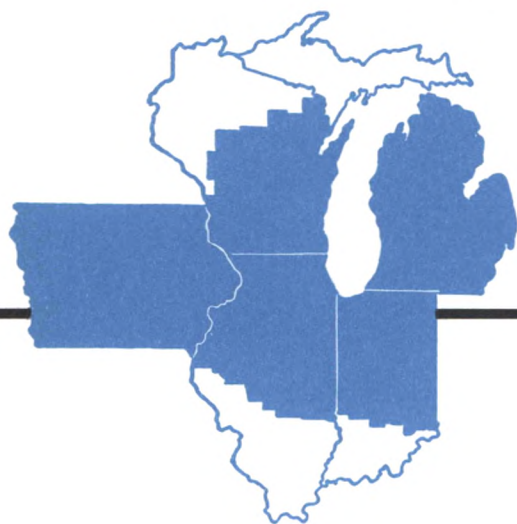


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1963 August



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BUSINESS CONDITIONS is published monthly by the Federal Reserve Bank of Chicago. George W. Cloos was primarily responsible for the article "The Trend of Business—four expansions compared," George G. Kaufman for "Trends in Banking and Finance—liquidity on the rise" and Allan R. Drebin, Assistant Professor of Accounting, University of California, for "Savings Accounts and Commercial Bank Earnings."

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THE Trend OF BUSINESS

Four expansions compared

The current business expansion is now two and one-half years old. The previous upswing which ended in mid-1960 already has been outdistanced, and most analysts believe the present movement retains sufficient vitality to justify an extended life expectancy.

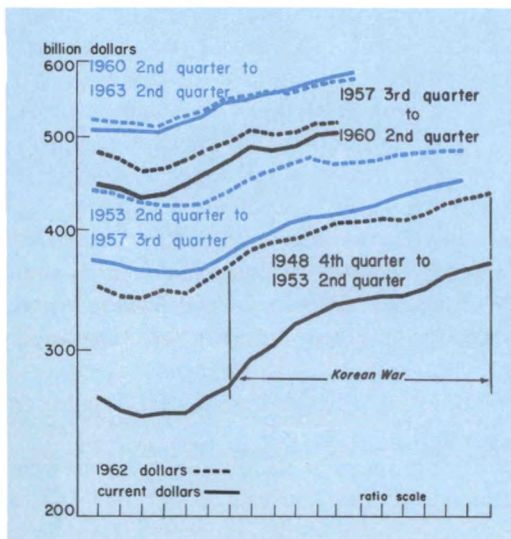
As in earlier postwar expansions, the one that began early in 1961 has been pronounced dead or moribund prematurely on more than one occasion. Such pronouncements were widespread last November. Three-fourths

of a group of business economists polled then by *Business Week* expected a recession of some degree in the first half of 1963. Instead, the leveling of activity apparent in the second half of last year gave way to a pronounced improvement in the current year as employment, industrial production and total spending on goods and services rose appreciably.

Information on economic developments in the second quarter of 1963 is now fairly complete. This was the ninth successive quarter of the expansion and marked the passage of three years from the 1960 peak in activity. This three-year span is sufficiently long to permit a comparison in broad perspective with changes in activity in earlier postwar business cycles.

The various postwar business expansions commonly are compared by measuring changes over similar time periods starting from the low points, or troughs, of the recessions that preceded recoveries. Although this approach is useful for some purposes, it clearly tends to "penalize" expansions that develop from mild recessions. Partly for this reason the present expansion frequently has been described as the least "satisfactory" of the postwar period. But the aptness of this judgment is open to question. Obviously, a substantial and rapid rise from a seriously depressed base may leave the economy in a less satisfactory condition than a less vigorous

Gross national product



rise from a higher initial level.

A similar problem is encountered if the changes in economic activity are measured beginning with the peaks that preceded recessions. The picture will vary depending upon the nearness to full utilization of resources of men and materials at the time the various business contractions began.

This analysis compares the postwar cycles on the basis of the relative declines and advances registered during the three years after the peaks that preceded the recessions. In this light the present expansion compares favorably in most respects with those that developed from the troughs in 1954 and 1958, although it falls short of the upswing after the 1949 low, which carried into the Korean war.

Three years from the 1960 peak

Points of reference used here are the high watermarks of the successive postwar business cycles as determined by the level of gross national product—total spending on goods and services—in “constant dollars”, that is, adjusted for price changes.¹ The periods begin in the fourth quarter of 1948, second quarter of 1953, third quarter of 1957 and

¹The peaks in gross national product are in the same quarters regardless of whether current or constant dollars are used. The subsequent movements in the two series, however, differ substantially.

