market share can be attributed to many factors, including the relative importance of thrift institutions in the SMSA market, price differences of NOWs between banks and thrifts, price differences of checking and NOW accounts at banks, and non-price differences among institutions, such as marketing efforts and auxiliary services.\(^8\)

The presence of thrifs in the market had some influence on the success of generating NOW accounts. The number of depositor accounts and total deposits held by thrifs was used to measure their importance in the selected SMSAs. These measures generally were related to the success of the largest banks in the battle for NOWs, although a one-to-one relationship did not occur. Banks gained the largest percentage of NOW balances in Lexington, where thrifs had the smallest percentage of offices and deposits.

A second factor affecting market share has been the pricing policies of banks and thrift institutions. Both banks and thrifs offer NOW accounts that pay interest of 5.25 percent, with no service charges if a minimum or average balance is maintained. If the balance falls below the stipulated amount, the depositor is assessed a monthly service charge that may include transaction fees. The average prices among the six institutions, along with other institutions, provide automatic teller machines on a joint basis.

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While thrifts typically had lower pricing terms, the price gap between banks and thrifs varied widely among the SMSAs. As expected, thrifs generally gained a larger share of NOWs in those markets where they established the greatest pricing advantages. Among the markets, for example, thrifs were the most competitive institutions in the Cincinnati and Cleveland markets, where thrifs had the highest proportion of deposits in the market. In the Lexington market, where thrifs had the lowest proportion of deposits, the Lexington savings and loan associations had the greatest pricing advantages.

**Summary**

Growth of NOW accounts in the 4D has been rapid, as most depository institutions have utilized their recently acquired authority to offer these interest-bearing transaction accounts. Over 75 percent of the NOW balances was generated during January and February of this year, and a large portion of those funds appeared to originate from checking and other types of transaction accounts. Banks have captured 87.5 percent of the NOW balances, despite charging higher prices than thrift institutions. Since January 1981 the bank share of net inflows to NOW balances has declined significantly, because of reduced volumes, the overall bank share fell only by 5.5 percentage points.

The success of banks in gaining NOW balances varied among the SMSAs examined. Much of the bank-market share variance can be attributed to differences in the relative importance of thrift institutions, differences in NOW account pricing between banks and thrifts, and pricing disparities between checking and NOW accounts at banks, and the non-price competition among institutions.

Paul R. Watro is an economist with the Federal Reserve Bank of Cleveland. The research assistance of Peggy Pennings is appreciated.

The views stated herein are those of the author and do not necessarily reflect those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.

**The Battle for NOWs**

by Paul R. Watro

Competition among depository institutions has intensified since January 1, 1981, when commercial banks, savings and loan, mutual savings banks, and thrift institutions were authorized to offer NOW accounts to nonprofit or quasi-nonprofit organizations. The banking industry as a whole can competitively lose some of its share of the third-party payments (or transaction account) market. Through aggressive marketing efforts and pricing schemes, banks can lessen the competitive impact of NOW accounts; indeed, some banks may even gain an additional share of the transaction account market.

Growth of NOW accounts and the market share of banks and thrifts showed substantial differences in the New England states, where NOW accounts have been available for several years. Much of the variance in the share of NOWs has been attributed to pricing and the extent that depository institutions actually offered NOW accounts. Differences in market share reflected the relative importance of thrift institutions in the state banking structure, pricing policies of thrifts and banks, and the stringency of minimum-balance requirements at banks and NOWs.

This Economic Commentary examines the growth of NOW account balances, along with changes in other transaction balances, at banks and thrifts in the Fourth Federal Reserve District since December 1980. NOW account balances of banks and thrift institutions are analyzed in six SMSAs—cincinnati, Columbus (Ohio), Dayton, Toledo and one each in Pennsylvania (Pittsburgh), West Virginia (Wheeling), and Kentucky (Lexington).

**Growth**

Growth of NOWs in the Fourth District (4D) has been rapid (see table 1). Fourth District depository institutions accumulated $3.3 billion in NOW balances during the first five months representing almost 15 percent of their total transaction deposits (NOW, demand, auto-

1. Banks and savings and loan associations are permitted to offer NOW accounts to nonprofit or quasi-nonprofit organizations that are granted tax exemptions by the Internal Revenue Service and to public institutions, such as state universities or city hospitals.


