The New York City Banks' Share in Commercial Banking

By FRANCIS H. SCHOTT AND RUDOLF THUNBERG*

The large New York City banks occupy a special position within the nation's banking system. In addition to providing local banking services, they extend a substantial part of the credit used by firms with nationwide operations and are a focal point of the country's network of correspondent banking. They also do the bulk of the country's international banking business — financing foreign trade, rendering financial services to foreign dollar holders, and trading in foreign exchange. Furthermore, as one of the primary sources of bank credit to dealers in United States Government securities, they are a major link in the transmittal of the impact of Federal Reserve System open market operations throughout the financial structure. This article discusses some recent developments in the share of this important group of banks in the nation's commercial banking.

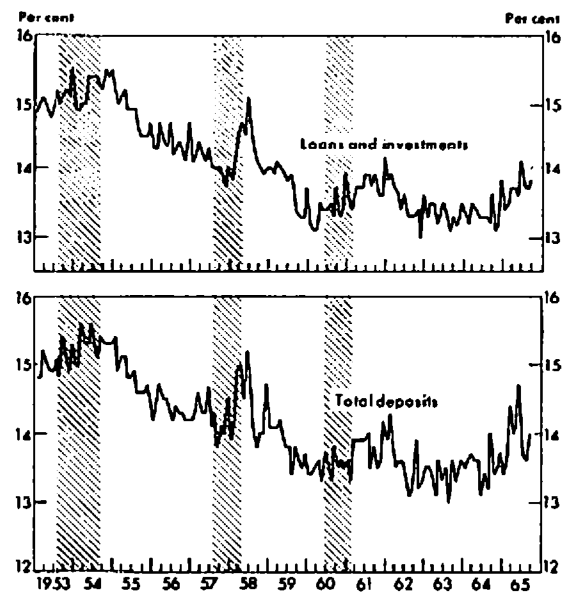
TRENDS IN THE NEW YORK CITY BANKS' SHARE IN COMMERCIAL BANKING

At its zenith, in 1941, the New York City weekly reporting banks' share in the total loans and investments and total deposits of the commercial banking system had risen to almost 25 per cent.[1] During the ensuing two decades, although the New York City banks grew substantially in absolute terms, their share in total credit and deposits followed a generally declining trend—as shown, for the years since 1952, in Chart I. During the 1960's, however, that downtrend has been arrested and to some extent reversed, as also shown in Chart I.

A number of factors contributed to the lagging relative growth of New York City banks until recent years. The population of the Northeast increased rather slowly in the postwar years. New York City's population, in particular, grew by only 4 per cent between 1940 and 1960, compared with an increase of almost 36 per cent for the nation as a whole. In addition, the composition of the population of the city underwent a change, as many middle-income depositors moved to the suburbs and were replaced by low-income groups. Laws covering branch banking prevented New York City banks from opening branches in the growing suburbs. Furthermore, corporate working

Chart I

NEW YORK CITY BANKS' SHARE IN MAJOR ASSETS AND LIABILITIES OF ALL COMMERCIAL BANKS



Note: Shaded areas represent recession periods, according to National Bureau of Economic Research chronology.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

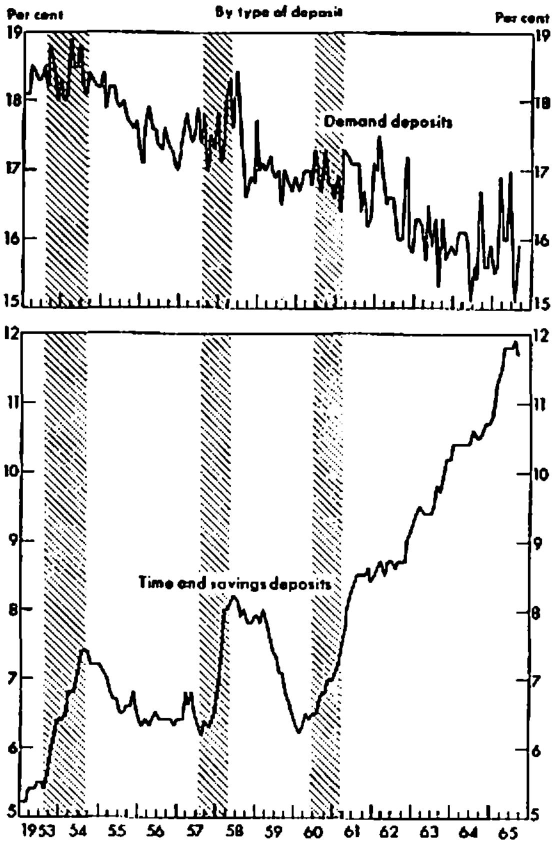
* Manager, Research Department, and Economist, Research Department.

