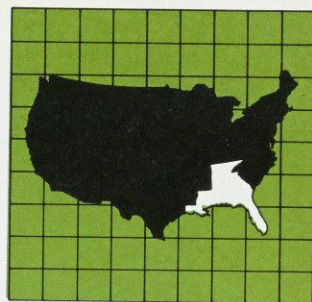


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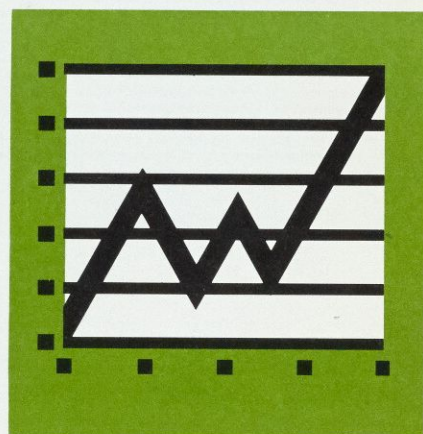
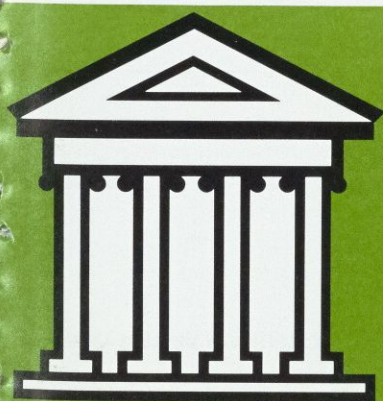
Correspondent Banks' New Era

CREDIT UNIONS

Goodbye Delicatessens?

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Growth Surge Since 1979



Economic Review



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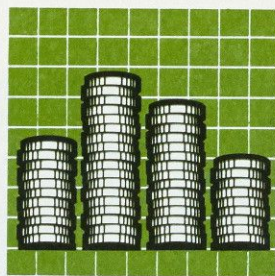
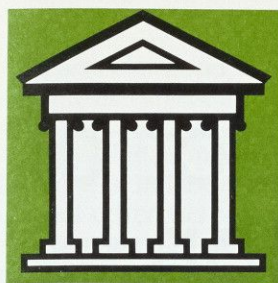
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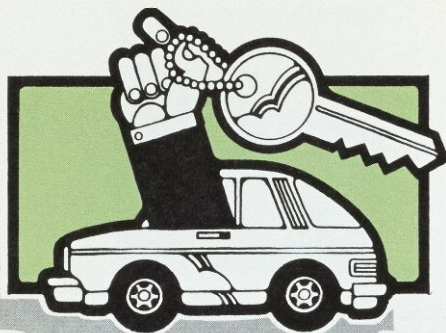
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The Impact of Disinflation



Although most people and businesses benefit when inflation begins to cool, such a trend can be less cheering to some who profit when prices are rising. Here's a look at how disinflation affects different groups in the Southeast.

The economic recession of 1981-82, while painful, saw a significant benefit: a dramatic slowing of inflation. Inflation, as measured by the Consumer Price Index (CPI), rose 12.4 percent in the year ending December 1980. By contrast, the level of the CPI in December 1982 was only 3.9 percent higher than a year earlier. The Producer Price Index (PPI) also moved up 12.4 percent from December 1979 to December 1980; in 1982, its advance was only 1.6 percent. Furthermore, both the CPI and PPI counted near-zero price hikes in the first quarter of 1983. For all 1983, a few forecasters look for inflation to fall below even the 3 percent level!

But this slowing of inflation shows up very unevenly to American families. Used car prices and medical care costs **rose** at double-digit rates in 1982. On the other hand, the cost of an at-home breakfast of steak, eggs and potatoes actually **fell** in 1982, as did the price of gasoline needed to fuel the family car. Overall, though, the general dampening of the inflationary fire has

set the stage for healthier future growth in living standards, particularly if inflation can be contained in the current economic expansion.

This article will look closely at some of the important price changes that contributed to the recent slowing of inflation and will examine how some people are affected by the current low-inflation environment. It will also report the current and expected price experiences of some business firms in the Southeast. Along the way it will review how price changes are measured and why it is important that they are measured properly.

Costs of Inflation

Inflation refers to a general upward movement of prices at roughly the same rate. This means that a given amount of money will buy proportionately fewer goods and services. In addition, changing market conditions can cause the price

of a particular good to move up or down compared to all others, independently of the rate of inflation. Actual price changes reflect a combination of general inflation and price changes relative to that general inflation. For example, rising energy use and other factors caused the price of oil to rise compared to other products in the 1970s. However, the rising cost of energy also contributed to the increase in the aggregate price level in the decade.

Sustained inflation, whether or not it is expected by producers and consumers, is costly. If sustained, inflation eventually erodes a country's capacity to produce more, channeling resources away from long-term investments that build up the nation's productive capacity. Typically, it also causes a shift in the distribution of purchasing power among citizens.

For example, when inflation is unexpected, as it may be early in its growth, individuals and businesses who own real assets (real estate and gold, for example) benefit. Since prices of such assets respond to money demand, those assets provide protection against higher inflation. However, owners of resources whose prices are fixed by long-term contracts, like bondholders, lose. So do those who sell in markets where prices respond slowly to inflationary pressures.

Recurring surprises in the rate of inflation can increase uncertainty about the future rate of inflation. Savers may become reluctant to invest in long-term financial assets out of fear that accelerating inflation will erode the value of their capital. Instead, they may buy short-term assets that offer protection from large capital losses.

Increased uncertainty also may heighten the reluctance of buyers and sellers to enter into long-term contracts. If workers and employers or suppliers and producers are unsure about future prices, they will want to renegotiate contracts. Those additional negotiations cost time and money. Moreover, planning becomes more difficult when contracts are made for shorter periods.

Surprise inflation also may waste resources when asset prices adjust at different speeds to general inflationary pressures. The varying price responses change relative prices of goods. In turn, these "faulty" price signals redirect resources into less useful activities. For instance, funds may flow into real estate or commodity speculation and away from long-term financial assets such as corporate bonds.

Even if inflation is anticipated perfectly, resources may be wasted and relative prices distorted.

Resources are wasted, for example, by the frequent reprinting of catalogs and posting of new prices. To cope with inflation, people also may strive to minimize holdings of non-interest bearing cash. In this effort they roughly balance the cost to them of more frequent cash withdrawals against the loss of purchasing power over time of idle cash balances. But they could use the resources expended in productive activity.

Inflation is also a kind of tax. Longer term, inflation-boosted incomes and the U. S. system of progressive tax rates cause tax-bracket "creep." In effect, taxes are increased without direct legislative action as incomes are boosted to higher tax brackets by inflation. The increasing real tax burdens reduce incentives for consumers to save and businesses to invest. Capital projects whose payoff is distant become less attractive in an inflationary environment than short-run profits available from less-productive investments. Concern over rising costs helps explain the increased resolve of the Federal Reserve System to contain and reduce inflation.

The Recent Inflation Record

Most of us gauge the course of inflation roughly by comparing the prices of goods we normally buy with the prices we paid in the "good old days." Depending on our age, the reference or benchmark period may be the depression years, the decade of the 1950s or, perhaps, the late 1960s. In fact, the U.S. Bureau of Labor Statistics (BLS) performs exactly the same calculations when it constructs the CPI.

Changes in the rates of increase in the CPI and its components in 1980 and 1982 reveal the extent and composition of disinflation recently. Overall inflation dropped by two-thirds from 1980 to 1982 but still lingered in 1982. Last December, the goods included in the CPI market basket together cost nearly three times as much as in the reference year, 1967, and were 3.9 percent higher than the previous December (Table 1).

A closer examination of the components of the CPI shows that the prices of many goods we frequently buy actually fell in 1982. Furthermore, two years earlier many prices were increasing at double-digit rates. Fruits and vegetables, meat and eggs all dropped in price at the local grocery store or super market, for example, helping keep overall food and drink price hikes below-average. More importantly, declining interest rates and a

Table 1. Consumer Prices: Major Expenditure Categories and Declining Subcomponents*

CPI-All Urban Consumers:	Percent Change		Index Value Dec. 82
	Dec. 81 - Dec. 82	Dec. 79 - Dec. 80	
All Items	3.9	12.4	292.4
Food and Beverages	3.2	10.1	279.1
• rice, pasta, cornmeal	-4.2	17.1	145.3
• beef and veal	-0.1	5.0	270.2
• poultry	-0.7	15.0	190.4
• eggs	-12.9	11.1	172.5
• fresh fruits and vegetables	-0.9	13.9	272.3
Housing	3.6	13.7	316.3
• homeownership financing, taxes, and insurance	-4.0	23.3	486.2
• fuel oil	-0.7	20.2	708.7
• sofas	-1.0	6.6	118.2
• TV and sound equipment	-1.6	1.8	107.2
Apparel and upkeep	1.6	6.8	193.6
• women's apparel (less shoes)	-0.3	1.6	105.5
• boys' and girls' footwear	-2.3	9.3	129.0
• jewelry and luggage	-3.5	21.4	142.2
Transportation	1.7	14.7	294.8
• gasoline	-6.6	18.9	381.3
• automobile parts and equipment	-0.5	8.6	136.5
• automobile finance charges	-8.8	25.3	173.8
Medical care	11.0	10.0	344.3
Entertainment	5.6	9.6	240.1
Tobacco products, personal care, and educational expenses	12.1	10.1	276.6

*Major expenditure categories show positive increases because omitted subcomponents (whose prices increased) more than offset falling prices for the subcomponents listed here.

glut-caused drop in gasoline and fuel oil prices held down the CPI's important housing and transportation components.

The importance of these components' price declines can be judged by the share of the consumer's dollar spent on these items. Eighty-three cents out of each dollar spent by consumers in December 1981 went for food and beverages, housing and transportation (Chart 1). Within the "big three," meats, poultry, fish and eggs accounted for 3.7 cents, homeownership financing, taxes and insurance for 12.9 cents, and motor fuel for 6 cents.

Of course, the CPI's price performance was not uniformly rosy in 1982. Medical care, tobacco, and personal and educational expenses posted double-digit price increases. So did pork prices, led by a hefty 23 percent rise in bacon prices

(which apparently caused some people to substitute steak for bacon in the breakfast menu). Fortunately, these items account for only a small share of the average consumer's spending.

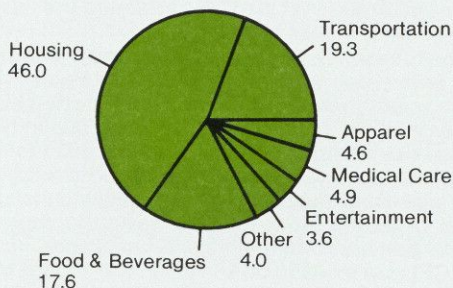
The Importance of Accurate Price Measurement

Accurate measurement of price changes helps consumers understand how much they are affected by inflation. But policymakers and economic analysts also need to know the pace of price changes to judge the effectiveness of anti-inflation programs, the health of the economy, and the impact of indexation efforts on the country's budget. These evaluations begin with the estimation of Gross National Product (GNP).

GNP is the broadest measure of the nation's final output produced in a year. GNP is thus a

Chart 1. Consumer Spending
(December 1981)

Pennies Spent Out Of A Dollar



summary measure of overall economic activity and an indicator of the nation's economic health. It is measured by adding up the dollar value of all the goods and services produced during the year. When prices are changing, however, the value of goods and services includes both quantity and price changes. To estimate real output alone, price indexes are used to convert actual dollar GNP to real GNP. Because the CPI and PPI are the indexes used to remove the impact of price changes from GNP, it is important that they are calculated accurately.

If the price indexes used to adjust GNP are inaccurate, then measured real GNP will differ from actual real GNP. For example, if the price indexes fail to reflect fully increases in the prices people pay, then we overestimate our well-being. This is because the faulty indexes remove only some of the price increases and thus only part of the purely nominal increase in GNP. Actual real GNP, in such a case, would be less than measured real GNP (see Box).

Accurate measurement of price changes also is important for indexation purposes. Price indexes are often used to protect the purchasing power or standard of living of the poor, the elderly, or workers. For example, since the mid-1970s Social Security benefits have been indexed to the CPI to ensure that retirees' living standards are protected from inflation. In most recent years, the cost-of-living increases went into effect in June and were reflected in July benefit checks. The percentage increase equalled the amount of change of the first-quarter average of the CPI of

the current year from that of the previous year. In 1980, this formula produced a 14.3 percent increase in pensioners' monthly benefits. This year, the average monthly benefit will rise by 3.4 percent. But legislation passed by Congress recently to ensure solvency of the Social Security system will delay this year's adjustment to December.

The cost of incorrectly indexing social welfare, Social Security, or labor contract cost-of-living adjustments has grown in recent years. Currently, the share of federal expenditures directly linked to the CPI or related measures has grown to one-third (or to over one-half if indirectly indexed expenditures are added). In effect, imperfect indexing to inflation takes money from Peter to give to Paul. Those who receive indexed income will benefit more when the price index used for indexing overstates their own inflation experience. That higher benefit is paid from the public coffers, which is filled with tax collections.

The relative price change that accompanies such indexation indirectly also causes resources to be directed toward less useful activities. For example, businesses may use more capital rather than more labor if workers are over-compensated for inflationary price increases. The bigger pay increase can occur if cost-of-living adjustment (COLA) clauses are pegged to overstated inflation in the CPI.

Recent Disinflation: Patterns and Implications

Several factors that fueled inflation in the late 1970s began to reverse themselves in 1980, thus helping to cool prices in the 1981-82 recession. Bountiful crop years worldwide combined with slowing demand (due largely to the worldwide recession) to dampen food price increases, for example. Low commodity prices generally, spurred by intense international price competition, have played an important part in limiting price increases. The softening of international oil prices is a well-publicized example of the commodity price bust that occurred in 1982. Together, the strong foreign exchange value of the dollar and worldwide recession caused U.S. import prices to decline in 1982, led by lower prices for crude petroleum and food products. These factors also lowered domestic inflation.

Anti-inflationary monetary policy and deregulation of industries such as trucking, airlines, and telecommunications also helped slow price increases. Restrained growth in money and credit

How Good Are The Price Indexes?

The use of inaccurate or incomplete information to estimate price indexes biases the measures from their true values and causes a variety of distortions in the economy and in the distribution of national income. Economists have identified several problems and issues in the construction and use of price indexes. Some issues are related to the calculation of real GNP estimates from current dollar estimates, while others relate to the use of price indexes to estimate changes in living costs.

One way that the methodology of constructing price indexes can affect the index value, and thus the estimated value of real GNP, is the use of prices listed in producers' price catalogs rather than prices actually paid by buyers. Tracking price changes from information on list prices can underestimate actual price declines in times of economic weakness if price discounting is prevalent. Similarly, tracking posted prices can underestimate inflation in boom periods if producers charge extra to allocate scarce supplies. The "transactions-list price" issue has been important historically in construction of the producer price indexes. It is of little importance with respect to the Consumer Price Index (CPI), however, because field workers traditionally have collected prices of consumer goods and services on an actual transactions basis.

The Bureau of Labor Statistics (BLS) has addressed this pricing weakness in its current comprehensive revision of the Producer Price Index (PPI) program. BLS is revising and improving the measurement of producer price changes to reflect adequately prices at which transactions actually occur. Currently, 191 out of the 493 mining and manufacturing four-digit industries in the Standard Industrial Classification (SIC), or almost 40 percent, are being calculated using procedures that adequately capture transactions prices. These 191 industries represent 57 percent of the value of all mining and manufacturing shipments. By 1986, all 493 mining and manufacturing industries will be calculated using the improved procedures. (Additional industries are brought into the system at six-month intervals.)

Other problems also bias the producer price indexes over the business cycle. These problems include adjustment for changes in the quality of products over time, reliability of reporter response, and other sampling and price measurement problems. Unfortunately, the net direction and magnitude of bias is unknown when all of these factors are taken into consideration.

The most widely used measure of inflation, and the one used for indexation purposes, is the CPI. Two frequently noted "shortcomings" of the CPI are the way it measures homeownership costs and its use of a fixed market basket. Critics of the CPI argue that these factors help explain why the CPI increased at a faster rate than some other indexes of inflation in the 1970s.

They also argue that the CPI overstated the rise in the cost of living in that period.

One reason the CPI may have overstated inflation is that, before last January, the official CPI treated the rise in the asset (investment) value of homeownership as an increase in the cost of living. In fact, a rise in housing values can represent an increase in wealth for homeowners who are not buying in the period of rising prices. This is because they could sell or refinance the housing asset or lessen other forms of saving to capture the capital gain associated with the housing price increases. The CPI also tends to be sensitive to mortgage interest rate changes and to attach too much importance to housing because mortgage costs are counted along with the purchase price.

The CPI is said to overstate cost of living increases because it tracks prices of a fixed market basket of goods and services despite changing consumption patterns. If consumption patterns change from the fixed, base-year market basket, then tracking the cost of buying the base-year basket will measure inaccurately the change in the cost of the more recently chosen market basket. Furthermore, if the prices of the original market basket increase faster than the actual goods chosen more recently, then the CPI will overestimate the increased cost of living.

Economists at the BLS are well aware of these "shortcomings." Starting with the January CPI for all urban consumers, BLS changed the way homeownership cost is officially measured. The new approach measures what a family would have to pay if it rented its home, filtering out the investment aspects of owning a home. Thus, wild swings in homeownership costs caused by volatile interest rates are eliminated. (In 1981, one-third of the rise in the CPI was caused by rapidly escalating mortgage interest rates.)

A major conceptual and measurement problem arises, however, in attempting to adjust for the changing market basket. Essentially there is no way of knowing whether a change in observed consumption patterns results in a higher or lower standard of living. A change can be caused either by varying prices or by a change in consumer preferences. For example, if the Smith family begins to skip its usual Sunday afternoon ride through the countryside because of rising gasoline prices, its standards of living is lower. If we want to use the CPI to index incomes to preserve living standards, the index should not count this market-basket change. If, however, the family foregoes the car ride so they can all go jogging together, then a measure used to index income should reflect this kind of market-basket change. This example illustrates that, in practice, there is no practical way to formulate the CPI so that it can be used exactly to index incomes to a particular living standard.

curbed aggregate demand and prices while de-regulation increased competition and thereby drove prices down. In 1982, intense price competition in the trucking industry helped restrain food price increases due to transportation costs. But the competitive pressure brought on by the recession itself also strongly deterred many price increases. In agriculture, for example, bargain-basement prices on farm machinery sold at foreclosure auctions were due to weak demand. In other industries, hard times have forced businesses to hold "garage sales" or to offer deep discounts (on, say, rentals of oil-drilling rigs). In these and other ways the recession played a critical role in reducing inflation.

Naturally, some factors responsible for the current disinflation are likely to change in the future. For example, favorable weather and crop conditions will not persist indefinitely. Furthermore, resumption of healthy world economic growth will reduce downward price pressure resulting from weak demand. But mounting evidence indicates that fundamental factors affecting inflation are improving. Even if progress against inflation abates, gains already made have had noticeable effects on different groups in society.

One difficulty in assessing who "wins" and who "loses" from slowing inflation is that the answer partly depends on whether the changed environment is anticipated. For example, investors demand an inflation markup in return for any expected falling purchasing power of money they lend. Whether they "lose" thus depends on the accuracy of their inflation forecast.

Another fundamental difficulty is that gains and losses from slowing inflation are relative. This means losers from inflation still suffer in a disinflationary environment, but they lose less; the opposite is the case for gainers from inflation.¹ For example, pensioners who receive a fixed dollar income, such as beneficiaries of insurance company annuities, suffer a smaller drop in purchasing power when inflation slows, but their purchasing power still declines. Similarly, borrowers paying down old loans with inflation-cheapened dollars still benefit, but less so, as inflation abates.

Despite these complications, there are gainers and losers from a slowing of inflation. Prices do

not all rise or fall at the same time. Prices in some markets, such as raw commodities, almost always begin to rise more promptly than in other markets, such as for final consumer goods. Prices also do not all move at the same pace. For example, the rate of inflation and nominal interest rates do not move in lock-step. As a result, changing inflation rates can turn losers into winners.



How do different inflation rates affect lenders and borrowers? Suppose the actual interest rate is 10 percent when prices are rising by 9 percent, as was the case for a time in 1980. This situation provided an investor with a one percent real return, only about one-third the historic average. If an investor had lent \$10,000 for one year then, he would have received back only \$9,100 in real purchasing power when the debt was paid off by the borrower, plus \$1,000 in interest worth \$900 in real purchasing power. Furthermore, this investor, if in the 50 percent tax bracket, would have had to pay \$500 in taxes on the interest income. After lending \$10,000 for one year, he would have been left with a total real after-tax purchasing power of less than \$9,600. In other words, for this lender the real after-tax interest return was negative.

The borrower, on the other hand, gained in the same circumstances. If he was also in the 50 percent tax bracket, he made an after-tax interest payment of only \$500 (half of the \$1,000 paid in interest was deducted from income) and gained \$900 from the decline in the real value of the \$10,000 principal payment. Thus, his after-tax real cost of borrowing was minus 4 percent.

¹Although prices actually fell in early 1983, it is unlikely that we are in the midst of an actual deflation, or sustained period of falling prices. The existence of long-term wage and resource-supply contracts, indexed

social security payments, welfare programs and unemployment compensation, and the minimum wage law make it practically impossible for prices to fall for a sustained period of time.

Other interest rate and inflation scenarios can generate quite different results, of course.² For example, zero inflation with a 10 percent nominal interest rate would generate an above-average real after-tax return to the lender and a high cost to the borrower. In general, disinflation benefits creditors because the dollars they are repaid will buy more than they would otherwise. The dollars received by bondholders and others on fixed incomes also stretch farther. Debtors, on the other hand, must pay off in "harder" money, particularly when inflation slows unexpectedly. The benefit to them of higher inflation thus declines.

Gainers and Losers from Disinflation

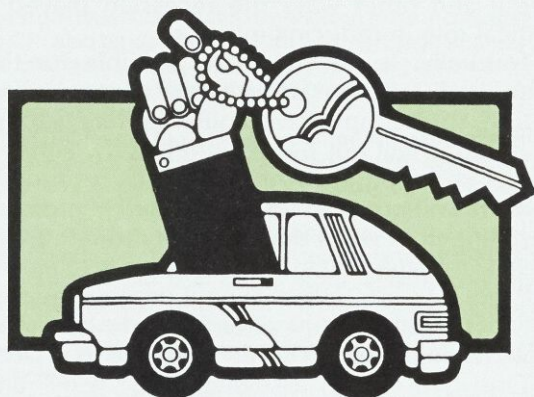
The changing inflationary environment actually affects most of us in many ways. As savers we win as inflation is checked, but we may lose as homeowners. Where we live and who we work for also helps to determine whether we gain or lose as individuals and as group members. We are likely to be affected in many ways simultaneously, in some ways favorably and in other ways adversely. For example:

● **Businesses** With slowing inflation, low-cost producers with strong balance sheets should be in better shape than highly leveraged firms. As inflation slows, benefits to businesses of paying off debt with cheaper dollars is diminished and thus liquidity strains on highly leveraged firms are heightened. This is because actual revenues fall short of revenues projected on the basis of continued high inflation, while the dollar pay-back schedule remains unchanged. In 1982, high interest rates also limited the capacity of leveraged firms to roll over or expand debt. That is why bankruptcies climbed across the nation during the year.

