

Research Department
Federal Reserve
Bank of
San Francisco

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Shifts in the Aggregates

The Federal Reserve this week raised its basic discount rate from 11 percent to 12 percent, and adopted a surcharge of two percentage points on frequent use of the discount window by large borrowers. The Fed took these actions "in view of the current level of short-term market interest rates and the recent rapid growth in the monetary aggregates and bank credit."

This latest money-tightening move calls attention to the fact that some (but not all) of the monetary aggregates have exceeded their growth targets for the year to date. Over the January-October period, the narrow M-1A measure of the money supply grew at a 5.5-percent average annual rate—within the target range announced by Chairman Volcker early in the year. But the broader M-1B and M-2 measures grew at 7.6 and 10.2-percent annual rates, respectively—both exceeding the tops of their targeted ranges. This divergence in growth patterns points up the difficulty of "fine tuning" the growth of individual aggregates.

An explanation of this divergence in growth patterns requires an analysis of the components of the various aggregates. M-1A includes currency and bank demand deposits. M-1B in addition includes "other checkable deposits" at banks and thrift institutions (mostly automatic transfer and NOW accounts). The much broader M-2 measure adds in savings and small time deposits at banks and thrift institutions, plus money-market mutual fund shares and overnight balances in the form of repurchase agreements and Eurodollar deposits. (The M-2 aggregate is more than four times larger than the narrower M-1A and M-1B measures.) Our analysis thus concentrates on the reasons why the M-1B components that are not included in M-1A, and the M-2 components that are not included in M-1B, have behaved as they have this year.

M-1A versus M-1B

M-1B has grown much faster than M-1A be-

cause of the faster-than-anticipated growth of other checkable deposits since last May—a 61-percent annual rate of increase in the May-September period alone. The increase has been significant in "negotiable order of withdrawal" (NOW) accounts in those states where depository institutions can offer NOWs, and even more in "automatic transfer from savings" (ATS) accounts. In the San Francisco Reserve District, ATS balances grew at a 78-percent annual rate between May and September, compared with a 24-percent growth rate between January and April.

On the supply side, the surge in ATS accounts reflects the results of the aggressive marketing campaigns that banks have undertaken this year. The legal status of such accounts had been uncertain because of an April 1979 court ruling which overturned the regulation which had authorized them. That legal cloud was removed this March, however, with the passage of the Monetary Control Act, and banks soon thereafter began their aggressive marketing campaigns. In part, banks pushed ATS accounts as a means of getting a head-start on their thrift competitors, who under the act will be able to offer NOW accounts nationwide at the end of this year. Meanwhile, some banks may find greater profit prospects with ATS accounts than with the forthcoming NOW accounts; for larger banks, marginal reserve requirements will be lower on ATS accounts than on newly authorized NOW accounts during the prolonged phase-in period for required reserves.

On the demand side, the pricing of ATS accounts apparently has induced consumers to switch funds from both traditional checking and savings accounts. Most banks pay 5¼ percent (the passbook-savings rate) on their ATS accounts, while requiring substantial minimum balances (\$1,500-\$2,000) from customers who wish to avoid service charges. This pricing strategy encourages households

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to transfer savings funds to ATS to meet minimum-balance requirements, and to shift checking funds to cover transaction needs.

It is clear from the unexpected growth in other checkable deposits (OCD) that to fine-tune the growth of each aggregate is, at best, a difficult undertaking. The unexpected increase in OCD balances due to the increased supply of, and demand for, such deposits caused M-1A to grow at a slower rate than otherwise expected, and caused M-1B and M-2 to grow at faster rates than expected.

M-1B versus M-2

Based on the target growth ranges, the M-2 aggregate was expected to grow at a rate 2.0 to 2.5 percent faster than M-1B—but the actual spread was about 3.0 percentage points. This slightly faster-than-anticipated growth in M-2, relative to M-1B, could be due to unexpected changes in any of the four major components that make up the difference between the two aggregates (see chart). Analysis of the growth patterns of these components—savings deposits, small time deposits, money-market funds, and overnight Eurodollars and repurchase agreements—suggests that, despite shifts among components, much of the growth came from funds shifted out of direct investment in the money markets.

Savings deposits. "Passbook" savings deposits declined steadily from November 1978 through May 1980, as consumers responded to rising market interest rates by switching funds to higher-yielding assets. With the late-spring decline in rates, the downward trend was reversed, as consumers apparently placed funds from maturing assets in passbook savings to take advantage of the liquidity offered by such accounts. Passbook flows have weakened more recently, however, in line with the latest upsurge in market rates.

Small time deposits. The growth in small (under \$100,000) time deposits more than offset the decline in savings deposits in the period November 1978-May 1980. This shift primarily reflected the introduction of two

certificates yielding a market-determined rate of interest—the 6-month money-market certificate and the 30-month time certificate. (The 6-month certificates now account for 54 percent of all small time deposits.) Most of the funds in this category probably came from savings deposits, but some funds probably also came from Treasury-bill holdings, which would have caused a greater-than-expected growth in M-2. The growth of this component moderated between May and August, but then accelerated again in response to rising interest rates, providing a mirror image to the movement in savings deposits.

