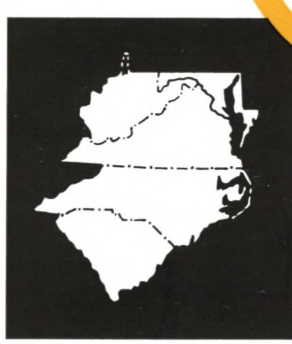
FEDERAL RESERVE BANK OF RICHMOND

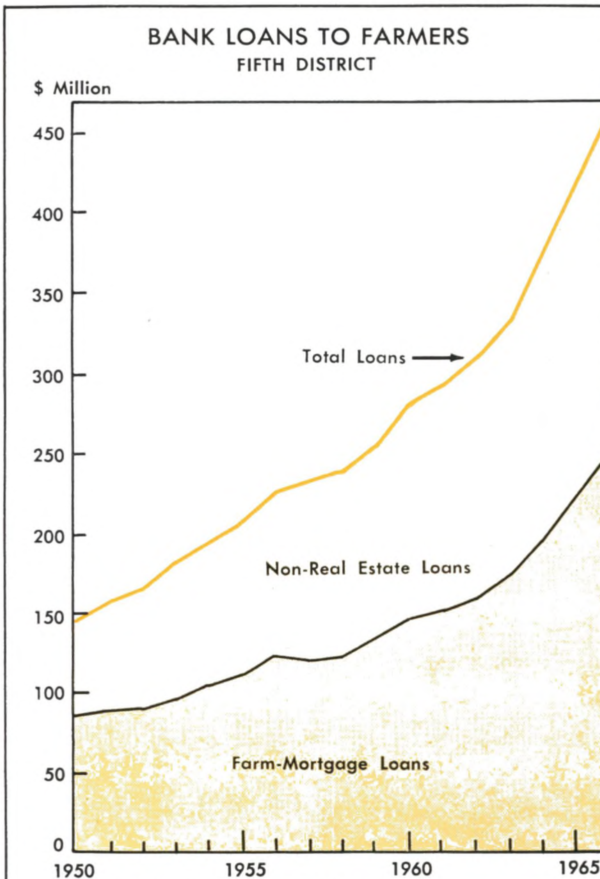
MONTHLY REVIEW



APRIL 1967

1966 Farm Loan Survey

FARM LENDING BY FIFTH DISTRICT COMMERCIAL BANKS



Source: U. S. Department of Agriculture.

It is common knowledge among agriculturalists and agricultural bankers that farm credit needs have been expanding quite rapidly in recent years. But details relating to the financial position of farmers, the security requirements of lenders, the purposes for which loans were made and their repayment conditions were known only in very general terms. Moreover, the extent and nature of the responses of lending institutions to the sharply increased credit needs of U. S. agriculture were often a matter of conjecture.

To fill in these important informational gaps the Federal Reserve System in mid-1966 conducted a detailed nationwide survey of loans extended to farmers by commercial banks. This survey, a follow-up of a similar canvass conducted in 1956, permits a study of changes which have taken place in sources and uses of farm credit over the past ten years. The format of the latest survey was discussed in the November 1966 issue of the *Monthly Review*. Some general results are reviewed in this article.

Major Purposes There were slightly fewer loans for farm real estate purchase outstanding in 1966 than ten years earlier, but the total amount was 84% greater and the average size of loan was 91% larger. The effective interest rate had also risen from an average of 5.5% per annum in 1956 to 6.2% per annum in 1966. Maturities on these loans ranged from less than one year to as long as 40 years on some loans insured by the Farmers Home Administration. About one-fourth of the outstanding farm-mortgage loans held by District banks on June 30, 1966, were for the purchase of farm real estate.

The greatest dollar volume of farm loans was devoted to current operating expenses, such as outlays for feed, fuel, labor, and other current expenses. Also included in this category were loans for the purchase of feeder livestock and for family living expenses. Rather surprisingly, the number of these loans remained virtually unchanged from 1956, but the amount outstanding had increased by 77% and the average size of loan rose in about the same proportion. There were twice as many loans for purchase of feeder livestock. These loans, however, averaged slightly smaller than ten years earlier as livestock feeding remains a relatively minor enterprise in the District. The substantially greater amount of borrowing for current expenses reflects the continued heavy dependence of the banks' farm customers on cash crops. A 15% rise in farmers' cost-of-living also contributed to the heavier borrowing.

The purchase of machinery was the third most important single purpose of loans. Despite declines in numbers of farmers borrowing for this purpose, there was a 21% increase in the number of machinery loans and the outstanding amount jumped by 131%. The average size of loan nearly doubled. Increases in this area of farm credit mirror the continuing marked trend toward mechanization.

The survey also indicates that District farmers continue to make basic improvements in their production plants. Bank loans made predominantly for this purpose numbered 16,000 and comprised over 10% of the amount of loans outstanding, approximately the same percentage as ten years earlier. The fact that loans for purchase of livestock other than feeders increased by 154% provides some evidence of a move toward a more diversified agricultural economy. While loans for the latter purpose remain a relatively minor part of total agricultural credit in the District, the sharp increase is indicative of new farming patterns which seem to be evolving.

The average size of loans for purchase of automobiles and other consumer durables has shown the greatest proportionate increase of any of the divisions included. More loans were extended for these purposes than ten years ago and their total amount more than doubled.