Moderating inflation and inflationary expectations have caused nominal interest rates to fall and long-term funding of investment projects through bond and equity issues to pick up. The AAA corporate bond rate dropped from over 15 percent in mid-1982 to 11.5 percent this April. During this same period, there was a substantial increase in the gross proceeds from new offerings

of corporate stocks and bonds. Firms not already saddled with a heavy debt load are in better position in this queue for funds.

● **Industries** As interest rates and their inflation markup component drop along with inflation, interest rate sensitive businesses such as housing and transportation are benefiting. Potential buyers of homes and cars who were unable to qualify for loans at the higher financing rates are coming back into the market. For example, overall mortgage interest rates fell from a high of 16.1 percent



in May 1982 to an average of 13.0 percent in March. Because of the sharp decline in interest rates, combined with relatively flat home prices and rising incomes, the monthly payment (principal and interest) on the median-priced existing home fell 16 percent from May to March. This means the average family needed to devote 30.6 percent of its income to buy the home in March, down from the 38.3 percent in May 1982.

In housing finance, there has been a decline in variable rate mortgages (VRMs) and an increase in fixed-rate mortgages. Home buyers prefer fixed-rate mortgages because they know how much they will be paying over the life of the loan. According to the Federal Home Loan Bank Board, the share of VRMs dropped from 45 percent of new loans in May 1982 to 30 percent in March. This decline is linked to lenders' reduced fears and uncertainty about inflation.

On the other hand, speculative real estate ventures, particularly those associated with creative financing of office buildings and farmland, may suffer as occupancy rates and rental increases fall short of the rise expected before inflation

²Inflation can either speed up the real effective pay-back schedule for a loan (but not the total real amount repaid) or cancel a portion of the real payment that would be paid with zero inflation. The amount cancelled will be zero only if the nominal interest rate—the real interest rate plus the inflation markup—fully incorporates the inflation experience.

abated. Rentals have softened in many cities and the national office vacancy rate climbed rapidly in 1982. By December, the Coldwell Banker office vacancy index was 10.3 percent, more than double its year-earlier level. For many cities, 1982 was a record year for new office construction and many construction projects will be completed this year. This new space suggests continued softness in occupancy and rental rates.

Lower inflation also deflates the capital gain that can be expected from tangible asset inflation-hedges. Tax shelter activities generally, including oil-drilling activity and purchase or lease of computers and other tangible assets, are becoming less attractive. As inflation-caused bracket creep slows, after-tax real returns to these investments become less attractive.

● **Government** The slowing of bracket creep will slow government revenue growth. But reduced inflation accompanied by declining interest rates also will benefit public borrowers by lowering the debt-servicing burden of public debt. Lower interest rates reduce the cost of rolling over existing debt or financing additional deficits. By lessening bracket creep, lower inflation may even slow the growth of the underground economy by reducing the incentive to avoid the real tax hikes that accompany bracket creep.

● **Consumers** To the extent that buyers lower their expectations of inflation, the "buy now, pay later" attitude will be reined. With prices falling or increasing less rapidly, the incentive to buy in advance of use is reduced. Some economists even argue that consumers are now liquidating household goods accumulated in the high inflation period.

The higher after-tax return that accompanies reduced inflation and bracket-creep should favor saving at the expense of consumption. (The Reagan administration's tax cuts also will spur more saving out of income). If consumers are slow to perceive reduced inflation, but not the reduced growth of their paycheck, spending out of slower-growing income also may lag as consumers feel poorer. However, rising wealth from higher prices of financial assets such as stocks and bonds should spur consumer purchases of goods and services.

● **Workers** Cost-of-living adjustment clauses in labor contracts have been moderating to reflect the lower inflation environment. Lower adjustments reinforce the gain already made against inflation by cutting prospective labor costs to businesses; they also help to keep

workers' jobs. However, other cost-cutting efforts to ensure profitability in a low-inflation, competitive environment may slow the recall of laid-off workers. The closing of high-cost plants in the "smokestack" industries is an example of these efforts.

● **Regions** If wage rates in non-unionized markets are determined competitively while union wages lag in adjusting to reduced inflation, then southeastern workers' incomes may trail those in other regions. This is because relatively few southeastern workers work under wage contracts



indexed to inflation. In 1980, fully 25.2 percent of all nonagricultural workers nationally were union members compared to only 16.5 percent in the Sixth District states.

Slower inflation should slow the shift of wealth from households, which are net savers as a group, to businesses and governments, which are net borrowers. This will likely generate complex gains and losses in the Southeast. On the one hand, businesses are owned disproportionately by wealthier individuals, and the Southeast has a disproportionately high share of the poor. (In 1979, Sixth District states had a greater share of people with incomes below the poverty level than the nation as a whole.) But government transfer payments also account for a higher share of personal income to Sixth District residents than nationwide. A slowing of these transfers may result indirectly from a reduction in the shift of wealth to the public sector.

The Southeast also may be affected adversely as inflation slows because the region is a net importer of capital, and the benefits of repaying debt with cheaper dollars will decline. But lower inflation and deregulation of capital markets also encourage greater saving and investment. A larger inflow of capital might result because of the relatively good investment opportunities in this part of the Sunbelt.

The cooling inflation environment also has caused businesses to alter their selling practices. As the inflation rate has dropped, many sellers have tried to hold the price line and maintain market shares by offering liberalized credit terms, discounts, rebates, and other inducements.

Southeastern and National Outlook

To find out more specifically how business practices have been affected by the lower inflation environment, the Atlanta Fed surveyed corporate buyers in the Southeast in April. In general, their experiences are in line with the way we, as individuals, have responded as thrifty consumers. Their outlook for the remainder of this year also sounds a cautious, but optimistic, tone.

That mail survey, directed at more than 40 current or former presidents of local chapters of the National Association of Purchasing Management in seven states, found the respondents optimistic that inflation will continue to be restrained, at least for the immediate future. The corporate buyers—from Alabama, Arkansas, Florida, Georgia, Kentucky, Mississippi and Tennessee—look for overall price increases in the modest 5 to 6 percent range as of year-end 1983.

A majority of the survey respondents reported that buyers are negotiating more with sellers. They also have been avoiding commitments to long-range contracts and are, instead, keeping material input inventories low. As a consequence, they are buying in smaller quantities, on an as-needed basis, when possible.

Buyers also are very cost-conscious and cash management-oriented. They appear to have been

successful in lowering costs, often by resisting price increases. One buyer reported that his company "doesn't honor price increases." Another noted that "discounting is more than usual."

These spokesmen—and women—for business also provide at least a partial perspective on the trend of production costs. The underlying "core inflation rate" is dominated by movements in wages and productivity, although capital and energy costs are sometimes important as well. Nonrecurring factors such as weather conditions are of minimal importance in calculating the core rate.³ Our respondents seem to be optimistic regarding cost increases in 1983, including labor compensation. Unsurprisingly, given their jobs, they are uncertain about the outlook for worker productivity.

Nationally, evidence suggests that the growth of productivity (real business product per labor hour), which declined throughout much of the 1970s and into the early 1980s, is poised to climb in the economic recovery. Although the average annual productivity index value for 1982 was only one percent higher than in 1977, a continued economic upswing undoubtedly will bring a more rapid increase in output than in man-hours worked. Indeed, first quarter 1983 data for the manufacturing sector showed productivity advancing at an 8.3 percent annual rate; it fell 1 percent in 1982. A gain in output per worker typically occurs during the early phase of expansions as employers rely on their most experienced workers and most efficient equipment. Cost-cutting efforts in recessions pay off in reduced machinery down-time and better manpower and equipment in recoveries.

Several longer-run factors that affect productivity also are turning positive. Worker efficiency may improve throughout this decade because of management and technological innovations, an increase in the amount of capital per worker, and favorable demographic characteristics of the work force. Certainly, these changes are responsible for an outpouring of articles on such topics as robotics and computers, quality circles and Japanese management techniques, and the consequences of a maturing Baby Boom generation.

³In general, stable prices (and an unchanged distribution of factor incomes) can result if increases in compensation per employee man-hour equal the trend of labor productivity. Suppose, for example, that compensation (wages plus fringe benefits) per hour is \$10 and that output per man-hour is one unit. Unit labor cost, or the labor compensation cost required to produce one unit of output, is thus \$10. If labor productivity improves by 2 percent, then output per man-hour rises to

1.02 units. If the worker receives a 2 percent hourly raise in compensation, then he will get \$10.20 per hour. But the unit labor cost will remain unchanged at \$10. If the price of the output also remains the same, then the difference between the price of the product and unit labor cost also remains the same. However, profits will increase by 2 percent because of the 2 percent increase in production.

The passage of tax incentives to encourage investment, deregulation of certain industries, and the closing of energy-inefficient plants in recent years add to the rosy productivity outlook for the 1980s. The lowering of inflation also should enhance productivity by shifting funds toward high-yield capital projects.⁴

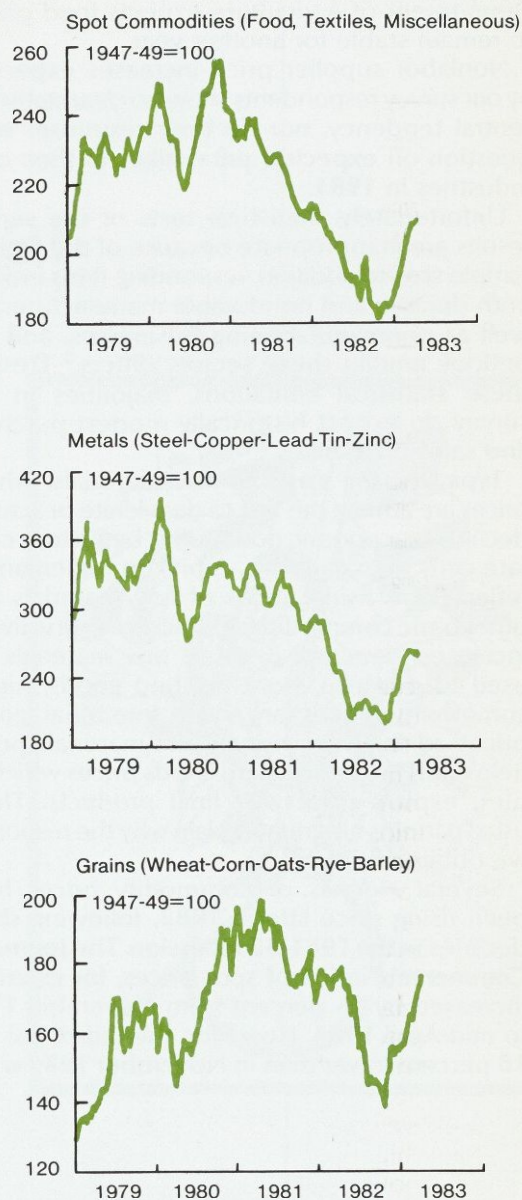
A second major variable that determines the core rate, worker compensation, also is moving toward lowering unit labor cost. (Unit labor cost measures compensation per unit of output.) During the 1981-82 recession, many unions opted for wage freezes to save jobs. Collective-bargaining settlements negotiated in the first three quarters of 1982 produced the lowest wage increases since the BLS started compiling such data in 1967. (About two-thirds of the improvement was due to a reduction in COLAs.) Compensation per hour for the entire business sector rose by just over 7 percent in 1982, the smallest increase in a decade, and substantially below the 10 percent average for 1980 and 1981.

National collective-bargaining settlements in 1983 also are expected to be moderate. In fact, the master agreement that went into effect March 1 at eight major steel producers' plants reduced wage rates about 9 percent and limited cost-of-living payments. It led an overall 1.4 percent drop in collective-bargaining settlements in the first quarter, the first such drop since the government began tracking them 15 years ago. Typically, the master steel contract has set the pattern for other steel contracts and has set the tone of negotiating talks in other industries, such as aluminum and copper.

Most of our survey respondents expect employer expenditures on wages and salaries, Social Security, private pension and health plans and other fringe benefits to grow about the same in 1983 as in the fourth quarter of 1982. During the fourth quarter, these costs gained 5.5 percent. During the first quarter of 1983, hourly compensation nationally increased only 4.7 percent, the smallest jump since the fourth quarter of 1971.

Because employee compensation accounts for about two-thirds of all production costs, the

Chart 2. Price Indexes



Source: Journal of Commerce

improved performance of unit labor cost overshadows the influence of energy, capital costs and nonrecurring factors on inflation. However, the news on these fronts also is positive, particularly the drop in world oil prices. Data Resources, Inc. estimates that the \$5 rollback of crude oil prices will slice 2.8 percentage points off the rise

⁴Against these positive trends lies the danger, according to many economists, that burgeoning federal deficits will "crowd out" private investment.

in the PPI in 1983 and 1 percentage point off consumer price inflation.⁵ Meanwhile, the U.S. Department of Agriculture expects food prices to remain stable for another year.

Nonlabor supplier price increases expected by our survey respondents show no clear statistical central tendency, nor do their responses to a question on expected price hikes in their own industries in 1983.

Unfortunately, statistical tests of the survey results are inappropriate because of the limited sample size. In addition, responding firms include both durable and nondurable manufacturers as well as nonmanufacturing businesses, and the outlook among these sectors differs.⁶ Despite these statistical limitations, majorities in our survey do expect historically modest purchase and sales price hikes.

Typically, the costs of raw materials, whose prices are among the first to decelerate or actually decline in economic downturns, begin to accelerate early in expansions. A pickup in demand is reflected in rising prices of raw materials and other basic commodities particularly sensitive to increased demand. Because raw materials are used to produce more finished goods, higher commodity prices are built into final goods prices. In this way, rising basic materials prices help explain intermediate goods prices which, in turn, explain prices for final products. These usual patterns also may explain why the responses we obtained differ.

Several indexes of commodity prices have been rising since late in 1982, following sharp declines in the 1981-82 recession. The **Journal of Commerce's** index of spot prices, for example, increased by 15 percent from November 1982 to mid-April 1983. However, the index was still 18 percent lower than in November 1980 when

it started a steep 30 percent decline which lasted for two years (Chart 2). The index was paced downward in the recession by precipitous peak-to-trough declines in metals (49.1 percent) and grains (30.1 percent) since 1980.

The recent partial recovery of spot prices has been led by a rebound in metals and grains prices. From November through mid-April grain prices jumped by almost 27 percent. The roller-coaster ride of these commodity prices reflects their sensitivity to demand.

Our respondents strongly indicated that a rise in raw material prices, including energy costs, would be a sign of a rekindling of inflation. These buyers also indicated that they have noticed some increases in materials prices—specifically, in metals prices. But, overall, they said that it is still a “buyers’ market.”

Many economists argue that the current raw material price increases confirm a pickup of economic activity and return of prices to profitable levels from below-cost prices during the recession. They say industrial commodities constitute only a small share of the cost of finished goods and, thus, exert little direct inflationary pressure. Nevertheless, future movements in these sensitive commodities prices will be watched closely as a leading indicator of the probable course of future price changes.⁷

Clearly, because the future is inherently uncertain, so are the inflation expectations of corporate buyers in the Southeast. But their outlook for overall price increases by the **end** of this year—in the 5-6 percent range—is encouraging. Their experiences also suggest that inflation has been brought under at least temporary control.

—William J. Kahley

⁵DRI, **U.S. Review**, April 1983, p. 171.

⁶A survey of businesses conducted by the U.S. Bureau of Economic Analysis in November-December 1982 showed that manufacturers expected the prices of goods and services they sell to increase by 5 percent in 1983, a slightly higher rate than in 1982. Public utilities prices, though, are expected to rise by 12.5 percent.

⁷Some other common, although not always accurate, leading indicators of a pickup in inflation (or inflation expectations) are rising precious metals prices and long-term interest rates and a drop in the foreign exchange value of the dollar. Precious metals are viewed by investors as an inflation hedge, as are some foreign currencies, while rising long-term interest rates may incorporate a rising inflation-risk premium.

MMDAs and Super NOWs: The Record So Far

The money market deposit account (MMDA) is one of the most successful new accounts ever to be offered by commercial banks or, for that matter by any type of financial institution. In the course of just four and one-half months this new instrument pulled in better than \$340 billion, dwarfing the combined total of the money market mutual funds. Super NOWs, while enjoying some success, have by no means measured up to expectations. This article tracks the history of these new accounts and reports on a recent Atlanta Fed survey on their characteristics and public acceptance in the Sixth Federal Reserve District.

Characteristics of the New Accounts

The MMDA has the following characteristics: (1) the account must have an initial average balance of at least \$2,500; (2) the account does not have to have a minimum maturity requirement but the offering institution is required to reserve the right to require at least seven days



An Atlanta Fed survey revealed wide variations in interest rates on both MMDA and Super NOW accounts. Unless its features are adjusted, the Super NOW account seems unlikely to match the MMDA's popularity with consumers.

notice prior to withdrawal; (3) the account has no interest rate ceiling on deposits as long as the average balance requirements are met; (4) the account can be checkable, but the account holder is limited to a total of three preauthorized transfers and no more than three checks per month; (5) deposits in MMDAs up to \$100,000 are insured; (6) the reserve requirement on the MMDAs is zero on personal accounts and 3 percent on nonpersonal accounts; (7) the account is available to all depositors including corporations.

The Super NOW account differs from the MMDA in three important respects. First, the Super NOW account provides the depositor with unlimited checking facilities. Second, it carries transaction account reserve requirements that effectively reduce the interest rate the financial institution is willing to offer the depositor. Therefore, the money market accounts, having at most a small reserve requirement, carries higher rates than the Super NOW. Third, the Super NOW account is available to individuals, proprietorships, and nonprofit organizations but not to corporations.

Banks and thrifts nationwide actively advertised the new accounts. Price competition was remarkable in some areas. For example, many banks and thrift institutions in the Atlanta area advertised what was termed a "bridge account" that would automatically convert to an MMDA on December 14. In order to attract consumer attention, many of the Atlanta institutions offered high interest rates on these new accounts.

First National Bank of Atlanta started the melee by offering 18.65 percent for the first 30 days on its money market deposit accounts. The 18.65 percent did not reflect market conditions for money but instead represented the date that the First National Bank was chartered. Reacting to this offer, many of the banks and S&Ls in the Atlanta area quickly jumped in and advertised introductory rates ranging from 20 to 22 percent for the first 30 days. The result was a very rapid inflow of funds into the new type of account. In fact, it was such a rapid inflow of funds that the offers were either severely limited or eliminated after just a day and a half to two days. Although the Atlanta experience was unique in the nation in terms of the number of institutions involved, a substantial number of financial institutions across the country offered rates at these levels. By all

indications the attempt was extremely successful. For example, one bank in the Coral Gables, Florida area attempted to raise \$5 million by offering 25 percent on a bridge account going into an MMDA. Within two days this bank had raised better than \$20 million and was forced to discontinue the offer. (This bank almost doubled in size as a result of offering 25 percent on MMDA accounts.)

**"The funds remained
even when rates fell..."**

Although the Atlanta banks were trying to attract permanent money, the extremely high rates offered on these MMDA accounts were expected to draw "hot money," money that is very sensitive to interest rates. In general the Atlanta banks expected a substantial outflow of these funds when rates returned to more normal levels. A survey of the institutions, however, revealed that funds shifted into the new types of accounts were by and large not hot money. The funds remained even when rates fell to a level comparable to those offered by the money market mutual funds. The extremely high rates were in effect for only 30 to 45 days. Some of the bridge accounts were initiated almost 15 days prior to December 14, the date on which the MMDA could be offered, which meant that the depositor could earn the introductory high rate for the period covered by the bridge account and the first 30 days of the MMDA. Four days after the 30 day period had expired, a telephone survey of Atlanta bankers indicated that they lost less than ten percent of the funds attracted by the high introductory offer. The Atlanta banks have continued to build these accounts and have experienced no strong runoff as a result of going back to market rates comparable to those offered by the money market mutual funds.

Other than the characteristics mandated by the DIDC, the characteristics of the new account were left largely to the financial institutions offering the accounts. For instance, although the DIDC mandated a \$2,500 minimum balance requirement, financial institutions can require

substantially greater minimum balances. Although the DIDC authorized financial institutions to allow checking privileges on the new account, they are not required to do so. As a result, the exact characteristics of the MMDAs differed substantially among financial institutions. For example, some commercial banks, in the belief that the consumer was looking for an investment account and not a transaction account, did not offer the checkable privileges on their MMDAs. This reduced their costs and allowed them to pay slightly higher rates than the MMDAs, which carry the checkable privileges.

Financial institutions also have a great deal of leeway in shaping their Super NOW offering. In fact, in an attempt to avoid the reserve requirements imposed on the Super NOW accounts, at least one financial institution offered what appeared to be a Super NOW but what was in fact an MMDA tied by a sweep arrangement to a regular NOW account. Since the MMDA account allows three preauthorized transfers and up to three checks per month, a sweep was used to automatically transfer funds from the MMDA account to a checkable NOW account, thus avoiding the reserve requirements on the Super NOW while allowing the depositor unlimited checking facilities.

The obvious reasons why the Super NOW has experienced less success than the MMDA are that the MMDA was offered first with limited checkable privileges, and the MMDA pays a higher rate to the depositor because it lacks reserve requirements on personal accounts. The depositor gains little by establishing a Super NOW unless the unlimited transaction facility is necessary. Therefore, it is not surprising that the Super NOW has experienced less consumer acceptance than did the MMDA. Table 1 shows a comparison of the size of the MMDA and Super NOW relative to other types of accounts as of April 1983.

To understand more about the MMDA and the Super NOW accounts, the Federal Reserve Bank of Atlanta surveyed institutions within our district. We wanted to find out: (1) what were the characteristics of the Super NOW and the MMDA accounts currently being offered; (2) what were the sources from which funds flowed into these accounts and (3) how were consumers accepting the new accounts.

