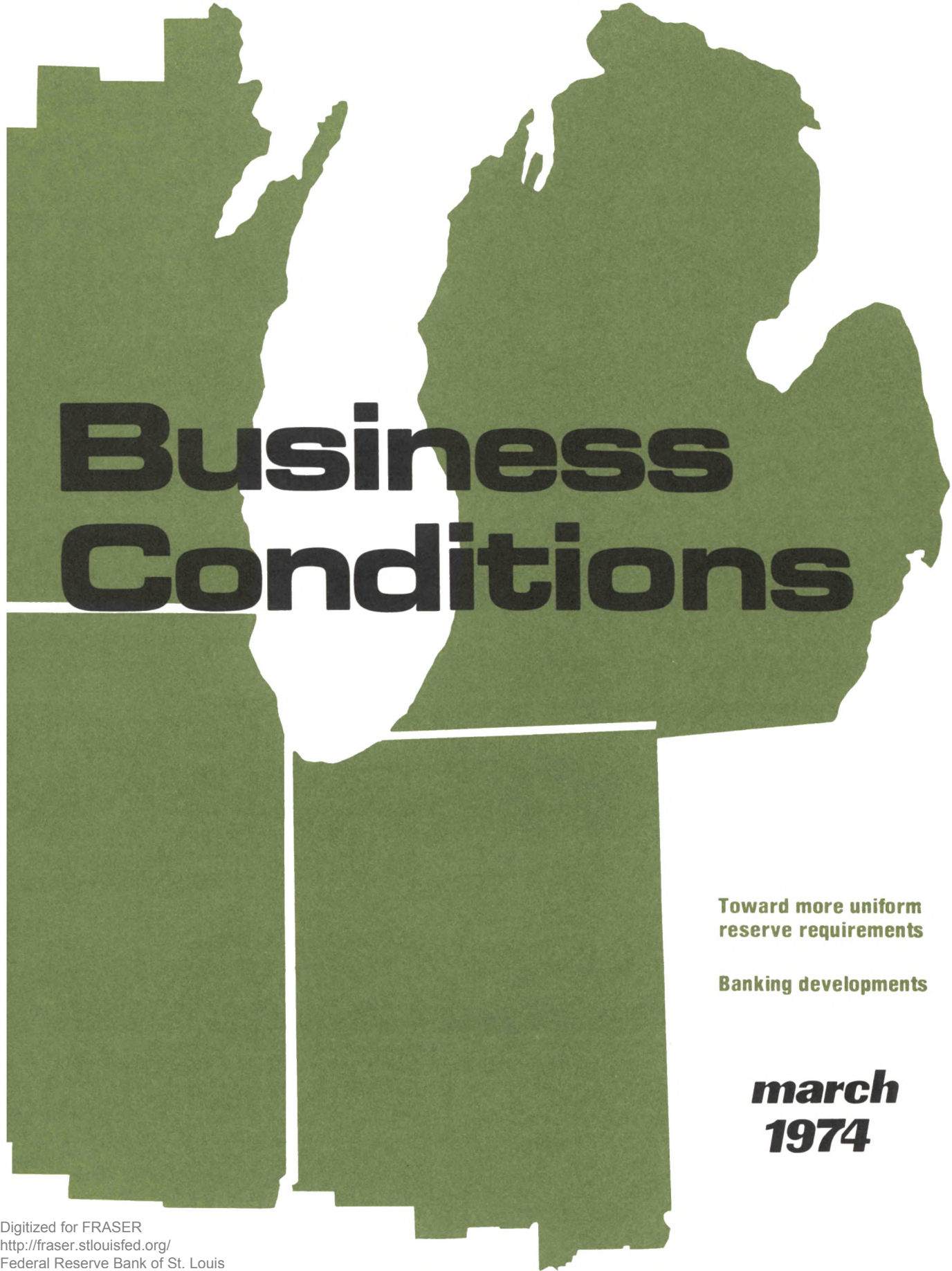
an economic review by the Federal Reserve Bank of Chicago



Business Conditions

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Toward more uniform reserve requirements

Late in January, the Board of Governors of the Federal Reserve System submitted to the Congress a proposal that would require all types of financial institutions whose deposits are used by the public in making money payments to hold reserves against those deposits in accordance with a schedule specified by the Board. This request to extend reserve requirements to nonmember institutions reflects increasing difficulties in exercising effective control over the monetary aggregates in the face of accelerated growth of money-type deposits at such institutions.

The Board's legislative proposal would require all but the smallest nonmember commercial banks to hold reserves against their demand deposits in the same form and amount as banks that are members of the Federal Reserve System. Savings and loan associations and mutual savings banks, as well as commercial banks, would be subject to reserve requirements on accounts subject to Negotiable Orders of Withdrawal (NOWs) where permitted (currently only Massachusetts and New Hampshire).

