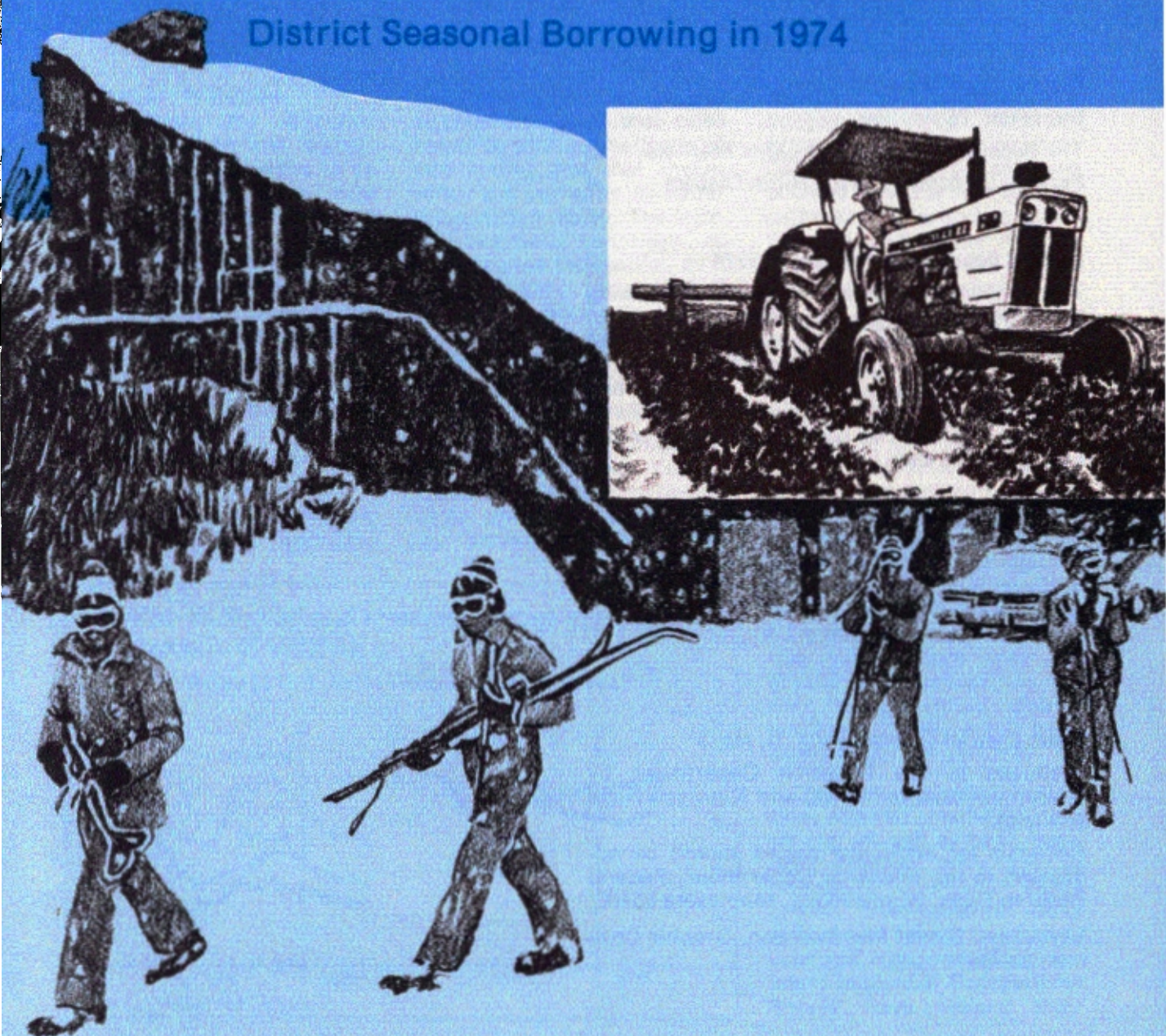


# Ninth District Quarterly

Federal Reserve Bank of Minneapolis  
July 1975

## District Seasonal Borrowing in 1974



## **District Conditions**

First Half '75 Review .....	1
The Recession's Impact on Labor Markets....	3
Foreign Investment in the Ninth District .....	6

## **District Seasonal Borrowing in 1974 .....10**

The Federal Reserve's seasonal borrowing privilege can provide an additional source of funds to many banks in the Ninth District. But so far, few banks have taken advantage of it. An examination of which banks borrowed and which banks did not may reveal some clues to why the privilege has been used so little and to how it may be used in the future.

## **Ninth District Quarterly Vol. II, No. 3**

Produced in the Research Department by Sharon Johnson (editorial) and Kathleen Rolfe (visuals).

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## District Conditions

### First Half '75 Review

At midyear, the economic decline in both the district and the nation appears to be ending. Looking back, economic conditions held up much better in the district than in the nation during 1974. But during the first few months of 1975, some of the strengths began to weaken, and district business activity fell off notably. By now, though, most areas have stabilized, and in some sectors improvement has already begun.

After a poor first quarter, district consumer spending

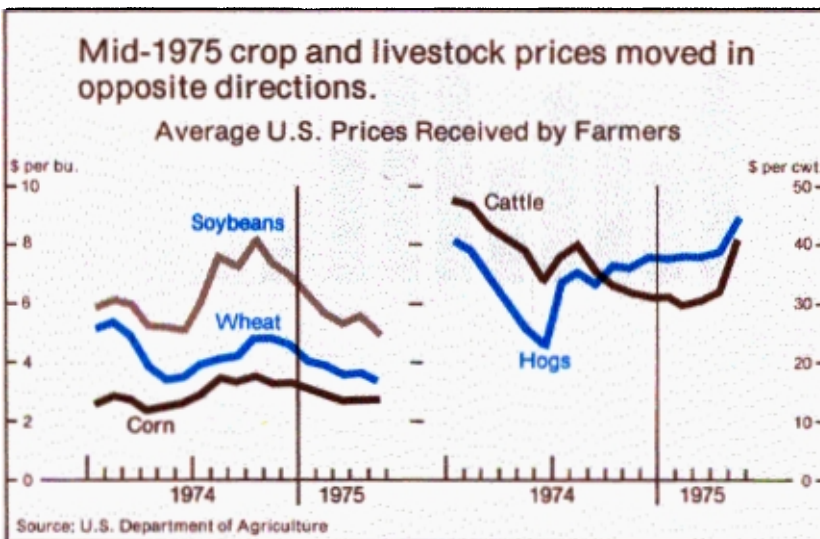
has started to revive. Regional retailers report that sales began to pick up modestly in late spring and that inventories are currently in better proportion to sales. The tourist business continues to thrive across the district, as it has throughout the period of recession. Recovery is not apparent in all areas of consumer spending, though: automobile sales continue to be down from a year earlier.

