BANKING

U.S. savings banks on the chopping block

"I've seen all my bank's sources of liquidity dry up over the last 48 hours," the president of a medium-sized New Jersey savings and loan institution complained recently. The same predicament faces savings and loans and mutual savings banks across the country.

There are two reasons. One is that interest rates are luring money out of low-interest rate savings deposits. The other is the agreement between Federal Reserve chief Volcker and the major commercial banks to limit credit to consumers, the housing industry, and to the savings banks themselves.

Mortgage money has nearly dried up since Oct. 6. Housing economists, such as Kenneth Biederman of the Federal Home Loan Bank Board, which regulates the S&Ls, are now predicting that new housing starts will drop to 1.4 million in 1980 from 1978's 2 million unit rate.

As it stands now, Volcker's tight money regime is going to be the trigger for a sweeping reorganization and consolidation of the nation's savings bank industry.

First, the upward ratchet of rates since Oct. 6 has sparked a wave of what bankers call disintermediation—the flight of funds out of passbook savings accounts which pay 5.25 percent into small-denomination Treasury securities, participations in large commercial bank deposits, and an endless variety of short-term investments which promise yields of 12 percent and higher.

The only way that savings banks have been able to hold on to deposits is to issue their own money market certificates. These are six-month certificates in the sum of $10,000 which carry an interest rate pegged to the three-month Treasury bill rate. However, these certificates are a very expensive source of money. Last week they paid a 12.65 percent annual rate. On the other side, savings banks are making an average of 8-9 percent of

GOLD

The gold-oil connection

As Dresdner Bank managing director Hans Joachim Schreiber remarked in an interview with the West German weekly Weltwirtswoche in July, the gold price has tended to approximate a 15-fold multiple of the oil price during this period since 1972. The continuing relationship in price between the two commodities is remarkably close.

The gold-oil price parallel reflects the fact that major Western European governments as well as Arab oil-producing countries have already adopted an *implicit* gold standard. During 1979, Saudi and Kuwaiti quasi-official investors, employing West German and French banks as intermediaries, have directed large portions of their new petrodollar earnings into gold in order to protect their holdings from inflation in the dollar sector. The launching of the European Monetary System (EMS), with its gold reserve pooling mechanism, in March of this year was an important first step by European governments towards full-fledged gold remonetization

New antigold campaign

What these developments mean is that the gold price is not likely to be stabilized until dollar sector inflation is gotten under control and the present upward spiral in oil spot market prices, rigged by multinational oil companies, is brought to a halt. U.S. inflation can be squelched *without a depression* if governments agree to use gold-back bonds to mop up the volatile Eurodollar market and put these funds to work in long-term productive investments in the developing sector.

their assets on fixed rate mortgages and other investments.

This combined earnings squeeze and loss of deposits will be fatal for many of the nation's savings banks, say well-placed bank analysts. Government officials meanwhile are working out the contingency plans for possible savings bank failures.

Coup de Grace

According to a report in the *Wall Street Journal* Oct. 25, the Federal Deposit Insurance Corporation, which was created after the 1931 bank holidays to insure deposits, is putting in place the procedures for merging savings banks into other savings or commercial banks. The FDIC is working out the details for allowing commercial banks to acquire savings banks, which are allowed to offer one quarter of a percentage point more on savings deposits than commercial banks are.

A bill that will pull the plug on the nation's savings banks is now before Congress. Debate opened up on the Depository Institutions Deregulation Act in Congress on Oct. 23. The bill is sponsored by Sen. William Proxmire and supported by Federal Reserve Chairman Volcker.

The bill would knock out Regulation Q, which would eliminate federal interest ceilings on deposits. The elimination of Regulation Q—enacted in 1933 to stop banking rate wars—combined with a new measure proposed by Rep. Henry Reuss to allow commercial banks to give interest on checking accounts, essentially wipes out every federal guarantee to the existence of savings and loans associations.

The overall objective of the banking legislation was passionately protested on the floor of the Senate by Sen. Robert Morgan of North Carolina. "I honestly think this bill should be entitled the 'Depository Institutions Abolition Act,' because I believe that the ramifications of this bill are so far-reaching that the effects could very well be the destruction of some of the finest financial institutions that have ever served this nation," Morgan charged. The result of these measures he said, will be the homogenization of the U.S. banking structure. "If this bill is passed, those savings and loans that are able to survive—and I predict there will be a very small percentage that will survive in their present form—will be engaged more in consumer loans than any other type of investment. Where are the young couples going to go to get a loan to build a home?"

—Lydia Schulman

The reader will note that during the 1975-76 period the gold-oil price relationship did not hold up. Between the beginning of 1975 and mid-1976, the gold price fell from its previous high of nearly $200 an ounce to close to $100, reflecting worldwide recession and a concerted International Monetary Fund-U.S. Treasury effort to demonetize gold by selling large amounts to the public. In 1979-1980, Treasury sales are unlikely to have this effect because of the existence of the EMS and the French and West German governments' political commitment to return gold to a central role in the world monetary system.

On Thursday, November 1, the U.S. Treasury plans to auction 1.25 million ounces of gold as part of its new strategy of selling "arbitrary amounts at arbitrary times." Previously, the Treasury had been auctioning only 750,000 ounces at regular monthly auctions. Although Thursday's sale may have a momentary depressing effect on the market, this is not expected to last for the above reasons.

Admittedly, certain pro-Anglo-American elements in the West German government have recently attempted to erode Chancellor Schmidt's support for gold remonetization. On Oct. 30, the *Journal of Commerce* reported that West Germany Treasury Undersecretary Manfred Lahnstein was opposed to coordinated central bank efforts to stabilize the gold price "because that would tend to remonetize gold." Lahnstein further reported that German bank regulators were "cracking down" on German banks which have purchased gold for their own accounts. It is expected that the regulatory authorities will issue a directive shortly requiring these banks to include their gold holdings in their open foreign-exchange position which by law cannot exceed 30 percent of a given bank's stock capital plus reserves.

This move is clearly intended to intimidate the Dresdner Bank, which has repeatedly embarrassed the U.S. Treasury by purchasing large amounts of gold at the public auctions. But a Dresdner spokesman in New York stated that the new regulatory requirement will have no effect on the bank since Dresdner has already functioned on the basis of the 30 percent guideline for the last several months. Lahnstein's outburst nevertheless indicates a deepening factionalization within the West German government which Schmidt will have to resolve in the coming weeks.

—Alice Roth