The Board's proposal also asks for wider ranges within which it would have authority to change required reserve-to-deposit ratios. All institutions meeting Federal Reserve requirements would be eligible to borrow at the discount window.

Except for the inclusion of the NOW accounts, which have only recently emerged as a means by which depositors can make payments directly from savings-type deposits, the proposal is a replay of a theme that has been repeated again and again over the past 20 years. In addition to urgings by the Board, recommendations for applying the same reserve requirements to all banks were made by the Commission on Money and Credit in 1961, by the President's Committee on Financial Institutions in 1963, and by the Hunt Commission in 1971. These groups advocated more uniformity in reserve requirements because their studies convinced them that such uniformity is a necessary precondition to effective monetary control.

Purposes

The stated purposes of the Board's proposed legislation are "to achieve better management of money and credit, to provide a more equitable system of reserve requirements among financial institutions that offer similar deposit services, and to permit Federal Reserve lending assistance to a broader range of financial institutions when and as they come under unusual liquidity pressures."

Within the United States, the Federal Reserve System has sole responsibility for monetary control. The principal reason for the System's reserve requirements is to serve as a lever by which it can carry out this primary central banking function—control over the quantity of money and credit. Most state authorities also impose reserve requirements, but the assets that satisfy most state requirements are not in a suitable form to serve monetary control purposes.

All commercial banks are chartered either by the Comptroller of the Currency (national banks) or by the banking authorities of the individual states. Membership in the Federal Reserve System is required for national banks but voluntary for state-chartered banks. Both federal and state banking authorities regulate the banks under their respective jurisdictions in the interests of sound

banking practices and the protection of depositors. Of over 14,000 commercial banks in the United States, over 8,400, or about 60 percent, were not members of the Federal Reserve System at the end of last year. The average nonmember is relatively small, however, so that this three-fifths of the bank population accounted for only 25 percent of the deposit component of the money supply and 22 percent of all commercial bank credit.

If these proportions remained constant or changed in some stable and predictable way, the problem posed for monetary control would not be significant. The evidence of the past few years, however, indicates that the nonmember sector is not only growing faster, but its growth is more erratic than the trend for member banks. Since 1960, about 750 banks have left the System through withdrawal or merger. Of the roughly 1,850 new state-chartered banks established since 1960, less than 150 have elected to join the System. This trend has accelerated over the past six years, with an annual growth in net demand deposits at nonmembers of 10 percent—double the pace at member banks on average, and three times as great in some years.

If potential shifts from national to state charters(relatively easy to effect) are ignored, further attrition can be expected from among the more than 1,000 state banks in the United States that are still members of the Federal Reserve System. These banks tend to be relatively large, accounting for roughly another 20 percent of all commercial bank demand deposits. While it seems unlikely that the very largest state banks (including some multi-billion dollar institutions) would leave the System, many banks with more than $100 million in total deposits have already done so. When one bank withdraws, pressure is transferred to competing members as they try to protect their competitive positions.

Thus, shrinkage in the proportion of deposits directly influenced by Federal Reserve action can be expected to continue. From 83 percent in 1960, this proportion declined to 75 percent in 1973. Even if the very large state banks remain members, this share can be expected to shrink further, as the competitive advantage enjoyed by nonmembers enables them to grow faster and as few *new* banks elect to

Member and nonmember banks—number and demand deposits

	United States			Seventh District		
	6/15/60	6/30/67	6/30/73	6/15/60	6/30/67	6/30/73
	(numbers)					
Number of banks						
Member	6,214	6,107	5,705	1,004	990	932
National	4,542	4,780	4,629	581	650	664
State	1,672	1,327	1,076	423	340	268
Nonmember	7,277	7,637	8,341	1,470	1,557	1,705
All commercial	13,491	13,744	14,046	2,474	2,547	2,637
	(percent)					
Nonmembers as percent of all commercial banks	53.9	55.6	59.4	59.4	61.1	64.7
	(billion dollars)					
Private demand deposits*						
Member	107.0	134.9	187.0	15.4	18.9	25.8
National	67.8	94.3	139.5	11.4	14.2	20.0
State	39.2	40.6	47.5	4.0	4.6	5.8
Nonmember	19.4	28.8	55.2	3.3	5.1	8.5
All commercial	126.3	163.7	242.2	18.8	24.0	34.3
	(percent)					
Nonmembers as percent of all commercial banks	15.3	17.6	22.8	17.6	21.2	24.7

*Does not include deposits of the U. S. Government or interbank deposits.

become members.

In addition to the basic problem, new developments, exemplified by the NOW accounts, are bestowing more and more of the characteristics of money on financial assets other than commercial bank checking accounts. A parallel development is the growing acceptance of the view that control over the rate of growth in the monetary aggregates is crucial to the health of the economy. Thus, the need for arrangements that will broaden the scope of the System's effective control over money is sure to become increasingly urgent.

