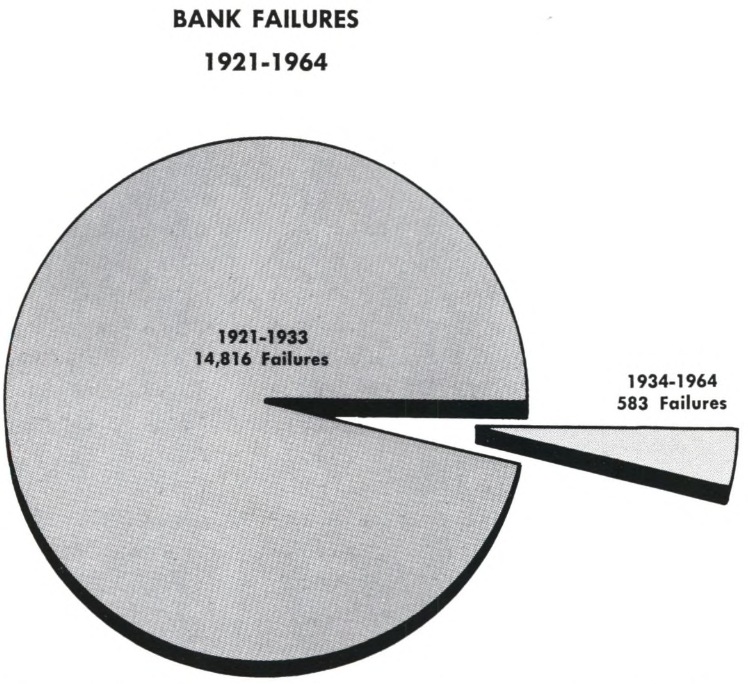
MONTHLY REVIEW



The total number of bank failures in the last three decades is only a fraction of the number of failures in the 1920's and early 1930's.

FEDERAL RESERVE BANK OF RICHMOND SEPTEMBER 1965

Recent Bank Failures—*Why?*

For the first time in a generation, bank failures in the United States have recently occupied a prominent place in the news. Fourteen banks have failed in the past two years. Coming after a lengthy period in which bank failures averaged only three or four per year, the increase in the failure rate has attracted widespread attention. Two Congressional committees have become sufficiently concerned to institute investigations. A perspective on these recent failures, however, should quickly dispel any fears for the soundness of the banking system.

In contrast with the epidemic of bank suspensions in the 1920's and 1930's, the recent closings do not involve a substantial fraction of the banking industry and are not the result of weaknesses in the economic environment. Each of the recent failures was due to conditions related primarily to the individual bank involved. They are all traceable to one or more of four major factors: changes in ownership for ulterior motives, misuse of certificates of deposit, bad loans, and bad checks or other uncollectable cash items. In almost every case two or more of these factors were present.

Changes in Ownership Of the 14 recently failed banks, eight changed hands shortly before encountering difficulty, two of them twice within a few months. In another the ownership of the stock was not as represented in its charter application. In each case, failure was directly related to the change in ownership. Some of the new owners were inept in the field of banking. Others apparently bought control of banks for the purpose of deliberately milking them of their assets. Most of the banks involved were relatively small but large enough to make internal looting attractive to the unscrupulous.

One bank with assets of $7 million had been operated in a very conservative manner for years and was perfectly sound until two persons with no previous experience in banking bought a majority of the stock and took over early in 1963. Through a series of loans and investments in their own interests, they drained the bank of over $1 million in less than six weeks. With some of the money they paid off indebtedness they had incurred to purchase the bank stock. Losses resulting from these transactions quickly exceeded the bank's capital and as a result it was placed in receivership.

In the same year the downfall of another bank with $30 million of assets was brought about in a similar manner. A group of amateur bankers acquired control through the purchase of controlling stock and directed bank funds to their own use. Some $900,000 of the bank's funds were used to repay loans with which the bank stock had been purchased. Within four months the new owners had expanded loans by $5 million. The diversion of bank funds for the benefit of the majority stockholders and their friends, relatives, and associates resulted in losses exceeding the bank's capital and it was closed in August of 1963.

A third small bank was exploited by two speculators in a somewhat more imaginative manner. These individuals first acquired control of the $2.5 million bank through relatively modest stock purchases, then hired money brokers to sell for the bank over $1 million in certificates of deposit. The certificates were sold to 23 savings and loan associations, each of which received a premium payment from the money brokers over and above the permissible interest rate. The two speculators then purchased $970,000 of inferior real estate mortgages at a sizable discount and sold them to the bank at only slightly less than the face value. Plans to market another $900,000 of questionable mortgages to the bank in a similar manner were thwarted by the closing of the bank.

Most of the banks which failed recently met their downfall at the hands of two or more get-rich-quick-partners, but one small midwestern bank was undermined solely by one man who purchased controlling interest and subsequently assumed the presidency despite the fact that he had no banking experience. Although the bank was an old one, it had assets of less than $1.5 million, which facilitated one-man control. The new president began paying checks drawn by other firms he controlled, without charging the drawers' accounts. The deficit was covered with forged notes. The president also caused the bank to extend questionable loans to his other corporate interests. When the directors objected, they were all replaced. He then marketed certificates of deposit in the amount of $100,000 through a money broker by paying a 1% bounty in excess of the maximum legal interest rate. Only $40,000 of the certificates of deposit were entered in the books of the bank as deposit liabilities, with the remaining $60,000 being used to eliminate from the books the loss items resulting from loans to his other businesses. These and similar actions quickly resulted in insolvency, and the bank was placed in receivership.

