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ECONOMIC REVIEW

The Southeastern Economy Moves Ahead in 1977

Changes in the Treasury's Cash Management Procedures

Federal Reserve Bank of Atlanta

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FEATURES:

The Southeastern Economy Moves Ahead in 1977. 3

Nearly all business sectors turned in a strong performance last year. Job growth, home construction, lending activity, and consumer spending were particularly robust. The good economic report was marred only by the severe losses suffered by farmers.

Changes in the Treasury's Cash Management Procedures . . 14

"TTS & Ls" will never be the same, come summer. Banks will find handling U.S. Treasury accounts quite a new ball game, and nonbank financial institutions will participate for the first time. The new procedures should help smooth the Fed's open market operations as well.

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Director of Research: Harry Brandt
Editing: Patricia Faulkinberry
Production and Graphics:
Susan F. Taylor and Eddie W. Lee, Jr.

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THE SOUTHEASTERN ECONOMY MOVES AHEAD IN 1977

This article was prepared by *Charles J. Haulk* based on material contributed by other Federal Reserve Bank of Atlanta economists Charlie Carter, John Godfrey, Frank King, and Gene Sullivan.

Introduction. For the past three years, much attention has been given to the recovery or lack of recovery in the southeastern economy from the worst economic downturn since the Great Depression. Now in January 1978, we can report that 1977 was a good year of growth in the Southeast for most sectors of the economy. Unfortunately, parts of the southern agricultural community suffered one of the worst years in recent history, throwing cold water on an otherwise strong economic performance.

Job growth, which gave cause for concern at this time last year, was substantial in 1977. Unemployment rates improved in each of the six District states, with particularly notable reductions in Tennessee, Alabama, and Florida. Retail sales showed strength in virtually every month. Construction contracts, new mortgage loans by savings and loan associations, and overall bank lending activity posted exceptional gains. Consumer confidence, as evidenced by large increases in consumer spending and in the use of instalment credit, was bolstered by declining unemployment rates, good credit markets, and income growth that apparently matched the national average.

As was the case for the nation, much of the economic growth took place in the first half of the year, with some sluggishness appearing during the second half. Several indicators were unusually erratic, changing direction from month to month rather than moving steadily upward throughout the year. However, the financial and construction sectors were strong throughout the entire period.

Through the remainder of this article, we will take a look at the various sectors to get a more detailed picture of how each fared during 1977. After that, there will be a brief comparison of the Southeast and U. S. economies in 1977 and, finally, a look ahead at some developments that are likely to influence business activity in 1978.

Bullish Consumers. Consumers in the Southeast were a key element of growth during 1977. There was evidence of strength in every phase of consumer activity. Income growth and unemployment seem to dominate consumer attitudes toward spending, and 1977 was an excellent year for both. Unemployment in the Sixth Federal Reserve District fell throughout the year, from 7.8 percent of the labor force in late 1976 to 6.0 percent in late 1977. Personal income growth was excellent, totaling 6 percent in the first two quarters alone. Manufacturing income, which generally moves closely with personal income during expansionary periods, increased 11 percent from late 1976 to late 1977, suggesting that personal income growth also remained relatively strong during the third quarter of 1977.

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Retail sales grew sporadically in 1977. During the bad weather of January, retail sales actually declined, getting 1977 off to a poor start. May and August were also weak sales months. However, the strong gains of the other months kept retail sales well ahead of the 1976 pace.

Other indicators of consumer activity were also strong but volatile. Department store sales were off early in the year, probably due to the severe weather. Stronger-than-normal seasonal gains in late 1976 may have been an additional cause for the slow January and February sales pace. Again in May, there was a drop in department store sales. Nevertheless, late 1977 store sales were about 12 percent higher than late 1976 sales.

Another somewhat volatile component of consumer activity was new car sales, as measured by new auto registrations. A three-month moving average reveals a strong growth pattern for the first five months of 1977. Since May, the three-month average has fluctuated around 120,000 units per month. In the last quarter of 1976, that average was 94,000 units per month. For much of 1977 then, new car sales ran almost 30 percent ahead of the 1976 sales rate. Confirmation of the strong car sector is found in the consumer instalment credit figures for 1977. The amount of outstanding auto loans at commercial banks increased 28 percent from late 1976 to late 1977. Not all of that jump reflects new car purchases, but loans for new automobiles do account for a very large percentage of outstanding auto debt.

Total consumer credit and instalment credit at commercial banks leaped 19 percent from late 1976 to late 1977, outpacing personal income growth. The largest gains occurred in automobile loans (28 percent), home improvement loans (17 percent), bank credit card plans (21 percent), and personal loans (19 percent). Bank holdings of mobile home paper outstanding declined as repayments of old loans more than offset extensions.

By August, total consumer credit outstanding at commercial banks in the region had reached approximately 8 percent of personal income. Nationally, commercial banks hold about 48 percent of the consumer instalment debt. If that ratio holds for the Sixth District, total consumer instalment indebtedness would be around $29 billion, or 17 percent of personal income. The willingness of consumers to obligate themselves to this degree is a strong statement of positive consumer sentiment. Overall, the consumer provided the Southeast economy with a very substantial stimulus in 1977.

Banks Enjoy a Strong Year. With economic activity advancing through the third year of recovery, bank credit extensions took on a pattern characteristic of this stage of expansion. All types of bank lending strengthened while bankers redirected their acquisitions of securities. Both consumers and businesses relied heavily on banks to meet their credit needs. The only sign of weakness occurred in Tennessee following that state's Supreme Court decision applying the 10-percent usury ceiling to consumer loans.