Closely related to the concern with monetary objectives, the Board's proposal aims to spread the costs that monetary control imposes on member banks more equitably among financial institutions that offer similar deposit services. Since this would mean a reduction in the competitive advantage nonmembers now enjoy, it is understandably opposed by them. As a partial offset to the loss in advantage that would accompany the equalization of reserve burdens, however, are the benefits of access to funds at the discount window.

Some of the opposition and/or indifference toward efforts for greater uniformity of reserve requirements, however, appears to be based on a misunderstanding of how the reserve ratio specified by the System serves as a link between member bank reserves and the quantity of money, how the central bank determines the quantity of the assets that are specified as reserves of member banks, and why the present structure of reserve requirements effectively imposes a tax on membership.

Reserves and money

Reserve requirements were written into most banking laws and regulations to assure liquidity to meet depositors' withdrawals. State laws vary with respect to both the percentage of deposits banks are required to hold as reserves and the types of assets that are reserve-eligible. Illinois law has no requirements whatsoever. In many states, the percentage requirements (required ratios of reserves to deposits) are not significantly different from those imposed by the Federal Reserve, but the form is different. Only vault cash and collected deposit balances at Federal Reserve banks qualify as reserves for Federal Reserve members. State nonmember banks, however, can count correspondent balances (collected or uncollected), and in many states, U.S. securities and even their home state's securities also count in partial fulfillment of requirements.

Actual liquidity is supplied, of course, by a variety of short-term assets and also through liability management. Legal reserves provide liquidity only to a very limited degree—what must be held cannot be paid out to depositors. However, it has long been recognized that the main function of cash reserve requirements is to limit monetary expansion.

Money is anything that can be used as a means of payment. But for economic policy purposes, the U.S. money stock is usually defined to include currency and bank checking accounts held by the public. Deposit balances of the U.S. Government and other banks are excluded. To the extent savings deposits, either at banks or at other financial institutions, can give rise to check-like instruments, such as the NOWs, they too are money. The distribution of the money supply between deposits and currency is determined by public demand—one being freely exchangeable into the other. Therefore, the capacity of the banking system to expand deposits is the real objective of monetary control. How do reserve requirements affect this?

In a "fractional reserve" money system such as ours, deposit expansion in the banking system is a multiple of the quantity of reserves. The size of that multiple is determined basically by the percen-

tage requirement. For every $1 increase in reserves, a 20 percent requirement permits deposits to rise $5, while a 10 percent requirement permits deposits to rise $10. To achieve its deposit growth target, the central bank must be able to control, or at least be able to predict, both the quantity of reserves and the reserve ratio. Given a fixed reserve requirement ratio, control over the growth in deposits is exercised by control over the volume of reserves. This is why the *kind* of assets that can be counted as reserves is so important. The Federal Reserve System cannot control the aggregate volume of correspondent balances and government securities. It can control the total amount of cash balances that banks hold in Federal Reserve banks. These balances are in fact created by the Federal Reserve, largely through its open market operations. As a base for money, they are equivalent to the gold against which bankers issued notes a century ago, but unlike that gold, the supply is determined in accord with the economy's needs.

How money grows

It is often difficult for observers, and sometimes even for bankers themselves, to understand the critical role of the central bank as the *source* of new funds to the banking system. With deposits constantly shifting among thousands of banks, a single institution is not able to see the multiple expansion process taking place. Suppose, for example, the Federal Reserve wants to provide additional monetary growth. It is likely to do this by purchasing government securities in the open market. Payment for the securities is made with a check on the Federal Reserve Bank of New York, which acts as an agent for the System's open market account. This check is deposited by the seller of the securities in a commercial bank, adding to the deposit liabilities of that bank and to its reserve balance at its Federal Reserve bank. This is a net addition to existing reserve balances that has resulted from the open market purchase. Deposits of the commercial banking system can continue to expand through the process of making loans and investments until total deposits reach the maximum amount that can be supported by the increase in member bank reserve balances.

To illustrate, in the abstract, suppose the reserve requirement were 15 percent and there were only one bank. That bank could immediately increase its earning assets and deposits by making loans until the initial increase in reserves generated by the open market purchase is supporting an increase in aggregate deposits almost seven times its size. (With a reserve requirement of 15 percent, $100 in new reserves will support a maximum of $667 in additional deposits.) The loan proceeds would be credited to the borrowers' deposits, but withdrawals by the borrowers from their deposits would merely appear in some other customers' deposits.