The average effective interest rate for bank loans to District farmers in June 1966 was 6.5%. As might be expected the rates were highest on loans for automobiles and other consumer durables followed by loans for machinery purchases. Loans for current operating and family living expenses and those for farm real estate purchase carried the lowest effective rate. They comprise nearly half of the number of loans granted to farmers.

Borrower Characteristics Despite the continuing decline in the number of farmers, District banks provided credit to about the same number of owner-operators as in 1956. Actually, the number of borrowers in the age group 45 and over was 17% greater than ten years earlier and the average size of loan to this group rose from $1,774 to $3,063. Total bank credit extended to farmers in this age group more than doubled in the ten years.

The number of farm borrowers in the under-45 age groups declined. This was expected, partly because off-farm employment opportunities are greater for these groups than for older farmers, who tend to become "locked in" their farm operations. Substantially greater amounts of credit, however, were extended to the younger farmers in 1966 than in 1956 despite a sharp decline in numbers. The volume increase amounted to 43% for the 35-44 age group and to 86% for those under 35. The average outstanding debt of the youngest group increased nearly two and one-half times during the ten-year period and that of the two older groups rose substantially. This implies that young farmers are obtaining a somewhat larger credit base early in their farming careers than was the case ten years ago.

Although their numbers comprise a very small proportion of the total, all outstanding farm credit to corporations has grown vastly—an elevenfold increase between 1956 and 1966. The average debt of farm corporations also grew rapidly and in 1966

PURPOSE OF FARM LOANS

Major Purpose	Number of Loans			Amount Outstanding			Average Size			Av. Eff. Int. Rate
	1956	1966	% change	1956	1966	% change	1956	1966	% change	1966
	(in thousands)			(millions of dollars)			(dollars)			
Current Operating Expenses:										
Feeder livestock	3	6	100.0	10	17	70.0	2,950	2,870	− 2.7	6.2
Other current operating expenses	129	128	− 0.8	82	146	78.0	635	1,835	189.0	6.1
Total	**132**	**134**	**1.5**	**92**	**163**	**77.2**	**693**	**1,217**	**75.6**	
Intermediate-Term Investments:										
Other livestock	6	12	100.0	13	33	153.8	2,210	2,832	28.1	6.5
Machinery	48	58	20.8	42	97	131.0	861	1,681	95.2	7.0
Autos & other consumer durables	20	24	20.0	11	23	109.1	569	1,542	171.0	8.0
Improve land & buildings	14	16	14.3	34	61	79.4	2,382	3,817	60.2	6.3
Total	**88**	**110**	**25.0**	**100**	**214**	**114.0**	**1,133**	**1,957**	**72.7**	
Buy Farm Real Estate	19	18	− 5.3	69	127	84.1	3,612	6,886	90.6	6.2
Other Purposes:										
Consolidate & pay other debts	11	12	9.1	25	41	64.0	2,329	3,456	48.4	6.7
Other	16	13	− 18.8	20	30	50.0	1,329	2,253	69.5	6.4
Total, All Purposes	**266**	**287**	**7.9**	**306**	**575**	**87.9**	**1,151**	**2,005**	**74.2**	**6.5**

was nearly four times as great as in 1956. It is also by far the largest of any group.

Owner-operators continue to constitute a substantial majority of banks' farm customers in the Fifth District. They accounted for 69% of all farm borrowers in 1966, compared with 67% in 1956. Total outstanding loans to this group have expanded by 88% and average size of debt has risen by a like proportion.

The number of tenants borrowing at banks fell 25% between 1956 and 1966, but the volume of bank credit extended to them advanced 68%. While the percentage increase in average size of debt was greater for tenants than for owner-operators, the average was less than one-third as great for the former as for the latter group. The number of landlords borrowing from banks also declined. Their total borrowing was 56% greater than in 1956 while the average size of loans was 79% higher. The remaining group, for which tenure was not known by the banker, was tabulated as "unknown," and is accounted for largely by borrowers whose notes were purchased from merchants, dealers, and other sources.

Net Worth Striking changes have occurred in the net worth positions of bank borrowers over the ten-year period. The number with net worths of less than $10,000 declined very sharply during the period while those with a net worth of over $25,000 doubled. Whereas 60% of the 1956 group had a net worth of *less* than $10,000, slightly over 60% of the 1966 group had a net worth in *excess* of $10,000. Among those for whom data were reported, borrowers with a net worth of $25,000 or more carried 62% of the outstanding debt while those whose net worth was $10,000 or less held only 13% of the total. In 1956 the latter group held twice as high a proportion of the total.

The average debt of all groups rose during the ten-year period and showed a greater proportionate increase among those with smaller net worth. The average outstanding debt of each group was consistently much smaller than their respective net worths, which suggests that banks' farm customers, taken in aggregates, are in a sound financial position. The ratio of average debt to net worth becomes progressively lower as net worth increases.

Characteristics of Farm Loans Changes in the renewal status, repayment methods, security requirements, and maturities of farm loans provide some insights into bank policy adjustments that have been made to adapt to the changing agricultural economy.

One of the striking features is the fact that banks extended both a greater number and a larger volume of loans to fewer borrowers in 1966 than ten years earlier. This may reflect an attempt on the part of banks to tailor their loans more specifically to meet the timing requirements of farmers. Unrenewed loans represented 65% of the total outstanding in 1966 compared with 61% in 1956, and planned renewals constituted 23% in each of the years. Unplanned renewals continued to represent a relatively small proportion of the total despite unfavorable weather conditions in several recent years.