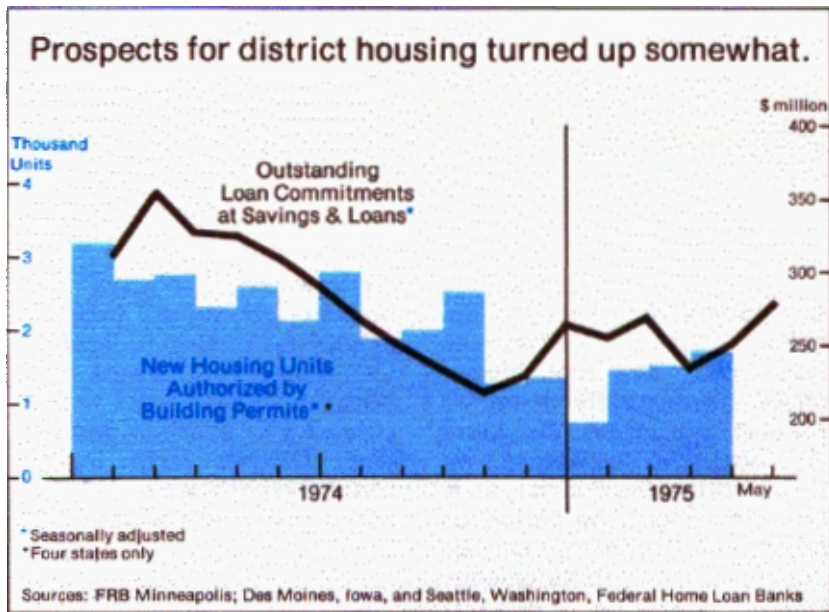
District crop conditions in early July were good, despite localized damage from floods. Crop prices decreased, but the overall index of prices

received by farmers was buoyed by higher livestock prices in the second quarter. Cattle and hog prices were boosted above a year ago by cutbacks in livestock production. District farm income could suffer, however, if large harvests depress prices.

There has also been slight improvement in the district's construction industry, with both residential and nonresidential building in the second quarter up from the previous three months. It is encouraging that outstanding mortgage loan commitments moved sharply upward to about \$1 billion at district S&Ls in May, and savings inflows to thrift institutions have been quite strong so far this year. There may be greater improvement on the way, though recent district construction activity has been weaker than the nation's.

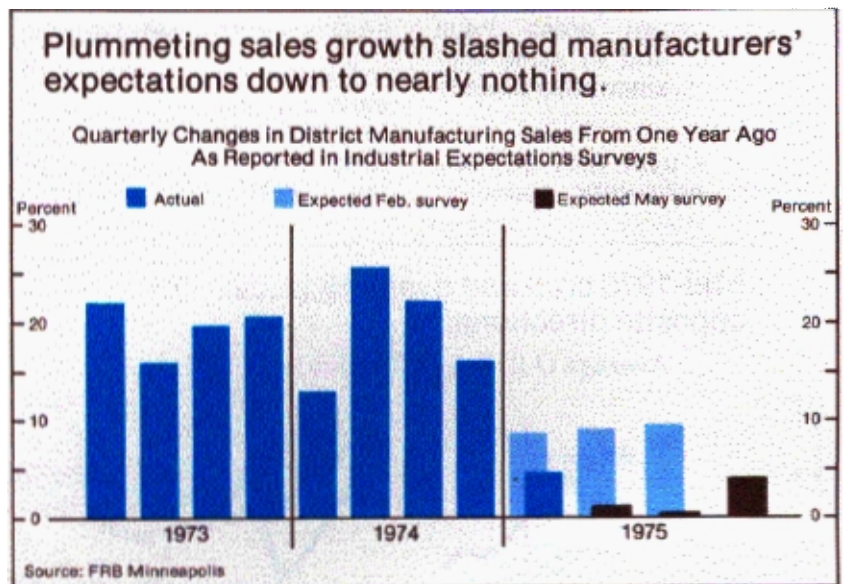
On the less encouraging side, district manufacturing activity as well as bank business lending have yet to improve. District sales growth plummeted in early 1975 from levels reached a year ago. Respondents to our latest Industrial Expectations Survey have revised their





sales expectations downward and look for little sales growth in the rest of this year. District bank loans declined in the first half, primarily due to a slowing in business loan demand.

The rise in the district's seasonally adjusted unemployment rate reflected the overall deterioration in district business activity during the first half of 1975. Even so, the local situation was better than that of the nation. Although district labor market conditions appear to be stabilizing, unemployment is expected to continue high during the remaining months of 1975.



### The Recession's Impact On Labor Markets

The district's unemployment rate, seasonally adjusted, has risen from 4.9 percent in late 1973 to 6.7 percent this past May.<sup>1</sup> But the national rate has gone up even more rapidly and to higher levels, from 4.7 to 9.2 percent, during the same period.

Currently the district has close to 200,000 residents seeking work. How does this and other district labor market developments of the current recession compare to national conditions? How has the recession affected various areas within the district? And what might be the outlook for district labor markets?

### District vs. National Conditions

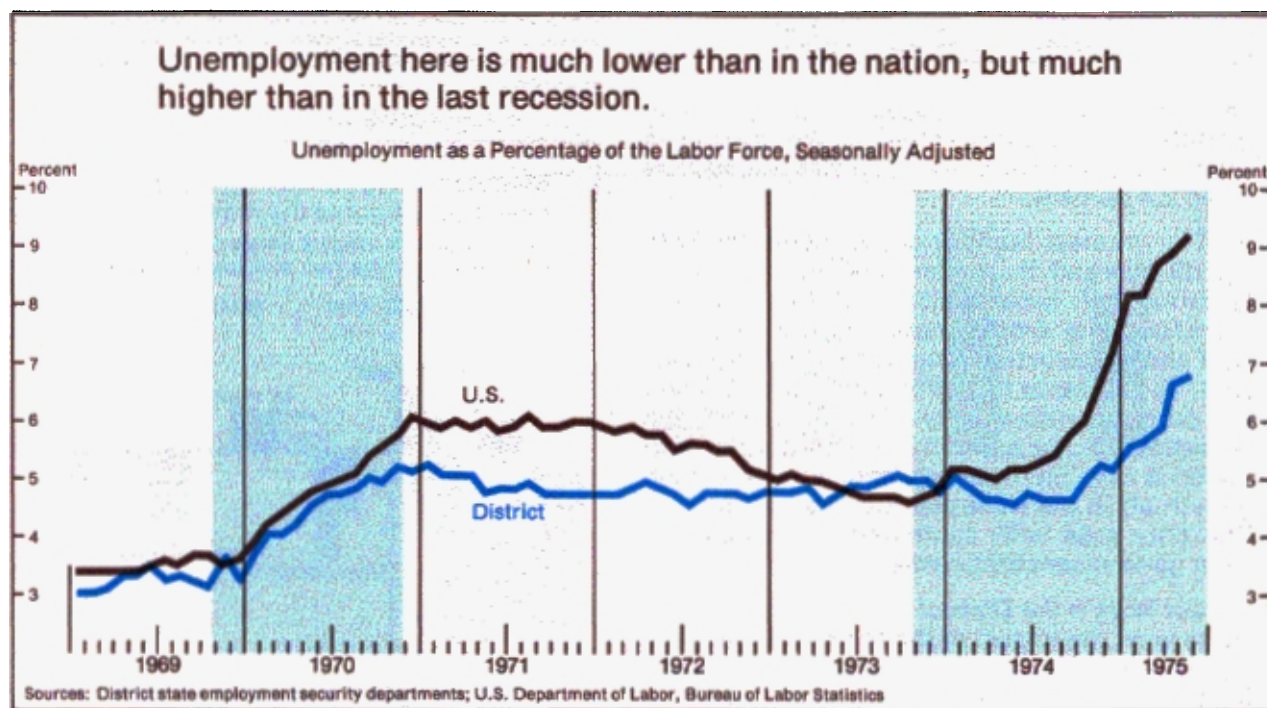
Labor market conditions in both the nation and the district changed little during the first half of 1974, but in the fourth quarter of last year and in early 1975, national conditions softened appreciably. Throughout that time, district developments lagged about one quarter behind

national trends, primarily because the region was relatively unaffected by large auto and other industry layoffs.<sup>2</sup>

