

Voice

^{of}
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Federal Reserve and Treasury Support the Dollar

On November 1 the Federal Reserve and the Treasury announced measures to strengthen the dollar in foreign exchange markets. In a joint statement, the Secretary of the Treasury and the Federal Reserve Board Chairman declared: "Recent movement in the dollar exchange rate has exceeded any decline related to fundamental factors, is hampering progress toward price stability, and is damaging the climate for investment and growth. The time has come to call a halt to this development."

The Federal Reserve Board announced the following specific measures:

- Approval of a 1-percentage-point increase in the discount rate at Federal Reserve banks from $8\frac{1}{2}$ to $9\frac{1}{2}$ percent. The discount rate is the rate charged member banks when they borrow from their district Federal Reserve Bank.

- Establishment of a supplementary reserve requirement, in addition to existing reserve requirements, equal to 2 percent of time deposits in denominations of \$100,000 or more.

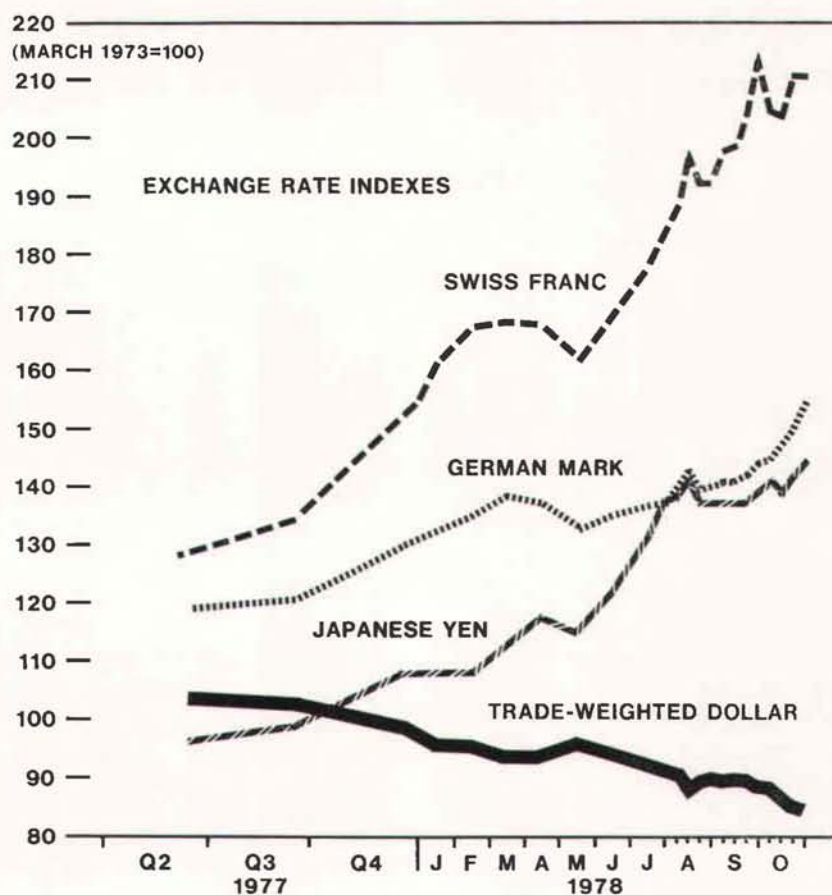
- Increases in the Federal Reserve's reciprocal currency (swap) arrangements with the central banks of Germany, Japan, and Switzerland by \$7.6 billion to \$15.0 billion.

The prearranged credit lines with the three countries are part of a network of reciprocal short-term credit arrangements with 14 central banks and the Bank for International Settlements, commonly referred to as the swap network. The foreign currencies made available through the expanded short-term credit arrangements with the foreign central banks can be used by the Federal Reserve to buy dollars in exchange market support operations.¹

The reserve requirement action, which increased required reserves by about \$3 billion, should help moderate the recent rapid expansion in bank credit. Together with the increase in the discount rate, the higher reserve requirements should increase the incentive for member banks to borrow funds from abroad, thereby strengthening the dollar in foreign markets.

1. One noteworthy aspect of the swap increase is that Japan is included, with an increase from \$2 billion to \$5 billion. The United States has not used this swap line in the past, and the increase could augur intervention in the yen as well as the German deutsche mark and the Swiss franc.

Dollar's value has progressively weakened over past year



NOTE: The trade-weighted dollar is an index of the weighted-average exchange value of the U.S. dollar against currencies of ten other countries. Weights are the 1972-76 global trade of each of the ten countries.

SOURCE: Board of Governors, Federal Reserve System.

Foreign countries have achieved much sharper reductions in their inflation rates

TABLE 1. Changes in Consumer Price Indexes of Seven Major Countries

(Percentage changes at annual rates)

Country	Three years ended 1977-Q2	1977-Q2 to 1978-Q2	Change	Forecast, 1978-Q2 to 1979-Q2
Germany	5.0	2.6	-2.4	3.3
Japan	10.5	3.7	-6.8	5.4
France	10.5	9.0	-1.5	11.0
United Kingdom	19.1	7.6	-11.5	8.8
Canada	8.9	8.9	.0	6.9
Italy	17.7	12.1	-5.6	13.5
Trade-weighted average of six countries ¹	9.8	5.5	-4.3	6.6
United States	7.5	7.0	-.5	7.7

1. Weights are the 1972-76 global trade of each of the six countries.
 SOURCES: Federal Reserve Bank of St. Louis.
 Organisation for Economic Co-operation and Development.
 Federal Reserve Bank of Dallas.

To augment the measures taken by the Federal Reserve, the Treasury announced the following measures:

- Issuing up to \$10 billion of Treasury securities denominated in foreign currencies, intended primarily for sale to private foreigners.
- Drawing \$3 billion in foreign currencies from its reserves at the International Monetary Fund and selling \$2 billion of its IMF Special Drawing Rights (SDR's) for foreign currencies.
- Increasing its gold sales to at least 1,500,000 ounces monthly beginning in December, up from 300,000 ounces currently and about double the previously announced level of 750,000 ounces that was to have begun in November.

To the extent that the gold is sold to foreign residents, increased gold sales will help reduce the U.S. trade deficit and absorb excess foreign-held dollars. The currencies acquired from the IMF, the sale of SDR's, and the issuance of foreign-currency-denominated Treasury securities—together with the amounts available through the Federal Reserve swap lines—provide up to \$30 billion in foreign currencies for support operations in exchange markets.

The goal of these measures is to reverse the decline in the dollar's value abroad. By showing an intention to support the dollar, the Treasury and the Federal Reserve hope to stem unwarranted

diversification out of dollars by private and official foreigners. In the long run, the recovery of the dollar will depend on actions by the Government to change underlying inflationary expectations.

The value of the dollar in foreign exchange markets has progressively weakened for over a year. Since September last year, it has fallen against virtually all major currencies except the Canadian dollar. During that period, it has declined 28 percent against the German mark, nearly 47 percent against the Japanese yen, and over 55 percent against the Swiss franc. The trade-weighted average value of the dollar, a broader measure of its value, has declined about 20 percent in the past year.² In the period from the end of August to the end of October, the dollar declined 7.6 percent on a trade-weighted basis, reaching a new low and precipitating the actions of the Federal Reserve and the Treasury.

2. This measure of the dollar's value takes into account the amount of foreign trade with different countries. The greater a country's exports and imports, the more that country's currency exchange rate affects the trade-weighted average value of the dollar. Thus, the index is a better measure of the dollar's value in international markets than is any single-country exchange rate.

**Increased competitiveness and relatively slower growth
expected to reduce deficit in U.S. current account**

TABLE 2. Current Balances of Major Countries

(Billions of dollars)

Area	1974	1975	1976	1977	Forecast	
					1978	First half, 1979
United States	-2.3	11.6	-1.4	-20.2	-25.0	-18.0
Japan	-4.7	-7	3.7	11.0	17.5	13.0
Germany	9.8	4.0	3.8	3.8	5.0	3.0
Other major European countries ...	-22.4	-4.5	-10.4	-6	4.0	5.5

NOTE: The current balance is the sum of the merchandise trade balance, net services, and private and official transfers.
SOURCE: Organisation for Economic Co-operation and Development.

A major reason for the recent bearish sentiment against the dollar has been a reversal in relative rates of inflation in the United States and other countries in the past year. Until recently, the United States had a lower rate of inflation than did its major trading partners. As shown in Table 1, the rate of inflation in the United States, as measured by consumer prices, was 2.3 percentage points less than the average inflation rates in major trading countries in the three years ended in the second quarter of 1977. Although the United States reduced its rate of inflation during the next year, anti-inflation policies in other countries were more successful so that, on average, their inflation rates fell more than 4 percentage points. Consequently, during the past year the inflation rate has been higher in the United States than abroad. Moreover, by estimates of the Organisation for Economic Co-operation and Development (OECD), the rate of inflation in the United States is likely to remain somewhat higher through 1979.