Change in major activity measures from same quarter three years earlier*

	Fourth quarter 1951	Second quarter 1956	Third quarter 1960	Second quarter 1963
	(per cent)			
Gross national product				
in constant dollars	16.7 (1)	6.9 (4)	7.0 (3)	10.4 (2)
Total industrial production	18.0 (1)	7.2 (3)	6.6 (4)	12.5 (2)
Total wage and salary employment	6.5 (1)	4.0 (2)	2.2 (4)	3.2 (3)
Unemployment	—9.3 (1)	70.0 (4)	35.8 (3)	12.9 (2)
Consumer price index	8.9 (4)	1.3 (1)	4.7 (3)	3.2 (2)
Wholesale price index	8.5 (4)	4.1 (3)	0.7 (2)	—0.7 (1)

*Numbers in parentheses indicate the rankings of the four cycles for each series.

second quarter of 1960. The accompanying charts show movements in this over-all measure of activity and also in industrial production, nonfarm wage and salary employment, unemployment and prices paid by consumers from these dates to the next peak just before activity began to decline once again.

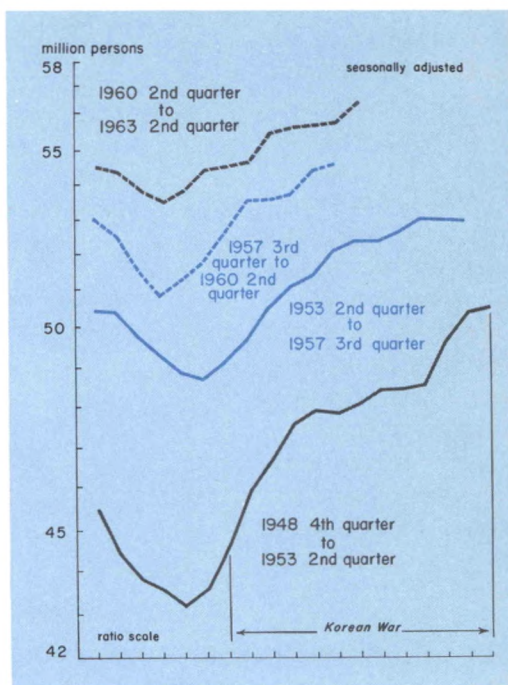
If the present period of rising activity were to equal that of the first two upswings, the current expansion would have a year or more to run. However, an indication of the relative strength of the expansion thus far can be obtained by comparing the changes in various measures of activity in comparable time spans in the four postwar cycles. In the above table, all data are adjusted for seasonal changes and monthly series are converted to quarterly averages.

The numbers in parentheses indicate the rankings of the four cycles in terms of the economic series used. The greater the rise in

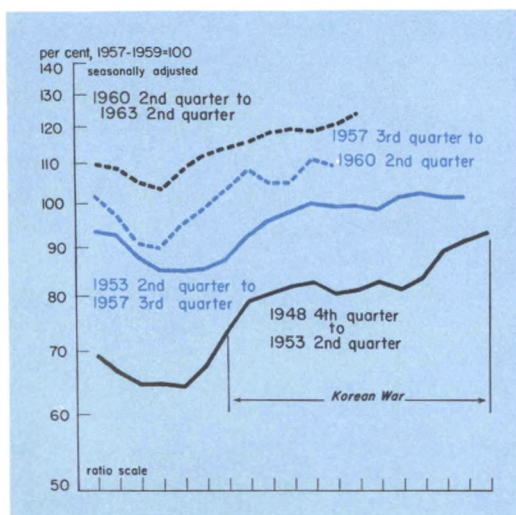
gross national product, industrial production and employment the higher the numerical rating. Conversely, the larger the amount of unemployment and the higher the price level at the end of the period, the lower the scoring of the expansion. This is because additional unemployment and higher prices are, of course, unfavorable developments.

The 1948-51 period easily stands as the most vigorous of the postwar expansions. The rise in employment was twice as great as in the most recent three-year period and the increase in output half again as much. It must be remembered, however, that during the second half of the earlier period the nation was engaged in active hostilities in Korea and a sizable rearmament program was under way. One of the unfavorable developments associated with this period was the 9 per cent rise in both wholesale and consumer prices. After mid-1950, moreover, the econ-

Employment in nonfarm establishments



Industrial production



omy was partially mobilized for war and extensive controls on prices, materials and credit were in effect.

The current expansion is markedly superior to each of the two immediately preceding ones—1953-56 and 1957-60—when evaluated on the basis of the increase in either total spending adjusted for price changes or industrial production relative to the previous cyclical peak. The rise in employment in the recent period was somewhat more than in 1957-60 but somewhat less than in 1953-56.

Despite a substantial improvement from the recession low, the United States unemployment rate averaged 5.8 per cent in the

second quarter of this year, compared with 5.3 per cent three years earlier at the 1960 cyclical peak.

