

FRBSF WEEKLY LETTER

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Shifting Shares

Since the summer of 1989 there has been a noticeable shift in the market shares of both western depository institutions and depository institutions across the nation as a whole. Savings institutions' share of total deposits has declined, while commercial banks' share has risen dramatically. In the West, savings institutions (savings and loan associations and savings banks) held over 50 percent of total (domestic) deposits in December 1988, versus only 46 percent for commercial banks. (Credit unions held the remaining four percent.) Although western savings institutions were able to maintain this market share advantage through mid-year 1989, since then, they have lost considerable ground to commercial banks. This *Letter* examines some of the factors that have led to these changes in market share in the West.

Deposit outflows

Once the crisis of insolvent savings institutions came to the public's attention in early 1989, the savings and loan industry nationwide began to suffer substantial net deposit outflows, with withdrawals consistently exceeding new deposits. In fact, early in the year, these net outflows even exceeded interest credited to existing accounts. As a result, the industry's deposits outstanding declined by \$15 billion during the first quarter of 1989. However, by May, net outflows had slowed, and deposits outstanding at the nation's thrifts had ceased their decline.

At western savings institutions, deposit outflows were not so large as to cause a decline in deposits outstanding in the first half of the year. Beginning around mid-year 1989, however, deposit levels nationwide began to fall again, and this time, western savings institutions were losers as well. Total deposits of thrifts in the West peaked at \$332.4 billion in July of 1989, and then, as shown in Chart 1, they began a steady decline.

A closer look at thrift balance sheets suggests that the lion's share of the decline was the result of a massive runoff in large certificates of deposit ("CDs" with \$100,000 or more outstanding).

Since mid-year 1989, when these jumbo CDs passed the \$100 billion mark at western savings institutions, this deposit category has declined by almost \$22 billion. Even after this runoff, these volatile, short-term, highly interest-sensitive funds still account for 25 percent of western thrift deposits, versus only 17 percent for banks. Chart 2, which plots the cumulative changes in large CDs at western banks and thrifts, shows that banks' large CDs actually rose, while thrifts' large CDs fell.

Chart 1

Total Domestic Deposits Outstanding (Twelfth District)

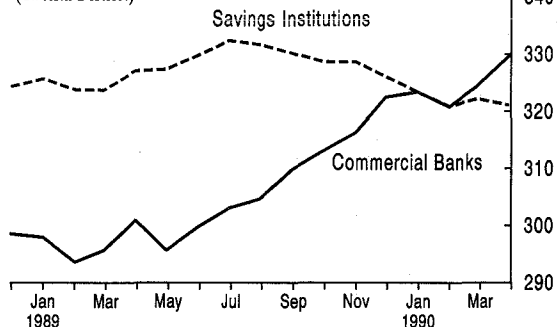
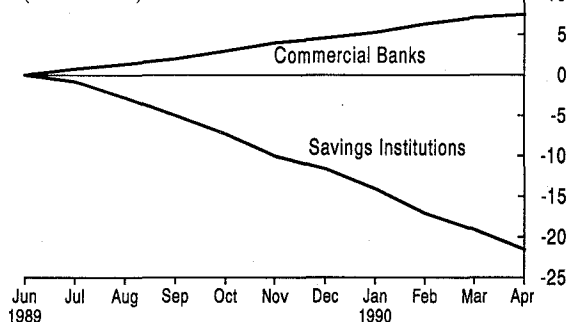


Chart 2

Cumulative Change in Large Time Deposits (Twelfth District)



Core deposits are steady

In contrast to the sharp decline in large CDs, western savings institutions' "core" deposits have grown since mid-year 1989. Core deposits include interest-bearing transaction accounts

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(NOWs), limited-transaction money market deposit accounts (MMDAs), savings deposits, and small-denomination time certificates of deposit (retail CDs). These "retail" funds are mostly generated from households and small businesses, and are a necessary source of funds for western savings institutions' lending activities, providing nearly three-quarters of thrifts' deposit funding, compared with about sixty percent of banks' total domestic deposits.

These core deposits at western thrifts grew by almost \$9 billion between mid-year 1989 and April 1990. This represents an annual growth rate of 4.7 percent. However, because core deposits at commercial banks expanded by \$18.5 billion over the period, or a 12.5 percent annual rate, western savings institutions have not kept pace with western banks in this category either.

Falling market share

As a result of these developments, by April 1990, western commercial banks (with \$330 billion in reservable domestic deposits) had clearly surpassed the savings industry (with \$320 billion in deposits). Since June 1989, savings institutions in the region have lost 3.2 percentage points of deposit market share, share that took years to build. Thrifts' market share fell to 47.1 percent, while banks' share rose to 48.4 percent.

Thrifts' core deposit market share (51.6 percent) has fallen a little over one percentage point from mid-year 1989, as they have lost market share for NOWs, MMDAs, and small time deposits. However, the biggest change has come about in the large time deposit category. Thrifts' share of large CDs has fallen by almost nine percentage points, from nearly 67 percent in June 1989 to less than 58 percent in April 1990.

