New England BUSINESS REVIEW

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Interest Rates Paid on Savings

On December 1, 1961 the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation announced that insured commercial banks would be allowed to pay up to 4 percent annually on savings and other time deposits held for a year or more. This action forced bankers to make a difficult decision. On the one hand, this ruling has enabled commercial banks to compete more effectively in the rapidly growing area of savings and other time deposits. These deposits of commercial banks have almost tripled in the Nation since the end of World War II, while demand deposits have risen only about 50 percent; in New England, the rises have been much smaller — 60 percent for time deposits and 25 percent for demand deposits. On the other hand, this rise in interest cost can add substantially to bank operating expenses.

In January and February of this year the Boston Federal Reserve Bank surveyed commercial banks and other savings institutions concerning their reaction to this higher allowable interest rate. Among commercial banks, 45 percent either have already raised their savings rate or intend to by the next interest rate period. Among other savings institutions, few have as yet taken any action. Whether a commercial bank raised its rate seemed to depend largely on the competitive situation among

(Continued on page 2)

commercial banks in its area. The intensity of this competition was generally greater where commercial banks had a high proportion of time to total deposits.

Those banks and institutions that commented on the action taken by the supervisory authorities were divided in their attitudes. More commercial banks favored than opposed the action, but among other savings institutions, the majority commenting were opposed.

Over-all Survey Results

About one-third of all commercial banks in the Boston Federal Reserve District by February had raised their rates on savings deposits as shown in the table on the next page. (Other time deposits including certificates of deposits comprise less than 15 percent of total time deposits in the region. The discussion here will refer only to savings deposits.) But among heavy savings deposit banks, banks with more than one-fourth of their total deposits in the time department, 44 percent had raised their rates while only 14 percent of the light savings deposit banks raised their rates. An additional 11 percent of the banks intended to raise their rates within the next interest rate period. All but 1 percent of the banks which raised their rates were previously paying the former maximum rate of 3 percent.

At present about one-half of both heavy and light savings deposit banks in the area are paying a maximum of 3 percent on their savings deposits. But 43 percent of the heavy savings banks are paying a maximum above 3 percent, while only 13 percent of the light savings banks are in this range.

The reaction of banks in the Nation as a whole was slightly different than that of banks in this District. A greater share of banks in the Nation, 49 percent, raised their rates. Also, as opposed to this District, rises were more frequent in the Nation among banks with a low proportion of savings deposits than among heavy savings banks, and more frequent among large than small banks.

Considerations in Rate Decisions

Banks were faced with making an important decision when the allowable maximum rate on savings deposits was raised. If they decided to go to the new maximum rate, over a period of time this would add substantially to their costs. According to data obtained in the Functional Cost Study conducted by the Federal Reserve Bank of Boston, a typical bank with $10 million in deposits and one-half of its total deposits on the time side would have an increase of up to $40,000 in its costs with an additional 1 percent paid on savings deposits. Since this bank's earnings before taxes were about $140,000 in 1960, it can be seen that the decision is an important one.

In view of the cost of a rise in interest paid on time deposits, why did so many banks raise their rates? In most of these cases, the probable alternative to raising rates was a reduction in the volume of time deposits held. As noted earlier, most banks that raised their rates have over a quarter of their deposits in time form, so one of their major functions is to accept and invest savings and other time deposits. If they no longer could compete effectively for these deposits, the prospect was for a reduction in bank size.

With persuasive arguments both for and against raising rates on savings deposits, it is not surprising that heavy savings deposit banks in the First District were split about evenly (55 percent did not raise rates and 45 percent did). The specific factors which led to decisions to raise in some cases, but not in others naturally varied from area to area. But there seem to be some common characteristics among the areas where raises were predominant, and most of these characteristics affect the degree of competition for savings deposits. First, all or most commercial banks in such an area are heavy time banks. A second closely related characteristic is that these are generally small cities or towns which have fewer savings banks than large city areas, and commercial banks consequently have a stronger tradition of competing for savings deposits. (In some smaller town areas, however, there is intense competition between a savings bank and commercial banks, and here the commercial banks raised their rates as soon as allowed to remain competitive at the higher level of rates which have evolved within the past year or two.) Third, branch banking has expanded in many of these areas, and the opening or threat of a new branch in an area where unit banks exist, tends to generate above-average competition.