Table 1. MMDA and Super NOW Deposits in U.S. Compared to Other Types of Accounts (\$billion as of end of April, 1983)

	Total
MMDA	341.2
Super NOW	29.4
Demand Deposits	242.3
Other Checkable Accounts*	90.8
Savings Deposits**	322.7
Money Market Mutual Funds***	176.1

* excluding Super NOW

** MMDA

*** General Purpose, broker/dealer and Institutional, taxable funds only.

Results of the Sixth District Survey

The survey consisted of a random sample of 176 banks and S&Ls in the Sixth Federal Reserve District. It was carried out over a one month period, and each respondent was resurveyed during the middle of April to establish comparative rates on the MMDAs and Super NOWs. Of the total number of organizations surveyed, approximately 80 percent of the institutions offered both the MMDA and the Super NOW account. Sixteen percent offered only the MMDA and only 6 percent said that they offered neither. Clearly, the Super NOW account is viewed as a complementary service to the MMDA; the Super NOW was never offered by itself (see Table 2).

Of those institutions that offered both the MMDA and the Super NOW, 84 percent allowed checks to be written against the MMDA account. Of those institutions that were only offering the MMDA account, 91 percent allowed checks to be written against these accounts. In the case of banks that offered only the MMDA accounts, we found that 100 percent allowed checks to be written against the MMDA accounts. Only some S&Ls offering only the MMDA accounts would not allow checks to be written against these accounts.

Ninety one percent of the institutions offering the MMDA required only \$2,500 as their minimum. One percent required \$3,000, seven percent required \$5,000 as a minimum and only one required \$10,000 or more as a minimum

Table 2. Banks and S&Ls Offering MMDA and/or Super NOW Accounts

	Percent of Banks and S&Ls	Percent of Banks	Percent of S&Ls
MMDA and Super NOW	80	79	82
MMDA Only	16	16	16
Super NOW Only	0	0	0
Offering Neither Account	6	5	4

Source: Federal Reserve Bank of Atlanta Survey

initial deposit. These same institutions that also offered Super NOWs indicated that 94 percent required the \$2,500 for the Super NOW, zero required \$3,000, five percent a minimum of \$5,000 deposit and one percent required \$10,000 or more. Of those institutions that offered only the MMDA, 91 percent required \$2,500, five percent required \$5,000 and five percent required \$10,000 or more. Few institutions were giving up the checkable feature as a cost saving method.

Some of the money market mutual funds also require that you make minimum additional deposits. We thought it would be interesting to find out how many of the banks and S&Ls reserved this privilege also. We found that of the organizations that offered both the MMDA and Super Now accounts, 87 percent had no minimum on additional deposits. Only six percent had \$100 minimums, five percent had \$500 minimums and one percent required a minimum of \$2,500 on additional deposits. For the Super NOW, the same group, 95 percent required no minimum size on additional deposits, four percent required \$100 and one percent required \$500. Of those institutions offering only the MMDA, 100 percent indicated that they had no minimum additional deposit size requirement.

If the minimum balance on the MMDA falls below \$2,500 and following customer notification is not brought back to this level, the account falls out of the MMDA category and is reservable as a transactions account. This effectively increases the commercial bank's cost associated with the

account. If the same occurs on a Super NOW account, it becomes ineligible to pay money market rates. Therefore, we examined the penalties on account holders whose accounts fall below the minimum \$2,500. We found that in the institutions offering both the MMDA and the Super NOW 69 percent had no charge on an MMDA that falls below the minimum balance. Only 31 percent of these institutions had a specific charge for an account holder whose account dipped below the \$2,500 minimum. The range of the charges ran from \$3 to \$15.

Turning to those same institutions that were offering Super NOW accounts, we found that 50 percent of those had no charge, but the remaining 50 percent that did charge required between \$2 and \$15 as a penalty. The same held true for those institutions that offered only the MMDA account. Sixty-four percent had no specific charge on accounts whose balances dipped below the minimum. Those that did, however, said their average charge ran between \$2 and \$10 for such a penalty.

To expand on this a bit, when the balances drop below \$2,500 the account effectively converts to a NOW account on which banks and S&Ls may pay no more than $5\frac{1}{4}$ percent. Most of the institutions applied these rates when minimum balances dipped below the \$2,500 mark while still considering them MMDAs or Super NOWs. However, a minority of institutions either switched the account to a different type of account, paid a lower rate of interest or paid no interest when balances fell below \$2,500.

Sixty-nine percent of the institutions that offered both the MMDA and the Super NOW indicated that if the minimum balance requirement was not met that they simply paid $5\frac{1}{4}$ percent interest on the account without restructuring the account. Only three percent paid no interest on these accounts, 18 percent switched them to NOW accounts and nine percent switched them to passbook savings. The percentages were very similar on the penalties associated with the Super NOWs. Sixty-five percent simply left them in the Super NOW category but paid only the $5\frac{1}{4}$ interest, 2 percent reduced the interest to 3 percent, 5 percent paid no interest at all, 20 percent shifted them back to a regular NOW account by changing the structure and nine percent switched them into passbook. Of those institutions that offered only the MMDA, 91 percent simply reduced the interest payable on the account to $5\frac{1}{4}$ percent, 5 percent

switched them into NOW accounts and the remaining 4 percent went into passbook savings.

Another penalty associated with below minimum balances had to do with increased fees for checking. Only 4 percent of the institutions surveyed actually applied an increase to the fees they charge for checking privileges if the MMDA balance dipped below the minimum. The average increase was approximately 50 cents per check but ranging between an increase of 20 cents to \$1 per check cashed. On the Super NOWs the average increase in fees was 30 cents per check with a range from 15 cents to \$1. Interestingly, none of the S&Ls increased their checking fees on MMDAs and only six S&Ls increased their checking fees on Super NOWs when minimum balances fell below the required level.

We were also interested in how the institution establishes the rate it pays on the MMDA. In the

“Only 28 percent of MMDAs and Super NOWs were indexed to a market instrument.”

vast majority of instances the actual rate on the MMDA was established by a management decision either based on local market conditions or on the institution's desire to maintain a spread, usually four to five percent, between its loan rate and its cost of funds. Only 28 percent of those institutions offering both MMDAs and Super NOWs said they indexed their offer rates on MMDAs to some type of market instrument. Eight percent tied their rate to the 91-day treasury bill rate and 5 percent tied their rate to the 182-day treasury bill rate. Another 6 percent tied their rate to an average of the money market fund rates and 8 percent tied their rates to time certificate deposits. Only one percent failed to specify. Twenty-three percent of these same institutions indexed their rate on the Super NOW. The percentages going to each of the above categories of market instruments were approximately the same. Of those institutions that offered only the MMDA account, 23 percent indexed their rate to a money market instrument, 9 percent to 91-day treasury bills, nine percent to money market funds and 5 percent failed to specify.

We found that approximately 72 percent of all firms adjusted their rates weekly. Eleven percent adjusted their rates monthly on the MMDAs. Rate revisions on Super NOWs tracked those on the MMDA very closely. Interestingly, in terms of how long these rates are guaranteed, 20 percent of the institutions did not guarantee the rate at all on either type of account. Twelve percent had a one day guarantee, 58 percent guaranteed it for a week and 10 percent guaranteed it for a month. Therefore, the guarantee and the interest rate vary substantially among institutions.

S&Ls tended to pay higher rates on both MMDAs and Super NOWs than commercial banks. On average, commercial banks paid 8.2 percent on MMDAs, and their rates ranged from 6 percent to 9.3 percent during the middle of April. The average paid by S&Ls on MMDAs was 8.4 percent, ranging from a high of 9.5 percent to a low of 7.5 percent. Therefore on the MMDAs, S&Ls paid approximately 25 basis points more than banks on average.

On the Super NOWs the story is much the same. S&Ls paid an average of 7.4 percent for Super NOWs, ranging from 6 to 8.5 percent. Banks paid an average of 7.2 for Super NOWs ranging from 6.0 to 8.8 percent. These tremendous rate variations among similar types of institutions as well as between different types of institutions indicate that neither MMDAs nor Super NOWs may be classed as a homogeneous account.

Consumers should be aware of the rate differential—among banks a differential on MMDAs of 325 basis points and among S&Ls a 200 basis point spread. The differential between banks and S&Ls over all markets ranged from 50 basis points to 150 basis points for MMDAs. Similar spreads were found for the Super NOWs. Consumers who want to maximize the return on their savings should consider not only the type of institutions paying the highest yield but also the return offered by specific institutions; it really makes a difference.

Turning now to service charges other than those associated with penalty charges because of below minimum balances, we find that approximately 69 percent of the firms surveyed had no monthly fees associated with the MMDA and 56 percent had no minimum fees associated with the Super NOW. Five percent indicated they had a flat fee on the MMDA that ran from \$2.50 to \$10, and 24 percent of the firms interviewed indicated that they had a flat fee on

The Banking Act of 1933 authorized federal regulatory agencies such as the Federal Reserve to establish interest rate ceilings on deposit accounts at commercial banks and prohibited the payment of interest on demand deposits.¹ The objective was to limit potentially ruinous price competition among commercial banks in order to ensure a safe and sound banking system for the public. As a result of these regulatory imposed interest rate ceilings on deposit accounts commercial banks were less able to compete through price among themselves. They were also restricted in the degree to which they could compete through price with financial institutions not subject to rate limitations. As long as market interest rates remained low and commercial banks were viewed by the public as providing a service or set of services that could be provided by no other type of financial institution, banks felt little competitive pressure from nonbank competitors. The public was offered no real alternative to demand deposit accounts and time and savings accounts that carried interest rate ceilings.

This situation continued until the late 1960s and early 1970s when banks began marketing large CDs aggressively to attract consumers. Consumers with sufficient funds also became interested in the direct purchase of Treasury Bills as interest rates rose. Consumers with insufficient resources to enter these markets were unable to acquire the higher yielding assets.

Then, in 1972, innovators created the first money market fund, basically a mutual fund pools the funds of many shareholders and invests the resulting funds in money market instruments. These funds turned out to be the inspiration for the new MMDA account offered by commercial banks. Money market funds grew rather slowly, at the end of 1977, 50 funds held approximately \$4 billion in assets. However, in 1978 in response to rising short-term interest rates, net assets of money market mutual funds increased to better than \$11 billion. As short-term interest rates continued to rise through 1979 and early 1980 the number and net assets of money market mutual funds exploded. By the end of 1980 money market mutual funds contained better than \$74 billion in net assets. These funds continued to increase during 1981 and 1982, reaching a peak on December 1, 1982, at \$232 billion.

As interest rates rose, small depositors found themselves increasingly disadvantaged by not being able to earn market rates through their commercial banks. The banks, in effect, were being subsidized by the small depositor. A bank was required by law to pay no more than 5¼ percent on time and savings accounts, but could lend these funds at prevailing market rates. While market-determined rates were slightly higher than the ceiling rates, small depositors were unconcerned. But when market rates exploded and the spreads widened, the small depositors began looking for alternative accounts that would pay market rates. In money market funds, consumers found what they were looking for.

The money market funds were based on a fairly simple concept. Small depositors were unable to invest in relatively safe instruments like commercial paper, commercial bank certificates of deposits, and treasury bills because of the large minimum denominations in which these instruments were offered. The money market funds simply accumulated or pooled the resources of interested investors and then acquired the money market instruments paying high rates. The result was a money market instrument available to small depositors that would pay money market rates.

Later, in search of higher yields or risk diversification, these funds began to invest in other types of instruments

such as bankers acceptances, Eurodollars, repurchase agreements and U.S. agency securities, but the basic concept remained the same. Pool the resources of small investors, invest in money market instruments with minimum denominations larger than the small investor could afford, and then divide up the earnings of the pooled funds in proportion to the size of the investors' deposits. As history shows, this was a very successful strategy.

As money market rates continued to climb during 1979 and early 1980, the money market funds continued to attract deposits at a rate which alarmed the regulated institutions. The plight of the thrift institutions exemplified the problem. As market-determined interest rates rose and banks and other regulated financial institutions were unable to offer competitive rates on deposits, an outflow naturally followed. Funds moved out of banks and thrifts into the money market funds paying the attractive rates. This outflow caused the S&Ls serious problems because they had funded long-term loans with short-term deposits subject to Regulation Q (interest rate) ceilings. In an attempt to reattract these funds or at least stem the outflow, commercial banks and thrifts were authorized to offer money market certificates in June 1978. The certificates were indexed to the six month treasury bill rate and were available in denominations as low as \$10,000. Other indexed certificates were to follow, but the net effect was to raise substantially the thrifts' cost of funds. In the absence of indexed certificates, depository institutions would have experienced even greater outflows which would have aggravated the situation further. As the investor sought higher returns, S&Ls faced the prospect of having to fund a larger portion of their outstanding loans with instruments that paid money market or near money market rates. Because the majority of their loans were carried at the low rates prevailing during the period in which the loan was actually made, the S&Ls found themselves paying more to attract funds than they were receiving on their loans. The result was severe pressure on profits resulting in the inability of a number of these institutions to survive.

Reflecting in part these pressures, Congress passed the Depository Institution Deregulation and Monetary Control Act of 1980, which among other things authorized the phaseout of Regulation Q restrictions. This act also established the Depository Institutions Deregulation Committee (DIDC) composed of the secretary of the Treasury, the chairman of the Federal Reserve Board, the Comptroller of the Currency, the chairman of the Federal Deposit Insurance Corporation, the chairman of the National Credit Union Administration and the chairman of the Federal Home Loan Bank Board. The purpose of this committee is to oversee and establish rules for the ultimate deregulation of interest rate ceilings.

The plight of the savings and loan industry and continuing high interest rates were partially responsible for the passage of the Garn-St Germain Depository Institutions Act of 1982. Section 327 of this act directed the Depository Institutions Deregulation Committee to authorize commercial banks, S&Ls and mutual savings banks to offer money market accounts free of any interest rate ceilings. The committee was instructed to structure the new account in such a way as to make it directly competitive with accounts offered by money market mutual funds. The committee quickly responded and on December 14, 1982 the MMDA was born. The DIDC then surprised the financial community by giving birth to another account dubbed the Super NOW. Regulated institutions found themselves with two new accounts directly comparable to that offered by the money market funds.

Super NOWs that varied from \$1 to \$10. Of those firms offering Super NOWs, another 20 percent had tiered fees that ranged from \$2 to \$10 depending on the size of the account.

We found that institutions differed in the way they established their rate schedules on the MMDAs and the Super NOWs. Some institutions pay a flat rate on all funds in either one of these accounts. Other institutions tiered their rates by deposit size. In the category of institution offering both the MMDA and the Super NOW, we found that 92 percent paid a flat rate on all funds deposited. Only 8 percent of that group tiered their rates. The flat rates ranged between 6 percent and 9.5 percent, an average of 7.9 percent. This indicates that among institutions there was better than a 3½ point differential between rates paid during the middle of the

“An estimated 20 percent or less of MMDA funds came from money market mutual funds.”

month of April. In terms of those tiered rates, we found that the progression normally had cutoff points at \$5,000 and \$20,000 and the increase in the interest rate differentials averaged about 40 basis points. These same institutions indicated that on their Super NOW account 95 percent of them had flat rates. The rates range between 5.25 and 8.75 percent, indicating again a range of approximately 3½ percentage points depending on the institution. The tiering structure was slightly different on the Super NOW accounts; the breaking points tended to be at \$5,000 and \$20,000 and the interest rate differential varied from 25 basis points to 100 basis points with the average being somewhere in the neighborhood of about 75 basis points. Of those financial institutions that offered only the MMDA account their flat rate, tiered rates and spreads matched those of the institutions that offered both the MMDA and the Super NOW.

Only six institutions had any type of withdrawal penalty. Seventy-two percent of the institutions that offered both MMDAs and Super NOWs had no fee for writing checks against the MMDAs, and 60 percent had no charge for

checks written against the Super NOW. Of the same type of firms, one percent indicated that there was a flat service charge on the MMDA, and 18 percent had a flat fee on the Super NOW. Twenty-five percent of these firms had a service charge based on the number of checks written against the MMDA, and fourteen percent had the same type of charge on the number of checks written against the Super NOW. Again, these charges can affect the effective yield on the MMDA or Super NOW, and the consumer should be aware of the vast differences in charges by various institutions.

Some institutions use additional benefits to attract consumers to the Super NOW or the MMDA. The most popular types of additional benefits were: revolving line of credit, traveler's checks, a toll free phone number, bill paying feature (pay by phone), bonus on MMDAs if check is drawn on a money market fund, and free checking account with an MMDA.

Where did the \$340 billion that flowed into the banks and S&Ls come from? Although many of the firms contacted could not answer this question, those that estimated the sources said about 20 percent or less came from money market mutual funds. Approximately 60 percent of the funds were inhouse. The remainder came from other banks and S&Ls in the local area or credit unions. Because the MMDA became available soon after the maturity date on a large volume of the all savers certificates, it was virtually impossible for these banks to indicate exactly where these funds were coming from. A lot of money transferred from the all savers certificate was put into very short-term instruments in order to be switched into the MMDA account at some later date as were funds from other money market instruments. Some of these funds apparently went into the overnight repo market, some were simply deposited into savings accounts, and some went into demand deposit accounts. In addition, funds being transferred from one institution to another may have gone through the demand deposit account of either the receiving institution or of another local institution that perhaps did not offer the MMDA, therefore further clouding the issue.

Conclusions

The MMDA and Super NOW are not standardized animals. They vary in terms of their rates, their penalties, their structure among institutions

Table 3. Summary Table. Selected Characteristics of the MMDA and Super NOW

	Bank		S & L	
	MMDA	Super NOW	MMDA	Super NOW
1. Percent of Firms using				
Flat Rate Interest	90%	91%	95%	98%
Tiered Rate Interest	10	9	5	2
2. Flat Rate Interest				
Average	8.158	7.163	8.143	7.363
Range	6.0 - 9.25	6.0 - 8.75	7.5 - 9.5	6.0 - 8.5
3. Fees for checking				
None	67%	46%	91%	78%
Flat Fee	0	29	2	4
By Balance of Account	1	9	0	4
By Number of Checks Written	33	16	7	14
4. Rates				
Reviewed: Daily	7%	8%	10%	10%
Weekly	76	74	71	74
Monthly	10	11	14	12
No specified time	6	7	5	4
Guarantee: None	13%	13%	24%	26%
1 Day	10	11	14	12
1 Week	67	67	49	52
1 Month	10	9	14	10
5. Monthly Fees				
None	85%	57%	86%	74%
Flat Fee	7	27	3	4
Tiered Fee	7	17	10	22
6. Range of Monthly Fees				
Flat	\$5.00 - 10.00	\$1.00 - 10.00	\$1.00 - 4.00	\$3.00 - 5.00
Tiered	\$3.00 - 10.00	\$2.00 - 10.00	\$3.00 - 10.00	\$1.00 - 10.00

and across institutional lines. Both the MMDA accounts and the Super NOW accounts showed substantial rate differentials, both among institutions offering these accounts and between types of institutions offering the account. Service charges and penalties also varied greatly. While a good percentage of the funds that flowed into MMDA accounts and the Super NOW accounts obviously came from money market funds, a larger percent came from other accounts within the bank or within the institution. To the extent the funds flowing into MMDAs and Super NOWs are coming from core deposits, the bank's cost of funds is driven up. But to the extent the funds are coming out of large CDs and money market certificates the bank's cost of funds may be declining. On the MMDAs and the

Super NOWs banks do not enjoy the Regulation Q subsidy associated with other types of deposit accounts. They are able to compete effectively, however, against the money market mutual funds.

It appears that the banks not only offer an MMDA that is competitive with the money market mutual funds as directed by the Garn-St Germain legislation, but these accounts also are perhaps in some way more attractive than the money funds accounts, as they are held locally and they provide insurance to the account holder. The lack of consumer response to the Super NOW account likely is the result of first, the MMDA coming on stream just slightly ahead of the authorization for Super NOWs, and second, the fact that evidently most people who

are investing in MMDAs are looking at the instrument as an investment, not as a transaction account. This can also be gleaned from the fact that the average account balance in the MMDAs runs somewhere in the order of \$23,000 at commercial banks.

Unless the minimum balance requirement on the Super NOW is lowered or some other feature of the account is changed to make it more attractive to the consumer, it will probably not match the popularity of the MMDA. The

MMDAs probably will continue to experience warm consumer acceptance. Our survey suggests that the Super NOW as currently structured may be a redundant account allowing only the advantage of unlimited checking privileges while returning approximately 1 to 1.5 percent less to the deposit holder. The advantage of unlimited checking is clearly outweighed for most depositors by the cost to the deposit holder.

—David D. Whitehead

Interstate Banking Is Prohibited. . . Or Is It?

The first composite picture of the extent to which U.S. and foreign banking organizations are providing interstate financial services is now available from the Federal Reserve Bank of Atlanta.

This special report, compiled with the cooperation of the 11 other Federal Reserve Banks, is an expanded version on an article in the May issue of this **Review**. It shows that in late 1982 banking organizations already controlled more than 7,500 interstate offices providing a wide range of financial services.

The 130 page inventory includes names of parent institutions, names of their interstate subsidiaries, the states in which these subsidiaries are located, and the number of offices of each subsidiary on a state-by-state basis as of late 1982.

Interstate Banking: Taking Inventory

—David D. Whitehead

—130 pp.

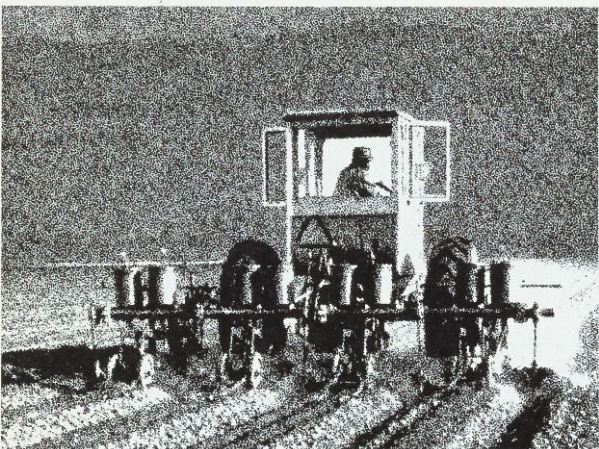
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The PIK Program's Mixed Effects

The Payment-in-Kind (PIK) program is part of a package of programs intended to help farmers battered by drought and low income. Farmers have embraced the programs wholeheartedly, but many farm-related businesses are concerned about weakening demand for chemicals, fertilizers, fuel, equipment, and labor.