Unemployment has been at successively higher plateaus in each postwar expansion. Moreover, the proportion of labor force unemployed stabilized relatively early in the current expansion and the number of job seekers nationally has been somewhat higher recently than a year ago. Unused productive facilities also have been relatively more significant at recent cyclical highs than earlier in the postwar period.

The 3.2 per cent rise in the consumer price index in the period ending in the second quarter of 1963 was less than in the earlier expansions, except 1953-56 when prices of foods, appliances and used cars declined as supplies became more abundant. From mid-1956 to the high point of the expansion in

1957, however, consumer prices rose 5 per cent.

Wholesale prices averaged lower in the second quarter than in the comparable period three years earlier. In the 1957-60 period there was only a slight rise. In the first two postwar cycles, however, wholesale prices increased substantially. As in the case of consumer prices, wholesale prices, led by prices of capital goods, continued to rise substantially after mid-1956 until well into 1957.

How much longer?

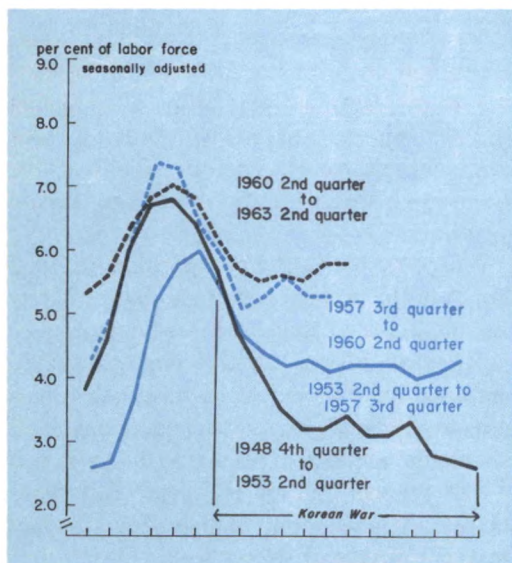
Some observers are suggesting again that the current upswing may be "getting tired." One reason for this view is that the expansion had continued for 28 months from the February 1961 low through June 1963, which compares with an average term of 30 months (only 26 months if cycles extended by wars are excluded) in 26 cycles during the period since 1854. But reasoning of this sort is of doubtful relevance.

Averages mean little when business cycles are compared, because peacetime expansions have endured from 10 to 50 months. Furthermore, the modern economy is profoundly changed from that of 100, 50, 25 or even 10 years ago. Momentous changes have occurred in governmental, financial and industrial institutions and in our economic relations with foreign nations.

There are several reasons for expecting the current expansion to continue for a substantial period of time. One of these is the maintenance of relative stability in prices of goods. During the past year prices of many commodities have been adjusted up or down, but no broad inflationary trend has developed that would make the economy vulnerable to a general price correction.

Capital expenditures, one of the most volatile sections of total spending have been

Unemployment rate



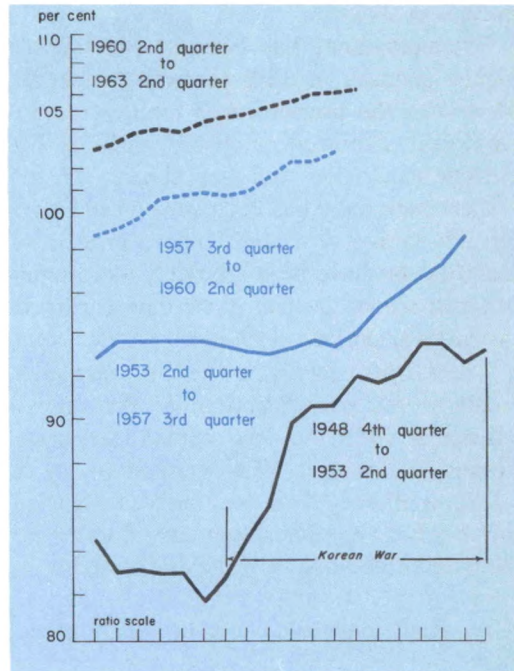
rising since the second quarter of 1961 at a relatively moderate pace and are expected to continue to increase at least through the remainder of the current year. Outlays on new plant and equipment are about 6.6 per cent of total spending today compared with 8.4 per cent in 1957 just prior to the decline that started in that year.

Inventory buildups have been associated with most of the cycles in the past. In the present expansion the rise in inventories has been modest when compared with sales. At the end of May total business inventories were only 1.46 times sales for the month. Before the declines which began in 1953 and 1957, this ratio was about 1.6 and before the 1960 decline it was 1.53. Auto inventories at midyear represented only a 39-day supply based on June sales, about the same as last year, but well below the levels of the same period in 1960 and 1961. Even the widely discussed rise in steel inventories was less this year than before the end of the strike threat in 1962.

