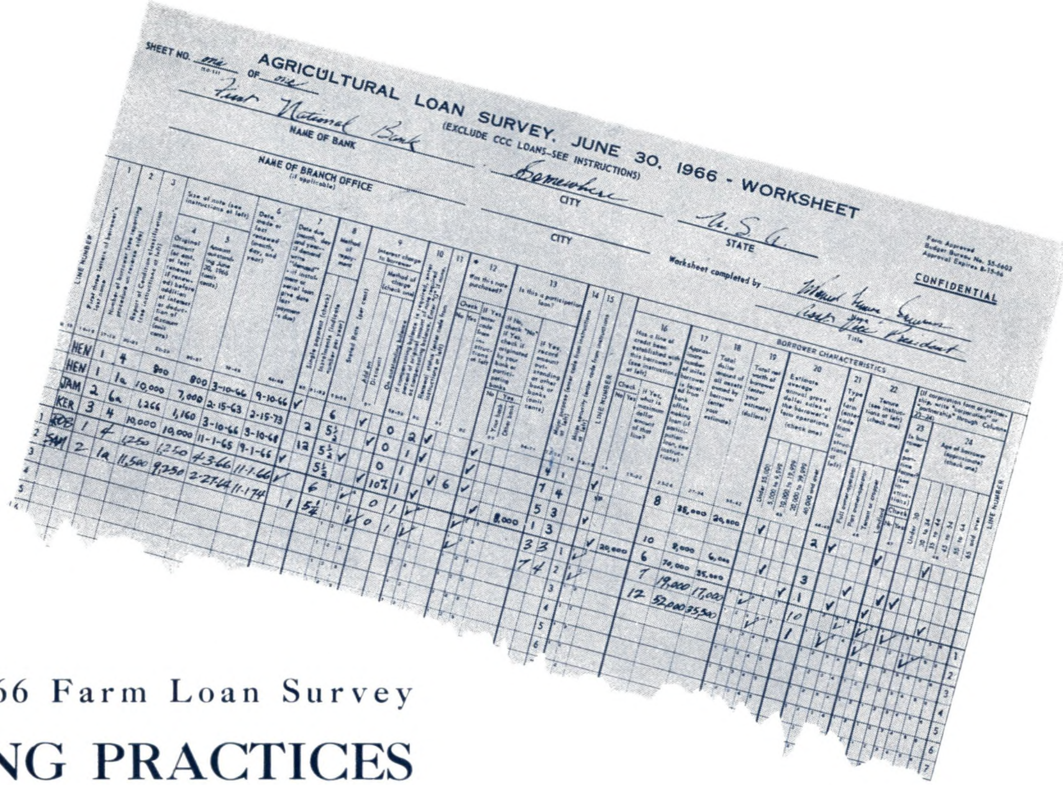
FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

AUGUST 1967


SHEET NO. one OF one
AGRICULTURAL LOAN SURVEY, JUNE 30, 1966 - WORKSHEET
(EXCLUDE CCC LOANS-SEE INSTRUCTIONS)
First National Bank
NAME OF BANK
NAME OF BRANCH OFFICE (if applicable)
Somewhere
CITY
U. S. A.
STATE
Worksheet completed by
Title
CONFIDENTIAL
BORROWER CHARACTERISTICS

II 1966 Farm Loan Survey

LENDING PRACTICES OF FIFTH DISTRICT COMMERCIAL BANKS

Bank lending policies differ widely from one bank to another. This fact was brought into focus quite sharply in a survey of bank loans to farmers, conducted by the Federal Reserve System on June 30, 1966. Not only are there wide differences in the loan-to-deposit ratios of District banks, but substantial differences also appear in the proportion of farm loans made for real estate purposes and in the use of lines of credit to farm borrowers. Furthermore, distinct differences are evident in interest rates charged on loans to various types of farms.

Bank Loan/Deposit Ratios Bank loans as a proportion of net deposits serve as one means of measuring the extent to which a bank puts its funds to work in the community it serves. A high ratio implies that a bank is utilizing a relatively high proportion of its lendable funds for loans which may contribute to economic growth in the community. On the other hand, a low ratio during the bank's peak season of loan demand indicates that it is serving primarily as a depository.

Nearly three-fourths of the banks had ratios in excess of 50% and nearly half were over 60%. Almost 10% of the banks, however, had ratios of less than 40%.

Farm Real Estate Loans District banks were quite heavily involved in farm real estate. Nearly half of the dollar volume of farm loans was secured by real estate. Of this total, however, it served as the major security for only 38% of the loan volume and constituted additional security for chattel loans on another 10%. This pattern held for all sizes of banks, but was somewhat more prevalent in northern portions of the District than in the Carolinas.

This heavy concentration in farm real estate credit by banks is a regional characteristic, confined to the Eastern and Southern states. Nationally, real estate loans comprise only 26% of all bank loans to farmers. In most other areas of the country, life insurance companies and Federal land banks dominate farm mortgage lending and this also holds true in the Carolinas, but in Maryland and West Virginia banks supply more farm mortgage credit than the other two lenders combined. While banks in Virginia do not dominate farm real estate lending to such an extent, they are still the largest lenders by a wide margin.