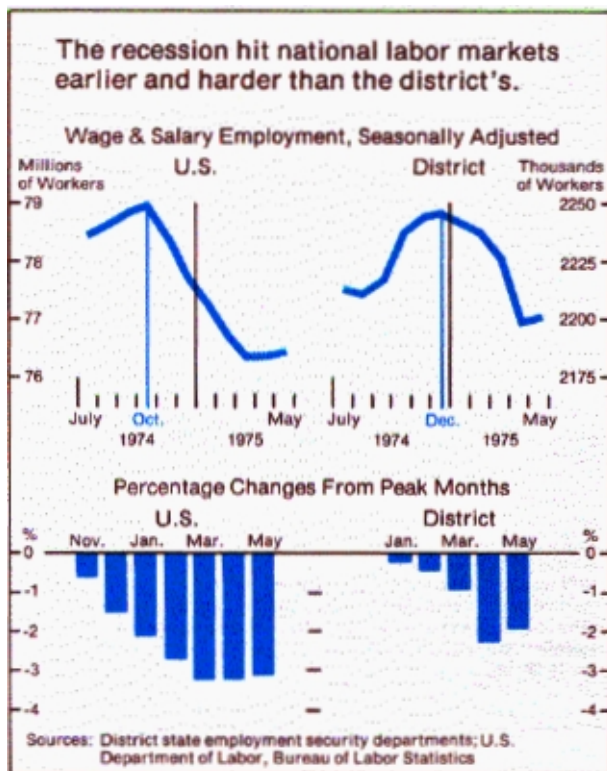
National payroll employment, on a seasonally adjusted basis, peaked in October and dropped a full 1.5 percent by December. District wage and salary employment continued to grow during this period. By May 1975, the national rate had fallen another 1.6 percent. By that time district employment had lost its strength; it peaked in December and fell 1.9

<sup>1</sup>Methods of computing labor force, employment, and unemployment estimates have recently been revised. For an explanation of the revisions, see Appendix, p. 9.

<sup>2</sup>The stronger performance of the district's economy relative to the nation's has been stressed in past issues. This also was pointed out in a recent Department of Commerce study, indicating that nonfarm personal income growth in district states between the fourth quarters of 1973 and 1974 was above the national average. In fact, North Dakota's gain was the fourth highest, South Dakota placed seventh, and Minnesota and Montana were sixteenth and seventeenth. "Cyclical Development in State Personal Income," SURVEY OF CURRENT BUSINESS, Vol. 55, No. 4 (April 1975), pp. 18-20, 60.







percent by May. Compared to a year ago, though, payroll employment in the district is relatively unchanged, while in the nation it is down 2.4 percent.

The greatest number of job losses for both the district and the nation has been in manufacturing and construction. In May, national manufacturing employment dropped 9.3 percent and construction employment fell 6.2 percent, as compared to district declines of 5.3 and 8.0 percent, respectively. The impact of the recession on the economy of the district and nation is even more widespread, with recent job growth off in the trade and service sectors too. The only area with continued expansion has been government employment.

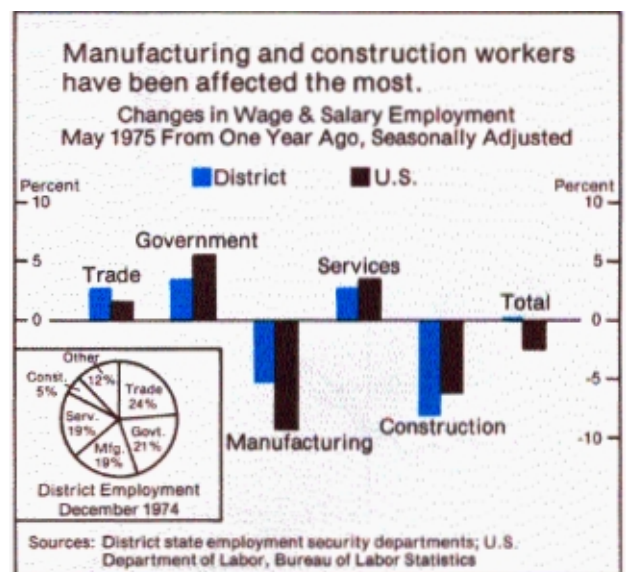
#### *Impact Within the District*

Up to now, the impact of the recession has been greatest in the Minneapolis-St. Paul metropolitan area which, as the region's most industrial-

ized area, accounts for approximately a third of district economic activity. This past spring about 80 percent more workers were looking for jobs there than a year earlier, and in April the Department of Labor added the Twin Cities to a list of major labor areas with substantial unemployment.<sup>3</sup> Twin Cities area workers on payrolls were 1.6 percent fewer in May than the year before, with declines being concentrated in manufacturing and construction.

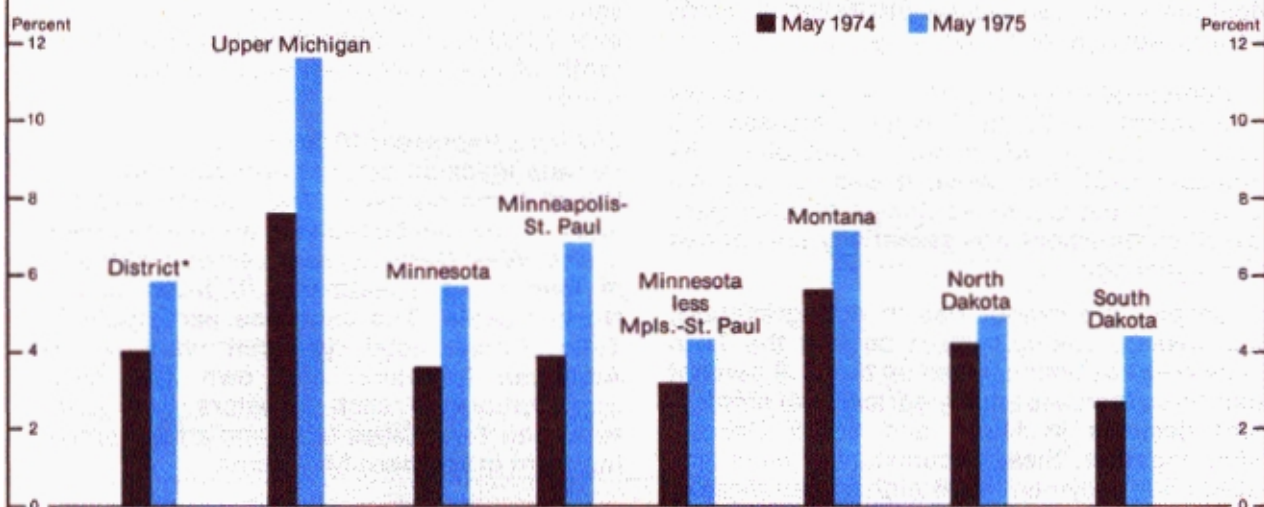
Effects of the recession have been less severe elsewhere in the district: wage and salary employment outside the Minneapolis-St. Paul area in May was up 1.3 percent from a year before. This area, primarily because of its agricultural orientation, is not as directly influenced by national economic fluctuations as is the Twin Cities.