A much more complex series of events led to the failure of a West Coast bank with assets slightly over $2.5 million. In 1961, an out-of-town couple bought control of the bank, which had served the small town in which it was located for several decades. Under the new management, the bank's assets quickly mushroomed to more than five times their former level. Profits in 1962 were almost as great as total capital and surplus in 1961, although the economy of the community had not changed significantly. The bank's explosive growth was due to large deposits placed by a money order firm partially controlled by the new owners, and to lending operations outside the area.

The money order firm, operated on borrowed money, fell into difficulties and the bank was sold to help meet ensuing demands. Shortly thereafter, the money order firm was also sold, and most of the firm's deposits were withdrawn from the bank. The second new owner of the bank had expected to increase deposits still further by selling certificates of deposit to savings and loan associations through money brokers, but news of the bank's relationship with the defunct money order firm made new deposits difficult to obtain. The bank paid as much as 2½% above the legally permissible rate on time deposits to attract funds. Meanwhile, many of the bank's loans were going bad. In 1962 and 1963 the bank had written off 20% of its total loans outstanding, but in 1964 the situation was even worse, and in July 1964, the bank was found to be insolvent and the directors voted to place it in liquidation.

Unsound Management Changes of ownership did not figure in six other bank failures of the past two years, but each of these cases involved serious errors of judgment or fraudulent practices on the part of existing management.

The largest of these banks, established in 1962, acquired assets of $54 million in less than three years of operation. Rapid growth was accomplished through a combination of deposits attracted by premiums above legal interest rates and questionable loans for which sizable fees were collected. At the time of closing the bank had over $20 million of certificates of deposit outstanding. Some of these deposits had been secured by the payment of additional compensation of as much as 3% above the maximum legal rate. Many of the loans were made to real estate speculators, who paid fees of as much as $120,000 for the privilege of borrowing. The bank encountered liquidity difficulties when many of its certificates of deposit matured within a short span of time and were not renewed. Those difficulties were dealt with for a time through borrowing at the District Federal Reserve Bank, but the true condition of the bank eventually was discovered and operations were suspended by the authorities.

A much smaller bank, with assets of slightly over $8 million at the time it was closed, apparently came to grief as a result of the company it kept and the gullibility of some of its officers. The management permitted three money order companies, purportedly owned by the same group, to draw on uncollected funds, and a junior officer of the bank entered credits in the amount of over $200,000 to partially cover the deficiencies. Substantial losses were also incurred through overdrafts, and through loans of approximately $2 million to borrowers who were not creditworthy. Some of the funds used in these operations were raised through the issue of certificates of deposit at premiums above the maximum legal rate on time deposits.

Three other small banks were ruined by the misdeeds of individuals. The largest of these had resources of slightly over $7 million. The president of this bank acquired money to pay gambling debts by fraudulently advancing money to himself on notes signed by others. The second bank, with resources of $600,000, made the mistake of honoring a large number of worthless checks drawn by one of its customers. The third, with total resources of only $75,000, was declared insolvent when an unrecorded deposit liability of $380,000 was discovered.

Perhaps the most glaring example of bank manipulation was uncovered in the collapse of a $3 million bank only a few months old. A group of small businessmen, including the president of a bank in another town, joined together to acquire a Federal charter for the bank. They were to invest about $300,000 of their own money and borrow the rest of the initial capitalization of $500,000. But before the bank opened its doors in April of 1963, control had been taken over through the acquisition of 51%

of the stock by another man who had not been one of the original charter applicants.

Most of the new capital was borrowed from a nearby bank with stock in the first bank pledged as collateral. Since the amount involved was several times the lending bank's legal limit, the loan could not legally be made directly to a single man. To meet this situation, the loan was divided between the majority stockholder, the president of the bank he was buying into, and three others, with an agreement that the new bank would maintain a compensating balance of $400,000 in the lending bank.

Of the newly-organized bank's capitalization of $500,000, only about $12,000 was unencumbered cash. Pressure to increase deposits led the organizers of the new bank to pay as much as 6% interest on certificates of deposit.

Early in the bank's brief history, $225,000 was withdrawn by the promoters through a complicated series of operations involving forged notes. These notes were then paid and additional money withdrawn through the use of seven new notes totaling $315,000 in the names of people who knew nothing about them or in fictitious names.

Shortly thereafter, the principals involved acquired control of another small bank through the use of additional doubtful notes. When they arranged to have $200,000 transferred to the first bank, an employee notified the State Banking Commissioner, who required return of the funds. But later, $400,000 was successfully transferred and most of it disbursed before it could be returned. Under pressure from the Commissioner, loans were transferred to cover most of the losses.

The difficulties of the bank were compounded by the seizure of one million dollars of counterfeit securities by the FBI when the bank's president and principal stockholder attempted to market them. Some months after the seizure of these securities, the bank which had advanced funds to the promoters for the original capital foreclosed on the stock pledged as collateral and took over the bank. This led to investigations which resulted in the bank being declared insolvent by the FDIC, and one month later, it was ordered closed by the Comptroller of the Currency.

New Legislation All the recent failures had one thing in common. They were the result of efforts on the part of one or more individuals to use the assets, and in some instances, the money-raising potential, of commercial banks for personal gain. In a few cases, the individuals were from outside the banks involved, but all too often, they bought into the bank and undermined it from within. It is because of this, as evidenced by the cases described above, that Congress amended the Federal Deposit Insurance Act in late 1964 to require the chief executive officer of every insured bank to report to the appropriate Federal banking authority any change in ownership of the bank stock resulting in a change in control of the bank. The Act also requires all insured banks to report loans secured by 25% or more of the stock of any insured bank. After a change in control, the bank is required to report to the appropriate Federal banking agency any changes in the chief executive officer or directors during the following year, and to provide a statement of the past and present business affiliations of the new chief executive officer or directors. This law does not eliminate the possibility of banks being taken over by unscrupulous operators, but it may discourage them, and certainly should alert the banking community to the danger.

