Research Department
Federal Reserve
Bank of
San Francisco

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FRB SF Weekly Letter

As The Dust Settles

The introduction of money market deposit accounts (MMDAs) last December was the single most important step in the deregulation of deposit rates at commercial banks and thrifts. Money market deposit accounts dramatically altered both consumers' holdings of savings deposits at banks and thrifts and institutions' competitive strategies for attracting these deposit balances.

The volume of funds moving to the new account was overwhelming as MMDAs attracted $367 billion by the middle of this year. The dramatic inflows greatly affected the market shares of depository institutions. In the Twelfth Federal Reserve District, which includes Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington, the surge in MMDA balances was particularly pronounced. District banks and thrifts attracted nearly $90 billion with the new instrument, about a quarter of the national total and well above the region's eighteen percent share of the national domestic deposit market.

An open field

Introduction of MMDAs on December 14 widened the scope for active competition between depository institutions and money market funds. The various indexed-ceiling accounts and longer-term ceiling-free accounts authorized over the past five years, such as the indexed 6-month money market certificate, had allowed banks and thrifts to offer fairly "competitive" rates on deposits. But the MMDA marked the first unimpeded opportunity for banks, savings and loans and mutual savings banks to compete with non-deposit instruments. Perhaps even more important, the new account gave banks and thrifts the opportunity to compete with each other for consumer and business deposits on the basis of "price," i.e., deposit rates, rather than engaging in non-price competition such as offering free or subsidized services, promotions, and convenient locations.

With the advent of the MMDA, many of this region's banks and thrifts jumped at the chance to improve their share of the region's $250 billion or more in retail savings-type deposits. By initially offering MMDA rates that were well above prevailing money market rates (some institutions were paying up to three percentage points or more above money market fund yields), these institutions sought to attract funds away from money market funds and other banks and thrifts. Other institutions quickly followed suit in order to remain competitive and to protect their share of retail savings balances. Such balances consist, in addition to MMDA deposits, of passbook savings deposits, and small-denomination (less than $100,000) time certificates of deposit.

Deposit shifts

In the first months, active bidding for MMDA balances not only attracted funds from non-deposit sources, but also caused tremendous shifting of deposits among banks and thrifts. By mid-year, when MMDA balances had stabilized, they had grown to a staggering 15.9 percent of the total domestic deposits of U.S. banks, and 17.3 percent of nationwide thrift deposits. Moreover, close to two-thirds of the MMDA balances came from other accounts at depository institutions.

In the Twelfth District, which typically has a higher ratio of personal deposits to total deposits, the new accounts reached a whopping 21.8 percent of bank deposits and 25.4 percent of thrift deposits by mid-year. In comparison, savings deposits, which traditionally have been a major source of below-market-rate core deposits, now account for less than 10 percent of total domestic deposits at both banks and savings and loans in the West, as compared to 13 percent at banks and 17 percent at S & Ls before the introduction of the MMDA.

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Adjustment period
MMDA pricing strategies, developed amid considerable uncertainty, played a crucial role in directing deposit flows and in altering market shares. Banks and thrifts faced major uncertainties about both the initial and long-run interest rate sensitivity of MMDA balances and the likely volume of MMDA deposits that would be generated.

Institutions also faced a number of trade-offs in competing for MMDA deposits. Higher introductory rates would attract a larger share of the market, particularly if MMDAs proved to be highly sensitive to interest rates in the beginning. However, higher rates would also raise interest expenses and could reduce near-term profits by inducing depositors to shift funds out of lower cost passbook and certificate accounts. Moreover, institutions faced the risk that rate-sensitive funds flowing into MMDAs in response to premium rates might readily flow out once the institutions stopped paying such rates.

Banks, especially the major institutions, gambled that rate-sensitivity would show up only during the transition period as savers shifted funds from non-deposit instruments and less liquid or lower yielding accounts. They believed that during the adjustment period, balances would be rate-sensitive as depositors shopped for the "best" deal. However, once funds had been shifted, account holders would be less likely, given the time and effort involved, to move funds around to take advantage of differentials of only a few basis points that could be reversed at any time. Thus, the banking industry leaders generally bid aggressively during the first few weeks following authorization of the new account, while savings and loans, weakened by several years of poor or negative earnings, generally followed a less aggressive strategy.

In the early weeks after the introduction of MMDAs, when rate premia were at their highest, most S&Ls in the West did not match bank rates (see Chart 1). In fact, during the first few weeks, major California banks offered rates about 25 basis points above their thrift competition. When combined with liberal cash bonuses to new depositors and heavy media and promotional campaigns, the aggressive strategy paid off for the banking industry: it captured over 60 percent of the District's MMDA balances by the end of January.

Another element of banks' strategy dealt with reducing their vulnerability to market share losses that might be caused by subsequent "rate wars." Banks attempted to lock their funds in by linking them to other products, such as automated teller machines, credit cards, or consumer lines of credit. This strategy has apparently been successful as banks have suffered only a slight loss in market shares since late January despite higher rates paid by S&Ls.