Although single payment arrangements continued

SELECTED CHARACTERISTICS OF FARM BORROWERS

Item	Number of Loans			Amount Outstanding			Average Size of Debt		
	1956	1966	% change	1956	1966	% change	1956	1966	% change
	(in thousands)			(millions of dollars)			(dollars)		
Age of Borrower:									
Under 35	30	23	− 23.3	35	65	85.7	1,166	2,876	146.7
35-44	61	46	− 24.6	93	133	43.0	1,521	2,870	88.7
45 and over	94	110	17.0	166	338	103.6	1,774	3,063	72.7
Corporation	*	**		1	11	1000.0	9,736	38,496	295.4
Unknown	14	13	− 7.1	11	28	154.5	762	2,104	176.1
Tenure:									
Owner-operator	133	133	0.0	246	463	88.2	1,849	3,485	88.5
Tenant	44	33	− 25.0	22	37	68.2	485	1,102	127.2
Landlord	11	10	− 9.1	27	42	55.6	2,415	4,324	79.0
Corporation	*	**		1	11	1000.0	9,736	38,496	295.4
Unknown	11	17	54.5	10	22	120.0	933	1,317	41.2
Net Worth of Borrower:									
Under $3,000	45	19	− 57.8	16	11	− 31.3	368	585	59.0
$3,000-$9,999	66	42	− 36.4	64	56	− 12.5	961	1,335	38.9
$10,000-$24,999	48	49	2.1	91	129	41.8	1,858	2,648	42.5
$25,000-$99,999	20	40	100.0	81	197	143.2	3,985	4,973	24.8
$100,000 and over	4	8	100.0	44	119	170.5	12,126	15,575	28.4
Unknown	16	36	125.0	10	63	530.0	656	1,765	169.1
Total, All Borrowers	**199**	**193**	**− 3.0**	**306**	**575**	**87.9**	**1,534**	**2,980**	**94.3**

* Only 129. ** Only 284.

SELECTED CHARACTERISTICS OF FARM LOANS

Item	Number of Loans			Amount Outstanding			Average Size		
	1956	1966	% change	1956	1966	% change	1956	1966	% change
	(in thousands)			(millions of dollars)			(dollars)		
Renewal Status:									
Note has not been renewed	187	203	8.6	187	374	100.0	1,001	1,846	84.4
Note renewed by agreement	62	67	8.1	99	168	69.7	1,610	2,509	55.8
Note renewed for other reasons	17	17	0.0	20	33	65.0	1,149	1,905	65.8
Repayment method:									
Single payment	216	230	6.5	224	375	67.4	1,039	1,633	57.2
Installment:									
Interest on unpaid balance	23	22	− 4.3	68	143	110.3	2,961	6,486	119.0
Interest on original amount	27	35	29.6	14	57	307.1	521	1,632	213.2
Security:									
Unsecured	52	89	71.2	54	129	138.9	1,030	1,440	39.8
Endorsed or co-maker	87	57	−34.5	42	45	7.1	480	786	63.8
Chattel mortgage, etc.	80	93	16.3	69	151	118.8	867	1,626	87.5
Real estate mortgage	41	38	− 7.3	124	219	76.6	3,021	5,787	91.6
Government guaranteed or insured	1	*		4	4	0.0	4,914	6,911	40.6
Other	5	9	80.0	13	28	115.4	2,578	3,082	19.6
Maturity:									
Demand	7	8	14.3	22	47	113.6	3,261	5,552	70.3
1-7 months	147	137	− 6.8	124	190	53.2	841	1,381	64.2
8-13 months	77	91	18.2	86	157	82.6	1,116	1,734	55.4
14-66 months	28	38	35.7	38	82	115.8	1,370	5,613	309.7
Over 66 months	7	12	71.4	36	99	175.0	5,168	8,098	56.7
Total, All Notes	**266**	**287**	**7.9**	**306**	**575**	**87.9**	**1,151**	**2,005**	**74.2**

Only 611.

to be the dominant method of repaying farm loans, there has been a sharp increase in the outstanding amount of loans repayable in installments. Only 27% of the outstanding loan volume was to be repaid in installments in 1956, but by 1966 this proportion had risen to 35%. Installment loans were, on the average, somewhat more than twice as large in the more recent year. Interest on these loans was most often computed on the unpaid balance, but computing interest on the original amount appeared to be making rapid gains.

Security There is no definite discernible trend of security requirements for farm loans, except that the relative importance of using an endorser or co-maker declined sharply. Loans involving endorsers or co-makers numbered 34% fewer in 1966 than in 1956 and accounted for only 8% of the total dollar volume in the former year. These loans also were of the smallest average size. Unsecured loans showed large gains, both numerically and in total volume, although they were second smallest in average size. They represented 20% of the number and 18% of the amount outstanding in 1956, but ten years later they represented 31% and 22%, respectively.

Loans guaranteed or insured by Government agencies, primarily by the Farmers Home Administration, were of the largest average size; they remained quite minor in numbers and in amount outstanding. Loans secured by real estate mortgages showed the largest increase in average size (92%) and represented the largest total dollar volume of any of the security classes. More loans were secured by chattel mortgages than any other type of security and these loans involved the second largest dollar volume in 1966.

