Time and Savings Deposits in the Second District Since the Change in Regulation Q*

Viewed against the experience of the last decade, the growth of interest-bearing deposits[1] at Second District member banks in the last three years has been remarkable (see Chart I). At the end of December 1962, these time and savings accounts stood at $18 billion, almost 70 per cent above their level at the end of 1959. Moreover, the rate of gain tended to accelerate during the period: in 1960, Second District members added $1.4 billion; in 1961, $2.4 billion; and in 1962, a record $3.4 billion.

The key factor in the sharp acceleration of growth in 1962 was the revision of Regulation Q, effective January 1 of that year, which raised the maximum rates member banks may pay on time and savings deposits (see Table I). Banks in the District reacted immediately by increasing interest rates paid on such deposits. Coming at a time when general economic and financial conditions were already favoring the growth of interest-bearing deposits,[2] the higher rates drew a quick and sizable response from the public.

The rise in commercial bank rates on time and savings deposits was, of course, not limited to this District. Banks throughout the country offered higher rates that enhanced the attractiveness of such deposits relative to other liquid assets that the public might have chosen to hold. Especially in the first several months after ceilings were raised, commercial banks were apparently successful in diverting funds from the markets for Treasury bills and municipal securities. As the year progressed, they also tended to capture a share of the funds that investors withdrew from the stock market. Indeed, a notable feature of 1962 was that the relatively large increase in bank deposits normally associated with a period of credit ease was concentrated to an unusual degree in interest-bearing rather than demand deposits.

But the growth in interest-bearing deposits was more rapid in the Second Federal Reserve District than elsewhere. This reflected in part the greater interest rate sensitivity of the large depositors prominent among the customers of the District's banks, and also the aggressiveness of many of these banks in exploiting this new avenue of competition. Moreover, time deposits of foreign governments, central banks, and official institutions increased after Regulation Q ceilings on such deposits were suspended for three years, beginning October 15, 1962, and Second District banks gained the greatest share of that increase.

This article examines in greater detail the nature of rate and deposit developments in the Second District during 1961 and 1962. It focuses, in particular, on variations in the behavior of rates and deposits among different types of institutions and areas.

Table I

MAXIMUM INTEREST RATES PAYABLE ON TIME DEPOSITS

In per cent per annum

Type of deposit	January 1, 1957 to December 31, 1961	Effective January 1, 1962
Savings deposits of:		
1 year or more	3	4
Less than 1 year	3	3½
Other time deposits payable in:		
1 year or more	3	4
6 months to 1 year	3	3½
90 days to 6 months	2½	2½
Less than 90 days	1	1

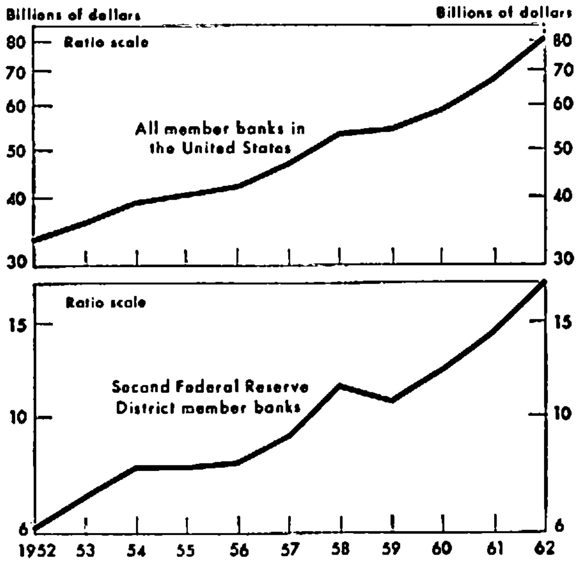
* Leonard Lapidus had primary responsibility for the preparation of this article.

