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economic commentary

Rate Deregulation and Deposit Shifting

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The deregulation of interest rates has provided increasing opportunities and choices for depository institutions and for individuals. Recent regulatory changes have dramatically altered both the deposit holdings of consumers and the balance sheets of depository institutions. Of major importance were the introduction of money market deposit accounts (MMDAs) in December 1982 and Super-NOW accounts in January 1983. In addition, all new time deposits with maturities of over 31 days were deregulated in October 1983. Competitive pressures induced depository institutions to pay higher rates on these new unregulated deposit accounts. Rate differentials motivated customers to increase their deposit holdings, particularly those paying higher rates. These changes not only altered the deposit structure of commercial banks and thrift institutions but also their deposit share. Such developments, in turn, affected the volume of required reserves and the composition of monetary aggregates.

Public response to MMDAs was especially overwhelming; by March 1984, these accounts attracted over $20 billion in the Fourth Federal Reserve District and $390 billion nationwide.[1] It is conjectured that most of these funds probably were transferred from lower-yielding regulated accounts and uninsured money market mutual funds.

This *Economic Commentary* examines deposit holdings of institutions located in the Fourth District to ascertain the deposit growth and shifting that resulted from the introduction of MMDAs and Super-NOWs. We compare deposits held by commercial banks and thrifts to determine which type of institution gained (or lost) market share since the accounts were authorized.

Deposit Growth

Having no rate ceilings, Super-NOWs and MMDAs have been very popular in the Fourth District and, indeed, throughout the nation. Fourth District depository institutions accumulated $23 billion in

Table 1 Fourth District Deposits[a]
Billions of dollars

Deposit type	Dec. 1982	June 1983	Mar. 1984
Total[b]	**120.7**	**129.1**	**137.0**
Transaction	24.8	26.1	27.4
Demand	18.3	17.0	16.7
Super-NOW	—	1.9	2.7
NOW	5.3	6.1	6.9
Other[c]	1.2	1.1	1.1
Savings	22.1	38.9	39.2
Traditional[d]	22.1	19.8	18.7
MMDA	—	19.1	20.4
Time	73.8	64.2	70.4
Large CDs	17.6	12.7	13.6
Small CDs	56.2	51.5	56.8

a. Deposits include those of commercial banks, savings and loan associations, mutual savings banks, and credit unions in the Fourth District. Figures are weekly averages based on daily figures for the first full week in December and March and for the third full week in June. Figures are slightly understated, as smaller institutions do not report on a daily basis.
b. Figures may not sum to total because of rounding.
c. *Other* includes automatic transfer savings (ATS) accounts and telephone and preauthorized transfers.
d. *Traditional savings* are nontransaction savings, such as regular savings and passbook savings.

SOURCE: Report of Transaction Accounts, Other Deposits, and Vault Cash, Federal Reserve System.

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1. The Fourth Federal Reserve District includes all of the state of Ohio, western Pennsylvania, northern and eastern Kentucky, and the northern panhandle of West Virginia.

Table 2 Fourth District Deposit Composition[a]
Deposits in percent; percentages are rounded

Deposit type	Dec. 1982	June 1983	Mar. 1984
Total			
Transaction	21	20	20
Savings	18	30	29
Time	61	50	51
Transaction			
Demand	74	65	61
Super-NOW	—	7	10
NOW	21	23	25
Other[b]	5	4	4
Savings			
Traditional[c]	100	51	48
MMDA	—	49	52
Time			
Large CDs	24	20	19
Small CDs	76	80	81

a. Deposits include those of commercial banks, savings and loan associations, mutual savings banks, and credit unions in the Fourth District. Figures are weekly averages based on daily figures for the first full week in December and March and for the third full week in June. Figures are slightly understated, as smaller institutions do not report on a daily basis.
b. *Other* includes ATS accounts and telephone and preauthorized transfers.
c. *Traditional savings* are nontransaction savings, such as regular savings and passbook savings.

