FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

Flexible Exchange Rates
Local Government Expenditures
Foreign Purchases of Domestic Securities
The Fifth District

DECEMBER 1969

Flexible Exchange Rates

Proposals for international monetary reform fall into two categories: those aimed at shoring up the present international monetary system and those aimed at a fundamental change in the nature of the system. Most of the official emphasis in recent years has been on supplementing the existing system, primarily by providing additional liquidity and credit facilities for financing international deficits.

Concern over the adequacy of international liquidity has led to two general increases in the quotas of the International Monetary Fund since its inception, and a third increase is in prospect for next year. The IMF's lending potential was further enhanced in 1962 by the General Arrangements to Borrow, under which the Group-of-Ten nations stand ready to lend the Fund up to $6 billion if needed. The Group-of-Ten recently agreed to extend this line of credit through 1975. Another provision for international liquidity initiated in 1962 is the network of reciprocal currency or "swap" arrangements. These standby agreements provide for the mutual exchange of currencies between two countries, with the international reserves thus created used by one or both countries to defend existing exchange rates against balance of payments pressures.

The most recent and fundamental step in providing for adequate growth in world liquidity is the facility for Special Drawing Rights finally adopted in 1969 after several years of study and negotiation. SDRs are intended to supplement existing reserve assets as a means of financing external deficits. They are to serve the same general role as official gold does presently, as their nickname, "paper gold," suggests.

Many economists believe, however, that while additional liquidity may be desirable, the more urgent need is for an improved international adjustment mechanism to correct deficits. According to this view, trying to solve current international ills with more and more liquidity is like trying to solve family financial problems by getting another credit card. To the extent that the adjustment mechanism corrects deficits, the need for liquidity is lessened.

The approach to reform reviewed here involves a greater degree of flexibility of foreign exchange rates. Flexibile exchange rates have long been advocated by a large segment of the academic community, and recently the idea of greater exchange rate flexibility has received increased attention in "official" circles. The Subcommittee on International Exchange and Payments of the Joint Economic Committee of Congress has urged the International Monetary Fund to study the possibility of greater exchange rate flexibility within its present framework. Several of the official delegates to the recent IMF meetings, including Secretary of the Treasury Kennedy, called for official study of the question. Finally, interest in exchange rate flexibility received new impetus from the recent German decision to allow the mark to float until a new parity was established.

General Principles An exchange rate is simply a price—the price of one currency in terms of another currency. Downward pressure is placed on the exchange rate of a country experiencing a deficit in its balance of payments as its currency is in excess supply in the foreign exchange market. Conversely, upward pressure is placed on the exchange rate of a surplus country since its currency is in excess demand at the existing rate. In perfectly free foreign exchange markets, exchange rates presumably would adjust until international equilibrium is restored.

But foreign exchange markets today are not free markets. Balance of payments pressures on exchange rates are currently offset by official intervention which permits only nominal changes in rates. With exchange rates pegged within a narrow band under the present system, these pressures fall first on the monetary reserves of the countries involved, and the burden of international adjustment falls ultimately on their domestic economies. And the do-

mestic goals of full employment and price stability are sometimes in sharp conflict with the requirements of international equilibrium. Substantial inflation may be required to eliminate an external surplus while unemployment and recession may be necessary to cope with a deficit. The natural reluctance to subject the domestic economy to such harsh external discipline is largely responsible for the increasing reliance on government controls over foreign trade and capital movements.

Proponents of flexible exchange rates argue that their system is the only alternative to nationalistic controls over international trade and investment on the one hand, or wide fluctuations in the domestic economy on the other. Instead of forcing the internal economy to adjust to a predetermined fixed exchange rate, they say we should let the exchange rate itself do the adjusting. Exchange depreciation would normally tend to make a deficit country more competitive internationally by making its exports cheaper abroad and its imports more expensive at home. Exchange appreciation in surplus countries would tend to stimulate imports and depress exports. The idea is simply to extend the free market into the area of international finance. If external payments do not balance at the existing exchange rate, the rate would adjust in the market until equilibrium is restored.

To say that exchange rate adjustment can promote external equilibrium does not mean that the internal economy is left unaffected. Exchange depreciation raises import prices relative to domestic prices and induces a shift in consumption patterns away from imports in favor of domestic goods competing with imports. Labor and other productive resources shift out of domestic production into export industries. Exchange appreciation in a surplus country would shift the patterns of consumption and production in the opposite direction. The underlying shifts in production and consumption patterns necessary to restore equilibrium are thus similar to those required under the present system of fixed rates. The principal difference is that under flexible rates these internal adjustments would respond to changes in the exchange rate rather than to deflation or inflation in domestic prices and money incomes.

Since the underlying adjustments are ideally the same under the two systems, there would seem to be little to recommend a flexible-rate system. Actually many advocates of flexible rates would be just as happy with fixed rates if internal prices and wages were as flexible in both directions as a free market exchange rate. But since prices, and particularly wages, tend to be rigid in a downward direction, the deflation necessary to cure a deficit under a fixed-rate system would exert downward pressure on the employment level. While exchange depreciation is not painless and usually involves a reduction in real income, it presumably would avoid the employment effects of domestic price and wage rigidities. Flexible rates are thus seen as a means of rendering rigid internal prices and wages flexible in terms of foreign currencies.