It is difficult to account for these regional differences. Perhaps a partial explanation is the fact that banks in the northern part of the District hold a higher proportion of their total deposits as time deposits and consequently are more willing to make long-term loans. It is also possible that the other two principal lenders have been less agressive in this area than elsewhere. Some would also argue that the usury laws found in District states are partly responsible for insurance companies being less active, but in view of the fact that the survey was conducted prior to the rapid rise in interest rates last year, and since many of the loans had been on the books for some time, this explanation seems quite inadequate.

Non-Real Estate Farm Loans A further measure of bank lending policies as they apply to farmers is the proportion of bank loans that are granted for non-real estate purposes. Included in this classification were loans for normal farm operating and living expenses and loans for purchase of machinery, livestock, and consumer durables. The accompanying table shows that this type of farm loan comprised less than 5% of all bank loans and discounts in the District on the date of the survey. Non-real estate farm loans, however, made up a much larger proportion of total loans of banks with the lowest loan/deposit ratios, which indicates that this category of banks is most heavily involved with agriculture. Banks with ratios between 50% and 60% were also quite active in this type of lending.

Lines of Credit Only 4% of the farm borrowers in the District were using lines of credit at the time the survey was taken. Use of the line of credit arrangement is beneficial both to farmers and to bank managers. The farmer is assured that needed funds will be available when needed, and the banker is aided in his planning by having some advice indication of the strength of loan demand. Probably more important than the number of farmers who receive lines of credit is the amount involved. On the date of the survey loans under such arrangements comprised nearly 12% of the total outstanding farm loans.

Lines of credit are not confined to large farming operations, although farmers with net worths of over $100,000 have by far the greatest proportion of the total. Nevertheless, over half of the borrowers involved had net worth of less than $50,000 and their total assets were under $60,000. This means that some relatively small farmers are using this credit tool. This is further substantiated when it is noted that the largest group included in the table had an average of only $24,000 in total assets.

Types of Farms The importance of tobacco in the District agricultural economy is evident from the last table. Banks which participated in the survey were asked to classify the type of farm operated by each individual borrower according to the product which accounted for over half of farm sales. Because

STATE DATA BASED ON LOAN—DEPOSIT RATIOS OF COMMERCIAL BANKS, 5th DISTRICT, 1966

	Under 30%	30-39%	40-49%	50-59%	60-69%	70% and Over	All Banks
Number of Banks							
District	18	61	128	204	219	192	822
Maryland	1	6	6	27	40	40	120
District of Columbia	0	1	0	2	1	11	15
Virginia	4	10	23	48	87	87	259
West Virginia	5	21	46	53	28	9	162
North Carolina	4	11	18	42	36	30	141
South Carolina	4	12	35	32	27	15	125
Real Estate Loans as % of Farm Loans							
District	37.9	60.2	56.1	49.6	49.3	43.9	48.0
Maryland	0.0	44.1	59.2	69.5	68.3	54.8	63.4
District of Columbia	0.0	89.6	0.0	0.0	100.0	29.9	59.8
Virginia	35.2	53.2	55.3	52.1	45.9	54.0	50.8
West Virginia	75.2	69.9	74.5	58.9	59.3	52.8	62.3
North Carolina	53.4	58.5	49.1	41.1	37.0	34.9	38.0
South Carolina	8.8	68.2	50.5	43.1	41.1	21.0	39.5
Loans to Farmers, Excluding CCC Loans as % of Gross Loans and Discounts							
District	13.8	4.2	8.1	9.8	5.0	3.3	4.7
Maryland	1.2	9.6	4.4	7.4	3.8	3.7	4.0
District of Columbia	0.0	0.2	0.0	0.0	0.1	0.0	0.1
Virginia	27.4	10.1	9.9	16.9	4.5	3.9	5.1
West Virginia	2.6	3.0	4.2	3.4	5.3	9.1	4.2
North Carolina	24.8	27.5	11.1	15.5	10.0	4.1	6.5
South Carolina	22.9	12.7	12.4	10.5	4.9	4.4	6.6

CHARACTERISTICS OF LOANS INVOLVING LINES OF CREDIT, 5th DISTRICT, 1966

Amount of Line of Credit	No. of Borrowers	Total Outstanding	Total Amount of Line	Average Assets of Borrowers	Average Net Worth
		(thousands of dollars)			
Under $5,000	3,537	5,181	8,125	24,083	18,101
$ 5,000-9,999	1,361	5,102	7,842	42,624	30,598
10,000-24,999	2,175	17,561	32,692	138,165	117,503
25,000-49,999	734	17,474	22,146	385,339	276,126
50,000-99,999	248	8,869	14,604	356,554	218,627
100,000 and Over	176	13,187	28,964	813,434	576,743

of this many farms that were listed as "general" undoubtedly raised significant amounts of tobacco and varying amounts were probably raised by farms placed in still other categories. Tobacco farmers *per se* were by far the dominant group, both from the standpoint of number of borrowers and number of loans. They were second most important in total amount outstanding exceeded only by the "general" group. On the other end of the scale, however, the average loan to a tobacco grower was the smallest of any of the major categories. Likewise, his net worth and total assets positions were the smallest.