In a banking system with many banks, however, the deposits created by new loans to borrowers are likely to be shifted to other banks, with a corresponding drain on the lending bank's reserve account, which gets charged when checks drawn on that bank are paid. The process can be repeated until all of the new reserves have been absorbed as required reserves against expanded deposits in the banking system as a whole. An individual bank, therefore, can increase its earning assets by only the difference between increases in its deposits and the reserves necessary to support those increases. Customer transactions shift deposits from bank to bank. As the deposits shift, the reserve base for them also shifts to the receiving bank.

It should be noted that the Federal Reserve's ability to purchase securities is totally independent of previously existing member bank reserve deposits. But

because the banker cannot distinguish between a deposit inflow that results from the System's purchase and any other credits to its reserve balance in payment for checks deposited by customers in the normal course of business, it may appear to him that the reserve balance he has to keep at the Reserve bank finances the Federal Reserve's purchase of securities rather than the reverse.

The System's ability to control money stems from the fact that money consists of either the System's liabilities (nearly all currency is Federal Reserve notes), or has a direct relationship to the System's liabilities (deposits must be supported by member bank reserves). It is by increasing (by buying securities) or reducing (by selling securities) the reserve base of the banking system that the Federal Reserve implements its monetary objectives. While there are other factors that influence the reserve base supporting deposits—drains to meet currency demands of the public being the largest—Reserve bank security purchases are in the long run the major source of bank reserves. Over the past ten years, Federal Reserve holdings of U.S. securities have increased by almost $40 billion. Of this amount, about three-fourths has been passed through the banks to the public in the form of currency (Federal Reserve notes). The rest has increased member bank reserves, providing the base for multiple deposit expansion.

Slippages

Even if reserve requirement percentages remain unchanged, the relationship between the amount of reserves supplied and the money stock—the reserve multiplier—is not constant for a number of reasons: (1) currency paid out to the public absorbs reserves on a dollar-for-dollar basis, (2) reserves must be held against some bank liabilities other than checking accounts of the public (U.S. Government balances, deposits of other banks, time deposits, and certain nondeposit liabilities) and different percentage requirements apply to some of these, (3) deposits may shift among member banks with different average reserve requirements (the schedule of graduation results in a higher average ratio for large banks than for small ones), (4) excess reserves may increase or decrease, and (5) deposits may shift to nonmember banks where the impact of Federal Reserve actions is greatly diluted.

The first three of these factors are reasonably easy to ascertain at any given time. Their effects can be estimated and allowed for in the effort to determine the volume of reserves necessary to achieve target growth rates in money, although admittedly they can give rise to some slippage in control in the short run.

Excess reserves tend to be erratic from week to week but have little effect on the multiplier over longer periods of time. Deposit shifts to nonmembers have much bigger effects on the reserve multiplier and are more difficult to offset, partly because they are difficult to predict and partly because offsetting action imposes costs on member banks.

Those who contend that the application of Federal Reserve requirements to nonmembers is unnecessary for effective monetary control point out that because nonmember banks hold reserves in the form of correspondent balances at member banks, against which member banks must in turn hold cash reserves, System reserve action does affect nonmember deposits. Clearly, however, the same amount of member bank reserves will support far more customer deposits at nonmember banks than at members. Under a 15 percent requirement, $1 of member bank reserves will support $6.67 in deposits of a nonmember bank which, in turn, will support (in a state with a 15 percent requirement) almost $45 of deposits at the non-

member. Such "pyramiding" of reserves was a major shortcoming of the old national banking system that the Federal Reserve Act was designed to correct.

The vastly increased leverage entailed in deposit shifts from members to nonmembers alters significantly the relationship between the amount of reserves supplied to the banking system and the overall rate of expansion in money.

What if reserve requirements were eliminated?

The second argument offered by those who oppose the Board's latest proposal is that open market operations, not reserve requirements, provide the major thrust of the System's control and that such operations have an impact on all banks. Without question, open market operations are the means by which the System controls the quantity of bank reserves. With or without reserve requirements, open market purchases of securities increase the total amount of outstanding currency or deposits at the Reserve banks (together called "high-powered money"), while sales reduce this total.

What would the elimination of legal reserve requirements imply for the System's open market operations, for monetary control, and for banks? First, the bank assets that now serve as "reserves" would not entirely disappear. All banks would still need to hold vault cash to meet customer demands, and many would continue to keep working balances at Federal Reserve banks. Without required minimums, however, average balances would be smaller. Federal Reserve note liabilities would continue to rise in keeping with the public's needs, but Federal Reserve deposit liabilities to member banks would be reduced to a "desired" rather than a "required" level.

The impact of the initial elimination of required ratios would be to release a large amount of funds for loan and deposit expansion. To prevent the inflationary effects of such expansion, the Federal Reserve would have to absorb these "excess" reserves by selling U.S. securities in the open market. Thereafter, the Federal Reserve would continue to provide for renewed expansion from this lower level in its note and deposit liabilities by purchasing securities in the open market.