Even if flexible exchange rates alleviated pressure on employment resulting from downward price and wage rigidity, unemployment could still result from resource immobility. International adjustment through the current account requires a reallocation of resources between domestic and foreign-trade sectors of the economy whether induced by fluctuations in the exchange rate or by fluctuations in the domestic economy. If resources are not sufficiently mobile, unemployment could result under either exchange-rate system. Under flexible rates, however, resource immobility would probably increase the magnitude of exchange-rate adjustment necessary to maintain external balance since it would reduce the sensitivity of output of various sectors of the economy to relative price changes.

Domestic Policy Independence Under a fixed-rate system there is a potential conflict between domestic policy objectives and the requirements of international equilibrium. Such a conflict would be most apparent in the case of a deficit country experiencing a domestic recession. Easy monetary-fiscal policies may well restore domestic prosperity, but at the expense of a worsened external deficit. Policies designed to correct the external deficit would tend to aggravate the recession. In recent years this dilemma has usually resulted in controls over international trade and investment rather than the sacrifice of domestic stabilization objectives.

At the other extreme is the case of a surplus country experiencing internal inflation. Successful efforts to curb the inflation would increase the external surplus while expansionary policies to reduce the surplus would intensify the inflation. This par-

ticular policy dilemma led to the Canadian adoption of flexible exchange rates in 1950; it also led the Germans to revalue the mark in 1961 and again this year.

Proponents of flexible exchange rates argue that their system would reduce or eliminate external constraints on domestic policies. Monetary and fiscal policies could pursue the desired combination of price stability and full employment while exchange-rate adjustments would maintain equilibrium in the balance of payments. Domestic policy could influence the total level of expenditure for domestic stabilization purposes because the exchange rate would be free to adjust to the extent necessary to induce the shifts in consumption and production patterns required for external equilibrium. Hence, in the previous example of a deficit country with an internal recession, expansive policies could raise the total level of output while the resulting exchange depreciation shifts a larger portion of it into export industries. In the case of the surplus country experiencing internal inflation, policy could be tightened to reduce the excessive level of total spending while exchange appreciation increases the portion of total spending going for imports and reduces the portion of total output being exported.

A related advantage often claimed for flexible exchange rates is that they block the international transmission of economic fluctuations commonly associated with fixed-rate systems. In other words, flexible rates are said to insulate the domestic economy from foreign inflationary or deflationary pressures.[1]

A foreign recession may be transmitted to the domestic economy under fixed exchange rates through a decline in export demand and a reduction in the foreign trade balance. In the absence of offsetting influences elsewhere, the reduction in net foreign spending for domestic output means a reduction in total spending, and thus total income. A foreign boom or inflation would increase export demand, improve the balance of trade, and thus raise the levels of total spending, money income, and prices. The Germans in particular have found that this transmission mechanism makes it difficult to maintain price stability in an inflationary world.

Flexible exchange rates may provide a degree of insulation from foreign price and income changes by neutralizing the net effect of a change in export demand on the balance of trade. A foreign recession would still reduce export demand, but exchange depreciation should limit the deterioration of the trade balance. The depreciation would discourage the fall in exports while encouraging a decline in imports. If potentially complicating capital flows could be ignored, exchange depreciation could be expected to prevent any worsening of the trade balance. With no change in *net* foreign spending on domestic output, there should be no imported recession. Conversely, a foreign inflation would increase export demand, but the resulting exchange appreciation would discourage the expansion of exports while encouraging import growth. The appreciation of the currency, which would not be possible under a fixed-rate system, would intercept the imported inflation. Flexible-rate advocates recognize potential complications in this insulation mechanism, especially those arising out of interest-sensitive capital flows; but they still maintain that a nation would have more economic sovereignty under flexible rates than under the present system.

Arguments and Counterarguments Several objections have been raised against the use of flexible exchange rates. The most important, perhaps, is the argument that international traders and investors require the certainty of stable rates to do business. The possibility of loss due to an adverse movement in the exchange rate, it is said, would discourage international trade and investment.

Propenents of flexible rates counter with several arguments. First, they reject any automatic association of free-market rates with unstable rates. They cite other commodities and other markets that enjoy relatively stable prices in the absence of government price fixing. Second, they argue that exchange risks are not entirely absent under the present system, since official par values are sometimes changed abruptly. Third, exchange risks can be hedged in the forward exchange market in much the same way as commodity traders hedge in the commodity futures market. Hedging does involve extra costs, however, and the cost of hedging some important kinds of transactions may be prohibitive. Finally, they maintain that there are all kinds of risks in international trade, and official measures taken to protect a fixed rate may create more problems for traders and investors than would the adjustment

[1] Robert D. McTeer, Jr., "Economic Independence and Insulation through Flexible Exchange Rates," Nicholas A. Beadles and L. Aubrey Drewry, Jr. (eds.), *Money, the Market and the State* (Athens: University of Georgia Press, 1968), pp. 102-133.

they seek to avoid. The risk of exchange fluctuation must be weighed against the alternative risks of controls over trade and investment and other restrictive measures designed to maintain fixed rates. Certainly the cause of international trade and investment has not been advanced by the recent measures taken by several countries, including the United States, to support official exchange parities.