The different attitudes toward raising rates is also evident in the speed with which banks made their decisions. Some banks' boards of directors met on Saturday, the day after the announcement of the increased maximum, to vote higher rates. Other banks waited until the competitive pattern for the area became clear before making a decision. Some banks are still undecided, and judging from the reaction to the 3 percent ceiling set on Jaunary 1, 1957, it is likely that more banks will eventually raise their rates.

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation increased the maximum permissible rates of interest payable by member and insured nonmember banks on savings deposits and certain time deposits, effective January 1, 1962.

Commercial banks are now permitted to pay up to 3½ percent on all savings deposits, and on time deposits and certificates of at least six months' term, and up to 4 percent on deposits which have been in the banks for one year or more. The old maximum rate was 3 percent.

Bank Adjustments to Higher Rates

Most banks will have to adjust operating policies to meet the increased costs of the higher rates. (An article describing this problem appeared in the *New England Business Review* for December, 1961.) An obvious action will be to acquire loans and investments which yield a higher return. Some bankers feel confident that they can cover the increased costs by switching out of lower-yielding bonds into mortgage loans and consumer instalment loans. Another switch which is often mentioned is from taxable bonds to tax-exempt state and municipal bonds.

Several bankers said that with the higher rates they will be able to gain time deposits which formerly went out of their region. With these increased funds they can acquire additional mortgage and consumer instalment loans. Thus, they feel they can not only pay the higher rate but they can also better service the loan needs of their communities.

Banks will also be forced to give added attention to reducing costs through more efficient organization of operating methods. Studies of costs of bank functions show that there are wide variations in the efficiencies with which various bank functions are performed.

Bankers will also give thought to utilizing their cash reserves more intensively. In some cases there is opportunity to pare down the average level of excess reserves and bank balances.

Some banks that raised rates will pay the new maximum only on special accounts. In this way they hope to differentiate between savers who want the high rate and those who were satisfied with the old rate.

Impact on Other Savings Institutions

Among the 460 other savings institutions surveyed — 293 savings banks, 58 savings and loan associations, and 109 cooperative banks — almost a quarter said they intended to raise their rates on savings deposits. Almost all those intending to raise rates have been paying less than 4 percent on regular savings.

At present, most of the other savings institutions, 60 percent, are paying a rate of 4 percent on regular savings. Only 2 percent of the total are paying over 4 percent on regular savings, 28 percent are at 3¾ percent, while 10 percent are at 3½ percent. Only two institutions out of the entire group surveyed are paying less than 3½ percent.

Banker Attitudes

One of the reasons often advanced in opposition to raising the maximum interest rate on time deposits was that this would be taken to mean that commercial banks should pay the new maximum and that they were able to do so. To determine how widely bankers held this opinion, the following question was asked in the survey: "Do you consider that the action of the Board in raising the permissive maximum to 4 percent suggests that this rate can be paid with safety or should be paid by all commercial banks?" About 1 out of 8 bankers answered yes to this question, about half as many did not respond or said they did not know, while the remainder, over 80 percent, answered no. Yes answers were somewhat more frequent among banks that were raising rates than among banks which were not.

This question was followed by a request for any comment the banker wished to make on the Board's action and the general competitive situation. About one-fourth of the commercial banks made comments, with 41 favoring the action and 32 opposed. Among other savings institutions, however, the unfavorable comments exceeded the favorable ones by 30 to 5.

