SOUTHEASTERN BANKING DURING THE RECOVERY

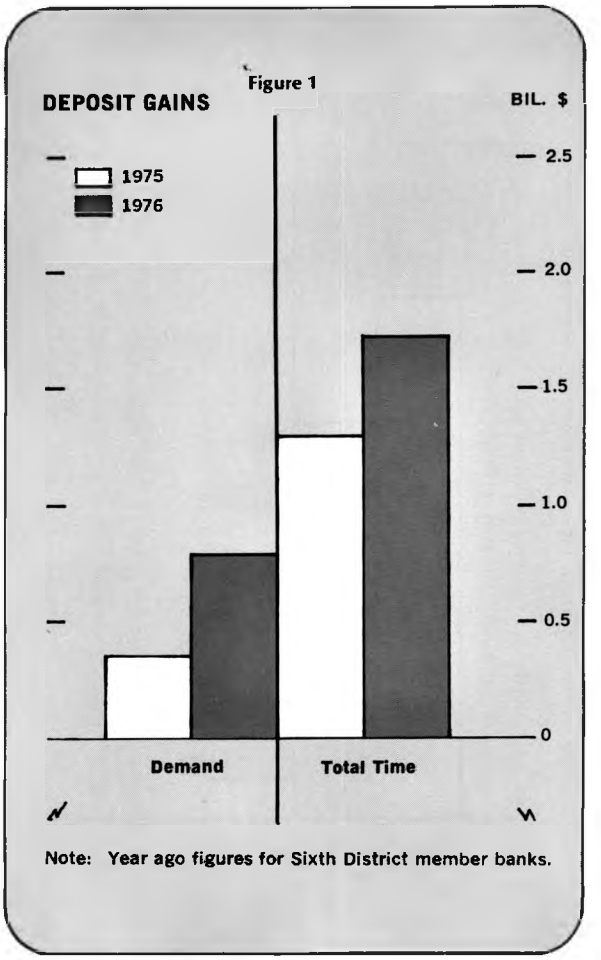
by John M. Godfrey

During the last two years, Southeastern banks experienced one of their worst years on record—1975—followed by a moderate but solid recovery in 1976. In 1975, District member banks suffered record loan losses, strained liquidity positions, a drop in overall lending and a reduction in earnings of almost 40 percent. The banking environment improved greatly in 1976, as loan demand picked up and deposits flowed in from more traditional and stable sources, liquidity positions improved markedly and loan losses were reduced. Earnings at most banks appear now to have rebounded. Compared to the more halcyon years of 1972 and 1973 when loans were advancing nearly 25 percent a year, 1976 seems bland. However, after the extremely dismal year of 1975, last year was quite an improvement. The extent of this recovery in banking and the prospects for 1977 are the subject of this article.

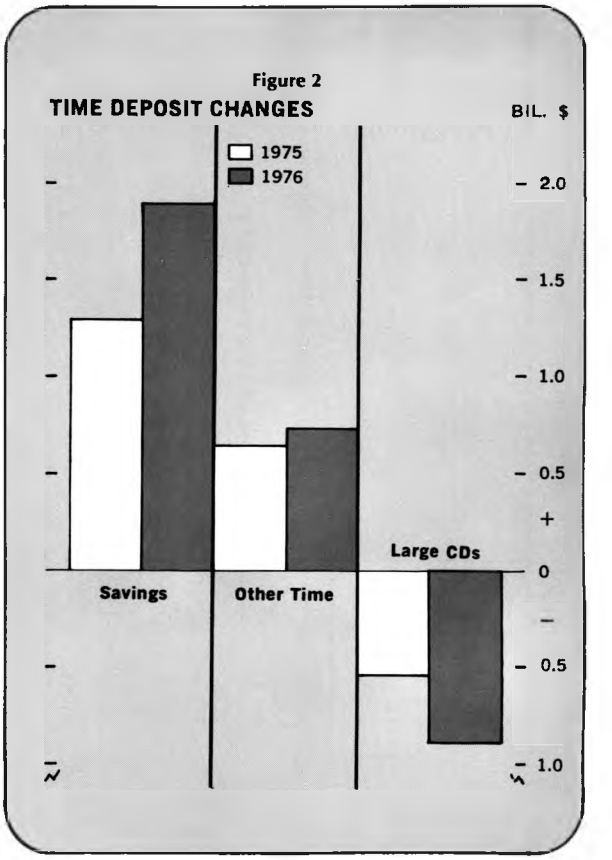
Stronger Deposit Gains. During 1976, total member bank deposits increased slightly more than $2.5 billion, up nearly seven percent. This growth contrasts with only a 4.7-percent rise the previous year. Deposit gains were strongest in Alabama and the District portion of Mississippi, where recovery has generally been the strongest. And through early 1977, deposit inflows have continued.