Another argument often heard is that speculation would be destabilizing if rates were flexible—that speculators would take a given change in the rate as a signal for further changes in the same direction and act accordingly. Supporters of flexible rates, on the other hand, argue that the present system is *more* conducive to destabilizing speculation since rates are held rigid while huge deficits pile up. Faced with rates that are clearly out of line with reality, speculators or traders with an uncovered position stand to make large gains if they are right and have little to lose if they are wrong. The events of the past couple of years illustrate the potential for one-way speculation under the present system. On the other hand, it is argued, if rates were determined in the free market, they would presumably adjust gradually to changing economic conditions, and speculators would not be faced with rates that are clearly undervalued or overvalued. The potential gain through speculation would thus be diminished and would be matched by a greater chance of loss.

Another argument against flexible rates is that they would eliminate an important external constraint against inflationary policies. Under fixed rates, it is argued, inflationary policies worsen the balance of payments and lead to a loss of gold or foreign exchange reserves. The reserve loss demands attention and forces the monetary authorities to adopt more restrictive policies. However, policies that would lead to reserve losses under the present system would lead to exchange depreciation if rates were free, and exchange depreciation may also be something to be avoided. It raises import prices and usually worsens the terms of trade. The question is: which provides the greater constraint on inflationary policies—reserve losses or exchange depreciation? While often asked, such a question misses the point that inflation is undesirable in itself and should be avoided, external constraint or not. No international financial system can force responsible domestic policies or substitute for them.

Limited Flexibility The discussion so far has assumed completely free exchange rates to focus on general principles. The near-term prospects for such a system, however, are not good. The world's monetary authorities are understandably reluctant to make such a radical departure from orthodoxy, and do not always have the power to make such changes even if they wished to. Rather, official attention has been directed recently to more limited forms of flexibility that would not break completely with the par value system.

The suggestions for limited flexibility receiving the most attention today involve some version of "wider bands," "crawlings pegs," or a combination of the two. Both these approaches aim at obtaining some of the assumed advantages of exchange flexibility without sacrificing the basic nature of the par value system.

The wider band proposal involves extending the range of permissible exchange rate variation around the par value beyond the present 1% limit sanctioned by the IMF. Presumably, many, though not all, of the advantages (and disadvantages) claimed for flexible exchange rates would apply to a lesser extent to a wider band. In urging official study of this proposal in 1965 the Joint Economic Committee of Congress gave its possible advantages as follows:

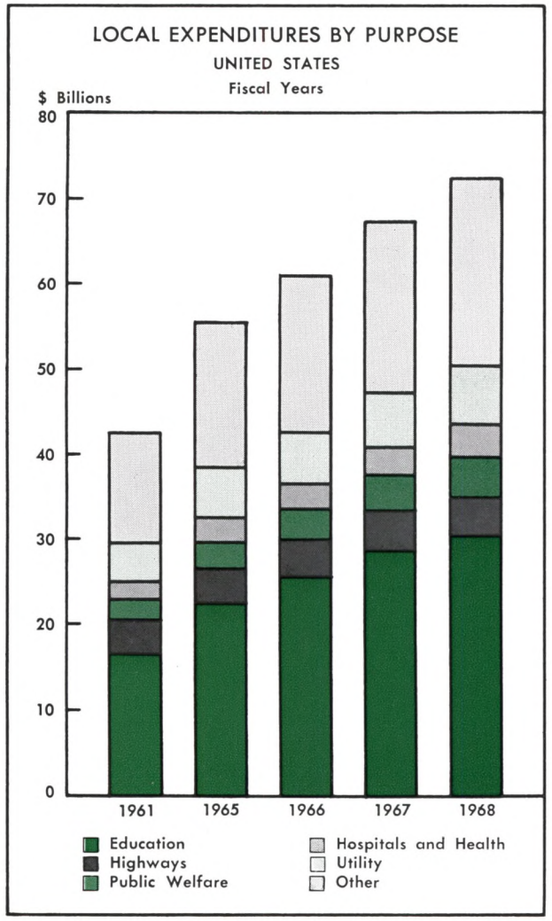
> Broadening the limits for exchange rate variations could discourage short-term capital outflows through free market forces, on which we should continue to place our main reliance; permit greater freedom for monetary policy to promote domestic objectives; discourage speculation against currencies by increasing the risk; and to some extent promote equilibrating adjustment in the trade balance through somewhat greater exchange rate variations than are now permitted.[2]

A wider band would represent only a one-shot increase in the ability of the exchange rate to adjust. Divergent national policies still would tend to push rates to their upper or lower support limits, and their ability to adjust in that direction would be "used up." The crawling peg proposal, on the other hand, provides for a gradual, but continuing, adjustment of the par value itself. The speed of adjustment might be determined in advance, say a maximum of one sixth of 1% per month, or it might depend on past market performance. For example, the peg could be set each month or each week at a level equal to the moving average of the actual market rate over a specified time period. Either way, the adjustment over short time periods would be too small, presumably, to make large scale speculation worthwhile.