With bankers both favoring and opposing the rate rise, the comments were quite varied and interesting. Among them were the following:

> Incredible as it may seem, it appears that many banks would have to say yes to the question if answered truthfully. However, even more harmful is the public reaction, as the great majority of the general public seem to fully believe in an affirmative answer to the question.
>
> As we do not believe in direct control of interest rates, the Board's action is in the right direction which need not result in impairment of safety.
>
> This was the wrong action to take in view of the U.S. Government policy of trying to keep long-term rates down and short-term rates up. Savings money should go in long-term mortgages and not in short-term commercial loans.
>
> What a mess! Agree with Federal Reserve Chairman Martin that Regulation Q should be lifted completely.

INTEREST RATES ON SAVINGS DEPOSITS (EARLY 1962) COMMERCIAL BANKS, DISTRICT I

	Total (percent)	Banks with Savings and Other Time Deposits: Less than ¼ total Deposits (percent)	More than ¼ total Deposits (percent)
Banks raising rate in 1962	34	14	44
Banks intending to raise rate soon	11	12	11
Present rates:			
Below 3 percent	14	28	8
3 percent	52	59	49
3½ percent	15	7	18
4 percent	19	6	25

We have not forgotten the bank holiday in the late 20's. Some trouble was caused at that time by some banks paying excessive rates on their time deposits.

If a bank's cost says no and due to competition the bank is losing accounts, then the situation, in spite of a bank's cost, demands that the answer be yes. A bank's existence depends on depositors.

Will all this increasing of rates boomerang due to bank's searching for investment and force the mortgage interest rates down rather than up?

Time will tell the final answer as to earnings by banking institutions. Shades of 1933 — !

Variations in Local Rate Patterns

Shown in the map on page 5 are the proportions of commercial banks in various localities which pay a maximum on regular savings of over 3 percent, 3 percent and less than 3 percent. The local rate patterns vary widely, with over three-fourths of commercial banks in Vermont paying above 3 percent while fewer than 1 in 10 Massachusetts banks does so.

Vermont exhibited the most intense competition among commercial banks for savings and time deposits. Thirty-seven out of the 45 banks which reported in the survey had raised their rates or intended to do so within the next interest rate period.

Almost all commercial banks in Vermont are heavy time banks which naturally intensifies the competition for time deposits. Vermont has only six mutual savings banks and it is the only New England state where commercial bank time deposits exceed mutual savings deposits.

While Vermont had the highest proportion of commercial banks going up on the savings rate, it did not have its highest proportion going to a 4 percent maximum. Only 29 percent presently have a 4 percent while 47 percent went to 3½ percent. Most other savings institutions in Vermont presently have a 3¾ percent rate on regular savings so a 3½ percent rate by commercial banks is competitive. The banks going to 4 percent probably would be classified as competitive leaders.

A special feature of commercial banking in Vermont is the extension of branch banking. There is one large branching system in the southern half and two in the northern half with especially keen competition between the latter two.

New Hampshire had the next highest proportion of banks raising rates and the highest proportion going to 4 percent. The competition for savings deposits has been led in general by savings banks which average the highest rates paid by mutual savings banks in New England. Most commercial banks, nevertheless, are heavy time banks, and 53 percent have already gone to a maximum of 4 percent, which tends to equalize their competitive position relative to savings banks.

Maine had a rather varied rate pattern. Almost three-fourths of the commercial banks in the Augusta area are at 4 percent while no commercial banks in the Aroostook and Bangor area are above 3. The Augusta area has a heavy concentration of savings banks and savings and loan associations and the commercial banks were following their rate lead. The Portland area also has many savings banks and savings and loan associations but few of the commercial banks raised their rates to their level.