<sup>3</sup>Major labor areas can be defined as the 150 largest standard metropolitan statistical areas, and as of April, 127 of them were considered areas with substantial unemployment. An area has substantial unemployment when unemployment in the area is equal to 6 percent or more of its labor force, discounting seasonal or temporary factors, and when the rate of unemployment during the next two months is expected to remain at 6 percent or more, discounting temporary or seasonal factors. If the problem becomes more severe, the area is categorized as having persistent unemployment.



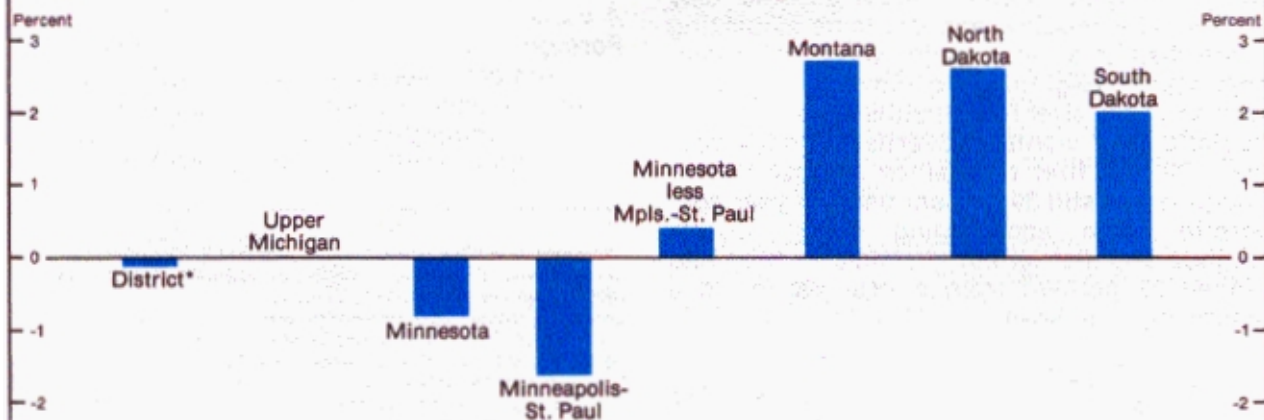
## Unemployment is up from a year ago throughout the district. . .

Unemployment as a Percentage of the Labor Force, Seasonally Adjusted



## . . .but payroll employment is down only in Minneapolis-St. Paul.

Changes in Wage & Salary Employment from May 1974 to May 1975, Seasonally Adjusted



\*Northwestern Wisconsin not available.

Source: District state employment security departments

The areas of strongest growth were Montana and North Dakota where by May 2.7 and 2.6 percent increases were reached in wage and salary employment. Counter to national developments, manufacturing employment in North Dakota was up substantially from a year ago and nonmanufacturing jobs advanced. Montana's increase can be attributed to gains in trade, service, and government employment.

Compared to a year earlier, wage and salary employment in South Dakota increased 2.0 percent, but in Minnesota, excluding the Minneapolis-St. Paul area, it was up only 0.4 percent. In the Upper Peninsula of Michigan, payroll employment was essentially unchanged from a year ago.

Despite the overall rise in nonagricultural jobs, district unemployment outside the Twin Cities area has been pushed up by a 1.9 percent labor force increase and by agricultural employment declines in North and South Dakota. Taken together, these circumstances have produced unemployment rates higher than those of a year ago throughout the district.

#### *The Labor Market Outlook*

The outlook for the district's 200,000 jobless may be improving. National wage and salary employment increased in April and May, indicating that general employment declines may be over. The situation appears to be stabilizing in the district as well, with wage and salary employment beginning to move up between April and May after four months of decline. The district's help wanted advertising index also rose—for the first time since August 1974—though it was still 39 percent below a year ago. Despite some encouraging signs, layoffs continue and district initial claims in May had jumped 37 percent from a year earlier to a historically high level.

*David S. Dahl*

#### **Foreign Investment in the Ninth District**

A number of foreign countries are currently investing directly in Ninth District companies.<sup>4</sup> Although nearly one-third of these investments are concentrated in the Minneapolis-St. Paul area, the rest are broadly scattered throughout the four complete district states. They represent a wide variety of industries and employ over 2,000 people (though this is less than one-tenth of one percent of total district employment).

#### *26 Firms Represent 10 Countries*

Canada leads all other countries in total number of firms owned in the district, and these eleven firms can be found in all four full district states. West Germany ranks second with a total of four direct investments in Minnesota and North Dakota. The Japanese participate in a Twin Cities hotel (a joint venture with American investors) and own two service organizations. French investors own both a suburban Twin Cities hotel and a food processing plant in southern Minnesota.

Altogether, European Community countries<sup>5</sup> own seven companies in the district. Investors from three other European countries each own one Minnesota firm, as do companies from South Africa and the Netherlands Antilles (West Indies).

#### *A Variety of Enterprises*

Foreign concerns are engaged in a variety of business activities here. The 19 manufacturing plants are about equally divided between durable and nondurable goods production. Durable goods manufacturers produce machinery and

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<sup>4</sup>Information in this article is based on data in U.S., Department of Commerce, Bureau of International Commerce, FOREIGN DIRECT INVESTORS IN THE UNITED STATES, Washington, D.C.: U.S. Department of Commerce, October 1973. Information was supplied by the State Departments of Economic Development in Minnesota, Montana, and South Dakota and the North Dakota Business and Industry Department. This Bank's staff verified data whenever possible. However, since there is currently no single up-to-date source of information about foreign investment in the United States, the data in this article may be incomplete.

<sup>5</sup>The members of the European Community (EC or Common Market) are Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, and the United Kingdom.



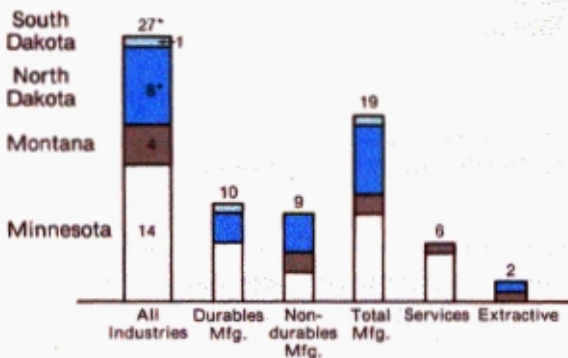
## Foreign-Owned Companies in the District: \* Where They Are and What They Do



Sources: U.S. Department of Commerce; Minnesota, Montana, and South Dakota Departments of Economic Development; North Dakota Business and Industry Department

## Manufacturing firms are the most popular with foreign investors.

Number of District Companies Owned by Foreigners  
By Type of Industry and Location of Company



\*One company counted twice because it both mines raw material and processes it into industrial and consumer goods.

Sources: U.S. Department of Commerce; Minnesota, Montana, and South Dakota Departments of Economic Development; North Dakota Business and Industry Department

equipment for industry, agriculture, and mining. The largest diamond core drilling company in the world has a manufacturing and contract drilling facility in northern Minnesota.