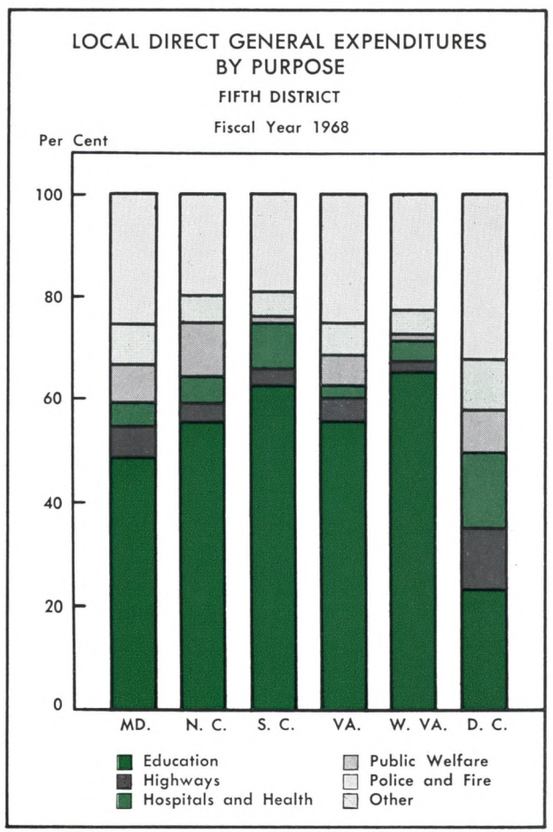
Robert D. McTeer, Jr.

[2] *1965 Joint Economic Report*, Report of the Joint Economic Committee on the January 1965 Economic Report of the President, March 17, 1965, p. 15.

LOCAL GOVERNMENT EXPENDITURES

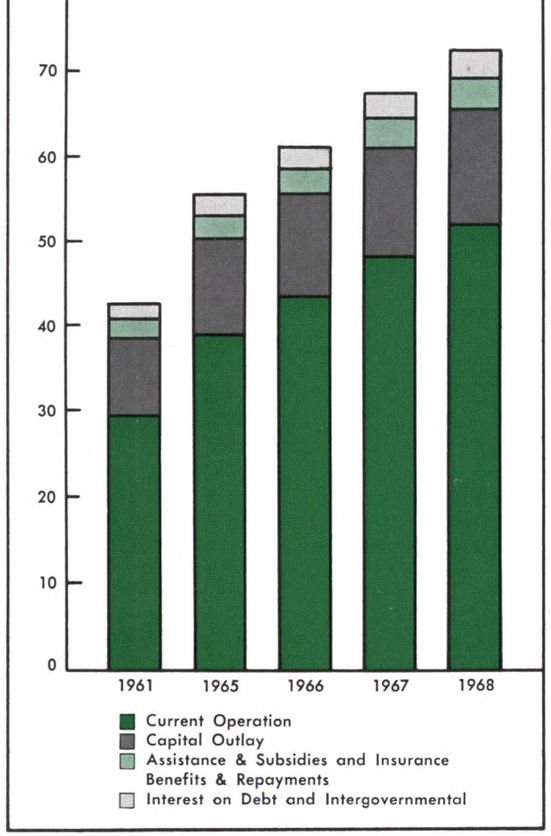


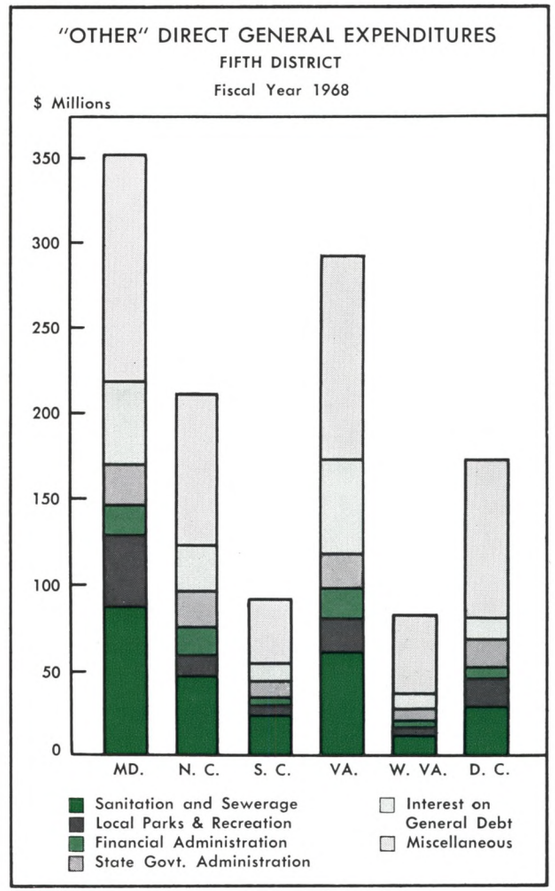
Total expenditures by local governments increased 60% between 1961 and 1968. Education expenditures ranged from 39% of total expenditures in 1961 to almost 42% in 1968 while utility expenditures, the second largest category, remained a relatively stable 9%-10% of the total. Highway disbursements declined from 8.5% in 1961 to 6.5% in 1968, but public welfare increased a full percentage point over the period to 6.7%. Payments for hospitals and health remained close to 5% of total outlays.