Another reason for the dollar's decline has been a persistent U.S. current account deficit since early 1976 (Table 2). This deficit in the balance of international payments tended to increase net foreign claims on U.S. assets (and decrease U.S. claims on foreign assets). Thus, the net stock of dollar assets in the hands of foreigners has been increasing during a period when domestic inflation was making the dollar a less attractive asset to hold.

Paradoxically, much of the deficit in the balance of payments has been a result of the relative strength of the U.S. economy. As shown in Table 3, real GNP has been growing more rapidly in the

United States than for foreign economies since 1975 (the last year the U.S. balance of trade was in surplus). The more rapid rate of growth of the domestic economy tended to increase the demand for foreign goods, pushing up total U.S. imports. By contrast, the relatively slow growth of the foreign economies caused them to demand fewer exports from the United States. We have posted larger and larger trade deficits, while our trading partners have been posting large surpluses. But this difference in growth rates has already begun to be reversed, and the OECD projects a faster growth rate abroad than in the United States for the first half of next year.

The more rapid rate of inflation in the United States since the beginning of 1977 is partly responsible for the trade deficit. Taken by itself, the higher inflation rate makes U.S. goods less competitive in foreign markets. However, in a system of floating exchange rates, as has existed since 1973, the exchange rate of a currency will tend to decline in order to offset domestic inflation and maintain international competitiveness. In fact, the value of the dollar in foreign exchange markets has recently fallen by more than enough to compensate for the higher U.S. inflation rate; from early 1977 to mid-1978, the cost of U.S. goods relative to the cost of foreign goods, adjusted for changes in exchange rates, fell about 6 percent. It is expected that the increased competitiveness of U.S. goods will help strengthen the U.S. current account balance by next year.

The actions announced by the Federal Reserve and the Treasury serve as bridging measures to support the dollar until more fundamental forces

**Growth strong in United States in past
but slowing relative to growth abroad**

**TABLE 3. Changes in Real Gross National Product
of Seven Major Countries**

(Percentage changes at annual rates)

Country	1975	1976	1977	Forecast	
				1978	First half, 1979
Germany	-2.5	5.7	2.4	2.5	2.8
Japan	2.5	6.0	5.1	5.5	4.5
France1	4.6	3.0	3.8	3.8
United Kingdom	-2.1	2.3	.7	2.8	1.8
Canada	1.1	4.9	2.6	4.0	4.0
Italy	-3.5	5.7	1.7	2.0	3.0
Trade-weighted average of six countries ¹	-.8	4.9	2.7	3.4	3.3
United States	-1.3	6.0	4.9	3.8	3.0

1. Weights are the 1972-76 global trade of each of the six countries.
SOURCES: Federal Reserve Bank of St. Louis;
Organisation for Economic Co-operation and Development;
Federal Reserve Bank of Dallas.

have time to take hold, assuming further progress in slowing domestic inflation. Exchange market intervention by the Federal Reserve and foreign central banks provides direct support for the dollar. The increase in the Federal Reserve discount rate and the supplementary reserve requirement on large time deposits put immediate upward pressure on short-term interest rates in the United States. Higher yields on dollar-denominated securities make them more attractive to investors, both domestic and foreign, and thereby increase the demand for dollars.³

Whether the measures announced by the Federal Reserve and the Treasury mark a permanent

turnaround for the dollar will depend on whether the factors that caused the dollar's decline are moderated or reversed. If inflationary expectations are reversed, and if current forecasts of lower U.S. growth than that abroad do materialize, we may not need to utilize the entire support package.

3. Investors also take into account differences in rates of inflation in different countries when comparing rates of return on financial assets. Although nominal interest rates have generally been higher in the United States during the period of the dollar's recent fall, the higher inflation here has made real interest rates much lower.

“Fed Quotes”

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

“Indeed, while there is a clear need to maintain the upward momentum of economic activity, we must be increasingly alert to the need to avoid excessively rapid growth. It is desirable that the pace of expansion moderate as a business cycle upswing matures and the economy approaches high levels of utilization of labor and industrial capacity. At times in the past aggregate demand overshot the level at which these resource constraints became significant, and inflationary pressures mounted dramatically. We can not run the risk of repeating that mistake.”

“Capital accumulation is a critical ingredient in the long-range growth of labor productivity and the raising of living standards. To compensate for the neglect of recent years, as well as to accommodate to the reality of scarcer and more expensive energy, a larger share of GNP must now be devoted to the expansion and modernization of the nation's capital stock.”

G. William Miller, Chairman, Board of
Governors of the Federal Reserve System
(Statement before the Committee on Finance,
U.S. Senate, September 6, 1978)

“In evaluating these unemployment figures, it should be remembered that the proper measure of the performance of the economy in providing jobs and absorbing unemployed resources is given, not by changes in unemployment, but in employment. In recent years, the labor force has grown rapidly. This has resulted from the entry of large numbers of women and teenagers particularly. It is accepted that very high rates of expansion are likely to cause overheating and ultimately an overshooting of capacity barriers. There are commensurate limits to the ability of the economy to reduce unemployment within a given time span. So long as the growth of the labor force is high relative to the economy's rate of expansion, the reduction in unemployment will proceed with less rapidity than we would like to see.”

Henry C. Wallich, Member, Board of
Governors of the Federal Reserve System
“Moving in for a Soft Landing” (Remarks in
the George S. Eccles Lecture Series,
Utah State University, Logan, Utah,
February 9, 1978)

“I have become persuaded that humility is the better part of valor for policy makers because it's so difficult to predict the results of policy actions. The prudent course for government would be to provide stable financial conditions.”

Mark H. Willes, President, Federal Reserve
Bank of Minneapolis
(*Wall Street Journal*, September 27, 1978)

"The Board continues to believe that over the long run interest rate ceilings on all deposits should gradually be removed to improve economic efficiency and to permit small savers to earn a competitive return."

G. William Miller, Chairman, Board of
Governors of the Federal Reserve System
(Letter to William Proxmire, Chairman,
Committee on Banking, Housing and Urban
Affairs, U.S. Senate, September 18, 1978)

"The real culprit is inflation. . . . The current taxpayer revolt would not exist were it not for the widespread frustration about inflation. It has been observed that the most insidious thing about inflation is that it tears at the fabric of society, and we are now seeing this happen."

"Group is pitted against group; everybody is out to get his; generous impulses are stifled."

"The best way for those of a liberal persuasion to achieve their ends is to join the fight against inflation. Too often in the past liberals have been identified as being concerned with poverty and economic distress, conservatives with inflation. It is not that simple. . . . The lesson of the real world is that unless we get inflation under control we are not going to have sufficient public support to deal with economic distress."

"We can't look for much success in efforts to talk down inflation. . . . New approaches are needed and should be tried."

"The most fruitful course is to pursue anti-inflationary fiscal and monetary policies—hold down government spending and keep the money supply from growing too fast."

"This kind of action often is not identified with the traditional liberal economic view, but, I suggest, is the most promising route to the liberal goal."

David P. Eastburn, President, Federal
Reserve Bank of Philadelphia
"Meat Ax Approach to Tax Cuts Can Be
Avoided" (*Wall Street Journal*, August 16,
1978)

"The basic purpose of Truth in Lending is to provide the consumer with information that indicates how much a particular credit transaction will cost. The consumer benefits by knowing the additional cost of using credit rather than cash and is able to compare and shop credit costs, thus maintaining a competitive discipline in credit pricing."

"The Board believes, however, that a simplified version of the Truth in Lending Act would operate even more effectively, would result in even greater awareness of credit costs, and would reduce the costs incurred by creditors in achieving compliance with the act's requirements. Thus, the Board believes that simplified Truth in Lending requirements would better serve the consumer."

Philip E. Coldwell, Member, Board of
Governors of the Federal Reserve System
(Statement before the Subcommittee on
Consumer Affairs of the Committee on
Banking, Finance and Urban Affairs, U.S.
House of Representatives, September 6, 1978)

Manufacturing Investment Booms in Texas

By Art Ekholm

Investment in manufacturing in Texas has been high and rising in recent years. At \$4,768 million in 1976, it was more than double the level in 1966 when measured in constant (1972) dollars (Chart 1). Texas led all other states in the amount of manufacturing investment in 1974, 1975, and 1976. For those three years, constant-dollar investment spending in the state grew at an average annual rate of 32.5 percent, in contrast to a 4.1-percent rate for the nation as a whole.