Most of the nondurable goods firms produce a wide spectrum of consumer goods, ranging from cheese to charcoal briquettes. Foreign plants are represented elsewhere in the food processing industry by two beet sugar processing plants. In another area of consumer nondurables, a foreign-owned company manufactures sportswear.

Industrial nondurable goods produced include refined oil, coal tar distillates, and agricultural twine and cordage.

The services provided by foreign firms are also highly diversified but do not include finance. In addition to ownership and participation in two hotels in the Twin Cities, foreigners own a shopping center and a grain brokerage business.

## Most foreign-owned companies are in Minnesota.

Number of District\* Companies Owned by Foreigners  
By Country of Origin and Location of Company

Country of Origin	State in Which Located				Total
	Minnesota	Montana	North Dakota	South Dakota	
<b>European</b>					10
Britain	1				1
France	2				2
Germany	2		2		4
Liechtenstein	1				1
Sweden	1				1
Switzerland	1				1
<b>Other</b>					16
Canada	2	3	5	1	11
Japan	2	1			3
Netherlands Antilles	1				1
South Africa	1				1
<b>Total</b>	14	4	7	1	26

\*Information for Upper Michigan and Northwestern Wisconsin not available.

Sources: U.S. Department of Commerce; Minnesota, Montana, and South Dakota Departments of Economic Development; North Dakota Business and Industry Department

One of the world's largest motorcycle manufacturers, a Japanese firm, has a research and development facility in the district. This organization recently developed a new product, a powered water ski, which is now being manufactured and sold throughout the United States.

### *Monitoring Foreign Investment*

A handful of highly publicized foreign invest-

ments last year focused attention on the inadequacy of information about total foreign investment in this country. As a result, Congress passed the Foreign Investment Act of 1974, requiring the government to collect and maintain information about all types of foreign investment, a project currently involving many different United States government agencies.

The Department of Commerce has organized a new Office of Foreign Investment in the United States, charged with obtaining information on foreign direct as well as portfolio investment. The Treasury is conducting a survey on foreign portfolio investment in the United States during 1974. Foreign ownership of farmland is the subject of a joint project of the Departments of Agriculture and Commerce. The initial step in this research, the study of federal and state regulations on foreign ownership of farmland, was conducted at the University of Minnesota Law School, and the results were recently published by the Department of Agriculture.<sup>6</sup> Finally, for several years the Federal Reserve System has been collecting information on foreign ownership of banks in the United States.

To coordinate information gathered by these agencies, President Ford established the Committee on Foreign Investment in the United States on May 9 of this year. The committee has primary responsibility for "monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment." These efforts to collect better information on foreign investment will eventually make it possible to assess the contribution foreign investment makes to the economy of the United States and the Ninth Federal Reserve District.

*Kay J. Auerbach  
Nels C. Johnson*

## Appendix

Labor force, employment, and unemployment estimates in this article are conceptually comparable to national measures of labor force conditions and are computed according to the labor force concept which measures employment and unemployment on a residence basis. In the past, state and area employment data was on a work force basis which measured employment on place-of-work data. The procedures for estimating state and area employment and unemployment have been overhauled, and estimates for Minnesota and the Minneapolis-St. Paul metropolitan area are now tied to the "Current Population Survey" which is used to compute national measures of employment and unemployment. For further information see James R. Wetzel and Martin Ziegler, "Measuring Unemployment in States and Local Areas," MONTHLY LABOR REVIEW, Vol. 97, No. 6 (June 1974), pp. 40-46.

Based on the labor force concept, district employment was found to be higher and labor force size smaller than originally estimated. Consequently, the district unemployment rate is lower than originally computed. For example, in 1974 the district's unemployment rate under the labor force concept averaged 4.8 percent, as compared to 5.4 percent under the work force concept.

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### *The Recession's Impact on Labor Markets*

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Wetzel, James R., and Martin Ziegler, "Measuring Unemployment in States and Local Areas," MONTHLY LABOR REVIEW, Vol. 97, No. 6 (June 1974), pp. 40-46.

### *Foreign Investments in the Ninth District*

Morrison, Fred L., and Kenneth R. Krause. STATE AND FEDERAL LEGAL REGULATION OF ALIEN AND CORPORATE LAND OWNERSHIP AND FARM OPERATION. Agricultural Economic Report No. 284, Economic Research Service, U.S. Department of Agriculture. Washington, D.C.: U.S. Department of Agriculture, May 1975.

U.S. Department of Commerce. Bureau of International Commerce. FOREIGN DIRECT INVESTORS IN THE UNITED STATES. Washington, D.C.: U.S. Department of Commerce, October 1973.

<sup>6</sup>Fred L. Morrison and Kenneth R. Krause, STATE AND FEDERAL LEGAL REGULATION OF ALIEN AND CORPORATE LAND OWNERSHIP AND FARM OPERATION, Agricultural Economic Report No. 284, Economic Research Service, U.S. Department of Agriculture, Washington, D.C.: U.S. Department of Agriculture, May 1975.



## District Seasonal Borrowing in 1974

John Rosine

The seasonal borrowing privilege, introduced by the Federal Reserve System in the spring of 1973, provides many Ninth District banks an additional source of credit during seasonally recurring periods of funds shortages. In 1974, the first full year for the privilege, about one in ten Ninth District member banks borrowed under the privilege and the volume of outstanding seasonal lending by the Federal Reserve Bank of Minneapolis peaked at better than \$20 million.

However, the privilege could have been used far more than it actually was: more than half the district's member banks are "potentially qualified" for seasonal borrowing.<sup>1</sup> Why didn't these banks use the new source of funds? In order to answer this question and to search for clues to the future use of the privilege, the following discussion will examine characteristics of 1974's borrowing and nonborrowing banks. Before doing so, it will be helpful to first summarize the provisions of the seasonal borrowing privilege.

### What Is the Seasonal Borrowing Privilege?<sup>2</sup>

The intent of the privilege, as initiated in April 1973, is to provide a seasonal source of Federal Reserve credit to banks in regions which are highly dependent on a seasonal industry, such as agriculture or tourism. Banks in such areas often rely on the seasonal industry as their main source of deposits and their primary borrower. Deposit inflows at these banks thus frequently coincide with seasonal downturns in loan demand; that is, the banks receive the greatest amount of deposits at the end of the industry's "season," when the industry has little immediate need to borrow additional

funds. Consequently, funds are most available when loan demand is lowest and least available when loan demand is at a peak.

Since many of the banks experiencing this type of seasonality apparently have little access to national money markets, they typically hold large volumes of liquid funds in the off-season in anticipation of the next season's upswing in loan demand. Funds are often held in the form of United States government securities which can be sold easily as loan demand increases. The seasonal borrowing privilege—by providing a reliable alternative liquidity source—is intended to enable those banks to maintain lower levels of liquid funds and thereby provide more year-round lending to local nonseasonal industries.<sup>3</sup>

An amendment to the Federal Reserve System's Regulation A got the new privilege go-

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<sup>1</sup>A "potentially qualifying" bank is one that, based on information available to the Federal Reserve System, appears to be eligible for seasonal borrowing. Positive eligibility cannot be established until the bank actually applies to use the privilege.