SOURCE: Report of Transaction Accounts, Other Deposits, and Vault Cash, Federal Reserve System.

MMDAs and Super-NOWs by March 1984 (see table 1). Some of these funds apparently were withdrawn from other deposit accounts, given the outflows of traditional savings, time, and demand deposits. A sizable portion of MMDA and Super-NOW balances probably was derived from sources other than depository institutions, such as money market mutual funds.

Between December 1982, when MMDAs were made available, and June 1983, the amount of funds held in MMDAs in Fourth District depository institutions snowballed to $19 billion. In contrast, the initial response to Super-NOWs was much less robust; less than $2 billion was deposited in these accounts during the first five months after their introduction. Super-NOWs grew more slowly at first because they were introduced after the MMDAs, paid lower interest rates, and were offered only to individuals and by fewer institutions.

Deposit growth at Fourth District institutions has decelerated from over a 13 percent annual rate between December 1982 and June 1983 to less than a 9 percent annual rate from June 1983 to March 1984. Time deposits, particularly small certificates of deposit (CDs), accounted for over $6 billion of the $8 billion net deposit inflows since June 1983. The removal of statutory rate ceilings and minimum-balance requirements on nearly all small time deposits in October 1983 probably helped contribute to their recent rise. MMDA balances grew $1.3 billion, or at a rate close to overall deposit growth. Super-NOW and NOW balances increased $1.6 billion as individuals apparently continued to switch demand balances into these accounts.

Deposit Composition

The deposit structure clearly changed as a result of the availability of MMDAs and Super-NOWs (see table 2). Prior to the introduction of these accounts, over 60 percent of total deposits consisted of time deposits, with transaction and savings balances accounting for the remaining deposits. Three-quarters of the transaction deposits were held in demand deposits, and one-quarter of the time deposits were held in large CDs that are usually sold to corporate customers. As a percent of total deposits, time deposits dropped sharply to 50 percent by June 30, 1983, and savings balances nearly doubled. Striking changes occurred within the major deposit categories. As of March 1984, MMDAs accounted for more than one-half of total savings, and interest-bearing checking balances (NOWs and Super-NOWs) represented 35 percent of total transaction accounts. Given the substantial inflows into MMDAs and Super-NOWs, depository institutions purchased fewer large CDs.

As institutions pay market rates on a larger share of their funds, asset-liability management becomes more critical to profitability. Managers need to match maturities of assets and liabilities to reduce their vulnerability to interest-rate changes. These adjustments take time, particularly for institutions with a relatively large portion of long-term assets, such as thrift institutions and smaller commercial banks.

Market Share

Rate deregulation provides opportunities for depository institutions to increase deposits by winning back funds that had been transferred into money market mutual funds and by luring deposits from other competitors. Before the introduction of MMDAs and Super-NOWs, $242 billion was held in money market mutual funds nationwide, compared with $187 billion held in these funds in March 1984. Although much of these funds derived from depository institutions, money market mutual funds redirected a significant portion of those funds back into the banking system through the purchase of large CDs. Since these CDs were typically bought from the largest banks, it is presumed that smaller institutions suffered proportionally larger deposit losses to money market mutual funds.

Thrift Institutions. The most aggressive depository institutions would be expected to gain a larger share of deposits than their competitors. Thrift institutions as a group increased deposits at an explosive pace following the introduction of ceiling-free accounts. Between December 1982 and June 1983, thrift deposits in the Fourth District grew at a 30 percent annual rate, nearly five times the deposit growth at commercial banks. Thrifts captured over two-thirds of the total deposits flowing into Fourth District depository institutions. Although most gains were attributed to MMDAs and Super-NOWs, thrifts also experienced net inflows in transaction accounts and large CDs. The only net outflows were from time deposits, but reductions were much smaller than those experienced by commercial banks.