Texas' share of national manufacturing investment has surpassed the state's share of national manufacturing output for many years. This was especially evident in the midseventies, when both share of investment and share of output moved above their long-run trends. In the 20 years from 1954 through 1973, Texas annually accounted for 4.5 to 7.3 percent of total U.S. manufacturing investment (Chart 2). Then, in 1974, 1975, and 1976, Texas' portion of the national total rose markedly to 8.5 percent, 10.2 percent, and 11.7 percent, respectively.¹ Coincident with the Texas investment boom of 1974-76, the proportion of national manufacturing output originating in Texas moved up from the range of 4.2 to 4.4 percent that prevailed in the late sixties and early seventies to 5.2 to 5.6 percent.²

1. These data are from gross plant and equipment expenditures by manufacturing firms, based on the combination of capital replacements and capital additions.

2. Output is measured on the basis of the value added by manufacture.

This boom in Texas manufacturing investment is most likely transitory. The three largest investing industries during the boom—chemicals and allied products, petroleum and coal products, and primary metals—have experienced a moderation in output growth during the midseventies that will bring about a slackening in capacity increases. Investment spending in manufacturing in Texas can be expected to subside and move around its long-run trend in coming years. While this trend has been stronger in the state than in the rest of the nation in the past, the differential will probably narrow in the future.

Sources of investment boom

The front-runners in the investment boom in Texas, chemicals and products and petroleum products, accounted for 56 percent of manufacturing investment in the state over the 1972-76 period. These two giants among Texas manufacturing industries, first and second in the value of output in 1976 (Table 1), recorded average annual growth rates in constant-dollar investment that were above the state average of 32.5 percent for the boom years 1974, 1975, and 1976. Investment, in constant dollars, by the chemical industry grew at an average annual rate of 34.6 percent over these three years, while investment in the petroleum products industry grew 59.2 percent per year (Chart 3). In contrast to these rapid growth rates in investment, both industries had output increases over the three boom years that averaged

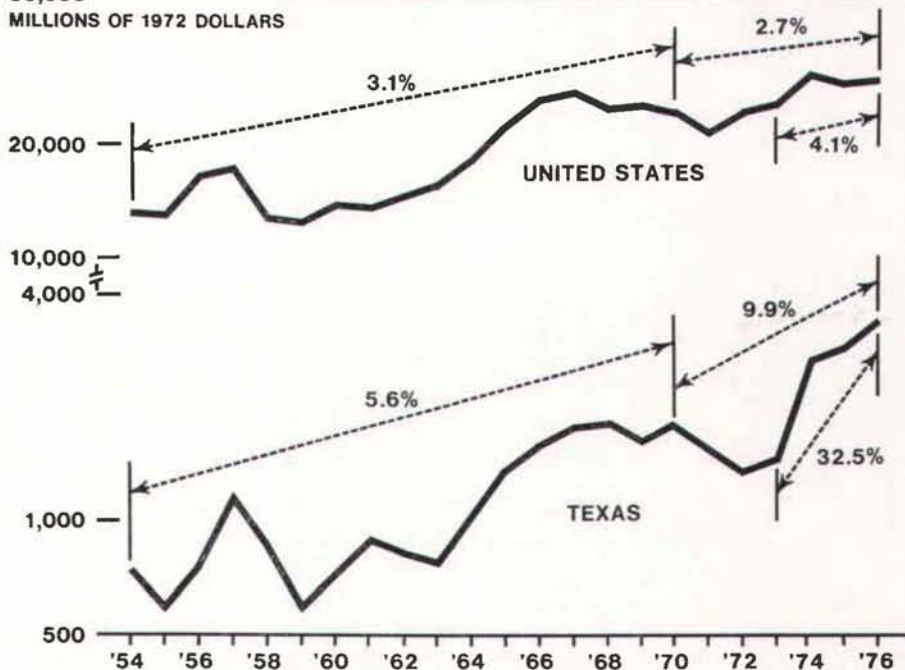
CHART 1

Manufacturing investment in Texas outpaced U.S. investment most sharply in 1974-76

RATIO SCALE

50,000

MILLIONS OF 1972 DOLLARS



NOTE: Equal slopes have equal growth rates. Percentages are average annual growth rates for the periods indicated.

SOURCES: U.S. Bureau of Economic Analysis.
U.S. Bureau of the Census.

only 3.5 percent per year.³ And through 1977 and into 1978, output gains have remained modest.

Why have these two industries experienced such rapid expansion in investment in Texas and modest increases in output? Some key influences are apparent:

1. Price pressures pent up by price controls between 1971 and 1974 spurred a burst of investment spending when controls were removed. This was followed by sales growth reductions due to reces-

3. The output increases are derived from the Texas industrial production index of the Federal Reserve Bank of Dallas.

sion and to consumer reaction to severe cost pressures on prices emanating from the energy intensiveness of these industries, price increases by the Organization of Petroleum Exporting Countries (OPEC), and shortages of natural gas due to price regulation.

2. Much of the investment was in Texas because (a) its abundant energy resources have traditionally drawn these industries to Texas; (b) price ceilings on natural gas sold interstate caused a reallocation to intrastate purchasers; and (c) a host of other locational factors, low tax rates, access to a rapidly growing regional economy, and so on, were conducive to activity in Texas.

CHART 2

Texas has provided rising shares of U.S. manufacturing investment and output



3. The increased investment spending required to meet environmental regulations did not create capacity.

4. Changes in relative energy prices induced investment spending to convert from natural gas to other energy sources—a process also tending to have no effect on productive capacity.

The third largest investing industry, primary metals, increased its investment spending at an average annual rate of 56.1 percent in the 1974-76 boom years. While Texas accounted for only 3.5 percent of U.S. output of primary metals in 1972-76, it received 5.8 percent of U.S. investment expenditures in this industry over the period. The main reasons for the rapid expansion of primary metals capacity in Texas were noted recently by Edward L. McClelland:⁴

1. Access to fast-growing Texas customers, especially construction, oil, and agricultural industries.

2. Lower cost of producing steel in electric furnaces than in other furnaces and the high electrical energy requirements for aluminum production—both in combination with the relatively cheaper electric utility rates in Texas.

While investment spending advanced sharply in the midseventies, Texas output of primary metals showed a major decline in 1975 and remains in the doldrums. Recession and foreign competition have been major roadblocks to expanded output of primary metals in the state.

These three industries—chemicals and products, petroleum products, and primary metals—accounted for almost two-thirds of Texas manufacturing investment in 1972-76 and recorded very rapid increases in investment spending from 1974 through 1976 (and possibly beyond 1976, the last year for which investment data are available).

4. "Southwestern Steel Producers Meet Foreign Competition," *Voice of the Federal Reserve Bank of Dallas*, February 1978, pp. 1-8.

This boom in Texas manufacturing investment is most likely transitory. The three largest investing industries during the boom—chemicals and allied products, petroleum and coal products, and primary metals—have experienced a moderation in output growth during the midseventies that will bring about a slackening in capacity increases.

However, the three Texas industries have recorded only modest increases in output through the 1970's (Chart 4). Chemicals and primary metals were affected more severely than most other Texas industries by the recession of 1975. Chemical output rebounded after 1975 but increased only 3.1 percent in the 12 months ended July 1978. Primary metal output, although remaining well below its 1974 level, increased through 1977 and into 1978, experiencing a growth of 3.7 percent since July last year. After slowing in 1974 and 1975, petroleum refining advanced about 7 percent from 1975 to 1976 and 10 percent the following year but increased only 4 percent in the 12 months ended July 1978.

Annual averages of national capacity utilization rates for these three industries in the 1970's show relatively high rates of capacity utilization in 1973. Energy considerations, for the most part, drew large portions of the ensuing investment expenditures to Texas. Expanded capacity, accompanied by reduced output or smaller increases in output during 1974-75, resulted in decreases in capacity utilization rates. These rates remain relatively low.

Nonelectrical machinery and fabricated metal products were also important investing industries in Texas over the 1972-76 period. Both output and investment expanded rapidly for the two industries. These manufacturers supply a wide variety of goods, including cans, metal doors, fabricated structural metals, computer equipment, compressors, and vending machines. But most notable are their sales of capital goods to the chemical and petroleum products industries and to oil and gas exploration, mining, and transport firms. Fifty cents of each dollar invested by the chemical industry is for nonelectrical machinery (22.1 cents) and fabricated metal products (27.9 cents). Over 20 cents of each dollar invested by the petroleum

products industry is for nonelectrical machinery (13.8 cents) and fabricated metal products (6.8 cents).⁵ Production of oil field machinery accounts for about 40 percent of nonelectrical machinery employment in Texas.

