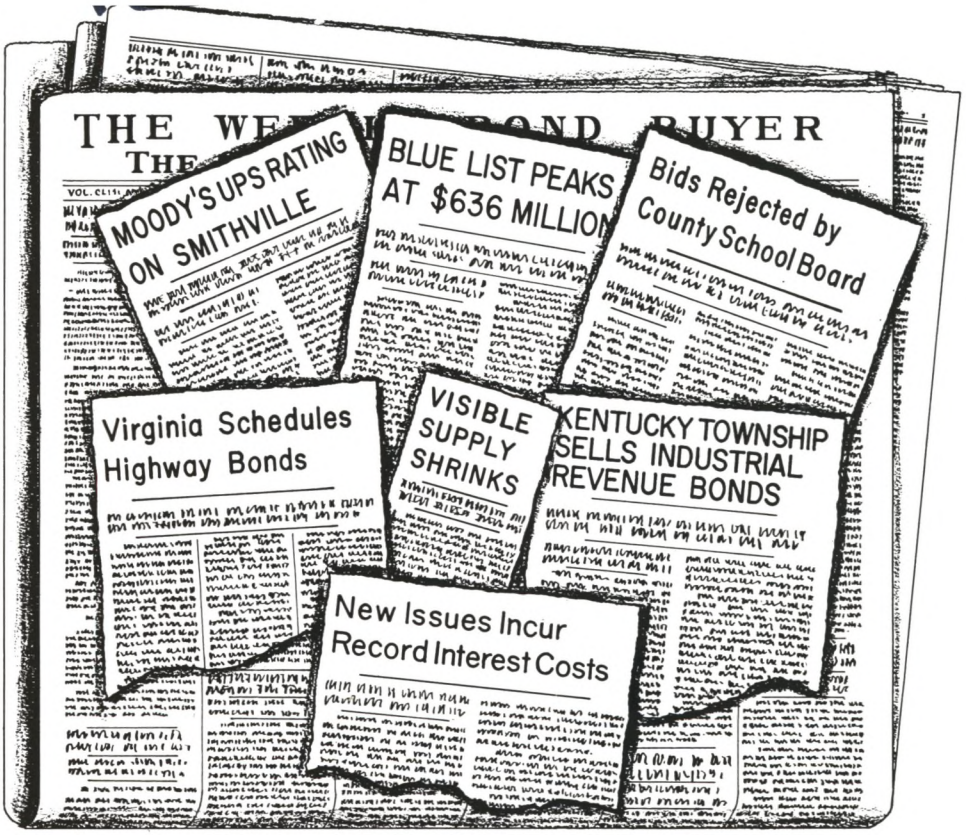
MONTHLY REVIEW



Growth and change in 1966 have kept the municipals market in the financial news.

FEDERAL RESERVE BANK OF RICHMOND NOVEMBER 1966

STATE AND LOCAL GOVERNMENT DEBT

PART 2

For many years state and local governments have relied on sales of bond issues to finance about one half to three quarters of their capital expenditures. In 1965 these governments borrowed almost $11.1 billion for such purposes as the construction of schools, water systems, and highways. This article will focus on the principal investment characteristics of state and local government securities, how they are sold, who buys them, and recent developments affecting them as capital market instruments.

The first article on state and local government debt, which appeared in the June 1966 *Monthly Review,* discussed general features of these securities, mostly related to the sources of supply. After suggesting the principal reasons for the tremendous increase in total state and local debt, from about $2 billion at the beginning of the century to almost $98 billion in 1965, it traced the origin and development of the unique tax exempt feature, and analyzed the relatively recent growth of nonguaranteed, or "revenue" bond financing. It concluded that the widespread existence of constitutional and statutory restrictions on the issuance of general obligations had not succeeded in slowing the expansion of debt financing, but had simply increased the quantity of nonguaranteed financing.

Investment Characteristics One of the most important features of state and local government securities, or "municipals" as they are commonly called, is the exemption of their interest from Federal income taxes. The exemption applies to interest only, and any gain resulting from a rise in the price of the bond is taxed as a capital gain. If a bond is originally *issued* at a discount, that portion of a realized gain between the discount and par is regarded as interest, because the discount is part of the cost which the issuing authority had to incur to sell its bonds. As such, the gain is tax exempt.

The tax exemption becomes increasingly valuable as the tax rate paid by an individual or corporation rises. An individual earning $50,000, or a couple earning $100,000 and filing a joint return, both of which are in a 62% bracket, would have to realize a taxable yield of 10% to equal a yield of 3.80% on a tax exempt municipal. A corporation in the 48% tax bracket would have to receive a taxable equivalent yield of 7.31% to equal the 3.80% tax exempt return.