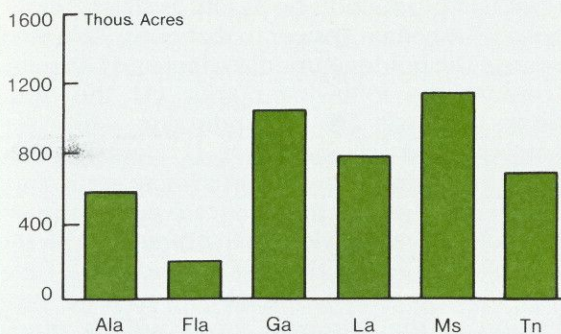


Responding enthusiastically to expanded government farm programs, southeastern farmers intend to reduce acreage sharply for certain farm commodities. As a result, production of corn, wheat, sorghum, rice, and cotton in the Sixth Federal Reserve District in 1983 will be much below last year. The impact seems certain to affect virtually every part of the District's economy.

Southeastern farmers, like their counterparts across the country, already appear to be benefiting from the 1983 programs that have brought hope to an agricultural economy battered by years of drought and substandard incomes. But if the expanded programs have introduced a measure of optimism for farmers, they have brought concern to farm-related businesses and workers whose livelihood depends on the acreage planted and harvested each season.

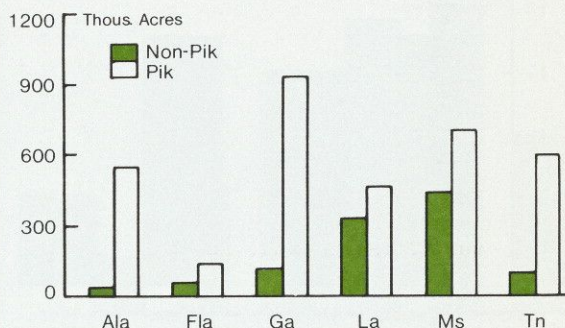
For farm suppliers, the cutback means a drop in farmers' purchases. Spending on fertilizer, fuel and farm chemicals will fall 10-20 percent in 1983. The number of farm workers needed also will shrink as many acres are idled. A sharp drawdown of crops in storage will occur, and southeastern livestock and poultry farmers may find feed prices significantly higher by 1984 should yields be below average this season.

**Chart 1. Total Acres Idled by Farm Programs
Sixth District 1983**



Source: Agricultural Stabilization and Conservation Service
United States Department of Agriculture

**Chart 2. Acres Out of Production
Sixth District 1983**



Source: Agricultural Stabilization and Conservation Service
United States Department of Agriculture

The Farm Programs

In an attempt to reduce burgeoning stocks of various farm commodities and to improve farm income, the Department of Agriculture this year is offering a diversified package composed of the familiar reduced acreage (RAP) and paid land diversion (PLD) programs, and the new payment-in-kind program, or PIK, offered for the first time.

While there are differences in how the programs treat individual crops, the general framework is similar. A certain portion of a farmer's acreage, usually 10 or 15 percent, may be left idle under the acreage reduction program, while an additional 5 or 10 percent can be diverted for cash under the paid land diversion program. By participating in the acreage reduction program, the farmer becomes eligible, among other things, to borrow from the Commodity Credit Corporation (CCC) and to participate in the PIK program. Under the PIK program, the farmer can follow two paths. He can opt to reduce his acreage by an additional 10-30 percent, or bid to remove his entire acreage from production. In return for reducing acreage, the farmer receives in payment a quantity of the pertinent commodity, on a proportional basis. Wheat farmers, for example, will receive 95 percent of their established yield, while feed grain, cotton, and rice farmers receive 80 percent of their yield. These crops will be supplied from CCC stocks.

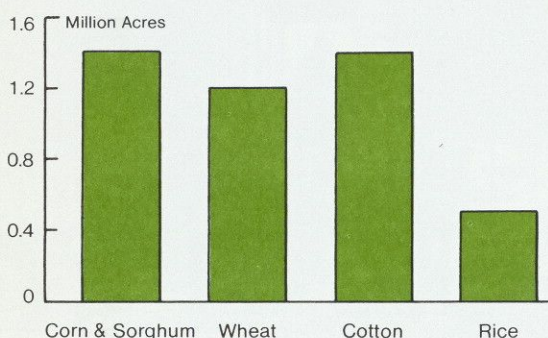
Because farm financial conditions are poor and commodity prices weak, participation in these various programs has been phenomenal. The

acreage reduction varies considerably by state (see Chart 1), but for the District approximately 4.4 million acres will be shifted out of crop production in 1983. This represents 37 percent of the acreage planted in these crops in 1982 and 16 percent of the acreage devoted to all major crops in the District.

The PIK program has drawn a strong response from southeastern farmers this year, which may be the only time the full program is offered. Chart 2 shows the acreage held out under the PIK and non-PIK programs. It clearly indicates that in Alabama, Georgia, and Tennessee farmers intend to idle considerable acreage in return for commodity payments. The difference in response to PIK and non-PIK programs has not been as great in Louisiana and Mississippi, where cotton and rice farmers have participated actively in non-PIK programs.

In the entire District, cotton acreage experienced the heaviest enrollment, 1.4 million acres, with corn and sorghum close behind at 1.3 million (Chart 3). A closer examination by crop and state reveals that the largest single enrollment was cotton in Mississippi, where 630,000 acres were signed up. Corn and grain sorghum (which USDA counts together) will be reduced the most in Georgia, with over a half million acres in PIK and non-PIK programs. There is some room for slippage in the non-PIK program because farmers might decide to plant acreage they originally had intended to idle. For leaving the reduced acreage program, a farmer must repay any advance deficiency or diversion payment plus interest and a

**Chart 3. Idled Acreage By Crop
Sixth District 1983**



Source: Agricultural Stabilization and Conservation Service
United States Department of Agriculture

small interest penalty. Leaving the PIK program, however, results in a much costlier penalty. For each PIK bushel or unit the farmer would have received, he must pay a penalty at the following rates: corn, \$.572; sorghum \$.544; rice \$.228; cotton \$.152; and wheat \$.86. The cash penalty for withdrawing from PIK is steep enough that farmers are unlikely to pull out after signing up.

The Impact on Production

Since no one will know for certain how much of what crop farmers will plant until they actually do so, production estimates can only be approximate. It is safe to say, however, that production of commodities involved in the farm program will be sharply lower than in 1982. The substantial acreage reduction farmers are locked into will ensure a production decline.

Given the intended acreage reduction and its myriad effects, it is important to estimate crop production this season. Fortunately, the USDA conducted a special May survey of planting intentions that should provide an acceptable approximation. The survey, combined with average yields, suggests sharp declines in most crops covered by the program. In the District, production of corn may decline 34 percent from 1982 assuming average yields; wheat may decline 30 percent, cotton 49 percent, and rice 32 percent. Grain sorghum, on the other hand, may decline only 2 percent from last year. Obviously, if yields are below average, then production will fall even further. Heavy rain during March and April delayed

corn planting for many southeastern farmers. It is possible that corn yields will be affected adversely with some farmers perhaps deciding to plant other crops.

But will production be as low as these figures indicate? A certain answer to that question would provide the holder immediate fame and fortune. Consider the following points: (1) the most fertile land will be in production while the marginal land will be idled, (2) farmers may fertilize and tend their planted acreage better, (3) the result of the previous two points should be a higher average yield than normal unless, (4) the weather adversely affects yield. Given the large acreage which is not being planted, production of the pertinent crops will be much lower than in 1982. The point to remember is that the acreage in PIK will not be planted in 1983 and it is this which impacts on all farm suppliers and hence the entire District economy. Final production figures will affect farm income, consumers, and users of farm commodities such as textile mills.

Farm Revenue

The combined revenue from estimated harvests and the PIK payments should cause net farm income to climb in the District. The average price in 1983 for most commodities is likely to exceed that of 1982, when farm products faced weak demand and a large surplus. What's more, total farm costs will be much lower as PIK payments reduce the overall per unit cost for a given commodity. In other words, if a farmer produces 50,000 bushels of corn at a cost of \$2 a bushel, his total cost will be \$100,000. If the farmer receives a PIK payment of an additional 10,000 bushels, to sell or store, it will reduce his per unit cost by 33 cents per bushel. Thus, his break-even cost will be lowered. This is offset somewhat, of course, by the cost of planting a cover crop on conservation acreage. The fact remains, however, that the break-even point declines even as greater price strength may occur. The profit per bushel therefore, should, rise in 1983. With a reduction in total costs, farmers' net revenue should climb.

Revenue of southern corn farmers may be especially good if yields are favorable. Corn harvest begins in July in many areas while corn farther north is harvested later. Since PIK corn payments for most southern states won't be made until October, there is at least a month or two when corn prices may be higher than average.

An older element in the government's farm programs is the paid land diversion program that, in essence, compensates farmers for idling a portion of their land. Only farmers who grow corn, sorghum, wheat, or rice may participate. In the Sixth District, a total of 218,481 acres will be shifted this year from growing the aforementioned crops into conservation.

District farmers who participated in the paid land diversion program this year have already received as much as half their diversion payments if they requested an advance. If the pattern of the past is followed, wheat growers will receive the remaining amount in December, with feed grain farmers' payments stretching into next spring. While such payments represent only a fraction of the District's farm income, their timeliness may prove invaluable to cash-starved farmers. Although the amount varies considerably by state (see Chart 4), farmers in the District as a whole will receive approximately \$22 million in 1983.

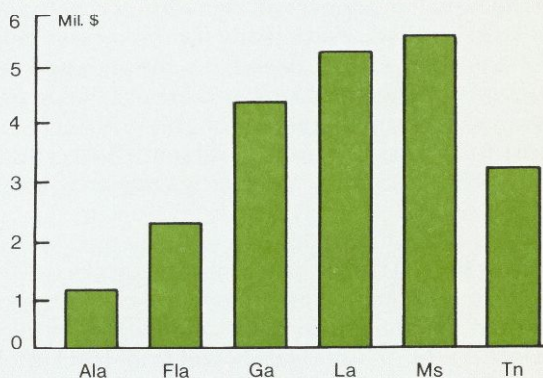
Another portion of the farm program also generates cash for farmers. Deficiency payments are made to enrolled farmers on their crop production if commodity prices fall below an established, or target, price. At present, there is no way to forecast accurately the amount of deficiency payments to be made in 1983.

Farm Suppliers

The farm programs clearly will affect farmers positively, but what about the multitude of businesses that supply farm inputs, transport or store farm commodities, or utilize farm production in their industry? District farmers, for instance, spend over \$1 billion annually on fertilizer and lime. Billions of additional dollars are spent on chemicals, seeds, and other supplies.

With sharp declines in planted acreage, farm suppliers can expect significantly weaker demand for many of their products during 1983. Chemicals, fertilizer, and fuel needs will be well below preceding years. Spending on farm chemicals for major southeastern crops appears likely to fall 15-20 percent during 1983. The sharpest decline so far seems to be in chemicals for cotton, reflecting the significant amount of idled acreage this growing season. Insecticide suppliers probably will bear the brunt of lowered sales. Because peanut growers anticipate a small increase in planting, chemical sales for that crop may increase

Chart 4. Estimated Diversion Payments
Sixth District 1983



Source: Federal Reserve Bank of Atlanta

slightly. Unfortunately for chemical dealers in Georgia, substantial corn acreage is being idled this year. Since corn accounts for substantial herbicide use, demand for those chemicals will decline sharply. Yet some herbicides will be used on conservation acreage.

Demand for fuel by the farm sector will decline an estimated 15 percent in 1983 because less fuel will be needed for tractors, combines, and other farm equipment. In addition, drying of grain will require less fuel than in 1982. Subsequently, sellers of fuels used by farmers can expect lower volume. The primary impact would appear to fall on diesel fuel, used in most farm equipment.

With the weak demand, combined with lower prices, many farmers will find themselves paying out less for fuel than at any time in recent years. Farmers who grow crops affected by farm programs are expected to lower their total fuel costs by as much as 30 percent this growing season.

Farm Equipment and Labor

While not as immediately evident as the reduction in some inputs, farmers' savings on labor and in the wear and tear on equipment should be substantial. Estimates indicate that 16 million fewer hours of labor will be needed for major crops this year. While planting of cover crops on conservation acreage will offset this somewhat, labor requirements may still fall 10-15 percent. Since most of this labor involves machinery, the reduced usage will cut maintenance costs and

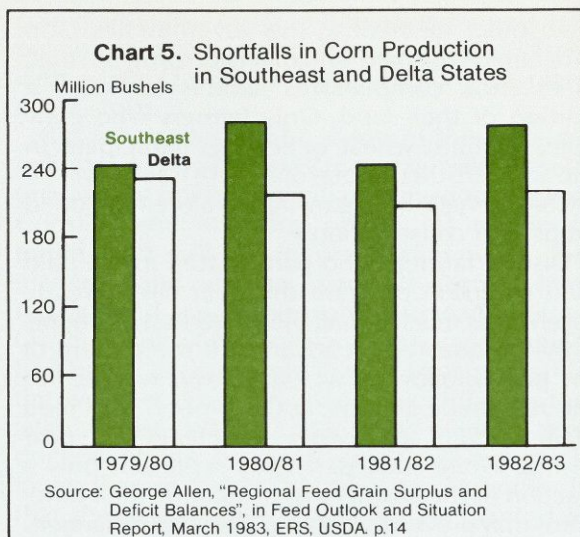
lengthen the life of the equipment. This is especially true for grain combines and cotton harvesters.

The negative aspect will be a reduced demand for farm workers, particularly for those who help in harvesting crops. Based on the acreage reductions in specific crops and other factors, the demand for farm workers probably will decrease most in Mississippi and Louisiana. Those states grow proportionately more crops requiring extra farm workers.

Farm equipment dealers who have survived the last two years largely on repair work may find 1983 to be harsh. With a likely fall-off in equipment repair and little sign of increasing sales before 1984, many dealers will find 1983 their worst year before improvement begins in 1984. Some good news, however, is likely for dealers this year. With the prospect of improving income, farmers will be better able to make payments on purchased equipment. In addition, as the farm economy slowly rebounds, less equipment should be returned to dealers.

Fertilizer

One of the major farm inputs, fertilizer, will be in considerably less demand in 1983 across the South. Farm suppliers and fertilizer manufacturers, of course, will be hit hardest by the slowdown. Under PIK, major crops will require an estimated 50,000 fewer tons (16 percent) of fertilizer this year than in 1982. Georgia and Mississippi farm suppliers will be affected most adversely, as their



states have the largest enrolled acreage. Dealers in cotton-growing areas also will be affected since a large portion of the District's cotton acreage will be idled this season. The large reduction in corn and sorghum acreage will have an inordinate effect on nitrogen demand because their production requires substantial quantities of nitrogen. Given that marginal acreage is the most likely to be withdrawn from production and that marginal acreage requires higher-than-normal fertilization, then a disproportionately large drop in fertilizer seems likely.

One significant aspect of the present farm program seldom mentioned is the reduction in soil erosion as acreage is idled. The more than four million acres being devoted to conservation usage will sharply lower erosion in 1983. It has been estimated that, on average, five tons of soil are lost per acre of row crops each year in the South.¹ If this is accurate, then the idling of four million acres of cropland will save 10-20 million tons of soil in 1983. Actually, the amount may be even higher because marginal land is the first taken out of production by farmers, and this land is most susceptible to erosion. Consider for example Class IV land, which is considered "fair" land. In the Southeast it is estimated to lose 8 tons of soil per acre and in the Delta region 10 tons per acre from sheet and rill erosion when cultivated. Future years should see increased



¹Basic Statistics, the 1977 National Resources Inventory, Soil Conservation Service, USDA, p. 161.

Table 1. Enrolled Acreage

	RAP	Paid Diversion	PIK (10-30)	PIK Whole Farm
ALA	24,760	11,199	352,996	192,778
FLA	28,419	29,123	60,968	74,106
GA	71,563	44,171	662,528	268,593
LA	275,164	51,124	396,423	63,288
MS	381,681	54,969	568,501	131,635
TN	69,996	27,895	252,456	344,006
TOTAL	851,583	218,481	2,293,872	1,074,406

profitability from higher yields on the land now being conserved.

Southern livestock and poultry producers may feel as much impact from the PIK program as do farm suppliers. The South is traditionally a grain deficit region, consuming more grain than it produces. Chart 5 shows USDA estimates of the corn deficit of the Southeast and Delta regions. While not exactly comparable to the boundaries of the Sixth District the deficits should be a good approximation. In addition, April corn storage figures indicate a decrease since January of 33 million bushels (31 percent). While April 1983 corn storage remains 8 percent above April 1982 with 76 million bushels, feed usage has been occurring at a rapid rate.

Potential problems for those feeding corn or other feed grains exist in a number of areas. Feed grain prices strengthened during the spring months placing the egg industry in a serious cost-price squeeze. By July corn stocks will be low, production will be below normal, and PIK payments for all southern states except Florida and Louisiana will not be made until October. Supplies during July and August, therefore, should be substantially below normal in the South.

In the longer term, the sharp cutback in corn production in the South (already a grain importing region) will mean: (1) lower stocks going into 1984, (2) a need for larger corn shipments from the Midwest, and (3) higher prices for corn in the South.

The precise impact of these cutbacks is most difficult to assess. Evidence suggests that the grain deficit in the South will be wider this

year because of curtailed planting. For instance, we can estimate corn production for the Sixth District in 1983 at approximately 136 million bushels compared to 1982's production of 165 million. This would mean that a large amount of grain must be shipped from other regions, resulting in higher prices for feed. If yields are low, the impact will be that much more severe. Higher feed prices might halt the expansion in the District's hog industry. Higher prices also would affect the poultry industry, since profit margins have been lackluster for some time.

Farm Credit

With participating farmers' expenses declining, the demand for farm credit has weakened. Lower interest rates in 1983 have failed to offset the fall off in farm credit demand. Limited information available from the Farm Credit System indicates a distinct drop in the number and amount of farm loans throughout the South. District offices of Federal Land Banks reported that the number of loans closed in March in the South declined 48 percent from the previous year. Production Credit Associations also noted a 22 percent drop from March 1982 in the amount of loans made.

What impact will PIK have on financially-distressed farmers? The most immediate effect will be the guarantee to the enrolled farmer of a partial, or whole, crop in 1983. Over one million acres of land were signed up in the "whole PIK" program, which means a substantial number of farms will be completely out of



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farming for this season. For these farmers there is no crop production risk, since their PIK payment will be their 1983 "production." They will have no costly inputs to buy and the only risk they bear is "price uncertainty" which, by various marketing techniques, can also be disposed of. The certainty of income for these farmers should increase the willingness of creditors to stand by them.

Even those farmers who are producing a partial crop this year can use their PIK entitlements in many instances to purchase needed inputs or even as collateral for a loan. The certainty of the PIK payment, with the issuance of certificates, is essentially equivalent to being paid in advance. In addition, many farmers were eligible under the RAP and PLD for advance payments of up to half their diversion and deficiency payments. For some farmers, this cash may have provided a badly needed lift.

Perhaps the greatest impact on farmers is indirect in nature. The establishment of the PIK program with the subsequent participation by farmers may have assisted in bringing to a halt the slide in value of farm assets. By helping farmers to remain in business and improving morale in the farm community, the farm program possibly supplied the impetus to keep the farm economy from suffering even worse. For some farmers a halt in their deteriorating equity position may be the biggest plus of all for the farm programs.

Next Year?

What about next year? Will PIK be extended to cover 1984? Secretary Block stated in May that he was 90 percent certain a wheat PIK program would exist in 1984. In fact, it is anticipated that the wheat program will be announced quite soon. There is more likelihood, on the other hand, that no program will exist for cotton or rice. The stocks of these two commodities are expected to be in a more acceptable position by 1984. For corn and grain sorghum, the possibility of a PIK program is directly dependent on the outcome of this season. If yields are below average, then stocks might be depleted to such a point that a PIK program would not be needed next year. If average or above-average yields prevail over most of the nation, then stocks are expected to remain in excess of that desired. A



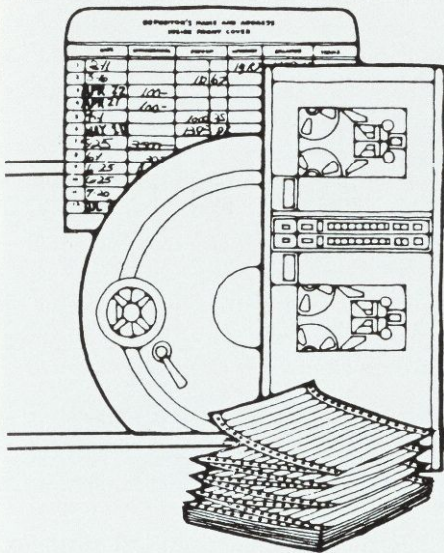
limited PIK program might then be in order. Such a limited program would be more agreeable to farm suppliers and agribusinesses.

Conclusion

The central purpose of the nation's expanded programs appears to have been fulfilled. Commodity prices have strengthened and net farm income projections have increased. The farm economy seems to be on the road back to financial health.

Yet the 1983 farm program's acreage reductions represent bad news for some businesses and workers in the Southeast. The most immediate impact will fall on suppliers of farm inputs such as fertilizer and chemicals. The precise effect will vary from one state to another depending on the number of enrolled acres and the pertinent crops. Another effect should be a continued lessening of demand for farm credit. Although figures are not yet available on spring lending activity, earlier indications suggested that credit demand had slackened. The acreage reduction will set off vibrations throughout various sectors of the economy, and a few areas have already felt some impact.

—W. Gene Wilson



Correspondent Banking And the Payments System

The correspondent banking industry is composed of banking institutions that provide services to other banks, in return for fees or deposit balances. Although the high visibility of the largest money center banks often conveys the impression that correspondent banks are the largest banks, the correspondent industry is composed of banks of many sizes. The data in Table 1 from the latest American Bankers Association survey illustrate that correspondent banks act as financial intermediaries at virtually all levels of the banking industry.

The services correspondent banks sell to their respondents are diverse, including every function which a larger, versatile banking company is capable of producing, and which smaller banks with much lower overhead cannot provide in-house. In one sense, the correspondent function is the larger bank's marketing arm aimed at financial institutions as the client base.

The most prominent correspondent services are check collection, wire transfer of funds, loan participations, buying and selling "fed funds" (short term loans between banks), and trading in government securities. Less uniformly provided, but still significant, are electronic data processing (EDP) services.

Correspondent services are critical, directly and indirectly, to the functioning of the nation's payments system. We will define the payments system to be the total set of institutions and procedures which act to transfer economic value. Efficient operation of the payments system produces benefits to many economic sectors and levels of society: households, businesses, financial institutions, and governmental bodies. The payment of value for goods or services purchased is executed in many different ways; in all cases, the payee benefits from prompt transfer.

Four important correspondent services that influence the system are shown in Table 2.