However, care must be taken not to overstate the importance of capital formation in the energy-intensive industries as far as the machinery and fabricated metal industries of Texas are concerned. Only about 11 percent of fabricated metal sales and 30 percent of nonelectrical machinery sales are directly for capital formation in the state, and these sales involve an array of products sold to a wide variety of industries. Exports to other states and foreign countries are important to both of these industries, accounting for 16 percent of fabricated metal sales and 45 percent of nonelectrical machinery sales. About 38 percent of the machinery exports are mining machinery and equipment.⁶

The nonelectrical machinery and fabricated metal industries became a part of the Texas manufacturing investment boom as market-access economies, scale economies, relative labor costs, and other favorable locational factors induced them to expand their Texas facilities to meet rapidly growing demands for their products not only within the state but around the world. Indicative of the influence of accelerated drilling for oil and gas was the increase in employment in oil field machinery production from 27,500 in 1971 to 45,900 in 1977, resulting in an average annual increase of 8.9 percent.

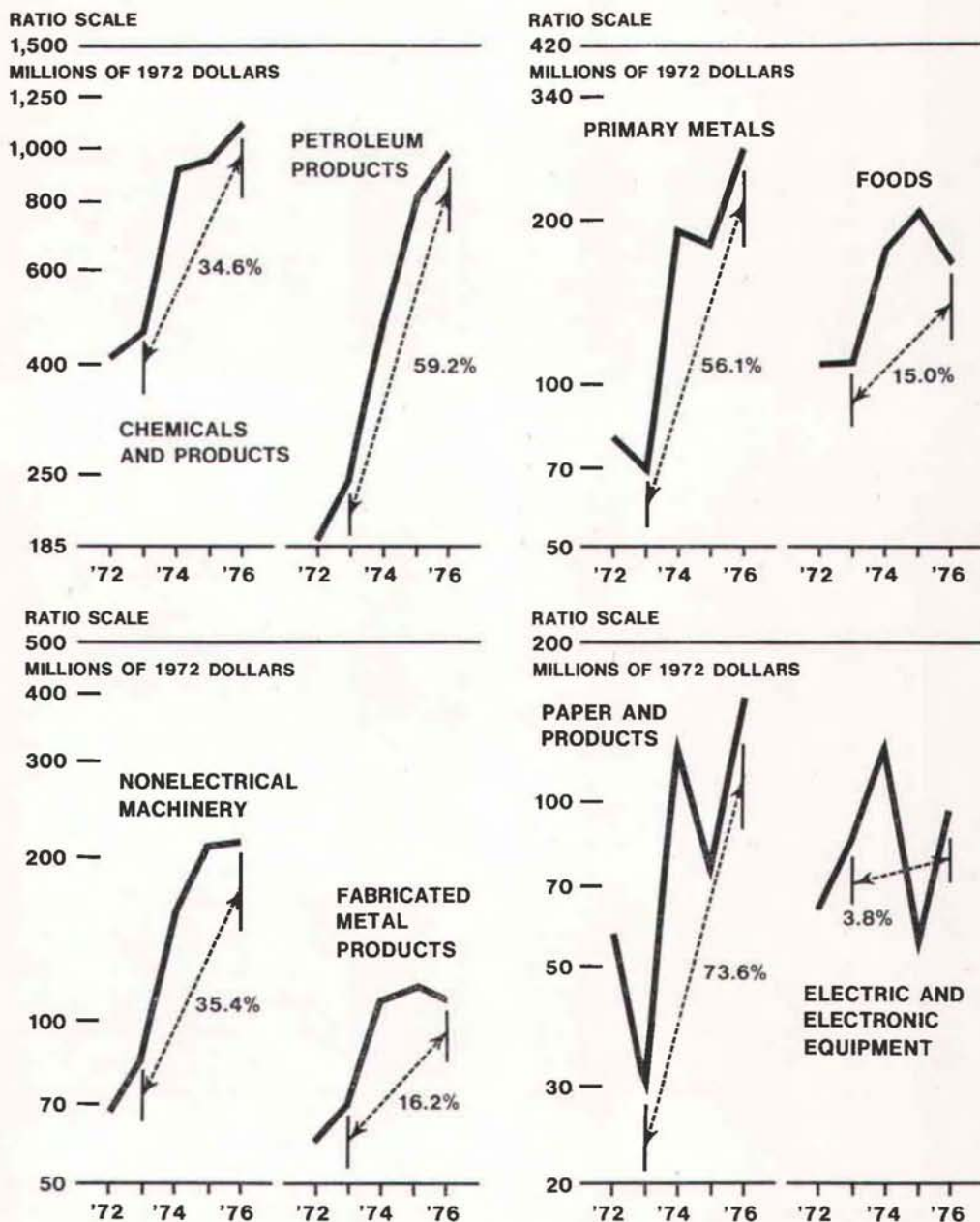
The remaining manufacturing industries in Texas, while responsible for only 27 percent of the manufacturing investment in the state over the 1972-76 period, also experienced high and rising investment spending in the midseventies boom. These industries do not appear to have as strong relationships to energy developments as the five previously mentioned. The food and kindred products, paper and allied products, and electric and electronic equipment industries ranked fourth, seventh, and eighth in Texas manufacturing investment expenditures and had average annual constant-dollar investment growth rates of 15.0 percent, 73.6 percent, and 3.8 percent, respectively,

5. "Interindustry Transactions in New Structures and Equipment, 1967," *Survey of Current Business*, September 1975, pp. 9-21.

6. Texas Department of Water Resources, Planning and Development Division, *The Texas Input-Output Model, 1972*, LP-24 (Austin, 1978).

CHART 3

Investment by most of the eight largest investing industries in Texas has experienced rapid growth



NOTE: Equal slopes have equal growth rates. Percentages are average annual growth rates for the periods indicated.

SOURCES: U.S. Bureau of Economic Analysis.
U.S. Bureau of the Census.

CHART 4

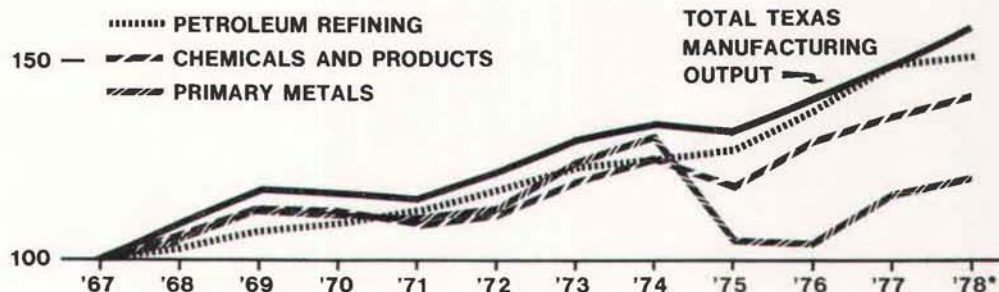
Moderate growth in output of top three investing industries in Texas will cause increases in capacity to slacken

RATIO SCALE

200

(1967=100)

(ANNUAL AVERAGES THROUGH 1977)



* 12 months ended July 1978.

NOTE: Equal slopes have equal growth rates.

during the boom (Chart 3). In all, 14 of the 18 manufacturing industries had shares of national investment spending that were larger than their respective shares of national output (Table 1).

Prospects

There is little prospect that the boom in manufacturing investment in Texas will continue undiminished. During the boom the top three investing industries were experiencing slow growth in output, and they have not experienced sharp output increases since. Even if advantages persist for Texas locations of these industries, stronger output advances than those thus far experienced would be needed to lay the groundwork for a continuance of recent investment levels.

Energy legislation imposing equal wellhead price restrictions on intrastate and interstate natural gas will enhance the relative attractiveness of out-of-state plant sites for chemical producers. However, delivered prices of natural gas will tend to be lower in Texas, and higher gas prices will provide a stimulus to recovery operations—both of which would tend to continue the advantage of

Texas locations for intensive users of natural gas. Although increases in prices of natural gas and crude petroleum will promote production in Texas, some projections have indicated production of the two resources will continue to decline. These declines will not be precipitous, and imports can be expected to supplement local production. Nevertheless, locational advantages for chemicals and petroleum products in Texas will decrease from the high levels of the midseventies, reducing the level of Texas investment by these two leading industries.