Large numbers of farmers, especially those in the tobacco and "general" categories, now seek to supplement their farm income with off farm work. These two categories now account for 65% of the part-time farmers who are bank borrowers, whereas in 1956 they accounted for 52%. The most dramatic increase during the decade was among the tobacco farmers. Part-time farmers in these two groups accounted for over 14% of all bank farm borrowers in 1966 compared with only 6% ten years earlier.

The survey revealed that over ¾ of the tobacco farmers had gross sales of less than $10,000 compared with ⅔ of the entire group. Only the meat animal raisers had a higher proportion of borrowers with gross sales of less than $10,000. Over 42% of the tobacco farmers were reported to have gross sales less than $5,000 and here again the meat animal category was the only one which scored lower.

On the other end of the income scale and except for the "not reported" category, tobacco farmers had the smallest proportion (4%) of borrowers with gross sales of $20,000 or more. High hand labor requirements combined with restrictive Government allotment programs certainly account for this in part. Fruit growers had the largest proportion of any major category with gross sales of over $20,000. Thirty per cent of them had sales in this amount, followed by dairy 24%, cash grain 20%, poultry 19%, vegetables 15%, other major products 14½%, cotton 13½%, general 6%, and meat animals 5%.

Interest Rates Interest rates charged on loans to various types of farmers reveal some unexpected relationships. The risks associated with product price changes that may occur as a result of unusual weather causing changes in supply are usually considered an important determinant of interest rates. Often larger loans are granted lower rates, too, because of lower servicing costs per dollar loaned. Monthly as opposed to yearly income will also in many cases result in lower interest rates. Yet dairy farmers paid the highest interest rates of any major group, despite the fact that their income is received monthly, their prices are predetermined, and their average loan is third highest of any category.

The highly integrated poultry industry tied with dairying for the highest level of interest rates paid. Here again, although there is a greater price risk to the integrator, income is received throughout the year in the case of broilers, and the average loan is second highest. On the other hand, meat animal and fruit and vegetable growers, which are perhaps subject to greater price and weather fluctuation than many of the other groups, were granted interest rates below the District average.

There is perhaps some explanation for dairy and poultry farmers paying higher effective interest rates. Poultry farmers rank first among farmers with notes overdue (7.8%) and 6.8% of the dairy farmers were in a similar position. These two groups also have an above average proportion of instalment loans, of both the discount and add-on variety, which in turn yield higher effective rates.

Some question may arise as to how rates can be as high as those listed when usury laws exist throughout the District. The rates listed, however, are average *effective* rates rather than the rate stated on the note. The use of discounted or add-on notes will yield a higher effective rate. This also holds true for many term loans.

Full-Time vs. Part-Time Farming Considerable industrial growth has been experienced in the District in the post-war period, and, as would be expected, this has had a large impact on farming. The number of part-time farmers who borrow from District banks nearly doubled during the 1956-66 decade, moving from 27,000 in 1956 to 48,000 ten years later.

They comprised only 13% of all of the banks' farm borrowers in the former year, but by last year they totalled about one-fourth. A farmer was considered a part-time operator in the survey if he received one-third or more of his gross income from off-farm activities.

All tenure groups were affected by the rise in part-time farming, but the part-owners (those who own part and lease part of their farms) were most heavily involved. As a group part-time farmers had somewhat more limited asset and net worth basis than did their full-time counterparts. They were also about 2 years younger on the average. This difference is most readily apparent among the older farmers. A much lower proportion of farmers 55 and older engaged in part-time farming than in the younger groups. A number of factors probably account for this. First, industrial opportunities are very limited for the older men. Second, their families are probably grown and there is less need for them to supplement their farm income and third, they simply may not want to change their ways and subject themselves to the discipline of a time clock.

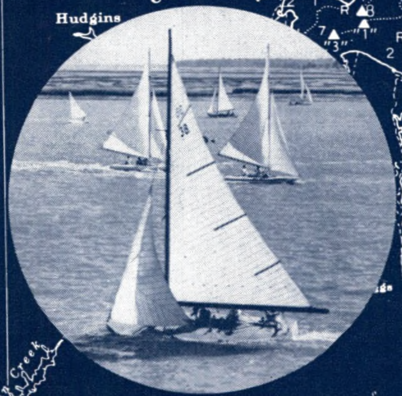
The younger men, on the other hand, probably have quite strong incentives to engage in part-time farming. It may give them the added income they need to educate their children and to live a better life while remaining on the farm. For some it may provide the added income and savings needed to become full-time farmers later on. For others it may serve as the means for gradually making the transition to complete dependence on their non-farm job.

Banks apparently do not make sharp distinctions between the two groups as far as their lending practices are concerned because the average outstanding debt was quite comparable in each case. Tenants and part-owners engaged in part-time operations did have lower average debts, but they paid somewhat higher interest rates, perhaps reflecting a higher proportion of their total debt being devoted to the purchase of automobiles and consumer durables. Full owners and landlords, on the other hand, had higher average debts.