Another favorable factor in the current expansion up to this time has been the avoidance of major labor disputes which interrupted earlier business upswings of the post-war period. Prosperous years have been marred by dislocations resulting from shutdowns in such vitally important industries as coal, autos and steel. In the past three years the number of idle man days caused by strikes has averaged well under 20 million annually, far less than in any previous postwar period of like duration. In 1952, 59 million idle man days were caused by strikes, and in 1959 the loss was 69 million.

The impact of the major steel strikes in October 1949, June and July 1952, July 1956 and from July to November 1959 is reflected in the accompanying charts. The recent labor-management agreement in steel

Consumer price index



*Figures are middle month of each quarter.

seems to offer assurance that no major shut-downs will occur in that industry for at least two years. But the possibility of crippling disputes in other important industries, especially the railroads, remains to cloud the generally favorable outlook for the period ahead.

Prospects for further expansion in total output in the months ahead are dampened by the intentions of many steel users to reduce inventories. Moreover, the important auto and homebuilding industries have been operating at extremely high rates and recent levels of activity are not expected to be exceeded in the second half of the year. But other sectors in the economy can readily supplant these as sources of strength.

Trends in banking and finance

Liquidity on the rise

Liquid financial assets held by the public increased 16 billion dollars in the first half of 1963, or at a seasonally adjusted annual rate of more than 7 per cent.¹ While this was a slightly slower growth than the record rate in 1962, it was substantially above the average increase of the prior 10 years.

Liquid financial assets represent principally consumer and business savings and may be viewed, therefore, as unused or stored purchasing power. Changes in holdings of liquid assets relative to total current spending on goods and services—gross national product—are commonly thought to be an important factor affecting future changes in over-all spending. Increases in the volume of liquid assets relative to gross national product gen-

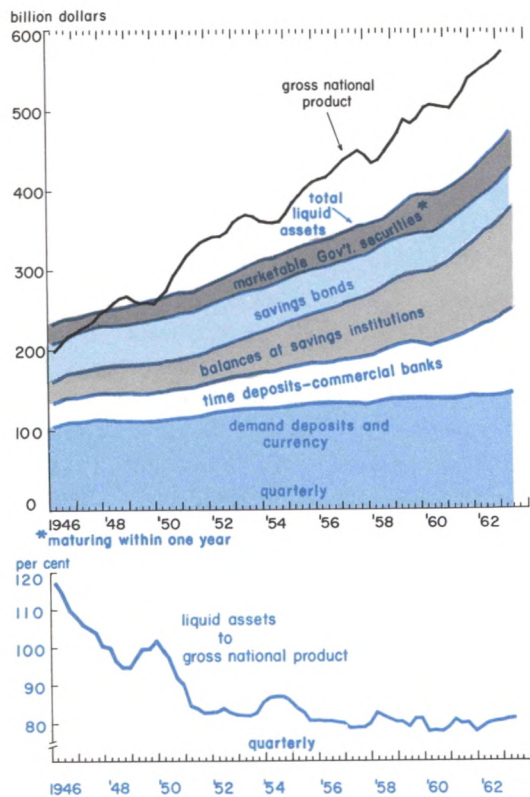
erally imply increased potential rates of spending in future periods. Decreases in the ratio of liquid financial assets to GNP, on the other hand, may foreshadow reduced spending. This tendency for an inverse relation to exist between changes in liquid assets and changes in spending may be seen in the chart on page 9.

Since the end of 1961, liquid assets have risen faster than gross national product. As a consequence, holdings of liquid financial assets now equal about 81.4 per cent of the total annual value of production. If this ratio is used, as a measure of the liquidity of the economy, the current level is the highest attained since 1958, although far below the high levels reached during and following World War II when many kinds of goods and services were in short supply. At the end of the war, liquid assets exceeded gross national product by 17 per cent. Since 1955, however, the public's holdings of liquid financial assets have fluctuated only between 83.7 per cent and 78.2 per cent of gross national product.

Rapid build-ups in liquidity are sometimes a cause for concern because of potential inflationary pressures which may accompany the anticipated sharp increases in spending. These potential pressures would be of particular concern if the liquidity build-up occurred while the economy was operating at or close to capacity and fully utilizing available manpower and plant facilities. The recent rise in

¹Liquid assets are those assets which are or can readily be exchanged for money and which either have a fixed value (such as demand and time deposits at commercial banks), or whose market value varies only slightly from their purchase price (such as short-term U. S. Government marketable securities). In this article, total liquid assets include private nonbank holdings of currency, demand and time deposits at commercial banks, savings deposits at mutual savings banks, share capital at savings and loan associations, postal savings deposits, U. S. Government savings bonds and marketable U. S. Government securities maturing within one year. This series is prepared monthly at the Board of Governors of the Federal Reserve System and published in *Economic Indicators* by the President's Council of Economic Advisors. For a detailed discussion of the concept of liquid assets and liquidity see Stephen A. Axilrod, "Liquidity and Public Policy," *Federal Reserve Bulletin*, October 1961.

