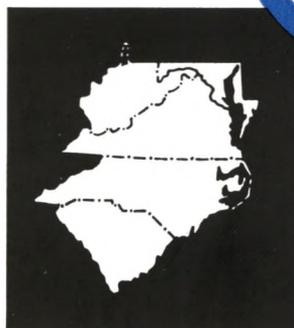


FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

Bank Investment in Municipals
Fifth District Skiing
Equipment Leasing
The Fifth District



DECEMBER 1967

Municipal Bond Portfolios of Commercial Banks

Since the "credit crunch" of 1966 the financial press has followed very closely the volume of new debt flotations as one indicator of tightness in financial markets. The tremendous volume of such securities in the last year and a half has been unprecedented, contributing in large part to recent record-high interest rates. The volume of new issues of municipals has been especially heavy during this period, although a pattern of steadily rising state and local government financing has existed for a number of years. Since World War II, new issues of long-term municipals have increased nearly tenfold, from \$1.2 billion in 1946 to \$11.1 billion in 1966. Between 1956 and 1966 total state and local government securities outstanding rose from \$47.4 billion to \$104.8 billion.

Role of Commercial Banks Commercial banks have been the principal investors in this rapidly expanded volume of municipals. From 1946 through 1966 holdings of municipals by all banks rose from \$4.3 billion to \$41.4 billion. The most rapid expansion has occurred in the past decade. Beginning in 1962, banks began to aggressively seek time and savings deposits through the issuance of certificates of deposit, and they were aided in their efforts by several upward revisions of the Federal Reserve's Regulation Q, which sets interest rates on time and savings deposits. They were highly successful. Over \$20 billion of CD's are now outstanding, and the increased level of deposits has led to heavy investment in municipals. During the past ten years, the increase in the dollar value of all-bank holdings of municipal issues has accounted for close to 90% of the increase in total bank security holdings. As a result, the ratio of municipals to total securities in bank portfolios rose from 16.1% in 1956 to 35.3% in 1966. In the latter year, commercial banks absorbed over 65% of the \$5.6 billion net increase in municipal bonds outstanding (new issues minus retirements).

The growing size of municipal bond portfolios has not been the only change in commercial banks' role in the municipals market. In the past ten years

the maturity structure of these municipal portfolios also has undergone a metamorphosis. Moreover, enlarged dealership and underwriting activities have marked the ascension of commercial banks to their pre-eminent position in the municipals market.

Postwar Decade [This section draws on Roland I. Robinson's *Postwar Market for State and Local Government Securities*.] The municipal segment of member bank portfolios grew markedly in the postwar decade. During this period the gross volume of new municipal issues accounted for about one-seventh to one-ninth of all long-term funds raised in the capital markets. From 1946 through 1956 member bank holdings of municipal obligations rose from \$3.3 billion to \$10.5 billion, an annual rate of increase of 11.1%.

At the end of World War II commercial bank portfolios were heavily loaded with United States Government obligations. Following the war these security holdings declined and the volume of loans outstanding increased. From 1946 through 1956 member bank holdings of Government securities fell from about \$72 billion to \$48 billion. At the same time total loans rose from about \$23 billion to \$78 billion. In an absolute sense the growth in loans far exceeded the \$7.2 billion increase in municipal bond holdings of member banks, but the 11.7% annual rate of growth in loans only slightly exceeded the 11.1% annual growth in municipal holdings for the period.

The expansion of bank holdings of municipals is attributable largely to two factors. First, the supply of new issues grew rapidly as state and local governments increasingly entered the market in order to finance growing programs and facilities. Adding to the immediate postwar needs of local governments were many public construction projects which had been deferred during the war. Second, high income-tax rates and the exemption of interest income on municipal bonds from Federal income taxes combined to enhance the attractiveness of municipal issues.

Tax advantages accruing to commercial banks

from holding municipal bonds are based upon several characteristics of tax law. Some institutions and funds are fully or partially tax exempt per se. This advantage reduces their attraction to the relatively low yields of tax-exempt municipal securities. Commercial banks, however, are subject to the full corporate tax rate on income, in part accounting for their large holdings of municipals. Furthermore, the tax exemption feature is available only on municipal securities. In 1941 the Federal Government withdrew the privilege of tax exemption existing for certain of its debt issues, and between 1941 and 1945 the volume of these tax-exempt securities outstanding fell from about \$5 billion to \$196 million, giving municipal issues a virtual monopoly on the privilege. Since 1960 municipal bonds have been the only tax-exempt security available in the capital markets. Finally, the development of the system of "tax swaps" in 1953 enhanced commercial banks' participation in the municipals market. For purposes of computing net taxable income, tax laws permitted banks to charge any net of capital losses over capital gains on sales of securities against current income. Since the long-term capital gains tax is 25%, banks in high income-tax brackets have been encouraged to make large sales of securities in years of declining prices in order to charge the losses against their income. The proceeds for the sales are almost immediately employed to purchase other securities, thus the name, "swaps." While certain other groups can arrange swaps for tax advantages, banks have been the largest users of the technique, and although municipal securities are not considered the best tax-swap instrument, the volume of secondary market transactions in municipals probably has been increased by bank swapping.