While there most likely will be a retreat from the investment levels of the midseventies boom, the underlying strength of Texas manufacturing in a variety of endeavors should maintain a rate of investment growth in line with the long-run trend. On the positive side, there has been strong growth in manufactures not closely tied to energy resources. In Texas, 55 percent of manufacturing employment is now in durable goods production, in contrast to 45 percent in 1950. Electronics, fabricated metals, and machinery have been strong growth industries in the state. Transportation equipment manufacturing, an important industry

TABLE 1

**Texas manufacturing investment led
by chemical and petroleum industries**

(Dollar amounts in millions)

Industry	Manufacturing investment (New capital expenditures, in 1972 dollars)		Manufacturing output (Value added by manufacture)	
	Texas annual average, 1972-76	As percent of U.S. average	Texas value, 1976	Texas, 1972-76, as percent of United States
Chemicals and allied products	\$ 778	19.3	\$ 6,187	11.0
Petroleum and coal products	548	35.6	3,915	30.9
Primary metal industries	160	5.8	984	3.5
Food and kindred products	155	6.1	2,646	4.9
Machinery, except electrical	148	6.1	3,178	4.8
Fabricated metal products	93	5.9	1,837	4.5
Paper and allied products	89	5.0	598	2.9
Electric and electronic equipment ..	86	5.1	1,444	3.2
Stone, clay, and glass products	77	6.2	921	5.0
Transportation equipment	42	1.7	2,003	3.4
Lumber and wood products	41	4.2	503	3.5
Printing and publishing	40	4.1	993	3.4
Rubber and miscellaneous plastics products	38	3.6	570	3.3
Apparel and other textile products	27	8.0	874	5.0
Instruments and related products	9	1.6	345	1.9
Furniture and fixtures	9	4.0	201	3.0
Miscellaneous manufacturing industries	9	1.8	293	1.8
Textile mill products	5	.6	109	.7
TOTAL, 18 INDUSTRIES	\$2,354	8.5	\$27,601	5.0

SOURCES: U.S. Bureau of Economic Analysis.
U.S. Bureau of the Census.

for Texas, has been in a slump during the 1970's but is expected to experience steady growth in the future as defense contracts recover. Non-durable goods industries—such as food and kindred products, apparel, and paper and allied products—have also been growing rapidly in Texas.

Strong population growth in the state will be a stimulus for investment by manufacturers with significant market-access costs. And low tax rates, comparatively low delivered prices for energy, the availability of nonunion labor, favorable weather conditions, and other locational factors will continue to give Texas a competitive edge in the plans of many manufacturing industries.

Perspectives

The relative importance of manufacturing and its components to the overall health of the Texas

economy should be kept in perspective. Manufacturing employment accounted for 20 percent of total nonagricultural employment in Texas in 1977, compared with 24 percent in the United States. And chemicals and petroleum products, which accounted for 56 percent of manufacturing investment in Texas over the 1972-76 period, employed only 13.9 percent of manufacturing workers in 1977 and only 2.8 percent of all nonagricultural

While there most likely will be a retreat from the investment levels of the midseventies boom, the underlying strength of Texas manufacturing in a variety of endeavors should maintain a rate of investment growth in line with the long-run trend.

TABLE 2

Sun Belt phenomenon a long-run experience in Texas

Item	Average annual growth rates (In percent)		Texas growth rate advantage
	United States	Texas	
Manufacturing employment			
1860-1900	4.0	7.0	3.0
1900-1950	2.0	4.3	2.3
1950-1970	1.5	3.6	2.1
1970-1977	.1	2.9	2.8
Population			
1860-1900	2.2	4.1	1.9
1900-1950	1.4	1.9	.5
1950-1970	1.5	1.9	.4
1970-1977	.9	2.0	1.1

SOURCES: Albert W. Niemi, Jr. (*State and Regional Patterns in American Manufacturing, 1860-1900*, Westport, Conn.: Greenwood Press).
 U.S. Bureau of Economic Analysis.
 U.S. Bureau of the Census.
 Federal Reserve Bank of Dallas.

high rates of growth have been the norm in Texas for more than a century. Texas has maintained an average annual rate of growth of manufacturing employment since 1860 that has exceeded national growth by more than 2 percent per year (Table 2). And the rate of growth has, in fact, been decreasing steadily. The growth of manufacturing employment in Texas during the 1970's is more remarkable in its contrast to the lack of growth in the rest of the United States than with respect to the historical trend in Texas.

A similar record is found in population trends. Population growth in Texas dipped from an average annual rate of 4.1 percent in the 1860-1900 period to 1.9 percent from 1900 to 1970. And during this century, an "advantage" of about 0.5 percent per year has been maintained over total U.S. population growth. Since 1970, Texas has grown at an average annual rate of 2.0 percent, increasing its differential relative to U.S. growth, which has slowed to 0.9 percent per year. Most of this differential is a result of rapid in-migration in the midseventies.

Over brief periods, the energy "crisis" and other events have produced abnormal differentials in growth rates, but the underlying trend has been quite consistent. In Texas manufacturing the underlying trend reflects more than a century of rapid growth, at declining rates and with declining differentials in relation to the rest of the nation. As Texas has matured—that is, developed an economic structure more like the rest of the nation—the growth differences have decreased.

workers in the state. A slowdown in investment by these two energy-intensive industries will have repercussions on a number of other sectors of the Texas economy but will not dominate the overall performance of the diversified state economy.

An additional perspective on Texas economic growth is required in light of the popular notion of a Sun Belt phenomenon, alleging remarkable growth in recent years, especially since World War II and particularly in the 1970's. However,

Through “the Window” at the Fed

By Carol C. Madeley

“You have a \$1 million, 15-day loan due November 27.”

After hearing these words from the loan officer of the Federal Reserve Bank of Dallas, John Wright, president of First National Bank of Smalltown, sighed with relief. His day had begun hectically with an urgent phone call that one of the bank's customers had unexpectedly transferred a substantial sum of money to another bank. Later, John learned a large loan to the town's major retail store had been approved. This was good news because the bank had been working on the deal for some time, but the loan plus the large transfer of funds left the bank with a temporary reserve deficiency.

Although the bank had a sufficient amount of securities that could be sold to cover the deficiency, selling now and buying back later would result in a loss as well as transactions expenses. Another alternative was to buy Federal funds, uncommitted reserves banks lend one another; but the rate, which fluctuates daily, was higher than the current Federal Reserve discount rate of $9\frac{1}{2}$ percent. Therefore, John decided to borrow from the Fed for the first time.

Although John received reams of Fed literature on the discount window, most of it sat in his In box, unread. Therefore, it was with some apprehension that John, not knowing exactly what to expect, called the Loan Department of the Federal Reserve Bank of Dallas.

After discussing the situation with the loan officer, John was pleasantly surprised at the lack of paperwork involved. Contrary to typical commercial loans, there was no application to complete and submit. Instead, documentation flows from the lender, the Fed, to the borrower.

The Loan Department already had both of the documents needed from First National. One, Authority to Discount, is a resolution adopted by the bank's board of directors that specifies which officers are authorized to borrow on the bank's behalf. The founders of John's bank had signed the document in 1919, and the Fed still had it on file. The other document already on file at the Fed, the Continuing Lending Agreement, specifies the terms and conditions for borrowing from the Fed.

John and the loan officer discussed the amount and length of the loan and agreed on \$1 million due in 15 days. John believed deposits would in-

crease over the next 15 days and, so, the loan could be paid at maturity; the loan officer assured him that if deposits did not increase as expected, the loan could be renewed.

The loan is considered adjustment credit, and the rate on such loans is the basic discount rate, currently 9½ percent. John pledged \$1 million of securities held in safekeeping at the Fed, and the loan process was completed. Immediately, funds were credited to First National's account at the Federal Reserve; later in the day, the Fed would send an advice of credit to the bank. At the loan's maturity, the Fed will charge First National's account for the amount of the loan plus interest, unless the bank requests renewal of the loan.

During the brief conversation, the loan officer reminded John that his particular bank would be eligible for seasonal borrowing in the spring and suggested that John contact him later, when convenient, to discuss this borrowing program.

Seasonal borrowing

Seasonal borrowing is available to member banks, like First National Bank of Smalltown, that serve specialized communities, such as agricultural, resort, or college areas. Because the Eleventh Federal Reserve District includes a number of agricultural areas, approximately 60 percent of the member banks in the District qualify for seasonal credit.

To qualify, a member bank must have a recurring seasonal need for credit. Seasonal needs could result from a variety of factors, such as those related to crop or livestock production cycles. In Smalltown, for example, as in many other rural towns, farmers typically borrow from their bank to finance the planting of crops. During the growing season, farmers' deposits at the bank fall continuously while their financing needs grow. A community's financing needs are often greatest when bank deposits are lowest. This puts a financial strain on the bank. After the crops are harvested and sold, however, financing needs decrease, loans are repaid, and excess funds are deposited in the bank. This cycle occurs every year, and every year the bank goes through alternating periods of financial pressure and ample funds.

To help banks cope with these seasonal pressures, the Federal Reserve will make a commitment to lend a bank sufficient money to carry it through periods when deposits are seasonally low and/or loan demand is seasonally high.

The seasonal borrowing program was first available to member banks in 1973 and was liberalized in 1976. A principal feature of the liberalization is that member banks can now borrow under the seasonal privilege while having net sales of Federal funds if such sales represent the bank's normal operating pattern. The revision was made in recognition of the growing number of small banks that use the Fed funds market as a permanent source of liquidity.