In the near future, correspondent banking will see fewer providers of services. Yet increased investment and price competition should increase efficiency in the nation's payments system.

Thus, correspondent banks play an integral role in the payments system, both directly (by presenting documents for payment and acting as an intermediate settlement agent) and indirectly (by providing liquidity to other financial institutions which execute customers' payments).¹ Because the U. S. banking system is composed of over 14,000 banks of vastly different sizes and scopes of service, the need for the correspondent function arises from geographic distance, market imperfections, economies of scale, limited knowledge and resources on the part of smaller institutions, and tradition.

Prior to 1980, the Federal Reserve System functioned at the "high end" of the correspondent bank size hierarchy. Fed members, often the largest banks, utilized Fed services at no fee (if the implicit fee represented by reserve requirements is not considered), and passed on these services, priced, to their customers, the smaller banks. With the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), however, this world changed. With the direct pricing of Federal Reserve services, the largest correspondent banks had a new competitor—the Fed itself—and the Fed had new customers—the smaller institutions that previously had been primarily customers of the large banks.

After an initial drop in service volume, the Fed has shown a keen competitive instinct; most correspondent banks, faced with newly modified Fed services (including a streamlined inter-district transportation network) feel a sharp competitive pinch. This drastic change in the competitive environment has produced several strong responses within the correspondent industry: sharp protests in the political arena and agonizing reappraisal of the correspondent function as a line of business by senior management in many institutions.

The problem as perceived by the banks is primarily evidenced by a squeeze on profits in correspondent banking. Previously, demand deposit balances more than adequately covered the costs of services provided; in fact, the existence of surplus balances led many observers to believe that the correspondent division was among the bank's most profitable. Now, however, as many as one-half of the banks responding to the ABA survey say that profits are flat or declining.

Table 1. Size Distribution of Correspondent Banks¹

Deposit Size	Percent of Banks
Less than \$250 million	11
251-500 million	22
501-1 billion	22
1-2 billion	16
2-5 billion	20
More than 5 billion	9
	100%

¹Shown are banks responding to the 1982-3 American Banker Association survey of correspondent banks believed to be representative of the correspondent banking industry.

On close examination, the sudden drop in profits in correspondent banking is due not only to direct competition by the Fed, but to several related and unrelated trends. Related directly to the DIDMCA is the rapid growth in clearing houses and broader clearing arrangements among banks. Unrelated but having the same adverse impact on correspondent service volume has been the continued growth of multibank holding companies, which internalize service provision, further concentrating the market for services to financial institutions.

Yet another factor is that the technology of the payments system is changing rapidly, and will continue to do so. The primary means of transfer of value by households is the paper check. Prior to the 1980s, there was no effective substitute for paper checks in the household market. With the advent and rapid acceptance of ATMs, however, this is changing. The latest knowledgeable projections² indicate a decline in paper check volume beginning no later than 1984, with various substitute technologies such as cash dispensers, credit cards (and perhaps, eventually home videotex devices) becoming increasingly dominant. This evolution begs the question of how the correspondent banking industry will manage its own evolution of service provision, away from check collection as the dominant

¹Final settlement is accomplished by the Federal Reserve System.

²Paul F. Metzker, Charles Haywood, and William N. Cox, "Displacing the

Personal Check: A Three-Phase Framework for Analysis and Projection," to be published in the August 1983 issue of this **Review**.

Table 2. Influences upon the Payments System by Correspondent Services

Correspondent Service	Nature of Influence	Method of Influence
Check Collection	Direct	Effects payment of obligations by presenting physical evident of obligation to pay to the payor's financial institution
Wire Transfer of Funds		Speeds payment
Loans to Banks and/or Overlines	Indirect	Provides liquidity to financial intermediaries enhancing transfer of funds from surplus to deficit regions
Trading in Fed Funds for Respondents	Indirect	Short-term source of liquidity to financial institutions
Trading in Government Securities	Indirect	Broadens and improves market for financial assets

service, and toward something else. What will the "something else" be?

From the statements being made and actions being taken by correspondent banks, it is apparent that the face of the correspondent banking industry is changing for good. There will almost certainly be fewer service providers in the future. It also seems likely that larger institutions will prevail, and that scale economies in service provision will prevail.³ As we look forward to increased concentration in the correspondent banking industry, is it possible to anticipate what effect will be felt on the payments system? Within this single broad question, several subsidiary questions arise:

1. What is the likely structure of the correspondent industry five years hence?
2. If industry structure changes significantly, how will the payments system be affected?
3. Will these changes yield a net positive or negative benefit to society?

Likely Changes to Correspondent Industry Structure

It is highly probable that the largest institutions in geographic markets will gain market share and influence, while smaller ones will become less important factors in providing correspondent services. Figure 1 depicts how large and small correspondent banks rank the importance and the profitability of different services.⁴ This display demonstrates that importance varies in the expected direction with profitability—the more profitable, the more important. The services shown can be grouped into two classes: those more important and profitable to larger banks (check collection, safekeeping, and EDP services) and those important and profitable to smaller correspondent banks (fed funds, securities buying and selling). Loans and loan participations appear to be roughly equally important in large and small banks, probably reflecting relatively efficient credit markets.

These perceptions by large and small banks suggest that some services have a "commodity" quality—they are price-sensitive (and therefore sensitive to cost/volume economies). The desirability of these services as a business line to the service provider cannot be enhanced by the quality of bank-to-bank collection, and EDP services will increasingly be the domain of larger banks that can compete based on price.

On the other hand, there are services in which size of provider does not seem to make a difference, and where in fact, smaller providers may be more profitable than larger ones. These "relationship" services will continue to be provided at all levels of the banking hierarchy.

When we combine these perceptions with bankers' assessments on the nature of competition in their markets (Table 3), a pattern emerges that may shed light on the future shape of the industry. Banks that are the largest correspondents

³Scale economies in correspondent banking are hotly disputed. See the November 1982 Atlanta Fed **Economic Review** and a Federal Reserve Board staff paper by David B. Humphrey, **Costs, Scale Economies,**

Competition, and Product Mix in the U.S. Payments Mechanism, Board of Governors, Federal Reserve System, 1980.

⁴"Large" is defined by relative size of correspondent volume in the primary market for each bank.

Table 3. Competitive Factors Reported By Correspondent Banks

	Who Is Your Most Important Competitor?	Why Did You Gain Customers?	Why Did You Lose Customers?	What Impact Has Fed Had?	More Or Less Profitable?
Largest Correspondent In Market	Federal Reserve	Credit, calling, reputation	Price	Hurt Profits	Same or less
Other Correspondent Banks	Large Bank	Calling	Price	Hurt Profits	More

Source: Based on the 1982 national survey of U.S. correspondent banks by the ABA's correspondent banking division. See the **ABA Banking Journal**, March 1983, pp. 43-46 for additional survey data.

in their own markets believe the Fed is the most important competitor, while others in the market point more often to the largest bank. Virtually all banks feel they have lost business based on price, while business gained is attributed to other factors; no significant difference is seen across different size banks. All banks believe the Fed has hurt correspondent banking profitability; however, the largest banks, to a greater extent than the others, believe their departments are declining in profitability.

What is apparently happening in many markets is that the largest correspondent bank, competing head-to-head with the Fed for business it perceives to be important, is remaining in services that are not now profitable, but not raising prices to redress the profitability problem. Some smaller correspondent banks are raising prices, in contrast. There is also evidence that smaller correspondents have reduced or are thinking of reducing emphasis on services that do not appear to be profitable. These are usually the "commodity" services mentioned earlier—particularly EDP and check collection.

Why should size of correspondent business make a difference in these business decisions? The answer lies in some combination of scale economies, existing processing capacity, and strategic commitment to correspondent networks. One difficulty in identifying economies of scale is that the correspondent services defined earlier as "commodity" services involve very

lumpy capital investment decisions. If a bank is the market leader and calculates that the business is presently unprofitable, it may nevertheless choose to remain in the business without increasing price on the assumption that smaller competitors will drop out, and that having a multiplicity of service relationships with many banks in its region has strategic importance. Obviously, a larger bank is better able to undergo such a period of marginal profitability than a smaller one.⁵

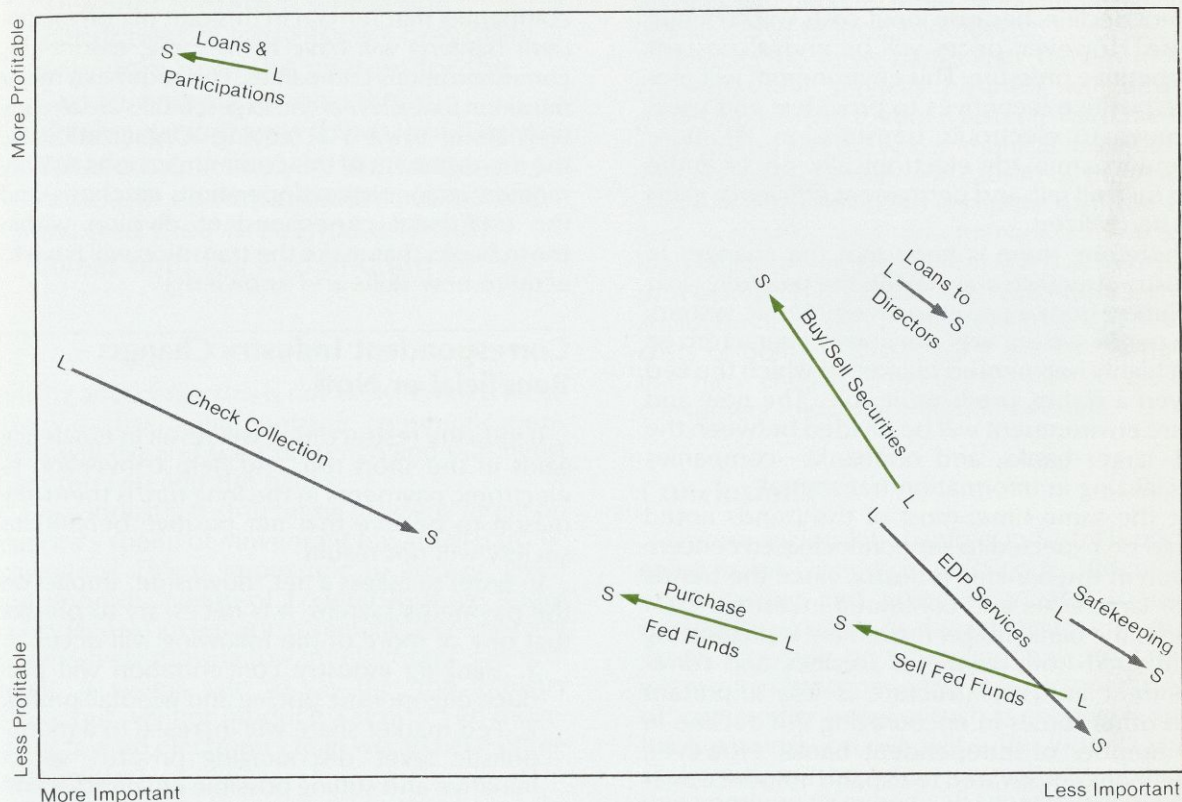
Non-bank providers and major out-of-region bank providers are gaining volume in many markets because of a mix of quality, economic, and competitive factors. Some smaller banks—users of correspondent services—have experienced a simultaneous increase in cost of service, reduction in quality (from those providers who have not been able to upgrade service) and competition from the regional correspondents in wholesale and retail (nonfinancial institutions) markets. This is leading many users to purchase commodity services from other sources that can provide high quality services efficiently, and that are not threatening as competitors. Smaller banks may group together, using "bankers' banks" to provide the service or buy them from third parties.

As consumer acceptance of substitutes for paper checks grows, smaller institutions are needing more assistance in providing ATM and credit card services (and perhaps in a later phase, videotex services). This is producing a slow but

⁵A major issue with the larger banks, therefore, is whether the Federal Reserve (the volume leader in most markets) is playing fair when it allows Reserve banks in some districts to price below total cost (including a cost

factor used to "adjust" the Fed to private sector equivalent cost of capital and tax burden).

Figure 1
Importance and Profitability of Eight Correspondent Services
(As viewed by Larger "L" and Smaller "S" Competitors)



Arrows point from the consensus of larger competitors to the consensus of smaller competitors
Gray=Comparative advantage for larger competitors Green =Comparative advantage for smaller competitors

systematic shift to "high-tech" correspondent services, including sponsorship of shared ATM networks or off-line processing of ATM transactions. Because of the investment required in equipment, software, and skills, the larger correspondent banks will find this business evolution more feasible than the smaller.

These trends should continue and strengthen, resulting in a market shake-out: fewer major bank competitors for most correspondent services. Since commodity services like check collection and EDP are the most vulnerable to efficiency gains, we will see nonbanks enter these fields as well. Banks that have volumes large enough and that are superior in computer processing will remain in the commodity lines of business, while those with smaller business bases and/or that are not demonstrably superior processors will inevitably drop out or accept market share losses.

Effect on the Payments System

Since correspondent banks presently play an important role in the payments system, and since the structure of the correspondent industry is changing toward more concentration, it is reasonable to expect these changes to have some effect on the payments system itself. What changes are likely?

The initial effect is likely to be an increase in payments efficiency. Providers of payments services are forced to upgrade quality and volume, or withdraw. If network relationships with other financial institutions are strategically important to a bank in the long run, the bank will make the investment required to yield stable profits in the new competitive environment. The new investments will improve service. (Over the last decade, growth in cash management services to business

has already increased payments efficiency in the business sector.)

In the short-run, prices for payments services will not decline, because input costs will continue to rise. However, prices will be under constant competitive pressure. This environment will produce positive incentives to providers and users to move to electronic transmission. As more payments are made electronically, prices in the long run will fall, and permanent efficiency gains can be realized.

Therefore, there is hope that the changes in industry structure may hasten the painfully slow evolution from a paper to an electronic system. The paper system was previously characterized by a highly fragmented market, in which the Fed played a stable, predictable role. The new and future environment will be divided between the Fed, larger banks, and nonbanks—companies specializing in information transmittal.

At the same time, most of the trends noted would be expected to support increased concentration in the banking industry, since the trends favor large scale and continued investment. Of course, the bank merger movement is progressing quite apart from payments services, and correspondent industry structure is less important than other forces in encouraging the decline in the number of independent banks. However, larger banks motivated to expand influence over larger areas and into many regions will be the same banks that have the capacity to provide a continued broad range of correspondent services to banks in many regions. Growth in the capacity to do correspondent processing is consistent with the capacity growth required to operationally link acquired institutions.

Bank earnings are likely to continue to decline as a result of this structural change. Smaller correspondents that substantially reduce their presence may be able to show expense reductions that produce net earnings gains. However, most providers will be under such heavy price and investment pressures that earnings from correspondent activities may not ever recover to past levels. Increased concentration will not produce windfall profits in the foreseeable future, as economic theory might predict; this outcome results from strong market pressure from the Fed and increasingly from nonbanks, and from geographic expansion by the larger banks, which brings new competition into regional markets.

The essence of what is occurring is that the payments services component of correspondent

banking—the provision of “commodity” type services—is rapidly changing from a “banking” business to an “information” business. The banking companies that remain in this part of correspondent banking will have to become, essentially, communications companies. This requires a major transition that a few of the largest banks are already well along toward achieving. Organizationally, the management of this communications activity requires major systems/operations emphasis, and the traditional correspondent division within those banks that make the transition will have to acquire new skills and knowledge.

Correspondent Industry Change: Beneficial or Not?

If industry restructuring will result in efficiency gains in the short run, and help conversion to electronic payments in the long run, is there any reason to believe that net positive benefits to society will not result?

In order to assess a net “downside” impact on the payments system, it is necessary to predict that one or more of the following will occur:

1. Banking industry concentration will produce oligopolistic pricing and windfall profits.
2. Fed market share will increase to a monopolistic level, discouraging private sector initiative and stifling possible efficiency gains.
3. Net disincentives to continue systems improvements will arise from (1) and/or (2).

To consider these possibilities, we need to forecast the future position and behavior of the two major participants: the Fed and large banks. For each participant, is there reason to believe that it would either gain enough market position to enjoy monopolistic pricing power, or be discouraged from continuing improvements to payments technology?

The Federal Reserve

After an initial volume decline, the Fed has been regaining market share. With its revised inter-district transportation network and continuance of prices that are lower than most competitors, it may gain further market share. However, the market has shown itself to be very price-sensitive. A characteristic of payment services is the existence of many options for executing payment. It would require a wholesale withdrawal of large banks and other providers from the system for the Fed to enjoy a monopolistic

"It would require a wholesale withdrawal of large banks and other providers from the system for the Fed to enjoy a monopolistic pricing advantage; this is not likely. What's more likely is that large nonbank communications firms will expand their presence and out-invest both the Fed and the banks."

pricing advantage; this is not likely. What is more likely is that large nonbank communications firms will expand their presence and out-invest both the Fed and the banks.

Does industry restructuring have any effect on the Fed's speed of movement toward electronic payments? This is impossible to answer, given the unpredictability of Federal Reserve Board policy vis-a-vis investing in communications systems or decisively moving toward electronic presentment. It seems safe to say that the industry shake-out will not produce a slower Fed movement toward electronics than would have otherwise existed.

Large Banks

The natural inclination of the larger banks for the foreseeable future will be to extend their geographic presence. This will result in increased competition in all lines of business, and as technology improves, in downward pressure on prices. Monopolistic pricing power within banking markets will tend to become less and less a concern. A single large bank may become a pricing leader in a given market, by keeping prices low, supported by increased volume. However, attempts to raise prices to increase profits are unlikely to succeed, given difficulty in differentiating the commodity service being delivered, and an increasing lack of market protection based on state-based restrictions on market

entry. As the business becomes more and more communications oriented, prices for commodity services will become more nationally based, and less sensitive to local conditions.

Overall, the large banks that remain in the correspondent services business will have a positive incentive to move faster toward the use of advanced electronic communications systems. The increased commitment caused by the market share shifts, pressure to compete with the Fed and nonbanks, and determination to extend market influence will push toward systems improvement. The cost-saving motivation here is analogous to events in retail banking, where high costs of doing business have forced the banks that have chosen to remain in retail to educate consumers toward automated banking.

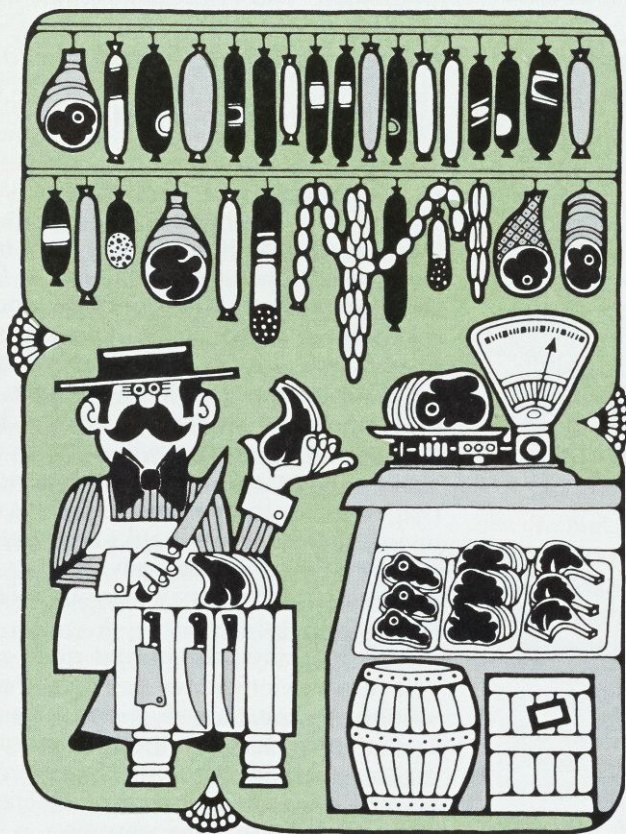
Conclusions

The correspondent banking industry is undergoing major changes in reaction to Federal Reserve pricing and competition and to other competitive trends in the financial services industry. Pressure on correspondent profitability will result in fewer providers of service, particularly of "commodity" services such as check collection. Bank earnings, on net, will suffer in this market shake-out, as the larger correspondent banks that continue to provide all services will have to invest heavily. Larger banks that wish to remain dominant in their regions and to expand in influence beyond their regions will make the required investment.

Increased investment and price competition will result in efficiency gains by the payments system. Despite a reduction in the number of service providers, competitive intensity will be greater than in the past. Incentives to move toward electronic payments will increase. Increased industry concentration is unlikely to lead to monopolistic pricing power, given the increasing importance of nonbank communications firms in the market. The result probably will be increased pressure on price.

—Peter Merrill

Southeastern Credit Unions: From Delicatessen To Supermarket?



Many larger credit unions are moving toward a more complete line of consumer services. The decision to move from "delicatessen" to "supermarket" is a difficult one, and CUs will face some large and unfamiliar competitors.

Credit unions occupy a distinctive niche in the array of retail financial institutions. Organized to serve members who share a "common bond," such as schoolteachers or employees of a particular corporation, credit unions have come to be regarded by their members as:

- (1) friendly and personal, often administered by fellow employees;
- (2) a convenient place to deposit savings at a reasonable rate of return, usually by direct deduction from pay checks; and
- (3) a source of consumer loans at inexpensive interest rates.¹

The distinctive niche has its drawbacks, however. Most credit union members, even as they praise the special advantages of CUs, do **not** regard them as "primary financial institutions." In the minds of most customers, credit unions are a **supplementary** source of financial services. In a 1982 survey of members by the Credit Union National Association (CUNA), fewer than three out of ten members described their credit unions as their "primary financial institution," while six out of ten named their banks. So, in general, credit unions have become something like a financial delicatessen—used and admired by a loyal body of customers who nevertheless turn to a supermarket for the bulk of their grocery needs.

Many managers and board members of established credit unions are dissatisfied with this

¹These are major findings of the 1982 and 1977 "National Member Surveys" conducted by the Credit Union National Association, Madison, Wisconsin.

Question: Who will be your most significant competitors between now and 1990?

	<u>Most Significant</u>	<u>Second Most Significant</u>	<u>Third Most Significant</u>
Banks	20	2	0
S&Ls	0	11	2
Money Market Funds	2	5	6
Retailers	1	2	5
Other Credit Unions	0	2	4
Finance Companies	0	0	2
Not Sure	0	1	4

situation. They are increasingly weighing the merits—and the risks—of transforming their “delicatessens” into financial supermarkets, competing head-to-head with commercial banks and other providers by offering a broader selection of financial services. In doing so, they hope to become the “primary financial institution” for the remaining seven-tenths of their members.