Gains
Measures of industry market shares for MMDAs and for total retail savings deposits (savings, small time, and personal MMDAs) attest to the success of the banks' early campaign and their ability to hold on to most of their gains in subsequent months. At mid-year, when MMDA growth had leveled off, District banks still held a 56 percent share of the MMDA market, and over $50 billion in MMDAs (nearly $40 billion in personal accounts and the remainder in non-personal accounts held by corporations, partnerships, governments and nonprofit organizations). With the traditional advantage of a full line of business services, banks captured an overwhelming 86.5 percent of non-personal MMDAs. At mid-year, western banks held a 51.4 percent share of the large market for personal MMDA balances; this brought District banks' share of total retail savings-type deposits up from 42 percent in November of 1982 to 45 percent by mid-year (see Chart 2).

Consequently, the savings and loan industry's market share of total retail savings-type deposits dropped slightly from 51

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percent to just under 50 percent, despite the addition of over $37 billion in MMDAs. S&Ls gained only a 46.2 percent share of the personal MMDA market. The Twelfth District's other thrifts—mutual savings banks and credit unions—also suffered losses in their market share of retail savings-type deposits. To regain their market share, thrifts have raised offering rates, but to little effect as market shares have changed little since February. For example, California S&Ls generally have been offering rates ranging from 25 to 75 basis points above prevailing bank rates, but they have had only slight success in regaining the market share they had earlier lost to banks.

It's not over yet

The California data indicate that the higher rates currently being paid by thrifts are not large enough to recapture the market share they lost. However, taken together, banks and thrifts have been successful in holding on to their existing MMDA balances despite small yield advantages favoring non-depository institutions, most notably money market mutual fund shares.

The last point is important because the competition for retail savings-type instruments has heated up again in recent weeks. The recent upturn in interest rates together with the October 1 deregulation of certificates portends another period of increasing competition among MMDAs, other deposit certificates, and especially, money market funds.

In principle, a wide enough yield differential in favor of money market mutual funds could attract a significant portion of the flows that have been moving into MMDAs. In the extreme, it could even cause some erosion of existing MMDA balances. However, banks and thrifts are not likely to let the differential grow large enough to adversely affect their funding strategies without adjusting their MMDA rates. Moreover, the inability of the thrift industry in the West to recapture its market share (from banks) with the use of differentials even larger than the present differential between money market mutual fund rates and MMDAs suggests that neither of these outcomes is likely.

Gary C. Zimmerman

Chart 1
CALIFORNIA MMDA RATE DIFFERENTIALS

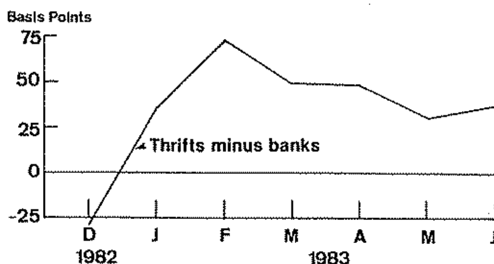
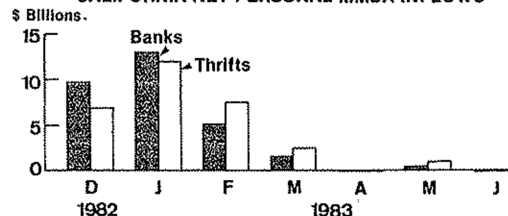


Chart 2
CALIFORNIA NET PERSONAL MMDA INFLOWS



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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/5/83	Change from 9/28/83	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	161,828	85	– 2,127	– 1.3
Loans (gross, adjusted) — total#	141,770	112	– 1,593	– 1.1
Commercial and industrial	43,041	– 17	– 3,114	– 6.7
Real estate	57,097	– 17	– 185	– 0.3
Loans to individuals	24,770	45	1,294	5.5
Securities loans	2,745	83	162	6.3
U.S. Treasury securities*	7,478	62	981	15.1
Other securities*	12,578	– 88	– 1,516	– 10.8
Demand deposits — total#	44,173	4,480	3,199	7.8
Demand deposits — adjusted	29,861	1,192	1,181	4.1
Savings deposits — total†	66,896	1,369	34,652	107.5
Time deposits — total#	66,512	– 599	– 35,181	– 34.6
Individuals, part. & corp.	61,035	– 446	– 30,572	– 33.4
(Large negotiable CD's)	16,980	– 365	– 22,209	– 56.7

Weekly Averages of Daily Figures	Week ended 10/5/83	Week ended 9/28/83	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	112	107	108
Borrowings	72	103	3
Net free reserves (+)/Net borrowed(–)	40	4	105

* Excludes trading account securities.
\# Includes items not shown separately.
† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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