[1] This article employs the term "interest-bearing deposits" to describe the aggregate of time and savings deposits at commercial banks. The term "time deposits", which is frequently used in reference to the combined series, is here used only in a narrower sense to describe deposits that usually have a specified maturity which in no case can be under thirty days and that are either in the form of a certificate of deposit or open account. "Certificates of deposit" are for specified amounts and are evidenced by either a negotiable or a nonnegotiable instrument. "Open account" time deposits are evidenced by a written contract, and funds may be added or withdrawn (subject to a restriction of at least thirty days) during the life of the contract. "Savings deposits" are distinguished from time deposits in that they may be held only by individuals or nonprofit institutions; a notice of withdrawal is not mandatory, but a notice of at least thirty days may be required at the option of the bank.

[2] For a general discussion of the factors influencing the growth of interest-bearing deposits, see Richard G. Davis and Jack M. Guttentag, "Time and Savings Deposits in the Cycle", *Monthly Review*, June 1962, pp. 86-91.

Chart I

TOTAL INTEREST-BEARING DEPOSITS
1952-62



Source: Board of Governors of the Federal Reserve System.

THE SITUATION IN 1961

By the end of 1961, interest rates at Second District member banks were pressing against Regulation Q ceilings. Reports to this Bank from a large sample of District banks indicated that in 1961 rates on savings deposits, in both the over- and under-one-year categories, averaged 2.95 per cent, a scant fraction below the 3 per cent ceiling; nine out of ten banks were at the ceiling. On open account time deposits, 91 per cent of the banks were offering the maximum legal rate on maturities of one year or more, and rates on negotiable time certificates of deposit (C/Ds) were also close to Regulation Q ceilings. Indeed, in 1961, almost eight out of ten commercial bankers surveyed in New York State felt that Regulation Q ceilings then in effect did not provide enough "headroom" for them to compete effectively for savings.[3]

The large urban banks, even more than other banks in the District, felt the need to foster the growth of interest-bearing deposits. Over the postwar period, these banks—especially those in New York City—had experienced a relative decline in their share of the nation's demand deposits. Corporate cash balances, which are particularly important to these banks, had been declining during 1959 and 1960 and, despite the business recovery starting in 1961, had failed to grow until the last few months of 1961. Gains in time and savings money seemed to offer such banks a means of increasing their deposit growth and thus, over the long run, a possibility of meeting more fully the credit needs of the large national corporations that are among their most important customers.

In 1961, the desire of these large banks to promote the growth of time and savings money was reflected not only in their posted rates on savings deposits, which were the highest in the District, but also in their introduction of C/Ds. The latter step represented a major policy move to attract time money, especially of domestic corporations; up to that time the large banks had rarely accepted interest-bearing time deposits from domestic firms.

This new instrument was immediately successful, and time certificates became a major element in the substantial growth of interest-bearing deposits in the District during 1961.[4] Time certificates at District weekly reporting member banks grew by $1 billion in 1961, accounting for over 70 per cent of the increase in these banks' time deposits and for just under half of the increase in their total time and savings deposits (see Table II).[5]

This growth, however, was not continuous throughout the year. By their nature, C/Ds are highly sensitive to competing open market interest rates and, as a result, their increase slowed down in the second half of 1961, when Treasury bill rates started to rise. Outstanding C/Ds at New York City banks had expanded from virtually nothing at the outset of 1961 to $1 billion at the end of July, but thereafter the rise in Treasury bill rates toward the Regulation Q ceiling narrowed the margin between bill yields and C/D rates on six-month maturities to only ⅛ of a percentage point in December 1961. Largely because of this, the volume of outstanding C/Ds stopped growing and then began to recede, falling back to the July level by the year end.

[3] New York State Bankers Association, *Growth Aspects of Savings Deposits*, December 1961, pp. 10-11.

[4] For a detailed discussion of the growth of certificates of deposit and its relationship to rates, see R. Fieldhouse, *Certificates of Deposit* (Boston: Bankers Publishing Company, 1962), Ch. 6.

[5] There are thirty-seven weekly reporting member banks in the District. These banks are among the largest and are located in the District's major cities. Their combined time and savings deposits accounted for 72 per cent of interest-bearing deposits in the District at the end of 1962. Separate data on their time and savings deposits have been available on a weekly basis since July 1959. Such a separation is available for all members in the District for call report dates, but only since the first quarter of 1961.