Bank lending for real estate purposes was one of the stronger areas of loan demand in 1977. Households increasingly sought bank loans for home mortgages. At the same time, business firms increased their requests for bank loans to finance the construction and acquisition of new commercial properties.

The pace of business loan growth was the strongest experienced since the 1972-74 period. Commercial and industrial firms, and especially some of the larger regional and national firms, turned increasingly to the District's banks for financing in the last year. These firms' bank borrowings typically lag those of the medium-sized and small firms, so that a rise in their requirements for working capital from external sources was expected. As the economic expansion continued, businesses again took down bank lines for their short- and medium-term financing needs.

Recent business loan growth came from many sources—manufacturing, trade, services, and construction firms. Along with this pickup in corporate loan demand, there was an advance in bank business loan rates. In late 1976, the prime rate was falling, eventually reaching 6 1/4 percent; in late 1977, banks had raised these charges to 7 3/4 percent.

As increased employment and larger paychecks swelled regional income,

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deposit inflows strengthened and District banks attracted substantial new deposits. Consumers were particularly attracted to the more liquid passbook savings accounts and higher yielding, but longer maturity, four- and six-year certificates of deposit. Business firms continued to place some of their temporarily idle balances in banks' savings accounts.

At the same time, many of the larger banks took steps to adjust their managed "money market" deposits in anticipation of higher interest rates and stronger loan demand. They expanded the volume of large-denomination certificates of deposit outstanding by nearly $150 million and sharply increased the maturity of these liabilities. Both of these actions tend to stabilize deposit structure and place banks in a better position to meet future credit requests.

A Boom in Housing. A resumption of strong growth in residential building combined with the early phases of several large engineering projects to provide a bright construction picture for both the present and the future. Still, the levels of real construction activity and employment achieved in 1977 were well below their record highs of the early 1970s, and the recovery in nonresidential building has been quite weak.

Along with the growth of construction jobs, construction contracts expanded rapidly during the year, exceeding their 1976 rate of recovery and more than doubling the national pace. A substantial portion of the growth in 1977 was accounted for by five very large contracts, four for electric generating plants and one for a space facility; without these contracts, growth was somewhat slower than in the nation. Housing was another stimulus, with the number of contracted housing units up by almost 40 percent. However, the square footage represented by nonresidential building contract awards rose only 6 percent.

The cumulative value of residential contracts during the first three quarters was up 50 percent over the same period in 1976. The gap between dollar and unit gains reflects rising construction costs and the building of larger units with more amenities. Thus, 1977 is the second year of recovery from the doldrums that plagued residential construction in most of the area during the 1973-75 period.

Several factors have given initiative for this recovery while others have limited it. On the plus side, rising incomes and employment in the Southeast have pushed up housing demand and allowed developers to work off inventories of houses and apartments that accumulated during the recession. A resumption of heavy inflows to savings and loan associations, which began in 1975 and continued through 1977, helped developers and purchasers of single-family homes to find financing at rates that were somewhat lower than their previous peak levels. The recovery in the national economy spurred buying of second homes in the coastal and mountain resort and retirement areas. This was a particularly important contribution in Florida. At the same time, continuing population and job growth began to press on apartment inventories in the Atlanta area and in parts of Florida. On the minus side, uncertainty about the future of the recovery, energy, and taxes, continuation of rapid rises in construction and housing costs, and stagnant Federal housing programs limited the extent to which housing needs could be satisfied.

In 1976, Florida regained its place as the area's residential construction leader after sharp declines in the number of units contracted in 1974 and 1975. Florida extended its lead in 1977, showing growth well above that of each other state. Even so, the number of units contracted in 1977 was only about half the number recorded in 1973. Florida's recovery was led by the southwest portion of the state and the Tampa-St. Petersburg and West Palm Beach areas.

Tennessee's housing rebound outdistanced that of the states other than Florida, with the Knoxville and Nashville areas accounting for much of Tennessee's strong residential recovery in 1977. Other District states did less well than Florida and Tennessee, but the lowest rate of growth in units contracted in any state was 25 percent.

Employment Moves Ahead in 1977. From late 1976 to late 1977, almost 295,000 new nonfarm jobs were added to southeastern

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TABLE 1

NONFARM EMPLOYMENT BY INDUSTRY
OCTOBER 1976-OCTOBER 1977
(thousands)

Industry	October 1976	October 1977	Amount Increase	Percent Increase
Construction	562.2	593.8	31.6	5.6
Manufacturing	2 055.1	2 137.8	82.7	4.0
Durables	902.7	967.1	64.4	7.1
Nondurables	1 152.4	1 170.7	18.3	1.6
Transportation and Public Utilities	571.0	582.1	11.1	1.9
Wholesale and Retail Trade	2 192.1	2 247.9	55.8	2.5
Finance, Insurance, and Real Estate	502.6	512.8	10.2	2.0
Services	1 652.6	1 705.1	52.5	3.2
Government	1 871.8	1 918.4	46.6	2.5
Federal	344.8	348.5	3.7	1.1
State and Local	1 527.0	1 569.9	42.9	2.6
Total Nonfarm*	9 518.0	9 812.6	294.6	3.1

*Mining included in total nonfarm but not shown separately.

payrolls. Significant improvements were noticeable in all major sectors.

