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Statement of J. L. Robertson, Vice Chairman
Board of Governors of the Federal Reserve System
before the
Subcommittee on Financial Institutions
Committee on Banking and Currency
United States Senate
on
S. 2923 and S. 3133

April 3, 1968

I appreciate this opportunity to present the views of the Board of Governors on S. 2923 and S. 3133. Senate bill 3133 would extend for two additional years the provisions of Public Law 89-597, which would otherwise expire September 21 of this year. This statute provides the authority for coordinated regulation of the maximum rates payable by Federally insured financial institutions to attract savings funds. It also fixes a 10 per cent statutory maximum on reserve requirements for member banks on time and savings deposits (in place of the former 6 per cent maximum), and authorizes the Federal Reserve Banks to buy and sell in the open market obligations of any Federal agency. Senate bill 2923 would extend for two years the authority for Federal Reserve Banks to purchase up to \$5 billion of obligations of the United States directly from the Treasury.

In the six months or so that have passed since the Congress voted to extend Public Law 89-597 for one year the need for continuation of the rate ceiling authority provided in that statute has increased rather than diminished. Interest rates in the money market have risen, and banks have had to raise their offering rates on large negotiable certificates of deposit. Banks are paying the 5-1/2 per cent ceiling rate on shorter and shorter maturities in an effort to avoid sizable runoffs in funds. The rise in yields available on market instruments also has contributed to a marked slowing over recent months in the

inflows of consumer savings to banks and other depositary-type institutions, compared with the very high rates of increase experienced last spring and summer.

Under these conditions, the competition for savings funds has tended to intensify. From the January 31 survey of time and savings deposits at insured banks we have thus far been able to process returns for the 700 banks that are most active in this business. The survey shows that the great majority of those banks are paying the maximum permissible rate for consumer-type deposits-- 4 per cent on savings accounts and 5 per cent on most varieties of time deposits under \$100,000. And we have the impression that the same situation exists with respect to savings banks and savings and loan associations--that most active competitors, desiring to protect their existing funds and stimulate the maximum inflow of new savings, are offering the maximum rates allowed currently by the regulations.

The situation obviously is one in which some institutions, if unrestrained by rate ceilings, would see an advantage in offering somewhat higher returns to savers. And if such competition were permitted, I have no doubt that a rate war would develop. Furthermore, I see no reason to expect a diminution of pressures on the funds position of banks and savings institutions any time soon. It may become necessary to adjust the structure of ceiling rates if financial markets continue to tighten, in order to make it possible

for the institutions to compete with the market and attract a reasonable share of new savings flows. But if such a change does become necessary--and I hope it will not--surely it would be best to limit the extent and nature of the rate increases, and thus to avoid the threat of competitive rate escalation.

If the legislation before you were permitted to expire, of course, the Federal Reserve and the Federal Deposit Insurance Corporation would retain authority to establish ceiling rates on the interest rates offered on savings and time deposits by member and nonmember insured banks, respectively. But we would lose a great deal of flexibility in distinguishing among types of deposits, and it was this flexibility that permitted us to establish a lower rate ceiling on time deposits under \$100,000. No matter what you think of such a distinction philosophically--and I for one find it objectionable--the realities of today's market absolutely require some scaling in maximum rates by size of deposits if banks are to compete for funds in the money market without at the same time disrupting the more traditional markets for small savings. Moreover, as a practical matter, I think that we would find it very difficult to continue limiting the interest rates paid by banks for savings if their competitors--the savings banks and savings and loan associations--were left free to post any rate they wished.

For these reasons, the Board believes it essential that Public Law 89-597 be extended, and we recommend that the authority

be made permanent. The need for effective rate limitation is especially acute under present circumstances, but the case for extending this legislation need not rest on current market conditions. Indeed, it is difficult to envision circumstances under which the Congress would find it advisable to allow this statute to terminate. If the underlying causes of today's stresses in financial markets are corrected, and rate ceilings are no longer needed, the statute contains authority for their suspension. On the other hand, as long as ceilings are needed, it seems advisable to continue the flexible, coordinated approach embodied in the statute for establishing them.