Table II

ANNUAL INCREASES IN INTEREST-BEARING DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT

Based on end-of-year balances

Type of deposit	1960	1961	1962	1960	1961	1962
	Billions of dollars			Per cent		
Second District — all members	1.4	2.4	3.4	13	20	23
Weekly reporting member banks:						
Total	1.0	2.1	2.7	14	26	27
Savings deposits	0.3	0.7	1.3	7	15	24
Time deposits	0.7	1.4	1.4	27	44	30
Negotiable time certificates of deposit	*	1.0	1.4	*	*	*
Other member banks	0.4	0.3	0.7	10	8	15

* Because C/Ds grew rapidly from very low levels, percentage increases for 1961 and 1962 are not significantly comparable with the percentage increases in other categories of interest-bearing deposits. For 1960, exact figures are not available but growth was insignificant.

Indeed, time accounts generally experienced slower growth in the latter part of 1961, as depositors sensitive to interest rate differentials—particularly business establishments, foreign official institutions, and state and local governments—turned to Treasury bills (see Chart II). On the other hand, savings deposits at weekly reporting banks grew strongly throughout the year, though with some tendency toward a slower rate of gain as the year progressed (see Chart III).

THE SITUATION AFTER THE CHANGE IN REGULATION Q

After the revision of Regulation Q at the beginning of 1962, the banks immediately responded by raising rates, thereby clearly demonstrating their willingness to pay a considerable price for an increased volume of time and savings money. According to a mid-January 1962 survey, almost 85 per cent of District member banks had already made upward changes in offered rates. Many had also added to, or improved, the "fringe" benefits they offered on savings deposits—for example, the payment of daily interest and the introduction of "grace" days at the beginning and end of interest periods. On the other hand, it appears that banks that did not raise their rates in January never raised their rates at all.

Typically the rate on savings deposits was raised from 3 per cent to 3.5 per cent for deposits of both under and over one year. Fully 80 per cent of District member banks moved to the 3.5 per cent maximum on "new" (under one year) savings deposits, and 60 per cent to that rate on deposits of one year or more. Only 20 per cent posted the 4 per cent maximum on deposits of one year or more, and these banks were concentrated in the New York metropolitan area, northern New Jersey, and Buffalo.

Rates on C/Ds were increased by about ⅛ of a percentage point for six-month to nine-month maturities and by ⅜ of a percentage point for maturities of one year and over. Rates on time deposits (open account) rose about ¼ of a percentage point.

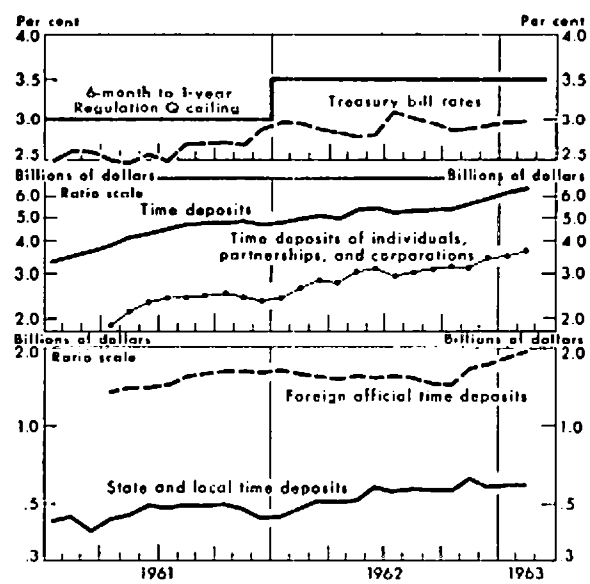
The effect of the more attractive rates paid on interest-bearing accounts at District banks was an acceleration in the growth of savings deposits and a renewed expansion of time deposits. In contrast to 1961, savings deposits played a significant role in the over-all increase of interest-bearing commercial bank deposits; they doubled their 1961 gains during 1962 and accounted for half of the total rise in interest-bearing deposits at large District banks.

Savings deposit gains at commercial banks were especially strong in January and February 1962. In subsequent months, too, the rate of growth remained well above that of 1961. In 1962, even the smallest monthly gain in seasonally adjusted savings deposits exceeded nine of the twelve monthly gains in 1961 (see Chart III).