Manufacturing was the leading contributor to nonfarm employment growth in the Southeast, accounting for over 83,000 new nonfarm jobs, or 29 percent of new nonfarm jobs in the region from late 1976 to late 1977. Manufacturing employment growth slowed in summer and fall but not nearly enough to offset the gains of the first half of the year. Durable goods-producing industries accounted for the largest share of manufacturing employment growth in the District—over three-fourths, or 64,000 of the new jobs. Lumber and wood products, fabricated metals, and machinery led the increase, reflecting a good year for auto production and home building.

Employment in nondurable goods-producing industries was not impressive, growing a slim 1.6 percent over the year and accounting for less than a fourth of new manufacturing jobs. Nondurable manufacturing jobs expanded rapidly through May but turned down in the last half of 1977. Declines in employment in paper and only moderate gains in apparel and textiles were primarily responsible for the unimpressive overall growth.

Led by a large increase in retail sales in the region, wholesale and retail trade concerns added 56,000 new jobs to their payrolls between late 1976 and late 1977. This rise represented almost a fifth of new nonfarm jobs in the region and a gain of 2.5 percent for the year. Employment in the trade sectors expanded rapidly from late 1976 through February 1977 but declined throughout much of the year.

Service sector employment expanded by nearly 53,000 over the year, providing 18 percent of nonfarm job gains. Increases in travel and tourism, gasoline sales, entertainment, and eating out contributed to service employment growth.

Government was the fourth largest source of employment growth in the region: Nearly 47,000 workers were added to government payrolls. State and local governments hired the preponderance of new public sector employees; much of this growth resulted from the large increase in CETA expenditures. Although growth of the number of employees on Federal Government payrolls in the District amounted to only one percent over the year, it was still faster than in the U. S. as a whole.

Construction, finance, insurance, and real estate and transportation and public utilities added almost 53,000 new jobs between late 1976 and late 1977, about one-fifth of the new jobs in the region. Construction employment expanded by 32,000,

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or 5.6 percent, reflecting an impressive year for housing, but seemed to level off during the third quarter. Employment in both the transportation and finance sectors increased 2 percent over the year. In sum, employment growth during the past year was substantial and the unemployment rate reduced.

Capital Spending Plans Increase. Data comparable to the national statistics on fixed capital formation are not readily available by state or region. The best substitute measures of business investment activity are nonresidential building contracts and announcements of new plants or expansions. After a strong first quarter in 1976, which was attributable in large part to a $3.75-billion uranium enrichment facility in Alabama, the remainder of 1976 was very weak in new plant announcements relative to the period 1973-75. In 1977, there was evidence of a resurgence in investment plans, with announcements of major spending plans of $600 million or more in every quarter. The third quarter figure was the largest total since the first quarter in 1976 and before that, the first quarter of 1974. (A chemical plant in Louisiana accounted for $500 million of the third quarter total.) Through the third quarter, over $3,500 million in new investments had been announced.

Of this amount, chemicals and allied products accounted for 43 percent, the largest share of any industry category. Following at 15 percent was paper and allied products. Petroleum and coal processing spending plans had the third largest share at 11 percent of the total. The remainder was comprised of a smattering of announcements from several industries. A significant fact to remember is that chemical plants typically have very high capital-to-labor ratios and, therefore, don't create employment opportunities to the degree that equal capital expenditures in other industries would. It is somewhat surprising that chemicals and paper had such large spending plans in view of the mediocre growth in those two industries in 1977.

The growth in value of nonresidential building contracts was relatively weak in the Southeast during 1977, in contrast with a 10-percent national expansion. Construction of industrial buildings and public buildings of all sorts slipped the furthest, but little strength was evident in store and warehouse construction either. Alabama and Louisiana, in particular, performed poorly, while Florida took a slight lead in growth of nonresidential building. Rapid growth of office buildings in earlier years still plagues that sector.

As mentioned above, five large nonbuilding contracts totaling almost $6 billion were awarded during 1977. Since the projects for which they were awarded will be constructed over a long period of time, their immediate effect on employment and spending will be small. However, these projects will provide a stable base of construction employment for some time.

Growth in the Manufacturing Industries. Overall, manufacturing output had increased 6 percent over the year, ending with the third quarter of 1977, according to production indexes computed by the Federal Reserve Bank of Atlanta. The growth pattern was erratic and flattened after June. There was strong growth in the rubber and plastics industry, lumber and wood products, and stone and glass. Moderate growth was achieved in furniture, apparel, and transportation. But gains were modest in the paper, chemicals, furniture, and textile industries. No growth or actual declines were posted by the tobacco, petroleum and coal, leather, and food industries. In general, durable goods industries outperformed nondurables, a trend which reflects the strong national and regional sales of automobiles and other durables and the sluggish sales of nondurable items. The lumber and wood industry benefited from the boom in house construction. The stone, clay, and glass industry classification also reaped the dividends of the higher demand for brick and concrete blocks. A soft market for asphalt paving materials may have contributed to the weak growth in petroleum refining and coal processing. Rubber's output growth was in response to strong car sales, which raised the demand for tires, as well as to recovery from the prolonged rubber strike of 1976. Employment statistics, discussed in another

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section of this article, corroborate the production trends.

Agricultural Developments in the Sixth District. When the hard, cold winter came to an end in early 1977, spring opened on an optimistic note for District farmers. Most of them foresaw high prices for commodities they intended to grow, and they were induced to expand production. Early surveys showed that intended acreage for most crops increased, and farmers borrowed heavily to finance their planned expansions in production. Developments proceeded according to plan until late spring, when it became evident that the weather had turned extremely dry. Many early crops literally withered in the fields. The corn crop was eradicated in many areas, forage crops dried up, and plantings of late crops were delayed or their growth was retarded to the point that yields of many suffered devastating blows.