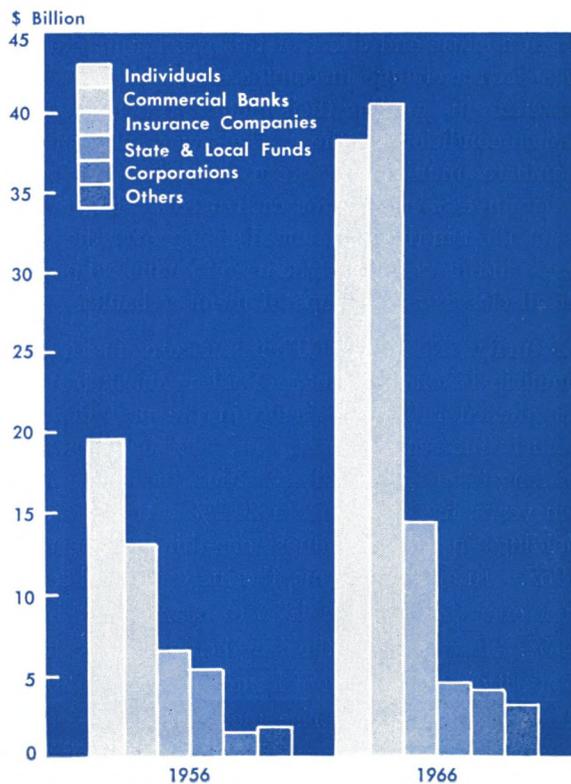
The maturity structure of banks' municipal portfolios shortened slightly during the postwar decade. Intermediate-term obligations were increasingly featured, predominantly at the expense of issues due beyond ten years. Between 1947 and 1956 the percentage of municipal holdings in one-to-five year maturities grew from 29.8% to 34.5% and the portion in five-to-ten year issues rose from 25.8% to 29.9%. Meanwhile, long-term issues were declining from 26.2% of the total to 20.1%.

Although the pattern currently seems to be changing, banks in the past have usually held municipal securities until maturity, not choosing to meet immediate cash needs by liquidation prior to maturity. Indeed, in the early years after the war the market for municipals was not large enough or developed enough to permit rapid liquidation in all cases. This

philosophy of portfolio management at least in part explains the decline of long-term holdings relative to shorter-term issues. With the tremendous increase in high-yielding loans in the late 1940's and early 1950's, commercial banks did not want to be tied in to these securities for long periods if more attractive investments were available. Thus, given their approach to liquidation, banks chose to invest in intermediate-term maturities.

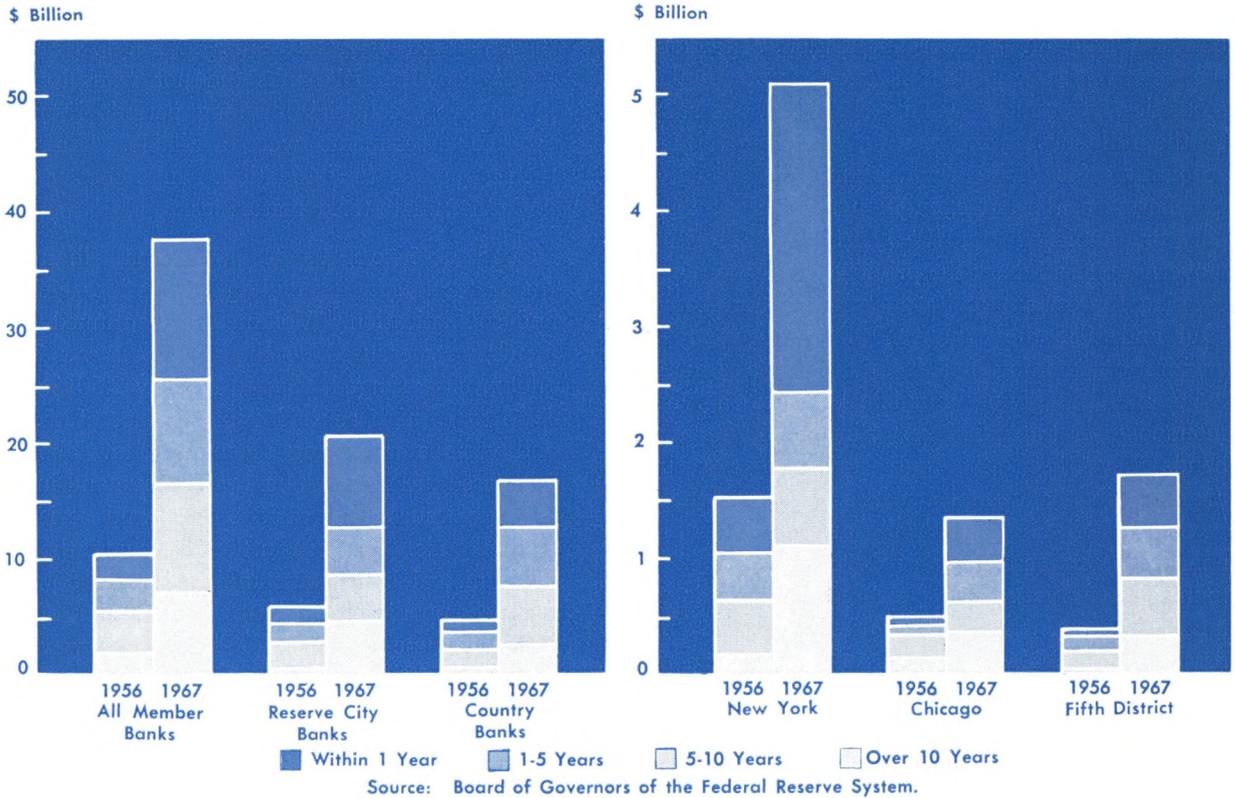
Period 1956 to Present Municipal financing in the past ten years has undergone considerable growth and sophistication. Volume has continued to rise; yields, as measured by the *Bond Buyer's* 20-Bond Index, have ranged from just below 2.50% early in 1956 to as high as 4.33% in October of this year; and various marketing techniques now abound, as witnessed in large numbers of revenue and industrial revenue issues, and various term and serial forms of the bonds. As seen in the first chart, the growth of municipal bonds outstanding from 1956 to 1966 was accompanied by a sharp redistribution of ownership to commercial banks. There has, however, been little change in the division of the total between local government offerings and state government offerings. The former account for about three-fourths of all municipal bonds.