SELECTED CHARACTERISTICS OF FARM LOANS AND FARM BORROWERS, 5th DISTRICT, 1966

	Numbers of		Average					
	Borrowers	Loans	Outstanding	Net Worth	Assets	Total Outstanding	Average Interest Rate	Part-Time Farm Borrowers
Type of Farm	(thousands)		(dollars)	(thousands of dollars)		(mil. dol.)		(number)
Meat Animals	16	24	2,960	48	63	71	6.4	7,683
Dairy	12	20	3,255	51	74	65	6.9	1,783
Poultry	4	6	4,645	48	68	30	6.9	1,069
Tobacco	75	113	1,237	19	25	140	6.3	10,980
Cash Grain	5	8	4,094	69	86	32	6.1	1,516
Cotton	4	6	2,407	36	51	15	6.6	852
Fruit	1	2	6,218	83	111	12	6.0	138
Vegetable	2	3	2,267	34	41	7	6.4	727
Other Major Products	3	6	2,655	44	56	15	6.8	520
General	55	80	2,028	27	38	161	6.4	16,805
Not Reported	16	19	1,432	35	49	27	6.8	937
Total	193	287	2,005	30	41	575	6.5	43,010
Tenure								
All Borrowers								
Full Owner	115	174	2,367	35	48	411	6.5	
Part Owner	18	30	2,039	25	37	60	6.3	
Tenant	33	47	792	5	7	37	6.5	
Landlord	10	15	2,815	58	74	43	6.3	
Not Reported	17	21	1,093	17	25	23	6.6	
Total	193	287	2,005	30	41	575	6.5	
Full-Time Farmer								
Full Owner	81	126	2,244	34	46	282	6.5	
Part Owner	11	19	2,120	26	39	40	6.2	
Tenant	25	36	857	5	8	31	6.5	
Landlord	4	7	2,232	39	51	15	6.1	
Not Reported	3	4	672	8	13	3	6.1	
Total	123	191	1,937	27	37	370	6.5	
Part-Time Farmer								
Full Owner	30	42	2,613	33	45	111	6.4	
Part Owner	7	10	1,790	23	33	18	6.6	
Tenant	6	8	546	4	6	4	7.0	
Landlord	5	7	3,094	64	78	23	6.3	
Not Reported	0.3	0.5	1,137	15	18	0.6	6.2	
Total	48	68	2,287	31	42	156	6.4	

Figures may not add to total due to rounding and exclusion of some corporations, partnerships and not reported items.



ailing
 one of the
dest sports in
e Fifth District.
kipjacks, bugeyes,
ungys, and log canoes
ere used to carry the
oods and harvest the sea-
ood of Maryland, Virginia,
nd the Carolinas for many
enerations. Inevitably, work
oats came to be used for cruising
nd racing, and sailing as a sport de-
eloped. The Chesapeake Bay log canoe
 still raced regularly, and these boats
 faster than many more modern craft.
 Sailing is also one of the newest sports
 the District. Within the past two decades,
e development of new boat building materials—
berglass, plastics, aluminum, and synthetic cloth
nd ropes, has led to the mass manufacture of stock
esigns, and has brought the price of a fine sailboat
ithin the reach of thousands of families. Several of
e nation's leading sailboat manufacturers are located
 the Fifth District, and other District factories produce
aterials for sails and rigging. Moving, storing, and
aintaining sailboats has also become a major industry.
ailboats require special trailers when moved overland. And
ey require care and maintenance when left in the water.
 Sailing is an exciting sport for the individual. The Finn,
e Kite, and a number of other one-design racing boats may be
ailed single-handed in competition. But this is a sport which
so appeals to families. There is racing competition for all ages
 bays and lakes throughout the District, and many families take
g cruises aboard larger boats. Since sailboats have an unlimited
uising range, the length of a vacation trip is limited usually by
e and the stamina of the crew. ■ The growing popularity of sailing
s increased participation in this activity more than 60% in the past
e years, and it is expected to grow another 50% to 60% by 1980.

FIFTH DISTRICT SAILING

POSTWAR U. S. INVESTMENT IN CANADA

Following World War II United States investors looked north to Canada's vast reaches of untapped resources and saw an area ripe for economic development. Soon after the war American capital began to flow into Canada in great quantity, and the flow has increased in the past decade despite sharp objections by some prominent Canadians against what they considered excessive foreign control of Canadian business.

Dependence on external sources of financing has been characteristic of Canada's economy during most of its history. British investments, mainly in railways and other government-supported expansion, were dominant from the turn of the century until the start of the war in 1914. Following the war the United States quickly became the leading foreign investor in the Canadian economy. Growth of United States investment was interrupted during the 1930's but began again in the 1940's. Since World War II Canada's foreign trade account has shown frequent deficits, which have been financed in large part by capital inflows. In contrast with sharp criticisms of too much United States control of Canadian business, Canada's businessmen and provincial leaders generally encourage foreign investment.

This article will concentrate on private investment. United States Government claims in Canada are small relative to other parts of the world. Private investment is predominantly long-term and attention will focus on both direct and portfolio investments, which together constitute private long-term investment. Consideration will also be given to the industries which have been major recipients of American capital.

