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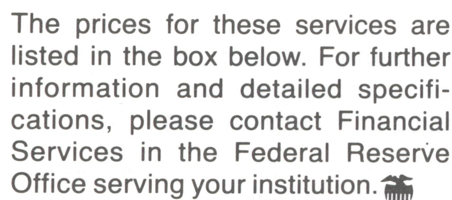
S.F. FED OFFERS TWO NEW SERVICES

On May 2, 1983, the Federal Reserve Bank of San Francisco announced the availability of two new services for payor financial institutions: "Printed Selected Totals by Account Numbers" and "Magnetic Tape of MICR Line." The services were offered concurrent with implementation of noon presentment of items.

Printed Selected Totals by Account Numbers should aid payor institutions that wish to monitor selected accounts or ranges of accounts for cash management purposes. The service provides a printout of: the account number (or range), the dollar amount, the number of items for each selected account or range of accounts, and a cash letter total. The printout is available at presentment, as is telephone notification. Non-machinable and package sorted items are not included in the account tables.

A daily *magnetic tape of the MICR line* of items processed on the Bank's high speed check sorters is available at presentment in either of two forms: (1) a tape that contains all items drawn on the payor institution in the order processed, including those items with unreadable characters or missing account number fields, or (2) a tape that contains only those items in which all five fields on the MICR line are readable. A sort of items that do not read is optional on the latter tape.

The prices for these services are listed in the box below. For further information and detailed specifications, please contact Financial Services in the Federal Reserve Office serving your institution.



New Services for Payor Financial Institutions

Service	Price
Printed Selected Totals by Account Number	\$300 per month for the first ten accounts \$ 12 for each account over ten Fees include file maintenance and notification by telephone
Magnetic Tape of MICR Line	\$ 25 per tape plus .1¢ per item (plus \$500 per month and .2¢ per item for optional sort of "bad" reads)

WESTERN FINANCE IN 1982

In 1982, the challenges posed by high interest rates, accelerating deposit deregulation, and a slowdown in the Western economy tested Twelfth District depository institutions' ability to maintain asset quality and earnings. Although District banks posted earnings of nearly \$1.7 billion in 1982 almost all measures of profitability suffered, especially during the first half of the year. Earnings rebounded in the second half as interest rates fell and margins widened, but not by enough to post an increase over 1981 earnings.

Since late 1982, the rapid increase in the pace of deposit deregulation taken by the Depository Institutions Deregulation Committee has set the tempo for heightened competition in 1983. In particular, the Money Market Deposit Account has given banks and thrifts a short-term, ceiling-free deposit instrument to compete with money market mutual funds and, in so doing, encouraged net savings inflows into depository institutions. The following report recounts the developments in Western finance in 1982 that preceded the more positive outlook for the current year.

Recession Hurt Credit Demand

The recession that plagued the Western region's businesses and households also curtailed their demands for credit through most of 1982. With weak loan growth and little change in banks' securities holdings, total bank credit growth was anemic. Only commercial and industrial lending continued to show moderate strength, but the display was due to poor business conditions and the unwillingness to use alternative sources of financing rather than to a resurgence in economic activity.

Commerical and industrial loans accounted for half of the \$13 billion (6 percent growth) in total loans. Through much of the year, businesses were under severe pressure to meet their borrowing needs in the short end of the market. Increased borrowing from banks filled the funding gaps arising from firms' temporary working capital needs. Western banks were a source of interim credit when funds in the commerical paper or long-term bond markets either dried up or became

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FED REDUCES DEPOSIT REPORT REQUIREMENTS

The Federal Reserve Board's amendments to Regulation D (Reserves of Depository Institutions) designed to reduce the deposit reporting burden for small institutions took effect April 28, 1983. The Board action implements provisions of the Garn-St Germain Depository Institutions Act of 1982 intended to reduce the administrative burden of such reports for commercial banks and thrift institutions with $2.1 million or less in total reservable liabilities.

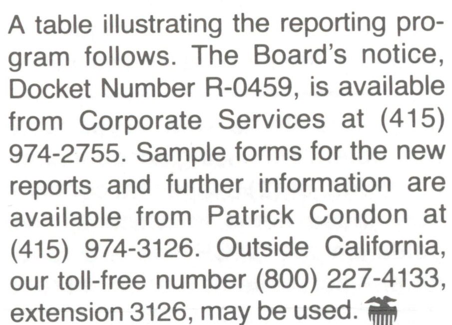
Under the amendments, institutions (other than U.S. branches and agencies of foreign banks or Edge and Agreement corporations) with $2.1 million or less in reservable liabilities (called fully exempt institutions) must file one of three kinds of reports based on their total deposits. Available data will be used to estimate deposits at fully exempt institutions with less than $2 million in total deposits. Fully exempt institutions with total deposits between $2 million and $15 million must file an annual two-item report (FR 2910a) covering one day in June each year. Fully exempt institutions with $15 million or more in total deposits must file a condensed six-item report (FR 2910q) for the same week each quarter.

