Remarks of
K. A. Randall, Chairman
Federal Deposit Insurance Corporation
before the
Annual Convention of the
Nebraska Bankers Association
in Lincoln, Nebraska
May 13, 1966

It is a pleasure to meet with you here in Lincoln and to participate in your annual convention. I value this opportunity to discuss with you our common interests and to talk to you about your aspirations as well as your problems and your plans for the future.

Because of the Corporation's responsibilities in the field of bank supervision and in light of my own background, my interest in the impact of current economic developments on banking practices and on your operations is obvious. Banks all across the country are broadening their loan portfolios and expanding the range of their services to meet the demands of a growing economy. The banks of Nebraska have kept in step with the times.

Banks in all parts of the country today must look beyond their own State and region to the national level because of the growing interrelationship of financial markets and the pervasive influence of national economic developments on regional economies. The United States is in its sixth consecutive year of general business expansion, the longest such period in peacetime history. Banks have played an important role in this unprecedented economic growth and have proved highly adaptable to the changing circumstances. As our economy continues to expand, this process of adjustment and adaptation must also continue.

In the first quarter of this year, gross national product rose to a high of slightly over 714 billion dollars. The productive capacity of

our factories is currently being utilized at levels approaching the preferred rate of 92 percent on the average, and the overall unemployment rate has reached and fallen below the long-sought 4 percent interim target. Almost one million persons have been added to nonfarm payrolls since the end of 1965. To date, the growth of the economy has been well balanced. It is a balance we do not want to endanger and a growth we do not want to check.

The economy is experiencing some upward price pressures, but their persistence depends on a number of 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 output and manpower that might stem from the Vietnam conflict, moreover, cannot be anticipated with any degree of certainty. Some of the strong expansionary forces could moderate as the Federal Reserve's credit restraint measures begin to take hold and as the recently enacted tax measures and the increased Social Security deductions hold down income growth. New plants and new workers will add to supply capabilities.

Because the economy is operating close to full employment levels, however, the margin of maneuverability has 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. They are also being called upon to fill a larger proportion of the nation's credit requirements as more of the credit demands shift toward banks.

The situation represents a clear challenge to bank management. The margin of error that can be tolerated in bank management decisions is necessarily smaller. There is greater responsibility placed on management--on its ability, understanding, and imagination. The challenges that we face provide a test of the inherent strength of our banking system and its capacity to continue to grow and to sustain balanced economic expansion at high levels.

To a significant extent, a continual shifting of demands from sector to sector and between various financial institutions is typical of a dynamic economy--and can be intensified by the economy's international responsibilities. But banks have also been able to strengthen their ability to supply a rising share of credit demands through the development of diversified lending facilities and services, supported by the liberalization of maximum rates payable on time deposits. As a result, commercial bank credit has risen on the average of 8-1/2 percent per year since the end of 1960. It has accounted for over one-third of the funds supplied by the credit markets in recent years, compared to one-sixth in the immediate post-Korean period when credit demands were also strong. This higher rate of bank participation in the credit markets can only be maintained as long as banks can satisfy efficiently the financing requirements of the economy.

The increase in savings deposits and time deposits in banks in recent years has been an important factor in enabling banks to expand their operations. But competition for savings among financial institutions has become much more intense, as we all know. It therefore is essential that banks compete effectively with other financial institutions for savings and make maximum effective use of those savings--without losing sight of the principles of prudent bank management and service in the public interest.

A new element that must be taken into account by banks is the significant change that has occurred in the nature of the savings market over the past several years. "Savings" 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. In addition, banks are now finding that they have to adapt to a slower growth in these corporate idle balances--as corporations increasingly draw on these balances to meet their own sizable credit requirements.

Mobilization of these idle short-term balances by banks as a source of loanable funds was accomplished primarily through the introduction of large, negotiable time certificates of deposit and supplemented by the use of repurchase agreements with corporations, the issuance of unsecured notes, and similar innovations. As a consequence, our financial resources have been more fully utilized. More recently, smaller denomination savings instruments have been offered by a growing number of banks to attract the interest-sensitive funds of small savers.

The advantages and disadvantages of many of these innovations are still being discovered. Until they have been fully tested and their value proved, 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.

To develop more information in this vital area, the FDIC and the Federal Reserve are simultaneously conducting surveys on the nature of the market for various types of savings instruments--including rates, maturities, and other terms. The two surveys together include all insured commercial banks, which are being requested to complete the questionnaires by May 18. We hope to publish aggregate figures for all of the banks participating in the survey as soon after the deadline date of the survey as possible.

At this time, banks might also undertake a reevaluation of credit and investment policies that might be heavily dependent on a continuing inflow of corporate balances--in light of these recent changes in the savings market. To avoid disruption of lending and investment policies, the liquidity of banks may need to be strengthened to resist more effectively the variations in savings inflows. A determination of the proper balance between liquidity and the maintenance of asset yields which will compensate for higher cost money must take into consideration all relevant factors. As a longer range policy, 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. These are but a few of the basic management decisions that must be made in the present environment.

Competition for loanable funds, in any event, should be determined, as always, by the bank's ability to utilize those funds productively and profitably. 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 cognizance of the cost burdens entailed, the possible volatility of the funds, the relative scarcity of high-quality investments, and the overall impact on the economy of additional injections of credit. 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.

These are interesting and challenging times. In many respects. the situations facing us are unique--and past experience provides only a few guideposts to go by. But the stakes involved are high and well worth our extra efforts--sustainability of economic expansion, reasonable price stability, and continued high rates of utilization of our plant and manpower resources. The banking community has responded with a high degree of statesmanship, imagination, and responsibility. Congratulations for a job well done.

New challenges, however, lie immediately ahead and call for continued alertness. But I am sure you will all rise to the challenge.