Much attention has been focused recently on changes in capital-asset ratios and loan-to-deposit ratios, and on changes in the balance sheet structure of banks. Questions have been raised concerning the possible deterioration of loan quality and excessive liberality in lending. But all of this concern is with the possibility of marginal errors in judgment by bankers. In the banks that failed, there was no wide range of marginal error. Either the bank was deliberately looted from within or the banker took risks which were well outside the scope of prudent banking.

BANK SUSPENSIONS

	1921-1929										1930-1932			
Capital Stock of:	1921	1922	1923	1924	1925	1926	1927	1928	1929	Totals	1930	1931	1932	Totals
$25,000 and Less	301	217	446	511	376	628	413	302	382	3,576	767	1,058	737	2,562
$25,001 to $49,999	36	41	47	59	43	102	65	39	65	497	142	220	140	502
$50,000 to $99,999	83	56	92	124	131	167	121	96	120	990	219	457	294	970
$100,000 to $199,999	47	25	32	59	46	48	48	45	58	408	132	284	144	560
$200,000 to $999,999	16	15	16	16	18	15	15	11	20	142	70	227	126	423
$1,000,000 and Over	3	----	----	----	----	----	----	----	6	9	11	32	11	54
Not Available	19	13	13	6	4	16	7	6	8	92	11	16	4	31
Totals	505	367	646	775	618	976	669	499	659	5,714	1,352	2,294	1,456	5,102

Source: Federal Reserve Board, Annual Report, 1932.

Historical Perspective The United States entered the decade of the 1920's with more banks than any country has ever had before or since. The nation's bank chartering policies over a long period had led to the establishment of a large number of small, weak banks. Many states had very liberal chartering provisions, some allowing new banks to be established with as little as $5,000 capital. Prior to the turn of the century, a Federal charter required a minimum of $50,000 capital, and in 1899, there were 10,283 state banks and only 3,617 national banks. But in 1900, national banking laws were revised to permit banks to be chartered by the Federal Government with a capital stock of as little as $25,000 in communities of 3,000 inhabitants or less. Passage of this Act was followed by a sharp increase in the issuance of both state and national charters. By 1921, there were 8,154 national and 22,658 state banks, a total of 30,812, or more than twice the number in operation today. Many of the new banks were small and weak, but due to the generally high level of prosperity, especially in agricultural areas, failures were relatively rare. In the two decades prior to 1921, about 85 banks per year closed their doors. Beginning in 1921, the failure rate increased sharply, and 5,714 banks suspended operations in the next nine years; most of them permanently.

Most of the suspended banks were small country banks with assets of less than $1 million. They had been chartered in a period of farm prosperity and rising land prices. Many of their loans were in the form of mortgages on farm real estate. Agriculture became overexpanded during World War I, and after the war, farm prices and the value of farm land fell sharply. With greatly reduced incomes, many farmers were unable to meet payments on bank loans. The accelerated movement of rural population to the cities further weakened banks in rural areas. Thousands of banks failed, but due perhaps to the general prosperity the failures caused no panic.

The panic came later when city banks began failing in even larger numbers. The banking collapse of the early 1930's had its roots in the 1920's. As non-agricultural prosperity increased, banks increased their loan-deposit ratios and made larger and larger numbers of demand and call loans secured by shares of stock. Banks assumed that these loans would provide liquidity, and in fact most of the open market call loans were repaid. But when the stocks with which the demand loans to individual customers were secured rapidly lost value during and after the crash of 1929, it was discovered that many of these loans were uncollectable. Borrowers who in other times might have shifted loans to another bank in order to repay the original lender found almost all banks attempting to call their loans simultaneously.

Today, a shortage of liquidity for the banking system as a whole could be countered by Federal Reserve action. Federal Reserve banks may provide additional reserves directly to banks through various kinds of advances, or indirectly through open market operations. But prior to 1932 this was not the case. Member banks could borrow from Federal Reserve banks only on collateral consisting of narrowly-defined "eligible" paper and open market operations were in a rudimentary stage of development. Thus, thousands of banks found themselves in an illiquid position and were unable to survive the waves of bank runs of the next few years. Between 1929 and 1934, more than 9,000 banks closed their doors, and very few were able to reopen.

In today's economic environment, the general collapse of our financial structure seems impossible. The banking system is altogether different and much stronger than in the 1920's and early 1930's. There are fewer small, weak banks, mainly because capital requirements are higher and bank charters are more difficult to obtain. The average bank today is older and larger, and most bank deposits are insured by the Federal Deposit Insurance Corporation. Knowledge of that insurance prevents the sort of bank runs which closed many banks in the early 1930's.

