THE PRESENT IN PERSPECTIVE

An Address by

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I am happy to have this chance to meet with you here in Chicago. I say this not to be polite or because of the inherent joys in making speeches--but, rather, because meetings such as this provide me with an opportunity to learn.

As a banker, I think it is understandable that I have a considerable interest in the problems which confront bankers. More specifically, as Chairman of the Federal Deposit Insurance Corporation, I have an obvious need to know as much as possible about the views, attitudes, and judgments of bankers. This kind of meeting generally affords an opportunity for informal exchanges on many subjects, and this is really the process which makes for balanced judgments.

As to the present-day need for balance and judgment, whether in bank management or in bank supervision, there can be little argument. Increasingly, the issues which unite or divide us are becoming more complex. These are clearly times which are testing our capacity to maintain and strengthen the viability of our banking system--especially in the context of our economic growth and our overriding national commitments.

In these informal remarks, therefore, I bring no easy answers. It is simply a fact of life nowadays that the easily-stated, categorical solutions frequently produce ramifications and chain-reactions which only compound the original problem.

In that context, my comments here are directed to perspective and reminder rather than to solution.

In our favor is the clear fact that the banking system is fundamentally strong and healthy. In deposits, in assets, in general efficiency, and in responsiveness to national and local needs--in fact, by virtually any standard--its strengths are woven into our past and continuing progress. Moreover, as banks steadily broaden their loan facilities and expand their range of services, their role will become increasingly important in the years to come.

Of course we cannot always have clear sailing. As our economy has grown, the environment has changed. Institutions and practices have changed, and our problems assume different forms. Perhaps our basic test, therefore, lies in our capacity to adapt and to reach thoughtful judgments.

At the present time, for instance, the U. S. economy is operating at 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 industrial plant 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 worked for--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 recently, after several years of reasonable stability, 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. On the other side of the coin, additional demands on the economy that might stem from the Vietnam conflict 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 continuing growth of supply capabilities.

It is nevertheless true that the margin of flexibility in the economy and the scope for freedom of action have obviously narrowed. 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.

This represents a clear challenge, both to bank management and to supervisory authorities. In a period of military involvement, when our resource use is pressing close to capacity limits, management decisions must be taken with a smaller margin of error. Greater responsibility is placed on management--on its ability, its understanding, and its imagination.

Bank supervisors face this challenge with you--a challenge that tests the inherent strength of our banking system and its capacity to continue to grow and to sustain balanced economic expansion at high levels.

A case in point is the current strong competition among financial institutions for savings. The increase in savings deposits and time deposits at banks has been an important factor in bank growth. And if banks want to continue to share in the task of satisfying the economy's rising demands for credit--both larger in size and more varied in nature than ever before--they _must_ grow. As a consequence, they must be prepared to compete with other financial institutions for savings and to employ these savings effectively, and, at the same time, observe the principles of prudent bank management and of service in the public interest.

The success achieved by banks in attracting a larger volume of savings has enabled them to supply a larger proportion of the nation's credit requirements. Their ability to supply a rising share of credit demands has been reinforced by the availability of diversified lending facilities and services and liberalization of the permissible ceilings on time deposit rates. These demands for credit, moreover, will continue as long as banks are able to satisfy the financing requirements of the economy efficiently.

"Savings", however, are no longer the homogeneous balances held by individuals and businesses in the form of savings and time deposits to provide the owner with some protection against unforeseen contingencies or a means of accumulating funds to finance major expenditures. "Savings" held in various types of time deposits now include a substantial volume of corporate funds, formerly held in inactive demand deposits, that are essentially short-term balances seeking temporary employment. This altered character of time money has made time deposits as a whole more sensitive to changes in interest rates. As a result, savings funds in financial institutions have become more volatile as they have become more responsive to interest-rate differentials--shifting between various short-term assets in search of the highest yields. Banks have had to adapt to a slower growth in these corporate idle balances--as corporations increasingly draw on these balances to meet their own sizeable credit requirements. They have had to adapt also to the increased mobility of these funds.

Banks have pioneered in the mobilization of these idle short-term balances through the development of large, negotiable time certificates of deposit and smaller denomination savings instruments, in addition to other innovation. Their advantages and disadvantages are still being discovered. Until they have been fully tested and their value proven, each of them should be used with caution. The unwise use of small-denomination savings instruments, for instance, could create numerous problems for the unwary bank--whether large or small.

Credit and investment policies based on a continuing inflow of corporate balances also should be reevaluated in light of these changes. The liquidity position of banks may need to be strengthened to resist the variations in savings inflows more effectively without disruption of lending and investment policies. Determination of the proper balance between liquidity and the maintance of asset yields which will compensate for higher cost money must be based on a careful consideration of all relevant factors. Dependence on these corporate idle balances, which have constituted an important source of growth for financial institutions in the recent past, might also be reduced as a longer range policy. These are but a few of the basic management problems in the present environment.

Another area calling for adaptability and management finesse on the part of financial institutions is the situation created by the current levels of economic activity--with shifting credit demands and limited savings flows. Continual shifting of demands from sector to sector is typical of a dynamic economy, but can be itensified by the economy's international responsibilities. It is a situation that again calls for adaptability.

Bank competition for funds, in any event, should as always be determined by each bank's ability to utilize those funds productively and profitably. But even those banks currently facing strong demands for credit must exercise selectivity in extending credit for productive uses. The competition for loanable funds should be pursued with full congizance of the cost burden entailed, the possible volatility of the funds, and the relative scarcity now of high-quality investments. This is a time for bank management to take an objective look at the quality of loan portfolios and at the nature of the funds being used.

In closing, let me repeat that my intention here has not been to deal with every subject nor to offer neatly-packaged solutions. If these few comments serve to remind you and me of the need for perspective and judgment, they will have served their purpose. I think it was Oliver Wendell Holmes who said that "a man may be judged not to have lived if he did not participate in the passions and perils of his times." All of us in banking have a rare opportunity to participate in the passions and perils of these times, as bankers have so often in the past. I am confident that balanced judgments and informed actions will reflect the traditional contributions of the banking industry in this country.

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