Maturity Loans of 1-7 months maturity were the only category that showed an actual numerical decline (7%) during the ten-year period. They also recorded the smallest increase in total volume (53%), which indicates that banks are stretching out the terms on many of their farm loans. Loans of 1-7 months maturity were advanced primarily for operating and family living expenses and remained the most used maturity class both in number and amount. Loans to be repaid in 8-13 months were second in importance in both number and volume. For these two categories, the average size was far smaller than for any other maturity class. Intermediate term loans, those with a maturity of 1-5 years, quadrupled in average size during the decade. These were primarily used for automobile and machinery purchase, for land improvement, and, to some extent, for farm real estate purchase.

Farm real estate loans were most often written for more than five year maturities, although demand notes were also used for this purpose. They were of the largest average size and experienced the greatest increase in amount outstanding during the ten-year period.

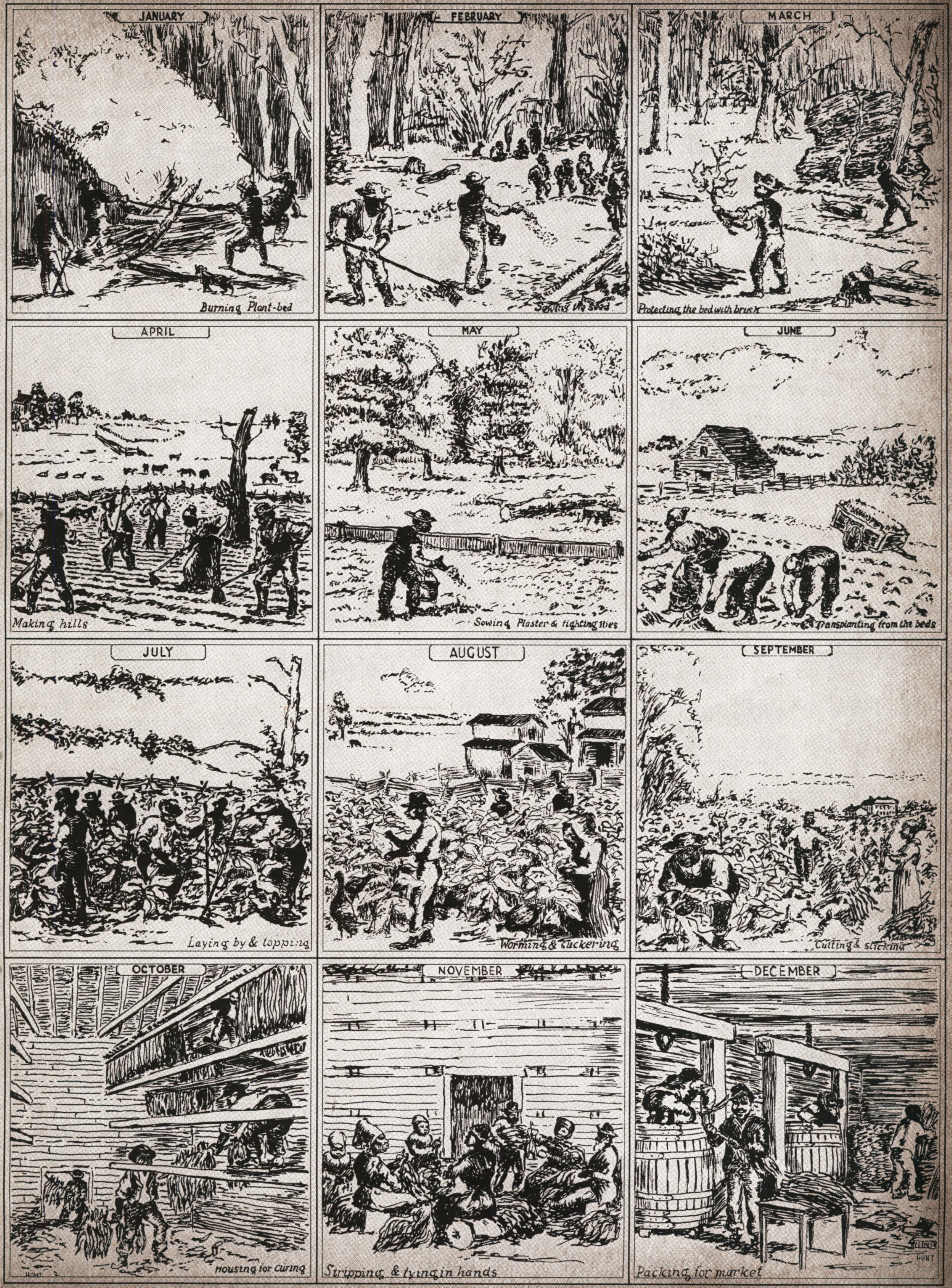
Origins of Industries

John Rolfe

Courtesy American Tobacco Company

TOBACCO

Few industries are as intimately related to the early growth and development of our nation as tobacco production and processing. From its primitive origin in Jamestown, the tobacco industry has expanded and prospered until it has become an important component of the District's economy. The theme of this expansion is deeply rooted in the history of the growth of the country. In an attempt to save the struggling colony of Jamestown, John Rolfe began experimenting with the tobacco plant in the hope of finding a source of income for the colony. His discovery that Virginia's soil was ideally suited for raising tobacco was to become the salvation of the new settlement. The colonists sent their first shipment of tobacco to England in 1613. Because of its high quality, American tobacco was quickly in great demand and by 1618 was selling at 55 cents a pound on the London market. Within the span of a few years, tobacco had become a cash crop on which the colony was heavily dependent. During the colonial period, tobacco was of such unique importance to the economy that it was at times used as money by the colonists. Tobacco trade flourished in Virginia, and the new commerce brought more settlers to the colony. The search for better soil led farmers to the Carolinas where many small tobacco farms soon replaced the virgin forests. Tobacco planters also moved north into Maryland, and by the 1650's great self-sustaining plantations could be found throughout tidewater Maryland and Virginia. Warehouses, storage sheds, and large tobacco barns were built all through the tobacco producing colonies to accommodate the new crop. They were signposts that tobacco had brought economic prosperity to the New World. By 1776, Maryland, Virginia, and the Carolinas were exporting an average of 100 million pounds of tobacco annually. It was not until the 19th century that Americans began manufacturing tobacco products on a significant scale. Up to this time trade had been so profitable that the rolling, cutting, and packaging had been left almost entirely to the foreign purchasers of tobacco. In the 1880's, however, the first cigarette making machine was put in operation, a step which marked the turning point for the domestic tobacco industry. The manufacturers of tobacco began building factories and plants with new and improved construction materials. Factory machinery, precision instruments, and work saving devices were tried, perfected, and used as the industry expanded. At the same time farmers were testing new plant nutrients, using new heating units for curing, and experimenting with new plant varieties. In the meantime, the public's taste had changed from snuff, to "chew," to mixtures for the pipe, to cigars, and finally to cigarettes. And the industry kept pace with the changing demand. The growth of the tobacco industry is of great importance to Fifth District states. In 1966 the District accounted for 58% of the total tobacco grown in the United States and 60% of the acreage harvested. North Carolina is the top tobacco producing state in the country, followed by Kentucky. Virginia ranks third, South Carolina fourth, and Maryland eighth. In fiscal year 1965 the Fifth District produced four-fifths of all cigarettes manufactured in the United States. North Carolina alone accounted for over 58% of the country's cigarettes, and Virginia was the second largest manufacturer with 22%. Today the tobacco industry can claim some of the most modern and productive factories in the Fifth District. Well equipped research centers and laboratories allow District tobacco farmers and manufacturers to experiment with an old, though still improving commodity.