<sup>2</sup>For a more detailed discussion of the design of the seasonal borrowing privilege, see the following reports: Emanuel Melichar, "Toward a Seasonal Borrowing Privilege: A Study of Intra-Year Fund Flows at Commercial Banks," REAPPRAISAL OF THE FEDERAL RESERVE DISCOUNT MECHANISM, Vol. 2, Washington, D.C.: Board of Governors of the Federal Reserve System, 1971-72, pp. 93-106; Emanuel Melichar, "Seasonal Discount Assistance at Rural Banks: Evaluation of a Federal Reserve Proposal," AGRICULTURAL FINANCE REVIEW, U.S. Department of Agriculture, Vol. 30 (July 1969), pp. 44-57.

<sup>3</sup>Some economists have seen alternative reasons for implementation of the seasonal borrowing privilege. E. J. Kane, for instance, suggests that the privilege was enacted to give small banks a greater incentive to retain membership in the Federal Reserve System. Edward J. Kane, "All for the Best: The Federal Reserve Board's 60th Annual Report," AMERICAN ECONOMIC REVIEW, Vol. LXIV, No. 6 (December 1974), pp. 835-850.

## Why seasonal borrowings?

Figure 1 At many banks, deposits fall at the same time that loans are rising, thereby reducing the reserve of loanable or investable funds.

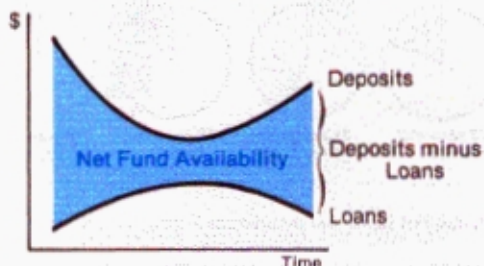


Figure 2 A bank's "seasonal needs" is the amount necessary to offset the decline in funds.

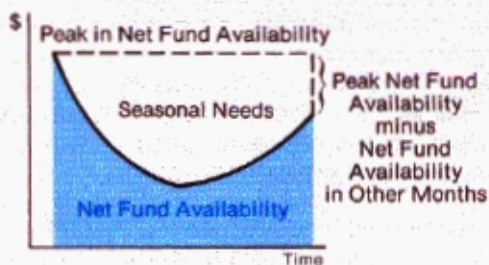


Figure 3 And part of the seasonal needs can be filled by seasonal borrowings.



Source: FRB Minneapolis

ing.<sup>4</sup> The amendment specified that a bank's eligibility for seasonal borrowing would be contingent on having a "seasonal need for funds" which persisted for at least eight consecutive weeks. The privilege would be available only to banks which lacked "reasonably reliable access to national money markets."<sup>5</sup>

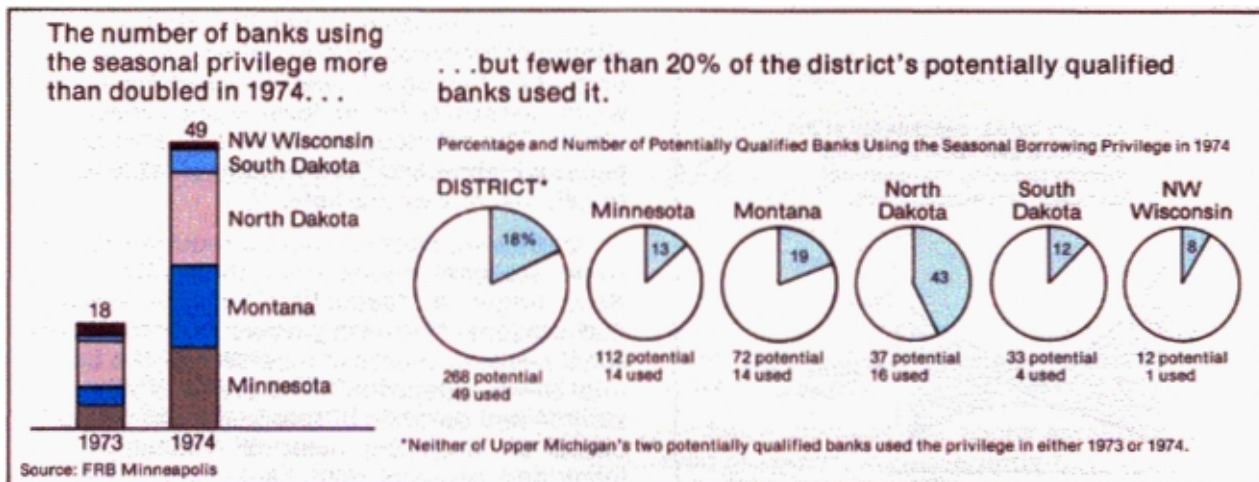
Borrowing banks would be required to meet some seasonal needs from their own funds. Accordingly, a "deductible" clause specified that seasonal borrowing would only cover seasonal needs in excess of 5 percent of the bank's total average deposits in the previous year. The volume and duration of seasonal loans would be based on historical seasonal fluctuations in loans and deposits, and banks would have to make advance arrangements for their seasonal credit needs.<sup>6</sup>

Concepts underlying the seasonal borrowing privilege can be illustrated graphically, as in Figures 1-3. Figure 1 shows loans and deposits at a hypothetical bank experiencing seasonality in its flows of loans and deposits. In this example, deposits decline from an initial peak level as customers draw down cash balances to pay for business expenses. Suppose that credit needs of the bank's customers increase at the same time. The difference between loans and deposits—defined as "net fund availabil-

<sup>4</sup>Board of Governors of the Federal Reserve System, ADVANCES AND DISCOUNTS BY FEDERAL RESERVE BANKS—REGULATION A, Washington, D.C.: Board of Governors of the Federal Reserve System, April 19, 1973, pp. 3-4.

<sup>5</sup>"Access to money markets" has been operationally defined as a size variable. For instance, Roland D. Graham, Senior Vice President of the Federal Reserve Bank of Minneapolis, while cautioning that size eligibility is determined "subjectively on an individual basis," writes in addition that "...most banks with deposits in excess of \$250 million can reasonably tap national money markets directly...while banks with deposits under \$100 million are under an apparent disability to do so." Banks in the \$100-250 million range are to be judged on their "actual capability...to raise funds...at reasonable rates." Roland D. Graham, "The Fed's New Seasonal Borrowing Privilege," COMMERCIAL WEST, Vol. 145, No. 28 (July 14, 1973), p. 8.

<sup>6</sup>Arranging for seasonal borrowing in advance is designed "to assist not only the borrowing member bank and lending Reserve Bank, but to help facilitate the Reserve System's efforts in carrying out monetary policy." Graham, p. 9.



ity"—first declines but later increases as cash receipts accrue to local farmers or business-people who use their new cash income to pay off loans or boost their own cash balances.

"Seasonal needs" are quantified as the variation in net fund availability relative to the peak in net fund availability. For instance, in Figure 2 the peak in net fund availability occurs at the beginning of the period. Seasonal needs are zero at that time but become positive thereafter. The bank could use seasonal borrowing to offset part of its seasonal decline in net fund availability, as in Figure 3.

#### Who Has Used the Privilege?

Nearly 50 district banks used the seasonal borrowing privilege in 1974, a substantial increase over 1973's total of only 18.<sup>7</sup> The district's volume of seasonal loans outstanding peaked in August 1974 at better than \$20 million. These totals may be misleading, though.

Fewer than one-fourth of the banks that potentially qualified for seasonal borrowing actually used the privilege. In the aggregate, the volume of borrowings amounted to only 2 percent of the total loans outstanding at all borrowing banks.