Direct Investment Direct investment is the largest single category of United States foreign investment. As the accompanying chart shows, it represented over 60% of total privately held foreign assets in 1965, and has accounted for a similar proportion of the growth in this area since World War II. The distinction between direct and portfolio investment is not always easily discernible. Generally, direct investment includes the establishment or acquisition by United States corporations of foreign branches and business offices and of foreign subsidiaries and affiliates where holdings of United States residents represent an important voice in management. Direct investment figures shown in the table are accumulated book values. Changes in these figures represent net flows of direct investment. These flows will differ, however, from the flows found in balance of payments statistics due to varying accounting methods.

Since the war direct investment assets in Canada have roughly equalled one-third of the value of total United States direct investment assets abroad. The more than $15 billion total in Canada at the end of 1965 was the largest amount in any one area of the world, and accounted for almost 60% of this country's total investment in Canada. Although the Canadian share of total United States direct investment dropped from 34.2% at the end of 1960 to 30.9% at the end of 1965, it was still over $1.25 billion larger than the sum in the Western European countries taken as a group.

Reinvested earnings and capital flows constitute net increases in direct investment abroad. The relative importance of these elements in Canada has varied since the war. Accumulated United States direct investment in Canada, as seen in the table, increased by almost 50% between 1946 and 1950. About 70%, or over $700 million, of the increase was reinvested earnings. This pattern changed, however, early in the 1950's. In 1952, for example, the net flow of direct investment to Canada reached a record high of over $600 million and was about equally divided between net capital movements and reinvested earnings.

While direct investment in Canada grew steadily in the decade prior to 1955, the real surge occurred in 1956 when the total increased by $1 billion to almost $7.5 billion. In the following year, 1957, the increase was only about $870 million as the economy entered a recession and earnings and reinvestments were reduced. The level of net new investment continued down in 1958 to about $700 million but rose to $840 in 1959, about equally divided between capital flows and reinvestments each year.

United States investment in Canada has been subject to several important influences during the 1960's. Late in 1960 Canada raised taxes paid by American parent companies on their Canadian earnings. In the wake of this action and the 1960-61 recession, American direct investment in Canada in 1961 grew by only $400 million. The net increase improved only slightly to $500 million in 1962, and the temporary collapse of capital inflows, due also to expectations of declines in the value of the Canadian dollar, led to a substantial loss of foreign reserves during the first half of 1962. The downward drift in the exchange rate of the Canadian dollar eventually resulted in the adoption of a fixed exchange rate by the Canadians in May 1962. Long-term capital flows resumed in the second half of the year.

Since 1963 the net increases in United States direct investment have been impressive. In 1963 the net flow to Canada was almost $900 million. Despite sales of interests in Canadian business totaling $140 million in 1964, the book value of direct investment increased by nearly $800 million. In 1965 the flow of American direct investment to Canada was almost $1.4 billion.

The attractivness of investment in Canada can be variously explained. The country's political and economic stability is certainly important. Canada's wealth of natural resources is also a basic attraction for foreign capital, and the proximity to markets in the United States results in low transportation costs. Canada's import tariff has also attracted foreign capital since producing in Canada is generally cheaper than exporting to Canada. Rates of return are difficult to derive and compare meaningfully but at first glance the rate of return on United States direct investment in Canada seems low, relative to returns in other areas. Measured by the ratio of the United States share in net earnings of subsidiaries and branch profits to total direct investment, the return on Canadian investment in 1965 was 7.9%. This was about three percentage points lower than the figure for all the areas of the world combined and contrasted markedly with the almost 52% return on American direct investment in the Middle East. Many variables can account for such differences but the lower rate of return in Canada reflects in large part the security offered by the factors mentioned above.

Portfolio Investment Foreign portfolio investment consists primarily of purchases of foreign dollar bonds or other foreign securities and of loans by private financial institutions. Stocks purchased in foreign businesses with less than 10% American control would be classified as portfolio investment. Figures on portfolio investment abroad are carried at market value and thus yearly increases reflect in some part the appreciation of past investments.

In the years immediately following World War II, American investors moved slowly into portfolio investment. From 1946 through 1955 accumulated United States portfolio investment abroad increased only $2.3 billion compared to an increase of $14.2 billion from 1955 through 1965. During this whole period, 1946-1965, the Canadian share of total American portfolio investment abroad fell about fifteen percentage points but still amounted to a healthy 44.1% in 1965. The great share of United States portfolio investment in Canada during the postwar period has been divided between foreign dollar bonds and other foreign securities. The total of bank loans and "other" claims was fairly steady until 1964 when it nearly doubled to $760 million. This, nevertheless, remains a small fraction of the total portfolio investments in Canada.

From 1950 through 1955 American portfolio investment in Canada grew at an average annual rate of only 2.4%, and much of the capital movement was associated with short-term fluctuations in exchange rates and bond yields rather than with more permanent investment. From 1950 through 1952, Canada received about 60% of a total of $1 billion of net new portfolio investment abroad by the United States. Bond issues by Canadian provinces and municipalities and large sales of common stock by Canadian corporations accounted for this outflow.

