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ROLE OF SMALL BANKS IN THE SAVINGS AND TIME DEPOSIT BUSINESS

Address of M. Monroe Kimbrel, President of The American Bankers Association, before the Luncheon Session of the 60th National Savings Conference Sponsored by the A.B.A. Savings Division, Hotel Roosevelt, New York, Monday, March 4, 1963. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Ga.

Before turning to my assigned subject, I would like to comment briefly on the progress of the Centennial program. As you know, last Monday was Feb. 25--the 100th anniversary of the signing of the National Currency Act. To observe the date and to get the Centennial activities under way, The American Bankers Association sponsored A Symposium on Economic Growth in Washington, D. C. The President of the United States participated in the program and I am sure that many of you either read about it in the newspapers or saw portions of his address on TV.

The President also signed a proclamation designating 1963 as the Centennial year. In the proclamation he requested "the people of the United States to join with Federal and State authorities and representatives of the banking industry in activities and ceremonies designed to pay tribute to the contribution which commercial banking has made to economic, social, and cultural lives of the people of this Nation."

Governors in many states have also issued proclamations officially recognizing the Centennial of the dual banking system. Last Wednesday, for example, it was my privilege to participate in a ceremony during which Governor Sanders read a proclamation before a joint session of the Georgia General Assembly.

Requests for the Centennial book, "Financing American Enterprise--The Story of Commercial Banking," are coming into the A.B.A. office at a brisk clip. Orders for the brief giveaway booklet, "How Banks Serve," are approaching the 300,000 mark.

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Many banks across the country have launched their own Centennial programs with Centennial themes incorporated into their advertising, in addition to special events tied into the Centennial.

It would take too long to enumerate the variety of activities banks have planned for the Centennial, but I do want to report that the observance is being widely supported and that if the present pace continues, 1963 will long be remembered as a high point in the history of banking. I hope you will continue to sponsor programs designed to show the vital role banks play in the process of economic growth.

This interest in economic growth was effectively highlighted by the symposium and, I hope, will be sustained at regional and state meetings patterned after the one in Washington. Economic growth is indeed a broad and complex subject. Dr. Gabriel Hauge, president-elect of Manufacturers Hanover Trust Company, and a moderator at the symposium, underscored that point when he was faced with the gigantic task of attempting to sum up what had been said during the day. Dr. Hauge said it was somewhat like Columbus discovering America. When he set out, he didn't know where he was going; when he arrived, he didn't know where he was; and when he left, he thought he had been someplace else.

I wouldn't attempt to summarize the symposium. However, as I listened to an address by Professor Paul W. McCracken of the University of Michigan, I couldn't help but wish that everyone who is responsible for savings services could have heard it.

Professor McCracken, who was a member of President Eisenhower's Council of Economic Advisers, made several points which have a direct bearing on the savings business.

Two of his points should be reassuring to some skeptics who think saving might be going out of style. We have all witnessed the tremendous increase in the

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disposable income of the American people. Some people have the impression that as more Americans buy the things they need, the total demand will decrease. Professor McCracken says this is not so. He referred to a study of the aspirations of people in five countries of widely disparate living standards. He said, "Americans are just as eager to improve further their standard of living as people in less affluent countries. . . . Moreover, within the United States, people in middle- and upper-income ranges are just as concerned about improving their levels of living as those with lower incomes . . . research has also established that each rise in people's levels of living, far from satisfying wants, actually generates aspirations to move further up the scale."

I believe these findings should indicate two things to bankers. First, these desires in many cases will be realized through savings. And the millions of people who develop the savings habit to reach specific goals or obtain specific items will continue to save when that first objective is reached. Secondly, the propensity to acquire material things is built into our system and one of the best ways to acquire these things is to save. This basic drive assures a stable foundation for the savings business.

On capital formation, Professor McCracken said our total reproducible wealth is now about \$1,700 billion--or about \$3 of investment for each dollar of current output. He said, "if the decade ahead is to be one of average economic progress, we shall have to add to this stock of wealth or capital another \$700 billion by 1973, in addition to that required for restoring the capital that expires each year."

This capital must come largely from savings. It will come from corporate savings in the form of retained earnings. It will come from equity markets taking the savings of investors, and it will come from bank loans. In the absence of significant demand-deposit growth, banks will be able to meet an expanding volume of loan demand only by attracting a larger flow of time and savings deposits.

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Now, after this rather long digression, I will turn to my assigned topic--time and savings business problems and prospects for small banks.

Let me start this discussion with a reverse twist by concluding at the outset that it is impossible to set up a single program that would be helpful and meaningful for all small banks. Too many variables are involved.

For example, last year saw a remarkable increase in time and savings deposits in commercial banks. Apparently, the increase was experienced by almost all banks. But let's look a little further. In the Sixth Federal Reserve District (the Atlanta district)--and I might add this is probably true across the nation--there was a wide range of fluctuations in savings and time deposits in small banks. For the first nine months of 1962, banks with less than \$5 million in deposits showed these results: 10 per cent of these small banks reported actual declines in time deposits; about one-fourth of such banks had gains of between zero and 9 per cent, one-third had gains of between 10 and 19 per cent, and about three-tenths had gains of 20 per cent or more.