If the rate ceiling authority is made permanent, the present statutory exemption for foreign official time deposits should be allowed to expire as scheduled on October 15 of this year. This exemption was originally adopted in 1962, before enactment of the present flexible authority over rate ceilings, and it was intended to permit banks to compete for foreign official funds and thereby to help alleviate the balance of payments situation. Since that situation has not improved during the intervening years, the exemption of foreign official deposits from interest rate ceilings continues to be justified. In recent amendments of their regulations, the Federal Reserve and the Federal Deposit Insurance Corporation have made clear their conviction that in present circumstances foreign official deposits should be free from interest

rate ceilings. As improvements in the international payments position of the United States are achieved, however, the need for special treatment for foreign official deposits should be reviewed from time to time in order to make sure that the discrimination involved is continued only as long as it is needed. If Public Law 89-597 becomes permanent law, the Board will then have the authority to continue, modify, or terminate this exemption administratively in the light of changing circumstances.

The authority in Public Law 89-597 for Federal Reserve purchases and sales of agency issues in the open market should also be made permanent. The objectives of this authority--to "increase the potential flexibility of open market transactions and . . . make these securities somewhat more attractive to investors" (S. Rept. No. 1601, 89th Cong., 2d session)--are long-range, and would be better served by eliminating uncertainty as to how long the authority may be exercised.

The Board proposes also that two minor related amendments be added to S. 3133. The first would amend the eighth paragraph of Section 13 of the Federal Reserve Act to permit advances to member banks to be secured by any obligation eligible for rediscount or for purchase by Federal Reserve Banks. This would broaden such lending authority to include as eligible collateral all of the direct obligations of Federal agencies, as well as obligations fully guaranteed as to principal and interest by such agencies. Since

the Federal Reserve Banks are authorized by Public Law 89-597 to purchase all such Federal agency obligations, we can see no reason why similar authority should not be granted as to their use as collateral for advances by Reserve Banks to member banks.

The second amendment we propose would broaden in similar fashion the types of collateral authorized for Federal Reserve Bank loans to individuals, partnerships and corporations under the last paragraph of Section 13 of the Federal Reserve Act. The collateral for such advances now may consist only of the direct obligations of the United States, and we propose to include also the obligations of Federal agencies. This provision of the Act is seldom used, but it could provide important protection to the business community under highly unusual or emergency conditions in financial markets. In June 1966, for example, we had made arrangements for the possible extension of credit to mutual savings banks, savings and loan associations, and other depository-type institutions under this authority, though none proved to be necessary. Addition of Federal agency issues would give wider latitude in such contingency planning, and we can see no reason why the types of assets made eligible for collateral should not, in this instance also, parallel the Reserve Banks' purchase authority.

I have suggested reasons for making permanent the rate ceiling and open market authority in Public Law 89-597. The Board believes also that the authority in that statute to raise reserve

requirements on time deposits should be made permanent if it is to be effectively exercised. Statutory expiration dates confront the Board with the prospect that if they should raise reserve requirements on time deposits above 6 per cent, the action might be automatically reversed, thereby reducing reserve requirements, at a time when such a reduction would have undesirable consequences.

Let me turn now to S. 2923, which authorizes the Federal Reserve System to purchase up to \$5 billion of U. S. obligations directly from the Treasury. As your Committee has heard before in the course of numerous extensions of this authority over the past twenty-six years, the authority has been used sparingly but affords the Treasury a useful measure of leeway in managing its cash balances and borrowing operations. Although one may question whether any purpose is served by the two-year limitation on this authority, presumably it has become so much a part of our traditions that there is little prospect that it will be abandoned. Moreover, a two-year extension has passed the House and I recognize that your Committee may be reluctant to adopt a different version. Therefore, even though a forceful case could be made for striking out the expiration date, I recommend, on behalf of the Board, that you report S. 2923 without amendment.

Amendments to Carry Out Federal Reserve Recommendations

1. To make Public Law 89-597 permanent: Strike out section 7 of that statute (S. 3133 as introduced amends section 7 to extend expiration date).

2. Collateral for advances by Federal Reserve Banks:

(a) Advances to member banks: Amend the eighth paragraph of section 13 of the Federal Reserve Act by striking out "secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks" and inserting "secured by such obligations as are eligible for rediscount or for purchase by Federal reserve banks".

(b) Advances to individuals, partnerships, and corporations:

Amend the first sentence of the last paragraph of section 13 of the Federal Reserve Act by inserting after "secured by direct obligations of the United States" the following: "or by any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States".