For eight major crops produced in the Sixth District, revenues expected at the harvest period were nearly 24 percent lower than had been anticipated at planting time. Not only were crops damaged by unusually dry weather, but bumper national output for most crops caused a price slide to accompany the downturn in production in the Sixth District. The combination of reduced prices and reduced output was sharply felt by corn farmers in particular, since anticipated revenue dropped 66 percent from springtime through harvest. Several other crops were adversely affected as well, but the impact was greatest on soybeans, where revenue dropped 35 percent, and on cotton, where the downturn was approximately 12 percent.

Instead of the anticipated revenue of nearly $5 billion from eight important crops during 1977, producers will apparently receive nearly $1.2 billion less. That reduction was sufficient to wipe out the expected net return over production costs for many growers. Because farmers had attempted to expand production of several crops in 1977, expenditures were unusually heavy. These added costs only accentuated the severity of the problem of the loss of income.

The situation was not uniformly bad for farmers, however. Tobacco and rice farmers

		Ac	
		1976	
		June	Jur
			(1,000
Sixth District States	Corn:	4,434	4,0
U.S.		71,085	70,8
	Rice:	712	5
		2,501	2,2
	Peanuts:	804	
		1,522	1,5
	Soybeans:	9,595	11,8
		49,443	57,9
	Cotton:	3,067	2,9
		10,914	12,8
	Hay:	3,577	3,5
		60,915	61,7
	Tobacco:	151	
		1,044	
	Sugar Cane:	621	
		757	

*The average of yields

**Expected yield times

experienced strong gains in revenue from levels anticipated earlier in the year because of price increases for these commodities during the time when other prices were falling. The picture was also brighter for livestock producers. Falling grain prices contributed to a reduction in feed costs, improving opportunities for profitable production, even though prices of animal products did not increase dramatically. Cattle feedlot operators began to increase placements, which in turn stimulated demand for feeder calves in the Southeast. The advance in calf prices lifted income from cattle production. In addition, pork prices held reasonably high throughout the year and production was increasing, contributing a boost to income from hogs. Poultry producers, likewise responding to the profitable incentive of prices averaging at or above year-ago levels and declining feed costs, expanded production and incomes in 1977.

For the District as a whole, income gains in the livestock sector offset part of the reductions in crop income. Total farm cash receipts through September were down $150

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TABLE 2

EAGE, YIELDS, AND EXPECTED PRODUCTION OF MAJOR CROPS

			Expected Yield			Expected Production		
	Percent Change June to Nov.		1977		Percent Change	1977		Percent Change
Nov.		Units	June*	Nov.		June**	Nov.	
			(per acre)			(millions units)		
,325	- 17.5	bu.	57.0	34.5	- 39.5	229.9	114.6	- 50.2
,553	- 1.8	bu.	81.7	91.5	9.8	5,786.2	6,366.9	10.0
582	- 0.7	lb.	3,860	3,771	- 2.3	22.6	22.0	- 2.7
,202	0.0	lb.	4,559	4,500	1.3	100.4	99.1	- 1.3
795	0.0	lb.	2,959	2,798	- 5.4	2,352.5	2,223.5	- 5.5
,510	- 0.1	lb.	2,509	2,376	- 5.3	3,792.9	3,587.5	- 5.4
1,785	- 0.5	bu.	23.2	21.8	- 6.0	274.2	256.8	- 6.3
,138	0.3	bu.	25.9	28.9	11.6	1,501.0	1,682.7	12.1
,936	0.0	lb.	421	477	13.3	1,235.8	1,398.9	13.2
,814	- 0.1	lb.	453	503	11.0	5,811.4	6,639.3	14.2
,503	- 2.0	tons	1.80	1.60	- 11.1	6.4	5.6	12.8
1,659	- 0.1	tons	2.08	2.08	0.0	128.4	128.4	0.0
152	0.5	lb.	2,017	1,980	- 1.8	304.3	300.4	- 1.3
965	0.3	lb.	2,036	1,987	- 2.4	1,959.7	1,918.2	- 2.1
615	- 1.0	tons	27.6	25.9	- 6.2	17.1	15.9	- 7.0
757	- 2.2	tons	36.2	36.0	0.6	27.7	27.2	- 1.8

Source: USDA, **Crop Production**, various dates.

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million, or about 2.2 percent, from the 1976 level. The decline for crops was $300 million, or 6.0 percent. By comparison, total U. S. receipts dropped one percent during the same period, reflecting a decline of $1.0 billion from marketings of crops during the harvesting season.

As indicated earlier, Sixth District farmers borrowed heavily to expand their production of 1977 crops. Credit outstanding has not been reduced through the harvesting season in proportion to the paydowns that were experienced in previous years, indicating the paucity of income from crop marketings. It is anticipated that there will be heavy carry-overs of loans into the 1978 cropping year. This refinancing undoubtedly will place pressure both on borrowers and on lenders, who may find it difficult to supply the additional capital needed to produce 1978's crops.

A new farm bill recently passed and signed into law by the President will be beneficial. It renews guarantees on farmer incomes at levels that promise to defray average production costs of major crops. That reassurance will undoubtedly stimulate farmers to produce heavily in 1978 and persuade lenders to do what they can to extend the credit that will be needed.