OWNERSHIP OF MUNICIPAL SECURITIES



Source: The Bond Buyer.

MATURITY STRUCTURE OF MUNICIPAL BOND PORTFOLIOS
MEMBER BANKS 1956 AND 1967



As the municipals market has grown, the marketability of municipal issues has naturally increased. Both a cause and effect of this greater marketability has been a change in commercial banks' investment practices in handling their municipal bond portfolios. When conditions in the markets warrant, banks now liquidate municipals before maturity in favor of other investments or for cash needs. The mutation is manifest in the pronounced change over the past ten years in the maturity structure of municipal portfolios of all classes and groups of member banks.

Maturity Patterns The average maturity of municipal bond holdings of all member banks has lengthened rather markedly in the past decade, as seen in the second chart. Member bank ownership of long-term municipal securities, those due in over ten years, has grown from 20.1% of total municipal holdings in 1956 to almost one-third of the total in 1967. In absolute terms, the increase has been from just over \$2 billion in 1956 to nearly \$12 billion in 1967. Emphasizing the lengthening of the average maturity is the volume of issues due beyond 20 years. These currently comprise more than one-fourth of member banks' holdings of long-term municipals.

The relative growth of long-term holdings has

occurred at the expense of the intermediate-term, one-to-five and five-to-ten year bonds, especially the former. These two maturity classifications accounted for 34.5% and 29.9%, respectively, of member bank municipal portfolios in 1956, but by 1967 the respective proportions had declined to 25.1% and 24.4%. Remaining virtually unchanged during this transformation have been short-term holdings, including warrants, short-term notes, bills, and other maturities due within one year. As a group, these securities have increased merely from 15.5% to 18.2% of total municipal portfolios.

With certain variations, municipal maturity structures of various classes and groups of banks have evidenced changes similar to those of member banks taken as a whole. Reserve city banks have had a rather more pronounced redistribution from intermediate- to long-term issues. Long-term bonds grew from 23.0% of the total portfolio in 1956 to 38.2% in 1967, while over the same period one-to-five year maturities fell from 32.6% to 20.8% of the reserve city group's municipal investments.

Country banks also lengthened their average municipal maturity but not as noticeably as reserve city banks, nor even as much as member banks as a whole. In fact, country banks still have larger per-

centages in the intermediate maturities than in long-term bonds. In general, country banks are not as large as reserve city banks and many of them do not have the market facilities which larger banks enjoy. In partial consequence of this, they are less willing to tie up large amounts of funds in long-term investments. From 1956 to 1967 long-term municipal holdings rose from only 16.6% of their municipal portfolios to a still low 23.6% of the total. Both of these figures are less than the corresponding percentages for all member banks and reserve city banks. The decline in the proportionate holdings of intermediate issues was similarly less pronounced. As with the other two classes, the relative decline of one-to-five year maturities was larger than the drop in the five-to-ten year issues. This, in part, is evidence of the lengthening maturity structure of municipal portfolios. The purchase of long-term issues results in a large part of the purchases still being classified as long-term or five-to-ten year investments at the end of the ten-year period.