Liquid assets rose faster than gross national product in 1962-63



liquidity, however, has occurred against a backdrop of considerable slack in the economy and prices generally have remained stable during the current business expansion. Indeed, the rise in liquidity itself is in part the result of a monetary policy designed to encourage spending and accelerate the pace of economic expansion.

The relation between liquidity, spending and prices is neither precise nor constant. It may be expected to differ depending among

other things on the composition and ownership of the liquid assets, the degree of economic slack and consumer expectations of future income and prices. Consequently, generalities concerning the relation between liquidity and inflationary pressures are difficult to support.

Time deposits rise rapidly

Among the various liquid assets, time and savings deposits at commercial banks recorded the greatest gain in 1962, with an increase of 19 per cent. This rise was by far the largest annual increase in these deposits in the postwar period and more than double the average rate of increase in the Fifties. The 1962 increase followed large gains in both 1960 and 1961. For the three years as a whole, time deposits rose by approximately the same dollar amount as during the entire preceding 10 years. During the first half of 1963, time deposits rose at a somewhat slower pace than in 1962 but still faster than in any other postwar year.

Net dollar inflows into savings and loan associations in 1962 were also large although the percentage increase was somewhat below both the increase in 1961 and the average annual rate of rise since 1951. In part, the slower rate of growth may be attributed to the narrowing of spreads between interest rates paid by commercial banks on time deposits and dividend rates paid by savings and loan associations following the raising of the interest rate ceiling applicable to banks effective January 1, 1962. Most of the slowdown in share capital growth occurred in the first half of 1962 when savers may have reappraised the way they divided their savings between commercial banks and savings and loan associations in light of the new interest rate differentials. In the last half of 1962, net inflows into savings and loan associations

regained their 1959-61 rate. This pace has continued in the first six months of 1963.

Deposits at mutual savings banks rose sharply in 1962 as did nonbank holdings of marketable Government securities maturing within one year. But the public expanded their holdings of money—demand deposits and currency—and Government savings bonds only slightly during the year.

Mortgage market easier

One effect of the record inflow of funds into deposit-type financial institutions has been the heavy demand by these institutions for suitable investments. As a result, interest rates on mortgages and securities issued by state and local governments have declined during much of the period since 1961. Reflecting these developments, rates paid on savings by some financial institutions recently have been reduced somewhat. Reductions in interest rates on time deposits have been announced by a few commercial banks, while

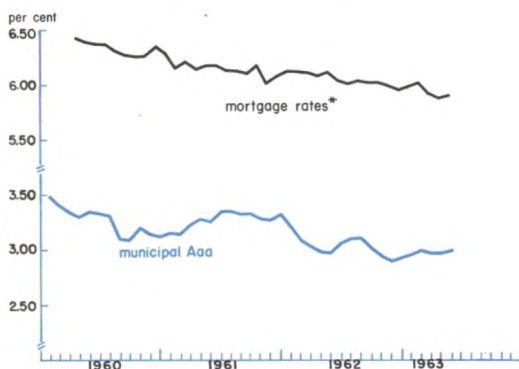
lower dividend payments have been reported by some savings and loan associations.

Interest rates on mortgage loans have declined at the same time that maturities have lengthened and the loan size has risen relative to the value of properties. Even though the supply of new mortgage loans has been large—a record volume in 1962—the competition for them has been strong. Many banks accelerated their acquisition of mortgage loans—the traditional loan outlet of savings and loan associations, mutual savings banks and insurance companies—because of the large amounts of funds available from time and savings deposits and their inability to utilize these funds in increased loans to business firms, their more usual customers. The supply of business loans was limited, in part, because of greater reliance by businesses on nonbank financing.

Banks lengthen municipal maturities

In the market for the tax-exempt obligations of state and local governments, interest rates declined significantly in 1962 even though there was a moderate increase in offerings. The decline may be attributed largely to commercial banks which turned increasingly to these securities as an outlet for their increased volume of funds. In 1962, acquisitions of state and local obligations by banks amounted to over four-fifths of the net increase in the volume of these securities outstanding. Since the beginning of 1962, banks have expanded their holdings of these securities more than 35 per cent. In addition, the average maturities of such securities held by banks appear to have lengthened. Comprehensive information on the maturity composition of municipal securities held by banks is not available. However, a recent survey of municipal securities held in safekeeping at the Federal Reserve Bank of Chicago by

Interest rates on mortgages and municipal securities have declined



*Effective interest rate on conventional Chicago area new home loans.