The quality of a bond is generally of great interest to investors. Rating agencies such as Moody's and Standard and Poor's assign quality ratings to many municipal issues, as well as to corporate bonds. These ratings are based on such factors as the past payment performance of the issuer, the amount of debt outstanding measured per capita or as a percentage of assessed property valuation, appraisals of economic prospects and, in regard to revenue bonds, estimates of the new asset's earning power. These ratings range from Aaa, signifying top quality in terms of earnings and risk, to C, the lowest quality and most speculative. Moody's Investors Service rates bonds of issuers which have over $600,000 of debt, but excludes bonds of all educational institutions, projects already under construction, enterprises without established earning records, or where

necessary financial data are lacking. A bond may be of superior quality although unrated. Ratings are given for both general obligations, which are backed by the full faith and credit of the issuing government, and revenue or other nonguaranteed bonds. Ratings have become important as the criteria for determining which bonds are eligible for purchase by regulated institutions. Banks, for example, may purchase only bonds in the top four categories—Aaa through Baa—or unrated bonds of equivalent quality. Ratings are also the basis for determining which bonds are acceptable as collateral for various types of loans and deposits.

Most municipal bonds are "serial," which means that a portion of the total offering matures each year, starting after the issue date. Some bonds are "term" bonds, with the entire issue maturing on one date. Prices of serial bonds are usually quoted in terms of the interest which will be obtained it the bond is held to maturity. This is known as a "yield basis". Prices of some municipals, including most revenue bonds, are quoted in dollars, and are known as "dollar bonds".

Underwriting and Distributing New issues of municipal bonds are purchased through bidding or negotiation from the issuer by securities dealers and dealer banks who buy them outright and then reoffer them to the public. This process is known as underwriting, and the difference, or spread, between the price the underwriter pays the issuing government and the price at which the bonds are reoffered to the public, is the underwriter's profit, after deducting his costs. Small offerings may be purchased, either through bidding or negotiation, and sold to investors by a single underwriter, but larger issues are usually marketed by syndicates. A syndicate consists of a number of security firms temporarily associated for the purpose of selling a particular bond issue. Each firm is assigned a percentage participation by the syndicate's managing firm, but syndicate agreements vary in regard to the extent of the member's liability for any losses incurred. In an undivided, or Eastern, account, the percentage indicates the extent of the member firm's liability for any residual unsold bonds or losses regardless of how many bonds the firm succeeded in selling. If a firm with 15% participation suceeds in selling 15% of all the bonds, it is still liable for 15% of the bonds which are not sold. In a divided, or Western, account, the percentage signifies the amount of bonds allotted to the member firm to sell, and the firm's liability ceases when it has sold its total allotment. If a firm sells more than its allotment in a Western account, it is helping another firm reduce its liability. Both Eastern and Western accounts are undivided as to selling, that is, the bonds remain with the syndicate manager and member firms confirm their sales with the manager. The chief advantages to the underwriter of retailing bonds through a syndicate lie in being able to reach a much broader market than would otherwise be possible, and in sharing the liability if the issue does poorly.

Most syndicate agreements are in effect for a 30-day period. During that time the bonds may not be sold by members of the syndicate at any price, or range of prices, other than that established by the syndicate. When the bonds are all sold, the syndicate dissolves. If the issue is not all sold at the end of 30 days, the syndicate may be renewed if a majority of the members consent. If the syndicate is not renewed, the unsold bonds are distributed among the syndicate members according to the terms of the agreement, and the members are released from all trading restrictions. Syndicate restrictions may be lifted at any time, however, upon agreement of the majority interests in the account, and in times of declining prices a slowly selling issue may be released within a few days of the original offering in order to avoid or to minimize losses to the participating members.

The Secondary Market There is no organized exchange for trading in municipals. The secondary market consists of over-the-counter transactions arranged by dealers for other dealers, institutions, and individual investors. Dealers advertise their inventories in the *Blue List,* a daily publication which lists the current offerings and the price the dealer is asking that day for each particular issue. Since the start of 1966, the par value of issues included in the *Blue List* has ranged between $260 million and $636 million. The *Blue List* represents the largest part, but not the total, of the floating supply. Dealer banks, for instance, may sell bonds out of their portfolios in addition to the issues listed on their offering sheets. Also, dealers may withdraw issues from the *Blue List* if they believe that prices are going to rise, and relist them later at higher levels. Finally, issues which do not have a fairly wide market are generally not listed. The over-the-counter market is primarily a telephone market. Millions of dollars worth of bonds are sold every day over the telephone. A price quoted over the telephone is considered absolutely firm, and, if the bid is accepted, a dealer will not renege under any circumstances.

Preparations for a Bond Offering Once a government or authority has decided to raise funds through a bond flotation it must follow a lengthy and complicated procedure in order to insure that the sale meets all legal requirements and is concluded on the most favorable terms possible. All phases of the planning are normally supervised by an attorney who specializes in municipal law, and the lawyer's opinion regarding the legality of the sale and the tax exempt status of the bonds is usually made available to all dealers and prospective investors. The issuer should also prepare a prospectus containing comprehensive data on its financial situation and estimates of reputable engineers or analysts regarding the cost of the capital improvement and, where appropriate, the income it will generate. Complete information should be submitted to a rating agency to assure the best possible rating and therefore the lowest possible interest cost.