The proportion of municipal portfolios classified as short-term has not differed significantly between classes of banks. Compared to the changes in intermediate and long-term holdings, the growth in the percentage of issues held which mature within one year has been marginal. Over the past ten years reserve city banks have held larger amounts of tax warrants, short-term notes, and bills than country banks, reflecting in part a dependence of municipal governments on large banks for short-term funds. Over the past decade country banks have had a larger part of short-term holdings in regular issues due within one year than in securities with original maturities of less than one year. The proportion represented by the latter, however, has been increasing.

Among classes of member banks, New York City banks have the longest maturity structure. Over one-half of their municipal investments are due in more than ten years. In 1956, 29.5% of their municipal holdings were due beyond ten years. Their investments in one-to-five and five-to-ten year maturities have fallen from about 30% in each in 1956 to roughly 13% in each in 1967. The increase of short-term holdings from 12.2% to 21.1% of the portfolios of New York banks is largely explained by the increase in securities with original maturities of one year or less.

The predominant role of large banks in the municipal market is obvious from the size of holdings of New York City banks and Chicago banks relative to the municipal investments of all Fifth District banks. Only in the past decade have Fifth District

banks come to hold a larger dollar value of municipals than Chicago banks. The maturity structure of Fifth District banks is very similar to that for all member banks, but the lengthening of the distribution over the past decade has been more pronounced than for all banks. In the Fifth District, maturities due in over ten years rose from 13.4% of total portfolios in 1956 to 28.0% in 1967. At the same time, one-to-five year maturities fell from 44.0% to 28.0%.

Dealer and Underwriter Positions Dealer and underwriter positions are held in the main by a relatively small number of large banks. Of over 6,100 member banks in the country, 130 hold positions as dealers or underwriters. One-half of that group have deposits over \$500 million, and account for 87.6% of the dollar value of total member bank positions. Although seemingly small, the number of banks engaged in dealer and underwriter operations has been growing with the market in recent years. In October 1955, only 57 commercial banks were listed in the *Blue List* directory of advertisers, and of those only about 20 seemed to operate continuously in the national market.

The location of dealer-underwriter banks is fairly concentrated into certain areas. Of the 130 banks with dealer-underwriter operations, 95 are reserve city banks. This group holds over 92% of the \$1.4 billion of total dealer and underwriter portfolios. Fifty-three of the 130 banks are evenly spread between the New York, Chicago, and San Francisco districts. These three districts alone account for 63% of total member bank dealer positions. In the Fifth District, eight banks act as dealers and underwriters of municipal bonds. In June 1967 they held about \$33 million of bonds in that capacity. These holdings, 2.3% of all such positions, were equal to or greater than those of only three other Federal Reserve Districts.

Year 1967 In the past year commercial banks have continued to be large purchasers of municipal bonds. For the first three quarters of 1967, the increase in bank holdings of municipals has accounted for about four-fifths of nearly \$11 billion of new capital raised by local governments. Over the year banks have made relatively large purchases in the short-term area. This probably has resulted more from an effort to rebuild liquidity following the 1966 "credit crunch" and from postponements by municipal governments of long-term financing due to high interest rates than from any basic change in investment philosophy. In fact, long-term purchases have been sizable also.

Joseph C. Ramage

At Beech Mt. the highest lift-equipped ski slope in the east is prepared for the winter.



North Carolina's oldest ski area above Maggie Valley features unlimited cross country skiing.



Skiers marvel at the beauty of a Hound Ears Mt. trail.



This is Bayside, Virginia, not New England.

Snowguns at Bayside enhance the winter wonder land.



That blizzard blowing at Blowing Rock is real.



With eight and one-half miles of slopes and trails, Wisp Mt. leads the southern slopes in length.



Sepp Kober, founder of the first southern professional ski school, demonstrates geländespringen at Hot Springs.



Pioneers on the Southern ski scene—Sepp Kober and Howard Head, metal ski developer—meet at Hot Springs.



A frosty trail in Western North Carolina.