NUMBER OF COMMERCIAL BANKS CLOSED BECAUSE OF FINANCIAL DIFFICULTIES

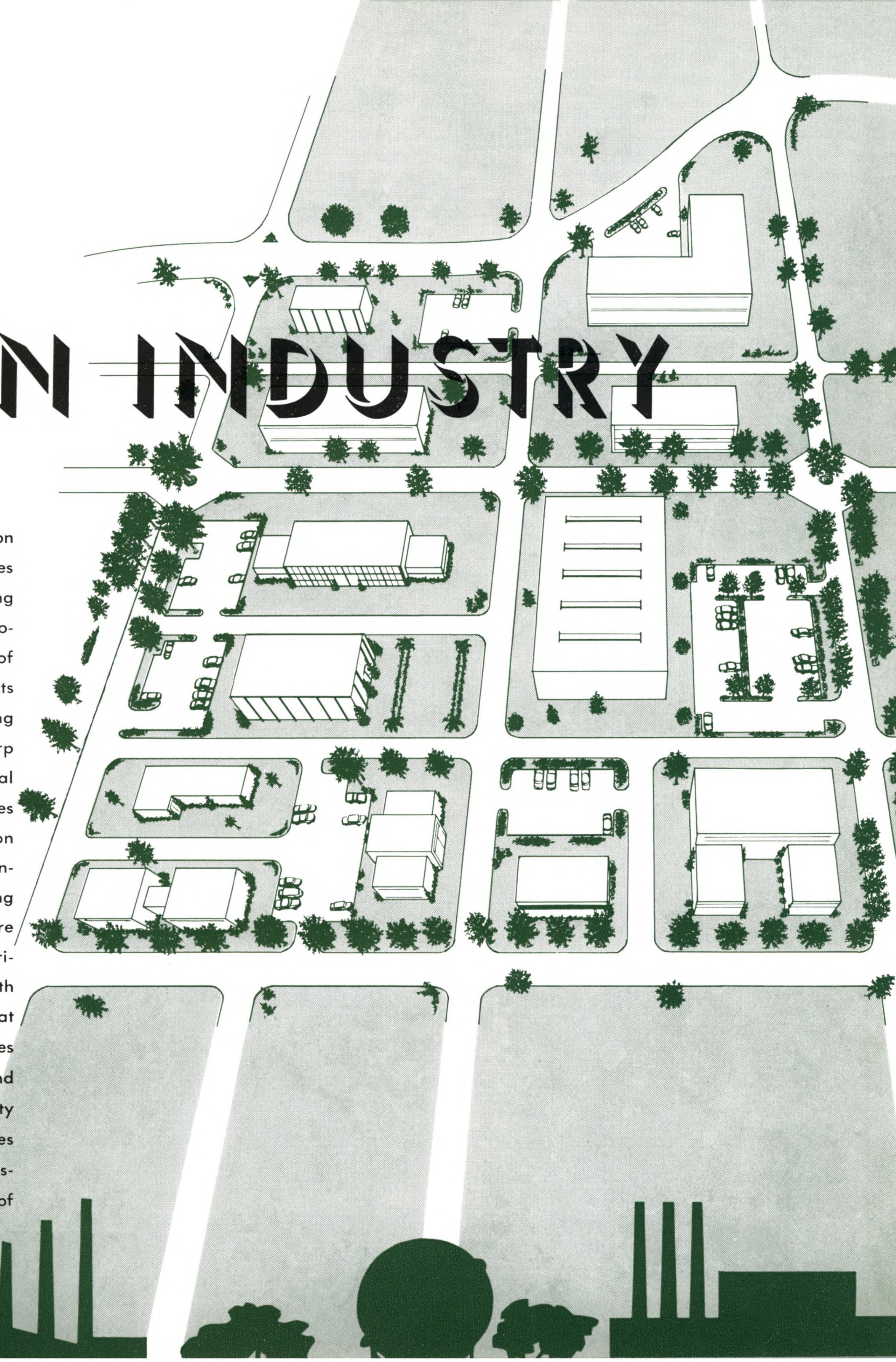
1933-1964

1933	4,000	1941	16	1949	9	1957	3
1934	61	1942	23	1950	5	1958	9
1935	32	1943	5	1951	5	1959	3
1936	72	1944	2	1952	4	1960	2
1937	83	1945	1	1953	5	1961	9
1938	79	1946	2	1954	4	1962	3
1939	71	1947	6	1955	5	1963	2
1940	49	1948	3	1956	3	1964	10

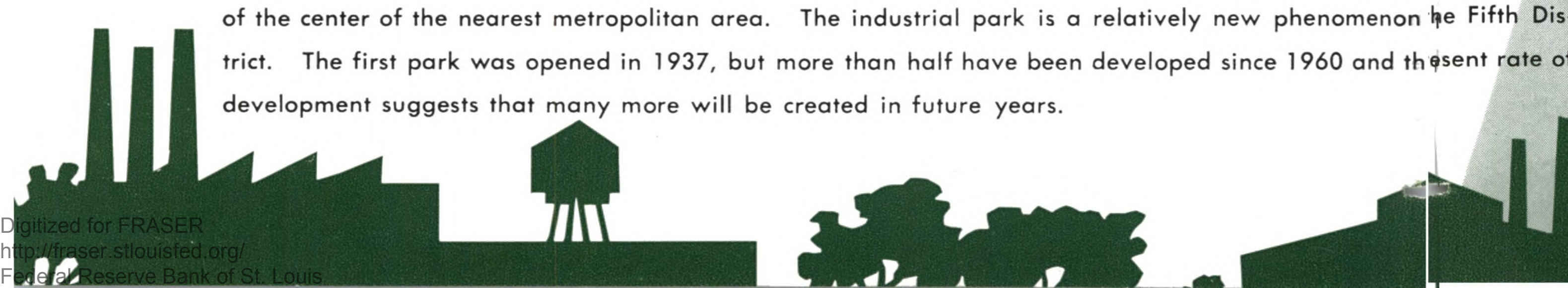
Sources: Federal Deposit Insurance Corporation, The Board of Governors of the Federal Reserve System.

