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FEDERAL DEPOSIT INSURANCE CORPORATION

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FUTURE FOR ECONOMY AND BANKING INDUSTRY IS PROMISING, DESPITE STOCK MARKET'S UNUSUAL BEHAVIOR

FDIC Chairman L. William Seidman today told the nation's bankers that the future of the economy and the banking industry looks promising despite the erratic movement of the securities markets.

Even in the face of the sharp decline in stock prices, "it is unlikely that a nationwide recession will develop," Mr. Seidman told attendees at the American Bankers Association convention in Dallas.

Of the recent unprecedented volume of activity on U.S. stock exchanges, Mr. Seidman said markets were so high that they were due to fluctuate. Despite these declines, he said, the economy looks strong.

Mr. Seidman said his optimism is based on strong performance by all of the leading economic indicators. Specifically, he noted:

1. The relatively flat wholesale price index suggests inflation is not developing;
2. Unemployment, at 5.95%, is the lowest since 1979, and weekly unemployment claims, one of the best early warning signals, have dropped more than 25%;
3. Leading economic indicators have moved up steadily over the last four years;
4. The Columbia University "long leading index" shows sizable growth through 1988;

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5. Purchasing agents predict an almost 4% growth in the Gross National Product;
6. Capital spending is estimated to increase by double digits, as evidenced by the 22% increase in corporate appropriations for new spending during the last two quarters;
7. Corporate profits are estimated to increase 10% this year;
8. Consumer confidence is at its highest level in 15 years, according to the Conference Board;
9. The U.S. deficit was down by $60 billion in the year just ended; and,
10. The dollar trade balance, while still high in real terms, is improving -- exports were up 15% over last year.

The future for the banking industry is promising on both the legislative and economic fronts, Mr. Seidman said. Nevertheless, he added, positive Congressional action is needed on the proposed repeal of legislation that imposes statutory restrictions on banks. Approval of such a repeal by Congress, he said, would let banks compete and thus improve their annual growth rate, which has been the lowest among all kinds of financial institutions over the past five years.

Letting banks compete is also the principal message in the FDIC's recent study on restructuring the financial services industry, the Chairman said. The study, released in draft form in April, was formally presented to Congress last week.

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Remarks By
L. William Seidman
Chairman
Federal Deposit Insurance Corporation

Before the Annual Convention of the
American Bankers Association
Dallas, Texas
October 19, 1987

Good Morning.

As Chairman of the FDIC, I appreciate the opportunity to talk with so many bankers at a most INTERESTING TIME for our industry.

"Interesting" because the legislative restructuring of banks is on the front burner, and "interesting" because the stock and bond markets' turmoil raises real questions about our economic perspective.

First, what about banking restructure and the FDIC's proposal.

A few weeks back, as many of you know, the FDIC completed a study on the need for restructuring the banking industry. The baby took nine months. It is nine chapters and 190 pages long. But I can sum it up for you in three words.

Those three words are:

"LET BANKS COMPETE!"

The need for an improved structure is evident from the numbers. Our economy is in its 59th month of continuous expansion -- the longest sustained period of peacetime growth recorded in 133 years!

The annual growth rate for commercial banks, since 1980, has been the LOWEST of all kinds of financial institutions. The growth rates of S&Ls, credit unions, life insurance companies, mutual funds, securities firms, and FINANCE COMPANIES -- have ALL been higher than banks.

Our banks should mirror the vitality of our economy. It is clear that they have not. For an insurer like the FDIC, this is disturbing news. Thus, the objective of our work was to search for ways to improve the economic prospects of American bankers.

The study took the following items as "givens" under current economic and political conditions:

-Deposit insurance, substantially in its present form, is not going to be changed.

-As long as deposit insurance allows banks to borrow on the credit of the insurance fund, safety supervision by the government will be necessary -- and desirable.

-Any threat to the banking system is a threat to the intermediation process, private sector liquidity, the payments system, and the U.S. economy.

-No system provides foolproof safety for every bank; our overall objective has been to keep the overall system safe and sound.

WHAT ARE WE PROPOSING?

Keep it simple--repeal laws that don't work, and don't complicate with

adding new ones.

Build an even BETTER SUPERVISORY WALL around banks. One that will protect the system from nonbanking activities conducted by subsidiaries, affiliates, or owners. With such a "wall" in place, direct banking regulatory and supervisory authority over nonbanking affiliates, subsidiaries, and bank owners, is not necessary.

Affiliates would operate in the free market on an unregulated basis (unless by some other regulatory agency).

Would this require a vast new effort on the part of the FDIC and other regulators? We don't think so. We can use the same kind of examination process we have now. Our approach is only a logical extension of safeguards that exist now -- such as those that protect a bank from insider abuse and conflicts of interest. The FDIC has been doing that successfully for more than half a century.

CAN REGULATORS -- AND BANKERS -- CONTROL CONFLICTS OF INTEREST? That is an issue on which reasonable men can disagree. But more people agree that controlling conflicts of interest is the key to an effective supervisory "wall". Based on 54 years of experience, our professional supervisory staff believes that conflicts can be regulated appropriately for safety and soundness of the banking system.

