The thrift industry primarily serves as an intermediary between people who wish to save in relatively liquid assets and people who wish to borrow mortgage funds. If long-term interest rates on mortgages are greater than short-term interest rates on deposits, thrifts generally can depend on a relatively stable supply of deposits and earn profits, retaining some of them in capital or net-worth accounts that are used to support additional mortgage lending. However, when short-term interest rates are higher than long-term rates, as they have been in 1981, many depositors withdraw funds from their savings accounts to buy higher-yielding assets. If net deposit outflows are large enough, some thrifts could be forced out of business.

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Thrifts, Extended Credit, and Monetary Policy
by John B. Carlson and K.J. Kowalewski

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certificates. Although earnings are low-
equal amounts of FH LMC participation
conform to FHLMC requirements for
2. As of December 31, 1980, interest-rate ceilings
averaged 14.7 percent; rates on two and one-half
S&L asset portfolios. Beginning on October 5,
fixed-rate loans to 20.5 percent for short-term
around the three-month Treasury bill auction
These equity securities are essentially agree-
tions in return for special equity securities.
net worth for FHLB regulations.
1981 rates on six-month money-market certificates
The Federal Reserve's extended credit pro-
gram provides an alternative to forced mort-
gage sales with attendant capital losses and
some of their mortgage assets, and they
industry sources (e.g., Federal Home Loan
thrifts. Thus the portfolio of all other sec-
dors shows $5-billion increases in MMMF
and automatic transfer service (ATS) ac-
s. Under the Federal Reserve's Regu-
ations A, extended credit can be made avail-
able to accommodate the needs of deposi-
tory institutions that may be experiencing
unknown program was authorized by the All
The act permits thrifts and com-
panies to maintain the book value
of funds deposited at thrifts and acquire
the Internal Revenue Service permits par-
rate, the potential net outflow of funds is
much greater. If it appeared that thrifts had
no effective means of coping with deposit
households withdraw (net) $5 billion
program will impair the Federal Reserve's
ability to conduct monetary policy. This
Economic Commentary discusses the Fed-
eral Reserve's new extended credit program
and how it affects the implementation of
monetary policy.
Portfolios of thrifts
To appreciate the potential role of
the extended credit program, it is useful to
are low or imbalanced. In turn, the
extended program allows solvent depository
institutions experiencing liquidity problems
to borrow from the Federal Reserve Banks.
The extension of the credit program
provides an alternative to forced mort-
gage sales with attendant capital losses and
then absorb the mortgages sold by the
thrifts. Thus the portfolio of all other sec-ndors is the affected thrifts
viewed at $5 billion of de-
their deposit loss, thrifts must sell mortgages
with book value of $6 billion, writing the $1-
 billion loss off the capital account. Money-
market mutual funds use the monies gained
through share sales to acquire short-term
assets from other all other sectors. These sectors
in turn absorb the mortgages sold by the
thrifts. Thus the portfolio of all other sec-
dors shows $5-billion increases in MMMF
shares and mortgages and $5-billion reduc-
tions in short-term assets and thrift deposits.
Perhaps also that all other sectors must be
in order to hold more mortgages and fewer
short-term assets. Mortgage rates thus would
rise relative to short-term rates, sug-
stating that the thrift write-off per dollar of
mortgage sales would rise with the scale of
thrift-deposit outflows.3

3. Although not shown in the T-accounts, thrifts
might be weakened, making it difficult for
thrifts to roll over large-denomination time
loans and terms RPs as they mature. In
August, these liabilities at thrifts soared
about $64 billion.

Extended Credit Program
The Depository Institutions Deregulation
and Monetary Control Act of 1980 author-
izes Federal Reserve Banks to extend credit
to depositary institutions that offer non-

Person deposits -5
Deposits at +1
Large CD's +4
Discount window +1
MMMF shares
Shares

<table>
<thead>
<tr>
<th>Account</th>
<th>Thrifts</th>
<th>All other sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal deposits</td>
<td>-6</td>
<td>-5</td>
</tr>
<tr>
<td>Capital account</td>
<td>-1</td>
<td>+1</td>
</tr>
<tr>
<td>MMMMF shares</td>
<td>-5</td>
<td>-4</td>
</tr>
<tr>
<td>Shares</td>
<td>+5</td>
<td>+4</td>
</tr>
<tr>
<td>Deposits at +1</td>
<td>+5</td>
<td>-5</td>
</tr>
<tr>
<td>Short-term securities</td>
<td>+5</td>
<td>+4</td>
</tr>
<tr>
<td>Discount window</td>
<td>+1</td>
<td>-1</td>
</tr>
<tr>
<td>Large CD's</td>
<td>+4</td>
<td>+3</td>
</tr>
<tr>
<td>Short-term securities</td>
<td>+5</td>
<td>+4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Account</th>
<th>Federal Reserve</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal deposits</td>
<td>+5</td>
</tr>
<tr>
<td>Deposits at +1</td>
<td>-1</td>
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<tr>
<td>Large CD's</td>
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</tr>
<tr>
<td>Discount window</td>
<td>+1</td>
</tr>
<tr>
<td>Short-term securities</td>
<td>+5</td>
</tr>
</tbody>
</table>

Economic Commentary, T-accounts are used to illustrate net changes in balance sheets resulting from portfolio shifts.

4. A T-account reflects a change in a balance sheet, typically as a result of a single transaction. In this Economic Commentary, T-accounts are used to illustrate net changes in balance sheets resulting from portfolio shifts.

5. Although net shown in the T-accounts, thrifts have been experiencing earnings losses that also are written off the capital account and absorb liquidity.