Drawings courtesy Dr. Joseph Clarke Robert, University of Richmond

THE EURO-DOLLAR MARKET

The last decade marked the growth and development of an international money market which effectively links together national money markets in the world's major countries. This market is often referred to as the "Euro-dollar" market, but this term is imprecise in at least two respects. First, currencies such as Swiss francs, British pounds, and German marks are traded in this market in addition to United States dollars; and second, non-European countries, notably Canada and Japan, are quite important in the market. This brief article is concerned with the foreign market in United States dollars, but it should be noted that this "Euro-dollar" market is part of a much broader market in foreign currencies.

What are Euro-Dollars? In the simplest terms, Euro-dollars are deposits, denominated in U. S. dollars, and placed with banks outside the United States. Euro-dollar deposits arise when the owner of a demand deposit at a U. S. bank transfers ownership of that deposit to a foreign bank in exchange for a deposit claim against the foreign bank denominated in dollars. The later claim is usually in the form of a time deposit. The foreign bank may lend these dollars to another bank in Europe, Japan, or even to one in the United States, or to a foreign importer to finance purchases in the United States.

Trading in the Euro-dollar market may involve substantial pyramiding of Euro-dollar deposits. For example, a European bank holding a deposit in a U. S. bank may make a Euro-dollar deposit with another European bank, which in turn may deposit the proceeds with another bank, and so on. Each redeposit transfers ownership of the original deposit at the United States bank, and the transfer process could, of course, shift the deposit to another United States bank. Each such redeposit creates new Euro-dollar deposit liabilities on the books of the foreign bank involved, and the total "Euro-dollars" thus created may be several times the amount of the original claim on the United States bank.

Origins of the Market The acceptance of deposits denominated in foreign currencies is a practice of long standing, but the Euro-dollar market as presently constituted goes back no more than about ten years. Some writers trace its beginnings to the early 1950's, when banks in Eastern Europe held dollar deposits with banks in Western Europe in preference to deposits in U. S. banks. But the functioning of the market on its present scale requires the free flow of short-term funds from country to country, and this was not possible until the general restoration of currency convertibility in 1958. In addition, the large deficits in the U. S. balance of payments beginning in 1958, which gave foreigners large holdings of U. S. dollars, also contributed to the growth of the Euro-dollar market.

Growth of the Market Precise data on the growth and size of the Euro-dollar market are not available. In recent years, however, the Bank for International Settlements has estimated the dimensions of the Euro-dollar and Euro-currency markets on the basis of reporting foreign currency positions of banks located in major countries.

The chart on page 9 is based on Bank for International Settlements data. In some respects, these data overstate the size of the Euro-dollar market. Some of the assets and liabilities shown arose out of the pyramiding of deposits described above, and thus overstate the amount of dollars available to the market. Some liabilities arose out of the use of credit lines with United States banks while some assets represent normal working balances in United States banks that are not available for trading in the Euro-dollar market. On the other hand, the data do not reflect the dollar positions of these banks toward residents of their own countries, and thus omit some balances that are available to the market.

On the basis of such data, the Bank for International Settlements estimated the size of the Euro-dollar market (excluding Canada and Japan) at the end of 1965 at about $9.5 billion. On the same date, dollar liabilities of commercial banks in eight European reporting countries to nonresidents totaled $11.4 billion, while dollar assets amounted to about $11.8 billion. Thus, total dollar assets and liabilities probably overstated the size of the Euro-dollar market by as much as $2 billion as of that date. Nevertheless, these data provide a rough indication of the dimensions of the Euro-dollar market.