The U. S. and Southeast Compared. The performances turned in by the nation and the Southeast during 1977 were quite similar. Both witnessed unemployment rate reductions, and both saw strong activity in the housing sector. Consumers carried a lot of the load in economic growth, as did the governmental sectors. Investment activity, though better than in 1976 and late 1975, was poor relative to prerecession levels in both instances. A look at a few specifics will illustrate the many similarities in the economic records of the nation and the Southeast for 1977.

Through the third quarter, the U. S. economy grew well. Real GNP growth averaged a 6-percent annual rate through the first three quarters. Personal income reached $1,560.6 billion by the end of September, up 10.8 percent from December 1976. In the Sixth Federal Reserve District states, personal income grew by 6 percent

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A YEAR OF GROWT

Manufacturing pay increased slowly during the middle of the year but surged ahead in the fall.

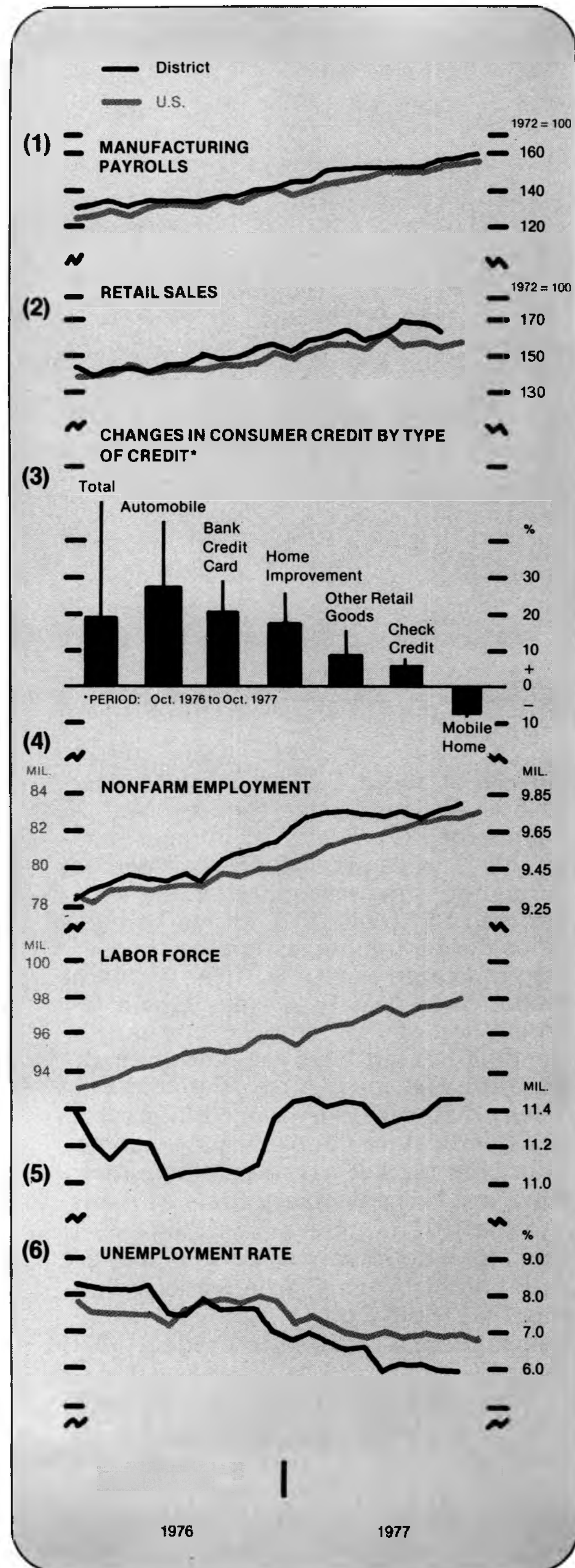
Retail sales growth was sporadic but increased for the year.

Consumer credit rose sharply in several categories.

Nonfarm employment was strong early in 1977 and again late in the year.

Southeastern labor force has grown more slowly than the nation's.

The nation and the Southeast had impressive reductions in unemployment rates.