There is still the possibility of additional failures due to dishonesty or ineptitude on the part of management. Out of more than 13,000 banks, it is not surprising that a handful should suffer management difficulties. By comparison with the failure rate among other firms of similar size, the bank failure rate is very low indeed. New legislation and renewed efforts of regulatory agencies may reduce the rate even further in the future.

PARKS WITH DESIGNS ON INDUSTRY



In recent years, the growing scarcity of suitable industrial sites together with the need for blerg production facilities into residential and commercial areas has led to the development of planned manufacturi communities called industrial parks. Some of them are no more than tracts of land adjoining railroads and ies, offering a building site for any company finding the location desirable. Others have been specifically deed to introduce industries into certain areas with a minimum of friction. They represent an attempt to reap benefits of industry in the form of increased employment and business activity while minimizing the undesir side-effects such as dirt, smoke, noise, and congestion. Many of the industrial parks feature spacious buildings ple parking facilities, and well-landscaped grounds. With pleasant residential communities surrounding them, th ffer a sharp contrast to the grimy, smoke-belching factories and dingy rows of company houses of a few years . Industrial parks may be owned and developed by towns or cities, railroads or utility companies, or by develop companies formed for that purpose alone. Parks often impose restrictions on the type of industry allowed, ar ometimes on architectural design, landscaping, and building-to-land ratios. Some parks are designed to attract ariety of industries. Others are tailored to fit the needs of a particular type of production, or of producers hg something in common. For example, of the 170 parks in the Fifth District nine have been designated as "researchks," and are devoted primarily to research laboratories or science-oriented industries. Parks of this type often p a high priority on proximity to colleges and universities with their laboratories, libraries, and scientific knhow. North Carolina's well-known Research Triangle Park is located almost equidistant from the University of N Carolina at Chapel Hill, North Carolina State College at Raleigh, and Duke University at Durham. There are al her colleges nearby. Most industrial parks are located in or near metropolitan areas, with their labor suppl arkets, and transportation facilities. In some cases, the choice of a location apparently has been influenced also by availability of educational, social and recreational opportunities. Sixty-four per cent of the District's parks are in ten miles of the center of the nearest metropolitan area. The industrial park is a relatively new phenomenon he Fifth District. The first park was opened in 1937, but more than half have been developed since 1960 and th esent rate of development suggests that many more will be created in future years.



TAX ANTICIPATION BILLS

In October 1951, the Treasury added a new variety of Treasury bill to its kit of debt management tools. This bill was designed specifically to help the Treasury smooth out the uneven flow of tax receipts while providing corporations with an attractive investment for funds accumulated for tax payments—hence the name, tax anticipation bills. Corporations like to purchase these bills for tax payment purposes because they are accepted at par on the tax date while actually maturing a week later, usually on the 22nd of the month. Of course the bills do not have to be used in lieu of tax payments, and some investors choose to hold them to maturity. Unlike other Treasury bills, tax anticipation securities are not offered on a regular basis, such as weekly or monthly, but are coordinated with the Treasury's estimates of cash income and outgo. The number of issues per year since 1951 has varied between one and five.

Between 1953 and 1958, the Treasury also designated nine certificates of indebtedness as "tax anticipation" securities. Like Treasury bills, certificates are required by statute to mature within one year from the issuing date, but they bear a fixed rate of interest whereas bills are sold at a discount and are redeemed at par. Although Treasury bills are now used for virtually all short-term financing, certificates were used frequently in the past when the Treasury felt that the amount to be raised was too large for the auction technique. Consequently, tax anticipation issues which exceeded roughly $2.5 billion were generally undertaken through certificate, rather than bill, sales. To date, there has been $94.4 billion of tax anticipation financing of which $66.8 billion was through bill issues, and the balance through certificates.

Schedule of Tax Payments and Receipts Although the Treasury collects personal income taxes through continuous payroll deductions, the largest collection occurs in April when the balance of the tax is due. The heaviest corporate tax payments also fall in the January-June period, although the concentration is not as pronounced as it was prior to 1960. In 1950 corporate tax payments were due in equal quarterly instalments in the year following the one in which the tax liabilities were incurred. Under the "Mills Plan," which became effective in 1951, the lag between the accrual and the payment of taxes was reduced. This plan called for successive yearly increases in the percentage of tax payments due in the first six months of the following year. In accordance with this schedule all 1954 corporate tax liabilities were paid in two equal instalments in the first half of 1955 and, beginning in 1956, corporations had to make tax payments on their estimated tax liabilities in the second half of the same year in which the tax was incurred. By 1960, tax payments were again evenly spread on quarterly dates, but since corporations may underestimate in their September and December payments, tax receipts are still heavier in March and June. A law passed in 1964 provided for a further step-up in tax payments. By 1970, the tax will be due immediately following the quarter in which the profits are earned.

The present schedule of tax payments by individuals and corporations results in the seasonal bunching of Treasury cash receipts in the second half of the fiscal year, that is, January through June. This usually produces a cash deficit in the first half of the fiscal year. In fiscal 1964, for example, the cash deficit of $4,802 million was the net result of a $9,725 million deficit in the first half of the year, followed by a $4,923 million surplus in the second half.

To offset this pattern the Treasury usually issues tax anticipation securities between July and December, scheduled to mature when cash receipts are the greatest. Of 35 tax bill issues, 20 were issued during this period while another seven were issued in January and February and matured before July of the same year. In effect, tax anticipation issues enable the Treasury to collect a portion of corporate taxes ahead of the actual payment dates, although it must pay interest on the advance payments.