Any member bank with deposits under \$500 million that experiences seasonal variations in its loans or deposits may be eligible for a seasonal credit line. The Reserve banks use computer projections to help identify banks in their districts that may qualify for seasonal credit. Subsequently, the Reserve banks advise qualifying banks of the availability of seasonal credit. If a member bank is interested, the Reserve Bank will prepare the necessary analysis and will work with the bank to determine need and extent of seasonal borrowing.

Federal Reserve interest rates

The same discount rate that applies to adjustment credit applies to seasonal borrowing. This rate, in addition to the other three Federal Reserve interest rates, is reviewed every 14 days by the Board of Directors of each Reserve Bank, and recommendations concerning the rate are sent to the Board of Governors in Washington. Any changes in the rates must be approved by the Board of Governors.

Borrowing at the basic discount rate must be secured by direct U.S. Government obligations, fully guaranteed Federal agency obligations, or eligible paper, which includes commercial, agricultural, and industrial paper, one- to four-family residential mortgage notes, bankers acceptances and other bills of exchange, construction loans, and factored paper.

Other paper, such as municipal securities, that is acceptable to a Reserve Bank may also be used to secure a loan but at a rate at least one-half of 1 percent above the basic discount rate. This second rate, called the 10(b) rate because it is provided for in Section 10(b) of the Federal Reserve Act, is currently 10 percent.

Collateral must be held by the Federal Reserve Bank unless prior arrangements have been made to permit another approved commercial bank to hold the securities under a custody receipt arrangement.

In addition to the two rates based on collateral, there are two other rates. A higher rate may be charged for prolonged borrowing (more than eight weeks) in significant amounts (when the loan exceeds, on average, the borrowing bank's required reserves). Typically, this rate is used when the basic discount rate is below market interest rates.

The reason that prolonged borrowing may incur a higher rate dates back to 1974. At that time, Franklin National Bank was in financial difficulty and borrowing heavily from the Federal Reserve Bank of New York. The loan was made at the discount rate of 8 percent, which was substantially below money market rates at that time. To avoid providing a large subsidy over an extended period of borrowing to an individual bank, and to avoid raising the basic rate considerably, the special rate was authorized. However, it is seldom used. This special rate, currently $10\frac{1}{2}$ percent, has typically been set at 1 to 2 percentage points above the basic discount rate.

Higher rates may also be charged on emergency credit made available to nonmember banks or other corporations facing emergency conditions. This rate, which is currently $12\frac{1}{2}$ percent, has never been used.

It is appropriate for member banks to use the discount window when faced with temporary reserve deficiencies, seasonal swings in credit demand or in deposits, or emergency situations. However, continuous borrowing at the discount window is considered inappropriate. Federal Reserve Regulation A lists other specific purposes for which use of the discount window is inappropriate. These include borrowing to obtain tax advantages, to profit from interest rate differentials, and to finance speculation in securities, real estate, or commodities.

Demand for loans from the Fed

The Loan Department of the Federal Reserve Bank is most active during periods of expanding economic activity when loan demand is strong. The demand for credit from the Federal Reserve is determined by general economic conditions and by the relationship between the basic discount rate and comparable money market rates. Borrowings generally increase in periods of rising interest rates and decline in periods of falling interest rates. This occurs primarily because

changes in the discount rate, especially in recent years, have lagged behind movements in money market rates. Consequently, in periods of rising rates, the cost of borrowing at the discount window becomes relatively more attractive than acquiring funds in other sectors of the money market.

For example, borrowings spurted sharply in the 1973-74 period of credit tightness when the discount rate was considerably lower than comparable money market rates. During 1973 the discount rate ranged from 5 percent to $7\frac{1}{2}$ percent, while the Fed funds rate averaged 8.74 percent. This trend continued in 1974, when the discount rate ranged from $7\frac{1}{2}$ percent to 8 percent while the average Fed funds rate was 10.51 percent. As a result of these interest rate differentials, average daily borrowing at the Federal Reserve Bank of Dallas in 1973 and 1974 was high—\$94.8 million and \$93.9 million, respectively.

The situation was reversed in 1975 and 1976, when interest rates were falling, and the discount rate was not lowered as quickly or as much as the Fed funds rate. During 1975 the discount rate ranged from $7\frac{1}{4}$ percent to 6 percent, while the average Fed funds rate was 5.82 percent. Again in 1976, the discount rate, which ranged from 6 percent to $5\frac{1}{4}$ percent, was consistently higher than the Fed funds rate, which averaged 5.05 percent. Thus, the number of banks borrowing from the Federal Reserve Bank of Dallas dropped significantly from 119 in 1974 to 30 in 1975. Average daily borrowing was \$7.6 million in 1975 and \$8.3 million in 1976.

During the second half of 1977, the Fed funds rate and the discount rate were roughly comparable. During 1978 the discount rate has tended to be slightly lower than market rates as interest rates have climbed steadily. As a result, Eleventh District banks started coming to the discount window again in 1977 and have continued to come in 1978. In 1977, 58 banks borrowed a daily average of \$47.6 million; comparable figures for the first half of 1978 are 65 banks borrowing \$76.1 million.

Many of the banks have found, as the Small-town bank did, that borrowing at the discount window is an important aspect of Federal Reserve membership. By providing a ready pool of funds for appropriate uses, the Federal Reserve helps member banks over periods of reserve difficulties.



Regulatory Briefs

Review of Recent Actions of the Board of Governors of the Federal Reserve System

- **EURODOLLAR BORROWINGS** must continue to be reported by member banks, even though the reserve requirement percentages against them have been reduced to zero. Questions may be referred to the Accounting Department of the Federal Reserve Bank of Dallas, (214) 651-6334.

- **SECURITIES BROKERS AND DEALERS** are now allowed, for the first time, to extend credit on nonconvertible over-the-counter corporate bonds, effective October 30, 1978. The securities, however, must meet the following standards: the outstanding principal and interest on a bond must be at least \$25 million; all payments of principal and interest on the bond must be current; and the bond must be registered with the Securities and Exchange Commission. For further information, contact the Consumer Affairs Division of this Bank, (214) 651-6171.

- **EIGHTY-ONE STOCKS** have been added to the Federal Reserve's over-the-counter margin list. The new list has 1,157 stocks that are subject to the same margin requirements (currently 50 percent) as stocks listed on national stock exchanges. Copies of the new margin list may be obtained by calling the Bank and Public Information Department of this Bank, (214) 651-6267.

- **A POLICY STATEMENT ON INTERCORPORATE INCOME TAX PRACTICES** of bank holding companies and their state member bank subsidiaries has been adopted by the Board of Governors. The statement warns that the Board will take supervisory action, including cease-and-desist orders, when it finds transactions that transfer assets and income from subsidiary banks to the parent company without providing offsetting benefits to the bank. For further information, contact the Holding Company Supervision Department of this Bank, (214) 651-6120.

- **AUTOMATIC TRANSFER SERVICE ADVERTISEMENTS** should clearly indicate that the new service involves two separate accounts—a checking account and a savings account—and should not convey the impression that interest is being paid on the checking account or that checks may be written against an interest-bearing savings account. Depositors must be informed at the time the automatic-transfer-of-savings service is authorized that the bank reserves the right to require at least 30 days' notice of withdrawal from savings accounts. Questions should be referred to the Consumer Affairs Division of this Bank, (214) 651-6169.

Homeownership Costs Up Sharply in the Southwest

By Charles N. Walush

Home buyers have received a double dose of inflation this year. Not only have new-home prices risen across the nation by an average of 15 percent above a year ago, but the cost of financing the purchase on credit has risen sharply as well. Established homeowners are also feeling inflation's grip as rising utility bills, taxes, insurance, and maintenance and repair costs are all making it more expensive to own a house.

The increase in homeowner costs has been particularly strong in the Southwest. While homeownership costs nationally have risen about 11 percent above a year ago, the cost of buying, financing, and maintaining a house in Houston is up 20 percent and in Dallas-Fort Worth 12 percent. The rapid rise in homeowner costs has shown no signs of abatement.

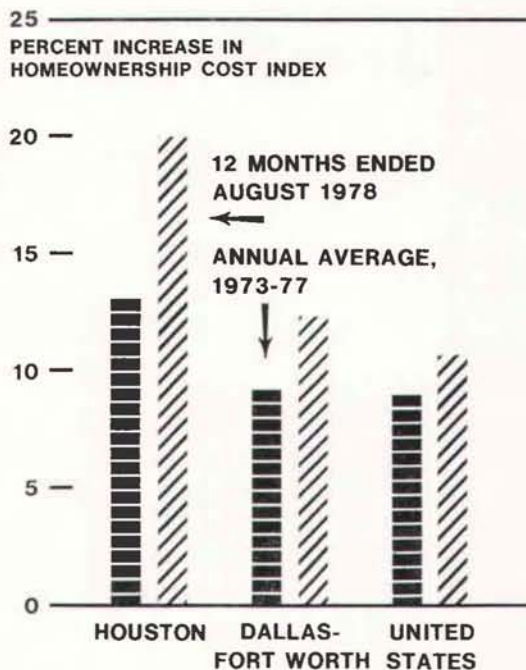
The most obvious source of higher homeowner costs is the rise in house prices. Historically, house prices have risen less in the South than in the nation as a whole, but this situation has

changed for the metropolitan areas experiencing housing booms in recent years. The price of new homes financed with conventional mortgages at major types of lenders in the Dallas-Fort Worth area averaged \$68,300 in the third quarter of this year, standing 24 percent above a year earlier. Previously owned homes in Dallas-Fort Worth sold at an average price of \$56,000, or 10 percent above a year earlier.