With this system, the vast majority of institutions previously deferred from reserve and reporting requirements remain free of reporting requirements. Former quarterly reporters that are fully exempt from reserve requirements have been converted into annual reporters, and former weekly reporters that are fully exempt are now quarterly reporters. The number of items reported by the latter two groups is also substantially reduced.

All nonexempt quarterly respondents will begin reporting on the same schedule as those fully exempt institutions that file the new reduced quarterly report. At present, institutions that report quarterly do so on a staggered basis, one-third reporting each month.

U.S. branches and agencies of foreign banks, and Edge and Agreement corporations, will continue to file a weekly Report of Transactions Accounts, Other Deposits and Vault Cash (FR 2900) and a Weekly Report of Certain Eurocurrency Transactions (FR 2950 and FR 2951) even if the family of related institutions has less than $2.1 million in reservable liabilities.

A table illustrating the reporting program follows. The Board's notice, Docket Number R-0459, is available from Corporate Services at (415) 974-2755. Sample forms for the new reports and further information are available from Patrick Condon at (415) 974-3126. Outside California, our toll-free number (800) 227-4133, extension 3126, may be used.



Reporting Requirements of Depository Institutions (Other than Edge and Agreement Corporations and U.S. Branches and Agencies of Foreign Banks)

Total Deposits	Reservable Liabilities: $2.1 Million or Less	Reservable Liabilities: More than $2.1 Million
Less than $2 million	No reporting required unless data are not available from other sources, then special filing of FR 2910a	(not applicable)
$2 million or more, but less than $15 million	Annually; FR 2910a	Quarterly; FR 2900 and FR 2950
$15 million or more	Quarterly; FR 2910q	Weekly; FR 2900 and FR 2950

REGULATIONS AND OPERATIONS UPDATE

Fees for Federal Funds Checks: Effective May 26, 1983, the following fees for processing Federal Funds checks will be established:

- $5.00 for each Federal Funds check processed
- $10.00 for each stop payment or returned Federal Funds check

Depository institutions will continue to bear the cost of printing and producing supplies of these checks.

For further information, please contact the Accounting Department of your local Federal Reserve Office.

Regulation D—Reserves of Depository Institutions: The Federal Reserve Board has amended Regulation D to reduce the deposit reporting burden for most small institutions. For a detailed discussion, please refer to the article on this subject in these pages.

Regulation Q—Early Withdrawal Penalties: In light of the severe damage caused by the recent earthquake in Coalinga, California, the Federal Reserve Board has suspended Regulation Q early withdrawal penalties for victims of the natural disaster.

A member bank, wherever located, can pay a time deposit before maturity without penalty upon a showing that the depositor has suffered a property or other financial loss in Coalinga as a result of the May 2 earthquake. The member bank should obtain from the depositor a signed statement describing fully the disaster-related loss, and have this statement approved and certified by a bank officer.

The Board's action is retroactive to May 5, 1983 (the day Coalinga was declared by the President to be a major disaster area) and will remain in effect until midnight, November 5, 1983. We understand that the FDIC is taking similar action for nonmember banks.

For further information, please contact our Law Department at (415) 974-2256 or 974-2254.

WESTERN FINANCE IN 1982

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prohibitively expensive. While this boosted banks' business loan growth throughout much of 1982, it reflected the fundamental weakness of the economy and disruptions in the normal lines of long-term financing.

By year-end, however, much of the pressure on business loan demand had subsided. Interest rates had fallen significantly, and the financial markets had begun to function in a more normal manner. Borrowers began taking advantage of the declines in long-term interest rates to raise funds in the equity and bond markets; simultaneously, borrowers began to pay down their short-term bank loans.

Faced much of the year with high mortgage and consumer credit interest rates, as well as the specter of rising unemployment, Western households severely curtailed bank borrowing. Real estate loans did increase by $3 billion (a four-percent increase) but most of the strength came from commerical real estate activity. Residential mortgage growth fell well below the rapid pace of recent years. Both supply and demand considerations accounted for the weakness. High rates had an obvious effect on the demand for both housing and mortgages. Moreover, many Western financial institutions—with sizeable portfolios of low-yielding long-term fixed rate mortgages—also had taken actions to limit their exposure to interest rate risk by limiting new extensions of fixed-rate mortgages or by selling rather than holding new mortgages.

Consumer loans for durables such as automobiles, appliances and furniture, exhibited continued weakness in 1982. In fact, consumer loans—primarily installment credit—at Western banks, have stagnated since 1979. While the decline in consumer loans was very small in 1982, it signaled the inability and unwillingness of many consumers to increase their debt burden amid continued concern over the course of the economy.

Funding Costs Up

Competition from money market funds and thrifts for both business and consumer balances, as well as the acceleration in deposit interest rate ceiling deregulation, also kept the cost of funds up. Almost the entire 1982 increase in domestic deposits ($16 billion) came in instruments paying market returns, placing continued upward pressure on costs. In addition, a $3-billion increase in non-deposit sources, primarily Federal funds and repurchase agreements, also provided banks with ample funds to expand asset growth during the year.

