Bank Adjustments to Seasonal Business Requirements

Within a few weeks, bank loans will reach a seasonal low point. After that, barring unforeseen developments, the normal fall and winter growth will commence. Partly in recognition of the probable seasonal requirements this fall and winter, the Board of Governors of the Federal Reserve System recently announced a reduction in member bank reserve requirements. To the extent that the recent reduction was designed to ease seasonal pressures, this action has precedent, for one of the Federal Reserve System's responsibilities is to provide the banking system with the reserves necessary to meet the needs of the economy. Determining the degree of adjustment needed and choosing a proper method of meeting seasonal business fluctuations are two of the major recurrent problems of the monetary authority.

Seasonal Business Fluctuations Present a Major Problem in Bank Operations

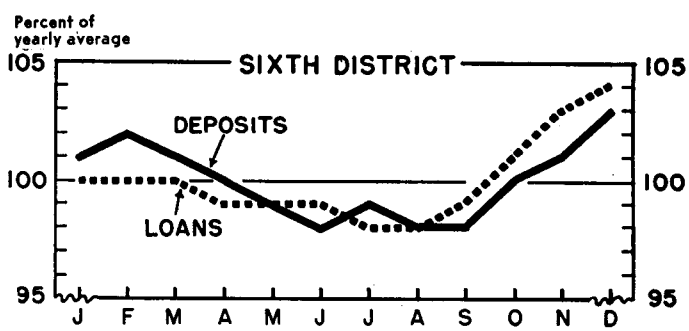
Individual commercial banks also face the problem of adjusting to seasonal fluctuations in loan demand. Many banks find this to be their most difficult problem, and they are forced to make considerably greater adjustments proportionately than those required for the entire banking system. Two factors tend to make their seasonal problem greater. On the one hand, the seasonal pattern of loan demand of a single bank may not coincide with that of the entire banking system because of particular economic characteristics of the community it serves. This means that it sometimes has to "paddle against the current" of the seasonal monetary adjustments of the Federal Reserve System. On the other hand, unlike the banking system, the individual bank's ability to grant loans is strictly circumscribed by the amount of its deposits. Because some banks experience seasonal deposit fluctuations almost directly opposed to the seasonal pattern of loan fluctuations, they frequently find that their ability to lend is weakest at the time when demand for loans is strongest.

In the Sixth Federal Reserve District, aggregate member bank loans follow almost the same pattern as that for the nation. Loans begin to rise in late summer or early fall, reaching a peak in December. In the early months of the year, a substantial liquidation of loans occurs until the low point is reached in midsummer. The seasonal pattern of bank loans for the entire District is, of course, a sum of many diverse movements in individual segments of the regional economy, and few individual banks find their experience to be precisely the same as that of the District aggregate. The process of meeting the seasonal requirements of business is a crucial point in the relation of the individual commercial bank to the Federal Reserve System, and is one of the greatest internal difficulties of bank management. Consequently, some knowledge of the seasonal problem is essential both to an understanding of Federal Reserve policy and to the intelligent operation of a commercial bank.

Seasonal Pattern of Loan Demand Varies Among Banks

In agricultural areas, bank loans typically increase in the spring because of farmers' needs for seed, fertilizer, and other production items. As the season advances and farmers need additional funds to cultivate the growing crops and to tide themselves over until the mature crops can be harvested and sold, loans increase. In some cases the loans are made directly to farmers, and in others they are made to retailers who extend trade credit to their farm customers. Normally, bank loans then are liquidated and remain at a low level until the cycle begins again in the spring.

In a number of areas in the Sixth District, the agricultural cycle dominates bank lending. In the South Georgia, Orlando, Jackson, Dothan, Macon, and Lafayette-Iberia areas, the agricultural loan cycle appears to be the characteristic pattern of lending. In these sections it is estimated that agricultural income payments to individuals

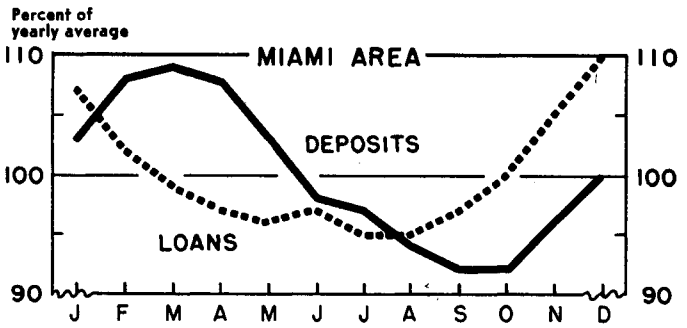


For the consolidated District banking system, deposit and loan patterns are similar, but variations occur in particular areas. For example, member banks . . .

are more than twice as great as manufacturing payrolls. The time of the peaks and troughs of total loans varies from area to area depending both upon the dates of planting and harvesting the major crops and upon the typical financing practices in regard to these crops.