Total local direct government expenditures in the Fifth District exceeded $1 billion in three District states, Maryland ($1.4 billion), Virginia and North Carolina ($1.1 billion). Total local outlays exceeded $530 million in the District of Columbia, $464 million in South Carolina, and $350 million in West Virginia. Education outlays, the major expenditure throughout the District, ranged from $125 million in the District of Columbia to almost $660 million in Maryland. Maryland is the only District state in which local expenditures more than doubled from 1961 to 1968, but local expenditures in South Carolina increased 99%.

"Other" expenditures by local governments went largely for sanitation and sewerage and for interest payments on general debt. Interest on general debt accounted for a little over 13% of total expenditures for all local governments, the same level as in 1961. In the District, interest payments ranged from a low of around 6% of the total in the District of Columbia to a high of almost 19% in Virginia, as compared with a 1961 low of less than 4% (District of Columbia) and a high of over 18% (Maryland). Local government administration expenditures as a percentage of total expenditures declined throughout the District except for the District of Columbia and Maryland.





Capital outlays accounted for approximately 20% of total expenditures from 1961 to 1968, and construction expenditures accounted for over three-fourths of capital outlays. Local governments made some payments to their state governments, but these amounted to only about 0.5% of total expenditures over the period. Compensation of local officers and employees, which comprises a part of each of the illustrated categories, has also consistently been around 48% of the total.

Katherine M. Chambers

Source: U. S. Department of Commerce.

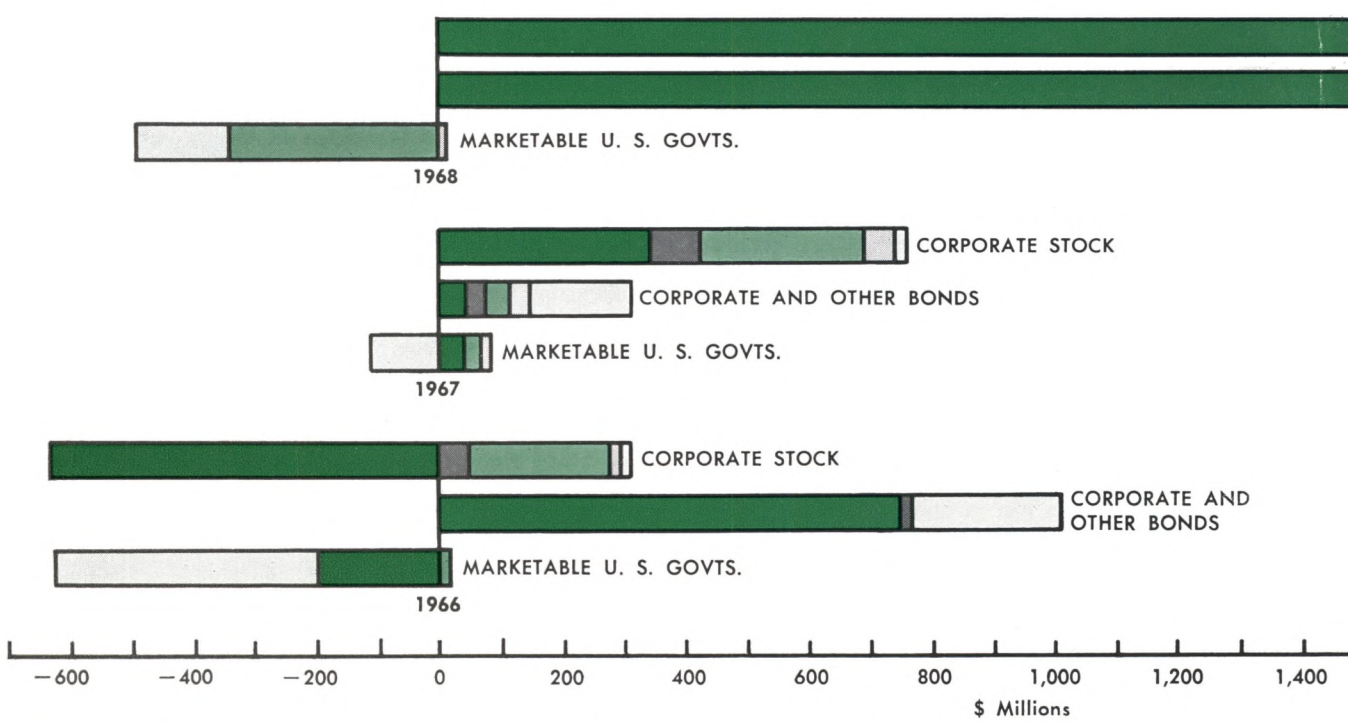
Foreign Purchases of Domestic Securities

Foreign purchases of U. S. securities have contributed significantly to the recent shifts in the United States balance of payments position. Net foreign purchases of U. S. corporate stocks and bonds, in particular, helped the United States achieve its small external surplus in 1968, the first on a liquidity basis since 1957. A decline in such purchases contributed to the sharp deterioration in the overall payments position in 1969. Of course, the flow of capital across national boundaries is important for reasons other than balance of payments considerations. International capital movements can contribute to economic welfare in much the same way as international trade in goods and services.

Net foreign purchases of U. S. securities, other than Treasury issues, represent a capital inflow into the United States, a plus item in our balance of payments accounts. Conversely, net foreign sales of such securities represent a capital outflow, or a negative item. On the other hand, foreign transactions in marketable U. S. Treasury securities are recorded "below the line" as a balancing item in the official balance of payments accounts. Since transactions in both categories of securities are considered, the statistics used here are not strictly comparable to those used for official balance of payments accounting purposes.