1 The New York City weekly reporting banks, presently thirteen in number, are those which provide the Federal Reserve with balance-sheet information each week. They include six of the country's ten largest banks, three other large banks, and four banks of intermediate size. All have their headquarters in New York City.

Chart II

NEW YORK CITY BANKS' SHARE IN DEPOSITS AT ALL COMMERCIAL BANKS

By type of deposit



Note: Shaded areas represent recession periods, according to National Bureau of Economic Research chronology.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

balances were gradually more widely spread through the nation's banking system since industrial growth was centered in the West and the South. Meanwhile, corporate treasurers became increasingly sophisticated in the management of liquid funds and tended systematically to minimize noninterest-bearing balances. The New York City banks—where corporations had traditionally held a large part of their liquid funds—for these reasons failed to participate as fully as previously in the growth of total deposits, although their share in total corporate deposits remained substantial.

Cyclical changes sometimes retarded and at other times reinforced the declining trend. Chart I shows that the percentage of total commercial bank loans and investments and deposits held in New York City tended to rise during recessions and to fall during expansions of economic activity. On the deposit side, the cyclical pattern was largely confined to time deposits, as shown in Chart II.[2] One possible explanation of this pattern is the following: prior to the introduction of negotiable time certificates of deposit (C/D's) at New York City banks in 1961 (discussed below), foreign holders of dollar assets and other interest-sensitive investors found time deposits an attractive outlet for their liquid funds primarily during recessions and not during expansions. Time deposit rates were considerably more stable over the course of the cycle than rates on Treasury bills and other money market instruments. This meant that time deposits became a relatively more attractive short-term investment medium as Treasury bill rates moved downward in recessions, and less attractive during expansions when bill rates moved upward.[3] The shifts in the form of holding liquid funds among different types of short-term assets that were thus induced had important implications for the relative shares of various groups of banks in total time deposits. In particular, the share of those banks that especially serve large and interest-sensitive customers tended to be enlarged during recessions and reduced during expansions.

The cyclical pattern of the share of New York City banks in the nation's banking business may also reflect differences among banks in the degree of utilization of available reserves. Large city banks manage their money position in such a way that they have minimal excess reserves at any time. During expansionary periods, therefore, these banks have typically had to satisfy at least part of any heavy loan demand by liquidating holdings of securities, merely substituting one form of bank credit for another. "Country" banks, on the other hand, have generally tended to hold excess reserves, which are usually especially large during recessions. Therefore, a portion of their portfolio growth during the ensuing economic expan-

---

[2] The demand deposit share of New York City banks (also shown in Chart II) appears to be affected only slightly by the cycle. One exception to this generalization occurred toward the end of the 1957-58 recession when the New York demand deposit share rose considerably along with the time deposit share. Unusually large Treasury financing operations in 1958 resulted in a temporary buildup of United States Government balances, concentrated for a time at large banks.