Larger flows into savings accounts benefited all thrift institutions in 1962. For example, deposits of District mutual savings banks and the dollar volume of shares of savings and loan associations grew somewhat faster in 1962 than in 1961. The total of these two forms of savings at the 1962 year end stood 8.3 per cent above 1961, whereas the gain in 1961 had been 6.2 per cent.

Chart II

TIME DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT AND TREASURY BILL RATES



Note: Data are not seasonally adjusted. The series on time deposits of foreign governments, central banks, and official institutions and of individuals, partnerships, and corporations were initiated in April 1961. Treasury bill rates are for new issues of six-month maturity.

However, the acceleration of the growth of savings deposits was even faster at local commercial banks than at competing thrift institutions. In 1960 and 1961, additions to savings accounts at weekly reporting member banks had amounted to 19 and 38 per cent, respectively, of total additions to accounts at mutual savings banks and savings and loan associations in the District. In 1962, they accounted for fully 50 per cent. These gains presumably were in part due to the erosion of the rate advantage previously enjoyed by other savings institutions. In 1960 the rate on new savings deposits at mutual savings banks and the return on shares at savings and loan associations in the District typically amounted to 3½ per cent, ½ percentage point above Regulation Q ceilings. After January 1, 1962, member bank rates generally moved to 3½ per cent, and savings institution rates to 3¾ per cent. Thus the rate advantage on new savings has been trimmed to ¼ of a percentage point.

Moreover, mutual savings banks in New York State cannot for the time being re-establish a wider differential on new savings, since their rate on these is limited by regulation to a maximum of 3¾ per cent. Recently, many of the mutual savings institutions in the larger cities have moved to 4¼ per cent on one-year savings[6] in order to be able to compete with the 4 per cent generally offered by commercial banks in these localities.

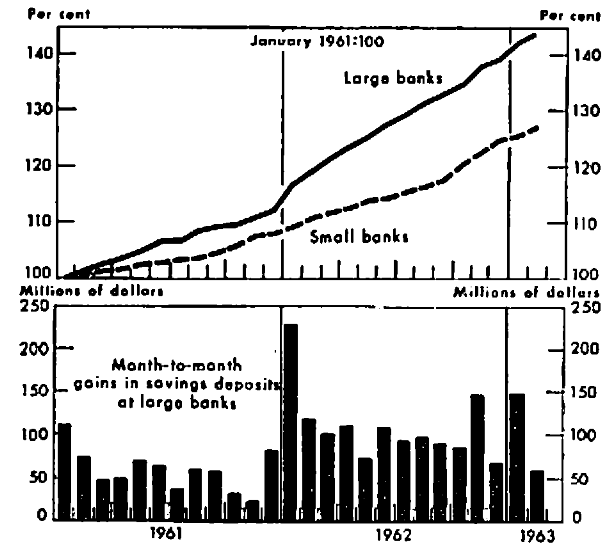
Time deposits have also responded to the more attractive interest rates now available. From the beginning of 1962 to the end of June, such deposits grew by $0.7 billion in an irregular pattern, which reflected a sensitive response to monthly fluctuations in Treasury bill rates. Their growth then ceased, partly for seasonal reasons, but it was renewed in the last two months of 1962, which saw a sharp rise of $0.7 billion in such deposits (see Chart II). Nearly half of this reflected additions to the time accounts of foreign official institutions, following the October suspension of Regulation Q ceilings on such accounts,[7] but there was also an apparently contraseasonal jump during December in time certificates issued to corporations. Gains in the volume of outstanding certificates carried through the first quarter of this year.

[6] New York State banking authorities have not exercised their authority to set a maximum rate on these deposits. Rate increases, however, are subject to their review.

[7] Before October, these foreign official time deposits declined, in sharp contrast to those of other depositors sensitive to interest rates (see Chart II). This probably occurred because foreign official institutions prefer short-term claims and Regulation Q ceilings on maturities of less than six months had not been raised in January. Rates on time deposits of such maturities were not competitive with open market rates.

Chart III

SAVINGS DEPOSITS AT LARGE AND SMALL BANKS IN THE SECOND FEDERAL RESERVE DISTRICT



Note: Data are seasonally adjusted. The figures for large banks represent savings deposits at weekly reporting member banks; figures for small banks represent total interest-bearing deposits, which are mostly savings deposits, at all other member banks in the District.

