COMPETITIVE BANKING FORCES IN THE SOUTHEAST; SIGNALS FOR THE SAVINGS INDUSTRY

Speech by Robert P. Forrestal, President,
Federal Reserve Bank of Atlanta
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Thank you for inviting me to your annual meeting. You and your industry have suffered much during the past few years. Your industry's doom has been prophesied by many. I do not believe that those prophecies need to be true. You people can make sure that your institutions survive and prosper and that they continue to serve the public. This morning I will talk to you about some of the signals that banking and economic developments are sending to you as you attempt to ensure your prosperity.

Last night's pickin' and grinnin' and my topic today both remind me of a story about the daughter of a rural family who still lived just up the road from her relatives. She was in the kitchen one day preparing to cook a ham. As part of her normal preparation she sliced about three inches off the end of the ham and a visiting friend asked her why. She replied that her mother had always done it that way, but she became curious about why. The next time she saw her mother she asked why she had always sliced three inches off a ham when she prepared it. Her mother told her "I learned it from your grandmother." The daughter, still curious, went on up the road to quiz her grandmother about cooking hams. When she asked her grandmother, the question surprised her and she answered "Why, honey, it's the only way I can get a ham into my pot." Doing things in the way that made sense to our grandparents may cause us to throw away some worthwhile vittles if conditions have changed.

Change pervades the environment in which you operate. You must adjust to it or be exposed to great losses. There was a time not long ago when thrift institutions appeared to be gaining advantages on banks through the process of change. In the late 1960s and early 1970s, the regulatory rate differential which favored thrifts in the

competition for time and savings deposits became codified and entrenched. In the late 1970s the Home Loan Bank Board ruled that you had statewide branching powers in all states—even where banks did not. Some of you used these powers to beat your banking brothers into attractive markets. In the early 1980s, Congress allowed you to attack your maturity matching and cyclical earnings problems by becoming more like commercial banks. In 1980, it gave you the power to offer NOW accounts, consumer loans, credit cards, second mortgages and trust services. In 1982, it allowed you to offer business loans and deposits.

When your earnings began to turn negative in the early 1980s, capital requirements were also streched for you in three ways. The Federal Home Loan Bank Board effectively decreased its capital requirements, and it allowed you to value those low-interest, fixed-rate mortgages that plagued your portfolios at book rather than at market. Then the Garn-St Germain Act gave you capital certificates to bolster your capital. (It gave these to banks also, but few qualified.) These legal and regulatory changes still allow you distinct advantages in markets where other institutions with higher regulatory or market capital requirements compete with you.

All of these changes in law and regulations gave you a leg up in the competition with your commercial banking rivals. You could offer higher prices for insured deposits, move into attractive market areas closed to many of them, get into their traditional product markets and operate with less capital. But as Congress was giving, Congress, inflation, and your competitors were also taking away.

The removal of interest ceilings on deposits effectively began with the introduction of six-month money market accounts in 1978. It has continued under Congressional mandate. Your advantageous differential survives on only a pitifully small proportion of the deposits you hold. Presently only transactions accounts and passbook savings deposits are subject to interest rate ceilings. Since year-end 1977, savings and loan

deposits subject to interest ceilings and the interest rate differential have declined from 92 percent to 12 percent of total deposits.

You have also felt the painful effects of the gradual deregulatioon of deposit ceilings in disappearing margins between earnings on fixed-rate, long-term mortgage portfolios and short-term, market-related deposits. Many of you still face the threat of a repeat of 1981 and 1982, if interest rates climb further from their present levels. Even in the relatively prosperous second half of 1983, 35 percent of federally insured savings and loan associations were losing money and the average rate of return on assets for the industry was 0.27 percent (versus .67 percent in 1979).

A less obvious but important change has been the redressing of some of banks' geographic disadvantages. They have found a variety of ways to offer their services outside of their head office county or state. Nonbank activities of bank holding companies, loan production offices, Edge Act corporations and, in some states, grandfathered branches all provide interstate banking vehicles. Through nonbank offices, out-of-state banks operate more than 30 mortgage company offices in Georgia alone. Incidently, all banks' loan production offices do not concentrate exclusively on business loans. For example, Chase's new Atlanta LPO specializes in loans to individuals. To the extent you are using your consumer lending powers, it is your direct competitor.