Virtually all state and local governments are required by their own laws to market general obligation bonds publicly, through the solicitation of sealed competitive bids. Bonds which are not backed by the full faith and credit of the issuing government, such as toll road and industrial aid bonds, may be sold competitively but are more often priced through direct negotiation with the underwriter.

It is in the best interest of the issuing authority to publicize the approaching sale by advertising in local and perhaps national newspapers. The object of such publicity is to receive as many bids as possible and to sell the bonds at the lowest possible interest cost. Sizable offerings are usually advertised with all pertinent information in the *Daily* or *Weekly Bond Buyer*, which is received by practically every firm concerned with tax exempt financing. If none of the bids received is satisfactory to the issuer, all may be rejected and the offering postponed or cancelled.

For most states and large municipal borrowers the procedures involved in bond sales do not pose significant difficulties. Large borrowers are usually familiar with the necessary steps and also maintain close contact with capital market developments. Small towns, counties, school districts, and other special districts, however, are often relatively unfamiliar with the correct procedures and market conditions. Mistakes may cause them to pay too high a price for borrowed funds, perhaps saddle the community with too heavy a financial burden, or even prevent the sale from occurring at all due to legal complications or lack of sufficient advertising. At least four states, Virginia, North Carolina, Michigan, and Louisiana, have created commissions which assist and oversee the borrowing operations of small governmental units. The Virginia Commission does not offer aid or advice unless requested by the locality, but in North Carolina localities are required by law to receive the Commission's approval before soliciting bids unless the issuing unit, by a referendum vote, decides to proceed with the issue despite the Commission's disapproval. The North Carolina Commission takes an active part in many phases of the bond flotation, including advertising, receiving the bids, and printing and delivering the bonds. The Commission's supervision assures investors that the correct procedures have been followed and that data on the community's finances will be readily available. The community benefits from the wider market and lower interest costs which result from dealers' and investors' knowledge of the Commission's standards and the uniformity of the offering procedures.

The Principal Investors Individuals have been the largest holders of tax exempts in the postwar period except for 1965 when commercial banks moved into first place. From 1955 through 1960 individuals held roughly 40% of the total outstanding. During the past six years, however, individuals' holdings of municipals have declined by about 5 percentage points, as shown in the pie chart. As a result of recent developments, it seems likely that individuals again hold the largest block of outstanding tax exempts. During this same period state and local governments have also become less important holders of tax exempts as public officials have become increasingly aware of more profitable alternatives, and as laws governing the investment of public funds have been liberalized.

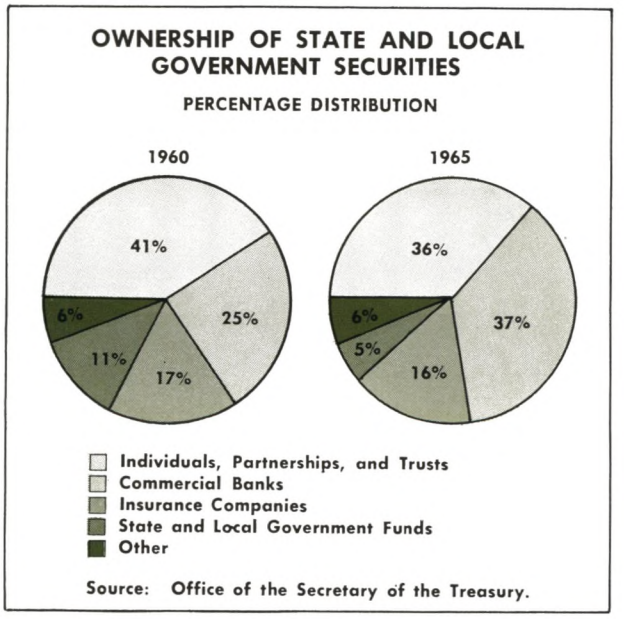
Commercial banks more than doubled their holdings of tax exempts between 1960 and 1965, from $16.8 billion to $36.6 billion. The latter figure represented about 37% of the total volume outstanding in 1965. The nation's one hundred largest commercial banks hold about one half of all municipals owned by banks, and about 19% of the total outstanding. Municipals averaged almost 10.5% of the total assets of these banks in June 1966, compared to about 6% in June 1961. In 1962 and 1963 the net increase in total bank holdings accounted for over three fourths of the net increase in total state and local securities outstanding, while in 1964 and 1965 bank acquisitions came to over 60% of the net addition to tax exempts.