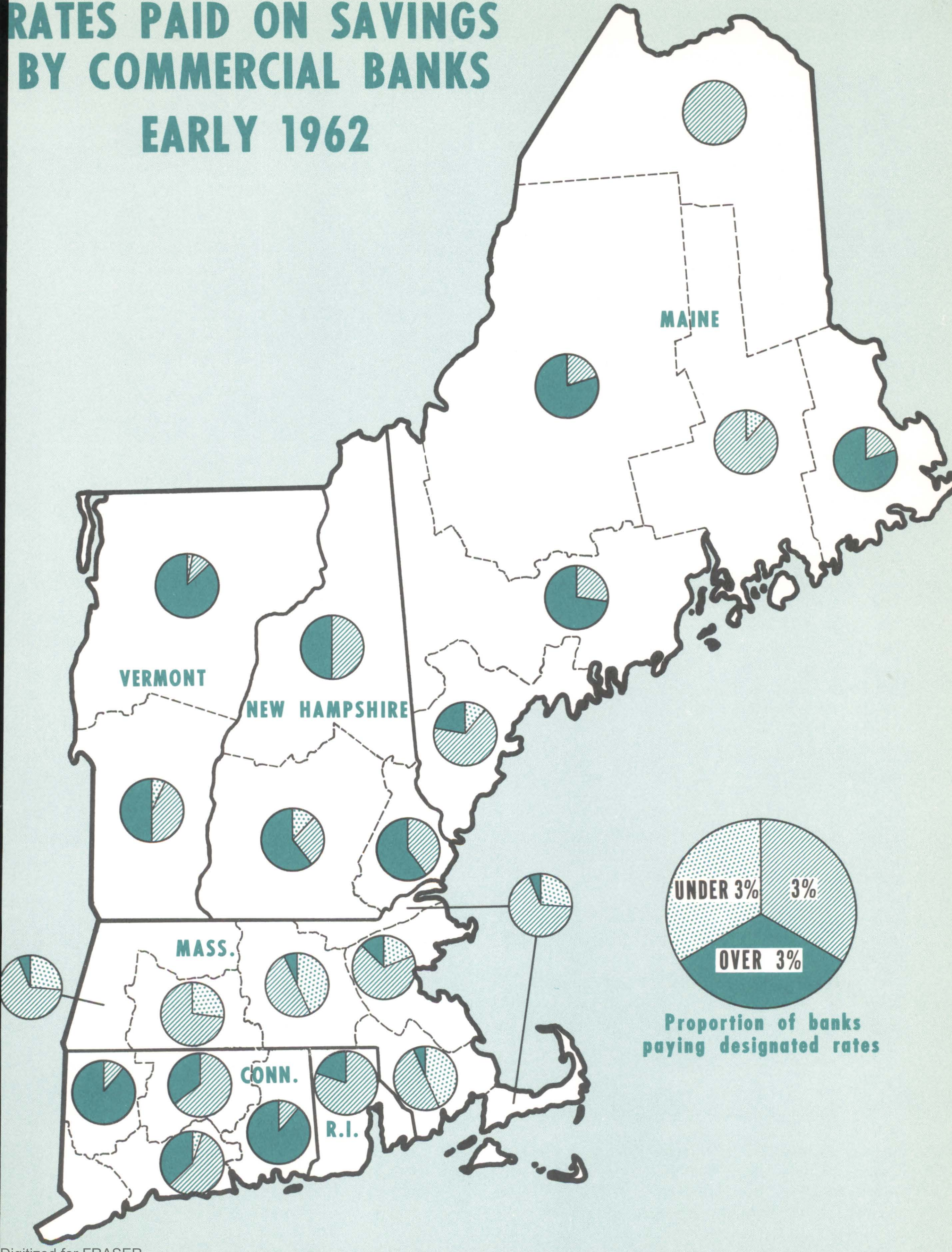
Massachusetts has the lowest proportion of commercial banks paying above 3 percent. Savings banks dominate the savings field, with the ratio of savings bank deposits to commercial bank time deposits being 6 to 1. Even many of the smaller towns have a savings bank. Commercial banks have generally not competed actively for time deposits in the past but some change may be occurring now. Loan-deposit ratios of most Massachusetts commercial banks are high so unless they can increase their deposits, their lending ability will be curtailed.

Rhode Island has few commercial banks. The state is dominated by two large branching systems which did not raise their savings rates above the previous maximum of 3 percent.