Even more than in 1961, expansion in the volume of C/Ds was the dominant form of time deposit growth in 1962. The increase in the volume of these certificates during the year accounted for the entire $1.4 billion gain in time deposits at weekly reporting banks. Not surprisingly, the growth was predominantly in maturities greater than six months, on which Regulation Q was liberalized, rather than in the short maturities, on which maximum rates were unchanged.

BANK SIZE AS A FACTOR IN DEPOSIT GROWTH AND INTEREST RATES

Within the District, most banks participated in the growth of interest-bearing deposits during 1962, but the larger banks did so much more than the smaller ones.[8] For this there were several reasons. First, the forces making for the growth of interest-bearing deposits had, since 1960, been stronger in urban than in rural areas. Perhaps

[8] However, the growth of interest-bearing deposits at the smaller banks made about the same relative contribution to total deposits as did the growth of such deposits at larger banks. This was due to the fact that for nonweekly reporting banks the share of interest-bearing deposits in total deposits was about twice as great as for weekly reporting banks.

Table III

GROWTH OF INTEREST-BEARING DEPOSITS, AND AVERAGE OFFERED INTEREST RATES ON SAVINGS DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT, BY SIZE OF BANK

Bank size (total deposits, millions of dollars)	Percentage increase August 1961 to August 1962 of interest-bearing deposits	Average rates on savings deposits: Under 1 year		1 year and over	
		1961	1962	1961	1962
		Per cent per annum			
Less than 5	10.5	2.90	3.35	2.90	3.41
5 to 20	11.6	2.96	3.40	2.96	3.52
20 to 100	11.8	2.97	3.41	2.97	3.56
100 to 1,000	18.7	3.00	3.46	3.00	3.61
1,000 or over	19.6	3.00	3.50	3.00	4.00
All banks	17.5	2.95	3.39	2.95	3.51

the most significant influence on the growth of interest-bearing deposits at city banks was the fact that, from the middle of 1960, open market rates of interest were stable at levels below commercial bank time deposit rates, encouraging investors to shift from Treasury bills to time deposits, especially C/Ds. Secondly, after the change in Regulation Q became effective, the large urban banks in the District made the largest changes in interest rate offerings on savings deposits; thus, to a greater degree than other District banks, they reduced or overcame the relative advantage of other investment instruments and of other savings institutions in their communities. Finally, the upturn in foreign official time deposits, consequent on their three-year exemption from Regulation Q, was registered almost entirely at large New York City banks, where such accounts are concentrated.

Interest-bearing deposits at weekly reporting banks in the District (all of them large banks) expanded over 27 per cent in 1962, in sharp contrast to a 15 per cent increase at the smaller banks that do not report weekly. As in 1961, both time deposits and savings deposits at these large banks outstripped the growth rate of over-all interest-bearing deposits at other member banks.

Time certificates of deposit, which played so great a role in the growth of time deposits during both 1961 and 1962, are issued almost exclusively by large banks.[9] In fact, it was not until 1962 that the practice of offering C/Ds spread in any significant degree beyond the original New York City issuers to other large banks in the District. During 1961 all of the $1 billion growth in outstanding C/Ds was accounted for by nine New York City banks. During 1962, however, other weekly reporting banks entered the new-issue certificate market and contributed $0.5 billion to the $1.4 billion increase in the District's total volume of outstanding C/Ds.

For savings deposits, too, weekly reporting banks showed greater relative gains than smaller banks in 1961, and widened the differences in 1962 (see Chart III). But, perhaps even more significantly, the smaller banks' savings deposits showed neither the acceleration of growth nor the unusual January and February gains evident in 1962 at the larger banks. Rather, the savings deposits of smaller banks apparently grew at about the same pace in 1962 as had been registered toward the end of 1961.[10] Part of the reason for this contrast is the fact that the large banks made greater inroads into the rate advantage of competing savings institutions than did smaller banks. As was indicated above, in New York City and Buffalo this advantage has typically narrowed to ¼ of a percentage point, whether the savings deposit is for under or over one year; moreover, in these cities many of the commercial banks offer daily interest payments and grace days. Outside these major centers, commercial banks have also generally reduced to ¼ percentage point their competitors' advantage on new savings, but still fall ½ point short on one-year savings. While grace-day arrangements are widespread, daily interest is rarely paid and many banks credit interest semiannually rather than quarterly.

