Remarks by
K. A. Randall, Chairman
Federal Deposit Insurance Corporation
Washington, D.C.
before the
Fall Conference of the
OREGON BANKERS ASSOCIATION
at
Portland, Oregon
Friday, October 7, 1966

On September 21, the President signed into law a bill giving the Federal Reserve and the Federal Deposit Insurance Corporation broadened authority to differentiate deposits by size as well as other reasonable criteria in setting interest rate ceilings on time money. In addition, the Federal Home Loan Bank Board was authorized for the first time to impose rate ceilings on member savings and loan associations. Insured mutual savings banks also became subject to rate ceilings.

The new law gives the three Federal supervisory agencies authority to respond with greater flexibility to situations such as the current intense competition for savings among financial institutions. Greater flexibility will enable the supervisors of financial intermediaries to assist the institutions under their jurisdiction in adjusting to the recent changes in the savings market.

Possibly of equal significance is the extension of interest rate regulations to all major types of financial institutions currently competing in the savings market. As recent experience has amply demonstrated, the savings market cannot be arbitrarily segregated into a commercial bank market, a savings and loan association market, and a mutual savings bank market. To varying degrees in different sections of the country and in particular localities, these financial intermediaries compete--and compete aggressively--with one another. Regulation of only

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

one segment of the market therefore not only places the unregulated segments in a more advantageous position but erects artificial barriers to the unrestricted flow of funds within what is essentially a single market.

As long as important sectors of the financial markets remain unregulated, however, regulation of interest rates through the imposition of rate ceilings may be relatively ineffective. For example, the existence of attractive alternative investment outlets--as at the present time--will tend to divert funds from savings institutions into Treasury bills, corporate securities, or other marketable instruments. The ability of the regulatory authorities to maintain a flexible posture under the recently enacted legislation, however, enables them to make further adjustments as needed.

The immediate goal of last month's changes in interest rate regulations and their extension to other types of savings institutions is to check further escalation in interest rates on time money. The reduction from $5\frac{1}{2}$ to 5 percent in the ceilings on commercial bank time deposits of less than $100,000 should help to moderate upward pressures in the consumer savings market and contribute to the maintenance of orderly conditions in the financial markets. The 4-3/4 percent and 5 percent maxima on rates payable by savings and loan associations on passbook accounts and 5 or $5\frac{1}{4}$ percent on certificate accounts--except in Alaska, California, and Nevada--should likewise serve as a restraining influence on further increases in rates. Rate competition, if carried to excess, can be damaging to the health of an individual institution as well as to the health of the financial community as a whole. A dampening of upward rate pressures is therefore a highly desirable objective.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I would like to stress at this point the fact that the interest rate regulations prescribe the maximum rates payable; these rates must not be construed as suggested rates. The ceilings established by the regulations are not intended for the purpose of setting the prevailing market rate for time money. The appropriate rate level on time deposit accounts must as always be determined by the management of each bank in light of its responsibility for the soundness, profitability, and liquidity of its institution.

To give banks the necessary flexibility to adapt their operations to the current economic situation and yet accord the regulatory authorities some control over the market, the ceilings were set at the levels announced last month. In certain areas of the country and in the major money market centers, rate pressures are strong, and financial institutions operating in such an environment must be able to remain competitive. Where the demand for funds is less intense, the upward flexibility in rates does not need to be used.

However, the more prolonged the pressures on interest rates--stemming from continued expansion of the economy and from Vietnam--the more widespread their repercussions. I think we are all becoming increasingly aware of the spreading of these pressures to smaller banks and to outlying areas. Banks outside the principal financial centers are finding their liquidity ratios declining, loan demand increasing, and deposit growth slackening. A growing number of banks are being asked to participate in loans generated by their city correspondents and there is strong demand for their Federal funds balances. Their margin of freedom to maneuver and to accommodate changing loan or deposit developments has been significantly narrowed. Therefore, moderation in interest rate policies

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

as well as in other areas of bank management is becoming ever more important.

It is too early to assess the probable impact of the new rate regulations. Any lessening of competitive rate pressures and of rate escalation will be a plus factor. A reversal of savings flows from savings and loan associations to banks or into the money and capital markets cannot be expected because the rate differential may not be large enough to encourage savers to change their investment patterns again. But the actions taken last month may prevent further shrinkage of savings inflows to savings and loan associations and minimize disruptive shifts of funds between savings institutions.

The overall impact will tend to be limited, in addition, by the fact that the broadened interest-rate authority will be in effect for only one year. Because it takes time for the interest rate adjustments to work their way through the financial system, the full impact may not be felt immediately. The situation in the financial markets, moreover, may make inadvisable an abrupt termination of the more flexible powers or may indicate a need for modifications of the authority. As a consequence, the Corporation has recommended that the provisions of the recently enacted law be reviewed by Congress well in advance of its expiration date to permit thorough consideration of its effectiveness and of the possible need to extend the life of the act. The flexibility granted the supervisory authorities in administering the interest-rate regulations would be desirable as a permanent feature of our financial mechanism.

Fundamentally, of course, the effectiveness of the new interest rate ceilings in lessening rate competition for time money depends on the general economic situation--on U. S. requirements for Vietnam and on the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

strength of the domestic economy. The near-term outlook indicates continued expansion in most sectors of the economy, although at a rate below the record first quarter. Demands for bank credit and capital will also remain strong as long as the economy continues to operate at close to full-employment levels. If the economic gains of the past several years are not to be dissipated, we must continue to utilize to the fullest our capabilities and resources in a responsible and imaginative manner.

# # # #

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis