# Another Look at the Southeast's Fed Funds Market

by Arnold A. Dill

Previous studies in this *Review* have described how the Fed funds market functions in the Southeast. These studies show, in part, that:

market participation of Sixth District member banks rose from 5 percent in 1958 to nearly 90 percent in 1972;

profit opportunity is the main market lure;

the larger the bank, the more likely it is a market participant and a net purchaser of funds;

major banks in the ten or so largest cities often stand ready to buy and sell funds in order to accommodate the needs of their smaller correspondents; and

District member banks in aggregate were usually in a net sell position but were often in a net buy position in 1966, 1969, early 1970, and again after April 1972.[1]

Rather than comprehensively examining the District market, this note focuses on only a few aspects. Specifically, it provides an insight into the structure of the Fed funds market, measures the degree of market participation by individual banks, and describes this region's long-run and cyclical Fed funds pattern.

## Fed Funds Behavior

To gain insight into the Fed funds market structure, we classified banks into six groups on the basis of market behavior for each year from 1969 through 1972. The first class includes banks that reported substantial transaction volumes and that both purchased (borrowed) and sold (lent) funds every week, or nearly every week of the year. The second consists of banks that both purchased and sold often during the year but on a smaller scale and less often than those in the first class. The third group includes banks that participated frequently in the market but mainly as sellers. The fourth contains banks that purchased frequently but seldom sold. The fifth class is occasional participants, those banks reporting transactions in fewer than twelve weeks a year. Nonparticipants make up the sixth grouping.

As shown in Table 1, the majority of District member banks were predominantly sellers (class 3) each year, but the number of such banks declined in 1972. Banks in the first and second classes increased sharply between 1969 and 1972, while occasional and nonparticipants (classes 5 and 6) decreased. In recent years, many have entered the market first as sellers and then have begun buying funds with gradually increasing frequency. Very few were found to

[1]For a general description of how the funds market functions in the District, see Arnold Dill, "Liability Management Banking: Its Practice in the Sixth District," this **Review**, December 1971. For a detailed study of the structure and characteristics of the District market, see Harry Brandt and Paul A. Crowe, "The Fed Funds Market in the Southeast," this **Review**, January 1968.

**TABLE 1**

**Sixth District Member Bank Participation in the Fed Funds Market**

| | Class 1* | | Class 2 | | Class 3 | | Class 4 | | Class 5 | | Class 6 | | All Classes |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No. | % | No. | % | No. | % | No. | % | No. | % | No. | % | No. |
| 1969 | 15 | 2.8 | 82 | 15.2 | 282 | 52.4 | 15 | 2.8 | 86 | 16.0 | 58 | 10.8 | 538 |
| 1970 | 23 | 4.2 | 86 | 15.8 | 361 | 66.1 | 7 | 1.3 | 36 | 6.6 | 33 | 6.0 | 546 |
| 1971 | 24 | 4.3 | 96 | 17.1 | 374 | 66.5 | 5 | 0.9 | 41 | 7.3 | 22 | 3.9 | 562 |
| 1972 | 34 | 5.9 | 122 | 21.2 | 365 | 63.5 | 6 | 1.0 | 39 | 6.8 | 9 | 1.6 | 575 |

*Class 1: Purchasing and selling Fed funds in at least 47 weeks of the year and with weekly average purchases or sales of usually $10 million or more.
Class 2: Purchasing in at least 12 weeks of the year and selling in at least 12 weeks of the year (but not necessarily in the same week), but at a frequency or volume of transactions less than banks in Class 1.
Class 3: Selling more frequently than buying and reporting transactions in at least 12 weeks of the year but buying in less than 15 weeks.
Class 4: Purchasing more frequently than selling and reporting transactions in at least 12 weeks of the year but selling in less than 15 weeks.
Class 5: Reporting transactions in less than 12 weeks of the year.
Class 6: Reporting no transactions.

be predominant buyers (class 4). Data for the first half of 1973 indicate that there has been a further increase in the number of banks in the first and second classes and a continued decline in occasional participants.

A surprisingly large number qualify as heavy buyers and sellers (class 1). In 1972, 34 banks in 15 large District cities both bought and sold substantial volumes of funds nearly every week, compared with only 15 in 7 cities in 1969. The number of banks, mostly moderately sized, that both purchase and sell funds frequently (class 2) is also large and growing—122 banks in 1972 compared with 82 in 1969. This indicates that many turn to the market, at least temporarily, to purchase needed funds as well as to dispose of excess and that this number is expanding. However, over 60 percent of member banks were still predominantly sellers in 1972, though this percentage may have peaked out. In that year, only nine did not participate in the market.

## Market Participation

Relatively few banks rely continuously on the market to finance their asset positions. Only twenty have nearly always been in a net purchase position since weekly data began to be collected in early 1969. The number regularly in a net purchase position has been increasing, however; but few of these have relied heavily on the market as a source of funds. The degree of market participation was measured by finding the ratio of interest expenses on funds purchases—net of earnings on funds sales—to total operating expenses. Only a small number ever reported net funds expenses as more than 5 percent of total operating expenses. For example, even in 1969 when money was tight and Fed funds interest rates were high, only 12 did (see Table 2). However, the number reporting high ratios should jump in 1973 because of sharp increases in Fed funds rates

**TABLE 2**

**Net Fed Funds Expenses as a Percent of Total Operating Expenses**

| | No. of Banks | | | |
|---|---|---|---|---|
| | 1969 | 1970 | 1971 | 1972 |
| 12% or more | 3 | 2 | 0 | 1 |
| 10-11 | 2 | 2 | 0 | 1 |
| 8-9 | 2 | 2 | 1 | 3 |
| 6-7 | 5 | 2 | 3 | 3 |
| 4-5 | 10 | 8 | 6 | 7 |
| 2-3 | 13 | 6 | 13 | 11 |
| 0-1 | 20 | 21 | 26 | 42 |

Note: Figures cover Sixth District member banks reporting positive ratios. Net Fed funds expenses are interest paid on Fed funds purchases minus interest earned on Fed funds sales.

**TABLE 3**

**Earnings on Fed Funds Sales as a Percent of Total Operating Earnings**

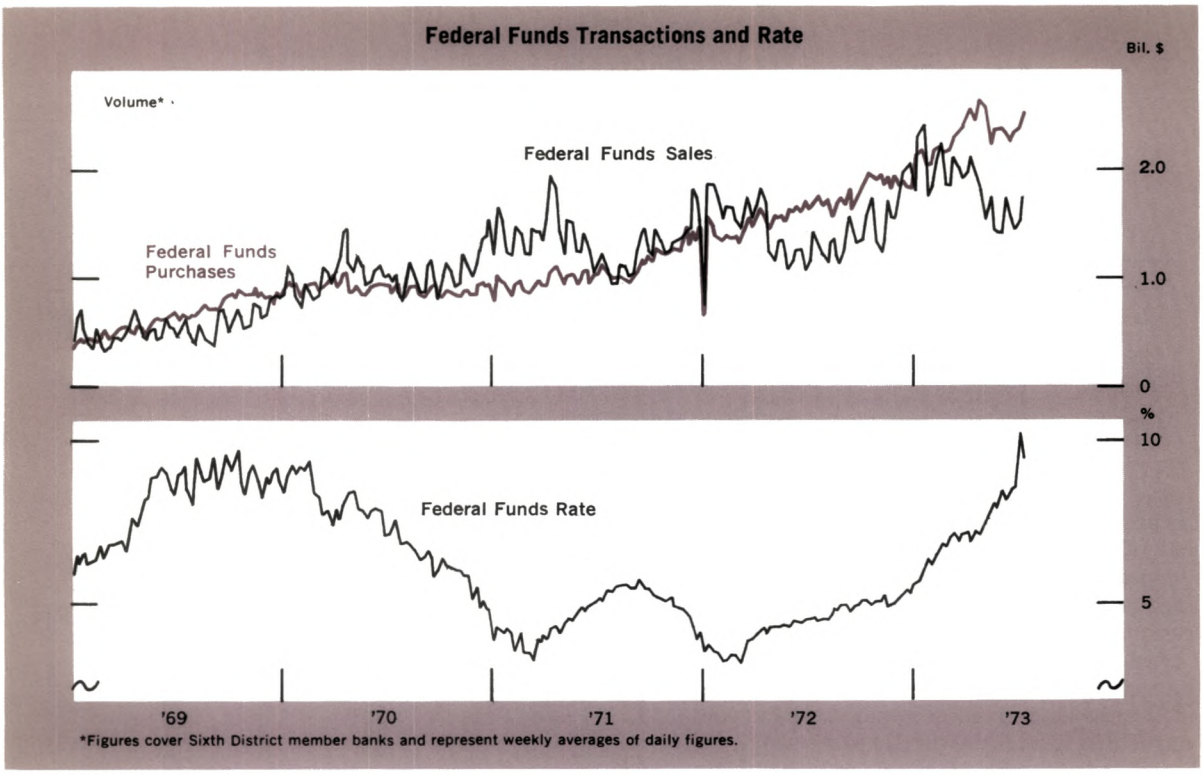
| | No. of Banks | | | |
|---|---|---|---|---|
| | 1969 | 1970 | 1971 | 1972 |
| 20% or more | 13 | 15 | 6 | 4 |
| 15-19 | 14 | 18 | 14 | 6 |
| 10-14 | 34 | 51 | 27 | 27 |
| 5-9 | 101 | 154 | 106 | 104 |
| 0-4 | 314 | 271 | 383 | 420 |
| No earnings | 62 | 37 | 26 | 14 |

Note: Figures cover Sixth District member banks.

and in the number of banks in a net purchase position. The highest ratio reported by an individual bank was, respectively, 28 percent in 1969, 22 percent in 1970, 9 percent in 1971, and 12 percent in 1972.

Funds sales, on the other hand, have been an important source of interest income to many banks, especially in 1969 and 1970 when Fed funds rates were high. Sixty-one banks in 1969 and 84 in 1970 reported funds earnings equal to 10 percent or more of total operating earnings (see Table 3).[2] The

[2]In each year, a few new banks that sold funds heavily in the months immediately after opening reported high ratios.




number in this category declined in 1971 and 1972, reflecting a decline in Fed funds rates. Because of sharp increases in rates, Fed funds income has become more important this year to those that are regular sellers.