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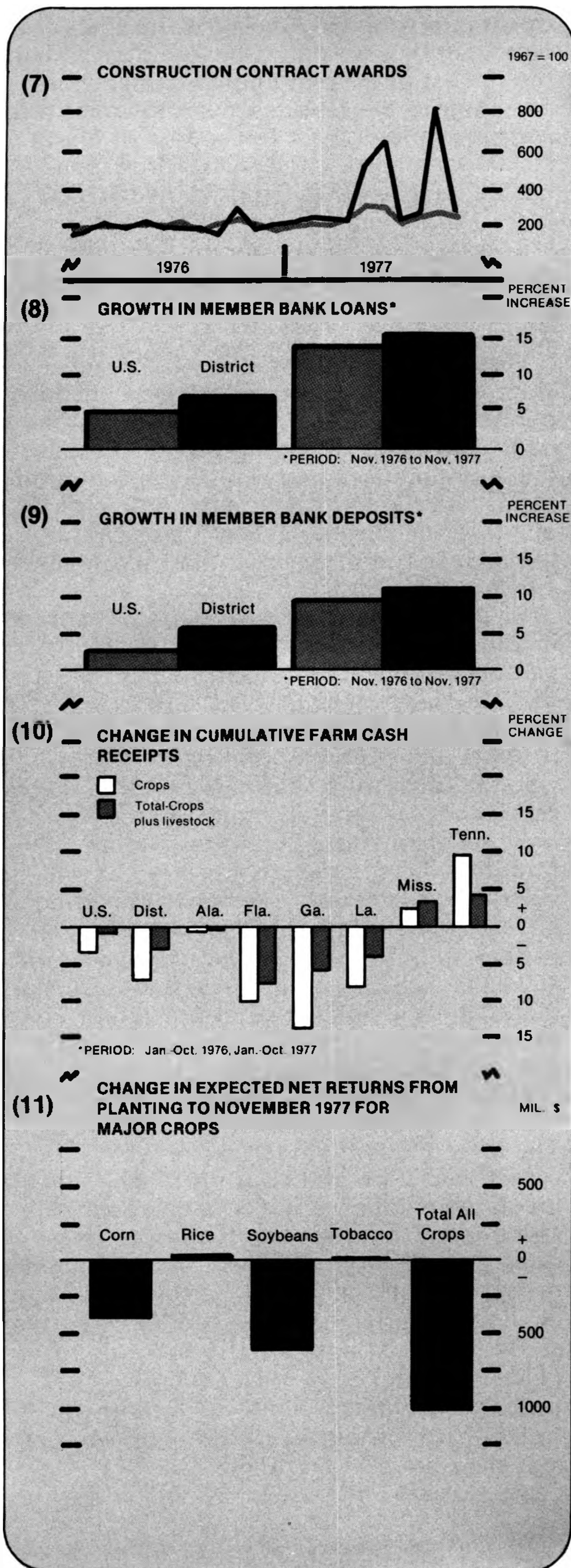

Construction contract awards reflect a solid growth year in construction.

Banking activity grew strongly in the Southeast in 1977.

Farmers sustained income reductions as cash receipts fell in most states.

Corn and soybean growers felt the effect of drought and low prices as net returns plummeted below expected levels.

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in the first two quarters, or 12 percent at an annual rate. Manufacturing income increased 10.8 percent from December 1976 to September 1977, matching the increase in the nation's personal income growth over the same period.

The Southeast had slower growth in manufacturing output than the nation. In both cases, evidence of flattening out appeared in the latter part of 1977.

Although labor force and employment growth was greater in the U. S. than in the District, the ratio of employment growth to labor force growth was greater in the District, resulting in a more rapid reduction in the District's unemployment rate. Manufacturing employment in the nation increased 2.9 percent by the end of September, while manufacturing jobs in the Southeast rose 2.5 percent. However, the average factory workweek was up one and a half hours in the District, while the U. S. factory workweek lengthened by less than one-half hour.

Contract construction employment jumped 8.0 percent nationally, while the Southeast could manage only a 5.6-percent hike. The slower southeastern growth reflects the relatively poor performance of nonresidential building activity in 1977.

The consumer sector was forceful in both the Sixth District states and the nation. Retail sales and auto sales were strong; consumer instalment credit expanded rapidly. Sales in the Southeast exhibited wider month-to-month fluctuations in 1977 than in recent years.

Activity at District commercial banks appears to have been stronger than in the nation as a whole. Deposits and loans rose more rapidly; Graphs 8 and 9 contain national and District comparisons. For national and Sixth District member banks, consumer instalment credit grew 19 percent.

So in sum, it seems fair to say that the nation and the Southeast enjoyed a good year economically, with the Southeast faring better in banking and housing but not as well in agriculture and employment growth.

State Comparisons. While the Sixth District as a whole had a good year in 1977, there were some important differences in individual state performances. We will highlight some of those.

Alabama, Tennessee, and Georgia had the greatest increases in nonfarm employment, while Tennessee and Florida had the largest decline in unemployment rates. The drop in the Florida unemployment rate was due in large part to the loss of about 70,000 members of the labor force. Tennessee, on the other hand, gained 70,000 labor force members in 1977. Georgia, Mississippi, and Louisiana posted only slight gains, and Alabama lost 5,000 members of its labor force during the first three quarters of 1977.

Farm employment was down in each state, as one might expect, largely because of the drought. Construction employment registered declines over the year in Alabama and Louisiana. Georgia, on the other hand, had the largest gain in construction employment due, in part at least, to the rapid transit rail system and air terminal construction in Atlanta.

Farm cash receipts, a measure of farm income that does not account for inventory changes, were well behind the 1976 levels for four District states. Alabama and Tennessee posted cash receipts gains for 1977 through October. Georgia and Florida farmers bore the largest declines, as the drought's effect was most severe in those two states. Manufacturing income growth was considerable in all states, reflecting the good growth in manufacturing employment.

Bank deposit and loan activity was quite strong in most District states. Banks in Alabama and the Sixth District portion of Mississippi reported the strongest gains in loan activity.

Other major developments of 1977 included several strikes in the Southeast. The largest was the dock strike which affected eastern and Gulf ports. The immediate economic effects of the dock strike seem to have been limited to the dock payrolls in port cities. An assessment of further damage, if any, to the South's economy will have to await more extensive study. In the Atlanta area, a strike by machinists at Lockheed idled several thousand workers. There was a short walkout by workers at the General Motors assembly plant at Doraville, Georgia. Alabama was hit with a wildcat coal strike,

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and Florida had a brief walkout of space facility employees. The UMW called a total strike on December 6. Work on a dam project on the Tennessee River was halted by the Environmental Protection Agency because of concern for a species of small fish found only in the Tennessee River. In Louisiana, a generating plant was canceled, reportedly because of a decision by the Utility Commission not to grant a requested rate increase.