In September 1963, the eight European countries and Japan showed dollar assets and liabilities that were about equal at just over $9 billion. Between September 1963 and March 1966 both assets and liabilities increased substantially, but dollar assets rose $4.8 billion, for a gain of more than 50%, while liabilities grew $3.8 billion, or about 40%. Much of this difference in growth is explainable in terms of developments between December 1965 and March 1966. In this brief period, assets fell $220 million but liabilities declined $860 million; and if changes in the position of Canadian banks are included, assets declined $450 million and liabilities fell $1,190 million.

Part of this decline was seasonal and part was probably attributable to the Voluntary Foreign Credit Restraint Program in the United States. But perhaps the most important factor was the tight money situation in the United States. This led to a reduced flow of dollars into the market from the United States and an increase in loans to the United States by reporting banks. Although not reflected in the chart, these forces became increasingly important and resulted in a very large increase in loans to U. S. banks in the second half of 1966.

London is the heart of the Euro-dollar market. In March 1966, United Kingdom banks accounted for over half of the dollar liabilities reported by banks in eight major European countries and more than one-third of the total of the ten reporting countries. Switzerland is also important, but the chart overstates the size of Swiss dollar holdings because dollar assets and liabilities of the B. I. S. are included in the Swiss totals. French and Italian banks reported substantial dollar holdings, but Paris is probably more important in the market than would seem to be indicated by the dollar position of French banks.

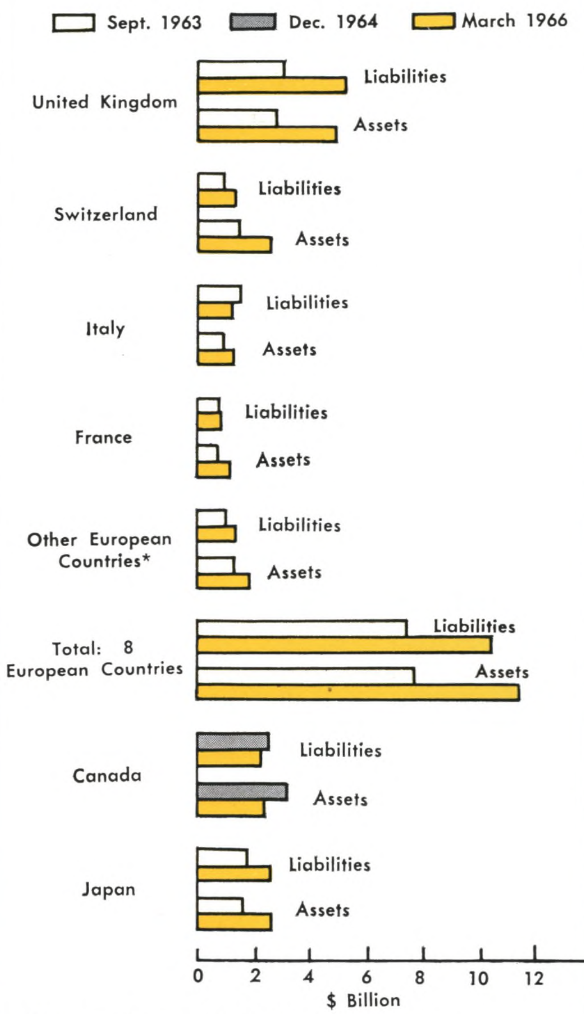
Two non-European countries, Canada and Japan, ranked next to the United Kingdom in terms of the size of dollar liabilities, but Canada appears to have been sharply affected by the Voluntary Foreign Credit Restraint Program of the United States. Between December 1964 and March 1966, dollar liabilities of Canadian banks fell $550 million and dollar assets plunged $740 million (23%).

Contributing Factors Confidence in the United States dollar is essential to the existence of the Euro-dollar market, but other factors contributed importantly to its growth. Among the most important were interest rate differentials between United States and foreign markets and legal and institutional restrictions on the movement and use of funds.

Euro-dollar deposits are for the most part interest bearing time deposits of relatively short maturity, but maturities may be extended out to five years, and interest is also paid on call money. Banks seeking to raise funds in this market must pay rates on deposits that are competitive with those on instruments of comparable quality, liquidity, and maturity in United States money markets. Loan rates, on the other hand, must be competitive with rates charged on local currency loans and in United States financial markets. This results in narrower margins between borrowing and lending rates in the Euro-dollar market than exist in regular financial markets.

The Euro-dollar market makes possible the avoidance of numerous restrictions on the uses of funds or on rates that may be charged. Banks in the United States, for example, may not pay interest on demand deposits and the rates they can pay on time deposits are limited by Regulation Q. No such restrictions apply to Euro-dollar deposit rates, so it is advantageous to many United States holders of

SHORT-TERM DOLLAR POSITION OF COMMERCIAL BANKS IN SELECTED COUNTRIES, VIS-A-VIS NON-RESIDENTS



*Belgium, Germany, Netherlands and Sweden.
Source: Bank for International Settlements 35th & 36th Annual Reports.

dollars to deposit them in banks outside the United States. On the other hand, United States banks may solicit funds in the Euro-dollar market at rates not subject to ceiling restrictions.

Other restrictions applying to United States banks which have importantly influenced the growth of the Euro-dollar market include legal reserve requirements, the interest equalization tax on some loans to foreigners, and the Voluntary Foreign Credit Restraint Guidelines on foreign loans. In addition, some restrictions on foreign banks, such as interest rate ceilings and maturity limitations on local currency loans, have also encouraged the growth of the Euro-dollar market.