District member banks increase proportion of long-term municipal securities in their portfolios*

Maturity	June 30, 1956	March 26, 1962** (per cent)	January 2, 1963**
Within 1 year . . .	18.1	11.3	11.6
1 - 5 years	44.7	45.3	42.3
5 - 10 years	30.0	33.8	35.0
Over 10 years . . .	7.2	9.6	11.1
Total	100.0	100.0	100.0

*Excludes Michigan and large Chicago Loop banks.

**These percentages are based on securities held in safekeeping at the Federal Reserve Bank of Chicago. Securities so held represented about two-thirds of the municipal securities reported by the respective member banks. The securities were value at par.

member banks indicates that these banks have increased the proportion of long-term securities in their portfolios.

Seventh District member banks were found to have expanded their holdings of municipal securities maturing in over five years from 43.4 per cent of their portfolios at the end of March 1962 to 46.1 per cent by the end of the year. The increase was about evenly split between securities maturing in five to 10 years and securities maturing in 10 to 20 years. The banks also held a greater proportion of long-term maturities in their portfolios of municipal securities at year-end 1962 than on June 30, 1956, the date of an

earlier complete survey. Securities maturing in over five years accounted for 46 per cent of the banks' total holdings of municipal securities at the end of 1962 compared with only 37 per cent in mid-1956.

The combination of continued rapid inflows of savings funds and reduced earnings on some types of new loans and investments have encouraged some financial institutions to re-examine the prices they pay for funds. For savings and loan associations, the situation has been reinforced by a boost in income tax rates effective in 1963. The greater the proportion of earnings paid in taxes, the less some associations consider available for distribution to the owners of share capital.

Thus far, reductions in rates paid by financial institutions for deposit and share money have been selective. Almost all of the reductions have been announced by the smaller institutions. These banks tend to place a smaller proportion of their resources in loans than the larger banks and, being in lower income tax brackets than larger banks, find the tax-free feature of municipal securities less attractive. At the same time that savings and loan associations in some areas have posted lower dividend rates, a few institutions in areas where the demands for mortgages remain strong have announced rate increases. On balance, these changes have tended to bring the rates paid by financial institutions on savings funds into closer alignment with the rates earned on the funds.

Savings accounts and commercial bank earnings*

Savings deposits have become increasingly important to commercial banks. At the beginning of 1963, the "passbook" type of deposit totaled 107 billion dollars and accounted for 36 per cent of total deposits. As recently as mid-1957, such accounts totaled only 44 billion dollars or 24 per cent of total deposits.

The growth of savings deposits mirrors in part the sizable increase in nearly all kinds of liquid financial assets but also reflects the concerted efforts of commercial banks to acquire such deposits. Banks have raised interest rates paid on savings and spent substantial sums on advertising to bring this service to the attention of potential depositors.

Not all bankers agree, however, that it is profitable to aggressively seek savings deposits, and, of course, it is essential that banks operate profitably if they are to serve their communities effectively.

Answers to the complex and perplexing questions about the profitability of time deposits are difficult for bankers to find and probably are not the same for all banks.

The problem is complicated by the fact that banks provide many closely interwoven services, making it extremely difficult to evaluate the costs and returns of any one alone. A change in policy affecting one service is likely to affect costs and returns of other services offered by the bank.

In this study of the profitability of the savings account component of time deposits, a method is suggested that may be helpful to individual banks in evaluating the profitability of savings accounts. In general, the results indicate that several categories of savings accounts may contribute little or nothing to profits and probably are maintained at a loss by many banks. Among these are accounts with small balances, accounts with excessive activity and accounts closed within short periods after they are opened. The study concludes that banks might find it profitable to make special efforts to attract larger, longer-lived accounts and to limit transactions activity in savings accounts.

The profit contribution

Revenues. Before a bank can determine whether its savings department contributes to profits, the revenues and expenses traceable to the savings function must be established. Because the savings department does not contribute directly to bank revenues, income attributable to savings accounts can be determined only by reference to the earnings of the funds provided from this source. A rate of return must be assigned to the net funds

*This article, including the tables, is based upon a study by Allan R. Drebin, "Savings Accounts and Commercial Bank Earnings," Bureau of Business Research, Graduate School of Business Administration, The University of Michigan, Ann Arbor, Copyright, 1963, used by permission. The study was initiated while Mr. Drebin was a Research Fellow at the Federal Reserve Bank of Chicago. The conclusions, of course, are those of the author. Copies of the full report may be obtained from the University of Michigan.

available from the savings department.

While gross returns on any loan or investment can be determined, it is difficult to associate specific assets with funds furnished by savings deposits. Some bankers favor the "pool" approach, wherein all investments are made from a pool of all available funds without regard for their sources. This simplifies accounting, perhaps explaining its popularity, but is not very useful unless it actually corresponds to the investment policy followed by the bank.