Demand deposits, net of interbank deposits, advanced more in 1976, rising nearly six percent, almost twice the 1975 rate. Renewed demand deposit inflows have enabled banks to reduce their dependency upon expensive borrowed funds.

Time and savings deposit gains also strengthened in the past year, as consumers and businesses added to such deposits. Passbook savings deposits rose nearly $2 billion, a 25-percent advance, which has resulted in a nearly 50-percent increase in the last two years. Several special situations, however, accounted for last year's exceptionally strong growth. In late 1975, profit-making businesses were allowed to hold savings accounts at banks; this probably accounted for about $300 million of the increase. Also, in June and July, many Mississippi banks had savings funds flow to their institutions as a result of publicity associated with problems at a large state savings and loan association. Both factors were



Note: Year ago figures for Sixth District member banks.



transitory and are not likely to occur again this year, although savings deposit gains continue to be strong.

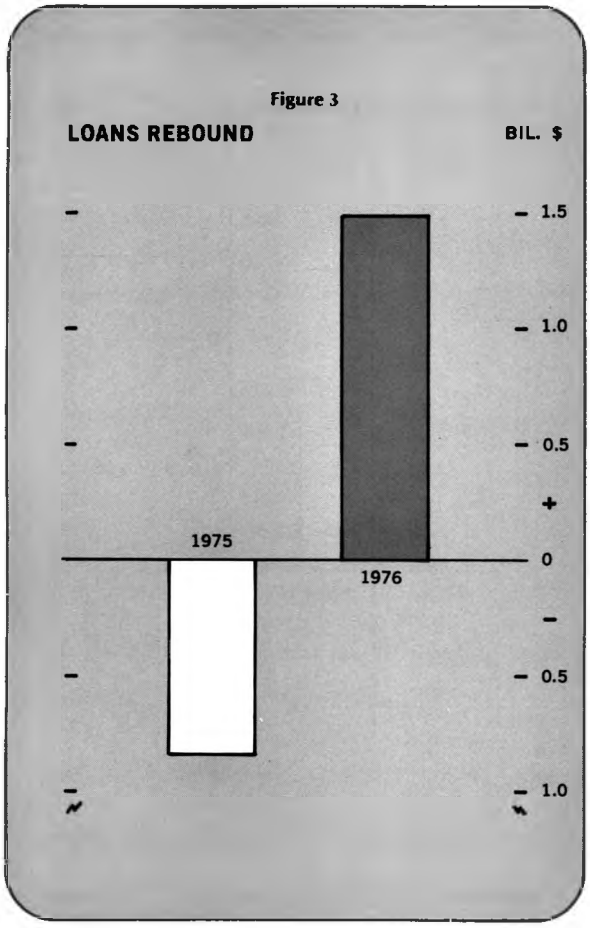
Time deposits other than the money market CDs advanced moderately again during 1976. During the last two years, however, there has been a decided shift in the composition of these "other" time deposits. These time deposits maturing in under four years have declined, while those maturing in over four years have nearly doubled. Longer maturing deposits generally return in excess of seven percent and, therefore, have put pressure on banks to add earning assets.

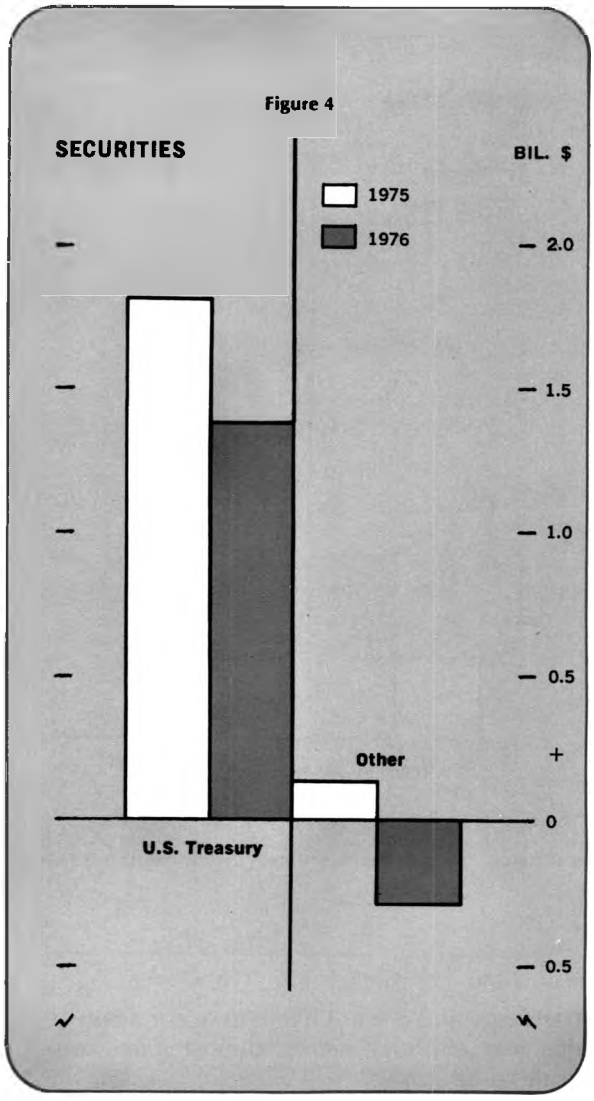
The larger banks, however, let nearly $900 million in large-denomination CDs run off as a result of a generally weak loan demand and strong deposit gains from other sources. Since late 1974, these banks have reduced the volume of CDs outstanding by about one-third and have thereby vastly improved their strained liquidity positions. Deposit inflows from more traditional and stable sources have enabled banks to reduce greatly their use of borrowed funds during the last two years.