What Lies Ahead? Last January, we were concerned about the slow growth in jobs in 1976. Looking ahead at that time, we expected the national and the southeastern economies to pick up steam in 1977. That expectation was generally realized, as the national and southeastern economies advanced strongly over 1976 levels.

What can we look for in 1978? Forecasters of the national economy present a mixture of forecasts, ranging from quite pessimistic to moderately optimistic. The consensus forecast calls for a 4- to 4.5-percent real GNP growth in 1978 with some further reduction in unemployment rates to around 6.5 percent. Prices are expected to increase 5 to 6 percent through 1978.

If the consensus is correct and if the southeastern economy follows national trends, we should expect 1978 to be a good year, with growth occurring in most sectors of the economy.

Where are the potential sources of growth for 1978? Unless long-term shifts in the basic structure of the economy have been under way in recent years, a sector that has been lagging behind can be expected to go through a catch-up phase. Using that reasoning, nonresidential building, which had a relatively poor year in 1977, could provide one source of stimulus. Fixed capital spending in general has been at depressed levels since the 1974 recession and might offer renewed strength. In that regard, however, the continued debate in Congress over energy legislation changes has created uncertainties in the business environment that are hard for business leaders to grapple with. A rebound in investment spending would be a salutary development for 1978 and for the longer-term outlook as well.

Given the relatively good financial situation of most state governments, some further stimulus is likely from that sector. Agricultural incomes should improve in 1978, with new price supports and the return of favorable weather for crop production adding to overall expansion in the South.

All this presupposes, of course, that substantial weakening does not occur in those sectors which showed strength in 1977. A few clouds have appeared on the horizon.

If interest rates were to rise further, housing sales and starts may be adversely affected. Exuberance by consumers now could result in a slowing in major credit purchases during late 1978 as instalment debt rises to record levels.

An area of concern for the employment situation is the possibility of more rapid labor force growth in 1978. The slowing of southeastern labor force growth since the 1974 recession to below national rates was probably due in part to outmigration of workers, as well as to discouraged workers temporarily leaving the labor force. Now, with unemployment rates below the national average, the potential for an inflow of workers to the region increases and with it the possibility of a poorer showing in the unemployment picture in 1978 relative to the nation. Job growth would have to increase beyond the 3-percent rate of 1977 to absorb the faster growth in the work force. Minimum wage increases, which went into effect in January 1978, will have a deleterious effect on either employment or prices, if not both. The impact is likely to be accentuated in the South because of the lower hourly earnings of workers in the region. ■

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CHANGES IN THE TREASURY'S CASH MANAGEMENT PROCEDURES

by William N. Cox

Under new legislation signed by President Carter in October 1977, the Treasury is now arranging to make substantial changes in its cash management procedures in early summer. The details are complicated and will not be treated here, but the changes are substantial enough that a brief description of them is of general interest.

The basic changes are four: (1) Many nonbank financial institutions—savings and loan associations, mutual savings banks, and credit unions—will gain the opportunity to hold Treasury funds; (2) all depositary institutions will have to pay the Treasury interest on balances held longer than one day; (3) the Treasury will reimburse them directly, on a per item basis, for the various transactions services provided; and (4) the Treasury will also be able to invest its cash balances in its own securities or those of Federal Government agencies.

Technicians at the Treasury, at the Federal Reserve, at commercial banks, and at other financial institutions are now in the process of understanding and reacting to these new arrangements. While they do, our purpose here is to outline the old arrangements and the context within which they operated, then turn to the new arrangements with an explanation of how they came to be introduced.

The Present Procedures. Currently, commercial banks which meet certain well-defined standards may handle certain financial transactions on behalf of the Treasury. As a depositary, a bank may receive tax payments from employers, sell and redeem savings bonds and some other Treasury securities, and cash Treasury checks.

Why would a bank want to be a Treasury depositary? There is some prestige involved, and many banks feel that their depositary status enables them to offer additional services to their customers. By far, the most important reason, however, is that the Treasury has traditionally held its deposits at the bank for several days before withdrawing them into the Federal Reserve System. Commercial banks holding these so-called tax and loan account balances for several days have been able to invest them at a profit while paying no interest to the Treasury.[1] The implicit agreement has been that the interest a depositary can earn by investing the deposits compensates for the costs of handling tax deposits and performing other services for the Treasury.[2]

From the establishment of the tax and loan account system in 1917 until 1974, the Treasury held most of its cash balances in these accounts, maintaining a much smaller working balance with the Federal Reserve Banks.[3] These arrangements worked very well in the Sixties, but as interest rates continued to climb in the Seventies, the Treasury began to reexamine the situation. More and more states and municipalities began to demand and get interest on their deposits, prompting some members of the public to ask why the Treasury didn't do the same thing. The

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[1]Tax and loan accounts have carried reserve requirements, however, ranging from 7 to 16¼ percent at member banks, depending on the size of the bank.

[2]Such as redeeming maturing Treasury securities, selling new issues of securities, and cashing Treasury checks Some nonbank institutions have also provided such services but without compensation.

[3]Occasionally, the Treasury has moved funds the other way on a prorated basis, redepositing balances *from* the Federal Reserve Banks back into the tax and loan accounts, but such redeposits in accounts were a small proportion of tax and loan deposits received by depositaries; almost all of the flow has run the other way

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answer had been, as we have seen, that the interest-free deposits gave rough compensation for services provided to the Treasury by depositary banks. But as interest rates went up, the Treasury began to suspect that the compensation was rising faster than the depositaries' costs. Studying the problem, the Treasury concluded in 1974 that the depositaries were indeed being overcompensated for their services.[4] Since then, the Treasury has kept most of its balances at the Federal Reserve rather than in the tax and loan accounts at commercial banks.