Connecticut has a competitive situation somewhat like that of Vermont since state-wide branching is permitted. There are many more savings banks than in Vermont, however. The savings banks tend to dominate the savings field in the large cities but commercial bank time deposits are substantial in the smaller towns. Commercial banks compete actively for savings in these smaller towns, and the presence of a branch bank here tends to make the entire system raise its rate which has repercussions in the larger cities such as Hartford and New Haven.

In conclusion, the rise in interest rates on savings and other time deposits appears to be an important factor on banking in the future. Overt competition among banks may become more intense than in the past several decades. Some banks will find profit positions narrowed, at least in the short run. As banks attempt to meet the higher costs, they may invest more heavily in the higher yielding mortgage loans and long-term bonds. Supervisory authorities may have greater need for watchfulness as to the quality of bank loans and investments. One possible result is some reduction in mortgage rates and long-term bond yields, and, perhaps, a tendency for short-term rates to rise.

RATES PAID ON SAVINGS BY COMMERCIAL BANKS EARLY 1962



SOURCE: FEDERAL RESERVE BANK OF BOSTON

Reduced Unemployment in Business Recovery

Unemployment has declined in New England this winter, reflecting the general improvement which the region as well as the Nation has experienced. By December there were nearly a third fewer jobless workers than during the February 1961 trough of the business cycle. In January unemployment was down 14 percent from January 1961.

The gradual contraction in the pool of unemployed was temporarily interrupted in the closing weeks of 1961 and early 1962 by the usual winter season curtailment in construction and other outdoor activities and by post-holiday layoffs in trade and post office employment. The prospects early this year were for further reduction in the number of unemployed workers in contrast to swelling unemployment in the early months of last year.

The general improvement in unemployment in the region has been underway since the spring of last year, but it was not until November that unemployment fell below the year-earlier level. Comparisons with year-earlier levels have continued to be favorable since that time.

Not only has the number of jobseekers in New England declined from a cyclical high of about 360,500 in February of last year to nearly 293,000 in January, but the proportion of idle workers in the work force has also decreased. In February 1961, about 8.2 percent of the work force was unemployed in the region. By January 1962, the proportion had fallen to 6.6 percent even though there were 19,000 more people available for work than when the recession was most severe.

Recovery has resulted in unemployment declines in most of the region's 17 major labor market areas. In March 1961, unemployment of more than 9 percent of the work force was reported in five areas, but in December, for the first time since the end of 1960, none of the major areas in the region were in this category. Reflecting a better job situation, the number of areas with an unemployment rate of less than 6 percent increased from 4 to 7 in the same period. Early in 1962, unemployment again rose above the 9 percent level in four areas, largely as a result of seasonal layoffs in construction and manufacturing. All of the areas are located in Massachusetts and have suffered from large labor surpluses for many years.

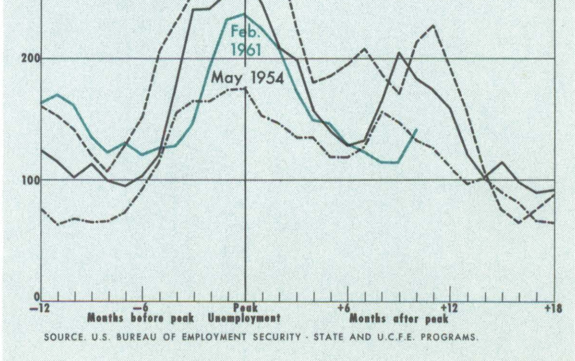
Insured Unemployment Declined Sharply

Insured unemployment in the region has declined even more strikingly than has total joblessness. Between February and December, insured unemployment decreased by 48 percent. While weekly totals of continued claims were well above year-ago levels in the first half of 1961, the disparity narrowed fairly rapidly after midyear and since early September there have been fewer workers collecting benefits than in the comparable year-earlier weeks.