In the absence of a legally prescribed minimum of reserves in relation to deposits, however, there would be greater uncertainty about the volume of deposits resulting from the System's open market operations. The multiplier would be a larger and a more unstable number, likely to be biggest under conditions when restraint on money growth is called for. In order to slow money growth, the Federal Reserve would have to restrict its open market purchases so as to cut the banks' balances at the Reserve banks below the "desired" level, thus reducing the willingness of banks to expand loans and deposits under conditions of strong loan demand.

For the banks, the absence of reserve requirements would mean somewhat larger earning assets for a given deposit level and therefore increased earnings, at least in the short run. As a result of competition, however, this earnings impact could be much less than expected. Higher profit potential would cause banks to bid up deposit interest rates and lower loan rates in their search for more business.

With required reserve ratios, however, there is less room for deposit variation resulting from variation in the reserve multiplier. The actual level of the reserve ratio is less important than the fact that a specific requirement exists. However, the lower the ratio, the larger the impact on deposits of unintended changes in the reserve base. Thus, the weakness of the link between reserves and deposits at nonmember banks, combined with the grow-

ing proportion of these deposits in the total money supply, has a tendency to weaken the System's control.

The importance of the System's ability to change required reserve ratios is a separate matter. Such changes have been made rather infrequently, partly because even a small change has a large and pervasive impact on potential deposit expansion or contraction. But there are times when such an impact is consistent with policy aims. Use of this tool, especially to increase the required ratio, has been limited in large part because increases raise members' costs—worsening their competitive position, increasing the incentive for banks to drop out of the System, and thus further eroding monetary control. In fact, it is the cost disadvantage specifically—and its effects on membership—that poses the greatest threat to the effectiveness of monetary control because it drives more and more of the nation's money supply into banks where the relation between deposits and the reserve base is very loose.

The matter of equity

Reserve requirements are a cost imposed on the banking system by the necessity for monetary control. Federal Reserve member banks are disadvantaged only to the extent this cost is greater for them than for competing nonmembers. Aside from the ability of nonmembers to count as reserves government securities that are clearly earning assets, from what sources do differences in costs arise?

Vault cash held to meet operating needs can be counted as reserves by both members and nonmembers. Reserve balances that members maintain at the Fed are working balances and serve some of the same purposes as deposits of nonmembers with correspondents—entitling the member to such services as check clearing, safekeeping, and money transfer facilities. In addition, member banks have access to the discount window. To a large extent, however, the average cash reserve balance is a nonearning asset. Member banks also must keep balances with correspondents, though often smaller than those maintained by nonmembers, to pay for services not provided by the Federal Reserve, such as loan overlines, and investment services.

Nonmembers, on the other hand, earn a full return in services on their collected deposits with correspondents—deposits that also satisfy their reserve requirements. In addition, items still in the process of collection, classified as "due from" banks, can be counted as legal reserves in most states even though they are only claims to assets that are still in the possession of another bank. Such uncollected balances may be half as large as a bank's required reserves. As a result, nonmember banks generally do not need to hold for reserve purposes more correspondent balances than are necessary for operating needs.

There have been some attempts to measure the differential cost burden for members—that is, what portion of required reserves is over and above the amount these banks would have to hold for operating purposes. One Federal Reserve official estimated the extra burden for a bank with a 13 percent requirement at about 7 percent of demand deposits. Whatever the differential, when translated into earnings it has increased over the years as interest rates have risen. Profit potential is thus greater for nonmembers, giving them an edge over members in attracting capital and competing for both loan and deposit business.

More convincing than any statistical estimate of the reserve burden, however, is the steady exodus from membership and the small percentage of new banks that become members. Moreover, to the extent deposit expansion outside member banks

accelerates, members have to bear the impact of System efforts to control expansion for the banking system as a whole.

In view of the inequity, why is there not solid member bank support for the Board's proposal? The explanation lies mainly in the concern felt by large- and medium-size member banks about the possible impact on their correspondent business. The overall reduction in correspondent balances would seem likely to be quite modest since not much change in the use of correspondent services would be expected. But any correspondent bank that supported a proposal that would increase costs for an important segment of its customers might expect to lose some of those customers to a more discrete competitor. This is particularly true for medium-large banks in cities outside the major money market centers where interbank deposits constitute a large portion of total sources of funds. It is within this group of banks that nonmember competition is felt most acutely, and where the failure to equalize costs is most likely to result in further loss of members.

Not compulsory membership!

The Board's current proposal does not require membership, nor does it threaten the authority of the state bank supervisory agencies with respect to chartering or regulatory functions. The Board is seeking the control of all money—not the control of all banks. Moreover, Federal Reserve requirements would apply only to those accounts that are directly involved in making money payments—demand deposits and the NOW-type accounts. Time deposits and other types of liabilities subject to reserve requirements at member banks would be exempt.