Presently, at least three Southeastern states are trying a new scheme to allow banks to hop over geographic barriers. Georgia, Florida and South Carolina have already passed regional, reciprocal interstate banking laws. (North Carolina may well follow.) When banks begin to take advantage of these laws, you may very well face some larger competitors. Some of these out-of state competitors will bring lending and deposit-raising skills to Georgia that you have not seen before.

What we have come to call nonbank banks are still on our horizon. Some members of Congress have predicted that the loophole that accounts for their existence will be closed during this term, but no action has been taken yet. Hearings on nonbank

banks in the House of Representatives have already produced a great deal of controversy on whether to close the loophole and how to close the loophole.

If nonbank banks are allowed to operate, these institutions will bring our financial system about as close to full interstate deposit-taking by insured banks as we can get without actually being there. Nonbank banks also will bring some large, strong competitors into your traditional markets. These competitors will be seeking consumer deposits just as you are. If you are interested in the possible impact, recall the introduction of money market deposit accounts in Atlanta. A price war similar to the one that accompanied that event is not out of the question if and when twelve to fifteen large out-of-state banks open nonbank banks in our capital city. The fall-out from that would effect deposit costs and flows all over the state.

The impact of this redressing of competitive balances can be seen in changes in shares of commercial banks and thrifts in both national and state deposit and loan markets. At the national level, savings and loans' share of financial assets held by private financial institutions fell by 11 percent between its peak in 1977 and the end of 1983. (Banks' share fell by 6 percent over the same period.) In Georgia, deposits of savings and loans and savings banks combined have fallen from 33.2 percent of total bank and thrift deposits in 1980 to 32.1 percent in 1983.

A further disturbing fact observed in the data on thrifts' operations is the slowness with which most of you have moved to use your new powers. These powers were designed to allow you to manage your interest rate risk more effectively and to diversify away from the inherently cyclical real estate industry. The powers were modeled on banks' powers because banks have achieved much better maturity management and much more stable earnings.

The way most of you have moved into these powers can be most charitably described as cautious. If one feels less charitable, one might say laggardly. Our economists have taken a look at your use of new powers in order to gauge the likelihood

of more maturity gap problems in your industry should interest rates continue to rise. For the country as a whole they have found that consumer loans made up a little more than 3 percent of savings and loan assets as of June 1983, up from 1.7 percent three years earlier. Non-real estate, commercial loans accounted for 0.2 percent of total assets in June 1983. In the Southeast, the pattern of nonchange has been similar. Consumer loans were up from 2.7 percent to 5.0 percent of total loans between June 1980 and June 1983. Commercial loans reached 0.3 percent of assets by June 1983.

Your operations continue to be dominated by real estate, assuring you of sharp cyclical earnings swings. As late as March of this year almost 91 percent of Georgia savings and loan associations' nonliquid assets were still related to real estate. This compares with 95 percent at the beginning of 1980.

You have made considerable strides in offering variable rate mortgages. These help to shield you from interest rate risks, but they subject you to the same risks of changes in the macro-economy that other real estate operations do. And despite your strides in variable rate mortgages most of you still offer fixed-rate mortgages and your portfolios are still dominated by them.

Knowing all this I am not too surprised that your industry faces harsh problems now that interest rates have rebounded from early-1983 lows. Your own decisions and the short time you have had to improve your situations make you vulnerable to your age-old plagues of interest rate risk and real estate cycles.

The irony you face is that despite your problems, your markets are attractive to new competitors. (Your problems are based on how you put the markets together.) Consequently, new competitors will tend to eat up any surplus earnings which buffered you against risk in the past.

Banking developments in the Southeast and the nation signal that you will see more competition in all your markets. Since no one has solved the problem of business

cycles yet, you should also be receiving signals that you will continue to see a cycical real estate industry and the more opportunities than you want to take interest rate risks. Both of these signals should tell you that you have a hard row to hoe if you continue to combine your traditional activities in the traditional ways. You should consider ways to diversify in order to avoid macro-economic risks. Diversification can also help to avoid interest rate risks. If diversification to match maturities on the balance sheet does not suit you, better hedge your risks off the balance sheet.

One type of real estate with which you are not likely to become familiar in the near term is the rose garden. Your competitors and the economy will not allow that to happen. But you now have a lot more ability to control your own destiny than you did even as late as 1980. You may diversify, you may avoid interest rate risk either on the balance sheet or off it, you may use your real estate skills in new and different ways. I urge you to take advantage of your opportunities because you and your industry have long served the public of this country well, and you have the skills to continue to do so.