Most major cities and non-agricultural areas of the District experience a seasonal pattern of loans almost directly the reverse of that experienced in areas dominated by agriculture. Loans begin to rise in late summer and early fall, reaching a peak in December. Then they decline throughout the spring. This pattern, in the main, is probably the result of the seasonal needs of trade and

manufacturing concerns. Many manufacturing concerns find some portion of their sales directly dependent upon holiday promotions, and they must accumulate inventories to meet this need. Also retailers ordinarily must build their inventories and extend more trade credit for holiday seasons. Finally, some institutions in the major centers



. . . in the Miami area find loan demand declining in the spring when tourist dollars are flowing in, whereas . . .

are important in financing the holding of farm commodities in the interval between the harvest and the actual processing or distributing of the finished products. All these activities combine to produce a trade and manufacturing pattern of seasonal loan demand. The importance of the major city banks is such that the over-all loan activity for the Sixth District in any year roughly follows this trade and manufacturing pattern.

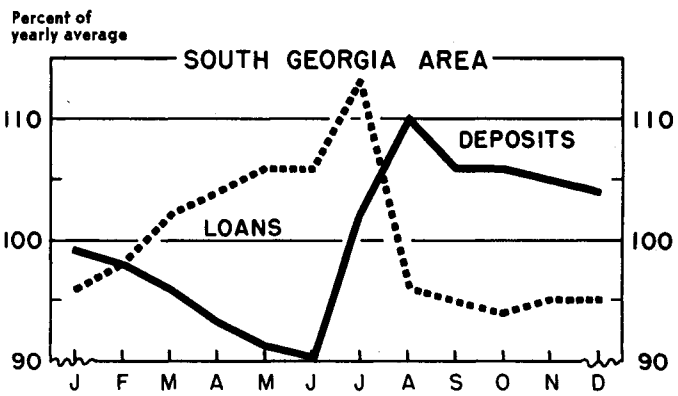
Loan and Deposit Fluctuations Do Not Coincide at Many District Banks

Nationally, seasonal fluctuations in deposits approximate very closely seasonal fluctuations in total loans. This, of course, follows from the very nature of the banking process. For many individual banks, however, loan and deposit fluctuations do not coincide, and the broad principles of credit creation and extinction offer little comfort. The problem of adjusting to seasonal patterns of business activity, therefore, constitutes a continuing and crucial aspect of the operations of these banks. Two types of areas in the District seem to be particularly affected in this respect.

In some areas of Florida, banks typically experience an enormous increase in deposits in the winter and early spring as a consequence of the inflow of tourists. Although there is little question that the communities obtain the major portion of their livelihood from such business, as the tourist season ends the banks begin to experience an outflow of deposits. Some deposits are lost when the transient population leaves. In addition, when the tourist season is over, the permanent residents ordinarily purchase goods from outside the area at a faster rate than they sell locally produced goods. Thus the banks periodically find themselves with large amounts of resources available for only very short-term loans. Unfortunately, however, the tourist industry has little demand for such loans since funds for current payrolls and inventories are obtained from cash payments by the guests. This means that banks in these areas must find short-term outlets for their funds elsewhere. Their problem is made more acute by the heavy peak servicing load, the need for temporary help, and the low return that can be realized on short-term funds.

Adjusting to seasonal changes is even more difficult for banks located in areas that are largely agricultural. Here the sharp fall of deposits during the spring and summer—nearly the entire period of rising loan demand—acts to restrict bank lending. On the other hand, the financing of agriculture is so important to these communities that, without adequate bank credit, it is extremely doubtful that they could survive. The seasonal problem, therefore, is of considerable importance to the community as well as to the lending institution itself.

Agricultural banks face another difficult time when the crops are sold. Almost immediately loans drop and deposits shoot skyward. Banks find themselves with free reserves and little loan demand. Furthermore, the high deposit level shrinks throughout winter and spring as the



. . . member banks in South Georgia face a growing loan demand in the spring and early summer when deposits are falling.

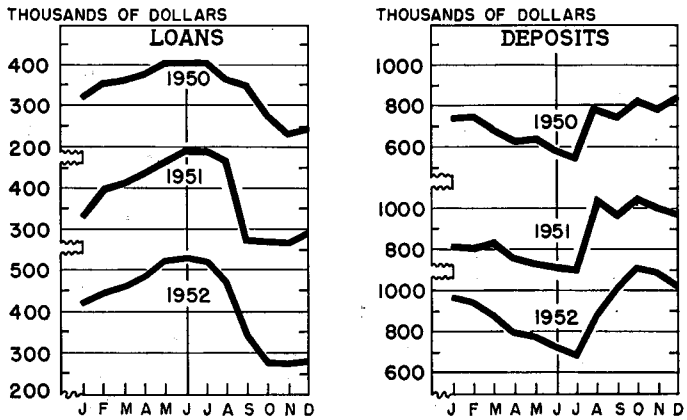
community continues to purchase goods from outside the area at a greater rate than outside areas purchase goods from it. This means that agricultural banks typically invest little of their fall rise in deposits in medium- and long-term outlets but instead keep most of it fairly liquid.