### Trends and Cyclical Behavior

Both purchases and sales by District members trended up strongly between 1969 and 1972 (see chart). Gross purchases grew steadily in 1969 and early 1970, leveled off from April 1970 to August 1971, and then grew steadily again. Gross sales fluctuated around the $500-million level in the first eight months of 1969 and then climbed rapidly through April 1971. Since then, sales have been on an upward trend but shown wider swings than purchases. Sales, moreover, usually reach a low in late summer and a high around year-end or early in the year.

In aggregate, District members were a net purchaser of funds from the rest of the banking system in much of 1969 and in most of the period since April 1972, generally times of high or rising Fed funds interest rates. Conversely, District members were in a net sell position from early 1970 to April 1972 when Fed funds rates were generally low or falling. An earlier article found the District a net purchaser in 1966, a tight money year, and a net seller in the early 1960's, a period of easy money. Over the past ten years, therefore, the District has usually been in a net buy position when money was tight and in a net sell position when money was easy. ■

# Bank Announcements

June 15, 1973

## SECOND NATIONAL BANK OF HOMESTEAD

*Homestead, Florida*

**Opened for business as a member.** Officers: Anthony P. Cassinelli, chairman; Paul Mansfield, Jr., president; Robert Swarthout, assistant vice president; George D. Munroe, cashier. Capital, $400,000; surplus and other funds, $600,000.

June 16, 1973

## UNITED CITIZENS BANK OF CHEATHAM COUNTY

*Ashland City, Tennessee*

Opened for business as a par-remitting nonmember. Officers: Charley Ray Harris, president; Shelton Harrison, chairman. Capital, $200,000; surplus and other funds, $400,000.

June 26, 1973

## THE WESTSIDE BANK OF VERO BEACH

*Vero Beach, Florida*

Opened for business as a par-remitting nonmember. Officers: Warren D. Haffield, president; Angelo J. Sanchez, vice president and cashier. Capital. $350,000; surplus and other funds, $262,000.

July 2, 1973

## AUBURN BANK AND TRUST COMPANY

*Auburn, Alabama*

Opened for business as a par-remitting nonmember. Officers: Kermit Wilson, president; John F. Dunlap, Jr., cashier. Capital, $377,000; surplus and other funds, $377,000.

July 7, 1973

## FENTRESS COUNTY BANK

*Jamestown, Tennessee*

Opened for business as a par-remitting nonmember. Officers: Glen Massengill, president; Don Free, vice president and cashier. Capital, $300,000; surplus and other funds, $450,000.

July 9, 1973

## CENTRAL BANK OF MISSISSIPPI

*Brandon, Mississippi*

Opened for business as a par-remitting nonmember. Officers: Charles H. Griffin, president; James E. Huffstatler, vice president and cashier. Capital, $510,000; surplus and other funds, $510,000.

July 9, 1973

## EXCHANGE STATE BANK

*Clinton, Mississippi*

Opened for business as a par-remitting nonmember. Officers: Edwin Faust, Jr., president; Odie Smith, Jr., vice president and cashier. Capital, $300,000; surplus and other funds, $450,000.

July 10, 1973

## FIRST SECURITY BANK

*Bradenton, Florida*

**Opened for business as a member.** Officers: W. James Tyrrell, chairman; Samuel L. Bender, president; Glen C. Dimon, vice president and cashier; Genevieve C. Roak, assistant cashier. Capital, $600,000; surplus and other funds, $400,000.

July 13, 1973

## AMELIA ISLAND BANK

*Fernandina Beach, Florida*

Opened for business as a par-remitting nonmember. Officers: A. B. Maxwell, Sr., president; Dale P. McKinney, vice president; James M. Horn, cashier. Capital, $400,000; surplus and other funds, $350,000.

July 15, 1973

## THE PERRY COUNTY BANK

*Marion, Alabama*

Opened for business as a par-remitting nonmember. Officers: Robert R. Frayne, president. Capital, $300,000; surplus and other funds, $300,000.

July 17, 1973

## FIRST STATE BANK OF ARCADIA

*Arcadia, Florida*

Opened for business as a par-remitting nonmember. Officers: William J. Briscoe, president; James C. Kynett, vice president and cashier. Capital, $275,000; surplus and other funds, $275,000.

July 19, 1973

## FIRST NATIONAL BANK OF PORT SALERNO

*Port Salerno, Florida*

**Opened for business as a member.** Officers: Duane K. Luce, chairman; Jack T. Williams, president and chief executive officer; Charles R. Harris, executive vice president; Mrs. Jean P. Sempey, cashier. Capital, $600,000; surplus and other funds, $400,000.

July 25, 1973

## BIVENS GARDENS BANK

*Gainesville, Florida*

**Opened for business as a member.** Officers: Robert F. Lanzillotti, chairman of the board; Robert L. Vasbinder, president; James L. Kaercher, vice president and cashier. Capital, $900,000; surplus and other funds, $270,000.