There are several particular reasons why many credit unions are showing “supermarket

“The distinctive niche [of credit unions] has its drawbacks, however.”

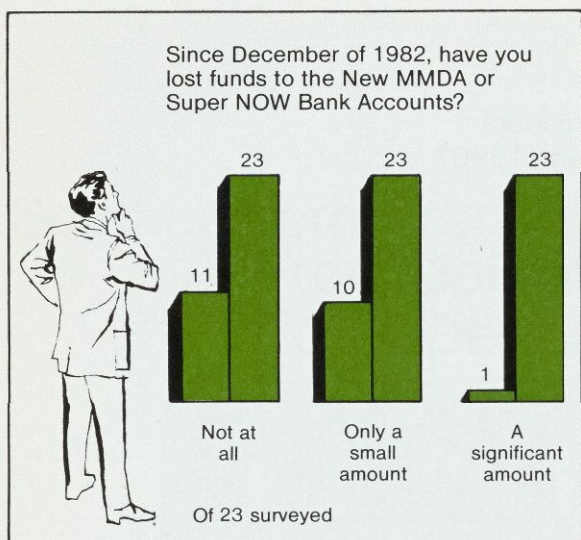
fever” today. Many managers of larger CUs feel they are close to saturation in terms of marketing traditional credit union services to a limited customer base, and therefore view expansion in the breadth of services as the only realistic way to continue growing. Most larger CUs have begun to offer share-draft (checking) accounts, since this became permissible in the Southeast in early 1981, and success with these accounts

has whetted their appetites for additional services. Also, today’s credit union manager increasingly is experienced and professional, tending to view expansion as the key to more responsibility and recognition of his or her job. Credit unions have seen their members tantalized by a growing array of financial services, such as credit cards and automatic teller machines, from a variety of new competitors including money market mutual funds and savings and loan associations. Many credit union managers feel, increasingly, that they must “run faster just to stay in the same position.” Finally, some credit union leaders are worried that they will lose the unique tax advantages they have enjoyed since the 1930s and are concerned with maintaining profits and markets if that happens.

The key question facing larger credit unions today, then, can be put in terms of a pair of alternatives:

—Should a credit union move toward a full-service orientation and become a supermarket or

—Should the credit union remain specialized, even if that means refraining from offering certain services and staying in the delicatessen business?



Survey of Larger Southeastern Credit Unions

We asked this question and others of the managers of 23 large credit unions in Georgia and Alabama in March. The occasion was a conference of these credit unions, "Directions '83," arranged by the credit union centrals of the two states. The credit unions represented were relatively typical of larger associations, except that they probably are more concerned about the future and their role in the future than their counterparts who were not present.

Two-thirds of these institutions said they are "willing to give up some of the traditional contact, if necessary, to move toward full-service orientation." One-third wanted to stay in the "delicatessen" niche.

Opinions were fairly strong on this subject. One credit union said, for example, that the best tactical move a credit union could make right now would be "to find out what services your members really want and provide them." The worst move a credit union could make, according to the same manager, would be to "act like a turtle and pull into a shell, ignoring all the change taking place." This kind of opinion characterized three-quarters of the institutions we questioned. Still, there were dissenters. One credit union said "the worst thing we could do is to jump into many new available services without proper personnel, resources, and research."

Perspective on the Credit Unions

The credit union movement offers one of the most fascinating chapters in U. S. financial history. Credit unions were promoted in the 1920s and 1930s by Edward Filene, a Boston department store magnate, as a means of offering an institutional borrowing and saving capability to blue collar workers in whom the banks showed little interest. Filene had borrowed the idea from Canada, and it also had antecedents in nineteenth century Europe. One of the key concepts associated with the credit union movement has been the "common bond" of employees either working in a particular trade or for a particular employer.

The credit union movement gained substantial impetus with the passage of the Federal Credit Union Act in 1934. As part of the New Deal banking legislation, this act made it possible for credit unions to obtain federal charters and sanctioned the substantial growth of smaller credit unions in the 1940s and 1950s. By the early 1970s, the credit union movement had achieved substantial maturity. By then there were over 20,000 credit unions and their deposits had been insured by a federal insurance program. The composition of depositors was becoming much more white collar in character, concentrated in government and the armed services, and credit union managers were becoming more and more professional.

The next big movement came in the late 1970s, when northeastern credit unions joined other thrift institutions in pushing for the negotiable order of withdrawal account, which was called the share-draft account in the case of credit unions. Under the Monetary Control Act of 1980, credit unions were allowed to offer these interest-bearing checking accounts nationwide at the beginning of 1981. In return, the larger credit unions—those with deposits over \$5 million—were required to hold reserves with the Federal Reserve System.

So share drafts essentially represented the first step by many of the larger institutions, who were frustrated at being a secondary financial institution for their customers, toward a full-service financial institution situation. There remained, however, the associations' "common bond" with particular employee groups or employers. This is very important to most credit unions. It makes direct deposit of pay checks into the accounts relatively easy, it often provides for payroll deduction of loan payments, and it offers the credit union publicity within the employee group or work place. It also offers an implicit screening of loan applications, since the employees generally know each other well—and possibly even provides a certain amount of leverage on the employee to be punctual with loan repayments. What's more, it offers a certain image of a cooperative, depositor-oriented institution rather than a profit-motivated bank. In some cases, the employee group or employer has provided volunteer assistance and office space and has even allowed credit unions to use available computer facilities. These employee and employer credit unions comprise by far the majority of the credit unions in the 1980s. Community charters for neighborhood credit unions have not yet become quantitatively important.

Question: Which financial services do you offer
or are you seriously considering?

	Now Offer	Seriously Interested	Not Seriously Considering
Share Drafts	23	0	0
Mortgage Loans	13	5	5
Preauthorized Transfers	13	5	5
Credit Cards	4	9	10
ATMs	6	5	12
Debit Cards	2	8	12
Telephone Bill Payments	1	16	6

Interestingly, every one of the 23 credit unions we surveyed said banks will be their primary competitors (20), or their second most important competitors (3), between now and 1990. In contrast, none of the institutions felt other credit unions would be their primary competitors in the late 1980s. This reflects the "common bond" limitation and a lack of overlap

"Only one-third wanted to stay in the 'delicatessen' niche."

among each credit union's members. S&Ls ranked far behind the dominant position of the banks in response to this question. Only a small number of the respondents saw S&Ls, retailers and money market funds as potential competitors in the 1980s.

Even so, the credit union managers feel they are doing well against these competitors. Every institution surveyed already offered share-draft accounts, in competition with bank checking accounts. When we asked the extent to which they had lost funds to the new money market deposit accounts or Super NOWs in early

1983, 11 of the institutions replied that they had "lost no funds at all," and only one said it had "lost significant amounts" to the new accounts being offered by banks and S&Ls.

The shape of the competition and the specifics of the move toward a "supermarket" configuration became clearer when we asked about the specific products. In addition to the share-draft accounts, two-thirds of the credit unions offer mortgage loans. One-fourth already have automatic teller machines—an amazing statistic considering the high cost of these devices—and two-thirds of the rest are considering their installation very seriously.

These credit union managers feel their members really want the ATM and plastic card capability and will leave the credit unions unless they offer these services. CUNA, the industry's trade group, has negotiated open-end contracts with several ATM manufacturers and with a large ATM network provider (ADP-Exchange), and member credit unions are utilizing these connections. More than half of the credit unions we surveyed are either offering or are seriously interested in offering credit cards, while a slightly smaller proportion are investigating debit cards. So these institutions look to such products to broaden the array of services in their move from delicatessen to supermarket.

They are optimistic that they will succeed in this process. Twenty of the 23 credit unions

Question: Between now and 1990,
do you expect that your
market share will....

Grow.....	20/23
Remain Stable	3/23
Shrink.....	0/23

Question: Between now and 1990,
do you expect that your
profitability will....

Increase	16/23
Hold Steady.....	7/23
Shrink.....	0/23

surveyed expected their market share with their customers to grow during the 1980s, and 16 of the 23 expected their profitability to increase. None of the 23 associations expected market share to decrease; only two expected a decrease in profitability. This is particularly interesting in light of the experience these associations already have with the share-draft accounts and their plans to add ATM, mortgage loan, and credit card capabilities.

Other Findings of the Survey

There were other interesting elements of our survey. Unlike banks, credit unions may accept out-of-state deposits. But they are using this capability only rarely. None of the credit unions reported that they had more than 10 percent of their deposits from out-of-state. Two-thirds had less than 5 percent, and the remaining one-third were situated close to their state lines.

These credit unions, with considerable variation, employ approximately one full-time employee for every \$1 million in assets. This is considerably higher than other financial institutions and reinforces these institutions' traditional emphasis on personal service and personal contact. Many leaders of the credit union industry privately estimate that a credit union must maintain a spread of 3 percent to 4 percent between the cost of deposits and the interest rates received on loans in order to

make a profit.² A recent study by Booz, Allen and Hamilton suggests that banks require about that spread or even a little less, while S&Ls require about 2 percent and money market mutual funds require only about 1/2 of 1 percent. All of these services are priced substantially below the fees typically imposed by commercial banks in the same markets.

**"Credit unions see commercial
banks as their number one
competitor."**

The survey also suggests that even though credit unions have been able to pay higher interest rates than banks on their savings accounts, and more recently on their share-draft accounts, they have not compensated for this by imposing higher fees for checking account services. This is interesting because many financial industry observers are suggesting that banks and others will have to resort to direct fees to compensate for higher interest rates on deposit funds. Only seven of the 23 credit unions assess monthly charges for checking services

²Confirmed by telephone with Robert C. Von der Ohe, Vice President, Economics and Research, Credit Union National Association, May 11, 1983.

Checking Account Fees Charged By Credit Unions

Monthly Fees on Active Shared Draft Accounts

Number Charging Monthly Fees: 7/23.

Average Fee: \$2.64 per month

None of the Credit Unions charges more than \$5.00 per month.

Two Credit Unions impose a charge for each check written.

Fees For Returned ("Bounced") Checks

Number Charging For Each Returned Item: 21/23.

Average Fee: \$8.52 per item.

One Credit Union charges more than \$10.00 per item.

Two Credit Unions charge less than \$5.00 per item.

Fees For Checks Stopped By the Writer

Number Charging for Each item: 19/23.

Average Fee: \$5.97 per item.

One Credit Union Charges More Than \$10.00 per item.

Eleven Credit Unions Charge Less Than \$5.00 per item.

regardless of minimum, and these charges average \$2.64 per month. The associations charge an average of \$8.52 for return items and an average of \$5.97 to stop a check.³

Smaller Credit Unions Somewhat Similar

To see what differences were apparent in the smaller cousins of these large credit unions, we also conducted a supplementary telephone survey of 11 representative small Georgia credit unions whose names were supplied to us by the Georgia Credit Union Central. These credit unions ranged in size from \$2 to \$8 million in deposits.

Like their larger counterparts, they see banks as their number one competitors; ten out of 11 said so. They are also similar in seeing S&Ls as a somewhat weak second, and in not talking

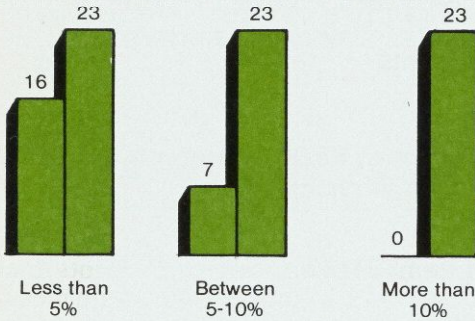
about other credit unions as potential competitors.

Six of the 11 said in telephone interviews that they would be willing to give up some of the personal ties, if necessary, in order to move toward full service banking. The remaining 5 were reluctant to commit to either of the statements mentioned above. So it appears, on the basis of this sketchy evidence, that the smaller credit unions are heading in the same direction as larger associations, but probably not so aggressively.

In comparison to the large credit unions, only seven of the 11 small associations offer the share draft, but most say they are seriously considering the addition of automatic teller machines. None now offers them, which is not a surprise in view of the substantial fixed cost. The associations say they are not seriously considering any other products, such as mortgage loans or credit cards. They also agree with their larger counterparts that regulatory costs have increased (nine out of 11), and they also are fairly optimistic about the future of their money share and their profitability.

³David Whitehead, "MMDAs and Super NOWs: Characteristics and Performance," *Economic Review*, Federal Reserve Bank of Atlanta, June 1983.

What Percentage of Your Depositors Live Out-of-State?



Of 23 surveyed

Question: During the past five years, the cost of conforming to regulations has....

Increased 20/23
 Stayed about the same..... 3/23
 Declined 0/23

Where Will It Lead?

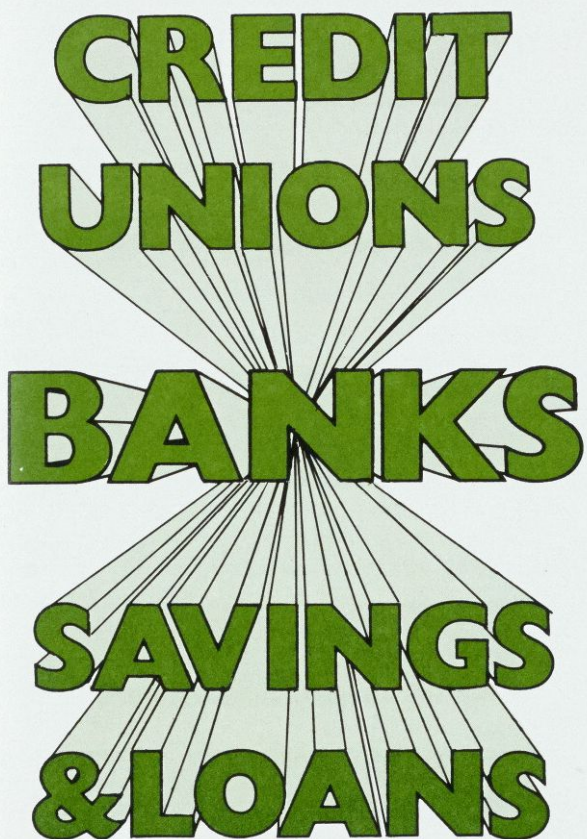
Clearly, many larger, well-established credit unions are moving seriously toward a more complete line of consumer financial services. Many have already been successful with share-draft checking accounts, and many report that their customers are asking for additional services, so there is reason to expect success.

On the other hand, these CUs are moving into territory already filled with competitors.

Savings and loans, stock brokers and retailers are offering the same services. There is a limited amount of retail financial business to be split among all these competitors. In the end, whether individual associations succeed with this broadening of services will depend on the particular competitive situation faced by each CU and on how well it carries out the move into new services.

—William N. Cox

Depository Institutions: Trends Show Major Shifts



**CREDIT
UNIONS
BANKS
SAVINGS
& LOANS**

In the early 1980s, commercial banks, mutual savings banks, savings and loan associations and credit unions in the United States entered a new era. Many of the old restraints that had affected their behavior and performance since the Great Depression were removed. Many new competitors also came into their markets from outside the chartered depository institutions, which had been their main competitors for 50 years.

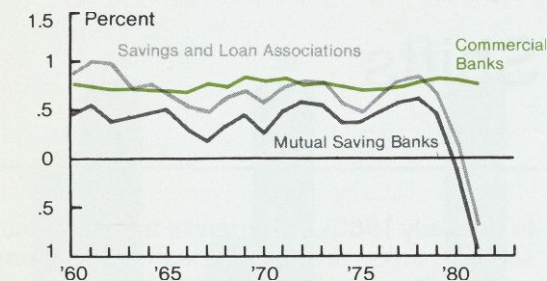
The depository institutions entered this era with very different functions and attributes. Yet each type of institution will have to function in much the same environment as the others from now on. What are these attributes and how did depository institutions acquire them? An accurate perspective on historical trends should help us project how the institutions will behave in the '80s and how they will perform. The data presented here seldom are assembled in one place with consistent definitions across institutions and over time. Utilizing this integrated data base, this article examines a number of interesting trends in the evolution of depository financial institutions over the last 20 years.

Market Shares and Offices

Twenty years ago, banks had more assets than other financial institutions and offered a wider array of services. In 1960, for example,

After growing more slowly than S&Ls or credit unions for most of the last 20 years, commercial banks have surged since 1979. Thrifts and credit unions were hurt more seriously by the recent period of high interest rates and recession.

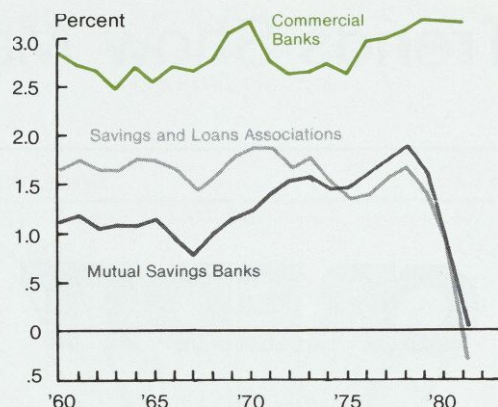
**Chart 1. Return on Average Assets
Depository Financial Institutions**



Source for Charts 1, 2, 4, 5 and 6:

Commercial banks - Board of Governors of the Federal Reserve System
Mutual Savings banks - Board of Governors of the Federal Reserve System; FDIC, **Annual Report**
Savings and loan associations - Federal Home Loan Bank Board, **Combined Financial Statements**

**Chart 2. Net Interest Margin
Depository Financial Institutions**



commercial banks held more than twice the volume of assets of S&Ls, mutual savings banks, and credit unions combined. They vastly exceeded S&Ls and mutual savings banks in the number of offices, but had only a few more offices than credit unions. Commercial banks at the time were general financial institutions offering both deposit and loan services to businesses and consumers. S&Ls, mutual savings banks and credit unions, on the other hand, offered limited services primarily to consumers. The vast majority of commercial banks' liabilities were subject to interest rate ceilings, whereas those of the thrift institutions were not subject to such ceilings until 1966. Banks' return on assets in 1960 was well above that of mutual savings banks, but not quite so high as S&Ls' return. Banks' net interest margin, however, greatly exceeded that of both types of thrift institutions (see Charts 1 and 2).

Between 1960 and 1980, the different types of institutions were dealt different hands (by the economic environment, regulations and, possibly, their own motivations) with which to play the competitive game of the 1980s. Over most of the period since 1960, commercial banks have grown more slowly than S&Ls or credit unions. Mutual savings banks, on the other hand, confined as they are to the more slowly growing Northeast, have lagged all three of the other types of institutions.

Since 1979 this trend has reversed dramatically as commercial banks grew rapidly and regained some of the business they lost during the 1970s. In this period, the other types of depository

institutions were facing serious financial problems and were unable to compete as effectively against commercial banks (see Table 1).

Even during the period when assets of commercial banks were growing more slowly, however, they were the only kind of depository institutions whose number was expanding even as the number of other depository institutions declined. In the case of S&Ls, the decline was quite rapid. The number of mutual savings banks and S&Ls declined throughout the period while that of credit unions rose from 1960 until 1970, their peak year. Their numbers have declined consistently since. Mutual savings banks and S&Ls disappeared almost exclusively through merger. Credit union numbers declined mainly through voluntary liquidations.

Commercial banks, on the other hand, increased in number from approximately 13,500 to almost 15,000 during the period. Even if we count banking units (bank holding companies plus independent banks), the number has declined only slightly since 1960 (see Table 2).

In recent years the continued increase in the number of banks and decline in the number of thrifts may have been partially the result of more liberal branching standards for S&Ls promulgated by the Federal Home Loan Bank Board. The influence of these standards came well after the number of thrifts started to fall, however. Further, the number of mutual savings banks has declined although they were not affected by the Bank Board's standards. The sharp declines in the

Table 1. Average Annual Asset Growth
Insured Depository Financial Institutions

	Commercial Banks, Domestic Offices	Mutual Savings Banks	Saving and Loan Associations	Credit Unions
1960-1981	9.31	7.34	11.42	13.29
1965-1970	8.66	6.27	6.50	11.22
1970-1975	10.53	9.31	14.05	16.13
1975-1980	10.08	7.30	13.34	13.82
1980-1981	9.67	2.00	5.80	7.17

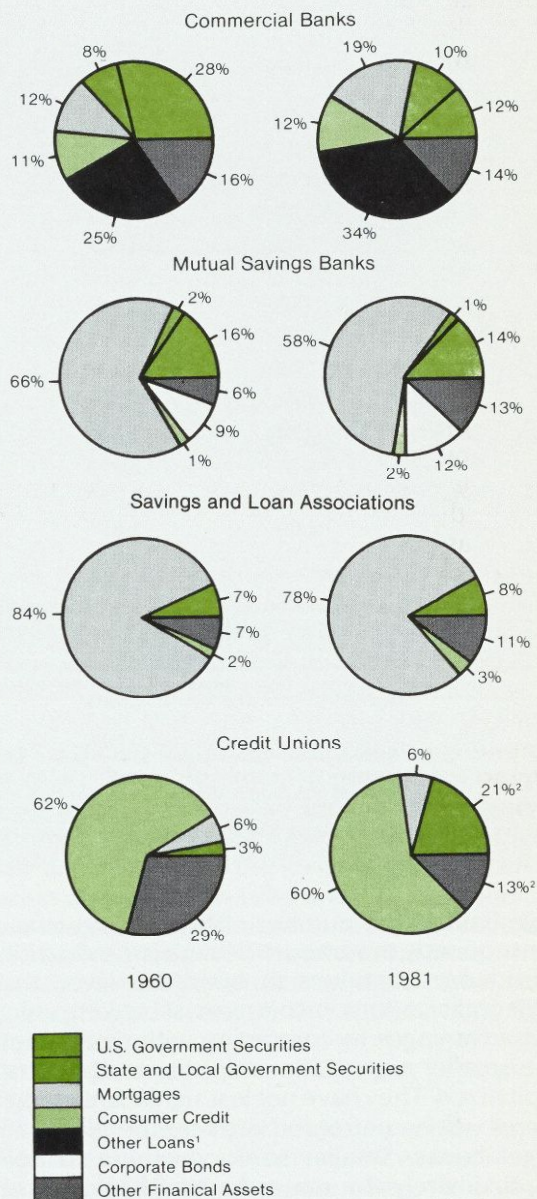
Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**
Credit Unions - CUNA **Yearbook 1979** and Credit Union **Statistical Reports 1981**

number of thrifts in recent years are probably more closely related to financial problems.