[3] See Richard G. Davis and Jack M. Guttentag, "Time and Savings Deposits in the Cycle", this *Review* (June 1962), pp. 86-91, as well as "Movements in Time and Savings Deposits, 1951-1962", Federal Reserve Bank of St. Louis *Review* (March 1963), pp. 5-10, and William R. Bryan, "Recent Trends in Time Deposits", *ibid.* (June 1964), pp. 7-11.

sion could be financed by reducing excess reserves. Consequently, country banks have tended to be more able to increase their total credit during expansions than New York City banks, and hence have gained relatively on New York City banks in these periods.[4]

In striking contrast to these earlier patterns, the downtrend in the New York City banks' share of commercial banking has been arrested over the course of the current prolonged period of economic expansion. Following a rise in that share during the 1960-61 recession, which was in accord with the historical patterns, the rise in the New York share continued well into 1961 (the early phase of the expansion), which was contrary to the historical pattern. Furthermore, the decline which then began appears to have been arrested since about the end of 1962. Indeed, after a period of substantial stability lasting until roughly mid-1964, the New York share began to rise and this movement continued through mid-1965. As a consequence, the New York banks' share, at roughly 14.5 per cent of total deposits and 14 per cent of total loans and investments of all commercial banks, in June reached about the highest levels since early 1959.

PRINCIPAL REASONS FOR RECENT IMPROVEMENT IN POSITION OF NEW YORK BANKS

The growth of the commercial banking system as a whole is influenced by a host of variables. These include especially the amount of additional reserves supplied by the Federal Reserve and technical factors such as reserve drains into additional currency in circulation, as well as the required ratio of reserves to deposits, and the deposit "mix" (if a difference exists—as it does—between reserve requirements on various types of deposits). The relative growth of any one bank or group of banks within the banking system, however, is determined primarily by relative success in attracting deposits. Beginning in the early 1960's, New York City banks began to take positive steps to halt the decline in their relative position.

Perhaps the most important of these moves was a change in attitude toward time and savings deposits. Before 1961, the large New York City banks generally took a negative attitude toward time deposits of corporations, and some although not all were quite indifferent to savings deposits. Since then, they have been bidding aggressively for temporarily idle corporate funds as well as for savings of individuals. Practically all the deposit growth of large New York City banks in recent years has in fact been in the form of time and savings deposits. Between September 1960 and September 1965, total time and savings deposits of the New York City weekly reporting banks increased by about 240 per cent ($11.8 billion), while demand deposits at these banks grew by only 8 per cent ($1.9 billion). In terms of the New York share in total deposits, this time deposit gain more than offset a further relative decline in demand deposits, as is evident from a comparison of New York's total-deposit share (Chart I) with the breakdown of this share by type of deposit (Chart II).

For reasons already noted, cyclical variations in the deposit share of New York banks have tended to be confined largely to time deposits. Therefore, a downturn of the New York share in time deposits would have been predicted for early 1961—the beginning of the current economic expansion—but no such downturn materialized. On the contrary, that share has been rising almost continuously, from barely 7 per cent at the beginning of 1961 to almost 12 per cent by mid-1965.

Once their decision to compete aggressively for time deposits was made, the New York banks achieved success largely through the medium of negotiable time certificates of deposit (C/D's). After being used locally and regionally for some years, mostly in the West and Southwest, this new money market instrument was thrust into national prominence in February 1961—at the trough of the last recession—when the large New York banks began to issue negotiable certificates for time deposits of substantial size. Almost simultaneously, Government securities dealers established a secondary market in C/D's, and the other major New York City banks as well as large banks around the nation began issuing these instruments.[5] Within a few months, the C/D had become a major money market instrument, and by early 1964 the volume of negotiable C/D's exceeded that of commercial and finance company paper and bankers' acceptances combined. Since then, C/D's have continued to gain, both in absolute amounts outstanding and relative to other

[4] The substitution of credit for excess reserves on the part of country banks during expansions may enlarge only their share in total bank credit and not necessarily their share in total deposits. Most likely, however, the banks at which the creation of additional credit takes place will retain a somewhat larger share of the deposits associated with this credit expansion than they generally hold, partly because of compensating-balance requirements against loans.