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES

(millions of dollars)

	Total					Canada				
	1946	1950	1955	1960	1965p	1946	1950	1955	1960	1965p
U. S. Assets and Investments Abroad, Total	18,693	31,539	44,947	71,388	106,065	5,625	7,252	10,632	17,198	25,995
Private	13,525	19,004	29,054	50,266	80,942	5,605	7,243	10,625	17,195	25,987
Long Term	12,263	17,488	26,668	45,357	70,801	5,448	6,993	10,320	16,650	24,694
Direct	7,227	11,788	19,313	32,765	49,217	2,472	3,579	6,494	11,198	15,172
Portfolio	5,036	5,700	7,355	12,592	21,584	2,976	3,414	3,826	5,362	9,522
Short Term	1,262	1,516	2,386	4,909	10,141	157	250	305	635	1,293
Public (U. S. Government Credits and Claims)	5,168	12,535	15,893	21,122	25,123	20	9	7	3	8

p Preliminary.
Source: Survey of Current Business and Balance of Payments Statistical Supplement to the Survey of Current Business, 1963.

As the spread in interest rates between the two countries narrowed at the end of 1952, American investors began to liquidate and Canadian borrowers turned to domestic funds. When the recession pushed rates in the United States down relative to Canada in the fourth quarter of 1953 and early in 1954, Canadian borrowers returned. To illustrate the dominance of Canadian securities in this country's portfolio investment abroad, in 1953 Canada was responsible for $125 million of $200 million the United States received in dividends and interest from such investment.

In 1956 the flow of American portfolio capital abroad became much larger and from 1956 through 1962 averaged $750 million per year. Almost one-third of the total flow went to Canada. During this period, 1958 was a peak year for United States portfolio investment in Canada due to large interest rate differentials resulting from relatively low rates in the United States. As the interest rate differential decreased after 1958, Canadian borrowers raised a higher proportion of their needs at home in 1959 and early in 1960.

The total of American portfolio investment in Canada as well as the rate of growth of such investments increased dramatically during the first half of this decade. The total at the end of 1965 represented an increase of almost 78% over 1960's year-end figure. In July 1963 President Kennedy proposed an "interest equalization tax" on the purchases of foreign securities by residents of the United States. It was designed to discourage the rapid outflow of capital from the United States. When the law was finally enacted in August 1964, however, new issues of Canadian securities were exempted. The value of United States portfolio holdings in Canada increased by $1,620 million in 1964. The 1965 increase, however, was only $630 million, due principally to a decline in United States holdings of corporate stocks.

Areas of Investment The industries which have received the largest part of America's total postwar investment abroad have also been the principal recipients in Canada. These are manufacturing, petroleum, and mining and smelting. Manufacturing has been, by far, the leader in the world and in Canada. At the end of 1948, of a total of $3.2 billion of United States direct investment in Canada, $1.6 billion, or one-half, was in manufacturing. At this time petroleum investment, with a total of $300 million, was only starting and was somewhat behind mining and smelting, and public utilities.

The areas of Canadian manufacturing receiving the largest amounts of American capital in 1965 were transportation equipment, chemicals, and paper, in that order. The only variation from this pattern in American investment in the rest of the world is that machinery replaces paper as the third largest recipient. Europe is the dominant machinery-producing area overseas and Canada is the largest paper-producing area. By the end of 1965 United States direct investment in Canadian manufacturing totaled over $6.8 billion, more than four times the 1948 figure.

From the end of 1943 through the end of 1950 manufacturing investment doubled from $0.9 billion to $1.8 billion. In 1952 new investments in aluminum production, requiring the financing of hydroelectric power and other facilities to develop the new capacity, were reflected in a sharp increase in the total. With the completion of the aluminum plants in 1953, however, new manufacturing investment decreased. By 1957 manufacturing in Canada was not growing as fast as earlier in the 1950's but still accounted for 40% of American capital in Canada. Since 1960, when investment in manufacturing was at its lowest in many years, the increases in direct investment have been growing steadily. In 1965 total American direct investment in Canadian manufacturing grew by $650 million.

Following new oil discoveries in Canada in 1947 petroleum investment grew rapidly and totaled $933 million at the end of 1953. By 1959 American petroleum interests in Canada had grown to almost $2.5 billion. In 1961 new petroleum investments declined to the lowest rate since 1949, reflecting completion of major phases of the industry's development. By the end of 1965, however, the accumulated book value of direct investment in Canadian petroleum was over $3.3 billion. This nearly doubled the investment in mining and smelting, which has been used predominantly in the postwar period to develop iron ore resources.

United States interests in the three large industries just mentioned are substantial and probably the main cause of the existing Canadian displeasure over foreign control of business. In the period from 1948 to 1959, nonresident ownership rose only from 32% to 34%, but in 1960 total United States investment in Canada represented more than 75% of all nonresident investments. Canadian financing tends to dominate such industries as merchandising, agriculture, housing, and public utilities. Petroleum and natural gas, however, exemplify the large, American-controlled industry. At the end of 1959 American interests controlled 69% of the industry in Canada and Canadians accounted for only 25%.