3. The term thrifs includes savings and loan associations and mutual savings banks. Con- ditions are excluded because they offer share drafts rather than NOW accounts.

The Fourth Federal Reserve District includes all of Ohio, the eastern part of Kentucky, the western part of Pennsylvania, and a small portion of West Virginia. Pennsylvania is the only state in the Fourth District where mutual savings banks operate.
4. Figures represent weekly averages based on daily figures for the first full reporting week (Thursday to Wednesday) in each month. These depositors switched funds from other accounts, yielding a $154-million net increase. Apparently many of these withdrawals were related to a high rate of growth in demand deposits ($2,330 million). Automatic transfer savings accounts began offering NOWs at lower charges and lower balance requirements than banks. While some of the savings deposits were transferred to NOW accounts, a large portion of these funds probably were shifted to higher-yielding investments of deposit and money-market funds.

Market Area

Banks had a natural advantage in introducing NOW accounts because of their near monopoly of the checking account market. In fact, some banks automatically converted checking accounts into NOW accounts. In some cases, thrifts have offered sliding-scale charges. If banks have competed effectively for NOW balances (see table 2). By February 1981, banks gained 91 percent of NOW balances in the 4D. A large portion of these funds probably originated from deposits that were switched from other accounts. In fact, smaller thrifts in some areas are offering automatic transfer savings accounts for individuals over the period examined.

duke higher-balance customers to switch to another institution if they already were receiving no-charge NOW accounts at a bank. In view of these factors, it is not surprising that banks have competed effectively for NOW balances (see table 2). By February 1981, banks gained 91 percent of NOW balances in the 4D. A large portion of these funds probably originated from deposits that were switched from other accounts. In fact, smaller thrifts in some areas are offering automatic transfer savings accounts for individuals over the period examined.

Market Area

Another way to gauge the relative success of banks and thrifts in attracting NOW accounts is to examine competition in individual market areas. Indeed, the geographical area in which depository institutions compete varies according to the type of product or service provided. Institutions compete for large construction loans in regional and national markets, whereas in Cleveland and to 99.0 percent in Lexington (see table 3). These variations in the bank-market areas are confined to smaller regional or local markets.

Table 2 NOW and Transaction Balances and Market Shares

<table>
<thead>
<tr>
<th>Date</th>
<th>NOW balances, $ mil</th>
<th>Difference</th>
<th>Market share, percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>January</td>
<td>12,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>February</td>
<td>13,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>March</td>
<td>14,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>April</td>
<td>15,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>May</td>
<td>16,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>June</td>
<td>17,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>July</td>
<td>18,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>1981</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>January</td>
<td>19,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>February</td>
<td>20,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>March</td>
<td>21,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>April</td>
<td>22,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>May</td>
<td>23,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>June</td>
<td>24,019</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>July</td>
<td>25,019</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

Table 3 Market Share and Thrift Competition in Selected SMSAs

<table>
<thead>
<tr>
<th>SMSA</th>
<th>Market share of NOW balances, percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cincinnati</td>
<td>87.2 90.0 96.9 96.8 97.2 98.3 833 967</td>
</tr>
<tr>
<td>Lexington</td>
<td>90.0 90.0 96.9 98.3 98.3 98.3 467 467</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>90.0 90.0 96.9 98.3 98.3 98.3 467 467</td>
</tr>
<tr>
<td>Toledo</td>
<td>53.0 50.0 50.0 50.0 50.0 50.0 100 100</td>
</tr>
</tbody>
</table>

5. Time deposits increased by $5.9 billion at 4D banks and thrift institutions, and money-market fund rates rose from 76.6 billion to 125.7 billion between December 1980 and July 1981.

6. Lower service charges might make it profitable for high-balance depositors to change institutions, particularly if they prefer to economize on their transaction balances.
4. Figures represent weekly averages based on daily basis and all credit unions are excluded. Daily figures for the first full reporting week (Thursday to Wednesday) in each month. Figures are slightly understated, because smaller institutions do not report on a daily basis.