Total unemployment is the most complete measure of unemployment, but it does not provide as current data as the unemployment insurance claims information. In late February insured unemployment was nearly 30 percent less than a year earlier. The strong cyclical forces have somewhat lessened the normal seasonal rise this winter in claims.

The chart below compares the current expansion with recoveries from previous postwar recessions. It is evident that the most recent recession was less severe in its effects on unemployment in New England than either the 1949 or 1958 recessions. The volume of insured unemployment was higher in these recessions, even though the work force was smaller and insurance programs had narrower coverage. Unemployment also returned more quickly to its prerecession low in 1961 than was the experience in earlier postwar recoveries.

The 1954 recession appears to have been less severe than the 1960-1961 downturn. The volume of insured unemployment was higher in the later recession, as well as the percent of insured unemployment to the total work force covered by insurance. In the 1961 trough this percentage was 7.5 percent, while it reached only 6.1 percent in the 1954 recession.



SOURCE. U.S. BUREAU OF EMPLOYMENT SECURITY - STATE AND U.C.F.E. PROGRAMS.

Pressures on Bank Earnings in 1961

MEMBER BANKS EARNINGS AND EXPENSES

(Amounts in Thousands of Dollars)

	Boston		Other First Dist. Banks	
	1961	Percent Change from 1960	1961	Percent Change from 1960
Earnings	**150,891**	**+ 1.2**	**287,966**	**+ 2.5**
Interest on bonds and stocks	22,479	+ 5.3	55,051	— 0.3
Interest on discounts and loans	92,240	— 0.7	182,421	+ 5.3
Service charges on deposit accounts	4,049	+ 3.3	24,210	+ 6.3
Trust department	20,636	+ 6.0	19,072	+ 6.7
All other income	11,487	+ 0.6	7,212	—39.4
Expenses	**79,591**	**+ 6.8**	**195,839**	**+ 3.7**
Salaries and wages	41,718	+ 4.3	83,263	+ 1.9
Interest paid on time	6,988	+42.9	40,107	+ 6.3
All other expenses	30,885	+ 4.3	72,469	+ 4.3
Net Current Earnings	**71,300**	**— 4.4**	**92,127**	**—**
Non-current transactions	—1,652	—	—8,631	—
Profit before Income Tax	69,648	+ 0.2	83,496	+ 5.0
Taxes on income	36,943	— 1.7	36,259	+11.2
Net Profits	**32,705**	**+ 2.5**	**47,237**	**+ 0.6**
Cash dividends	17,415	+ 3.5	24,223	+16.2

Despite downward pressures on interest rates and upward pressures on operating expenses throughout 1961, bank earnings were maintained close to 1960 levels.

Although current expenses of both country and city banks rose faster than earnings, the experience of Boston banks and other First District banks differed. Smaller cost increases and slightly better earnings enabled the other First District banks to match their net current earnings of the previous year, while those of Boston banks declined by 4.4 percent.

The condition statements of member banks of District I indicate the largest increase in total assets in more than 10 years. This over-all growth in earning assets contributed to the stabilization and slight rise of current gross operating earnings.

Changes in the growth structure of individual assets also had an influence on earnings. Boston banks invested in securities to a greater extent in 1961, having relatively less growth in loans. Consequently, while investment income rose, loan income decreased slightly. Just the opposite relationship prevailed in the other First District banks, where there was an increase of 7.1 percent in loans and discounts, which is the primary source of bank earnings and which had a 5.3 percent increase in income. The comparatively stronger growth in loans was a major factor in the increase of 2.5 percent in their gross operating earnings.

Banks outside Boston increased their demand deposits by 6.8 percent and time deposits by 5.8 percent. Boston banks' demand deposits rose 3.5 percent while their time deposits increased 46.3 percent. However, the Boston banks have a smaller proportion of time deposits than do the outside banks, which also have a greater proportion of "regular savings" than "other time deposits". Furthermore, the Boston banks' time deposits have not been stable, suggesting unusual sensitivity to interest rates. The price paid for the year's addition to these deposits involved a 42.9 percent increase in interest costs.