In order to restrict the change to the minimum consistent with monetary needs and to moderate the adverse earnings impact, especially on small banks, the proposal would exempt the first $2 million of nonmember net demand deposits and NOWs. This provision would effectively exempt most banks with total deposits of $4 million or less. There are more than 3,000 of these small banks but they account for less than 3 percent of the nation's demand deposits. A four-year phase-in provision would cushion the impact on the qualifying banks. Thus, it is not proposed that there should be complete uniformity. But because demand deposit requirements are the most burdensome to most banks, adoption of the proposal would go a long way toward equalizing costs while plugging a growing leak in monetary control.

Operating vault cash would continue to serve as reserves. At present percentage requirements, the increase in required reserves under the proposal would exceed vault cash by an estimated $2.3 billion. These additional reserves would have to be supplied by the System gradually, in line with the transition schedule, but they would not have any further expansion potential since the deposits they would support already exist.

The proposal to widen permissible ranges of reserve requirements would allow the Board somewhat more flexibility in using variable reserve requirements as a policy tool and would permit lower requirements on savings accounts with third-party transfer privileges than are applied to regular checking accounts. A lower minimum on members' time and savings deposits would permit further flexibility on passbook savings deposits, already at the low end of the reserve requirement range.

The proposal does not specify the terms and conditions under which nonmember institutions could borrow at the discount window. Extension of this privilege is not just a trade-off for more onerous reserve requirements but to provide greater assurance to communities served by nonmember institutions that

Federal Reserve System reserve requirements—present and proposed

	Present	Proposed
Institutions covered	Federal Reserve member banks.	All commercial banks; other financial institutions that accept demand deposits or interest bearing deposits from which the depositor is allowed to make withdrawals by negotiable or transferable instrument for the purpose of making payments to third persons (NOWs).
Liabilities subject to reserve requirements	For member banks, all net demand deposits, all time deposits, and certain nondeposit liabilities (net demand deposits are demand deposits less cash items in process of collection and "due from banks").	No change for members. For nonmembers, only net demand deposits and NOWs.
Exemptions	None for banks covered.	None for members. First $2 million for nonmembers on both net demand deposits and NOWs.
Range within which Board can change reserve requirements	Net demand deposits: Reserve city banks 10-22% Country banks 7-14% Time deposits (including NOWs) 3-10%.	Net demand deposits 5-22%. NOWs or similar accounts 3-20%. Time and savings deposits of member banks 1-10%.
Reporting	Federal Reserve members report as requested by Board.	All institutions receiving demand deposits or offering NOWs required to report deposit liabilities and required reserves, as requested by Board.
Credit available through Federal Reserve discount window	To Federal Reserve member banks. Other institutions eligible only in emergency.	Expanded to nonmember institutions required to maintain Federal Reserve reserve requirements.
Implementation		Provides for four-year transition period with respect to amount of demand deposits held by nonmember institutions at the time of enactment of the new law. On base period deposits, the percent of required reserves that would have to be carried during the first year 20% second year 40% third year 60% fourth year 80% thereafter 100%. Additions to demand deposits over base amount subject to full reserve requirement when law becomes effective.

their credit needs can be accommodated in times of stress.

District impact

There are more than 1,700 nonmember banks in the Seventh Federal Reserve District—one-fifth of all nonmember banks in the nation. Deposit data as of mid-1973 indicate that the $2 million exemption of net demand deposits would make the proposal inapplicable to more than 700 of these banks, including half or more of the nonmembers in Iowa and the district portion of Wisconsin, and 37 percent in the district portion of Illinois.

Membership experience in this district has been fairly typical, with attrition increasing with interest rates. In the six years ending December 31, 1973, 67 district banks with total deposits of more than $1 billion withdrew from membership. Of 131 new state-chartered banks, only four joined the System. In 1973 alone, none of 27 new banks joined. In the six-year period, 35 new national banks offset part of the decline in state members.

District data also indicate a trend toward greater attrition among larger institutions. Of all withdrawals since 1967, roughly one-third were below $5 million in total deposits and half were below $10 million. In 1973 alone, 12 banks with more than $400 million of deposits converted to nonmember status. None was smaller than $5 million, and only one-fourth was in the below $10 million group. Two of the withdrawals were banks with over $100 million in deposits, one of which involved conversion from a national to a state charter.

Now or when?

Change from established patterns is always difficult to accomplish. This is especially true in situations where the change imposes costs on some groups or reduces their advantage relative to others. Moreover, it is easy for the opposition to point to other factors that may cause even more trouble for the Federal Reserve in its efforts to implement monetary policy.

But while no one can say at exactly what point the rising share of money-type liabilities not subject to central bank reserve rules will cause a significant dilution in monetary control, the trend toward reduced control is clear, and the groundwork is already laid for acceleration in this trend. The time to take corrective action is before the problem becomes critical.