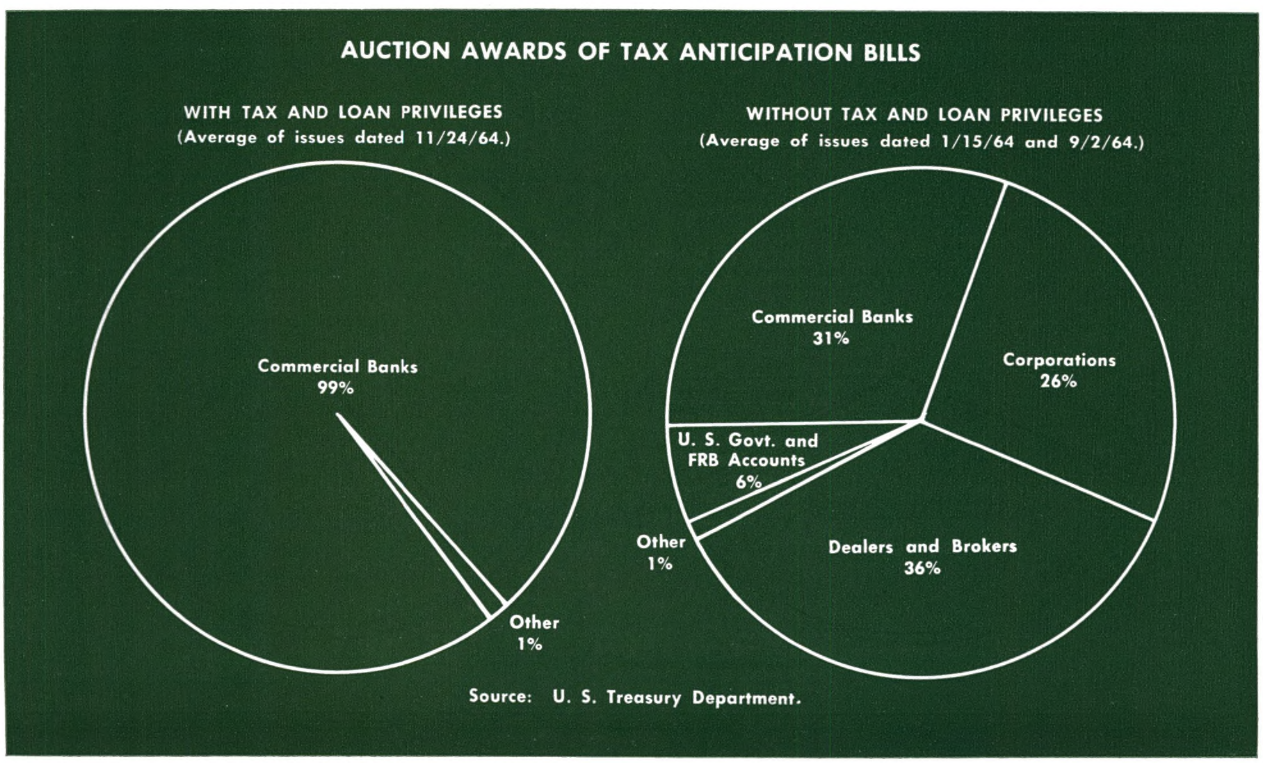
From the corporations' point of view, accrued tax funds represent cash which should be profitably invested, if possible, before being surrendered to the Government. Prior to 1950, the lag between the earning of profits and the actual tax payments was long enough to allow treatment of tax liabilities in much the same manner as retained earnings. With the shortening of the time lag in tax payments, however, corporations either have had to find suitable short-term investments or simply let the cash accumulate in demand deposits. In view of the rise in interest rates in recent years most corporations have elected the former alternative.

A corporate Treasurer has many choices in investing funds destined for tax payments, such as tax anticipation bills, regular Treasury bills, commercial and finance paper, certificates of deposit, bankers' acceptances, or Government securities bought under repurchase agreements with dealers. Tax anticipation bills offer all the advantages of regular Treasury bills: no risk of default, an active and continuous market, and short maturities which make them relatively free from risk of loss if sold before maturity. In addition, they have the added attraction of a week's "free" interest, as mentioned previously.

Characteristics The great majority of tax anticipation bills have been scheduled to mature in March and June. Only five issues have matured in September, and one in December. Of the $66.8 billion tax bills issued from 1952 through June 1965, 42% were scheduled to mature in March, 45% in June, 11% in September, and 2% in December. Maturities of individual bill issues have ranged from 52 days to 268 days, with 178 days the average length. The volume of tax anticipation bills issued annually has varied from a low of only $800.5 million in 1953, to $9,031.5 million in 1960. At the end of 1964, the volume outstanding was equal to 7% of total Treasury bills outstanding.

Like regular Treasury bills, tax anticipation bills are sold at a discount in a competitive auction. The Treasury determines the amount to be sold, and the price and allotments are established by the nature of the bidding. Unlike regular bill auctions, however, any bank qualifying as a depositary usually has been allowed to pay for all or part of the bills allotted to it for itself and its customers by credit to the Tax and Loan account which it holds for the Treasury. When such privileges are granted (as they were for every new issue prior to 1962) the value of the deposit is directly reflected in the banks' aggressively high bids, resulting in low yields. Whereas tax anticipation bills which are sold without Tax and Loan credit will usually bear rates within 1 or 2 basis points of outstanding Treasury bills of comparable maturity, those sold with Tax and Loan privileges may carry rates 15 to 30 basis points below those of comparable bills. (A basis point is one-hundreth of one per cent.) Banks have apparently found that the Treasury deposits acquired in this manner are profitable enough to offset the subsequent selling of most of their awards at prices below those originally paid. Since 1962 the Treasury has disallowed Tax and Loan credit on 6 out of 10 issues in order not to aggravate our balance of payments situation by placing pressure, even for a short time, on our short-term interest rates.

