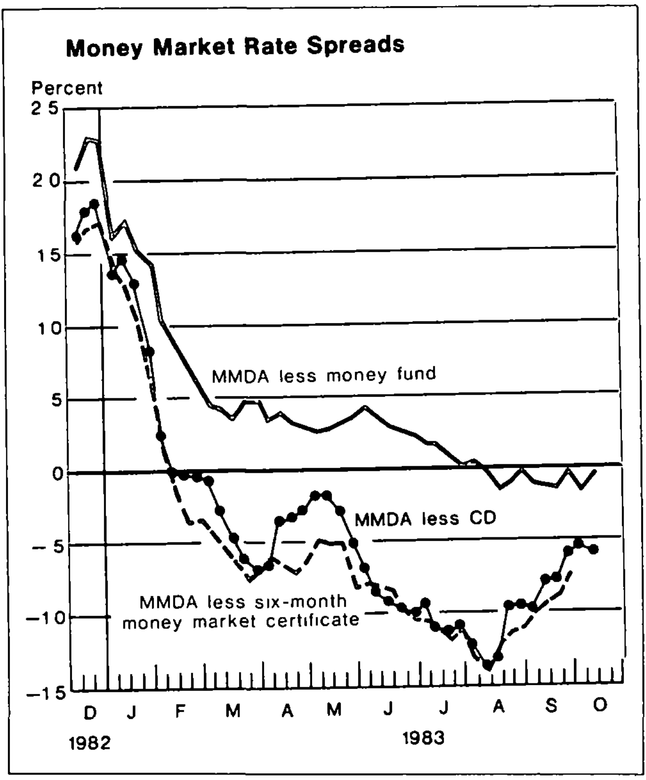
MMDA Rates and Flows

In recent months, rates on money market deposit accounts (MMDAs) have continued to decline relative to rates offered on competing assets and, as a result, MMDA growth has leveled off. Initially, rates on MMDAs averaged more than 2 percentage points higher than rates on alternative assets such as money market mutual fund shares and small time deposits (*e.g* , three- and six-month money market certificates). The difference in rates declined steadily between January 1983 and August 1983 Since then, the average rate on MMDAs has been below the average rate on money funds (chart)

As MMDA rates have come more in line with rates on other assets, deposit flows into MMDAs have diminished, and in several recent weeks there have been net outflows At the same time, deposits at money funds have leveled off after having fallen by about $50 billion in the first half of 1983 Also, investors on balance have stopped shifting funds from small time deposit accounts to MMDAs Small time deposits at commercial banks and thrift institutions fell by over $135 billion from December 1982 through June 1983, but in the third quarter these accounts increased by about $35 billion. As MMDA inflows have dropped off, banks and thrift institutions also have issued more large certificates of deposit as an alternative source of funds Certificates of deposit outstanding rose $14 billion from July through September, after they had fallen by $30 billion in the first six months of the year



While MMDAs and money funds are similar in terms of liquidity and transactions costs, MMDAs carry FDIC insurance Consequently, in theory, investors should be willing to accept a somewhat lower rate on them than on money funds. However, the flows of funds during the last few months suggest that banks and thrift institutions were able to attract "new money" (from outside the banking system) to MMDA accounts only by paying a premium over the return from money funds and other competing assets Unless depository institutions are again willing to pay a significant premium, net flows into the MMDAs from other accounts should remain comparatively modest from now on Moreover, the introduction of unregulated small certificates of deposit on October 1 may cause shifts from MMDAs to these instruments, if the rates offered are sufficiently above MMDA rates to compensate for the reduced liquidity of the 32-day minimum maturity

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