Western banks recorded a $2-billion increase in NOW account balances, but small-denomination time deposits (under $100,000) provided the bulk of new deposits. Of course, the strength in small time deposits reflected the enormous popularity of market-return deposit instruments and the wide variety of newly authorized instruments that became available in 1982. These instruments attracted a continued flow of below-market-return checking and savings balances. Large time deposits ($100,000 and over), which represent nearly one-third of domestic deposits at District banks, also continued to be a major source of funding, especially earlier in the year.

The surge in small denomination time deposit growth in 1982 was even more dramatic when one notes that Western banks reported a $1-billion decline in holdings of six-month money market certificates ($28 billion as of December). Indeed, other factors such as the sharp decline in short-term interest rates boosted growth in the 2½-year small-savers certificate (SSC). SSC's jumped by over $3 billion to the $9-billion level. All-Savers Certificates began maturing in October, and quickly declined in importance. By year-end, they were surpassed by ceiling-free IRA balances, which had grown to $1.5 billion. The 7- to 31-day money market account authorized in September also was a big hit with depositors, although, at year-end many of these deposits were transferred into the newly authorized ceiling-free insured money market deposit account (MMDA). Authorization of the MMDA's for offering in mid-December resulted in a dramatic shift in the composition of banks' consumer deposit base. Over $15 billion rapidly moved out of checking, NOW's, savings and other types of short-term consumer instruments into the new account. The authorization of the Super-NOW account in January is likely to reinforce this trend.

Earnings Slump

Aggregate earnings of Western banks deteriorated in 1982, falling about ten percent from 1981, as many institutions suffered from narrowed interest margins, weak asset growth and rising loan losses. Many institutions also felt continued upward pressure on overhead expenses, especially personnel costs and occupancy expenses. Most banks' second half earnings also suffered because of the necessity of adding to their loan loss cushions.

Net interest income at Western banks rose slightly in 1982 as earnings from the $13 billion increase in loan volume more than offset reduced earnings from narrowed margins on the remainder of the portfolio. Despite the overall reduction in interest margins, caused primarily by the soaring cost of consumer deposits, there were some bright spots on the funding side. Falling interest rates and weak loan demand combined to help Western banks record sizeable reductions in expenses for off-shore borrowing as well as for managed liabilities and other purchased funds.

Unlike interest income, operating earnings failed to keep pace with operating expenses. Thus, the small increase in net interest in-

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Federal Reserve Notes is produced monthly and is distributed to depository institutions by the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, California 94120.
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WESTERN FINANCE

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come easily was overshadowed by continued sharp increases in overhead expenses and a tremendous jump in banks' provision for loan losses. The fifty percent increase (nearly $.5 billion) in loan loss provisions at Western banks was the most significant factor in lowering District banks' aggregate earnings in 1982. This erosion of asset quality was a reflection of the troubled nature of many national and international credits held by large institutions, as well as problem loans arising from the depressed local markets facing some smaller banks. And while earnings suffered, most banks took significant steps to provide an adequate cushion against future losses arising from the weakened state of the economy.

Twelfth District Thrifts

The housing slump added to the difficulties faced by Western savings and loan associations in 1982. Apart from the accelerated pace of deposit-rate deregulation, the year represented a continuation of trends that have emerged over the last several years.

Like banks, S&Ls continued to witness a change in the composition of their portfolio of liabilities to one both higher in cost and more interest-rate sensitive. On the asset side, mortgage lending activity continued at a very slow pace as high interest rates and flat or declining housing prices provided little incentive for consumers to buy housing. However, during the last half of 1982, mortgage interest rates turned downward. This trend, if continued, may provide the stimulus to mortgage demand that the S&L industry has been looking for.

Thrifts were more successful in retaining funds in 1982 than in 1981. Whereas in previous years money flowed out of S&Ls into high-yield money market fund accounts, in 1982 thrifts were authorized to offer several new competitive deposit instruments. Preliminary estimates showed an $8 billion deposit inflow for Twelfth District S&Ls in 1982, about two-thirds of which was in large certificates of deposit. Passbook savings and NOW accounts captured some transitory funds in the latter part of the year, while total market-return small-denomination time deposits were up by about $2 billion even after the All-Savers runoff. Along with the new MMDA, these instruments helped retain consumer funds that might otherwise have been lost to money market funds.

Many S&Ls still found themselves facing continued operating losses in 1982 as the cost of funds crept up and yields on mortgage portfolios remained low. However, while operating losses continued to reduce net worth at some institutions, the industry's outlook was already brightening at year-end in the face of lower interest rates and a modest recovery in housing.

Prospects for the Future

In the near future, the competition among financial institutions for corporate and consumer savings should intensify. Institutions will likely place additional emphasis on the design of deposit instruments and other services in order to create a package that is not only attractive to consumers but profitable to the institutions themselves.

The competition for savings will affect lending operations. Because business loan demand will probably remain weak, at least through the early stages of the recovery, institutions will search for profitable lending opportunities. Certainly, consumer installment and mortgage lending could be poised for a recovery if the general level of interest rates continues its gradual decline. However, more interest-sensitive consumer deposits also are likely to affect the form as well as the cost of mortgage and installment contracts as institutions take steps to promote more adjustable rate loan products and to implement more cost-effective service fee schedules.