Implications of the Market The Euro-currency market is in a continuing state of evolution. Since the mid-1950's it has grown from a quite limited market in United States dollars into a worldwide market involving transactions in a number of major currencies. This evolution toward a truly international money market has important implications for national monetary conditions, balance of payments positions, and the management of the money position of large commercial banks.

One result has been the development of an international interest rate structure independent of the rate structure within any individual country. This has tended to reduce interest rate differentials between national money markets and to limit to some extent the ability of monetary policymakers to determine the level of domestic rates. The impact of Euro-dollar rates on the rate structure of a particular country, however, depends on the size of Euro-dollar flows relative to total financial flows and upon the effort made to insulate domestic credit markets from the effects of Euro-dollar operations. But if a central bank attempts to hold interest rates in a particular country above those in money markets in other major countries, or if commercial banks try to maintain artificially high rates through cartel arrangements, a sharp influx of Euro-currency funds into that country is likely to put downward pressures on domestic rates.

The Euro-dollar market is small relative to financial markets in the United States, but it has nevertheless exerted an important influence on interest rate policy in this country. Outflows of short-term funds into the Euro-dollar market were the cause of several changes in Regulation Q, and they also were partly responsible for the "Operation Twist" policy which endeavored to hold short-term rates higher and long-term rates lower than otherwise would have prevailed.

Commercial banks are making increased use of the Euro-dollar market to adjust their liquidity positions and central banks are using it to supplement monetary policy operations in domestic money markets. It has been estimated, for example, that in the second half of last year large commercial banks in the United States borrowed as much as $2.5 billion through their European branches. The individual bank may increase its reserves in this manner by drawing reserves from other banks, of course, but such borrowing does not increase the reserves of the banking system as a whole. But since the bank is not required to hold legal reserves against its liabilities to foreign branches, its required reserves will decline and the loanable funds of the system will be increased.

These heavy borrowings last year, combined with year-end window dressing operations of European commercial banks, put strong upward pressure on interest rates in the Euro-dollar market. Among other unfavorable results, these pressures threatened to pull funds out of sterling and to put intense downward pressure on spot sterling. To meet this situation, several European central banks, the Federal Reserve System, and the B. I. S. took concerted action to relieve pressures in the Euro-dollar market. The Swiss National Bank, for example, bought spot dollars from commercial banks and sold them forward over the year-end. The dollars thus acquired were immediately channeled back into the Euro-dollar market. The B. I. S. drew upon a $200 million swap line with the Federal Reserve and placed the dollars in the Euro-dollar market. The Netherlands Bank rechanneled funds into the market, while the German Federal Bank and the Bank of Italy took action to reduce the pullback of Euro-dollar placements by their banks.

This concerted action by major central banks points up the growing recognition of the Euro-dollar market as an international money market. In addition, central banks have for some years used operations in the market to influence domestic monetary conditions. The German Federal Bank, for example, has at times offered dollar swap facilities to commercial banks on favorable terms to encourage the banks to place these funds abroad and thus reduce domestic liquidity. The Bank of Italy has provided similar swap facilities to Italian banks. On the other hand, a central bank may add to domestic liquidity by encouraging commercial banks to draw funds from the Euro-dollar market and convert them into the local currency. These operations in the Euro-dollar market, therefore, are quite similar in effect to central bank open market operations.

THE FIFTH DISTRICT

Despite an apparent slackening in the economy, nonagricultural employment continued upward in all District states in late 1966 and January of 1967. On a seasonally adjusted basis, nonagricultural employment increased 77,500 or 1.3% in January. This compares with a national gain of almost 0.5%. Insured unemployment rates in the District remained below the national level of 3.5% in the week ended March 4 in all states except West Virginia. The rates were the same or slightly below year earlier levels throughout the District, except in the Carolinas.

Construction The construction industry is still depressed despite the slight upturn at the end of the year. The slackness is now beginning to have repercussions in other District industries—especially furniture, and to a limited degree, textiles.

The seasonally adjusted index of construction contract awards in the District for both residential and nonresidential construction fell further in January. Nonresidential construction suffered the greatest month-to-month decline (22.9%). However, on a year-to-year basis, it declined 33.0% compared with a 41.5% drop in residential construction. Nevertheless, the January index of total construction contracts in the District (160) continues to run ahead of that of the nation (126). In February the index increased to 143 nationally.

Valuation of building permits issued is another indicator of construction activity. As is evident in the accompanying table, in the first two months of 1967, the District as a whole showed moderate declines both from the last two months of 1966 and from a year earlier. This was the result, however, of widely different movements in the various states. West Virginia had very large gains in both comparisons, and South Carolina showed somewhat smaller, but still quite significant increases. At the other extreme, the District of Columbia and Maryland experienced large declines. Changes in North Carolina and Virginia were nearer the District average.

In spite of this weakness in District construction activity, all states reported increases in construction employment, seasonally adjusted, for the three month period ending January 1967. The greatest increase was from November to December with 12,000 new employees compared with the estimated December to January gain of 7,400 new employees.

Textiles Soft spots continued in the textile industry during the last quarter of 1966 and early 1967. A recent survey by the Federal Reserve Bank revealed that order backlogs, new orders, and shipments remain sluggish, and inventories of finished goods have risen. Last year's surge in imports continues to disturb the industry. The Commerce Department reports that cotton textile imports totaled 160 million square yards in January, up 20% from December. The profit squeeze of late last year is also a matter of considerable concern to textilemen.

