortage was satisfied, credit demands began to shift toward spending on plant and equipment and consumer durable goods. The pressure on savings and loan associations leveled off.

Continual shifting of demands from sector to sector is typical of a dynamic economy. It is a situation calling for adaptability. A period of rapid growth followed by a period of slower growth could provide a salutary pause for consolidation of gains and correction of weaknesses. Management is tested equally in a period of stability as it is in a period of rapid expansion. The sustained expansion of the past five years may have caused us to forget momentarily that this is true.

These are interesting and challenging times. We are still learning to live in an economy operating at sustained high levels of output and resource utilization. The financial sector plays an important role in this process. Our success depends heavily on our adaptability to changing circumstances. It is a test, I am sure, that management of our financial institutions will pass--not necessarily with ease because the problems are complex but certainly with great credit to their profession.

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