Why didn't other district banks use the privilege? For one thing, many banks for which

the seasonal borrowing privilege might be ideally suited are not members of the Federal Reserve System and so are not eligible for seasonal borrowing. Some of the large member banks in the Ninth District, having access to national money markets, do not qualify either. But a more complete understanding of the reasons why more potentially qualifying member banks did not use the privilege necessitates a closer look at the characteristics of borrowing banks and at economic conditions in 1974.

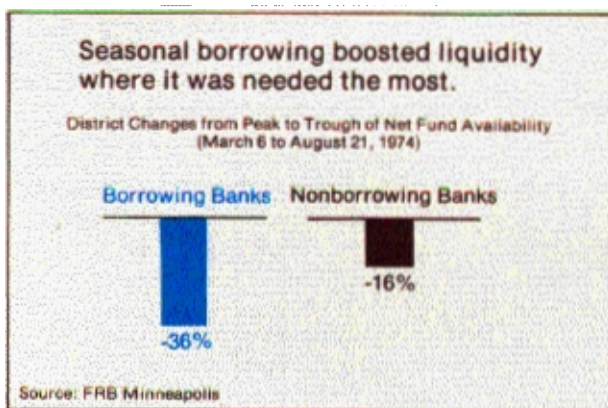
#### Were needs greater at borrowing banks?

Seasonal economic factors probably affect some banks more than others, and presumably, banks with the greatest seasonal needs would be most likely to use the seasonal borrowing privilege. Evidence suggests, in fact, that 1974's seasonal decline in net fund availability was sharper at borrowing banks than at banks

<sup>7</sup>The experience in the Ninth District corresponds to the experience in other agricultural districts and in the nation. For a review of the Kansas City and Dallas districts, see, respectively: Margaret E. Bedford, "The Seasonal Borrowing Privilege," MONTHLY REVIEW, Federal Reserve Bank of Kansas City, June 1974, pp. 10-16; and Carl G. Anderson, Jr., "Seasonal Borrowing Increases: Further Gains Seen for 1975," FARM AND RANCH BULLETIN, Federal Reserve Bank of Dallas, March 1975.

The national experience for 1973 is summarized in Emanuel Melichar and Harriet Holderness, "Seasonal Borrowing at the Federal Reserve Discount Window," AGRICULTURAL FINANCE REVIEW, U.S. Department of Agriculture, Vol. 35 (October 1974), pp. 42-51.





which might have qualified for but did not use the privilege.

In the aggregate, the decline in net fund availability from March 6 through August 21 (that is, from peak to trough) was 36 percent at borrowing banks, compared to 16 percent at nonborrowing banks. Over that period, non-borrowers' deposits grew slightly while borrowers' deposits slid nearly 4½ percent at borrowing banks; the rate of loan growth was about the same for the two groups of banks.

How did banks in each group offset their declines in net fund availability? They sold government securities. The peak-to-trough cut-

**Both borrowing and nonborrowing banks cut back their liquid assets in early 1974.**

U.S. Government Securities as a Percentage of Total Loans Outstanding on the Date of Peak Net Fund Availability at District Banks Potentially Qualified to Use the Seasonal Borrowing Privilege

	Borrowers	Nonborrowers
1970	25.36%	25.88%
1971	24.38	32.44
1972	32.56	29.77
1973	25.51	33.36
1974	18.95	20.04

Source: FRB Minneapolis

back in holdings of United States securities, expressed as a percentage of loans outstanding, was about the same for the two groups of banks and amounted to about a fourth of the total securities held on March 6, 1974.

As another offsetting measure, borrowing banks as a group borrowed in the federal funds market to a greater extent than nonborrowers.<sup>8</sup> Borrowers bought fed funds throughout most of 1974, while the nonborrowing group remained a seller of federal funds until late that summer.

On balance, the borrowing banks were less liquid in the summer of 1974 than were other potentially qualifying banks which did not borrow. It might therefore be argued that the seasonal borrowing privilege was indeed helping to boost liquidity where it was most needed (though it should also be noted that some of the borrowing banks had loan-to-deposit ratios of less than 50 percent at the time they were borrowing).

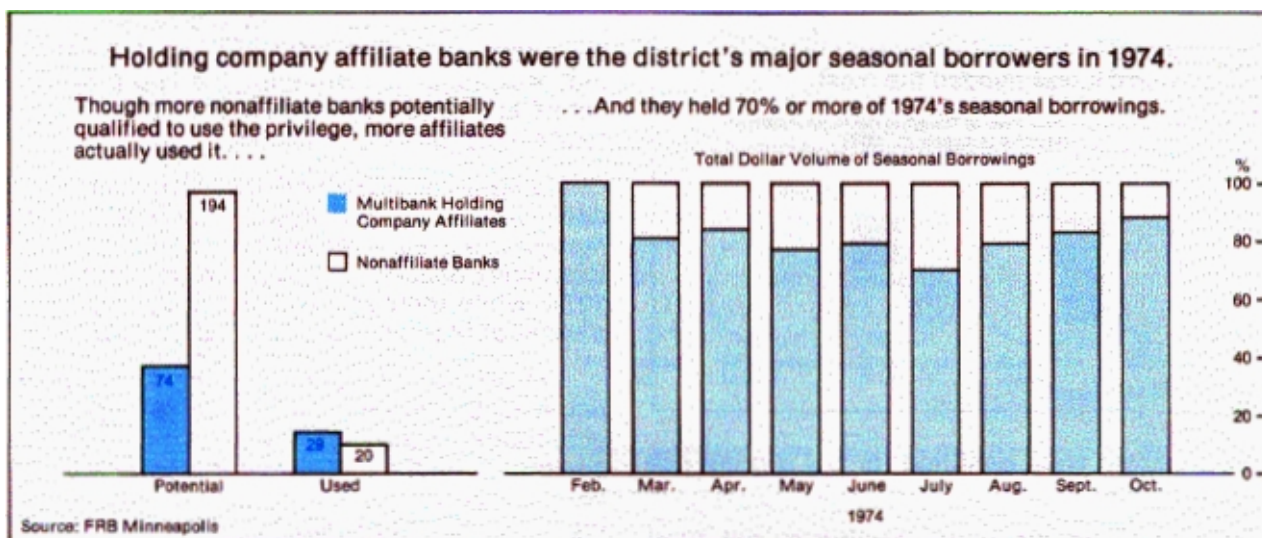
#### *Did bank structure make a difference?*

Regulation A emphasizes the small-bank nature of the seasonal borrowing privilege by limiting its use to banks which have no access to national money markets. Identifying banks without such access is not easy in practice, but small nonaffiliate banks in rural areas would seem to meet that requirement. Yet these banks were not the main users of seasonal borrowing in 1974.

Instead, the majority of Ninth District banks which used the seasonal borrowing privilege last year were multibank holding company affiliates which—it can be argued—have greater access to nonlocal sources of funds than do nonaffiliate banks. Among the affiliates, roughly 43 percent of the potentially eligible borrowers actually used the privilege; among other banks, only about 13 percent used it.

The total volume of borrowing by multibank holding company affiliates was better than two-

<sup>8</sup>Federal funds are interbank loans with one-day maturities.



thirds of total seasonal borrowing over nearly all of 1974. The greater incidence of borrowing by holding company affiliates may have been due to any of several factors: greater financial sophistication among affiliates, differing managerial practices, or greater promotion of seasonal borrowing by holding companies.