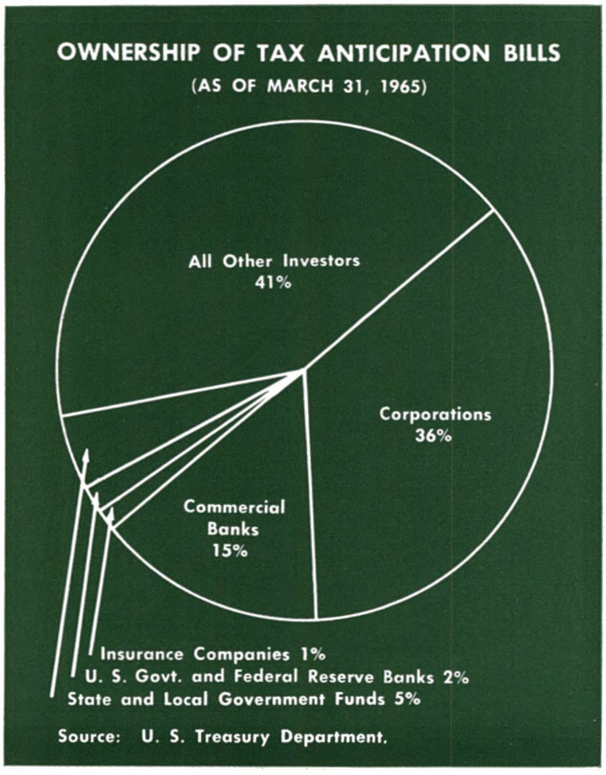
Tax and Loan Accounts Tax and Loan accounts are a depositary system authorized by Congress to



supplement the Treasury's account at Federal Reserve Banks. They are an outgrowth of the War Loan accounts established during the First World War to facilitate management of the increased volume of Treasury financing. By pledging certain securities as collateral, and upon recommendation by the District Federal Reserve Bank, any bank or trust company may be designated by the Secretary of the Treasury as a Special Depositary. These banks are then eligible to qualify as depositaries for Federal taxes, and may receive such deposits as corporate and personal taxes and social security payments, up to the amount for which they are authorized. The Government does not receive interest on these balances, but neither do the banks charge the Treasury for the many services they perform for it.

The system has various benefits, but perhaps the most important is that it minimizes the effects of Treasury financial operations on the economic stability of the country. Since the Treasury is unable to mesh receipts with expenditures, the depositary system allows deposits of tax payments to remain in the banking system, and usually in the community from which they were collected, until they can be returned by Treasury disbursements.

On a more specific level, Tax and Loan accounts greatly reduce the wide swings in money market conditions which otherwise would accompany every large Treasury borrowing or period of heavy tax payments to the Treasury. As funds flowed to the Treasury out of the commercial banking system, banks would have to compensate for the loss of required reserves by restricting credit without economic justification, or by liquidating securities or short-term paper with resulting downward pressure on security prices. Alternatively, the Federal Reserve System would have to supply reserves, presumably through open market operations, which would also disturb the money market. Conversely, a sudden influx of reserves would have the opposite effect by raising security prices and lowering yields as banks invested the money, again provided that the System did not take offsetting action.



Underwriting and Ownership Since 1959, the year in which the most complete data became available, commercial banks have been the principal underwriters of tax anticipation bills. Of the $43,135.5 million bills auctioned in the last seven years, commercial banks have been awarded 83%. When issues which carried Tax and Loan privileges are separated from those which disallowed such credit, however, a striking pattern emerges in the allocations. Commercial banks were awarded an average of 97% of all tax anticipation bills auctioned with Tax and Loan privileges, and only 36% of those auctioned without such privileges. In the latter case, dealers were awarded 35% and corporations almost 16%.

Data on the ownership of tax anticipation bills indicate that commercial banks hold their sizable auction awards only temporarily. Since 1959 their year-end holdings have averaged only about 23% of the total outstanding, while corporate ownership has averaged about 31%.The category of "other" investors, those not reporting in the Treasury Survey, owned an average of 27%. Insurance companies, and U. S. Government investment accounts and Federal Reserve Banks owned about 1% and 2%, respectively.

Impact on Money Market Tax anticipation bills exert some influence on the money market by mitigating the seasonal churning associated with the tax dates. To the extent that these securities are surrendered by the corporations for tax payments, the amount of cash which might otherwise have been borrowed from banks, or which might have been raised through the sale of other money market instruments, is correspondingly reduced.

THE FIFTH DISTRICT

BANKING SUMMARY

Reflecting generally robust business conditions, credit expansion at Fifth District weekly reporting banks has reached record proportions this year. For the first seven months of 1965, loan and investment growth at these banks, which account for more than half of the District's banking resources, has outstripped the gains in the same period last year when the discount rate was lower and reserve policy somewhat easier.

Strong Loan Demand Total credit at the District's weekly reporting banks rose 4.5% from January through July, compared with 3.4% in the same months of 1964 and little if any gain in the comparable period of other recent years. Heavy loan demand accounted for the growth this year. Investments declined steadily from January through July as bond holdings were reduced to provide funds for increased loans.