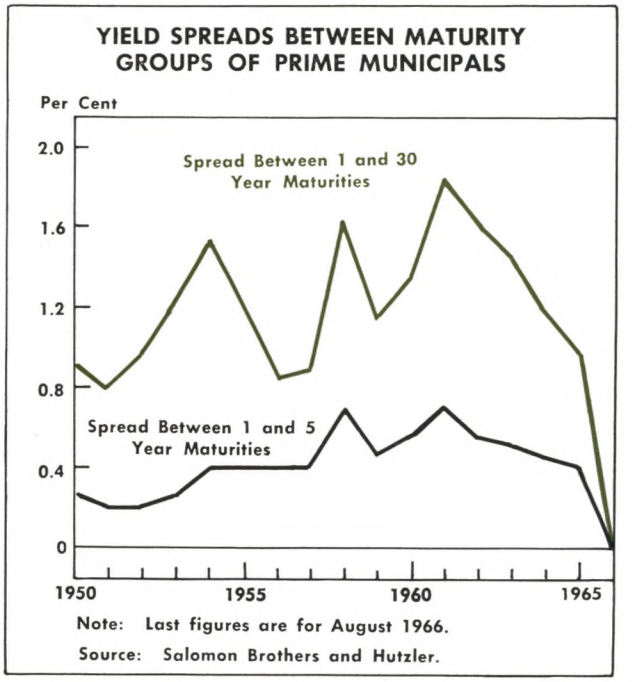
The surge in commercial bank buying of municipals can be traced in part to changes in ceilings on the interest rates which commercial banks are permitted

to pay on time and savings deposits. The Board of Governors of the Federal Reserve System has raised these ceilings four times since the end of 1961, most recently in December 1965. As banks paid progressively higher rates on their time deposits, and attracted a large volume of new high cost deposits, they sought higher yielding investments.

Insurance companies rank third in importance as holders of municipals. Fire and casualty companies are the principal holders as life insurance companies receive little benefit from the tax exempt feature. Nonfinancial corporations have been stepping up their purchases, although their total holdings are still relatively small. Other holders include mutual savings banks, savings and loan associations, corporate pension trust funds, dealers and brokers, and foreign investors.

Recent Developments For the past few months the total demand for funds has exceeded the supply of loanable funds, with the result that prices of capital market instruments have fallen and yields have risen. Although a number of tax exempt offerings either have been cancelled or postponed due to the high rates, the volume of financing by state and local governments during the three quarters of this year, at $8.5 billion, has exceeded the volume during the same period of each of the previous two years by about $600 million. At the same time commercial banks, which had become the mainstay of the municipals sector, have become increasingly strapped for funds to satisfy the strong demand for loans, and have moderated or halted their purchases of municipals. Indeed, some banks sold large blocks of their tax exempt holdings during August.





Individuals apparently have filled at least part of the gap left by commercial banks. During the period 1962-1964 aggressive buying by commercial banks had depressed municipal bond yields, and Aaa-rated bonds had traded generally in a 2.90%-3.20% range. 1965, however, yields on prime tax exempts rose 42 basis points, and the higher levels revived the interest of individual investors. The net increase in individuals' total holdings of municipals more than doubled between 1963 and 1965, from $1.6 billion to $3.7 billion. Individuals continued to step up their purchases in 1966 as yields on Aaa-rated bonds climbed another 64 basis points, reaching a peak, thus far, of 4.04% near the end of August when commercial bank sales were heaviest. During the past two months, yields have receded and the volume of new issues has slackened.

Another recent development has been the declining yield spread between short- and long-term municipals, as illustrated in the chart. This has been due partly to the general scarcity of short-term funds, and partly to the switch in buying interest from commercial banks to individuals. Individuals are usually interested mainly in long-term investments while banks prefer one to five year maturities. The slowdown in bank purchases of shorter term bonds has contributed to higher yields on those maturities.

■ The Columbia Standard Metropolitan Statistical Area, centering on Columbia and West Columbia-Cayce, reads out to cover all of Lexington and Richland counties. Nearly 1,500 square miles are included. ■ The City of Columbia, pictured here, is asantly situated where the Broad and Saluda Rivers join to form the Congaree. It is near the geographical center of the state. Columb has been the state capital since 1786. The state house in use today was completed in 1905. ■ The metropolitan area is ed by four airlines, four railroads, and twenty-five motor freight companies. There are more than 4,000 businesses c in-dustrial plants here. Five commercial banks have home offices in the area, with branches throughout the state. ■ New investment in the area by manufacturing industries in 1965 was $150 million, and the annual product of these industries was valued at twice that much. Wages paid were about $55 million, and the number employed in manufacturing and trade was more than 34,000. The largest industry in South Carolina, textiles, is represented in the Columbia area by 14 plants which produce a variety of household and industrial fabrics and yarns. Their annual product in 1965 was valued at $99 million. ■ The University of South Carolina and five other colleges, plus several business and trade schools, are in the area. Fort Jackson, a major army training center, is in Richland County.