The charts show net purchases and sales by foreigners of long-term U. S. securities by area and by type. Long-term securities are those with no contractual maturity (equities) or those with an original maturity of over one year. "Foreigners" are defined by the Treasury Department to include all individuals and institutions located outside of the United States, including U. S. citizens. Foreign institutions include foreign subsidiaries of U. S. businesses and banks, foreign pension and mutual funds, foreign governments and central banks, other official institutions of foreign countries, and international and regional institutions such as the International Bank for Reconstruction and Development. Transactions undertaken by residents of the United

NET PURCHASES (+) AND SALES (−) OF LONG-TERM SECURITIES BY AREA



Note: Net purchases or sales for a given area of less than $10 million are included as "Other".

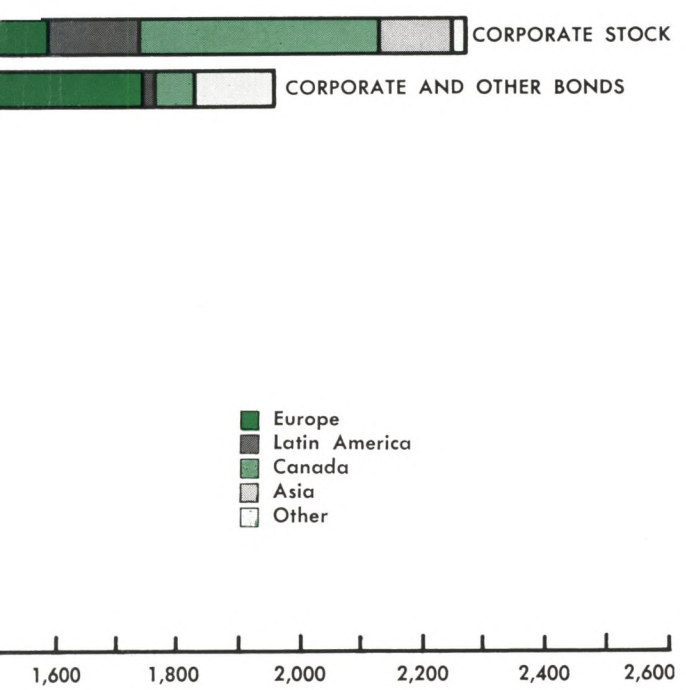
Source: U. S. Treasury Department.

States are also counted if the transactions are recorded for the account of foreigners.

The transactions are shown for each country or geographical area in which the buyer or seller of record resides, but this may not in all cases be the residence of the ultimate buyer or seller. For example, Swiss banks handle transactions for customers in many countries, and Switzerland is credited with these transactions even though the ultimate owners are not necessarily Swiss.

Major Purchasers of U. S. Securities The first chart shows that Europe continued to be the source of most of the foreign transactions in U. S. securities through 1968. The major European "purchaser" of U. S. corporate stock was Switzerland with net purchases of $822 million, followed by the Netherlands, France, and Germany. Part of the Dutch purchases were accounted for by a large direct investment in the United States by a Dutch company.

U. S. corporate and other bonds, which include issues of states and municipalities, and of agencies of the U. S. Government which are not guaranteed by the United States, were also popular among Europeans with Switzerland ($510 million) and the United Kingdom ($522 million) the major purchasers. Germany, France, and Belgium-Luxembourg were also large net purchasers. Though Europeans in general were net sellers of U. S. Government securities in 1968, the United Kingdom was a net purchaser at $52 million.



Most transactions in U. S. securities from the Latin American area come from the Netherlands Antilles and Surinam and the Bahamas and Bermuda. The Bahamas and Bermuda had net purchases of $140 million of U. S. corporate stock in 1968, the highest in the area, while the Netherlands Antilles and Surinam were the largest purchasers of corporate and other bonds. Much of this activity is the result of actions by investment trusts which attract funds largely from Europe, but also from the United States and other areas. Transactions in U. S. Government securities in this area were small in 1968.