Several secondary sources of income, although of lesser importance in terms of absolute magnitudes, have been relatively more stable income providers than loans and investments. For example, in the Boston banks, trust department earnings were the other major source of earnings in 1961. The growth in the trust department income since 1955 has not been less than 5 percent nor greater than 14.5 percent in any one year. The same cannot be said for loan earnings, which have had year-to-year variations ranging from −3.8 percent to +29.6 percent.

At outside banks, trust department earnings were also relatively stable and increasing, although not yielding quite the volume of income as service charges on deposit accounts.

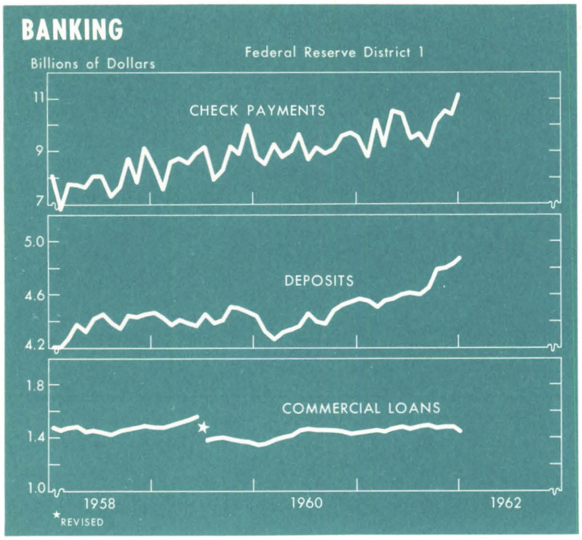
Dividends

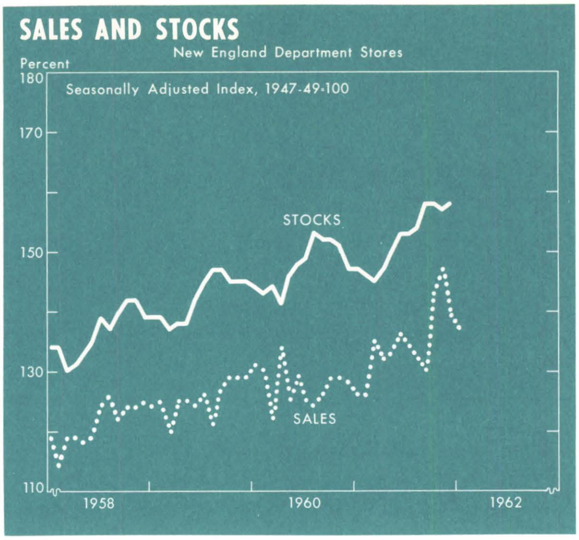
Cash dividends disbursed increased 3.5 percent in Boston and 16.2 percent in other First District banks. The dividends of banks outside Boston occurred with a current net profits increase of only 0.6 percent, indicating the dividends may have been delayed from 1960 earnings. In that year net profits increased 38.0 percent while dividends increased only 0.6 percent.

MEMBER BANKS STATEMENT OF CONDITION

(Amounts in Thousands of Dollars)

	Boston		Other First Dist. Banks	
	Dec. 31, 1961	Percent Change from Dec. 31, 1960	Dec. 31, 1961	Percent Change from Dec. 31, 1960
Total Assets	3,476,326	+ 7.1	6,446,256	+ 6.4
Total reserves, cash and balances	**846,972**	**+ 7.3**	**1,185,013**	**+ 5.4**
Total investments	**843,569**	**+10.6**	**2,034,632**	**+ 6.1**
U.S. securities	699,165	+10.3	1,469,204	+ 4.8
Other securities	144,404	+11.9	565,428	+ 9.4
Total loans and discounts	**1,679,736**	**+ 4.6**	**3,103,773**	**+ 7.1**
Commercial and industrial loans	944,309	+ 2.0	1,068,679	+ 8.6
Real estate loans	137,280	+ 5.4	840,695	+ 6.0
Other loans to individuals	326,437	+ 2.7	966,626	+ 7.4
All other loans	314,321	+15.7	294,236	+ 4.4
Reserves for bad debt losses	42,611	+ 5.6	66,463	+ 8.7
All other assets	**106,049**	**+19.8**	**122,838**	**+ 5.7**
Total liabilities and capital accounts	3,476,326	+ 7.1	6,446,256	+ 6.4
Liabilities	**3,125,293**	**+ 7.4**	**5,907,667**	**+ 6.5**
Demand deposits	2,659,722	+ 3.5	4,085,254	+ 6.8
Time deposits	338,086	+46.3	1,557,661	+ 5.8
All other liabilities	127,485	+15.2	264,752	+ 7.2
Capital accounts	**351,033**	**+ 4.5**	**538,589**	**+ 5.4**