COLUMBIA

SELECTED STATISTICS WITH RECENT AVERAGE ANNUAL GROWTH RATES

	Annual Growth Rates Period Indicated		Columbia SMSA
	Columbia	U. S.	(Most Recent Year)
Population (1960-65)	2.6	1.6	295,900
Civilian Labor Force (1960-65)	3.2	1.4	106,200
Unemployment (1960-65)	5.9	— 2.5	4,900
Employment (1960-65):	3.0	1.6	101,000
Agricultural	— 7.0	— 4.3	3,400
Nonagricultural Wage and Salary:	3.4	2.3	82,300
Manufacturing	5.6	1.4	16,500
Trade	2.5	2.2	17,900
Services	2.1	4.2	10,100
Value of Retail Sales (1958-63)	4.8	4.2	$293,344,000
Value of Wholesale Sales (1958-63)	4.3	4.4	$403,301,000
Total Commercial Bank Deposits (1960-64)	5.3	7.4	$211,750,800
Private Commercial Bank Deposits (1960-64):			
Demand	4.5	2.5	$107,186,900
Time	9.7	15.0	$ 21,975,000
Estimated Personal Income (1959-64)*	7.4	5.3	$ 55,324,000

*First quarter only for Columbia SMSA.

Sources: Board of Governors of the Federal Reserve System; Sales Management, Inc.; South Carolina Employment Security Commission; U. S. Department of Commerce.

Photograph courtesy Greater Columbia Chamber of Commerce

THE 1966 FARM LOAN SURVEY
ITS SCOPE AND ITS PROCEDURES

Agriculture is one of the most rapidly changing sectors of the American economy. Consolidation, mechanization, and the implementation of new technology are progressing at an impressive pace. To keep informed on the manner in which the nation's banks are meeting the ever-changing credit needs of this vital industry, the Federal Reserve System conducted farm loan surveys in 1947, 1956, and the summer of 1966. The results from this year's survey are still being processed. The purpose of this article is to describe the changing background of the demand for farm credit, and the scope and procedures of the survey.

Farm Numbers Decline The number of farms in the United States has fallen by more than one-fourth in the past ten years. The Fifth District has experienced an even sharper decline, with the number reduced by nearly one-third. Much of the reduction in the number of farms has been the result of consolidation, however, and so the average size of farms has increased. The changes in numbers and size of farms have no doubt had substantial effects on the credit requirements of farmers. One of the purposes of the loan survey was to determine the nature and extent of those effects.

Directly associated with the decline in farm numbers has been a decline, though less sharp, in the number of farm wage workers. But the increase in output per worker has been phenomenal. Where one farm-worker supplied enough farm products, on the average, for 19.5 persons in 1955, it is estimated that he supplied enough for 37 persons ten years later. This has come about through the adoption of extensive new technology in the form of more productive farming methods, the use of newer, larger, and better equipment, increased fertilization, improved varieties of seeds, and expansion of the farm production plant itself. Current farm operating expenses have increased about one-third during the period, reflecting in part the use of more skilled labor at higher wages. Farmers' investments in machinery and motor vehicles have expanded by more than one-fourth as consolidation into larger units and greater specialization has made the use of the most modern techniques and equipment feasible. Information on the extent to which banks have furnished the credit needed for these changes was sought in the survey. In addition, information was obtained on whether the needs were met with short, intermediate, or long term loans.

Farm Land Value Rises The rise in the value per acre of farm land and buildings has been substantially greater in the past decade than in any comparable period in this century. The acreage values of farm land in the Fifth District rose over 70% during the most recent decade and for the nation as a whole the rise was over 60%. More significantly, farm land values have been rising at an increasing rate. Comparisons of the asset and net worth positions of borrowers in this survey and a similar one conducted in 1956 will be made as a partial means of determining the extent and the significance of these changes. Banks lending to farmers have found their task complicated by the rapid increase in land values. Any instability tends to create some uncertainty.

Farm Lending Increases The outstanding volume of nonreal estate loans to farmers has increased by 139% in the past ten years and that of real estate loans has increased by 135%. These figures would imply that lenders have, indeed, responded to the needs for agricultural credit, but they reveal only limited information on the purposes for which loans were granted or the security for them. They do not reveal the repayment status of these loans or the rates and terms that were granted. Nor does available information disclose the asset, income, or net worth positions of farm borrowers. All of these factors are important to lenders when they are making decisions on who will receive their credit support in these rapidly changing times; they are of utmost importance to the farmer because credit availability may determine whether or not he can continue to farm.

Farm Income Rises Adjusting lending to changing farm needs is, however, only one side of the coin. The other equally important side is keeping lending in line with farm income, from which the ability to repay loans is derived. The index of prices received by farmers rose only 16 points from 1956 to 1965, hence farmers did not benefit very greatly from any increases in the prices they received for their products. Productivity increases, however, have tended to offset the modest size of the increases in prices received. Statistics reveal that realized gross

income of all farmers in 48 of the 50 states rose 31% during the 1956-65 period. Realized gross farm income is comprised of cash receipts from farm marketings, government payments, value of home consumption, and the gross rental value of farm dwellings. In the Fifth District farmers realized a boost in their aggregate gross income of 16 per cent during the above period.