Many textile mills have cut back production with some mills reducing their workweek from six to five days and a few have cut it to three days. The average textile workweek in the District declined one full hour in January to 41.2 hours compared with 42.2 hours a year earlier. Textile employment in the District in January declined almost 0.5% from December but was up 2.9% over a year ago.

VALUATION OF BUILDING PERMITS ISSUED
FIFTH DISTRICT STATES

(in thousands of dollars)

	Last 2 mos. 1966	1st 2 mos. 1966	1st 2 mos. 1967	% change from year ago	% change from last 2 mos. 1966
District of Columbia	28,422.0	27,165.3	13,558.2	− 50.1	− 52.3
Maryland	23,381.1	26,716.5	11,940.1	− 55.3	− 48.9
North Carolina	50,413.1	47,581.3	46,052.4	− 3.2	− 8.7
South Carolina	7,332.7	15,012.7	18,545.1	+ 23.5	+152.9
Virginia	41,353.2	55,929.0	49,364.1	− 11.7	+ 19.4
West Virginia	1,736.2	2,395.4	5,599.7	+133.8	+222.5
Total	**152,638.3**	**174,800.2**	**145,059.6**	**− 17.0**	**− 5.0**

Several textile plants have announced cuts in capital expenditures of about one-third from last year's level. A number of trade sources question whether reinstatement of the 7% investment tax credit will have any immediate effect on the pace of plant expansion in the industry. They indicate, however, that the trend toward modernizing existing facilities will continue in 1967.

The slump in residential construction and automobile sales has curtailed demand in important segments of the industry. Millmen report sluggishness in the market for carpeting, bedspread and drapery fabrics, and upholstery material. In addition, the textile industry is now confronted with the prospect that defense orders will be reduced sharply. Figures in the Federal budget for fiscal 1968 indicate a cut of 35% or more in Defense Department textile purchases. The new minimum wage law which went into effect February 1 has also occasioned some concern among millmen. Some industry leaders fear that it will lead to a general escalation of wages in all operating grades and thus further tighten the profit squeeze.

In spite of the generally bearish tone of most reports from the industry, a significant number of millmen look for an upturn in the industry in the 4th quarter of 1967. According to trade sources, prospects in retail soft goods appear especially bright.

Furniture After an unprecedented period of buoyant expansion, the furniture industry encountered a significant easing of demand late last year. The recent slump in residential construction, among other factors, was a major contributor. As in the case of textiles, profits are currently in a squeeze, as costs continue to rise in an environment highly unfavorable to compensating increases in prices.

Industry observers report that the new minimum wage law has not only raised wage costs but also contributed indirectly to increases in materials costs. The cost of hardwood lumber has risen and its availability over the long term is now beginning to concern the industry. Many manufacturers are already looking for foreign sources to fill the gap which they see developing in domestic markets.

The following table reveals that there have been definite declines in new orders and backlogs, on a month-to-month as well as year-to-year basis. Order cancellations and inventories have increased significantly. Manufacturers are pondering how long it will take to work off these excess inventories. Despite these factors which represent a declining civilian demand, both payrolls and production are up.

Some manufacturers are looking to the April Furniture Market in High Point to pull the industry out of its slump. Others are a bit more pessimistic. Profits in 1967 are not expected to approach the record levels of 1966 unless there is an early reversal of present trends.

FIFTH DISTRICT FURNITURE ACTIVITIES

Index (1957-59=100)

Item:	December 1966	January 1967	% change January 1966-January 1967
Orders Booked	139.6	190.0	− 5.3
Shipments	165.4	193.2	+ 9.2
Unfilled Orders	312.3	317.3	− 9.8
Cancellations	455.0	419.1	+22.7
Production	185.7	218.4	+17.4
Payroll	271.6	273.5	+16.6
Finished Goods on Hand	223.0	235.0	+26.5
Accounts Receivable	131.7	133.1	+10.9

Banking The first months of 1967 have been marked by moderate credit expansion for banks in the Fifth District. Total bank credit at the 28 weekly reporting banks grew 1.7% from the beginning of the year to March 15, as a result of a substantial increase in total investments. On March 15 investments at weekly reporting banks had climbed $186.7 million, or 7.2%, since the first of the year. Holdings of U. S. Government securities gained $111.2 million from December 28, 1966, and other securities, chiefly municipals, increased $75.5 million.

This rather substantial increase in investments has been partially offset by persistent declines in loans. Although loans have not fallen as sharply as they did in the first weeks of 1966, they had declined $61.7 million by March 15, 1967.

A large portion of the decline in lending has been centered in loans to other financial institutions, which had dropped $55.4 million by March 15. Commercial and industrial loans had fallen $25.2 million since the beginning of 1967, and the "all other loan" category was down $22.8 million. Consumer installment loans continued to decline in the early months of 1967. The drop of $11.4 million by March 15 reflects the slump in automobile, appliance, and furniture sales. Although this decline is not proportionally as large as the national decrease, it is an indication of the caution shown by Fifth District consumers in 1967.

Gains were reported in only three of the major loan categories. Loans to domestic commercial banks registered the largest increase for 1967 with a gain of $62.4 million. Real estate loans had shown a slight increase of $5.6 million since the beginning of the year, and agricultural loans had gained $0.8 million.