MANUFACTURING INDEXES (seasonally adjusted)	MASSACHUSETTS (1950–52 = 100) Jan. '62	Dec. '61	Jan. '61	NEW ENGLAND (1950–52 = 100) Jan. '62	Dec. '61	Jan. '61	UNITED STATES (1957 = 100) Jan. '62	Dec. '61	Jan. '61
All Manufacturing	120	122	111	124	125	113	114	115	101
Primary Metals	109	117	96	113	107	86	102	100	71
Textiles	47	50	44	68	71	64	n.a.	119	98
Shoes and leather	114	127	128	123	131	127	n.a.	n.a.	97
Paper	114	118	103	124	128	119	n.a.	125	111

Seasonal adjustment revised for Massachusetts and New England. 1961 data available on request.

	NEW ENGLAND Jan. '62	Percent Change from: Dec. '61	Jan. '61	UNITED STATES Jan. '62	Percent Change from: Dec. '61	Jan. '61
BANKING AND CREDIT						
Commercial and Industrial Loans ($ millions) (Weekly Reporting Member Banks)	1,456	— 2	+ 2	32,324	— 1	+ 3
Deposits ($ millions) (Weekly Reporting Member Banks)	4,884	+ 1	+ 7	122,341	0	+ 8
Check Payments ($ millions) (Selected Cities)	11,888	+ 8	+18	294,298	+ 3	+19
Consumer Installment Credit Outstanding (index, seas. adj. 1957 = 100)	118.8	— 1	0	126.6	0	+ 2
TRADE						
Department Store Sales (index, seas. adj. 1947–49 = 100)	137	— 2	+ 9	150e	— 4	+ 6
Department Store Stocks (index, seas. adj. 1947–49 = 100)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EMPLOYMENT, PRICES, MAN-HOURS & EARNINGS						
Nonagricultural Employment (thousands)	3,693	— 3	+ 2	53,735	— 3	+ 2
Insured Unemployment (thousands) (excl. R. R. and temporary programs)	179	+26	—24	2,524	+25	—23
Consumer Prices* (index, 1957-59 = 100)	105.7 (Mass.)	0	+ 2	104.5	0	0
Production-Worker Man-Hours (index, 1950 = 100)	87.8	— 2	+ 6	90.5	— 5	+ 2
Weekly Earnings in Manufacturing ($)	88.40 (Mass.)	— 1	+ 7	94.96	— 1	+ 7
OTHER INDICATORS						
Construction Contract Awards ($ thous.) 3-mos. moving averages Nov., Dec., Jan.)						
Total	140,470	— 9	+16	2,792,641	— 7	+ 4
Residential	55,609	—15	+27	1,206,960	— 8	+17
Public Works	27,353	+13	+53	540,212	— 6	— 5
Electrical Energy Production (index, seas. adj. 1957–59 = 100)	124	+ 1	+ 8	129	+ 2	+10
Business Failures (number)	77	+40	+35	1,447	+13	+ 3
New Business Incorporations (number)	1,116	+ 2	+41	18,343	+24	+12

*index changed from 1947-49 to 1957-59.

e = estimate

n.a. = not available