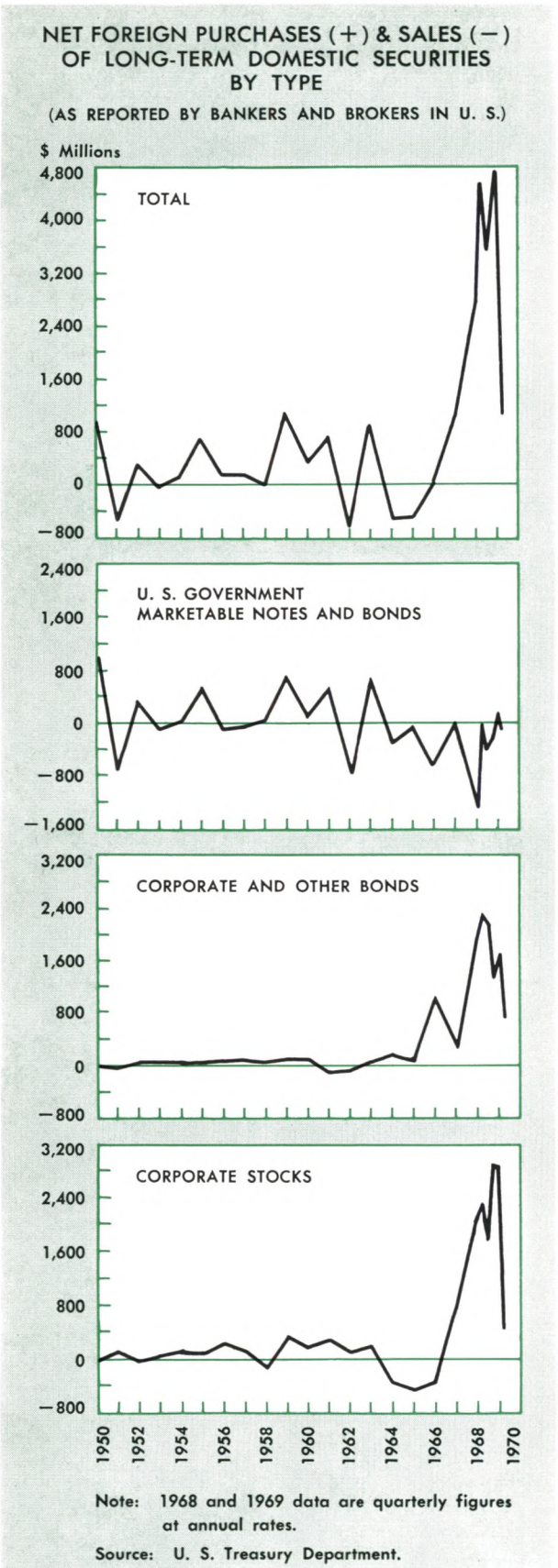
The Asian category also showed net purchases of U. S. corporate stock in 1968 with the largest purchases ($54 million) from the "Other Asia" group which includes Vietnam. Other major purchasers were Hong Kong ($37 million), the Phillipines ($20 million), and Israel ($9 million). Transactions in U. S. Government securities and corporate and other bonds were minimal with net purchases of the former and net sales of the latter for 1968.

International and regional organizations, such as the International Bank for Reconstruction and Development, have generally invested the proceeds of new security offerings in the United States in nonliquid U. S. assets. In 1968, these organizations were net sellers of U. S. Government securities ($161 million) but net purchasers of corporate and other bonds ($117 million) and of corporate stock ($12 million).

Africa and Australia have both been relatively inactive in U. S. long-term securities, except for $10 million of corporate and other bonds purchased by Australia in 1968.

Reasons for Foreign Purchases of U. S. Securities The foreign demand for U. S. long-term securities comes from both official and private sources. Many foreign central banks and Treasuries hold a sizable part of their international reserves in the form of dollars. In order to earn a return on these holdings, they are invested in dollar-denominated securities. U. S. securities are generally attractive to both official and private investors because of the relative economic and political stability of the United States (thus a relatively low exchange risk) and because of the broadness of the U. S. securities markets.

The increase in foreign purchases of U. S. stocks



through 1968 coincided with a period of rising stock prices; foreign purchases declined as stock prices turned down in 1969. The prospects of capital appreciation may also be a reason for the increase in the foreign private demand for U. S. debt securities. Prices of all types of bonds have fallen consistently since 1965. The average yield on Moody's corporate Aaa bonds in 1965 was 4.49% per annum as compared with 6.18% in 1968. To the extent that rising yields give rise to expectations of a reversal in the bond market, there is an opportunity for capital appreciation.

Other attractions of U. S. securities have been relatively stringent U. S. disclosure policies applied to companies listed on the major exchanges, the maintenance of overseas branches by U. S. brokers, and the Foreign Investors Tax Act of 1966. The disclosure practices in the United States are stricter than those in other countries thus allowing the investor to become better informed. The brokers' foreign branches make it relatively easy, at least for Europeans, to make transactions in U. S. securities, and the Foreign Investors Tax Act liberalized U. S. income tax policies on capital gains and the dividends for foreign individuals holding U. S. securities. In addition, potential foreign investors may be introduced to U. S. equities through convertible Eurodollar bonds. Holders of these bonds have the option of converting those bonds into the common stock of the parent U. S. company.

Recent Developments Net foreign purchases of U. S. securities decreased sharply in the first half of 1969, contributing to a serious deterioration in the U. S. balance of payments. The decline in net foreign purchases was largely attributable to declining U. S. stock prices and the relative attractiveness of competing investments such as Eurodollar deposits. In June, foreigners sold more U. S. corporate stock than they bought, for the first time since 1966. According to preliminary figures, sales of stock exceeded purchases in July also, but in August net purchases by foreigners were again recorded. Net sales by foreigners of corporate and other bonds and marketable U. S. Government notes and bonds also took place in June, but net purchases were recorded for both in July and August, again according to preliminary data. Recent behavior would seem to indicate that while foreign purchases of long-term domestic securities have fluctuated in 1969, there has been a long run increase in foreign demand for U. S. securities.