Treasury Cash Management and the Fed. Pulling these balances out of the banks and into the Federal Reserve has been an interim and somewhat unsatisfactory solution, however, because it has caused some day-to-day difficulties for the conduct of Federal Reserve open market policy. When the Treasury's balance at the Federal Reserve moves up or down, the aggregate amount of bank reserves changes equally and oppositely. The Fed usually tries to offset these changes by open market operations. A stable Treasury balance at the Fed, therefore, reduces an important source of instability in bank reserves and thereby reduces the complications of open market operations—the principal tool of monetary policy. For this reason, the Treasury tried to maintain a steady working balance until 1974. It did this by calling in funds from the tax and loan accounts to replenish payments out of the working balance at the Fed and by redepositing funds into the tax and loan accounts when the balance at the Fed increased.

This stability vanished, however, when the Treasury decided to reduce the proportion of its funds held in the tax and loan accounts. Subsequently, most of the Treasury's overall cash holdings have been held at the Fed and most of the swings in the Treasury's cash have been reflected in that account. Accordingly, the Fed has had to conduct a much larger volume of offsetting open market operations under the interim arrangements. Under the new arrangements, the Treasury balance at the Fed should regain much of its previous stability, particularly now that the Treasury can also buy its own securities in the market.

Since an increase (decrease) in the Treasury's balance at the Fed generally prompts the Fed to use open market purchases (sales) to offset the effect on bank reserves, a movement of Treasury funds from tax and loan accounts into the Fed reduces the Treasury's net interest expense. The Fed reacts to an increase in the Treasury's balance, for instance, with an equivalent purchase of Treasury securities from private holders. The interest on these additional securities is consequently paid to the Fed rather than to private investors. The Fed returns the entire additional interest payment to the Treasury, whereas private investors return only a small proportion in the form of income taxes.[5]

The New Procedures. The procedures now being implemented reflect an attempt by the Treasury to retain and improve the advantages of the interim arrangements while eliminating the interference with the Fed's open market operations. As before, a bank may qualify with the Treasury to accept tax and loan deposits from the public. Collateral requirements are unchanged. Unlike the earlier situation, however, other financial institutions may also qualify. Each depositary—bank or nonbank—will have to choose one of two new ways to handle the Treasury's money. Under the "remittance option," the depositary agrees to transfer to the Treasury account at the Federal Reserve all tax and loan deposits one day after receipt. In effect, an institution choosing this option will have no use of the Treasury's money, will be unable to earn interest by investing Treasury balances, and will not have to pay any net reserve requirements against them.[6]

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[4]Report of a Study on Tax and Loan Accounts, Department of the Treasury, June 1974.

[5]At the end of each year, the Fed adds up the Treasury interest and other receipts, deducts the Fed's operating expenses, and returns the difference through the legal device of a tax on Federal Reserve notes. On average, more than 90 percent of interest paid to the Fed is returned in this way. In the example above, however, *all* the additional interest would be repaid, since the Fed's operating expenses are not affected by the additional holdings of Treasury securities.

[6]These one-day deposits actually do carry reserve requirements. Technically, however, the deposits will be offset by an increase in "cash items in process of collection," which will be deducted in the calculation of reserve-bearing deposits. So there will be no *net* reserve requirements against the one-day deposits. Similarly, because checks deposited for the Treasury's account cannot be collected in one day, the deposits are not investable.

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Alternatively, the depositary may choose to sell the Treasury interest-bearing notes on the day after the deposits are received, with the rate of interest tied to a yet-to-be-established rate on national repurchase agreements. The Treasury will call in the balances, with interest, whenever it wants to bring the money into its account at the Federal Reserve. These notes will not be considered deposits, and member banks will not have to hold required reserves against them. The Treasury expects such notes to have an average maturity of about ten days, whereas the current tax and loan deposits are usually called in about two days.

Since under the new arrangements a depositary will either be unable to invest Treasury funds (the remittance option) or will have to pay the Treasury interest on such funds (the note option), the depositary will no longer be receiving the use of interest-free funds as an implicit compensation for services provided to the Treasury. Instead, the depositaries—bank or nonbank—will be compensated directly and explicitly on a per item basis.[7] Thus, the use of funds and the provision of services will be "unbundled"; depositaries will be able to evaluate each function separately.

Two Choices. Each prospective depositary, therefore, has two choices to make in response to these new procedures: (1) whether or not to be a Treasury depositary, and if the answer is "yes," then (2) whether to operate under the remittance or the note option. Neither decision is irrevocable. Each institution would probably first decide whether it would be better off under the note option or the remittance option: Can the institution earn enough from reinvesting the Treasury funds to more than offset the interest paid to the Treasury and the costs of handling the reinvestment? Then, to decide whether to participate at all, the institution would combine the potential earnings from the preferable option with the other relevant considerations—the Treasury's new reimbursements relative to the internal costs of handling Treasury transactions, the value of additional customer services it can offer as a depositary, and the speed with which Treasury funds received can be collected as investable or transferable balances. ■

[7] Reimbursement, for example, will include 50 cents for each Federal tax deposit received. Reimbursement levels have been set by the Treasury from its own cost figures.

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