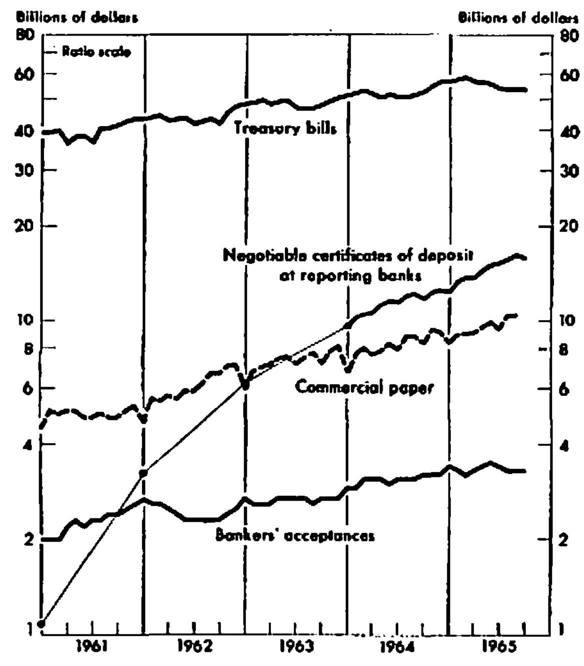
[5] See Richard C. Fieldhouse, "Certificates of Deposit", this *Review* (June 1963), pp. 82-87, and the updated version of that article in this Bank's *Essays in Money and Credit* (December 1964), pp. 42-46.

money market instruments (see Chart III). In mid-October 1965—after a seasonal dip in September—the total amount of negotiable C/D's outstanding at all weekly reporting member banks exceeded $16.3 billion.

The negotiable time certificate has greatly contributed to a broadening of the competition for bank deposits from the local and regional to the nationwide level. Furthermore, the competition for profitable loans and investments has also been broadened, since the C/D market facilitates the search for the needed resources once the lending opportunity arises. The large money market banks have turned out to be strong competitors, particularly because a C/D possesses greater marketability if it is issued by a bank of national repute. This criterion is readily met by the large New York banks, which are therefore able to obtain deposits by issuing C/D's at somewhat lower interest rates than smaller and less well-known banks. The competitive strength of New York "prime banks" is reflected in the absolute and relative growth of their outstanding C/D's. For all New York City weekly reporting banks, the total has grown from virtually zero in early 1961 to almost $7 billion in early September 1965; and the New York share among all weekly reporting banks has risen from a negligible percentage in early 1961 to more than 40 per cent by mid-1965 (see Chart IV).[6]

Chart III

SELECTED MONEY MARKET INSTRUMENTS: VOLUME OUTSTANDING



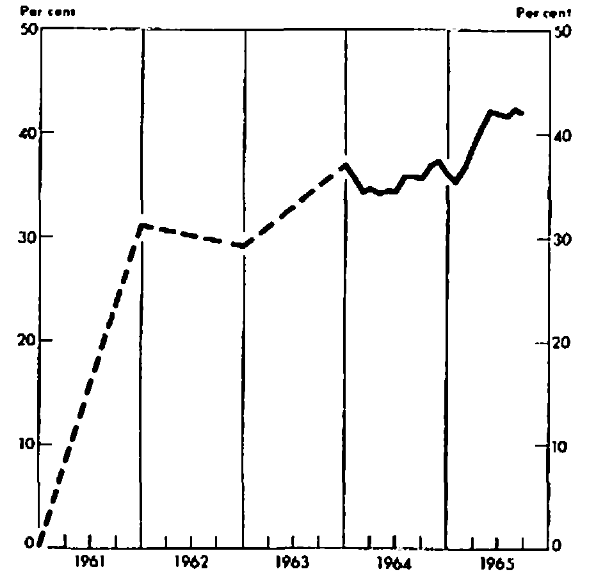
Note: The figures on negotiable certificates of deposit outstanding for the year-ends of 1960, 1961, and 1962 are based on a survey of 410 member banks (no within-the-year figures are available for this period). Beginning in December 1963, monthly figures become available from reports supplied by the approximately 350 weekly reporting member banks for the last Wednesday of each month. Both the early survey sample and the current weekly reporting sample are believed to cover most banks that have appreciable certificates of deposit liabilities.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