Business loans rose at a faster pace in the first seven months of the year than in any comparable period in the last decade. Strikes and threats of strikes led to increased loan demand for inventory building, and record automobile sales stimulated loans to finance dealers' stocks. These demands abated somewhat in July, but consumer and real estate lending continued strong as the rate of growth of business loans tapered off. The "all other (primarily consumer) loans" category showed an increase of 10% in the first seven months compared with 8.4% for the same period last year. Real estate loans also rose approximately 10%, down somewhat from the 15.4% increase in the same period in 1964. Agricultural loans, which have been setting new records in the Fifth District since 1962, also moved to new highs in 1965, rising 73% in the first seven months compared with 70% in the same months last year. The increase is partly due to a very strong seasonal pattern, however, and large percentage declines may occur before the end of the year.

Investment Portfolio Shifts Total investments declined 2.7% in the first seven months of this year compared with 3.4% for the same months in 1964. The movement out of U. S. Government securities which began several years ago appears to have accelerated this year. In the first seven months of last year, holdings of U. S. Government securities fell 7.4% through August 5, while other securities, primarily municipals, rose 5.5%. In the same period this year, U. S. Governments were reduced 10.8% while other securities rose 12.9%. These portfolio shifts may be associated with increased interest costs for time deposits, which, according to some observers, has encouraged banks to seek higher returns on their investments. Yields on both short-term and long-term Governments have been low relative to time and savings deposit rates since mid-1963. As a consequence, banks have steadily reduced their holdings of Governments, especially short-term, and have added to their holdings of tax-exempt municipals and higher-yielding corporate securities.

CHANGES IN LOANS, INVESTMENTS, AND DEPOSITS

Fifth District Weekly Reporting Member Banks
(% Change)

	December 30, 1964-August 4, 1965	January 1, 1964-August 5, 1964
Gross Loans	+ 7.9	+ 7.0
Commercial and Industrial Loans	+ 5.9	+ 2.9
Real Estate Loans	+10.1	+ 15.4
Loans to Domestic Commercial Banks	− 7.0	+244.0
Loans to Other Financial Institutions	+14.3	− 11.5
Security Loans	−18.0	− 20.3
Agricultural Loans	+73.0	+ 70.3
All Other (Primarily Consumer) Loans	+10.0	+ 8.4
Total Investments	− 2.7	− 3.4
U. S. Government Securities	−10.8	− 7.4
Other Securities	+12.9	+ 5.5
Total Bank Credit	+ 4.5	+ 3.4
Demand Deposits	+ 0.7	− 6.4
Time Deposits	+14.1	+ 13.0

CHANGES IN NUMBER OF BANKS AND BRANCHES

Fifth District States*

December 31, 1964 to July 31, 1965

	Fifth District	D. C.	Md.	Va.	N. C.	S. C.	W. Va.
Commercial Banks							
Number of banks, beginning of period	882	15	121	277	152	133	184
New banks organized	6	....	2	2	....	1	1
Mergers and absorptions	17	....	1	9	4	3	....
Liquidations	....	....	....	....	....	....	....
Number of banks, end of period	871	15	122	270	148	131	185
Net change	− 11	....	+ 1	− 7	− 4	− 2	+ 1
Branches							
Number of branches, beginning of period	1,841	78	355	465	707	236	....
New branches established	59	3	9	27	8	12	....
Banks converted into branches	17	....	1	9	4	3	....
Branches discontinued	2	....	....	....	1	1	....
Number of branches, end of period	1,915	81	365	501	718	250	....
Net change	+ 74	+ 3	+ 10	+ 36	+ 11	+ 14	....
Net Change in Banking Offices	+ 63	+ 3	+ 11	+ 29	+ 7	+ 12	+ 1

*Including six West Virginia counties which fall outside the Fifth District.

Deposits The rate of increase of time deposits at District weekly reporting banks accelerated sharply in June and July, although growth earlier in the year was slower than in 1964. At the end of July these deposits were up 14% from last December, compared with 13% for the comparable 1964 period. Some of the increase represents individual savings accounts, but much is due to sales of negotiable certificates of deposit to business corporations. Rates on both certificates of deposit and passbook savings were raised after the relaxation of Regulation Q restrictions on rates last fall, and this may have led to some substitution of time deposits for demand deposits and other liquid assets. Demand deposits have not shown the explosive growth of time deposits, but since the middle of May they have expanded more rapidly than in the comparable period of any of the previous four years. They rose 0.7% in the first seven months of 1965 compared with a 6.4% decline in the same months last year.

Changes in Banking Structure Recent trends in the banking structure of the Fifth District have continued this year, with the number of banks declining and the number of branches increasing. There were 882 banks in the District at the end of 1964. Six new banks were organized in the first seven months this year, but 17 were eliminated through mergers and absorptions for a net reduction of 11. The number of branches rose from 1,841 at the end of last year to 1,915 on July 31. Fifty-nine new branches were established, 17 banks were converted into branches, and two branches were discontinued for a net increase of 74.

The largest changes in the District banking structure continued to occur in Virginia, as has been the case since the Virginia banking law was amended in 1962. Two of the District's six new banks and 27 of the 59 new branches were in Virginia. In addition, nine Virginia banks became branches as a result of mergers. In only two states, Maryland and West Virginia, were there net increases in the number of banks. Two new banks were established in Maryland and one was eliminated through merger. The only change in West Virginia was the establishment of one new bank. Mergers reduced the number of banks in North Carolina by four. One new bank and three mergers resulted in a net decline of two banks in South Carolina, which also had a net increase of 14 branches, the second largest in the District. In that state, there were 12 new branches, three banks converted to branches, and one branch discontinued. North Carolina added 11 additional branches and Maryland 10, while three new branches were opened in the District of Columbia. Branch banking is prohibited in West Virginia.