Each Banker Must Recognize His Seasonal Pattern and Make Appropriate Adjustments

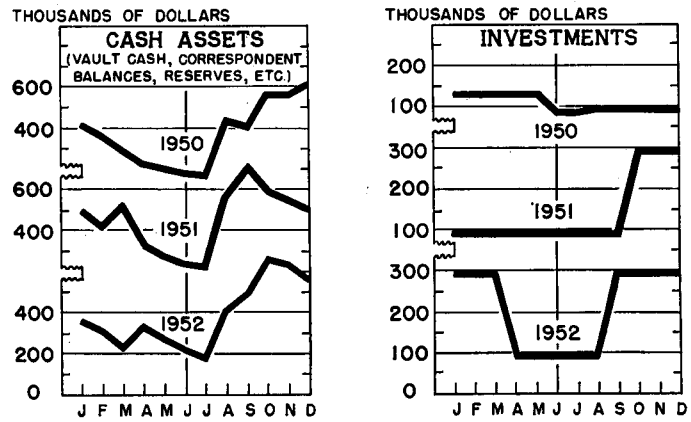
Some bankers, because of long experience in their communities, are able to make appropriate adjustments to seasonal loan and deposit fluctuations almost intuitively. Others find it necessary to keep records and make simple charts showing the monthly volume of loans, deposits, cash assets, and investments. If the monthly figures for the last few years are placed one year above another, as in the chart on page 6, the banker can obtain an idea of the timing and amplitude of the seasonal cash requirements of his area, as well as some impression of mistakes made in previous years. If the seasonal pattern is obscured by major growth trends, assistance in isolating the seasonal pattern may be obtained from the Research Department of the Federal Reserve Bank of Atlanta.

There are many methods by which the individual bank can deal with the seasonal problem. Fluctuations in loans and deposits may be dealt with entirely by variations in

SEASONAL PATTERNS AT A SIXTH DISTRICT RURAL BANK



To plant, grow, and harvest crops, farmers need money; therefore, BANK LOANS rise in the spring. But since farm income is low then, DEPOSITS fall. When crops are sold, deposits rise, loans are repaid, and . . .



. . . at this particular bank, CASH ASSETS increase. The bank is finding that the most profitable way to utilize its funds is to adjust its INVESTMENTS so that they mature as cash is needed.

cash assets such as balances with correspondent banks, reserves, or vault cash. It is apparent, however, that banks following such a practice are missing important opportunities for obtaining revenue through short-term investments. The most widely favored method of adjusting to seasonal cash requirements is to purchase Treasury bills when funds are available so that the bills mature in time to provide the cash required to meet expected deposit run-offs.

To banks that are located in small towns and have staff limitations, the purchase of Treasury bills is perhaps the best method of adjusting to seasonal needs. In recognition of the problems of those who cannot follow money market conditions constantly, individuals and banking institutions are allowed to purchase as much as 200,000 dollars' worth of three-month Treasury bills on a non-competitive basis in any one week. The non-competitive-bill buyer gets the average rate of accepted bids on bills in the particular week in which the purchase is made. Because the bills are short-term and readily marketable before maturity, there is only a small chance of loss if a miscalculation is made.

The third method of adjusting to seasonal business requirements is to maintain a more fully invested position on a permanent basis and to rely upon borrowings in periods of heavy cash requirements. This is attractive in that it allows a bank to invest in longer-term securities with the added advantage of higher earnings. To follow this practice naturally requires the maintenance of favorable relations with the institution supplying the temporary loans. It is a well-established rule of prudence among banks that borrowing should only be occasional and for short periods, and to replenish reserves temporarily rather than to meet continuing operating needs. Many bankers, however, are reluctant to depend upon these temporary loans to supply their customers' needs.

The ideal solution, of course, would be to develop offsetting seasonal credit outlets. In some agricultural communities, new industries whose seasonal patterns are the opposite of those of the farm economy offer an outlet for bank funds during the periods of peak deposits and low loan demand. In major cities, banks can partly counteract the typical spring loan decline by developing a farm loan department that, of course, would do its peak business in the spring. While the offsetting of credit outlets is perhaps the most profitable solution, it is not always practical. Most agricultural communities do not have enough industrial activity to offset the enormous seasonal swings in farm credit demands. City banks, moreover, may be reluctant to alienate correspondent banks by entry into the farm loan field.

Federal Reserve System Aids Seasonal Adjustment But Methods May Change From Time to Time

One of the tangible accomplishments of the System has been its success in dealing with the seasonal fluctuations in credit needs. Short-term interest rate fluctuations that followed a seasonal pattern before the founding of the Federal Reserve System have shown much less seasonal change in recent years. There has seldom been any serious question that this function of the System is both legitimate and most useful to the economy.

Despite the nature of the recurring problem, no routine procedure for assisting commercial banks in meeting seasonal needs has been developed. Because both the seasonal pattern and the amplitude of fluctuation are changing constantly and can seldom be predicted with absolute accuracy, the monetary authorities must determine continually whether the provision of reserves in the fall is only allowing seasonal needs to be met or whether the added reserves may be feeding inflation. Finally, the method of making seasonal adjustments must be determined in the light of current conditions.

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