THE FIFTH DISTRICT

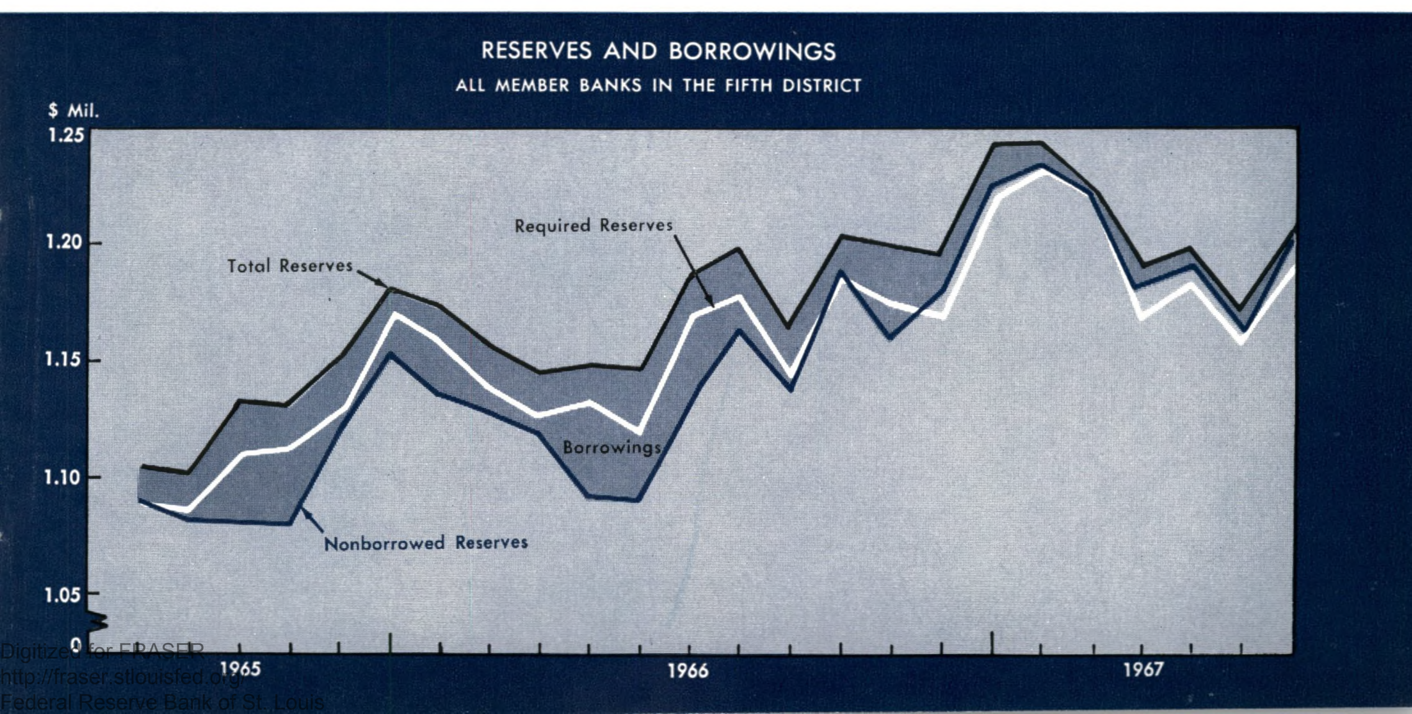
BANKING DEVELOPMENTS—FIRST HALF, 1967

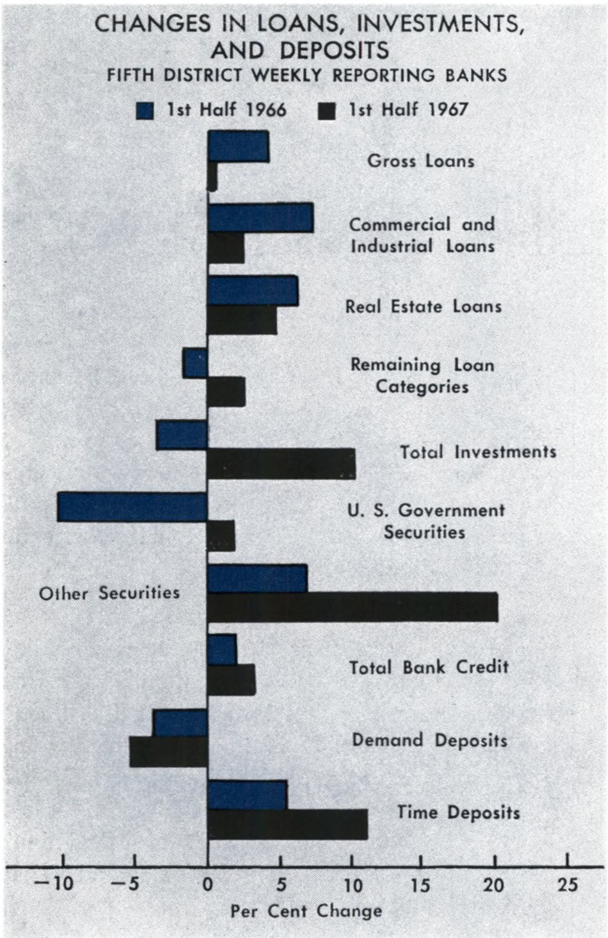
In the fall of 1966, the Federal Reserve returned to an expansive monetary policy after several months of gradually increasing restraint. The tight money policy of 1966 was a relatively brief interruption in an expansionary monetary policy dating back to 1960, but the reaction of commercial banks to the swelling volume of reserves in the first half of 1967 was very different from their reaction to reserve increases in the preceding six years. In the earlier years, loan demand was strong and growing, and most reserve increases became the basis for new loans. Toward the end of the expansion, many banks liquidated substantial amounts of securities in order to obtain even more reserves for loan expansion. But in the first half of 1967, most additional reserves were used to expand investments, and less than half of the growth in total bank credit was in the form of loans. Bank loan demand, at least at prevailing rates, was relatively slack. Some corporations apparently used the proceeds of new bond issues to pay off outstanding bank loans. Banks used excess reserves to build liquidity and to add substantially to holdings of long-term securities, especially municipals.