Sitzmarks with a Southern Accent

* If one could speak of schussbooming Uphill, he would seem to be describing the ski industry in the Fifth District. Growth in both size and number of ski resorts in the last few years has been phenomenal. For instance, North Carolina, which five years ago had only two resort areas, now has seven with more in the planning stages. Maryland in that time has jumped from one to four, Virginia from two to four, and West Virginia from four to seven, all with older slopes expanded in size. North Carolina can boast not only the country's southern-most ski slope at Sapphire, less than five miles from South Carolina, but also, in the northern part of the state near Banner Elk, the highest lift-equipped ski slope east of the Rockies. * Although these southern slopes may not be as long, as steep, or as challenging as those in the north and west, "a slope in hand is worth two in Sugarbush," as one observer put it. And the ski buffs seem to be proving him right. The number of skiers at many of the areas has been increasing at an average as high as 50% a year. * The Diesel Set skier of today is a different breed from the old "climb the mountain, sleep on the floor" hardy of yesteryear. He usually travels in packs (it's cheaper that way) and demands much for his money in accommodations and conveniences. As a result of his demands, the initial capital outlays and capital improvements made by developers range from \$5 million recreation complexes and plush private clubs in North Carolina to a state park slope in West Virginia intended primarily for the local trade. Most have plans for continued expansion. * Many of the District resorts had flourished as three season operations for quite a few years. In fact the spa at Hot Springs, Virginia, America's matriarch of resort hotels, was established before the Declaration of Independence was signed. Most, however, were forced to suspend operations during the winter months, while praying for an early spring thaw. Not so now with the magic of snow that "falls upside down." * At Maggie Valley, on the threshold of the Great Smoky Mountains, a dude ranch became the Tarheel State's first ski resort in the winter of 1961-62. At that time only one restaurant and two motels in the area remained open during the winter. Now there are 22 motels and lodges and seven restaurants operating for ski season. A former warm weather resort located in Basye, Virginia, has increased its payroll to almost eight times the amount three years ago after two years of ski slope operation. A sporting goods store in one Virginia city, although about 150 miles from the nearest ski slope, allotted 375 square feet to a ski shop on the basis of an active 300-plus member ski club. In four years, the shop size has doubled and sales have tripled. For those following the

continued on next page

trend from green to white to green, this would seem to indicate that there is "no business like snow business." * Practically all of the resorts are located in the region designated by the President as Appalachia, an area with high unemployment and low income. The extensive construction necessary for building the slopes and the persons required to maintain the resorts make skiing in Dixie a boon to the unemployed, and, with new money coming into the areas, a boost to the economy. The real estate developments which have blossomed as an adjunct to the resorts are no small factor. Chalets for sale or rent and lots for building cluster around the ski areas. While the publicity put out by many of the resorts has improved their summer business, they still pass out bumper stickers reading "help stamp out summer" and "THINK SNOW." * It was those who were really thinking snow who found how to turn all that white into green (money). The developers of the snowgun made the snow fall upside down and made it all possible. With the right combination of compressed air and water ejected at below freezing temperatures, as much as 10 inches of snow, tailored to the skiers' needs, can be laid on a slope overnight. The equipment has proved so successful in the sunny southland that most of the northern and some of the western resorts are installing snowguns as insurance against nature's unpredictability. * While the U. S. ski industry schusses toward the billion dollar mark, a sizable portion of the trade is being acquired by the District's only equipment and apparel manufacturer. About twenty years ago in the small town of Timonium, Maryland, with some borrowed money and a dream, an aircraft engineer from Baltimore launched a project which revolutionized skiing and developed into a multi-million dollar business. Adapting engineering principals, he built the simple "aluminum-sandwich" ski which was to become the criterion by which all other skis have since been judged, if sales figures alone are used as a basis. He put the skiing world on metal. Of all the high quality skis sold today, 80% are metal. Through diversification into production of quality line apparel and research into the development of fiberglass and plastics for equipment, he continues as a leader in the ski industry. * From all indications the Fifth District is making a wide sitzmark on the ski scene. With an estimated 5 million skiers in the U. S., the southern entrepreneurs are making mountains out of moguls and expecting them to bring in at least their share of cold cash. *

Patricia G. Abernathy

Equipment leasing is a time-honored practice in American industry. For many years, machinery has been leased to users by manufacturers so they could retain control over maintenance and replacement and assure satisfactory service. Sometimes the lease arrangement has been used to avoid local property taxes or to take advantage of other tax considerations. Frequently, users have leased equipment to avoid tying up scarce capital or going into debt. Lessees have acquired almost every type of equipment in this manner—automobiles, trucks, office equipment, manufacturing machinery, and recently, multi-million dollar jet aircraft. Equipment is available on lease not only from manufacturers and regular suppliers, but also from leasing companies, and in recent years, from commercial banks. In almost every undertaking involving the use of productive goods, leasing is now an alternative to buying and sometimes a more attractive alternative.

Types of Leases Equipment leases are often classified as "operating leases," sometimes known as maintenance or service leases, and "financial leases." The operating lease is used when the lessee does not want to buy the equipment, but only wants to use it. He may prefer not to buy either because he needs the equipment only for a limited time or because he would prefer to have the lessor maintain it. This type of lease usually involves payments which add up to less than the price of the equipment over the term of the lease, and the leased property is reclaimed at the expiration of the lease. Usually the lessor agrees to provide maintenance or service over the term of the lease or to replace the equipment if it should become defective. In the case of an automobile or truck lease, for example, the lessor would generally be required to maintain the vehicle in good repair and provide tires, batteries, and other parts, but not gas and oil.