Generally, these region-wide patterns also hold across individual states in the region. There are some differences, however. Despite losing ground in California, thrifts, with a 52.4 percent market share of total deposits, still maintain nearly a nine percentage point lead over commercial banks. In the western states outside of California, savings institutions' aggregate market share fell from 34.1 percent to 31.2 percent.

Safety and soundness concerns

The reasons for the decline in western savings institutions' market share are relatively easy to

identify. A key factor, of course, has been depositors' concerns about the financial health of the thrift industry. Despite the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in August 1989, safety and soundness concerns and the potential costs of the rescue plan have yet to be completely resolved. The well-publicized seizures of insolvent thrifts by the Office of Thrift Supervision (OTS) and limited progress by the Resolution Trust Corporation (RTC) in disposing of failed thrift assets have kept the issue in the public eye.

These concerns about the safety of thrift institutions undoubtedly were the primary cause of the sharp decline in large CDs at western thrifts and the significant increase in large CDs at western banks. Since balances over \$100,000 exceed the legal deposit insurance limit, these deposits are the ones most likely to suffer losses in the event of a thrift failure. Thus, it is not surprising that these deposits appear to be shifting from savings institutions to banks, which are generally perceived as being healthier.

The pattern of large CD outflows at individual institutions underscores the argument that safety and soundness considerations are playing a major role in deposit movements at western institutions. Some of the most rapid outflows have occurred at institutions that are considered the weakest financially, that is, those with "speculative" grade debt ratings. At the same time, deposits at many of the better capitalized thrifts have continued to expand.

Moreover, since almost all balances in thrifts' core deposit accounts are covered by deposit insurance under the Savings Association Insurance Fund (SAIF), it is not surprising that these deposits have continued to grow, albeit sluggishly. However, the fact that western bank deposits have grown far more rapidly suggests that there may still be some concerns about safety and soundness regarding even insured core deposits at savings institutions.

Regulatory constraints

Another factor that may have contributed to western savings institutions' loss of market share is the more stringent regulations governing their operations and growth since the passage of FIRREA. Many thrifts (almost 600 SAIF-insured institutions nationwide, according to a recent

American Banker listing) have less than three percent tangible capital. These institutions must raise additional capital to meet the more stringent capital standards imposed on the industry by FIRREA. Thrifts attempting to meet these standards by limiting expansion or by selling assets are not likely to compete aggressively for new deposits. In addition, regulators also have taken actions that have reduced the growth of and reliance on large CDs at some thrifts. FIRREA set a 50 basis point limit on premiums (above local market rates) for institutions in conservatorship.

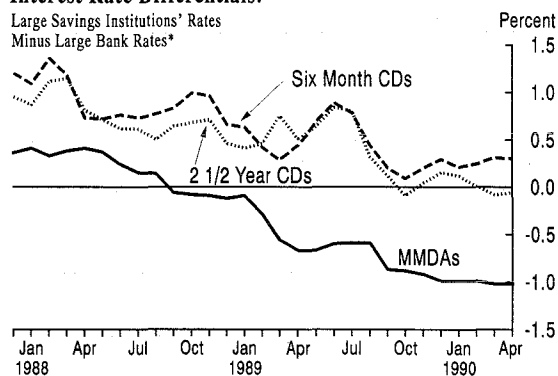
The impact of these actions is clearly evident at the approximately thirty-seven thrifts in this region (with about \$38 billion in deposits) that are currently under OTS conservatorship. Large time deposits outstanding and brokered deposits have fallen most sharply at these institutions. In addition, RTC sales of these and other weak thrifts to commercial banks will increase banks' deposit share.

Rate competition

Changes in deposit rate pricing in the West reflect these regulatory constraints. Interest rate data published by the *Bank Rate Monitor* indicate that, on average in California, large thrift institutions no longer are paying higher rates on deposits than their large bank competitors are. As shown in Chart 3, since the middle of 1989, the interest rate premiums large thrifts traditionally offered on core deposits have been dramatically reduced, eliminated, or in the case of MMDAs, replaced with a premium in favor of the banks.

In addition to regulatory constraints on savings institutions, it appears that these pricing changes also are the result of a change in western banks' deposit pricing strategies. To meet growing needs for funds, large banks have become more aggressive in pricing MMDAs, in particular.

Chart 3
Interest Rate Differentials:



*California: Bank Rate Monitor

At the margin, these pricing changes have had an impact on retail deposit growth. The weakness in thrifts' core deposit growth appears to be closely correlated with these pricing changes. For example, by September 1989, the premium banks were offering on MMDAs had risen to nearly 100 basis points, and as the bank premium rose, the growth rate of bank MMDAs soared, and thrift MMDA levels stagnated. After June 1989 a similar pattern occurred with 2½ year CDs.

Continued downtrend

The thrift industry in the West and in the nation as a whole will be under pressure to boost capital and limit expansion for some time to come. Moreover, troubled thrifts will continue to find their growth options severely limited by the regulators. These factors will constrain thrifts' ability to compete aggressively for deposits, making a falling market share a fact of life for the industry in the near future.

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