Total reserves at Fifth District member banks declined seasonally in the first six months of this year, but the very low level of borrowing from the Federal Reserve is evidence of the easy availability of reserves. Another indicator of the increase in reserve availability at Fifth District banks was the sharp rise in time and savings deposits. At District weekly reporting banks, time deposits rose almost 11% to a total of $4,212 million in the first six months of 1967 compared with a 7% increase in 1966. Negotiable certificates of deposit in denominations of $100,000 or more accounted for about 15% of the increase, rising from $315 million on January 4 to $376 million on June 28, 1967. Demand deposits followed roughly the same pattern as in other recent years, but with a 5% drop to $5,847 million in the half-year, compared with a decline of less than 4% in 1966.

Investments Expanded Rapidly After sagging sharply in 1966, total investments at District weekly reporting banks rose over $300 million in the first half of this year to a total of almost $3 billion. Approximately two-thirds of the 10% increase occurred in long-term municipals, which rose from less than $1 billion to well over $1.2 billion. For the country as a whole, commercial banks absorbed about two-thirds of the net expansion of state and local government issues in the first six months of 1967, compared with about one-third in the previous year as a whole. Holdings of 1-to-5 year Governments also rose substantially, from about $850 million to $975 million.

Holdings of Treasury bills and other Governments with maturities of one year or less fell substantially





from March through June. Short-term municipals and over-five-year Governments declined moderately, and holdings of government agency participation certificates and miscellaneous stocks and bonds edged up slightly.

Liquidity Restored It frequently has been mentioned in the financial press that the recent investment bulge at commercial banks represents a liquidity build-up. Banks trimmed their investments sharply in 1966 in an effort to meet record loan demands, and the ample reserves provided in recent months, together with loan demand well below that of a year ago, have made it possible to restore liquidity to a more comfortable level. If liquidity is defined in the usual sense, however, in terms of the ability of a bank to raise cash on short notice with small risk of loss, the lengthening of investment portfolios would seem to be inconsistent with this objective. But liquidity has no hard and fast definition. It must be viewed in terms of the needs of the moment. Liquidity is usually maintained for two purposes: to meet deposit withdrawals and to provide for loan expansion. In view of the public's attitude toward both deposits and loans in the first half of 1967, the pattern of bank portfolio management seems quite logical.

At Fifth District banks, demand deposits declined while time deposits rose; and the increase in time deposits included relatively few large denomination negotiable certificates of deposit. Thus these deposits may be considered to be fairly stable, presenting no need for increased holdings of short-term securities to cover possible withdrawals. A very slow rate of growth in gross loans also minimized the necessity for liquidity to cover loan expansion. The high cost of time deposit funds provided ample incentive to invest in long-term securities, where the rate of return was highest, and the promise of a fiscal policy which would make Treasury bills available in the near future on favorable terms strengthened that incentive.

Loan Demand Off Gross loans at Fifth District weekly reporting banks, after falling seasonally in the first two months of this year, began to rise slowly in March, but at the end of June, they totaled approximately $6.5 billion, up only $16 million from the end of 1966. Commercial and industrial loans rose less than 3% in the six month period, compared with 7% in the first half of 1965 and 9% in the first half of 1966. They totaled $2.1 billion at the end of June. The growth of real estate loans also lagged well behind the past two years through April, but in May they turned up sharply and rose at about the same pace as in other recent years through the end of June. For the first half of the year, real estate loans rose 5½%, compared with 6½% and 8% for the same months in 1966 and 1965 respectively.

Consumer installment loans gained less than 1% at weekly reporting banks in the first three months of this year, but they turned up slightly in April, and by the end of June had risen $28 million to a total of almost $1.4 billion. Loans to commercial banks and other financial institutions fluctuated widely from December through June, and fell $137 million during the period to $621 million. Agricultural loans have grown far slower in 1967 than in other recent years. They rose slightly more than 15% during the first six months, to a total of $67 million, compared with increases of 31% in the first half of 1966 and 78% for the same period in 1965.

PHOTO CREDITS

6. & 7. Virginia Chamber of Commerce; Richmond Newspapers, Inc.; South Carolina State Development Board. Chart—U. S. Coast and Geodetic Survey.