Table III shows the close relationship of bank size (and therefore community size) to the increase of interest-bearing deposits. And it indicates that this factor is also important in explaining interest rate levels.

Interest rates paid by District commercial banks on savings accounts necessarily varied only slightly before the lifting of Regulation Q ceilings. Within this narrow range, however, the influence of bank size was clearly evident: rates were consistently higher in the progression from very small banks to the very large banks. After the increase in ceilings this pattern of rates was maintained, though with larger differentials, because the larger banks made greater upward changes than the smaller ones.

These rate spreads doubtless reflected traditional differences between different geographical markets which vary in their competitive temper. In and around urban areas, various factors keep rates competitively high—

[9] This pre-eminence of large banks results from the fact that the demand for such negotiable instruments comes largely from national corporations whose primary banking relations are with large banks. In addition, C/Ds issued by small banks are not so readily acceptable in the secondary market and, if traded, will be subject to a larger discount than certificates of well-known "money market" banks.

[10] This inference is based on data for total interest-bearing deposits at the smaller banks, since separate monthly data on savings deposits at these banks are not available. The inference seems reasonable, however, because almost 90 per cent of interest-bearing deposits at nonweekly reporting banks are savings accounts—a proportion that remained stable from September 1961 to September 1962.

including the concentration of savings institutions and also the easy access to organized investment markets. But such specifically urban characteristics were by no means the only factors in the 1961-62 contrasts between the rates paid by large and small banks.

There is good reason to believe that the banks which posted the largest increases in rates on savings deposits were those with sound loan and investment opportunities that would go unsatisfied unless deposits grew more rapidly. The large banks' deposit growth had failed to keep pace with that of other banks during the postwar period, and their loan-deposit ratios, which were among the highest in the nation, indicated that the large banks were finding it more difficult to meet the entire growth of loan demand. Thus in 1961, dissatisfaction with Regulation Q among commercial bankers in New York State was found to be directly associated with bank size and with the level of loan-deposit ratios.[11]

On the other hand, there is no evidence that reluctance to bear the cost of higher interest rates (as measured by the ratio of interest-bearing to total deposits) played any significant part in determining which banks raised rates and which did not. Banks with a high proportion of their deposits in time and savings accounts raised rates with the same relative frequency, and by as much, as did banks with a low proportion.

Why were banks willing to accept large relative increases in their costs? Certainly, some banks—especially those subject to competition from New York City and Buffalo banks—considered the higher rates necessary to protect existing deposits from competitors. Nevertheless, the fact that rates were increased so quickly after ceilings were raised (in contrast to a much slower response to a previous change in the interest rate ceiling in January 1957) probably indicates that the desire to take advantage of lending opportunities was an important motive. Indeed, many District bankers are convinced that, with demand deposits growing relatively slowly, only active promotion of time and savings deposits can sustain the kind of growth of commercial bank resources that is needed to maintain or improve their profits prospects over the long run. It is worth noting that, despite sharply higher interest costs, net income of the average Second District commercial bank in 1962 actually was slightly higher than in 1961.

SUMMARY

The growth of interest-bearing deposits in the Second District since the lifting of Regulation Q ceilings has been strongest at large banks in large cities, in both time and savings deposits. The response to the Regulation Q change was a broadly based, general rise in interest rate offerings, with the large deposit-seeking city banks making the greatest upward changes on savings accounts. A substantial effect of the higher rates was the renewed growth of negotiable time certificates of deposit, which at the end of 1961 had lost their competitive advantage over Treasury bills. Another result was an acceleration in the upward trend of commercial bank savings deposits, stemming mainly from the significant cut in the rate advantages of competing savings institutions. At the higher rate levels, time and savings accounts also became an attractive investment for a considerable flow of funds diverted or withdrawn from securities markets during 1962.

[11] New York State Bankers Association, *op. cit.*