The financial lease resembles more closely the purchase of goods on an instalment basis. Usually such a lease is non-cancellable for its entire term, and payments will total more than the price of the equip-

MENT LEASING

ment. The agreement frequently provides for the lessee to take possession of the equipment at the termination of the lease after paying an additional nominal fee. The financial lease is used when the lessee actually wants to acquire the property, but when a lease offers some advantage over an installment purchase, such as a lower down payment or reduced tax liability.

Leasing vs. Purchasing Leasing in one form or the other frequently provides advantages over outright purchasing. Many smaller businesses find such an arrangement a useful substitute for a loan. The lease may in effect provide 100% financing and on a longer-term basis than any available loan. Sometimes a lease is available to an individual or company who, as a result of a poor credit rating, would be unable to qualify for a loan of equivalent size. Leasing may also provide a hedge against obsolescence. Rapidly advancing technology continually provides new and better machines, but as a result, today's mechanical marvel may be tomorrow's white elephant. To avoid being stuck with outdated equipment, the user may prefer to lease machines for relatively short periods of time, replacing those which have been by-passed by later developments. The lessor must, of course, charge fees which will cover the depreciation of his assets, but the user of the machinery is saved the problem of justifying new purchases, establishing a high rate of depreciation for tax purposes, and marketing the outdated equipment.

For a time, the way in which many government contracts were handled provided an incentive to lease equipment. Under contracts negotiated on a cost-plus basis, the practice in many instances was to allow lease payments in full as costs, but to disallow interest payments on borrowed funds. Depreciation allowances also had to be related to the life of the equipment, rather than to the life of the contract. As a result, many defense contractors found it more profitable to lease equipment than to buy it, especially when its purchase was financed

by borrowed funds. Government auditors are aware of this discrepancy, however, and now apparently treat lease payments and similar costs on a comparable basis.

Some firms find leasing preferable to purchasing on credit because it minimizes the amount of debt appearing on the balance sheet. A debt to a supplier or a loan payable is clearly a liability, but in the past large amounts of equipment have been leased with no evidence of indebtedness appearing in the firm's statement of condition. In recent years, however, it has become more common to make some reference to leases, either in a footnote on the balance sheet or as a liability representing the sum of future payments due. The American Institute of Certified Public Accountants, after a study of accounting principles related to leasing, issued a policy statement holding that leases which in effect are installment purchases should be treated as purchases, and should appear on the books as such. Other leases should be noted on the balance sheet, with sufficient information available to indicate the true financial position of the firm. Strict adherence to these recommended accounting procedures in some instances would dilute or eliminate the advantages of leasing.

Recent developments in Federal tax laws have removed some of the advantages of equipment leasing and in some instances, added others. Accelerated depreciation allowances may make leasing less attractive to the lessee, in that the depreciation deduction may exceed the deduction for rental payments under a lease agreement for several years after the acquisition of an asset. But the 7% investment tax credit now provided under the Internal Revenue Code may offer benefits to both the lessor and lessee. The credit may be claimed by either, but of course not both. If the lessor claims the tax credit, he may give the lessee some of the benefit in the form of lower rental payments. This has the effect of spreading the benefit of the tax credit over a period of years for the lessee.

In some instances, the lessor has claimed the tax credit because the lessee could not take full advantage of it under the law, and then passed on some of the benefit to the lessee. For example, when a major airline placed a multi-million dollar aircraft order, it could not benefit directly from the tax credit because companies can deduct the cost of new equipment from their tax bills only up to \$25,000 a year plus 25% of the company's tax liability above \$25,000. The airline had heavy expenditures but a small tax liability, and so instead of buying the planes outright, it leased them from a syndicate of banks which could take full advantage of the tax credit and share the benefit with the airline in the form of lower financing costs.

Leasing by Banks Commercial banks have financed equipment leasing for many years. Some of the oldest leasing companies have relied upon banks for operating funds, and banks have frequently looked upon such companies as attractive borrowers with highly acceptable collateral. Bank interest in lease financing was no doubt stimulated somewhat when the amendment of Regulation Q on January 1, 1962, resulted in a substantially larger amount of funds available for intermediate and long-term investment. But bank entry into direct leasing dates from the Comptroller of the Currency's letter of March 13, 1963, to the presidents of all national banks, in which he ruled that direct leasing of equipment constitutes "legal and proper banking activities for National Banks." A number of state banking commissions subsequently granted permission for banks under their jurisdiction to engage in direct leasing. Some of the larger banks immediately moved into the field, and the dollar volume of bank equipment leases quickly reached substantial proportions.