Table 3 Deposit Share of Fourth District Institutions
In percent[a]

	Thrift institutions			Large commercial banks			Other commercial banks		
Deposit type	**12/82**	**6/83**	**3/84**	**12/82**	**6/83**	**3/84**	**12/82**	**6/83**	**3/84**
Total[b]	33	35	36	35	33	32	32	32	32
Transaction	5	8	8	54	51	50	41	41	42
Super-NOW	—	15	13	—	39	46	—	46	41
NOW	16	19	19	34	33	32	50	48	49
Savings	39	39	38	27	29	30	34	32	32
Traditional	39	41	42	27	27	25	34	32	33
MMDA	—	37	35	—	33	35	—	30	30
Time	40	44	45	32	27	26	28	29	29
Large CDs	13	20	24	67	57	53	20	23	23
Small CDs	49	50	50	21	20	19	30	30	31

a. For each date, the figures sum to 100 percent for each type of deposit. For example, of all NOW accounts in June 1983, 19 percent were held by thrifts, 33 percent by large commercial banks, and 48 percent by other commercial banks.

b. Deposits include those of commercial banks, savings and loan associations, mutual savings banks, and credit unions in the Fourth District. Figures are weekly averages based on daily figures for the first full week in December and March and for the third full week in June. Figures are slightly understated, as smaller institutions do not report on a daily basis.

SOURCE: Report of Transaction Accounts, Other Deposits, and Vault Cash, Federal Reserve System.

Thrifts registered market share gains for various types of deposits, typically paying higher rates on deposits such as MMDAs and Super-NOWs (see table 3). From December 1982 to June 1983, thrifts captured 37 percent of the MMDA deposits and increased their share of total deposits from 33 percent to 35 percent. In the same time period, thrifts' share of transaction balances mushroomed from less than 5 percent to 8 percent, primarily as a result of the introduction of Super-NOWs and gains in NOW balances. Thrifts also improved their market share for time deposits by paying higher rates and increasing their penetration in the large-CD market.

Thrifts have continued to increase their share of total deposits but at a slower pace since June 1983. Inflows of time deposits, particularly large CDs, were largely responsible for gains in the share of deposits. Similar to previous changes, market share increases by thrifts were generally linked to losses incurred by the largest commercial banks.

Commercial Banks. Despite market share losses in most deposit categories, commercial banks gained in their share of MMDAs and Super-NOWs since June 1983. These increases were attributed to only the largest commercial banks, as smaller commercial banks held their own in MMDAs and lost a significant share of Super-NOW balances.[2] Large commercial banks continued to rely less on the CD market and more on MMDAs and Super-NOWs. Although evidence indicated that the largest commercial banks paid lower rates on

2. Eighteen banks are included in the group of largest commercial banks, each of which has deposits of over $900 million.

Super-NOWs and MMDAs than other depository institutions, the largest commercial banks increased their share of both types of deposits.[3] Such gains could be attributed to providing a larger variety of complementary services with these accounts.

Conclusion

Higher interest rates encouraged individuals to open MMDAs and NOWs by reducing balances held in other deposit accounts and drawing on funds held outside depository institutions. Most of these changes took place during the first few months after these accounts were introduced.

Depository institutions now hold a larger portion of interest-paying transaction balances and higher-paying savings accounts. Fourth District deposit data do not support the allegation that the largest banks would benefit the most from rate deregulation. On the contrary, the largest commercial banks have actually suffered a loss in their share of deposits, while other commercial banks and thrift institutions in particular experienced market share gains. These changes may be transitory, however; from June 1983 to March 1984, the share of total deposits held by thrifts and smaller banks increased only slightly.

3. Commercial banks with deposits over $900 million averaged 6.70 percent on Super-NOWs, 8.28 percent on personal MMDAs, and 8.11 percent on business MMDAs; other depository institutions averaged rates of 7.29 percent, 8.41 percent, and 8.36 percent, respectively. These findings are based on a November 1983 survey of 112 Fourth District depository institutions. For a discussion of other survey results, see Paul R. Watro, "Deregulation and Deposit Pricing," *Economic Commentary*, Federal Reserve Bank of Cleveland, April 23, 1984.

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