Chart IV

NEW YORK CITY BANKS' SHARE IN NEGOTIABLE CERTIFICATES OF DEPOSIT OUTSTANDING

Based on special survey and weekly reporting bank data



Note: It is assumed that no negotiable certificates of deposit were outstanding at New York City banks in 1960. The percentages shown for the year-ends of 1961 and 1962 are based on figures supplied by nine large New York City banks and the early sample of certificates of deposit outstanding (see note to Chart III). Beginning December 1963, the underlying data cover all New York City weekly reporting banks. The nine New York banks included in the early series covered all those with significant certificates of deposit liabilities. For the New York banks as a group, therefore, the difference in the coverage of the early series and that of the current reports is negligible.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York

[6] The relative rate of growth of C/D's outstanding at various groups of banks appears to have become closely linked to the relative strength of various types of loan demand. The reason is of course that relative loan demand influences the degree of aggressiveness with which banks bid for C/D funds. For example, business loan demand has been very active in 1965, and New York banks make proportionately more business loans than other groups of banks. This factor has been particularly important during 1965 in leading New York banks to compete aggressively for deposits. As a consequence of this and several other factors, the rise in the New York City bank share in outstanding C/D's was especially pronounced in the first half of 1965.

MAXIMUM RATES PAYABLE ON TIME AND SAVINGS DEPOSITS UNDER FEDERAL RESERVE REGULATION Q*

In per cent per annum

Type of deposit	Jan. 1, 1936– Dec. 31, 1956	Jan. 1, 1957– Dec. 31, 1961	Jan. 1, 1962– July 16, 1963	July 17, 1963– Nov. 23, 1964	Nov. 24, 1964– Present
Savings deposits:					
1 year or more	2½	3	4	4	4
Less than 1 year	2½	3	3½	3½	4
Other time deposits:					
1 year or more	2½	3	4	4	4½
6 months or more but less than 1 year	2½	3	3½	4	4½
90 days or more but less than 6 months	2	2½	2½	4	4½
30 to 89 days	1	1	1	1	4

* Since October 15, 1962, time deposits due to foreign official institutions have been exempt from interest rate ceilings under Regulation Q.
Source: Board of Governors of the Federal Reserve System.

The Federal Reserve has facilitated the spectacular growth of C/D's by allowing banks to pay time deposit rates competitive with those on other money market instruments, and this is precisely what the banks have been doing during the current sustained period of economic expansion. Since 1961, the maximum rates payable on time and savings deposits under the Board of Governors' Regulation Q have been raised three times (see table). The most recent revisions, in July 1963 and November 1964, have emphasized liberalization of rates on time deposits of short-term maturities. Although these Federal Reserve policy changes were occasioned by the need to keep permissible time deposit rates in line with other national and international money market rates, they also permitted a demonstration of competitive strength on the part of money market banks, which may be especially well situated to capture short-term corporate funds. Additionally, the exemption from interest rate ceilings on time deposits of foreign official institutions since October 1962 was primarily designed to make dollar deposits attractive to such foreign authorities. Nevertheless, it may also have had the effect of enlarging the New York banks' share of total deposits, since these banks in fact hold the bulk of the official foreign deposits in United States banks.[7]

[7] More generally, it is likely that large New York banks—well-known outside the country—would be the deposit institutions favored by all categories of foreigners. Both official and private foreigners were substantial gainers of dollar deposits over the course of the major United States balance of payments deficits of the years 1958-64.

ADDITIONAL FACTORS STRENGTHENING THE NEW YORK BANKS' POSITION

It has already been pointed out that the relative improvement in the position of New York City banks over the past few years cannot be attributed to strength in attracting demand deposits, for the share of New York City weekly reporting banks in total demand deposits of the banking system has still generally declined. Nevertheless, it should be noted that this decline might have been worse (and the over-all gain of the New York banks less) without the reductions in reserve requirements on demand deposits of "central reserve city" banks from 18 per cent to 16.5 per cent in 1960 (made effective in two steps in September and December of that year).[8] A reduction of a bank's reserve requirement tends to result in a substitution of loans and investments for cash reserves at that