Banks have found many compelling reasons to engage in direct equipment leasing, but the strongest, apparently, is customer demand. Bank customers, noting the advantages of leasing cited above, have asked their banks to purchase equipment on their behalf. Banks have strong incentives to accommodate their customers whenever possible, especially when such accommodation brings respectable earnings, and lessees have been willing to pay rates resulting in attractive yields. Few banks, however, are in a position to offer leases comparable to those of large equipment manufacturers and suppliers. Since banks do not produce the equipment they lease and have

no facilities for servicing it, they generally do not provide operating leases. Their activities are confined primarily to financial leases, similar in some respects to instalment or term loans. Financial leases frequently do not yield the tax benefits of an operating lease to the lessee, and the lessor does not claim equipment having a substantial residual value at the termination of the lease, but they still offer advantages for both parties. The lessee may obtain 100% financing, may improve the appearance of his financial statements, and in some instances may derive a tax advantage. The bank may be able to acquire business which otherwise would be lost, and may sometimes earn a higher yield.

Leases do not necessarily bring higher net returns than loans, however. Unless a bank handles enough leases to establish routines for processing them, costs may be considerably higher than loan costs, and may more than offset the difference in rates. The risk factor apparently is about the same as for a comparable loan. The risk of default is essentially the same in each instance. It depends on the ability of the borrower or lessee to pay, not on the type of instrument involved. In the event of default, the lessor, on the one hand, may have some advantage over the lender if the receiver rules that rental payments must be continued during the period of receivership. Such a ruling may be forthcoming if the business continues to operate, using the leased equipment. A lender in similar circumstances might have to wait until a reorganization has been completed or some other statement has been reached. On the other hand, the lender has the advantage over the lessor in that a lender qualifies as a general creditor, and may qualify for the payment of any unsatisfied balance after the disposal of equipment used as collateral, whereas the lessor can only reclaim the equipment in the event of a default on a lease. He has no claim as a general creditor.

For many banks, the departure from traditional banking practices inherent in direct leasing are great enough to discourage them from entering the field. They have found, however, that close affiliation with a nonbank leasing company may offer them the opportunity to meet the demands of their customers through traditional channels. The lessee leases the equipment from the leasing company, and the leasing company discounts the lease with the bank. Then the customer has his equipment, the bank has its loan, and the problems involved in making and servicing direct leases are avoided.

Harmon H. Haymes

THE FIFTH DISTRICT



AGRICULTURAL OUTLOOK FOR 1968

Domestic demand for farm products will expand further; exports are expected to continue at a high level; farm output will remain high; production expenses will continue to increase; and net farm income will probably equal the reduced level of 1967. This, in a nutshell, is the national outlook for agriculture in 1968 as seen by top economists of the U. S. Department of Agriculture.

In appraising the agricultural outlook for the year ahead, USDA's analysts assumed that general economic activity in 1968 would expand further and at a somewhat faster pace than in 1967. They also assumed average growing conditions and took into consideration the probable effects of changes in the farm programs for cotton, corn, sorghum grains, and wheat.

More detailed forecasts of the Department of Agriculture are given below.

Farm Prices, Costs, and Income Farm prices in 1968 promise to show some improvement over the reduced levels of 1967, primarily because of prospects for higher prices for livestock and livestock products. Expectations point to a decrease in grain production and a sizable increase in cotton production, but overall crop output in 1968 will probably show little change from that in 1967. Though gains are unlikely to be big, output of livestock products is expected to at least equal the record production of 1967.

Farm production expenses in 1968 will probably increase by another \$1 billion, the same as in 1967. Prices paid for production items of nonfarm origin will likely continue their upward trend. Overhead items such as real estate taxes, interest payments, and depreciation charges will be sharply higher. Feed and fertilizer usage will likely increase, and wage rates will be higher.

Both cash receipts from farm marketings and Government payments to farmers are expected to increase in 1968. These gains will likely boost the nation's realized gross farm income to a new record high of slightly more than \$50 billion. But the continued rise in production expenses may largely offset the gain, and realized net farm income will probably remain at the 1967 level of about \$14¾ billion. This

would be sharply lower than the near-record \$16.4 billion in 1966 but well above all other years since 1952. Realized net income per farm and after-tax income of farm people seem likely to increase, however.

Supply and Demand Conditions There is considerable variation in the 1967-68 *supply* situation of the various farm products. Supplies of soybeans, peanuts, and the "free" supplies of feed grains are at record levels. Supplies of most kinds of tobacco have been adjusted downward toward a better balance with requirements. Cotton supplies are significantly lower, but wheat supplies are larger. Little change is expected in the supply of total crop food products.

Demand for farm products, both at home and in foreign markets, is expected to continue strong in 1968. Here at home, a further expansion in economic activity and the accompanying increases in employment and wage rates indicate a continued rise in disposable personal income. Gains in consumer buying power will also be accompanied by a growing population. With rising incomes and retail food prices 2% to 3% higher, expenditures for food will probably climb some 3% to 5% higher in 1968. The percentage of income spent for food will likely remain about the same as the 17.7% in 1967, however.

