REMARKS BY

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The intense competition for savings has pre-empted much of the attention of Congress and the financial community in recent months. Various proposals have been advanced to curb commercial bank use of certificates of deposits and to try to dampen the race for savings. These proposals have ranged from a plan to bar outright the issuance of certificates of deposit to the grant of additional authority to the Federal Reserve to differentiate between time deposits by size of deposit as well as by type and maturity.

I do not intend, however, to discuss these proposals specifically today. Rather, I should like to examine with you the background of recent developments and the meaning of these developments for the financial system of the future.

The various proposals have been formulated in response to the recent intensification of competition among financial institutions for savings, which has taken place against a backdrop of continued high levels of economic activity and concern over the availability of mortgage financing. The pressures expected in the financial markets last month around the corporate tax and dividend payment dates and from the end-of-month crediting of dividends to savings and loan share accounts were successfully weathered, but a number of problems remain. Savings and loan associations still face strong competiton for savings, although the suspension of dividend restrictions by the Federal Home Loan Bank Board in early July may help to slow the decline in their savings inflows. The competition for savings, moreover, will tend to persist as long as economic activity continues to expand and as long as attractive alternative investment opportunities are available in the money and capital markets.

To understand how this situation developed and what its relevance is to the financial industry as a whole, I should like to review briefly some of the events leading up to the current situation. For 15 years after World War II, competition between banks and nonbank financial intermediaries was moderate because the nonbank institutions were able to attract and retain an ample supply of funds to finance the housing boom. Banks in turn concentrated on building up their loan portfolios and in improving their earnings.

Developments since the early 1960's, however, have transformed the competitive environment. In the first place, increasing pressure has been placed on the nation's plant and manpower resources as the domestic economy approaches full employment levels. Some easing in the upward pressures on the economy has been provided by a tapering off in demand in some segments, such as housing, but the sluggishness in housing has tended to reduce the number of attractive investment opportunities for the specialized thrift institutions. Secondly, interest rate patterns have been modified significantly, largely as a result of the persistence of sizable deficits in the nation's balance of payments position. Thirdly, more aggressive lending by the nation's commercial banks, aided by the introduction of the large-denomination CD and liberalization of interest rate ceilings on time and savings deposits, has strengthened the competitive position of commercial banks. This competition, however, did not begin to pinch other financial institutions until recently when strong market pressures, reinforced by more restrictive monetary policies, necessitated market rationing of scarce financial resources among competing users. Uncertainty about the extent of future international commitments further complicates the outlook.

There has also been a fundamental change in the nature of what we call "savings" in the monetary sense. Time and savings deposits were formerly a highly stable element in bank liabilities, with depositors placing their funds with a bank for extended periods of time and at relatively low rates of return. But "savings" now includes also a large volume of idle balances of corporations seeking temporary investment. "Savings" therefore tend to be more sensitive than before to interest rate differentials and more vulnerable to the lure of alternative investment opportunities--either at other financial institutions or in market instruments. Growing interest-rate consciousness has spread also to the small saver so he too is more responsive to varying rates of return on different asset holdings.

The growth in the volume of time and savings deposits at banks has enabled banks to engage more actively in mortgage financing, in the extension of consumer instalment credit, and in term lending. But the increased volatility of these deposits has also made it essential for banks to maintain an adequate liquidity cushion against fluctuations in these balances.

These then are some of the principal factors figuring in the recent pressures in the savings market. This pressure has intensified recently with the shrinkage in personal savings in the first quarter of this year and sharp increases in market rates of interest. Personal savings fell from an annual rate of $27.1 billion in the final quarter of 1965 to a rate of $24.4 billion in the first quarter of this year. A larger percentage of savings, furthermore, is being channelled directly from the saver to the borrower through the money and capital markets rather than through financial intermediaries. As a consequence, the banking industry has supplied only about 30 percent of the nation's private credit requirements so far this year, compared to 40 percent in 1965.

Adjustment to a slower rate of savings inflow--true for both commercial banks and other financial intermediaries this year--can be a painful process, particularly if credit demands remain as strong as they have been. The judicious use of monetary and fiscal policy instruments to restrain demand can ease the adjustment process. Even more important is the contribution that financial institutions themselves can make to a successful adjustment.