Market Share

Banks had a natural advantage in introducing NOW accounts because of their near monopoly of the checking account market. In fact, some banks automatically converted checking balances to NOW accounts at a bank. In view of these factors, it is not surprising that banks have competed effectively for NOW balances (see table 2). By February 1981, banks gained 91 percent of NOW balances in the 4D. A large portion of these funds probably originated from deposits that were switched from other accounts. Other types of bank deposits—demand, automatic transfer, telephone and pre-authorized savings—declined over this two-month period.

Since January 1981, however, thrifts have consistently gained an increasing large share of the net inflows of NOW accounts. After gaining only 7 percent in January, thrifts increased their share of monthly inflows of NOW balances, reaching a high of 29 percent in July. Although the volume of NOW growth has decreased greatly, thrifts have improved their overall share of NOW balances outstated by 5.5 percentage points since January, reaching 12.5 percent in July.

Because of the growth in NOW accounts, thrifts increased their share of total transaction balances from 1.7 percent in December 1980 to 13.5 percent in July 1981. This was accomplished by a $141-million increase in NOW balances, offset by a $93-million decline in other transaction balances, for a net gain of $47 million. In contrast, banks experienced a net reduction of $167 million in transaction balances.

Market Area

Another way to gauge the relative success of banks and thrifts in attracting NOW accounts is to examine competition in individual market areas. Indeed, the geographical area in which depository institutions compete varies according to the type of product or service provided. Institutions compete for large construction loans in regional and national markets, whereas in Cleveland to 90.0 percent in Lexington (see table 3). These variations in the bank.
Tables 1 and Table 2 are tables presenting data on NOW accounts and transaction balances. Table 3 is a table showing market share and thrift competition in selected SMSAs.

Table 1 NOW Growth and Other Deposit Changes

<table>
<thead>
<tr>
<th>Deposit type</th>
<th>Miles of dollars</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOW</td>
<td>996</td>
<td>2,152</td>
<td>2,888</td>
<td>3,014</td>
<td>3,176</td>
<td>3,314</td>
<td>3,314</td>
</tr>
<tr>
<td>Demand</td>
<td>20,000</td>
<td>17,648</td>
<td>17,702</td>
<td>17,360</td>
<td>17,139</td>
<td>17,730</td>
<td>17,913</td>
</tr>
<tr>
<td>Automatic transfer</td>
<td>1,139</td>
<td>765</td>
<td>588</td>
<td>561</td>
<td>561</td>
<td>564</td>
<td>595</td>
</tr>
<tr>
<td>Telephone and preauthorized</td>
<td>819</td>
<td>736</td>
<td>646</td>
<td>686</td>
<td>690</td>
<td>630</td>
<td>615</td>
</tr>
<tr>
<td>Total transaction</td>
<td>29,191</td>
<td>23,390</td>
<td>21,033</td>
<td>21,906</td>
<td>22,205</td>
<td>21,948</td>
<td>22,173</td>
</tr>
</tbody>
</table>

Note: a. Deposits include those of banks, saving and loan associations, and mutual savings banks in the Fourth District.

Table 2 NOW and Transaction Accounts and Market Share

<table>
<thead>
<tr>
<th>Year</th>
<th>December</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>1,026</td>
<td>956</td>
<td>928</td>
<td>995</td>
<td>1,019</td>
<td>1,034</td>
<td>1,026</td>
</tr>
<tr>
<td>1981</td>
<td>1,019</td>
<td>1,026</td>
<td>1,034</td>
<td>1,026</td>
<td>1,019</td>
<td>1,034</td>
<td>1,026</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Deposit type</th>
<th>1980</th>
<th>1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOW balances, $ mil</td>
<td>1,026</td>
<td>1,019</td>
</tr>
<tr>
<td>Banks</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Thrifts</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Market share, %</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Time</td>
<td>3,245</td>
<td>3,245</td>
</tr>
<tr>
<td>Federal Reserve System</td>
<td>3,245</td>
<td>3,245</td>
</tr>
</tbody>
</table>