[8] The "central reserve city" category of banks, which was terminated and merged with the "reserve city" category in July 1962, included the largest banks in New York and Chicago. The reductions of the central reserve city bank reserve requirements were accompanied by an increase in the reserve requirement on demand deposits of "country" member banks—from 11 per cent to 12 per cent—in November 1960. Also during 1960 and the preceding year, however, all vault cash was gradually made eligible for inclusion in legal reserves. (This action by the Federal Reserve's Board of Governors was permitted under the same law of Congress that required an end to the central reserve city category of banks.) The inclusion of vault cash in legal reserves most benefited country banks, which as a group hold much higher ratios of vault cash to deposits than do money market banks. The reserve requirement on time deposits has long been uniform for all member banks, and has been 4 per cent since late 1962 when it was lowered from 5 per cent.

bank, and a higher ratio of earning assets to liabilities in turn will make deposits potentially more profitable, thus encouraging the bank to intensify its competition for deposits.[9] Therefore, the reduction in the reserve requirement for central reserve city banks has perhaps tended to retard the relative decline of demand deposits at New York banks.

The long duration of the current expansion is, in itself, a factor that has recently tended to halt the decline in the relative position of large banks as the smaller banks have gradually drawn down and utilized the excess reserves with which they typically enter a period of economic expansion.[10] During the first three years of the current expansion, country banks again increased their earning assets by reducing their cash reserves in relation to deposits, but since early 1964 the excess cash ratio of country member banks has remained virtually unchanged. New York City banks, however, have reduced their excess reserve-deposit ratio only negligibly during the entire expansion.

It should also be noted that the development of the Federal funds market over the past few years has provided a means of mitigating the cyclical pattern of relative credit and deposit gains of country banks in an economic expansion. The possibility of rapid redistribution of reserve balances through that market has enabled the New York City banks to buy and use excess reserves previously held idle at country banks. The New York City banks have, in fact, generally been net purchasers of Federal funds.

Liberalized laws with respect to branch banking may also have been responsible for some of the improvement in the relative position of New York City banks. Prior to the passage of the New York State Omnibus Banking Act in 1960, banks with headquarters in New York City were not allowed the privilege of branching outside the city. Since 1960, New York City banks have been allowed to open branches in two adjacent counties as well as in the five counties in the city. Even today, however, the major New York City banks have relatively few branches outside the city, and it is possible that the deposits of these branches may partly represent only funds transferred from city offices rather than net additions to total deposits of these banks. Nevertheless, it is well to keep in mind that the share of the New York banks in the national totals currently represents a somewhat larger geographic area than, say, ten years ago.

CONCLUDING COMMENT

The recent competitive gain of the New York City banks represents the reversal of a long-term trend. For this reason, it is a noteworthy development that deserves close observation and further study. Yet, the previous trend lasted so long and was so consistent that a few years' change cannot be accepted as a definitive turn.

It can be argued, for example, that the shift from a local to a national deposit market implicit in the development of time certificates of deposit is a once-and-for-all change that may already have spent its main force in affecting the relative shares of various groups of banks in the banking business. There could well be some truth in this reasoning. Although the total volume of C/D's was still generally advancing through the first nine months of this year, their rate of growth has leveled off somewhat in 1964-65, compared with 1961-63. Meanwhile, large banks in New York and elsewhere have again found novel ways of attracting resources, such as nonnegotiable "acknowledgments of advance" and negotiable unsecured promissory notes. Provided the New York banks can compete in a nationwide market for loanable funds, they may well be able at least to maintain the gains already made.

[9] As noted previously, there is also the more general possibility that compensating balance requirements on loans will tend to keep somewhat higher deposits at the banks originating the loans than these banks would obtain from credit and deposit creation throughout the banking system. Cash reserves released by a reduction in reserve requirements are of course initially available for credit expansion at the particular banks for which the regulations have been changed.

[10] There are of course other important differences between the current and earlier expansions besides the greater duration of the present one. One such difference is that monetary policy has generally been easier. For example, total member bank reserves increased at an annual rate of 4.0 per cent from the cyclical trough of February 1961 through September 1965, compared with 0.6 per cent in the April 1958-May 1960 expansion and 1.0 per cent in the August 1954-July 1957 advance. However, the significance of this difference for relative shares in banking of various groups of banks is by no means clear.