Now is an opportune time to pause and take a critical look at the position of your own institution--its ability to weather market pressures without undue stress and strain, its weaknesses and its strengths, and its potentialities. Recent experience has given us some idea of the kinds of problems that might be encountered in the future. Is the asset and liability structure of your institution, for example, appropriate for the present and adaptable for the future--or has it changed little over the years in response to changing times? Basic questions such as these must be faced squarely by each and every one of us and answered realistically.

Careful consideration, for example, should be given to the problems of liquidity as they relate to the new types of savings instruments and to the possibility that undue reliance is being placed on them. It should also be determined whether the competition for these interest-sensitive funds is bringing any real net gain to your institution--or only higher interest costs.

Essentially similar questions should be considered by other financial institutions. Has the previous rate of growth been unsustainable--and might it be unrealistic to assume continuation of these growth rates? Has the economic environment changed and the focus of credit demands shifted away from your institution? Are your operations geared to adjust during periods of rapid change--either through your ability to attract savings or to adjust portfolios? Are your liabilities well matched with your assets in maturity and stability? Is your scope of activity too narrow--or too broad and diffuse--

for optimum economic efficiency?

The answers to questions such as these did not seem urgent as long as the economy expanded at a steady pace and few imbalances developed. But in a period of rapid change, seemingly minor flaws can develop into major sources of difficulty. The alternative of direct assistance to a sector of the economy facing special problems must also not be forgotten. Because the financial markets have just gone through a period of uncertainty and turmoil, the current period of relative peace and quiet should be taken advantage of as an unexcelled opportunity to reassess our positions and plan ahead.

The Corporation stands ready to assist in this necessary and worthwhile task. We are always prepared to support the financial system in periods of stress and to preserve public confidence in the market mechanism. In periods of transition, we will do all within our power to minimize frictions and disturbances arising in the financial markets which can hurt the participants in these markets.

At the same time, we have been doing some re-thinking of our own. As a result of this re-examination of the philosophical basis of bank supervision and of its application to everyday problems, we have reached some general but relevant conclusions.

In the first place, it is vital to the continued health and strength of our financial system that flexibility be maintained in the posture, operations, and outlook of the supervisory authorities--and that banks should also try to maintain maximum flexibility to adapt to changing economic circumstances. Flexibility permits a finer adjustment attuned to the particular occasion, which may change rapidly and with little warning. Emphasis on the need for maximum flexibility, however, should not be equated with a desire for maximum powers on the part of the supervisory authorities. We do not need--or want--all-embracing powers over financial institutions. We ask only for enough flexibility to permit us to perform responsibly and effectively.

Secondly, with the growing interdependence of financial markets, it becomes obvious that one segment of the market cannot be effectively compartmentalized and isolated from another. Financial flows will always take place between various sectors of the financial markets--surmounting whatever artificial barriers or constraints that might be imposed. As a consequence, it is essential that supervisory actions recognize these interrelationships and consider whether regulations should realistically be applied across-the-board and impartially to all sectors of the financial market. Such a policy, however, does not mean that action designed to correct specific problems in one sector has to be applied indiscriminately to other sectors that may not share the same problems.

Thirdly, in periods of flux, solutions may have to be tailored to the needs of the moment. For example, the current competition for savings tends to have a greater impact on the special-purpose financial intermediary than on the more diversified general-purpose institution. Commercial banks are better able to shift or restructure their portfolios to meet changing conditions than institutions whose investments are heavily concentrated in a restricted number of outlets and in longer term investments. Thus, thrift institutions today are finding that the composition of their portfolios and the average rate of return can be changed only slowly, largely because their investment alternatives are limited.

For this reason, the single-purpose institution may have to evolve in new directions. Whether the changes will take place on the asset side of the balance sheet or on the liability side or on both is not yet clear. But, whatever the outcome, it seems increasingly clear from recent experience in the financial markets that some change will--and should--occur.

Before I conclude, I would like to caution against the hasty adoption of incorrect solutions. Bank supervisory actions must always be taken with care and on the basis of as complete information as can be obtained. Rigid solutions formulated on the basis of false assumptions or mininterpreted facts could be highly inhibitory to future action--as well as harmful. Our financial institutions in general are strong and virorous, and the supervisory role is best confined to assistance which promotes flexibility of response by financial institutions--and in this manner optimal utilization of our financial resources can be achieved.

In a free enterprise economy, the primary responsibility for the preservation and strengthening of our financial system must rest with the individual financial institution and not with the supervisory authorities. The Corporation's contacts with bankers over the years have given us full confidence in your ability and determination to fulfill these responsibilities. Let me assure you that you have our wholehearted cooperation at all times.

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