The reserve requirement issue is not a matter of infighting between regulatory agencies. If the central banking concept is valid, it must apply to all types of liabilities that serve as money regardless of the institution involved. There is no other major country where part of the banking system is not subject to the central bank's reserve requirement.

The Board's proposal, though a compromise with complete uniformity, would be a move in the right direction. It would increase the capability of the System to achieve monetary objectives by eliminating one source of slippage between its control variable, reserves, and the quantity of money and credit that is considered consistent with the nation's economic goals. This is a matter in which the public interest has a high stake. Sooner or later, the changing structure of the payments mechanism, combined with the ravages of an inflation that may be at least in part traceable to monetary control problems, will overcome the inertia and the political pressures that delay reform and place an unfair burden on member banks.

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Banking developments

Consumer-type time and savings accounts

A comparison of the results of the Federal Reserve's annual survey of time and savings deposits at all member banks on October 31, 1973 with the quarterly sample survey on July 31 indicated that Seventh District member banks were able to maintain, but not expand, the total amount of their savings and small-denomination time deposits following last summer's changes in interest rate ceilings. Other findings in the annual survey of all 935 district member banks were:

- About three-fourths of the banks had moved to the higher maximum savings rate by October 31.
- About 70 percent of the banks were issuing four-year, no-ceiling certificates.
- Three-fourths of the issuing banks were paying 7¼ percent or less on these certificates.
- Most of the increase in four-year certificates appeared to be accounted for by shifts out of lower-yielding accounts.
- Large-denomination time deposits, other than negotiable certificates of deposit, continued to expand at a rapid rate.

The Federal Reserve System and the Federal Deposit Insurance Corporation announced a new schedule of maximum rates payable on time and savings accounts at the start of the third quarter. By July 31, over one-half of the member banks in the district had raised their rates to the new maximums. By October 31, according to the annual survey, about three-fourths of these banks with total deposits of less than $100 million were paying the maximum allowable rate on passbook savings (the same proportion as a year earlier). Larger banks, however, with a higher proportion of consumer savings in these accounts, were slower to raise their rates. Only 66 percent were paying the ceiling rate on passbook savings by October 31 (compared to 74 percent a year earlier). Some of these banks may have decided that moving from 4½ percent to the new 5 percent ceiling would increase the cost of these accounts while providing little deterrent to the loss of interest-sensitive money, given the much higher yields available elsewhere.

According to the October survey, almost all banks were offering time certificates and open account deposits in denominations of less than $100,000 with

Consumer-type time and savings deposits
Seventh District member banks
October 31, 1973

Size of bank	Percentage paying maximum rate			
		Maturity		
	Savings accounts	Less than 1 year	1 to 2½ years	2½ to 4 years
Total deposits less than $100 million				
Illinois	78	83	82	95
Indiana	69	80	84	97
Iowa	84	85	85	98
Michigan	54	68	70	94
Wisconsin	82	82	78	95
Total	**74**	**80**	**80**	**96**
Total deposits $100 million or over				
Illinois	92	95	92	97
Indiana	44	83	83	100
Iowa	67	100	100	83
Michigan	41	79	89	93
Wisconsin	80	100	90	100
Total	**66**	**89**	**90**	**96**

original maturities up to two and one-half years. About 81 percent of the smaller reporting banks were offering time deposits with maturities of two and one-half to four years, and 89 percent of the larger banks were offering them at that time.

Under the revised regulations, banks could issue ceiling-free certificates requiring deposits of at least $1,000 with maturities of four years or more as of July 1, 1973. In this district, 69 percent of member banks with total deposits of less than $100 million and 93 percent of district banks with total deposits of $100 million or more were offering these certificates at the end of October. About three-fourths of all issuing banks—large and small—were paying 7¼ percent or less. Effective November 1, 1973, a ceiling rate of 7¼ percent was established for these four-year time certificates.

From the end of July to the end of October 1973, total outstandings in consumer-type time and savings accounts at the reporting banks declined less than 1 percent. There was, however, a change in the distribution of funds among the various types of deposits. Passbook savings at both large and smaller banks declined by about 2 percent. Substantial declines were reported in time certificates and open account deposits with maturities of less than two and one-half years. The sum of these losses, however, was about equal to the total gains registered in the higher-yielding time deposits with maturities of two and one-half to four years and the ceiling-free, four-year certificates.