Over the longer term, this increase in the number of commercial banks, together with a decline in other institutions, should not be surprising. In fact, it is quite consistent with studies of economies of scale in financial institutions. These studies indicate that commercial banks' unit costs begin to rise slightly once the unit has assets in the neighborhood of \$50 million to \$75 million. Studies of savings and loan associations, which may be generally applicable to mutual savings banks, indicate that costs decline to a much greater size of institution, possibly in the neighborhood of \$500 million in deposits. The more specialized thrift institutions thus appear able to take advantage of much greater scale economies than do commercial banks. Consequently, thrifts appear to have more motivation to merge and combine in order to achieve large scale production.

Further consolidation of both types of institutions—thrifts and commercial banks—probably has been inhibited by branching laws that prohibited interstate banking and in many cases intrastate branching for banks and thrifts until late in the 1970s when the Federal Home Loan Bank Board changed its policies to allow more statewide branching for S&Ls. Prohibitions against commercial bank statewide branching still exist in many states. Sixteen have limited branching, 11 still only allow unit banks, and 12 states still have significant prohibitions against multibank holding companies. Further reasons for lack of consolidation may include the U. S. Supreme Court's antitrust guidelines that ignore nonbank competition and nonlocal competition in dealing with combinations of commercial banks. These guidelines as enforced by the regulatory agencies

Chart 3. Distribution of Financial Assets
Depository Financial Institutions
1960 and 1981



Source: Federal Reserve System, **Flow of Funds**

¹Primarily business loans

²The shift in credit union assets from other assets to U.S. Government Securities resulted primarily from a shift out of deposits at S&Ls.

Table 2. Number of Depository Financial Institutions
(Insured and Noninsured)
In The United States

Year	Commercial Banks No. of Charters(1)	Banking Units(2)	Mutual Savings Banks(3)	Savings & Loans	Cedit Unions(5)	Total Units(6)
1960	13,484	13,105	515	6,320	20,456	39,936
1965	13,818	13,403	506	6,185	22,119	42,213
1970	13,705	12,931	494	5,669	23,699	42,793
1971	13,804	12,951	490	5,474	23,284	42,199
1972	13,950	12,837	486	5,298	23,115	41,736
1973	14,194	12,630	482	5,170	22,999	41,281
1974	14,488	12,642	480	5,023	22,964	41,109
1975	14,654	12,688	476	4,931	22,703	40,798
1976	14,697	12,708	473	4,821	22,615	40,617
1977	14,740	12,750	467	4,761	22,407	40,385
1978	14,741	12,753	465	4,725	22,177	40,120
1979	14,738	12,815	463	4,684	22,002	39,964
1980	14,870	12,787	460	4,592	21,731	39,570
1981	14,882	12,693	441	4,347	20,814	38,235

Sources: Commercial and Mutual Savings Banks: FDIC **Annual Report** (1940-1980) Federal Reserve System **Annual Report** (1981). Bank Holding Companies: **Federal Reserve Bulletin** (1940) Assn. of Bank Holding Companies (1950), Federal Reserve System **Banking and Monetary Stats.** (1960-1970), **Annual Stats. Digest** (1971-1981). Savings and Loan Associations: U.S. League of Savings Assns. **Savings and Loan Fact Book.** Credit Unions: CUNA, **Yearbook, 1979** (1940-1979), **Credit Union Statistical Report, 1981** (1980-1981). Securities Dealers: SEC **Annual Reports.**

Notes: (1) Includes 480 banks not insured by FDIC in 1981.
(2) Banking Units = (Commercial Banks + Bank Holding Companies - Bank Subsidiaries of Bank Holding Companies).
(3) Includes 111 banks not insured by FDIC in 1981.
(4) Includes 568 savings and loan associations not insured by FSLIC in 1981.
(5) Includes 3,581 credit unions not insured by NCUSIF in 1981.
(6) Banking Units, Savings and Loan Associations, Mutual Savings Banks, Credit Unions, and Securities Dealers.

have limited the number of bank mergers and consequently the amount of bank consolidation.

Evidence continues to build, however, that large organizations in commercial banking enjoy few advantages in competing with small ones. The smaller organizations appear to be better capitalized. They have not lost significant market shares when confronted with competition from larger banks. Smaller banks continue to hold approximately the same share of banks' assets that they did in the early 1970s. They have, however, increased their share of all banks' profits.

While numbers of institutions declined or remained stable, commercial and mutual savings banks and S&Ls together increased the number of offices that they operated by almost 250

percent, to 81,158 (see Table 3). Commercial banks lagged with only a 230 percent gain while mutual savings banks jumped 368 percent. (Data on credit union offices is unavailable, but we expect that their gain was small.)

Balance Sheet Trends

Balance sheet trends in the four types of institutions were quite similar between 1960 and 1981. The only major exception reflects a difference in the portfolios of assets and liabilities of commercial banks and of the other three types of institutions, a difference that has persisted since 1960.

Chart 3 shows this continuing difference. Despite some asset shifts, commercial banks continue to be general institutions holding substantial

Table 3. Number of Offices of Depository Financial Institutions (Insured and Noninsured) in the United States

Year	Commercial Banks No. of Charters	Mutual Savings Banks	Savings and Loans	Total Units
1960	24,103	1,002	7,931	33,036
1965	29,736	1,222	9,179	40,137
1970	35,585	1,581	9,987	47,153
1971	37,174	1,686	10,435	49,295
1972	38,822	1,840	11,149	51,811
1973	40,912	1,974	12,206	55,092
1974	43,193	2,122	13,798	59,113
1975	44,916	2,322	15,449	62,687
1976	46,101	2,553	16,729	65,383
1977	47,911	2,781	17,848	68,540
1978	49,598	3,006	18,975	71,911
1979	51,590	3,338	20,192	74,788
1980	53,649	3,583	21,325	78,557
1981	55,440	3,583	22,135	81,158

Sources:

Commercial and Mutual Savings Banks: FDIC **Annual Report** (1940-1980), Federal Reserve System **Annual Report** (1981).
Savings and Loan Associations: U.S. League of Savings Associations, **Savings and Loan Fact Book**.

Table 4. Net Worth - Asset Ratio, Insured Depository Institutions (percent)

Year	Commercial Banks	Mutual Savings Banks	Savings and Loan Associations	Credit Unions
1960	7.99	8.54	6.94	4.81
1965	7.46	7.80	6.79	5.59
1970	6.58	7.35	6.96	6.27
1971	6.32	6.95	6.53	5.90
1972	5.95	6.80	6.22	5.71
1973	5.67	7.00	6.23	5.53
1974	5.65	7.14	6.19	5.58
1975	5.87	6.66	5.81	5.32
1976	6.11	6.42	5.58	5.07
1977	5.92	6.40	5.45	4.72
1978	5.80	6.53	5.51	4.39
1979	5.75	6.69	5.58	4.43
1980	5.80	6.25	5.26	4.32
1981	5.83	5.35	4.27	4.50

Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**
Credit Unions - CUNA, **Yearbook 1979** and Credit Union **Statistical Reports 1981**

proportions of securities of both the U.S. and state and local governments, mortgages, business loans and consumer loans. Mutual savings banks have continued to specialize in U.S. government and corporate securities and mortgages. S&Ls' asset portfolios remain dominated by mortgages, and credit unions still specialize in consumer loans.

Limitations on activities of the thrift institutions and credit unions made it impossible for them to expand their activities into business lending and in some cases, consumer lending and transactions deposit taking. These limitations have only been reduced since 1980. The 1980s will see whether dropping these limitations will induce the four types of institutions to be more similar in their portfolios and in the types of accounts they offer and hold.

Even before those limitations were reduced, however, broad similarities in balance sheet trends existed among the institutions. These similarities include decreased liquidity and capital for all institutions, increased use of nondeposit liabilities, declines in deposits subject to interest ceilings in the 1970s, declines in securities holdings, increases in total loans as proportions of assets and declines in mortgage loans to total loans for thrift institutions throughout most of the period.

As markets for short-term assets improved during the 1960s and 1970s, the quick availability of liquid assets induced financial institutions to decrease holdings of short-term easily marketable assets. Cash and securities as a percentage of assets at all four types of institutions declined. Taking their place were more loans and securities of other types. Capital as a percentage of total assets also fell during the 1960s and particularly during the 1970s (see Table 4). The late 1970s saw a leveling off of this decline for commercial banks and indeed in 1980 and 1981 commercial banks' capital-asset ratios increased. In the late 1970s and early 1980s, however, because of substantial earnings problems, capital asset ratios at the thrifts increased the steepness of their descent. Credit unions' net worth-assets ratios declined overall in the 1970s but rebounded slightly in 1981.

Limits on interest that could be paid for deposit liabilities induced commercial and mutual savings banks and S&Ls to increase nondeposit liabilities during the late 1960s and the 1970s (see Table 5). Commercial banks led in this movement, increasing nondeposit liabilities earlier and taking on a greater proportion of nondeposit liabilities than the thrifts by the mid 1970s. S&Ls jumped back into the lead as users of nondeposit funds in 1981. Commercial banks and mutual savings

Table 5. Nondeposit Liabilities to Total Liabilities Insured Depository Financial Institutions (percent)

Year	Commercial Banks	Mutual Savings Banks	Savings and Loan Associations
1960	2.83	1.84	6.49
1965	4.50	1.41	10.71
1970	7.40	1.57	10.74
1971	7.87	1.35	9.56
1972	8.87	1.36	9.29
1973	10.86	1.86	11.08
1974	10.93	2.20	12.51
1975	10.37	2.00	10.40
1976	10.65	1.84	9.35
1977	11.39	1.92	10.90
1978	13.18	2.71	12.90
1979	14.54	3.59	14.13
1980	15.27	4.00	14.45
1981	16.85	5.99	17.80

Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**

banks held mainly private nondeposit liabilities in the forms of commercial paper, notes and debentures and other borrowings. Savings and loan associations' nondeposit liabilities came primarily through loans from the Federal Home Loan Banks, although their borrowings from other sources also increased as a proportion of assets.

As higher interest rates and innovation by nondepository institutions eroded interest rate control in the 1970s, the regulators were forced to remove interest rate ceilings for more and more types of deposits. This culminated in Congress ordering the Depository Institutions Deregulation Committee (DIDC) to remove the interest ceilings gradually through April 1986.

Predictably, deposits not subject to interest rate ceilings increased rapidly in the late 1970s with inflation and high interest rates. Those subject to interest rate ceilings declined quite rapidly (see Chart 4). Throughout the period, demand deposits at commercial banks grew at a much slower pace than time and savings deposits. The gap between growth rates increased in the latter part of the 1970s as interest rate ceilings were removed from time and savings deposits while demand deposits remained subject to an interest prohibition (see Table 6). The adoption of NOW accounts that lifted the ceilings on personal transactions deposits did little to stem the tide.

Table 6. Average Annual Growth in Demand and Time and Savings Deposits

Insured Commercial Banks		
Year	Demand Deposits	Time and Savings Deposits
1960-1981	4.40	12.57
1965-1970	6.07	9.65
1970-1975	5.37	14.35
1975-1980	6.12	16.55
1980-1981	-10.93	17.14

Source: Federal Reserve Board

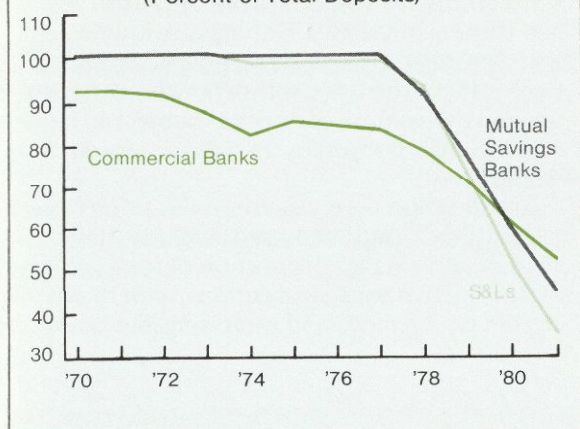
Thrift institutions, although limited to a great extent in the types of assets they could hold, steadily but slowly decreased the proportion of mortgages in their portfolios throughout the 1970s after increasing mortgage holdings in the 1960s. Mutual savings banks took on more corporate securities; S&Ls took on more consumer loans and government securities.

Income and Expense Trends

In contrast to the similar balance sheet trends among commercial and mutual savings banks, S&Ls and credit unions, quite different earnings trends evolved for these institutions during the 1960s and 1970s. Commercial banks' earnings were considerably more stable during this period than those of the other institutions. For the whole period, the difference between the high and low return on assets for commercial banks was only 14 basis points. The spread for savings and loan associations and mutual savings banks (even before the earnings debacle of 1979, 1980 and 1981) was at least three times that of commercial banks (see Chart 1). Similarly, return on equity (or return on net worth) varied much more greatly among S&Ls and mutual savings banks (see Chart 5).

After the introduction of market indexed certificates in mid-1978, rising interest rates pulled thrift institutions' interest costs up much more rapidly than interest revenues could rise. Thus, thrifts' earnings plummeted from 1979 through 1981. Thrifts' problems would not have been avoided had market rates not been introduced. Without market rates, thrifts could not have bid for deposits. This would have forced nondeposit borrowing at market rates or induced a liquidity crisis.

Chart 4. Deposits Subject to Interest Ceilings
Depository Financial Institutions
(Percent of Total Deposits)

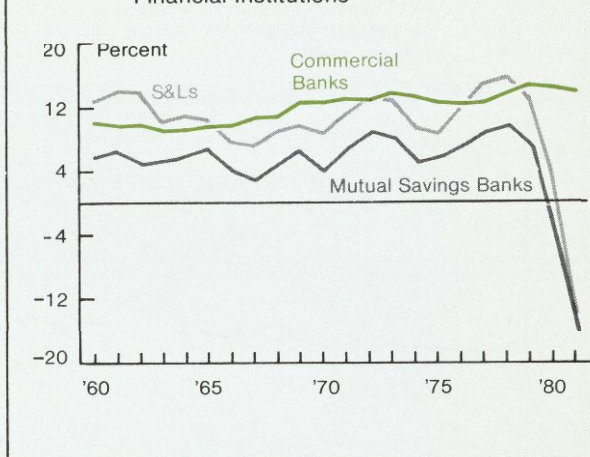


As might be expected, thrifts' earnings appeared to be driven mainly by changes in interest rates. Bank earnings, on the other hand, do not appear to have been so sensitive to interest rates as they were to activity in the economy. Recession, which brings on more business failures and more loan delinquencies, was more closely related to earnings declines at commercial banks than were higher interest rates (see Chart 6). And expansion in the real economy was closely related to expansion in bank earnings. Thus, while thrifts' earnings appeared to be interest rate driven, commercial banks' appeared to be loan-loss driven.

Throughout the period, interest revenue increased as a proportion of total revenue for commercial banks and S&Ls but not for mutual savings banks. This increase in interest revenue as a proportion of total revenue continued into the late 1970s and early 1980s, when depository financial institutions were urged to unbundle financial services and to generate revenues through fees rather than through interest.

For the entire period, interest costs rose more rapidly than interest revenue for these institutions. The difference in cost and revenue growth rates was sufficient to keep net interest margin in the same range until the thrifts' problems hit in 1979 (see Chart 2). Even in the 1979-82 period, commercial banks' earnings remained stable. Thrift institutions, because of their asset and liability mismatch, suffered from rising interest rates and decontrol of deposit interest ceilings through sharply declining earnings. These earnings

Chart 5. Return on Average Net Worth Depository
Financial Institutions



declines brought massive losses and cut thrifts' capital severely. Commercial banks weathered the high interest rates in relatively good shape with continued stable earnings, net interest margin and return on assets and with rising capital-asset ratios. Much of their financial advantage going into the latter part of the 1980s stems from this particular period.

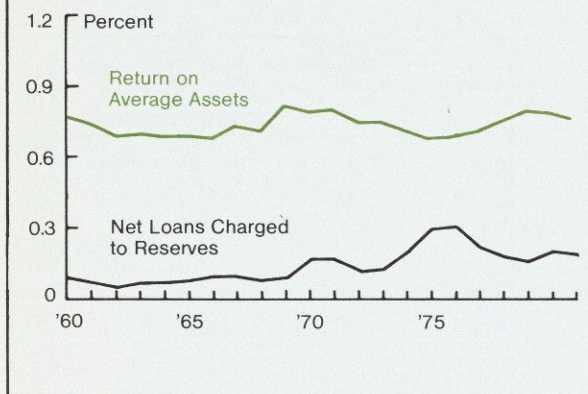
How Now?

Currently, commercial banks appear to be in good shape compared to thrift institutions. Earnings of the industry have not fallen, although recessions plagued the economy in 1980 and 1982. Capital increased more than assets in the 1980-1981 period. Several of the 1970s trends, however, appear to be continuing. Deposits subject to interest ceilings have continued to fall in the last three years. New MMDA and Super NOW accounts bid fair to continue this trend. Commercial banks are becoming more dependent on liabilities whose costs fluctuate with the market. The interest dependence of commercial banks does not seem to be declining despite moves to unbundle and charge fees. Non-interest expenses also continue to rise.

Thrift institutions, however, appear much more seriously harmed by the recent period of high interest rates and recession. As a result of negative net interest margins and returns on assets, thrift institutions' capital has declined to historically low levels. Since most are mutual institutions and, short of stock conversions, have no practical

Chart 6. Commercial Banks

Net Loans Charged to Reserves as a Percentage of Assets, and Return on Average Assets



way of raising capital except through earnings, their net worth has dropped.

Interest rates have fallen since mid 1982, and some thrift institutions have reported second half earnings increases. Earnings are low, however, and borrowing from the Federal Home Loan Bank is high. The use of other nondeposit funds is up, and the volume of deposits subject to interest rate ceilings continues to fall rapidly at these institutions.

Credit union reserves are down since the mid 1970s. Their deposit-type liabilities make up a smaller and smaller proportion of total liabilities, indicating that these institutions, with the others, are becoming more and more sensitive to market interest rates.

—B. Frank King



FINANCE

STATISTICAL SUPPLEMENT

	APR 1983	MAR 1983	APR 1982	ANN. % CHG.		APR 1983	MAR 1983	APR 1982	ANN. % CHG.
\$ millions									
UNITED STATES									
Commercial Bank Deposits	1,266,033	1,240,521	1,129,500	+ 12	Savings & Loans				
Demand	303,661	291,377	295,680	+ 3	Total Deposits	593,039	579,199	530,388	+ 12
NOW	78,331	72,737	59,083	+ 33	NOW	17,493	16,053	9,864	+ 77
Savings	324,217	304,431	152,093	+113	Savings	136,114	174,957	93,760	+ 99
Time	588,934	603,360	652,132	- 10	Time	392,442	391,195	427,399	- 8
Credit Union Deposits	57,318	53,480	46,215	+ 24		FEB	JAN	FEB	
Share Drafts	5,148	4,584	3,098	+ 66	Mortgages Outstanding	472,409	472,915	507,374	- 7
Savings & Time	45,795	43,471	39,607	+ 16	Mortgage Commitments	21,945	19,343	15,338	+ 43
SOUTHEAST									
Commercial Bank Deposits	140,298	138,502	123,395	+ 14	Savings & Loans				
Demand	36,536	34,446	35,805	+ 2	Total Deposits	86,699	84,232	78,030	+ 11
NOW	10,385	9,685	7,785	+ 33	NOW	2,987	2,706	1,632	+ 83
Savings	35,794	33,342	15,108	+137	Savings	24,599	22,715	11,937	+106
Time	63,007	64,198	68,277	- 8	Time	59,817	59,556	64,523	- 7
Credit Union Deposits	5,308	5,058	4,388	+ 21		FEB	JAN	FEB	
Share Drafts	425	372	318	+ 34	Mortgages Outstanding	66,023	66,085	75,904	- 13
Savings & Time	4,448	4,303	3,721	+ 20	Mortgage Commitments	3,461	3,168	3,442	+ 1
ALABAMA									
Commercial Bank Deposits	14,939	14,740	13,942	+ 7	Savings & Loans				
Demand	3,749	3,516	3,610	+ 4	Total Deposits	4,752	4,592	4,455	+ 7
NOW	926	875	669	+ 38	NOW	147	136	83	+ 77
Savings	2,987	2,816	1,580	+ 89	Savings	829	756	578	+ 43
Time	7,797	7,986	8,520	- 8	Time	3,850	3,768	3,820	+ 1
Credit Union Deposits	883	855	760	+ 16		FEB	JAN	FEB	
Share Drafts	83	71	63	+ 32	Mortgages Outstanding	3,602	3,625	3,984	- 10
Savings & Time	747	729	635	+ 18	Mortgage Commitments	97	76	51	+ 90
FLORIDA									
Commercial Bank Deposits	49,157	47,796	40,783	+ 21	Savings & Loans				
Demand	13,218	12,487	13,014	+ 2	Total Deposits	52,834	51,160	47,400	+ 11
NOW	4,433	4,116	3,447	+ 29	NOW	2,074	1,881	1,146	+ 81
Savings	16,041	14,954	6,476	+148	Savings	16,680	15,416	8,000	+109
Time	16,614	17,190	19,069	- 13	Time	34,370	34,259	38,194	- 10
Credit Union Deposits	2,414	2,285	2,013	+ 20		FEB	JAN	FEB	
Share Drafts	222	198	174	+ 28	Mortgages Outstanding	38,769	38,710	47,019	- 18
Savings & Time	1,864	1,804	1,582	+ 18	Mortgage Commitments	2,595	2,394	2,978	- 13
GEORGIA									
Commercial Bank Deposits	20,217	19,569	16,991	+ 19	Savings & Loans				
Demand	6,647	6,178	6,164	+ 8	Total Deposits	10,626	10,416	9,792	+ 9
NOW	1,373	1,275	1,093	+ 26	NOW	311	268	170	+ 83
Savings	4,462	4,304	1,647	+171	Savings	2,475	2,373	1,206	+105
Time	8,667	8,714	9,029	- 4	Time	8,014	7,928	8,463	- 5
Credit Union Deposits	1,017	962	796	+ 28		FEB	JAN	FEB	
Share Drafts	50	39	28	+ 79	Mortgages Outstanding	8,427	8,481	9,325	- 10
Savings & Time	895	861	725	+ 23	Mortgage Commitments	276	286	131	+111
LOUISIANA									
Commercial Bank Deposits	22,834	24,201	22,203	+ 3	Savings & Loans				
Demand	6,107	5,835	6,277	- 3	Total Deposits	8,908	8,681	7,683	+ 16
NOW	1,384	1,295	1,070	+ 29	NOW	191	179	100	+ 91
Savings	4,906	4,495	2,480	+ 98	Savings	2,475	2,174	1,240	+100
Time	12,931	13,077	12,948	- 0	Time	6,334	6,402	6,357	- 0
Credit Union Deposits	172	163	119	+ 45		FEB	JAN	FEB	
Share Drafts	15	13	13	+ 15	Mortgages Outstanding	7,293	7,245	7,191	+ 1
Savings & Time	164	154	111	+ 48	Mortgage Commitments	300	235	209	+ 44
MISSISSIPPI									
Commercial Bank Deposits	11,418	11,147	10,218	+ 12	Savings & Loans				
Demand	2,451	2,322	2,415	+ 1	Total Deposits	2,537	2,525	2,403	+ 6
NOW	813	757	573	+ 42	NOW	79	69	45	+ 76
Savings	2,244	2,027	749	+200	Savings	518	485	225	+130
Time	6,203	6,302	6,710	- 8	Time	1,973	1,999	2,148	- 8
Credit Union Deposits	N.A.	N.A.	N.A.			FEB	JAN	FEB	
Share Drafts	N.A.	N.A.	N.A.		Mortgages Outstanding	2,037	2,029	2,201	- 7
Savings & Time	N.A.	N.A.	N.A.		Mortgage Commitments	25	24	17	+ 47
TENNESSEE									
Commercial Bank Deposits	21,733	21,049	19,258	+ 13	Savings & Loans				
Demand	4,364	4,108	4,325	+ 1	Total Deposits	7,042	6,858	6,297	+ 12
NOW	1,456	1,367	933	+ 56	NOW	185	173	88	+110
Savings	5,154	4,746	2,176	+137	Savings	1,622	1,511	688	+136
Time	10,795	10,929	12,001	- 10	Time	5,276	5,200	5,541	- 5
Credit Union Deposits	822	793	700	+ 17		FEB	JAN	FEB	
Share Drafts	55	51	40	+ 38	Mortgages Outstanding	5,895	5,995	6,185	- 5
Savings & Time	778	755	668	+ 16	Mortgage Commitments	168	153	57	+195

Notes: All deposit data are extracted from the Federal Reserve Report of Transaction Accounts, other Deposits and Vault Cash (FR2900), and are reported for the average of the week ending the 1st Wednesday of the month. This data, reported by institutions with over \$15 million in deposits as of December 31, 1979, represents 95% of deposits in the six state area. The major differences between this report and the "call report" are size, the treatment of interbank deposits, and the treatment of float. The data generated from the Report of Transaction Accounts is for banks over \$15 million in deposits as of December 31, 1979. The total deposit data generated from the Report of Transaction Accounts eliminates interbank deposits by reporting the net of deposits "due to" and "due from" other depository institutions. The Report of Transaction Accounts subtracts cash in process of collection from demand deposits, while the call report does not. Savings and loan mortgage data are from the Federal Home Loan Bank Board Selected Balance Sheet Data. The Southeast data represent the total of the six states. Subcategories were chosen on a selective basis and do not add to total.