Of greater significance from the standpoint of lending has been the change in gross income per farm. Here somewhat more support is found for the large increase in aggregate debt because on a per farm basis gross income of the nation's farmers has increased about 75 per cent. The District has experienced a smaller, but still substantial, increase of slightly over 67%. Questions asked in the survey sought information which would reveal how farms representing various commodity and income groups have fared from the standpoint of credit and income.

Scope of the Survey The 1966 farm loan survey included data submitted by about 1,700 member and nonmember banks in the United States. Each of the the System's twelve Reserve Banks was responsible for contacting the sample of commercial banks in its district. Besides yielding a great deal of specific information about farm credit the survey is expected to aid monetary authorities in evaluating the flow of capital and credit into agriculture.

The survey was designed to yield rather detailed information on the rates, terms, and amounts of loans to individual farm operators as well as the major purpose and security of these loans. Various borrower characteristics, such as age, tenure status, income, asset and net worth positions, type of operation, and location with respect to the bank were also obtained. These factors should give a good picture of the type of farm borrowers now being served by commercial banks. More comprehensive information on both borrower and loan characteristics was obtained than in similar surveys conducted in 1947 and 1956, but to some extent comparisons with the earlier surveys will be possible to determine trends that have developed in agricultural lending in the post World War II period.

The Federal Reserve's survey dealt only with commercial banks, but it was complemented by similar studies conducted by other agricultural lenders. The Farm Credit Administration surveyed loans made by Production Credit Associations and Federal Land Banks, and the United States Department of Agriculture is reporting on borrower characteristics of loans made to new borrowers by the Farmers Home Administration. Major life insurance companies are contributing data on their loans for comparison purposes.

The banks which participated in the survey provided the individual loan characteristics and borrower characteristics on a worksheet which was prepared by the Federal Reserve System in cooperation with the American Bankers Association, Farm Credit Administration, and the United States Department of Agriculture. The completed worksheets were checked for accuracy and consistency in the Federal Reserve Banks. The information was then punched into computer cards and sent to the Board of Governors in Washington for tabulation.

Selection of the Bank Sample In the Fifth District, 144 banks were selected for the survey sample. All commercial banks in each of the five District states and the District of Columbia were arranged into different categories (strata) depending on the amount of farm loans that had been reported outstanding on the June 30, 1965 Report of Condition. The different strata and the rate of sampling in each stratum are shown in Table I. In stratum 1, for example, all banks which had total farm loans in excess of $3,000,000 were included in the sample, but in stratum 3 only about one in two were included and in stratum 5 about one in four.

Banks from each state were arranged in categories according to size and then were randomly selected at the rates specified in Table I to become a part of the sample. Due to the very limited agricultural loan volume of banks in the District of Columbia, banks from that area were included with those of Maryland for selection purposes. The number of banks selected from each of the Fifth District states is shown in Table II.

Selection of the Borrower Sample In an effort to avoid an unduly heavy reporting job by any one bank, each was asked to report on a relatively small alphabetic segment of borrowers. Based on Social Security records for the Southeastern United States, 20 segments of approximately equal size were set

Table I
STRATA AND SAMPLING RATES OF BANKS
Fifth District

Stratum	Farm Loans Outstanding ($000), June 1965	Per Cent Banks Sampled
1	3,000 and over	100.00
2	2,000 to 2,999	71.43
3	1,400 to 1,999	48.00
4	1,000 to 1,399	42.55
5	500 to 999	23.97
6	200 to 499	11.32
7	50 to 199	05.70
8	1 to 49	03.23
9	None	02.80

Table II
NUMBER OF SAMPLE BANKS IN EACH STRATUM, BY STATES
June 1965

Stratum	Maryland and D. C.	Va.	W. Va.	N. C.	S. C.	Total
1	6	5	-	10	3	24
2	1	5	-	3	1	10
3	2	4	1	5	-	12
4	4	9	1	6	1	21
5	4	12	4	9	6	35
6	4	8	4	4	4	24
7	1	2	3	1	2	9
8	1	1	1	1	1	5
9	1	1	1	1	-	4
						144

up. The breakdown is shown in Table III. The largest banks, those in category 1, were assigned only one segment, chosen at random, for example, Cox-Doy. This resulted in the banks in stratum 1 reporting on approximately 5 % of their farm borrowers. The letters shown were to be the first three letters of the borrower's last name. Banks in strata 2 and 3 were assigned two of the original alphabetic segments, for instance, Cox-Fop (or Cox-Doy and Doz-Fop), which resulted in banks in these categories reporting on about 10% of their loans. Banks in each of the smaller categories were requested to report on progressively larger proportions of their farm loans.