Four-year time deposit certificates less than $100,000 without interest ceiling
Seventh District member banks
October 31, 1973

Size of bank	Percent issuing	Percentage paying 7.25% or less	7.50%	Over 7.50%
Total deposits less than $100 million				
Illinois	65	90	7	3
Indiana	77	64	33	3
Iowa	51	67	33	0
Michigan	82	91	6	3
Wisconsin	81	29	61	10
Total	**69**	**73**	**23**	**4**
Total deposits $100 million or over				
Illinois	95	78	11	11
Indiana	83	67	20	13
Iowa	83	40	60	0
Michigan	100	100	0	0
Wisconsin	90	44	56	0
Total	**93**	**78**	**16**	**6**

Time deposits over $100,000, other than negotiable certificates of deposit, expanded rapidly as banks continued to offer attractive rates to their customers. In July, amounts outstanding at the large banks were almost seven times the amounts outstanding during the October 1972 survey. From July to October 1973, these deposits rose another 23 percent. ■

Interest-bearing deposits of individuals, partnerships, and corporations in denominations of less than $100,000 at Seventh District member banks

SMSA[1]	Total weighted average rate[2] October 31 1972	1973	October 31, 1973 Savings: Amounts outstanding (millions)	Savings: Change from year ago (percent)	Certificates and open accounts: Amounts outstanding (millions)	Certificates and open accounts: Change from year ago (percent)
	(percent)					
Illinois						
Bloomington	4.87	5.39	31	+ 3.3	31	+ 7.8
Champaign-Urbana	4.98	5.55	44	+ 6.5	53	− 1.4
Chicago	4.77	5.36	5,021	− 3.8	3,247	− .3
Rock Island-Moline	4.76	5.29	121	+ .9	193	+15.2
Decatur	4.90	5.44	53	+ 5.3	83	− .7
Peoria	4.77	5.30	143	+ 1.3	103	+ 3.1
Rockford	4.88	5.48	161	+ 5.4	147	+ 5.4
Springfield	4.88	5.51	112	+ 2.6	129	+ 5.0
Other	4.96	5.48	498	+ 9.7	871	+13.0
State total	4.80	5.38	6,184	− 2.1	4,857	+ 2.8
Indiana						
Anderson	5.00	5.56	18	+23.7	22	+ 9.4
Gary-Hammond	4.53	5.26	206	+ 9.0	259	+ 8.2
Indianapolis	4.90	5.42	457	+ 7.5	692	+ 7.5
South Bend	4.84	5.42	127	+ 9.1	136	+16.6
Terre Haute	4.88	5.36	71	+ 8.0	60	+13.3
Other	4.86	5.38	676	+ 8.6	1,050	+11.1
State total	4.83	5.38	1,555	+ 8.5	2,219	+ 9.3
Iowa						
Cedar Rapids	4.72	5.13	44	+ 5.0	62	− 2.3
Des Moines	4.95	5.25	157	+12.2	155	− .9
Dubuque	5.06	5.50	48	+13.9	60	+ 8.4
Sioux City	4.95	5.58	60	+ 7.6	72	+ 9.6
Waterloo	5.00	5.56	35	+17.7	52	+12.2
Other	5.04	5.08	393	+21.0	918	+13.3
State total	5.01	5.18	737	+16.2	1,319	+ 9.4
Michigan						
Ann Arbor	4.40	4.82	169	− 2.6	101	+35.1
Battle Creek	4.82	4.85	32	− .8	24	+44.1
Detroit	4.69	5.32	3,505	+ 2.5	2,877	+ 1.8
Flint	4.76	4.97	467	+ 8.8	171	*
Grand Rapids	4.64	5.05	396	− 3.2	437	+12.1
Jackson	4.46	5.05	102	+ 4.8	56	+ 7.0
Lansing	4.59	4.93	479	− 2.8	384	+ 3.0
Saginaw	4.73	5.12	105	+ 2.2	56	+21.5
Other	4.79	5.25	955	+10.5	844	+ 7.4
State total	4.69	5.22	6,210	+ 3.1	4,950	+ 2.3
Wisconsin						
Appleton-Oshkosh	4.99	5.54	91	+ 6.9	111	+ 4.2
Kenosha	4.86	5.25	64	+ 7.3	51	+13.3
Madison	5.05	5.39	32	− 2.1	60	+ .4
Milwaukee	4.80	5.45	608	+ 1.2	423	+ 4.8
Racine	4.96	5.41	58	+ 3.2	63	− 1.6
Other	5.04	5.52	431	+10.1	702	+ 8.3
State total	4.93	5.47	1,284	+ 4.7	1,410	+ 6.6
Seventh District	**4 79**	**5.32**	**15,969**	**+ 2.2**	**14,755**	**+ 4.5**

*Less than .05 percent.

[1]"Other cities" include SMSAs in which there are less than three banks. Davenport-Rock Island-Moline SMSA data were disaggregated in order to include Davenport banks in the Iowa data.

[2]Calculated by weighting each bank's reported offering rate by the dollar amount of outstanding balances in its corresponding deposit category. If a bank did not offer a particular type of contract on October 31, any outstanding balance in that category was excluded in calculating the weighted rate for the area.