United States agricultural exports during fiscal year 1968 appear to be headed toward \$6.7 billion, the same as two years ago and close to last year's record of \$6.8 billion. Sales for dollars are expected to reach \$5.1 billion, also near last year's record dollar sales of \$5.2 billion. While the value of farm exports will be near last year's level, the volume of products shipped will likely be higher.

Outlook for Commodities Brief reviews of highlights in the outlook for major Fifth District commodities follow:

Poultry and Eggs: Prospects for 1968 point to a slight decline in egg production, a small increase in broiler production, and fewer turkeys. The moderate cutbacks indicated for production of eggs and turkeys and the smaller gain in prospect for broiler output reflect producers' response to lower prices and higher production costs in 1967.

There may be somewhat less competition from red meats in 1968, and this could strengthen the demand for poultry. Broiler and egg prices may average the same the first half of 1968 as in 1967 but are likely to average moderately above the relatively low levels of 1967 during the last six months. Turkey prices through the first half of 1968 will likely average below a year earlier, but if production is cut back as anticipated, they may average a little above 1967 the last half of the year.

Meat Animals: Livestock farmers are expected to produce about the same amount of red meat in 1968 as in 1967. Fed beef output probably will be larger than in 1967 and may just about offset a further decline in cow slaughter. Fed cattle prices for the year as a whole may average a little higher than in 1967.

Hog slaughter during the first six months of 1968 may be about the same or slightly smaller than a year earlier. Hog prices during the period are expected to be about the same as a year ago. Hog slaughter and prices later in 1968 will depend chiefly on the size of next spring's pig crop. Any sizable increase would likely result in a sharp decline in prices.

Dairy Products: Milk production in 1968 is expected to be about the same as in 1967. Gains in output per cow will likely offset the continued decline in milk cow numbers. Total use of milk may rise since both commercial sales and Government donations of purchased dairy products are expected to increase. The farm price of milk may average near the 1967 average, provided dairy supports and Federal milk marketing order provisions continue at 1967 levels, and cash receipts from dairying will probably change little from the record \$5.8 billion received in 1967.

Tobacco: Supplies of most kinds of tobacco have been adjusted downward toward a better balance with requirements. The national flue-cured marketing quota for 1968 is essentially the same as in 1967. Overmarketings of the 1967 crop are expected to exceed undermarketings, and the adjustments to take this into account will reduce the 1968 total of individual farm quotas below 1967. Marketing quotas for burley, Maryland, fire-cured, dark air-cured, and certain cigar tobaccos will be announced by February 1. The overall support levels for 1968 tobacco will be 4% higher than in 1967 if the parity index the rest of the year remains at its October level.

United States production and consumption of cigarettes rose to new record levels in 1967. The number of cigarettes smoked per capita also increased and was second only to 1963. A further modest increase in cigarette consumption is expected in 1968.

United States exports of unmanufactured tobacco in 1966-67 were nearly one-third above 1965-66 and the largest since 1919-20. Tobacco exports in 1967-68 may be slightly below the 47-year high of 1966-67 but well above other recent years. The uncertainty of the political situation in Rhodesia, the world's second largest exporter of flue-cured prior to United Nations economic sanctions against its tobacco, continues to cloud the outlook for United States tobacco exports.

Cotton: This year's small cotton crop and continued relatively large disappearance point to another sharp reduction in cotton stocks. Stocks may fall to around $6\frac{3}{4}$ million bales by next August. This would be $5\frac{1}{2}$ million less than last August and more than 10 million below the record high stocks of nearly 17 million bales on August 1, 1966. Domestic mill consumption in 1967-68 is expected to be a little over 9 million bales. Our cotton exports will likely be about as large as last year's 4.7 million bales.

The 1968 cotton program is designed to increase production and to encourage production of a higher proportion of medium and longer staples.

Soybeans and Peanuts: Soybean supplies for the 1967-68 marketing year are estimated at a record 1.1 billion bushels, 12% above a year earlier. Soybean usage is expected to increase at a faster rate than last year, however. Domestic use may rise as high as 600 million bushels compared with 551 million in 1966-67. Soybean exports may increase to around 280 to 300 million bushels in comparison with 257 million last season. Despite prospective increases in exports and domestic crush, the carryover into 1968-69 will probably be $1\frac{1}{2}$ times the 91 million bushels at the beginning of this year. Soybean prices at harvesttime averaged slightly below the support rate of \$2.50 per bushel. They are expected to return to the support level later in the season.

Peanut supplies in 1967-68 are also estimated to be at a record level, about 3% above a year earlier. Total edible consumption is expected to increase, and peanut exports may be about the same as last year, but they will face larger competitive world supplies. Prices of peanuts are expected to average around 11.4 cents per pound, a little above last year.

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PHOTO CREDITS

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