Other bankers contend that funds furnished by time deposits are converted to specific types of loans and investments, primarily real estate mortgages, and when all the funds cannot be placed in mortgages, the remainder is invested in tax-exempt municipals with similar maturities.

Any bank can ascribe a suitable earnings rate to the savings function by inquiring into its own investment policies. This rate, multiplied by the dollar amount of funds furnished, provides a figure for gross revenue attributable to savings deposits.

Expenses. Savings department expenses fall into four categories: those proportional to amount of deposits; those depending upon the number of accounts; those varying with account activity, and those related to average account life.

Interest paid on deposits is the largest expense item. Although computed in a variety of ways that may alter the results slightly, interest costs are nearly always proportional to amount of deposits, as are deposit insurance and examination charges.

The other expenses, many of them joint costs, cannot be estimated as easily. Individual banks assign these costs on differing bases, but in general the savings department should shoulder all the direct costs incurred as a result of its operation. The department

should share in the "fixed costs" to the extent of benefit obtained from such costs.

Allocation of building expenses and other "fixed costs" to departments is at best a difficult problem. Possibly even more difficult is the evaluation of the impact on other departments of any steps taken to eliminate unprofitable savings accounts.

Although the whole must equal the sum of its parts, the maximization of departmental income is not always consistent with attaining the maximum profit for the entire establishment. In taking steps to maximize profits of the savings department, a bank must consider the over-all effect of such action on its complete banking operation.

An illustrative example

A "model" bank based on the actual records of five large banks was used to illustrate the steps which can be taken to help in identifying any unprofitable accounts. Since the model is not based upon a representative sample of banks, it does not permit conclusions as to whether savings accounts are profitable generally. However, it does serve to illustrate some characteristics of accounts which may be generally applicable.

Account size. The size distribution of accounts has an important bearing on profits, since revenues are proportional to amount of deposits while some costs are independent of deposit balances.

Information on distribution of accounts by size was available from two large banks. For these banks, 67 per cent of the total number of accounts had balances of less than 500 dollars, yet these small accounts comprised only 8 per cent of total savings deposits. The remaining one-third of the accounts, with average balances above 500 dollars, included 92 per cent of total savings deposits in these banks. The percentage attributable to each

size category is shown in the following table.

Account size (dollars)	Accounts (per cent)	Deposits
Under 100	43	1
100-500	24	7
500-1,000	11	9
1,000-5,000	18	44
5,000-10,000	3	21
10,000-25,000	1	11
Over 25,000	*	7
Total	100	100

*Less than ½ of 1 per cent.

Account activity. An attempt was made to determine whether or not any relation exists between account size and activity. Analysis of a sample of savings accounts at a large commercial bank during a six-month period indicates that small accounts tend to be more active than large ones, as is indicated below.

Account size (dollars)	Number of accounts	Transactions	
		Average number*	Accounts idle (per cent)
Under 100	231	2.79	42.4
100-500	212	3.73	30.6
500-1,000	149	3.27	25.5
1,000-5,000	390	2.68	24.6
5,000-10,000	172	2.37	26.1
10,000-20,000	70	1.77	30.0
Over 20,000	23	1.52	26.0
Total	1,247	2.83	29.6

*In six-month period.

Except for the under-100 dollar category, the average number of transactions declined as size of account increased. The higher percentage of inactive accounts in the under-100 category implies a rather high rate of activity among those accounts that had transactions.

More than half of the accounts studied had either one or no transactions in the period, while 7 per cent had 10 or more

transactions. The latter group accounted for 40 per cent of the total activity, but supplied only 4 per cent of the total savings deposits.

Account mortality. This characteristic was studied because of the cost of opening and closing accounts. A sample of 1,575 accounts opened in January 1950 was studied for the years 1950-60 (see table on page 15).

The smaller accounts were found to have somewhat shorter lives than the larger ones, but the difference was slight. However, of the accounts in the sample with initial deposits of 100 dollars or less, more than one-fourth were closed within the first year. Unless the average balances were much greater than the original deposits, the bank probably lost money in handling these accounts.

More accounts were closed in the first year than in any other year in all sizes except 500-1,000 dollars, which lost two more accounts in the second year than in the first. The accounts were closed in a fairly regular pattern of progressively diminishing numbers during the 11-year period. The percentage of total accounts in each category at the end of the period was practically unchanged from that at the beginning.

A little more than one-third of the 1,575 accounts were still open when the period under study ended. By assuming that these accounts would be closed at the rate indicated by the experience of the last several years, the average life expectancy of accounts was estimated to be about 12 years.