Although these results defy generalizations, we can examine some of the factors that influenced the wide variations. In doing so, we can establish a check list for each of our banks to consider in relation to our own performance.

The starting point for any bank--regardless of size--is carefully considering the competition for savings and earning assets in the market area served by the bank.

First, let us examine one of the factors influencing the cost of our deposits--the rate paid on savings deposits. If we want to be purely theoretical, we can state that banks can earn maximum profits on savings and time deposits by raising savings rates to a point at which the cost of pulling in the last dollar of savings funds is just equal to the added revenue which can be earned on that dollar.

This is theoretical and is very simple to diagram on a piece of paper by charting costs and revenues. However, measuring the factors involved is an entirely different matter.

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It is obvious that when we consider an increased rate we should attempt to make the best judgment possible on the amount of increased deposits. This will require that we examine several factors, such as the level and distribution of income in the area we serve. It will require an accurate appraisal of the inclination of the people to save. It will require an understanding of the people's preference for time deposits as compared with other financial assets. Then, too, we must consider the degree of competition from other banks and nonbank financial institutions in the area. Finally, we must consider the size of the rate increase. The more dramatic the hike in rates, the more deposits we should attract.

To examine these factors alone, however, is to ignore a major consideration. That is the increased cost of maintaining present deposits that goes along with the costs involved in attracting new savings. When we analyze the cost, we must calculate the entire cost.

For example, if a bank had \$2 million in time deposits for which it paid 3 per cent interest, the cost would be \$60,000. If the rate were raised to  $3\frac{1}{2}$  per cent and deposits rose 20 per cent, or to \$2.4 million, interest costs would be \$84,000. The increase of \$400,000 in time deposits would cost \$24,000. From this we can see that each new dollar of time deposits would cost six cents.

Still another factor we must weigh in attracting time deposits is where the deposits will come from. If a large portion of the gain is simply a transfer from demand deposits, then earnings assets would increase only by the amount of excess reserves released. If reserves for demand deposits are 11 per cent and reserves for time deposits are 4 per cent, a transfer of \$100 from demand to time deposits produces excess reserves of \$7. Naturally, if the deposits come from outside your bank, the potential for expanding your earnings assets is substantially larger.

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So far we have mentioned only the factors to be considered on the input side--the attraction of time deposits. Let's take a closer look at the other side--increasing earning assets.

The first consideration should be the strength and nature of the loan demand in the bank's market area plus the general level of interest rates on loans and investments. It is just common sense to figure out in advance what we can do with the additional deposits when we get them.

In many cases a new approach on the part of management is required. If management is not willing to acquire higher-yielding assets and does not go after them in an aggressive manner, it will be faced with increased costs, constant revenues, and declining profits--a formula for stagnation.

Two areas where banks have started to compete more vigorously are the fields of consumer credit and real estate credit. This again defies categorical analysis. In my home state of Georgia during the first nine months of 1962, expansion of real estate loans was equal to about half of the increase in time deposits. But the Federal Reserve Bank of Atlanta reported that in Florida expansion of real estate loans accounted for only 9 per cent of the increase in time deposits.

Fortunately, during much of 1962, economic activity expanded and generally created a demand for loans. Small banks responded by expanding loans. It was also fortunate that interest rate levels held up relatively well. Banks boosted earnings by acquiring state and local Government bonds, longer-term Governments and other securities in addition to expanding higher-yielding loans.

But these conditions are bound to change. They will change on a national level and the variations of change in areas will continue to be felt. For this reason I would be reluctant to set up strict guidelines for small banks to follow in their time and savings business.

Yet, given these circumstances and admitting the variables, I cannot refrain from making a few broad statements about the role of time deposits in small

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banks. To start with, most of the small banks are rural banks. Their customers are engaged in agriculture or agriculturally related business. As you know, the credit demands of agriculture have been rising while the number of farms is decreasing. The larger farms that remain are being run as businesses are run. These farmers know the advantages of sound credit programs. At the same time they--like all businessmen--do not keep their demand deposits any higher than they have to.

This puts the country banker in an awkward situation. While his loan demand is increasing, his demand deposit base is not keeping pace. If he does not compete, and compete effectively for time deposits, he will see more and more of the local credit demands going to city banks or nonbank lenders.

The small banks can--and most of them now do--work closely with correspondent banks in handling large loans. The small bank can also develop a working relationship with a correspondent bank so that the large correspondent bank purchases loans from the small bank when seasonal volume becomes very heavy. But these arrangements will not be a good long-run solution if the small bank permits itself to accept a smaller and smaller role in servicing local needs.

On previous occasions, I have said that new meaning is being injected into the word competition. Every business in the country is facing higher costs and is fighting hard to try to maintain profit margins. Banks are feeling the competition perhaps more than many other industries. I believe this is good for banking. Competition not only brings to the surface our weaknesses but also confirms our strong points. Competition has provided a driving force for progress in banking in the past. It will exert the same pressure in the future. We cannot ignore it--it is an integral part of our system. We cannot change it--for that would mean changing our economic system. We cannot eliminate it--it's ingrained in human nature. We can and should recognize it, adjust to it and make it work for us.