Table 3 Market Share and Thrift Competition in Selected SMSAs

<table>
<thead>
<tr>
<th>SMSA</th>
<th>Market share, %</th>
<th>Thrifts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cincinnati</td>
<td>97.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Cleveland</td>
<td>97.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Houston</td>
<td>95.6</td>
<td>4.4</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>95.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Miami</td>
<td>94.3</td>
<td>5.7</td>
</tr>
<tr>
<td>New York</td>
<td>93.1</td>
<td>6.9</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>92.8</td>
<td>7.2</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>91.9</td>
<td>8.1</td>
</tr>
<tr>
<td>Richmond</td>
<td>90.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>

Note: a. All of the largest depositary institutions in the selected SMSAs offered NOW accounts, two of the Pittsburgh banks did not offer them to individuals. These banks, however, continued to provide time and transaction savings accounts. NOW accounts are similar to transaction accounts in that they are demand deposits; however, NOW accounts are interest-bearing and have a lower required balance than transaction accounts.

b. Market-share balances of NOW accounts are estimates based on the proportion of total deposits at offices within the SMSAs.

c. Prices are averaged from charges by the three or four largest banks in each of the SMSAs during the first five months of 1982. Minimum-balance requirements refer to those maintained in transaction accounts only; in Pittsburgh, however, NOW accounts are collected to the extent required. NOW and checking accounts refer to the least-cost minimum-balance type, assuming monthly transaction of three deposits and fifteen checks. An average service charge is used for institutions offering sliding-scale charges.

market share can be attributed to many factors, including location, the presence of thrift institutions in the SMSA market, price differences of NOWs between banks and thrifts, price differences of checking and NOW accounts at banks, and non-price differences among institutions, such as marketing efforts and auxiliary services. 8.

The presence of thrifts in the market had some influence on the success of generating NOW accounts. The number of deposit offices and total deposits held by thrifts was used to measure their importance in the selected SMSAs. These measures generally were, including the relative importance of banks in the battle for NOWs, although a one-to-one relationship did not occur. Banks gained the largest percentage of NOW balances in Dayton, where thrifts had the smallest percentage of offices and deposits.

A second factor affecting market share has been the pricing policies of banks and thrift institutions. Both banks and thrifts offer NOW accounts that pay interest of 5.25 percent, with no service charges if a minimum or average balance is maintained. If the balance falls below the stipulated amount, the depositor is assessed a monthly service charge that may include transaction fees. The average prices of the three or four largest banks and thrifts operating in the selected SMSAs form a basis for price comparison. 9. Pricing elements can include monthly service charges, per transaction fees, and the minimum balance required to avoid any charges. While prices often vary among institutions, the average pricing terms of the largest banks and thrifts are assumed to reflect the auxiliary services than thrifts. Cincinnati and Cleveland thrift institutions apparently were the most competitive with banks, as the third largest savings and loan associations provide other automatic teller machines or overdraft protection. 10. The Cincinnati savings and loan associations, along with other institutions, provide automatic teller machines on a joint basis.

9. Average prices were calculated from the prices charged by the three or four largest banks and thrifts during the first five months of this year. When the pricing terms of one of the three largest institutions were not comparable, the prices of the fourth largest institution were used.

Marketing efforts, more banks were found to offer these auxiliary services than thrifts. Cincinnati and Cleveland thrift institutions apparently were the most competitive with banks, as the third largest savings and loan associations provide other automatic teller machines or overdraft protection. 10.

Summary

Growth of NOW accounts in the 4th District has been rapid, as most depository institutions have utilized their recently acquired authority to offer these interest-bearing transaction accounts. Over 75 percent of the NOW balances was generated during January and February of this year, and a large portion of these funds appeared to originate from checking and other types of transaction accounts. Banks have captured 87.5 percent of the NOW balances, despite charging higher prices than thrift institutions. Since January 1981 the bank share of net inflows to NOW balances has declined significantly, because of reduced volumes, the overall bank share fell only by 5.5 percentage points.

The success of banks in gaining NOW balances varied among the SMSAs examined. Most of the bank-market share variance can be attributed to differences in the relative importance of thrift institutions, differences in NOW account pricing between banks and thrifts, pricing disparities between checking and NOW accounts at banks, and the non-price competition among institutions.