FDIC bank supervisors, and the directors of the banks themselves, have effectively safeguarded the vast majority of banks from conflicts of interest for the last 50 years.

Inherent in our banking system is the conflict that exists when, as is usually the case, directors of the bank are also borrowers from the bank. Potential conflicts can also exist in the relationship between a bank holding company and its subsidiaries or affiliates. In both cases, SUPERVISION has been effective in preventing such conflicts from jeopardizing the system.

Our experience teaches us that when the rules are reasonable, the great majority of bankers will play by the rules. Thus, the supervisory challenge in creating a "safety and soundness" wall is to identify and restrain the small percentage who would abuse the system. The view of our supervisory staff is that, with the right tools, they will find most of the small number of abusers. So FDIC would, therefore, be able to preserve the system's safety.

Our confidence is based on the fact that the great majority of bankers are honest, want to live by the rules, and will police conflicts of interest by themselves. Again, FDIC experience has proven this to be so.

Thus we answer the PIVOTAL question; "Can we control conflicts of interest?" The answer is a resounding YES.

Here are a some of the other contents of the FDIC's restructuring proposal:

-Capital placed in nonbanking subsidiaries should not be counted as

part of regulatory capital requirements. If such capital is lost, the bank's safety and soundness would not then be affected.

-Additional activities can be classified as "banking" and thus permissable for banks. Certainly, mutual funds, commercial paper, securitization, and revenue bonds should be "inside the bank" activities.

Most regulation of bank holding companies could be removed.

There are many more details. They merely supplement the idea that, to "Let Banks Compete" -- we need a restructured system. Changes don't need to be done all at once. But we have to proceed with all deliberate speed to a system that "Lets Banks Compete". The existing legal and regulatory framework is inefficient and outdated. Government's presence in the banking marketplace must be modernized.

It is said that "There is nothing as powerful as an idea whose time has come." That statement, we believe, applies to a restructuring of financial systems today.

We ask you to review the FDIC proposals, for they are intended to help ALL banks. The FDIC looks forward to hearing from you. Let's develop a plan that unites the banking industry!

Next, if restructuring looks promising, what about the economic outlook -- given the dramatic drop in the stock and bond markets in the last few days? As of last Friday, the Dow Jones averages were down 15 percent -- and interest rates were up over 200 basis points.

This morning it rallied about 200 points, and has since slipped back again in heavy trading.

At the FDIC we have an INSURER'S interest in these events. Here in the Southwest (Dallas), we have seen, over the past two years, what near-depression can do to the banking system, and to our deposit insurance cost.

Are we looking at a nationwide recession now? The FDIC says NO!!

By historical standards, the stock markets have been remarkably high. And the near term outlook for the economy is REMARKABLY strong.

The markets' price earnings ratio for the Standard & Poor's 500 in August, 1987, topped the 1929 high (22 to 20). Yields from stocks were 2.6 percent, compared with three percent in 1929. To return to traditional (20 year) yield spreads between stocks and bonds would take a much larger adjustment than the one that happened last week. Yes, the markets were high, and -- since nothing goes up forever, the markets were due to fluctuate.

At the same time, the economy looks strong. There remain an unusual number of favorable indicators. Let me point out just TEN:

1. Renewed inflation is nowhere to be found. Note the last wholesale price report, which was essentially flat. Fed Chairman Greenspan has seen

"No evidence" of inflation burst in the numbers, and the FDIC agrees.

2. Unemployment is down to 5.9 percent -- the lowest level since '79. Weekly unemployment claims (one of the best early warning signals) have fallen sharply from 350,000 to 250,000 -- a more than 25 percent drop.

3. The Commerce Department's leading indicators have been moving steadily up from 180 percent in August, 1986, to 193 percent in August, '87.

4. Columbia University's "long leading index" signals growth through next year.

5. The Purchasing Agent's association's report predicts strong growth in the manufacturing economy, at almost a four percent GNP growth rate.

6. Capital spending by business is estimated to increase by double digits. Evidence of this can be found in the 22 percent increase in corporate appropriations for new capital spending during the last two quarters.

7. Corporate profits are estimated to increase by ten percent this year.

8. Consumer confidence is at its highest level in 15 years, according to the Conference Board. And the twin deficits -- trade and the U.S. Budget -- are moving in the right direction.

9. The U.S. budget deficit is down by $60 million in the year just ended. As you heard from the Senator, the new Gramm-Rudman-Hollings expense control measure is in place.

10. While the dollar trade balance remains stubbornly high, in real terms, the situation is improving. Exports were up 15 percent over the last year. As William Lilley III of the American Business Conference said, "The current trade reports should cause neither celebration NOR despair."

While I have given you ten reasons why we should believe our economy will remain strong over the near term, panic can change that outlook.

But I remind you -- all markets fluctuate, and the stock markets have been VERY high by all historical standards. We don't think this adjustment in the markets should change our country's multitude of underlying economic strengths.

Based on the evidence, the future for the banking industry looks promising, both on the legislative and economic fronts. We need to continue to work together to fulfill that promise.

We at the FDIC are pleased to have this opportunity to join all of you today in "Banking on The Future".

Thank you.