Table III
ALPHABETIC SEGMENT OF BORROWERS REPORTED

Segment Number	Stratum 1	2 and 3	4 and 5	6 and 7	8 and 9
1	AAA — BAR	AAA — BOY	AAA — COW	AAA — DOY	AAA — KIL
2	BAS — BOY	BOZ — COW	COX — HEM	DOZ — KIL	KIM — ZZZ
3	BOZ — CAP	COX — FOP	HEN — MCK	KIM — RIC	
4	CAR — COW	FOR — HEM	MCL — SGZ	RID — ZZZ	
5	COX — DOY	HEN — KIL	SHA — ZZZ		
6	DOZ — FOP	KIM — MCK			
7	FOR — GRH	MCL — PES			
8	GRI — HEM	PET — SGZ			
9	HEN — HUS	SHA — TOV			
10	HUT — KIL	TOW — ZZZ			
11	KIM — LOS				
12	LOT — MCK				
13	MCL — MUP				
14	MUR — PES				
15	PET — RIC				
16	RID — SGZ				
17	SHA — STD				
18	STE — TOV				
19	TOW — WES				
20	WET — ZZZ				

An excellent response by the sample banks yielded information on 9,759 loans to 6,496 borrowers. For the breakdown by states, see Table IV. In addition to receiving replies from nearly all of the head offices of banks, 313 branches reported on their loans to farmers. Most of the loans were made to people in the same general locality as the bank, as was demonstrated by the intimate knowledge bankers had of the borrower's operations and characteristics, but there were a few loans to borrowers in other states and even in foreign countries. Nevertheless, the vast majority of the loans were reported to be within a 15 to 25 mile radius of the banking office.

Results of the Survey Tabulation of Fifth District data from the survey is nearly complete and the results will be made available through later articles in the *Monthly Review*. Comparisons will be made with the earlier surveys where possible to focus on trends that are developing. The changes in the net worth and asset positions of farm customers of the District's banks will be reviewed, not only as they pertain to borrowers in general, but also the differences in lending practices for various commodity groups, such as tobacco farmers, dairy farmers, and the like. Similar comparisons will be made on such things as total indebtedness, loan purposes and security, rates and terms, and such borrower characteristics as age, tenure status, and whether or not the borrower is a full or part-time farmer.

Knowledge gained from the survey will also be made available on a national basis. The material collected by each of the District banks will be consolidated and will serve as the basis for several articles in the *Federal Reserve Bulletin*.

Table IV
NUMBER OF BORROWERS AND LOANS REPORTED BY STATES

State	Borrowers	Loans
Maryland and D. C.	508	701
Virginia	1,734	2,798
West Virginia	305	481
North Carolina	3,361	4,896
South Carolina	588	883
Total	6,496	9,759

THE FIFTH DISTRICT

Business activity continues to advance in the Fifth District although uncertainty over future prospects appears to be growing. Seasonally adjusted bank debits fell slightly in September but ran 1% ahead of the same month last year. The District index of building permits issued (seasonally adjusted) showed gains for the second consecutive month in September. The index recorded substantial increases in the third quarter after relative stability in the second quarter. The cumulative index for the first nine months of 1966 was about 1.5% ahead of the same period last year. Sales of retail establishments have picked up, although on a national level the latest survey conducted by the University of Michigan Research Center indicates that consumer optimism is waning. Interestingly, the survey also points out that consumer plans to make major purchases are almost unchanged from last year.

Employment September data on total nonfarm employment for the five states (D. C. not available) show a slight decline from August. The decline is probably accounted for in part by the return of students to school. Employment decreased in all major categories except transportation, communications, and public utilities where there was an increase and in finance, insurance, and real estate where no change occurred. Growth in nonfarm employment in the five District states since last September, shown in the table, compares favorably with that of the nation. Relative gains in four major employment categories were greater for the District than for the nation.

In the week ended October 1, the rate of insured unemployment in Maryland, North Carolina, Virginia, and the District of Columbia fell to the lowest level since the beginning of the present expansionary period in early 1961. West Virginia equalled the record low for the period established last month, and South Carolina was within .2% of its lowest point.

Manufacturing The index of manufacturing man-hours in August was virtually unchanged from July. However, the index shows a 5% increase over August 1965.

According to recent reports, durable goods manufacturers point to weakness in their sector of the District economy. They indicate declines in new orders, backlogs, and hours worked per week although employment is reported up slightly. Nondurable goods manufacturers (except textiles), on the other hand, report increased strength in recent weeks. New orders and shipments seem to be up slightly, as are hours worked and employment.

Furniture The Fall Furniture Market which opened October 21 in High Point, North Carolina, has been described as "a slow market with big at-

TOTAL NONFARM EMPLOYMENT
FIFTH DISTRICT STATES*
(seasonally adjusted in thousands)

	5th District September	% Change From Year Ago 5th District	% Change From Year Ago U. S.
Total Nonfarm Employment	5,076.0	4.7	4.9
Manufacturing	1,660.6	4.6	5.7
Durables	626.8	7.3	7.6
Nondurables	1,033.8	3.0	3.1
Nonmanufacturing	3,415.4	4.7	4.6
Mining	71.7	4.8	1.8
Contract Construction	330.0	2.7	1.7
Transportation, Communications, and Public Utilities	314.7	4.1	2.3
Trade	974.7	3.3	3.9
Finance, Insurance, and Real Estate	208.8	4.0	1.8
Services and Miscellaneous	642.8	4.1	5.0
Government	872.7	7.8	7.8

*Excludes D. C. because September 1966 data are not available.