#### *Was strong farm loan demand a factor?*

Farming is a seasonal activity, and the probability that a bank will qualify for seasonal borrowing appears to increase as the bank is more involved in farm lending.<sup>9</sup> Farm loan demand in 1974 was quite strong because farm inputs cost more, merchant-dealer credit was tighter, and replanting and inventory financing needs were greater. Hence it might be argued that agriculturally oriented banks should have been quicker to use the seasonal borrowing privilege in 1974.

Again, what would seem obvious was not the case. Many district banks which borrowed in 1974 had less than 20 percent of their loans to farmers. And in the first half of 1974, when farm loan demand was apparently strong, many of the borrowing banks were cutting back on farm lending, both in relative and in absolute dollar amounts and relative to total lending.

(Still, farm lending by borrowing banks may have been greater than it would have been in the absence of a seasonal borrowing privilege.)

#### *How did credit conditions affect borrowing?*

It might be argued that high interest rates of 1974 together with usury ceilings in some Ninth District states tended to discourage banks from lending to seasonal industries such as farming. Interest rates on farm loans have typically been less variable than rates on commercial loans, and the high interest rates in the summer of 1974 may have caused somewhat of a shift away from seasonal lending.

On the other hand, the Federal Reserve discount rate through the summer of 1974 was less than the rate on fed funds, and there appeared to be ample loan opportunities in sectors other than farming or other seasonal industries. If anything, credit conditions in 1974 should have encouraged, rather than discouraged, the use of seasonal borrowing. Yet

<sup>9</sup>Virginia Timenes and Emanuel Melichar, "Seasonal Borrowing Privilege: A New Dimension in Administration of the Federal Reserve Discount Window," 1973 PROCEEDINGS OF THE AMERICAN STATISTICAL ASSOCIATION, Washington, D.C.: The American Statistical Association, 1974, p. 808.

many banks—even some which did not use the seasonal borrowing privilege—turned to the costly fed funds market in 1974 when they might have borrowed at a lower rate under the seasonal borrowing privilege.

*What other factors might have discouraged banks from using seasonal borrowing?*

Looking at the 1973 experience, Margaret Bedford of the Kansas City Federal Reserve Bank suggests that the low rate of seasonal borrowing may have been due to the late date at which the privilege was implemented, since by April of that year many banks had already arranged for alternative sources of credit.<sup>10</sup> Others have suggested that the 1974 experience was due to a failure by banks to anticipate the sharp upturn in loan demand which actually occurred that summer. Having failed to anticipate seasonal needs, banks had not applied in advance for seasonal borrowing, as they are required to do.

More specific to the Ninth District experience in 1974, a high proportion of potentially qualifying North Dakota banks used the seasonal borrowing privilege. This may have been partly because a law in that state restricted the

interest rate on deposits to levels no greater than 6 percent, thereby encouraging an outflow of funds and increasing the need for all types of borrowing by banks.

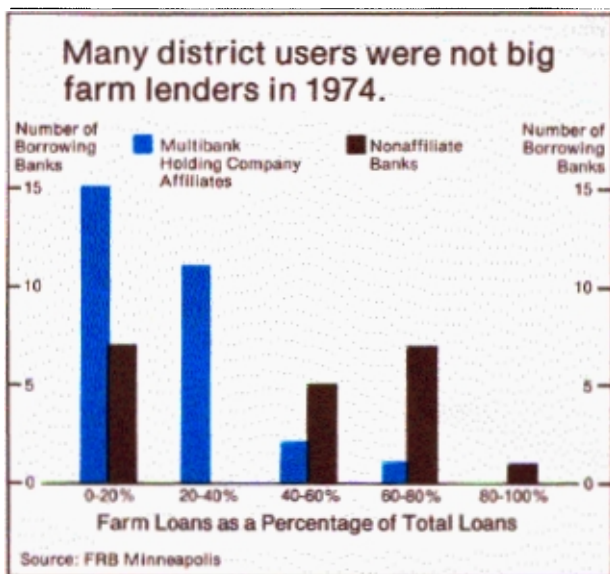
Finally, it might have been that many of the small banks which could have profited from using the seasonal borrowing privilege did not do so because of a general reluctance to be indebted or because of a reluctance to be indebted to the Federal Reserve System in particular.<sup>11</sup> Evidence to support or refute the "reluctance theory" is not available.

### Summary

Several features characterized the Ninth District's seasonal borrowing experience in 1974. First, borrowing banks appear to have been more hard-pressed for funds than other banks. Second, multibank holding company affiliates were quicker than nonaffiliates to use seasonal borrowing during 1974's credit crunch. Third, there is no indication that small, agriculturally oriented banks made substantial use of a privilege which seems to have been tailored for them; why they refrained from borrowing is still not clear.

Some banks did make good use of the seasonal borrowing privilege to supplement their liquidity over the summer of 1974. However, a bank's liquidity depends on a number of secular and cyclical influences as well as on recurring seasonal influences, and it is not certain that funds borrowed under the privilege were being used primarily to help meet the loan demand of a seasonal industry.

The purpose of the privilege is to supplement bank liquidity during times of seasonal pressure. Since it provides banks a reliable



<sup>10</sup>Bedford, p. 13.

<sup>11</sup>The "reluctance theory" insofar as it applies to the regular discount mechanism is discussed in Clay J. Anderson, "Evolution of the Role and the Functioning of the Discount Mechanism," REAPPRAISAL OF THE FEDERAL RESERVE DISCOUNT MECHANISM, Vol. 1, Washington, D.C.: Board of Governors of the Federal Reserve System, 1971-72, pp. 135-163.



**Lending increased at district borrowing banks in the first half of 1974.**

	Multibank Holding Co. Affiliates	Nonaffiliate Banks
<b>Percentage Change</b>		
December 31, 1973, to June 30, 1974		
Total Loans	9.6%	12.4%
Loans Secured by Farmland	0.0	19.7
Loans to Farmers	-4.0	11.3
Commercial Loans	20.7	29.7
Total Deposits	-0.9%	0.5%
<b>Loans as a Percentage of Deposits</b>		
December 31, 1973	64.7%	62.4%
June 30, 1974	71.5	69.9

Source: FRB Minneapolis

banks can employ the privilege to benefit their communities''<sup>12</sup> and that only after a time lag of several years will the use of the seasonal borrowing privilege reach its full potential.

source of seasonal liquidity, it was hoped that qualifying banks would cut back their seasonal holdings of liquid securities and would instead use funds to boost loan volume in their local communities. Is the privilege accomplishing this purpose?

It is perhaps too soon to tell. Among borrowing banks in 1974, loans did increase while government securities declined. But the same was true among nonborrowing banks, indicating that it may have been general business conditions, rather than the seasonal borrowing privilege, which caused portfolio adjustments at borrowing banks. If the use of seasonal borrowing correlates with general business conditions, then it follows that at least some banks will rely on the privilege in the future when less costly funds are not available elsewhere. And conversely, when alternative sources of funds are available at lower rates, seasonal borrowing may not be widely used.

On the other hand, the seasonal borrowing privilege is only two years old, and many banks are perhaps not yet familiar with its use. It may be that, as Melichar and Holderness at the Fed's Board of Governors write, "...a patient and persistent effort [by Federal Reserve Banks] will be required to demonstrate that

<sup>12</sup>Melichar and Holderness, p. 50.

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