In Houston, where new housing subdivisions continue to be pushed farther from downtown for want of available land, the closer-in existing homes are being sold at a premium. The result has been a relatively modest 9-percent increase in new-home prices versus a 15-percent rise in prices of previously owned homes. Prices of previously owned homes in Houston-Galveston averaged \$67,000 in the third quarter, compared with the \$62,500 average for new homes.

Although the rise in home prices may be the most obvious source of inflation in homeowner

Homeownership costs have surged in Houston and Dallas-Fort Worth



SOURCE: U.S. Bureau of Labor Statistics.

costs, home prices do not appear to be the fastest rising cost. Financing, tax, and insurance costs have risen even faster, as measured by the U.S. city average consumer price index. In August the financing, tax, and insurance component of homeownership costs was nearly 15 percent above a year earlier. The Dallas-Fort Worth and Houston consumer price indexes do not provide a detailed estimate of the major components of homeowner costs, and it is possible that some components have not risen as rapidly in the Southwest as in the United States. But interest rates and insurance rates probably have changed at roughly comparable rates in most major cities. Taxes, while generally rising, have a closer tie to local influences.

Mortgage interest rates are about 70 to 80 basis points above a year ago. In September, mortgage interest rates averaged about 9.7 percent at major lenders in Dallas-Fort Worth and Houston-Galveston, compared with 9.5 percent nationally. The higher mortgage rates in these areas are par-

tially offset by other financing terms. Down payments average 15 to 20 percent in Dallas-Fort Worth and Houston-Galveston, compared with the average of 25 percent at the nation's major mortgage lenders; and the term of mortgages in the two areas averages about 30 years—slightly longer than the national average.

The cost of maintaining and repairing houses has not risen as fast as for most other components of homeowner costs. According to the U.S. city average consumer price index, maintenance and repair costs have increased at about the same 8-percent rate as the general price level but well below the rates of inflation for other homeowner costs.

Finally, and perhaps most annoying to homeowners, there has been the rise in utility bills. Fuel and utility expenses in Houston and Dallas-Fort Worth stand 24 percent and 13 percent, respectively, above a year earlier. In July and August, the rise in fuel and utility costs accelerated to annual rates of 40 percent and 22 percent in Houston and Dallas-Fort Worth, respectively, reflecting, in part, rate adjustments put into effect at that time by utility companies plus increased energy usage during the summer.

Since established homeowners are insulated from a further rise in home prices and financing costs, only the most recent home buyers feel the full effect of the rise in homeowner costs. The relatively rapid increase in homeowner costs in the Southwest has meant a deterioration of the housing cost advantage for this region's home buyers. In fact, the average cost of homeownership for 1977 home buyers in Dallas-Fort Worth stood nearly 15 percent above the national median cost, according to a recent survey by the U.S. League of Savings Associations. Lower taxes and utility bills placed Houston's 1977 home-buyer costs below the Dallas-Fort Worth average and left Houston ranked near the median cost level for the nation.

Although recent home buyers in Dallas may be paying more in housing costs than home buyers nationally, those who have owned their homes for several years in the Southwest continue to find this a relatively inexpensive region in which to live. One measure of the cost of housing for established homeowners is provided by the U.S. Bureau of Labor Statistics with its urban family budgets. The Bureau has estimated that in the autumn of 1977, the annual cost of owning a house for a family having an "intermediate" budget and

living in Dallas was \$2,835, compared with \$3,638 nationally. Comparable homeownership costs for Houston were estimated to be \$2,695 and for Austin \$2,570. These estimates are for a hypothetical family with precisely defined characteristics and include an assumption that the family bought its house six years earlier.

Much of the rise in homeownership costs in the Southwest was caused by the relatively strong expansion of construction activity in this region. In-migration of population helped to place Houston and Dallas-Fort Worth among the nation's most active housing markets. The cost of this success was tight supplies of many building materials and higher construction costs.

Coinciding with the housing expansion and the rise in home prices was a tightening of the mortgage markets. Beginning late last year, savings in-

flows slowed at savings and loan associations. Since then, mortgage interest rates have risen to near the 10-percent usury ceilings in the southwestern states of Louisiana, New Mexico, Oklahoma, and Texas.

Rising house prices and mortgage interest rates have been the major sources of higher homeowner costs. Further increases in housing costs will depend largely on the strength of housing demand. Insofar as materials and houses remain in tight supply in the strong growth areas of the Southwest, costs may continue to rise significantly. Mortgage interest rates in coming months will reflect both the pace of inflation and the overall demand for credit.

Federal Agencies Find Large Number of Equal Credit Violations

A large number of equal credit violations have been identified by bank examiners of the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (FDIC). The agencies recently reported their findings to the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs.

The Federal Reserve Board reported that over 95 percent of the 861 member banks examined were found to be in violation of some aspect of the equal credit laws. Altogether, 17,817 violations were identified, most of them technical in nature, such as incomplete application forms and credit denial forms.

The figure for national banks is close to 90 percent, reported the Comptroller of the Currency. The Comptroller's staff examined 1,682 national banks.

The FDIC reported that 45 percent of the state nonmember banks it examined were found to have violated equal credit laws in some way.

Most violations are corrected upon being identified. If they are not corrected, however, the three agencies may use cease-and-desist orders and referrals to the Justice Department to enforce the equal credit opportunity laws. So far, FDIC has issued 13 cease-and-desist orders.

New Dollar Coin Approved

Production of a new dollar coin honoring Susan B. Anthony, the 19th century women's suffrage advocate, has been approved by the Congress and the President. The new coin, which will be a little larger than a quarter and made of the same copper-nickel material, is expected to be in circulation by mid-1979.

If the coins were to replace a large number of dollar bills, they would save the Government millions of dollars a year in printing and handling costs. The coin will cost about 3 cents to produce and will last at least 15 years, while a dollar bill costs 1.7 cents to produce but lasts only about 1½ years. In addition to the lower total production costs, the Federal Reserve will realize savings in lower handling costs for the coin than for the paper notes.

The new coin offers advantages to retailers. Change-making will be easier because the coins will not stick together or fold like bills. In addition, the new coin will work well in cashier machines that automatically dispense the coin portion of a customer's change.

Vending machine interests like the coin because it will fit their machines, unlike the little-used dollar coin currently in circulation.

New Savings Certificates Help District Banks Resist Disintermediation

By Mary G. Grandstaff

The record inflows of savings deposits that large banks in the Eleventh District had experienced in 1975 and again in 1976 were halted in the second quarter of last year as short-term interest rates began to rise sharply. Increased small time deposits (those with denominations less than \$100,000) offset the savings outflow for a while. But by early 1978, yields on Treasury securities of comparable maturities exceeded interest rates on even the longest maturities of bank time deposits. Banks stepped up their issuance of large time deposits (those with denominations of \$100,000 or more)—which are not subject to regulatory ceiling rates—not only to attract new deposits but also to offset the outflow of other time and savings deposits.