Source: U. S. Department of Labor and State Departments of Labor.

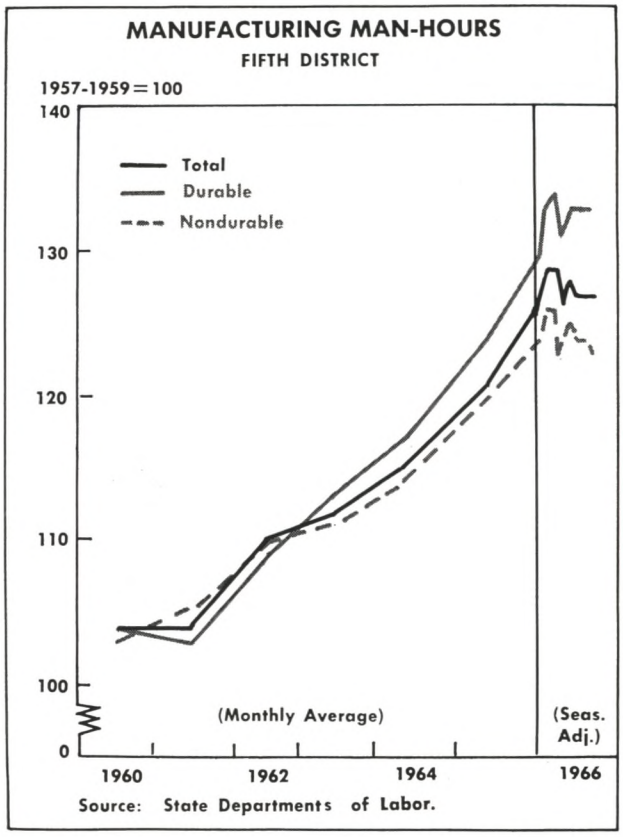
tendance, but poor buying". Retailers are finding prices up generally about 2% to 3% from the April show and at least 4% to 5% higher than last October. Trade sources report that most manufacturers expect no adverse effect on sales as a result of higher prices, but some retailers express concern that reduced home-building may cause some drop in sales.

Tight labor remains the industry's biggest problem, and many spokesmen indicate that it is the greatest deterrent to expansion. Coupled with technological developments and a reported shortage of good quality hardwood lumber, manpower problems have encouraged utilization of more wood substitutes, and this year's lines will include more structural and decorative plastics than ever before.

Textiles The textile industry continues to experience some soft spots and industry spokesmen are concerned over the rapid rise in imports during the past year and the probable adverse effect on the industry of the suspension of the 7% investment credit. Recent reports suggest that new orders, backlogs, and prospects for profits are down, while inventories have risen. Prices continue under downward pressure. One of the leading manufacturers of man-made materials recently announced a 4-to-12 cent price reduction in its polyester blends; similar action was immediately taken by others in the field. Trade reports indicate that this action brings the quoted price more nearly in line with the actual trading price. It also makes the prices of man-mades more competitive with the recently reduced raw cotton prices.

The unprecedented labor shortage is also one of the most pressing problems facing the textile industry. Not only is labor scarce, but the turnover rate is quite high. The scarcity of manpower has created special interest in the Southern Textile Exposition which opened in Greenville, S. C. on October 17. The latest technological innovations are shown here.

Increasing wages are another major concern of millmen. As of August 1966, the average hourly earnings of textile workers in the Fifth District were $1.95—a $.10 increase over the year ago level. Average hourly earnings will go even higher again in February when the minimum wage rises to $1.40 under the new law. This is expected to set off a ripple effect as semi-skilled and skilled workers demand proportional increases.



South Carolina has made particularly notable progress in the textile industry. In the last two years, over $810 million has been invested in new textile plant and machinery in the state. Between August and December of this year, nine new textile spinning and weaving plants will go into full production with investment exceeding $63 million. These new plants will provide approximately 2,250 new jobs at an average investment of $30,000 per job.

In North Carolina, the textile industry is one of the fastest growing industries and was the first to reach a $1 billion payroll in 1965. It provides employment for some 247,000 people and accounts for about two fifths of the state's work force.

Cigarettes American cigarette smokers who reacted sharply to the Surgeon General's report in January 1964 seem to be ignoring the new "caution" label which started appearing on cigarette packs this year. According to the U. S. Department of Agriculture estimates, per capita consumption among persons 18 years and over is 215 packs of cigarettes this year, a rate second only to the record 217 packs in 1963. August cigarette shipments climbed to the highest monthly level in 1966, up 8.7% from the previous year.