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The Battle for NOWs by Paul R. Watro

Competition among depository institutions has intensified since January 1, 1981, when commercial banks, savings and loan associations, and mutual savings banks were permitted to offer negotiable order of withdrawal (NOW) accounts nationwide. Depository institutions can now compete for interest-bearing transaction accounts of households and nonprofit organizations. 1

The banking industry as a whole can conceivably lose some of its share of the third-party payments (or transaction account) market. Through aggressive marketing- and pricing schemes, banks can lessen the competitive impact of NOW accounts; indeed, some banks may even gain an additional share of the transaction account market.

Growth of NOW accounts and the market share of banks and thrifts showed substantial differences in the New England states, where NOW accounts have been available for several years. 2 Much of the variance in the share of NOWs has been attributed to pricing and the extent that depository institutions actually offered NOW accounts. Differences in market share reflected the relative importance of thrift institutions in the state banking structure, the pricing policies of thrifts, and the stringency of minimum-balance requirements at banks and thrifts.

This Economic Commentary examines the growth of NOW account balances, along with changes in other transaction balances, at banks and thrifts in the Fourth District since December 1980. 3 NOW account balances of banks and thrift institutions are analyzed in six SMSAs—fourth largest institution were used.

Pennsylvania (Pittsburgh), and Kent-ucky (Lexington). Growth

Growth of NOW accounts and the market share of banks and thrifts showed substantial differences in the New England states, where NOW accounts have been available for several years. 2 Much of the variance in the share of NOWs has been attributed to pricing and the extent that depository institutions actually offered NOW accounts. 1

3. The term thrift includes savings and loan associations and mutual savings banks. Credit unions are excluded because they offer share drafts rather than NOW accounts.

The Fourth Federal Reserve District includes all of Ohio, the eastern part of Kentucky, the western part of Pennsylvania, and a small portion of West Virginia. Pennsylvania is the only state in the Fourth District where mutual savings banks operate.

1. Banks and savings and loan associations are permitted to offer NOW accounts to nonprofit or- ganizations that are granted tax exemptions by the Internal Revenue Service and to public institutions, such as state universities or city hospitals.


The Federal Reserve Bank of Cleveland August 10, 1981

Federal Reserve Bank of Cleveland

145.5 billion in NOW balances after representing almost 15 percent of their total transaction deposits (NOW, demand, auto-

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The presence of thrifts in the market had some influence on the success of generating NOW accounts. The presence of offices and total deposits held by thrifts was used to measure their importance in the selected SMSAs. These measures generally were, however, related to the success of banks in the battle for NOWs, although a one-to-one relationship did not occur. Banks gained the largest percentage of NOW balances in Lexington, where thrifts had the smallest percentage of offices and deposits.

A second factor affecting market share has been the pricing policies of banks and thrift institutions. Both banks and thrifts offer NOW accounts that pay interest, with no service charges if a minimum or average balance is maintained. If the balance falls below the stipulated amount, the depositor is assessed a monthly service charge that may include transaction fees. The average prices of the three or four largest banks and thrifts operating in the selected SMSAs form a basis for price comparisons. 

Pricing elements can include monthly service charges, per transaction fees, and the minimum balance required to avoid any charges. Prices often vary among institutions, the average pricing terms of the largest banks and thrifts are assumed to reflect their auxiliary services than banks. Cincinnati and Cleveland thrift institutions apparently were the most competitive with banks, as the three largest savings and loan associations provide either automatic teller machines or overdraft protection.

Summary

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August 10, 1981

The Battle for NOWs

by Paul R. Watro

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1. Average prices were calculated from the prices charged by the three or four largest banks and the three or four largest thrift institutions. Since January 1981 the bank share of net inflows to NOW balances has declined significantly, because of reduced volumes; the overall bank share fell only by 5.5 percentage points.

2. Summary of NOW balances of banks and thrifts showed substantial differences in the New England states, where NOW accounts have been available for several years. As of the third week of January, 4D banks of the Federal Reserve System represent almost 15 percent of the total transaction deposits (NOW, demand, auto-

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