In June this year, banks as well as other thrift institutions were authorized to offer two savings certificates that had not previously been permitted. The new options were a six-month certificate—with a minimum denomination of \$10,000—at a rate pegged to the most recently issued six-month Treasury bill and an eight-year certificate—with a minimum denomination of \$1,000—at a rate of 8 percent. (The ceiling rate commercial banks may pay on the latter actually is $7\frac{3}{4}$ percent per annum

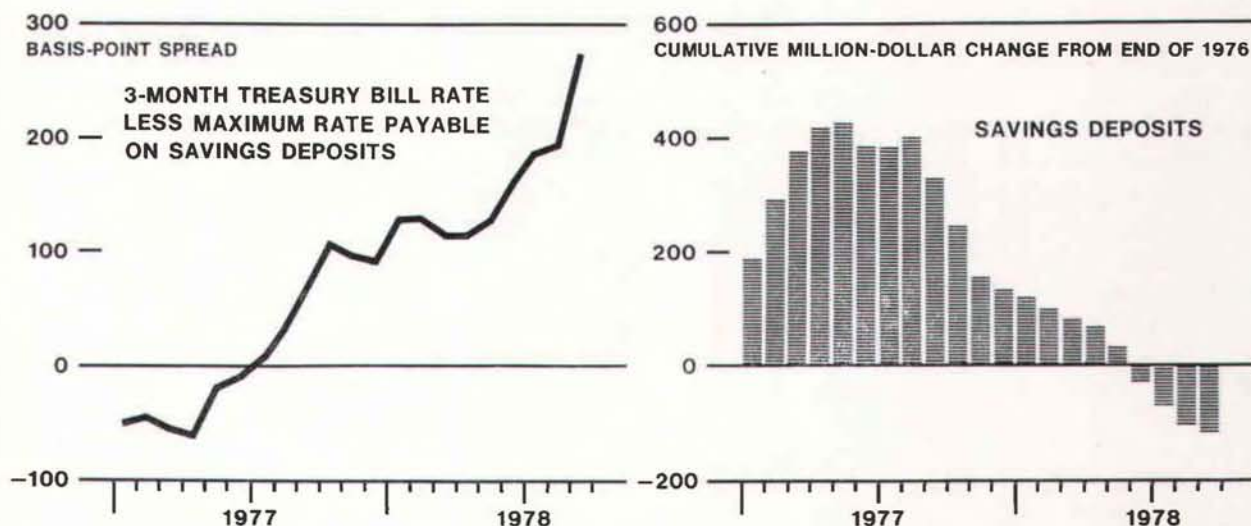
because of the mandatory differential of $\frac{1}{4}$ percentage point between rates commercial banks and savings and loan associations may pay on deposits.)

These new options have afforded many savers yields not previously available at commercial banks. And an analysis of recent changes in the composition of time and savings deposits at commercial banks provides some insight into the favorable acceptance of the two certificates, as well as the ability of commercial banks to retain deposits that otherwise probably would have flowed into U.S. Treasury or other securities.

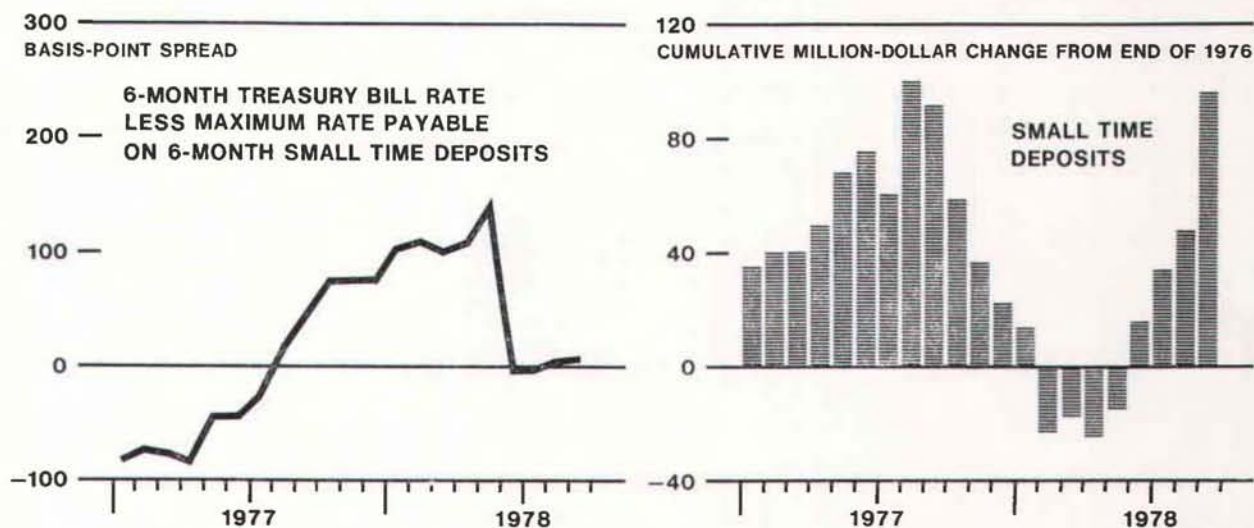
From the end of 1974 to early 1977, time and savings deposit inflows were concentrated in savings deposits. That rapid buildup in savings deposits occurred because of the steep decline in short- and intermediate-term interest rates. Changes in savings deposit rates (on the downside) tend to be less than for time deposits because substitutions vis-a-vis Treasury bills are less strong (owing to the smaller amounts involved).

When rates on savings deposits exceeded the yields on most alternative short-term investments, many investors transferred proceeds from maturing time deposits and other investments to savings

Savings deposits at large banks in the Eleventh District declined sharply as banks were unable to raise rates to competitive levels



Small time deposits also declined because of unfavorable rates but began to rise noticeably after the new certificates were offered



SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

deposits. And savings deposits at large commercial banks in the District rose an unprecedented 124 percent—or \$1.4 billion—between December 1974 and May 1977.

The decline in savings deposits since that time has been steady and only slightly less dramatic. Just as falling money market interest rates had caused a large volume of investment funds to be placed in savings deposits in the earlier period, rapidly rising rates on alternative investments made savings deposits increasingly less attractive to investors beginning in the second quarter of 1977. Between May 1977 and September 1978, savings deposits at large District banks declined more than a fifth to about \$2.1 billion.

As savings deposits began to fall in 1977, these banks were able, for a while, to increase their total time and savings deposits by offering higher rates on small time deposits. These deposits, which had risen only slightly in 1975 and 1976, grew about 7 percent in the first eight months of 1977. In the last part of the year, however, small time deposits were becoming increasingly less competitive with alternative investments. By September, rates on alternative investments had risen enough to cause a sustained net outflow of small time deposits. By the beginning of 1978, yields on Treasury securities of comparable maturities exceeded the rates banks were permitted to pay on even their longest maturities of time deposits.

With savings declining and small time deposits becoming increasingly less competitive, commercial banks found it necessary to rely more heavily—and finally entirely—on large time deposits to

offset the outflow of savings and small time deposits. As a result, large time deposits began to increase in the last half of 1977. Between June 1977 and September 1978, the volume of large negotiable certificates of deposit outstanding at large banks in the District expanded about \$2.6 billion, or 61 percent, to \$6.8 billion and other large time deposits rose 21 percent to \$2.5 billion.

The two savings certificates that commercial banks were authorized to offer beginning in June appear not only to have provided smaller savers with a higher yield than previously available at commercial banks but also to have given banks an additional effective tool for resisting disintermediation. Probably because of the new certificates, inflows of small time deposits have picked up. In the first four months after the new certificates were offered, small time deposits at large District banks increased \$323 million, or 8.6 percent. That was more than twice the growth in the same months in 1977 and over three times the gain in the comparable period in 1976.

Very favorable acceptance of the two new certificates is the most logical explanation for the rebound in small time deposits since May. This excellent acceptance is, in turn, a result of the very favorable yields. Although rates on the new six-month certificate dipped slightly in August, they still remained well above the maximum rates payable on comparable small time deposits and in September resumed their upward climb.

Uniform Trust Rating System Adopted by Federal Regulatory Agencies

A uniform interagency system for rating trust departments of commercial banks has been adopted by the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The new system is similar to the uniform rating system for other bank departments that was adopted in May 1978.

Federal bank examiners will evaluate the following six critical areas of a trust department's administration:

- Supervision and organization
- Operations, controls, and audits
- Asset administration
- Account administration
- Conflicts of interest
- Earnings, volume trends, and prospects

Each area will be rated from 1 (highest performance) to 5 (critically deficient), and these six scores will be combined into a single overall composite rating.

An earlier version of the system was field-tested by examiners of the three agencies, who agreed that the system works well.

Use of the uniform rating system will provide a basis for comparison between trust departments of commercial banks regulated by different Federal agencies.

Documentation Requirements Changed for Obtaining Social Security Numbers

Recent changes in the documentation requirements for obtaining a social security number became effective in May 1978. Knowledge of these changes could enable banks to better serve their customers, who are required by the Treasury's Financial Recordkeeping and Reporting Act regulations to have a social security number in order to open any demand or time and savings deposit account.

Under the changes, everyone who applies for an original social security number must provide two documents as evidence of age, identity, and U.S. citizenship or lawful alien status. A variety of documents can be used to fulfill the new evidence requirements.

The best evidence of age and U.S. citizenship is a birth certificate. When that is not available, other documents that may be used include a Certificate of Naturalization or a U.S. passport.

Evidence of identity can be provided by any document, in addition to the birth certificate, that shows the person's picture, signature, or other identifying information.

It takes about six weeks to issue a social security number and deliver the card after all the required evidence has been submitted. Evidence may be submitted by mail by persons under 18, but if the individual is 18 or over, he must apply in person at the social security office.

Further information—as well as a supply of the leaflet "Applying for a Social Security Number" and Form SS-5, an application for a social security number—can be obtained from any social security office. The leaflet explains the kinds of evidence that can be used.