Katherine M. Chambers

The Fifth District

MEMBER BANK BORROWING

Daily borrowings at Fifth District member banks reached record highs in the first six months of 1969. On May 23 borrowings outstanding from the Federal Reserve Bank of Richmond climbed to a record $132.7 million and on June 27 hit a new high of $137.7 million. Daily borrowings in the District averaged $44.8 million in the first half of 1969—over half again the $29.3 million which District banks borrowed in 1966, another year of stringent credit conditions. In this year of record borrowings, it seems particularly appropriate to review the mechanics of the discount process and outline some of the characteristics of the borrowing banks.

The Federal Reserve discount window extends credit to member banks on a short-term basis to enable them to adjust their asset positions when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can be met by use of the bank's own resources. To use the discount window a banker simply places a telephone call to the Fed's Discount and Credit Department specifying the amount he would like to borrow, the collateral he will use, and the number of days he intends to borrow. The telephone request must be confirmed by a signed note. Bankers located in the Charlotte

MEMBER BANK BORROWING IN THE FIFTH DISTRICT FOR 1967, 1968, AND THE FIRST HALF OF 1969

	Deposit Classification						
	Over $250 Million	$100-250 Million	$50-100 Million	$25-50 Million	$10-25 Million	$5-10 Million	Under $5 Million
Number of banks in District*	15	11	20	42	116	102	72
Total number of banks borrowing							
1967	11	5	8	7	25	13	9
1968	14	8	14	12	26	10	5
First half 1969	14	10	12	12	26	11	5
Total borrowings† per borrowing bank			Thousands of dollars				
1967	87,540	115,320	25,914	9,314	9,832	2,655	2,826
1968	370,317	144,135	58,154	38,813	6,419	5,591	1,202
First half 1969	378,814	190,385	52,649	30,425	6,561	6,022	606
Daily borrowings per borrowing bank			Thousands of dollars				
1967	240	316	71	26	27	7	8
1968	1,015	395	115	106	18	15	3
First half 1969	2,081	1,046	289	167	36	33	3
Adjusted daily borrowings per borrowing bank			Dollars borrowed per $1 million in total deposits‡				
1967	274	1,677	1,076	890	2,130	997	2,017
1968	1,262	2,224	1,530	3,018	1,209	1,773	785
First half 1969	2,678	7,222	3,745	4,589	2,387	4,179	772
Average number of borrowing days per borrowing bank (Range of borrowing days)			Days				
1967	8 (1-32)	28 (4- 80)	22 (4- 42)	11 (2- 30)	38 (2-114)	17 (2-47)	31 (7-78)
1968	24 (7-62)	43 (4-117)	39 (3-130)	32 (3-104)	21 (1- 95)	22 (1-82)	9 (2-25)
First half 1969	22 (1-55)	37 (7- 77)	29 (3-110)	26 (1- 70)	15 (1- 58)	27 (2-78)	6 (2-19)

* Based on December 1968 Call Report.
† Sum of borrowings outstanding each day.
‡ Deposits as of annual call date.

and Baltimore Branch areas contact their respective branch offices.

After specifying the amount to be borrowed, the banker must indicate the kind of collateral he intends to use. Two types of collateral are used most often: U. S. Government obligations and eligible paper. U. S. Government securities are the simplest means of securing a loan since a member bank usually maintains an inventory of Government securities at its Federal Reserve Bank. Verification of these securities is easy and quick, and the bank is able to have the loan that day.

For borrowing purposes a member bank's note may not have a maturity of more than 15 days. At the maturity of the note the amount of the loan is automatically charged to the bank's account, but the bank is then free to take out a new loan. This sort of borrowing occasionally continues for months. A bank may partially or fully repay its loan at any time.

The table included in this article shows member bank borrowings in the Fifth District for the past two and a half years. Total borrowings, which are defined as the sum of borrowings outstanding on each day, clearly show that all but the smallest banks are borrowing substantially more this year than in either 1967 or 1968. The table also indicates that smaller banks, on the whole, do not use the discount window to the extent that the larger banks do. For example, 24 out of 25 banks having deposits of over $100 million used the discount window sometime during the first part of 1969, whereas only 42 of 290 member banks with deposits of under $25 million borrowed from the Federal Reserve during the half-year. This does not necessarily mean that the small banks have not needed funds, for they often borrow from their correspondent banks. It does seem remarkable for 1969, however, when monetary policy was tightening and the discount rate was substantially below the Federal funds and Treasury bill rates.

Member banks in the smallest size class had the lowest rate of borrowing in 1969 even after adjustment for the deposit size of the bank. For example, the table indicates that the average member bank having over $250 million in deposits had total borrowings per day of $2,678 for every $1 million in total deposits that it held during the first half of 1969. The average bank in the under $5 million class had total borrowings per day of only $772 for every $1 million of total deposits held. The largest average borrowings fell in the $100-250 million and $25-50 million groups.

If there is one outstanding theme shown in the table, it is that fewer of the smaller banks borrow, and if they borrow, they borrow less often and for relatively smaller amounts. In 1969, for example, the percentages of District banks which borrowed were, from smallest to largest size groups, 7%, 11%, 22%, 60%, 91%, and 93%. Of the 72 banks in the under $5 million size group, only five borrowed during both 1968 and the first half of 1969. The number of borrowing days did not show such a positive relationship to bank size, but the smallest banks in the District again showed a reluctance to borrow very often. The average borrowing bank in the under $5 million class owed money to the Fed during 6 days in the first half of 1969 and 9 days in 1968.

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