Bank Lending Recovery. After having posted a small decline in outstanding loans in 1975, District bank loans advanced about $1.5 billion in 1976. While last year's five-percent loan advance was modest compared to the nearly 25-percent jump recorded in both 1972 and 1973, it does mark a decided recovery in bank lending from the overall decline of the previous year. Loans had begun rising at small- and medium-sized banks in the spring of 1975, but sustained lending did not develop at larger banks until mid-1976.

Most of the strength in bank lending last year centered around consumer, real estate and business loans. Large District and national firms have probably continued to pay down their bank lines.

Since late last summer, business firms have stepped up their borrowing at the District's





largest banks. This trend has continued through early 1977. Business loans rose nearly $120 million in 1976, compared to a net reduction of nearly $300 million in the previous year. Most of the increase has centered around loans to wholesale and retail trade firms and textile and apparel goods manufacturers. Loans to mining firms and other extractive industries continued to rise, as did loans to foreign business firms. Firms in the service industries which had repaid large amounts of loans in 1975 increased their borrowing slightly in 1976. Loans to construction firms, transportation, communication and other public utilities, and durable goods manufacturers continued to decline through 1976.

Securities Portfolios Add Income and Liquidity. With weak loan demand and strong interest-bearing deposit gains, District banks have purchased considerable amounts of U.S. Treasury securities in order to generate taxable income and rebuild liquidity. During the last two years, District banks have more than doubled their holdings of government securities. In 1975, they added $1.8 billion and in 1976, $1.4 billion. In 1975, nearly 60 percent of their increase came in short-maturities issues—Treasury bills and notes maturing in less than a year. These holdings vastly improved the liquidity position of the banks. Last year, however, they stepped up their purchases of longer-dated notes and bonds in an attempt to increase earnings, since rates on short-maturity issues were low. As loan demand strengthens, they will be able to reduce these Treasury holdings and obtain the funds to lend to their traditional customers: business firms, consumers and real estate mortgage customers.

Table 1
BUSINESS LOANS RECOVER
32 LARGE SIXTH DISTRICT BANKS

Million $	Cumm. 1975 (1/75-12/75)	Cumm. 1976 (1/76-12/76)
Durable Goods Manufacturing	− 17	−50
Nondurable Goods Manufacturing	− 6	+55
Mining	+ 29	+30
Wholesale and Retail Trade	− 96	+82
Transportation, Communication and Other Public Utilities	− 58	−53
Construction Firms	−113	−53
Service Firms	−127	+10
Foreign Businesses	+ 25	+42

Up until 1975, District banks had been substantial purchasers of "other" (mostly municipal) securities, which had provided them with considerable tax-exempt income. However, with sharply higher provisions for loan losses developing in 1975 and early 1976, the banks had less use for nontaxable income and, therefore, cut back or even reduced their municipal holdings. This was especially true in Georgia and Florida. Since mid-1976, the loan loss situation has improved for many banks so that they have again begun building up their municipal holdings to once again take maximum advantage of tax-exempt earnings.

Prospects. As bank deposit inflows continue to be strong and with bank liquidity positions vastly improved, District banks are in a good position to meet increased loan demand. They have curtailed their use of expensive and interest-sensitive borrowed funds and have acquired sizable securities portfolios that can be reduced when they are able to add new loans. Since most banks appear to have made adequate provisions for most identified problem loans, earnings should rise as the expense of providing for loan losses declines. And since making loans is usually more profitable than holding securities, a higher loan demand will boost earnings even if lending margins come under pressure because of increasing costs of funds during the year. The improvement in District banking that began during 1975 should continue in 1977 with more and more banks sharing its benefits. ■