Money-market mutual funds. The exponential growth in money-market funds (MMFs) also reflected the sharp rise in market interest rates of the past two years. The growth in this category, like the growth in small time deposits, probably represents a shift of funds out of savings deposits. The growth was much greater than expected, however, reflecting a sudden increase in consumer acceptance of this type of financial instrument—and reflecting also the ability of MMFs to entice funds out of direct money-market investment. Small corporations, for example, frequently find that MMFs provide greater liquidity and yield higher returns than direct investments, net of expenses. M-2 thus has grown more rapidly than the market expected because of shifts of funds out of money-market instruments, which are not included in M-2.

Overnight Eurodollars and RPs. On balance, outstanding Eurodollars and repurchase agreements have changed relatively little since a year ago. Month-to-month changes have been substantial, however, reflecting changes in banks' needs for funds. For example, Eurodollar balances declined sharply in November 1979 and again in April 1980 for several reasons, including Federal Reserve money-tightening measures—specifically, the imposition of increased marginal reserve requirements on managed liabilities. Yet given the uneven growth of Eurodollars and RPs, they don't seem to provide an explanation for the overall growth of M-2 this year.

Spreads between aggregates

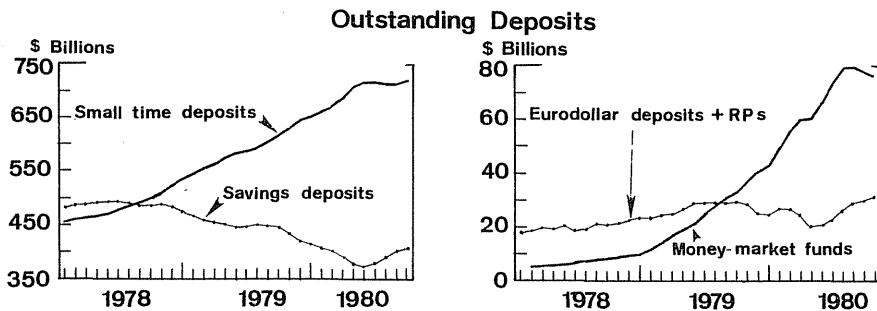
Because of the differential impact of the factors affecting the growth of the various monetary aggregates, the spreads between the actual growth rates have been greater than expected this year. Over the first three quarters, the actual spread between M-1A growth and M-1B growth has amounted to 2.0 percent annually, compared to the 0.5-percent spread implicit in this year's targets. Meanwhile, the spread between actual M-1B growth and actual M-2 growth has amounted to 3.0 percent annually, compared to the 2.0-2.5-percent spread implicit in the targets.

In the case of M-1B, much of the divergence can be explained in terms of the unanticipated growth in other checkable deposits, especially ATS accounts. Perhaps two-thirds of ATS balances come from M-1A demand deposits, so that unexpected ATS growth slows M-1A growth and widens the spread between M-1A and M-1B. The spread is further widened by the injection into ATS balances of funds shifted from assets other than checking accounts.

A similar, though smaller, divergence has developed this year between the actual and implicit spreads between M-1B and M-2 growth. The somewhat faster growth of M-2, relative to M-1B, represents a shift of funds from direct investment in Treasury bills and other money-market instruments not in M-2, to money-market funds and money-market certificates. These two components of M-2 grew unevenly, but overall at a very rapid pace, over the year to date.

When the Federal Reserve set growth targets for M-1A, M-1B, and M-2 last February, and when it reviewed them last July, it stressed the need for wide growth ranges because of the many uncertainties affecting the behavior of various components of the aggregates. The divergent growth patterns of those components this year suggest that there was reason for such concern. The 1980 experience with the aggregates thus will provide grist for the Fed's mills when it develops revised monetary targets for 1981.

Barbara Bennett



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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities	Amount Outstanding	Change from	Change from			
			11/12/80	11/5/80	Dollar	Percent
Large Commercial Banks						
Loans (gross, adjusted) and investments*	144,133	1,052	8,697	6.4		
Loans (gross, adjusted) — total#	122,016	1,034	9,710	8.6		
Commercial and industrial	35,736	58	3,818	12.0		
Real estate	49,217	100	6,817	16.1		
Loans to individuals	23,733	- 8	- 154	- 0.6		
Securities loans	1,202	20	- 366	- 23.3		
U.S. Treasury securities*	6,687	2	- 777	- 10.4		
Other securities*	15,430	16	- 236	- 1.5		
Demand deposits — total#	47,193	-1,068	1,141	2.5		
Demand deposits — adjusted	35,273	857	2,987	9.3		
Savings deposits — total	29,484	- 417	481	1.7		
Time deposits — total#	67,103	1,226	9,431	16.4		
Individuals, part. & corp.	58,180	1,211	8,897	18.1		
(Large negotiable CD's)	26,139	520	4,674	21.8		
Weekly Averages of Daily Figures	Week ended	Week ended	Comparable			
	11/12/80	11/5/80	year-ago period			
Member Bank Reserve Position						
Excess Reserves (+)/Deficiency (-)	n.a.	n.a.		39		
Borrowings				277		
Net free reserves (+)/Net borrowed(-)	n.a.	n.a.		- 238		

* Excludes trading account securities.

Includes items not shown separately.

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