CONSTRUCTION

	MAR 1983	FEB 1983	MAR 1982	ANN % CHG		MAR 1983	FEB 1983	MAR 1982	ANN % CHG
12-month Cumulative Rate									
UNITED STATES									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	44,533	44,869	52,090	- 15	Value - \$ Mil.	45,373	42,812	37,576	+ 21
Industrial Bldgs.	4,783	4,999	7,091	- 33	Residential Permits - Thous.				
Offices	11,255	11,867	15,374	- 27	Single-family units	620.5	584.3	511.0	+ 21
Stores	5,186	5,228	6,114	- 15	Multi-family units	500.2	480.4	391.3	+ 28
Hospitals	1,778	1,580	1,659	+ 7	Total Building Permits				
Schools	812	781	802	+ 1	Value - \$ Mil.	89,906	87,681	89,665	+ 99
SOUTHEAST									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	6,582	6,487	6,626	- 1	Value - \$ Mil.	8,056	7,529	7,432	+ 8
Industrial Bldgs.	634	677	816	- 22	Residential Permits - Thous.				
Offices	1,443	1,430	1,365	+ 6	Single-family units	128.7	121.6	105.7	+ 22
Stores	962	968	1,074	- 10	Multi-family units	96.1	91.1	92.3	+ 4
Hospitals	377	345	281	+ 34	Total Building Permits				
Schools	136	105	84	+ 62	Value - \$ Mil.	14,638	14,016	14,058	+ 4
ALABAMA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	377	371	422	- 11	Value - \$ Mil.	274	260	269	+ 2
Industrial Bldgs.	39	46	75	- 48	Residential Permits - Thous.				
Offices	73	72	55	+ 33	Single-family units	5.9	5.5	4.6	+ 28
Stores	67	61	50	+ 34	Multi-family units	4.3	4.3	5.2	- 17
Hospitals	30	30	31	- 3	Total Building Permits				
Schools	7	5	6	+ 17	Value - \$ Mil.	651	631	691	- 6
FLORIDA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	3,398	3,307	3,351	+ 1	Value - \$ Mil.	4,678	4,350	5,015	- 7
Industrial Bldgs.	354	380	389	- 9	Residential Permits - Thous.				
Offices	718	708	584	+ 23	Single-family units	66.6	62.6	61.3	+ 9
Stores	549	519	593	- 7	Multi-family units	57.0	53.0	62.5	- 9
Hospitals	210	178	157	+ 34	Total Building Permits				
Schools	53	21	21	+152	Value - \$ Mil.	8,067	7,658	8,366	- 4
GEORGIA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	983	980	1,050	- 6	Value - \$ Mil.	1,586	1,500	1,040	+ 53
Industrial Bldgs.	127	134	187	- 32	Residential Permits - Thous.				
Offices	229	227	255	- 10	Single-family units	30.0	29.0	20.6	+ 46
Stores	84	84	112	- 25	Multi-family units	15.0	14.9	9.7	+ 55
Hospitals	26	25	30	- 13	Total Building Permits				
Schools	10	13	32	- 69	Value - \$ Mil.	2,568	2,480	2,090	+ 23
LOUISIANA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	1,064	1,066	905	+ 18	Value - \$ Mil.	758	708	580	+ 31
Industrial Bldgs.	61	63	89	- 31	Residential Permits - Thous.				
Offices	316	310	293	+ 8	Single-family units	12.9	12.1	9.4	+ 37
Stores	122	165	166	- 27	Multi-family units	10.1	9.5	7.9	+ 28
Hospitals	60	62	27	+122	Total Building Permits				
Schools	53	52	19	+179	Value - \$ Mil.	1,822	1,774	1,485	+ 23
MISSISSIPPI									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	169	161	172	- 2	Value - \$ Mil.	208	193	145	+ 43
Industrial Bldgs.	11	13	20	- 45	Residential Permits - Thous.				
Offices	16	14	44	- 64	Single-family units	4.0	3.8	3.0	+ 33
Stores	40	39	32	+ 25	Multi-family units	2.5	2.2	1.9	+ 32
Hospitals	10	5	6	+ 67	Total Building Permits				
Schools	5	5	0.8	+525	Value - \$ Mil.	377	354	317	+ 19
TENNESSEE									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	591	601	725	- 18	Value - \$ Mil.	552	517	385	+ 43
Industrial Bldgs.	40	41	56	- 29	Residential Permits - Thous.				
Offices	92	100	135	- 32	Single-family units	9.4	8.6	6.8	+ 38
Stores	100	100	118	- 15	Multi-family units	7.2	7.2	5.1	+ 41
Hospitals	42	44	21	+100	Total Building Permits				
Schools	9	9	5	+ 80	Value - \$ Mil.	1,143	1,118	1,109	+ 3

NOTES:

Data supplied by the U. S. Bureau of the Census, Housing Units Authorized By Building Permits and Public Contracts, C-40. Nonresidential data excludes the cost of construction for publicly owned buildings. The southeast data represent the total of the six states. The annual percent change calculation is based on the most recent month over prior year. Publication of F. W. Dodge construction contracts has been discontinued.



GENERAL

	LATEST DATA	CURR. PERIOD	PREV. PERIOD	YEAR AGO	ANN. % CHG.		APR 1983	MAR (R) 1983	APR 1982	ANN. % CHG.
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UNITED STATES

Personal Income (\$bil. - SAAR)	4Q	2,616.1	2,581.8	2,483.7	+ 5	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Prices Rec'd by Farmers				
Plane Pass. Arr. 000's		N.A.	N.A.	N.A.		Index (1977=100)	137	134	135	+ 1
Petroleum Prod. (thous.)	APR	8,712.0	8,729.1	8,687.2	0	Broiler Placements (thous.)	84,992	84,834	83,782	+ 1
Consumer Price Index 1967=100	APR	295.5	293.4	284.3	+ 4	Calf Prices (\$ per cwt.)	67.20	68.40	62.60	+ 7
Kilowatt Hours - mils.	DEC	170.3	160.5	172.4	- 1	Broiler Prices (\$ per lb.)	24.7	25.4	26.2	- 6
						Soybean Prices (\$ per bu.)	6.04	5.82	6.11	- 1
						Broiler Feed Cost (\$ per ton)	215	210	215	0

SOUTHEAST

Personal Income (\$bil. - SAAR)	4Q	267.9	262.1	246.9	+ 9	Agriculture				
Taxable Sales - \$ bil.		N.A.	N.A.	N.A.		Prices Rec'd by Farmers				
Plane Pass. Arr. 000's	FEB	4,332.1	4,373.3	3,984.9	+ 8	Index (1977=100)	121	119	118	+ 3
Petroleum Prod. (thous.)	APR	1,407.0	1,400.0	1,395.0	+ 1	Broiler Placements (thous.)	32,818	32,526	32,082	+ 2
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	65.21	64.98	59.18	+10
Kilowatt Hours - mils.	DEC	26.2	25.0	25.5	+ 3	Broiler Prices (\$ per lb.)	24.1	24.8	24.6	- 2
						Soybean Prices (\$ per bu.)	6.18	6.00	6.36	- 3
						Broiler Feed Cost (\$ per ton)	10.83	10.89	10.95	- 1

ALABAMA

Personal Income (\$bil. - SAAR)	4Q	34.7	33.9	32.9	+ 5	Agriculture				
Taxable Sales - \$ bil.	NOV	23.0	22.5	21.7	+ 6	Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	90.6	93.7	91.6	- 1	(Dates: JAN, JAN)	158	-	158	0
Petroleum Prod. (thous.)	APR	55.0	56.0	56.0	- 2	Broiler Placements (thous.)	10,916	10,718	10,746	+ 2
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	63.20	63.60	57.00	+11
Kilowatt Hours - mils.	DEC	3.5	3.4	3.7	- 5	Broiler Prices (\$ per lb.)	24.1	24.8	24.6	- 2
						Soybean Prices (\$ per bu.)	6.02	5.99	6.33	- 5
						Broiler Feed Cost (\$ per ton)	11.00	11.00	11.00	0

FLORIDA

Personal Income (\$bil. - SAAR)	4Q	70.9	68.4	61.1	+16	Agriculture				
Taxable Sales - \$ bil.	APR	68.4	67.9	67.4	+ 1	Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	2,379.9	2,387.5	2,177.5	+ 9	(Dates: JAN, JAN)	524	-	538	- 3
Petroleum Prod. (thous.)	APR	65.0	65.0	81.0	-20	Broiler Placements (thous.)	2,040	1,983	1,960	+ 4
Consumer Price Index - Miami Nov. 1977 = 100		MAR	JAN	MAR		Calf Prices (\$ per cwt.)	71.60	69.40	62.40	+15
Kilowatt Hours - mils.	DEC	7.1	6.8	6.7	+ 6	Broiler Prices (\$ per lb.)	23.5	24.0	25.0	- 6
						Soybean Prices (\$ per bu.)	6.02	5.99	6.29	- 4
						Broiler Feed Cost (\$ per ton)	12.70	12.40	12.30	+ 3

GEORGIA

Personal Income (\$bil. - SAAR)	4Q	55.2	54.0	51.2	+ 8	Agriculture				
Taxable Sales - \$ bil.	3Q	39.4	37.2	38.1	+ 3	Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	1,454.8	1,474.2	1,319.6	+10	(Dates: JAN, JAN)	224	-	205	+ 9
Petroleum Prod. (thous.)		N.A.	N.A.	N.A.		Broiler Placements (thous.)	13,009	13,223	12,873	+ 1
Consumer Price Index - Atlanta 1967 = 100	APR	297.6	295.1	280.2	+ 6	Calf Prices (\$ per cwt.)	60.60	61.50	55.00	+10
Kilowatt Hours - mils.	DEC	4.1	3.8	4.1	+ 0	Broiler Prices (\$ per lb.)	24.0	24.5	23.5	+ 2
						Soybean Prices (\$ per bu.)	6.20	5.90	6.37	- 3
						Broiler Feed Cost (\$ per ton)	11.00	11.00	11.50	- 4

LOUISIANA

Personal Income (\$bil. - SAAR)	4Q	44.7	44.4	42.5	+ 5	Agriculture				
Taxable Sales - \$ bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	260.4	262.6	247.1	+ 5	(Dates: JAN, JAN)	204	-	219	- 7
Petroleum Prod. (thous.)	APR	1,200.0	1,191.0	1,164.0	+ 3	Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Consumer Price Index 1967 = 100		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	65.50	65.90	61.00	+ 7
Kilowatt Hours - mils.	DEC	4.1	4.3	3.7	+11	Broiler Prices (\$ per lb.)	24.5	26.0	27.0	- 9
						Soybean Prices (\$ per bu.)	6.29	6.18	6.50	- 3
						Broiler Feed Cost (\$ per ton)	9.00	9.50	9.50	- 5

MISSISSIPPI

Personal Income (\$bil. - SAAR)	4Q	20.4	19.9	19.3	+ 6	Agriculture				
Taxable Sales - \$ bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	25.2	28.9	28.6	-12	(Dates: JAN, JAN)	280	-	216	+30
Petroleum Prod. (thous.)	APR	87.0	88.0	94.0	- 7	Broiler Placements (thous.)	6,865	6,603	6,503	+ 6
Consumer Price Index 1967 = 100		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	68.00	65.50	62.30	+ 9
Kilowatt Hours - mils.	DEC	1.8	1.7	1.6	+13	Broiler Prices (\$ per lb.)	25.5	26.5	25.5	0
						Soybean Prices (\$ per bu.)	6.08	5.97	6.30	- 3
						Broiler Feed Cost (\$ per ton)	11.00	11.50	11.00	0

TENNESSEE

Personal Income (\$bil. - SAAR)	4Q	42.0	41.5	39.9	+ 5	Agriculture				
Taxable Sales - \$ bil.	DEC	28.7	27.4	26.9	+ 7	Farm Cash Receipts - \$ mil.				
Plane Pass. Arr. 000's	FEB	121.2	126.3	120.5	+ 1	(Dates: JAN, JAN)	192	-	166	+16
Petroleum Prod. (thous.)	APR	N.A.	N.A.	N.A.		Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Consumer Price Index 1967 = 100		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	61.40	63.40	56.90	+ 8
Kilowatt Hours - mils.	DEC	5.6	5.0	5.7	- 2	Broiler Prices (\$ per lb.)	23.5	24.0	22.5	+ 4
						Soybean Prices (\$ per bu.)	6.33	5.91	6.30	+ 0
						Broiler Feed Cost (\$ per ton)	9.20	9.10	9.30	- 1

Notes:

Personal Income data supplied by U. S. Department of Commerce. Taxable Sales are reported as a 12-month cumulative total. Plane Passenger Arrivals are collected from 26 airports. Petroleum Production data supplied by U. S. Bureau of Mines. Consumer Price Index data supplied by Bureau of Labor Statistics. Agriculture data supplied by U. S. Department of Agriculture. Farm Cash Receipts data are reported as cumulative for the calendar year through the month shown. Broiler placements are an average weekly rate. The Southeast data represent the total of the six states. N.A. = not available. The annual percent change calculation is based on most recent data over prior year. R = revised.



EMPLOYMENT

	MAR 1983	FEB 1983	MAR 1982	ANN. % CHG.		MAR 1983	FEB 1983	MAR 1982	ANN. % CHG.
UNITED STATES									
Civilian Labor Force - thous.	109,873	109,647	108,761	+ 1	Nonfarm Employment- thous.	88,240	87,718	89,679	- 2
Total Employed - thous.	97,994	97,265	98,471	- 0	Manufacturing	18,147	18,069	19,207	- 8
Total Unemployed - thous.	11,879	12,382	10,290	+15	Construction	3,478	3,395	3,631	- 4
Unemployment Rate - % SA	10.3	10.4	9.0		Trade	20,129	20,033	20,306	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	16,030	15,970	16,176	- 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	19,216	19,032	18,828	+ 2
Mfg. Avg. Wkly. Hours	39.6	38.8	39.1	+ 1	Fin., Ins., & Real Est.	5,378	5,360	5,304	+ 1
Mfg. Avg. Wkly. Earn. - \$	347	339	327	+ 6	Trans. Com. & Pub. Util.	4,884	4,873	5,049	- 3
SOUTHEAST									
Civilian Labor Force - thous.	14,025	14,064	13,854	+ 1	Nonfarm Employment- thous.	11,380	22,347	22,440	- 1
Total Employed - thous.	12,537	12,466	12,501	+ 0	Manufacturing	2,128	2,126	2,210	- 4
Total Unemployed - thous.	1,488	1,598	1,353	+10	Construction	602	603	658	- 8
Unemployment Rate - % SA	10.5	11.1	9.8		Trade	2,697	2,685	2,673	+ 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	2,172	2,168	2,172	0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	2,292	2,279	2,219	+ 3
Mfg. Avg. Wkly. Hours	39.8	39.7	39.4	+ 1	Fin., Ins., & Real Est.	657	653	645	+ 2
Mfg. Avg. Wkly. Earn. - \$	301	300	285	+ 6	Trans. Com. & Pub. Util.	690	689	701	- 2
ALABAMA									
Civilian Labor Force - thous.	1,738	1,740	1,683	+ 3	Nonfarm Employment- thous.	1,304	1,302	1,315	- 1
Total Employed - thous.	1,478	1,456	1,452	+ 2	Manufacturing	326	325	341	- 4
Total Unemployed - thous.	260	284	231	+13	Construction	58	58	55	+ 5
Unemployment Rate - % SA	14.6	15.9	13.8		Trade	265	265	264	+ 0
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	293	293	292	+ 0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	219	219	214	+ 5
Mfg. Avg. Wkly. Hours	40.0	39.8	38.8	+ 3	Fin., Ins., & Real Est.	59	58	58	+ 2
Mfg. Avg. Wkly. Earn. - \$	302	298	281	+ 7	Trans. Com. & Pub. Util.	70	70	72	- 3
FLORIDA									
Civilian Labor Force - thous.	4,610	4,679	4,565	+ 1	Nonfarm Employment- thous.	3,846	3,838	3,816	+ 1
Total Employed - thous.	4,202	4,235	4,174	+ 1	Manufacturing	462	464	470	- 2
Total Unemployed - thous.	408	444	390	+ 5	Construction	236	237	262	-10
Unemployment Rate - % SA	8.9	9.7	8.9		Trade	1,026	1,023	1,012	+ 3
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	644	641	641	+ 0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	949	944	911	+ 4
Mfg. Avg. Wkly. Hours	40.3	40.0	39.9	+ 1	Fin., Ins., & Real Est.	287	286	280	+ 3
Mfg. Avg. Wkly. Earn. - \$	294	290	274	+ 7	Trans. Com. & Pub. Util.	234	234	230	+ 2
GEORGIA									
Civilian Labor Force - thous.	2,676	2,651	2,626	+ 2	Nonfarm Employment- thous.	2,209	2,198	2,184	+ 1
Total Employed - thous.	2,460	2,424	2,419	+ 2	Manufacturing	495	494	504	- 2
Total Unemployed - thous.	216	227	204	+ 6	Construction	94	94	101	- 7
Unemployment Rate - % SA	8.3	8.3	8.1		Trade	521	517	508	+ 3
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	445	444	437	+ 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	384	380	368	+ 4
Mfg. Avg. Wkly. Hours	40.0	40.4	38.9	+ 3	Fin., Ins., & Real Est.	118	117	115	+ 3
Mfg. Avg. Wkly. Earn. - \$	281	284	260	+ 8	Trans. Com. & Pub. Util.	145	144	145	0
LOUISIANA									
Civilian Labor Force - thous.	1,839	1,833	1,838	+ 0	Nonfarm Employment- thous.	1,589	1,589	1,629	- 3
Total Employed - thous.	1,616	1,610	1,672	- 3	Manufacturing	192	193	212	- 9
Total Unemployed - thous.	223	223	166	+34	Construction	115	116	127	- 9
Unemployment Rate - % SA	12.0	11.9	10.2		Trade	364	364	365	- 0
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	313	312	311	+ 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	307	306	300	+ 2
Mfg. Avg. Wkly. Hours	39.4	39.4	41.5	- 5	Fin., Ins., & Real Est.	80	80	79	+ 1
Mfg. Avg. Wkly. Earn. - \$	377	379	383	- 2	Trans. Com. & Pub. Util.	124	125	131	- 5
MISSISSIPPI									
Civilian Labor Force - thous.	1,052	1,043	1,054	- 0	Nonfarm Employment- thous.	783	780	798	- 2
Total Employed - thous.	930	913	942	- 1	Manufacturing	196	195	206	- 6
Total Unemployed - thous.	122	130	112	+ 9	Construction	39	39	41	- 5
Unemployment Rate - % SA	11.4	11.7	9.6		Trade	159	159	159	0
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	182	182	185	- 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	124	123	122	+ 2
Mfg. Avg. Wkly. Hours	39.2	39.1	38.6	+ 2	Fin., Ins., & Real Est.	33	33	33	0
Mfg. Avg. Wkly. Earn. - \$	258	258	246	+ 5	Trans. Com. & Pub. Util.	39	38	39	0
TENNESSEE									
Civilian Labor Force - thous.	2,110	2,118	2,092	+ 1	Nonfarm Employment- thous.	1,649	1,640	1,698	- 3
Total Employed - thous.	1,851	1,828	1,842	+ 0	Manufacturing	457	455	477	- 4
Total Unemployed - thous.	259	290	250	+ 4	Construction	60	59	72	- 17
Unemployment Rate - % SA	11.7	12.8	11.8		Trade	362	357	365	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	295	296	306	- 4
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	309	307	304	+ 2
Mfg. Avg. Wkly. Hours	39.6	39.7	38.4	+ 3	Fin., Ins., & Real Est.	80	79	80	0
Mfg. Avg. Wkly. Earn. - \$	293	294	268	+ 9	Trans. Com. & Pub. Util.	78	78	84	- 7

Notes: All labor force data are from Bureau of Labor Statistics reports supplied by state agencies.
Only the unemployment rate data are seasonally adjusted.
The Southeast data represent the total of the six states.
The annual percent change calculation is based on the most recent data over prior year.

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