For release on delivery
Tuesday, December 2, 1975
11:00 a.m. EST

SAVINGS BANKS IN THE UNFOLDING FINANCIAL ENVIRONMENT

Summary of Remarks by

Robert C. Holland, Member

Board of Governors of the Federal Reserve System

before the

Twenty-Ninth Midyear Meeting of the

National Association of Mutual Savings Banks

New York, New York

December 2, 1975

I am pleased to participate in this meeting today, for I have long been intrigued by your industry. We have a financial system that is characterized by a kind of tug-of-war between specialized versus general-purpose institutions. In that tug-of-war, savings banks seem poised in the middle, more specialized than the general-purpose lenders, yet distinctly broader in their outreach than the traditional personal thrift and home financing institutions.

Is that position a viable one in the long run, or are mutual savings banks themselves in the process of evolving toward one extreme or the other? I am not sure of the answer to that intriguing question, but I am sure that certain underlying economic forces are going to have a great deal to do with that answer. These powerful forces are hard at work on the savings bank industry, and I daresay that before long they will have forged the shape of your future. Each one is formidable in its own right. Taken together -- and they are interrelated to some extent -- I doubt that any institution is strong enough to escape unscathed.

The first and most dangerous of these economic forces is inflation. Year after year price increases have been ravaging our society, distorting values and creating feverish booms and recessionary aftermaths.

Savings banks are among the institutions most subtly threatened by inflation. That may sound like an incongruous statement, for with both its assets and its deposits stated in fixed dollar terms, a savings bank would seem fully hedged against changing price levels and might justifiably be oblivious to them. But you may be sure your depositors are not. Money left for safekeeping with you has been gradually losing its value. If and to the extent that depositors become disillusioned with that process, your kind of institutions will have become obsolescent. You have much at stake in the battle against inflation, and you would be well advised to become even more active in support of long-run anti-inflationary measures.

To brake inflation, the single most effective counterforce is saving. More saving provides the wherewithal to finance desired investments with less upward pressure on prices. In so doing, of course, saving can also finance a pleasantly rising standard of living for the community as a whole.

The demands for saving, however, have often been overreaching, and they are likely to be intense during many of the years ahead. Some of the biggest added demands for savings in the near-term future are likely to come from quarters which mutual savings banks have not traditionally served -- such as investments to provide more and better forms of energy. Considering that the highest and most appealing bidders for funds usually tend to get the most, there is a chance that these more insistent bidders will manage to pare down the share of total savings flowing through thrift institutions -- unless, of course, thrift institutions loan portfolios are redesigned to accommodate more of such types of credit.

An outgrowth of the interplay of these elemental forces has been a succession of business ups and downs.

These economic fluctuations have been accompanied, for the past decade or so, by some of the sharpest interest rate fluctuations in our history. Moreover, I see little on the horizon to keep that kind of outsize cyclical oscillation of interest rates from happening again and again over the years ahead. Indeed, given the changes being made in financial markets and instruments and institutions to accommodate such changes, it would not be surprising to me to see future cyclical peaks in interest rates that reached higher and lasted longer than those we have just lived through.

In this kind of unfolding financial environment, the competition for savings will be episodically fierce, both among financial intermediaries and between those institutions and the instruments available in financial markets. To remain in the thick of the savings business, thrift institutions will probably have to offer more varied and rewarding types of deposit liabilities.

I am no expert in the savings field, but I can imagine the proliferation of longer-term savings certificates, goal-related savings contracts, variable interest rate deposits, and even deposits with both interest and equity pay-outs. To be able to afford such liabilities, institutions may need to be acquiring some fraction of their assets in forms which also carry variable interest rates, or some kind of "equity kicker" like a share in any capital gain on the property being financed. The profitable scope for such savings innovations is as wide-ranging as are people's varied motives for saving. The better those motives are understood, the more efficiently instruments can be tailored to meet them. For that reason, I have often thought that an industry as dependent upon saving habits as yours could usefully spend an appreciable part of its budget on basic studies of why people save.

I believe one could fairly say that mutual savings banks, at the present moment, are not ideally suited to the possible future environment that I have been sketching. If you are going to play a vigorous role in that future, some changes are likely to be needed. Members of your industry are already seeking more flexibility by advocating passage of the proposed Financial Institutions Act, a course I heartily applaud. Some mutual savings bankers are also exploring an added measure of protection against future economic vicissitudes by affiliation with an assured payments channel and lender of last resort, namely, the Federal Reserve System. And I hope you can understand the Federal Reserve's own desire to position itself to operate better in that rapidly changing future, by spreading monetary reserve requirements over all deposit-type liabilities in all banking and thrift institutions.

I, myself, hope that all of these sought-for changes are achieved. It seems to me that your industry can develop the cohesion needed to pursue these and other changes effectively. They imply changes, of course, in law and regulation as well as in the institutions' own operating philosophy.

But the ability to achieve such change is more than a little constrained by the theology that surrounds much of the mutual savings bank movement. That theological feeling exists both among mutual savings bankers and those who legislate concerning them. You know better than I how malleable that might be.

Change in the savings bank industry is handicapped by another common factor. Most of the changes mentioned above involve costs as well as benefits to the firms involved. It is reasonable for any institution involved in the process of change to try to cut down the costs and enlarge the benefits that change brings with it. But trying too hard for too long to avoid or minimize those costs can slow the process of change. And in this fast-changing world, institutions that are too slow to change can face a shrinking future.

* * * * *