Interest, the largest element of expense for the savings department, is largely proportional to deposit dollars. If all expenses varied in this manner, then it would be impossible to select any group of accounts as being unprofitable, as long as the whole department was profitable, since revenues also are proportional to deposits. But the study shows that transactions activity, account opening

Account mortality—1950-60

Account size (dollars)	Original accounts		Original accounts closed					Accounts still open (per cent)
	Number	Per cent	First six months	Second six months	Second year (per cent)	Three to five years	Six to eleven years	
Under 100.....	795	51	16	10	10	16	16	32
100 - 500.....	307	19	10	11	9	19	17	34
500 - 1,000.....	117	7	7	3	12	22	15	41
1,000 - 5,000.....	281	18	6	10	8	20	18	38
5,000 - 10,000.....	57	4	5	11	9	14	26	35
Over 10,000.....	18	1	6	22	0	6	22	44
Total.....	1,575	100	12	10	10	17	17	34

and annual maintenance costs are not proportional to account size. Furthermore, these costs are substantial and, therefore, it is possible that small accounts might not yield enough revenue to cover the costs incurred in servicing them.

In the five large banks for which records were available the following average costs were determined:

to make a deposit	\$0.42
to make a withdrawal	0.45
annual maintenance	1.00
to open and close account (combined)	3.00

The earnings on net available funds averaged 4.12 per cent and the effective interest paid on savings averaged 2.80 per cent. There was considerable variation in these costs and returns among the five banks.

Improving profits

In general, a bank's profitability will be enhanced by plans that tend to increase average account balances, to decrease transac-

tions and to lengthen account life, provided these do not also have a detrimental effect on other departments of the bank.

For the model bank—using figures provided by the selected banks for revenues and expenses—it was estimated that the savings department as a whole contributed about 296,000 dollars to the after-tax earnings of the bank. Accounts with balances of less than 500 dollars, however, incurred a loss of about 86,000. Presumably the bank could realize annual savings of about this amount by requiring a 500 dollar minimum balance, assuming that the personnel, equipment and space devoted to the accounts eliminated by this action could be shifted to other uses or eliminated, and again assuming there would be no adverse effects on other departments of the bank.

However, it is likely that customers whose savings accounts were driven away by this action would also take their credit needs, demand deposits and other possibly profitable banking business to other institutions.

It also would tend to eliminate those depositors whose balances grow from modest opening figures to substantial sums.¹

Commercial banks also hold that they have an obligation to serve the financial needs of the entire community. Elimination of small savings accounts may be in conflict with this "service" concept, even though it might improve a given bank's profits.

Direct measures aimed at limiting the number of transactions permitted in individual savings accounts do not appear to be a good answer to the problem of high activity because of the strong possibility of creating ill will. Interest incentives probably would serve this purpose better, but an individual bank may not have much latitude because of competition from other banks and financial institutions.

Reducing or eliminating interest on certain classes of accounts, say, those with balances of less than 500 dollars, might be tried. However, it seems likely that of accounts in the 100-500 dollar range—many, because of their long life and low activity, do contribute to earnings—would shift to institutions offering interest while accounts with balances of less than 100 dollars might be retained since these draw so little interest that it is of minor consequence. In the model bank, interest cost on accounts of 100 dollars and less was only about 36,000 dollars while acquisition,

¹Dr. Elmer M. Harmon, vice president, Bowery Savings Bank, New York City, in the *American Banker* last fall, noted that of all depositors with current balances of 10,000 dollars or more, one out of four had opening balances of 500 or less. He further estimated that had the Bowery refused to accept or maintain accounts of 500 dollars or less, it would have 67 per cent fewer depositors and 26 per cent less in deposits.

service and maintenance costs were about 162,000 and revenues were about 50,000.

While the larger accounts tend to be the most profitable, and should be actively sought, they can present problems. Many banks avoid accounts with very large balances, probably because of fears that their liquidity position would be threatened by large, unexpected withdrawals. This problem could be minimized if large accounts were acquired from a variety of sources, thereby providing diversification.

The study of activity and mortality indicates that large accounts may remain open longer and have fewer transactions than small ones, but additional measures can be taken to promote longer life and limited activity. The payment of an interest bonus on the first anniversary of a deposit works in this direction. It might also be helpful to calculate interest by a method which allows little or no interest on balances remaining with the bank for less than six months. Account activity might also be reduced somewhat if interest was computed so as to provide a smaller return on accounts which have high turnover.

Service charges seem to hold the greatest promise for combating transactions activity, allowing the bank to recover deposit and withdrawal costs. A system of service charges should enable banks to pay higher interest rates which would be particularly attractive to the larger and less active accounts. Those whose accounts are profitable would benefit, since the added interest should more than offset service charges. Those whose accounts are not contributing to profits would be charged for the cost of bank services provided for them or would close their accounts.