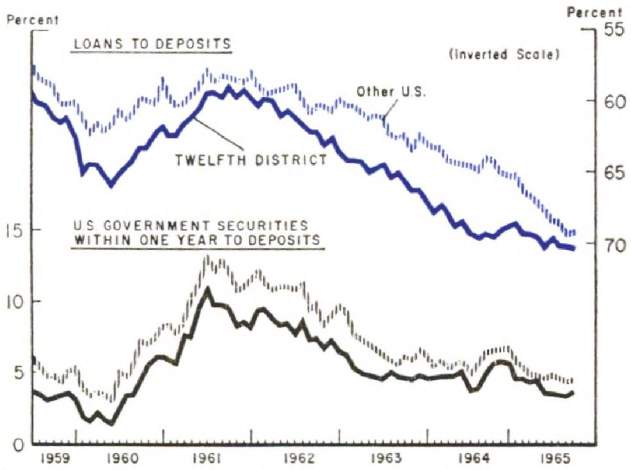
Lending: Some Tightness

WESTERN FINANCIAL activity remained strong in the third quarter, despite a slowdown in bank-loan expansion, and bank reserve and liquidity positions stayed relatively tight. Total member-bank credit increased by $476 million (seasonally adjusted)—far above the second-quarter gain, but only one-third of the size of the substantial first-quarter increase. But the bank-earnings picture looked happier than it did earlier in the year, which suggests that banks have made progress in overcoming the cost handicap created by the higher rates paid this year on time and savings deposits.

Tightening reserve pressure was increasingly evident in the third quarter, as net borrowed reserves of District member banks edged up to $38 million. Average daily required reserves increased $20 million during the quarter; excess reserves also rose slightly, but daily average borrowings increased from $63 to $70 million. In addition, District banks borrowed more heavily in the Federal funds market. Between the second and third quarters, they increased their net purchases of Federal funds from other banks from $86 to $122 million (daily average basis), and they also reduced their net sales to securities dealers.

Liquidity positions tighten further during July-September period



Source: Federal Reserve Board; Federal Reserve Bank of San Francisco

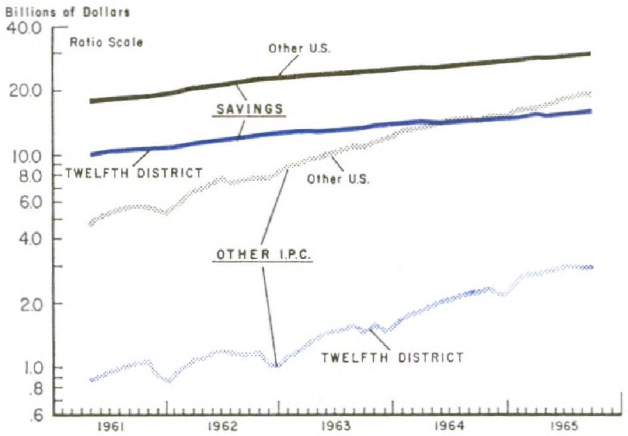
Liquidity and municipals

Despite the relative slowdown in the pace of loan expansion, District-bank liquidity positions tightened during the summer quarter. The loan-deposit ratio, an inverse measure of bank liquidity, rose to a postwar peak of 71 percent in September. Moreover, the ratio of short-term Government securities to deposits dropped from 4 to 3½ percent during the quarter. But this ratio may understate the liquidity of District banks, to the extent that they have increased their holdings of short-term municipal securities. And both liquidity ratios ignore the fact that District banks hold only a relatively small proportion of their total deposits in the volatile form of time certificates of deposit.

While member banks were increasing their loans by $348 million, they were expanding their security holdings by $128 million (seasonally adjusted). Municipal and Federal Agency portfolios continued to increase, as part of the effort by banks to raise operating revenues and thereby offset the higher costs resulting from increased rates paid on time deposits. Actually, the rate of expansion of such securities slowed during the quarter, but the gain for the year to date amounted to 26 percent. Banks meanwhile continued to reduce their U. S. Government security holdings, but by a relatively small amount ($116 million) which reflected the slowdown in the rate of loan expansion.

District member banks recorded mixed trends in deposits during the July-September period. Demand deposits adjusted dropped $103 million (seasonally adjusted), reversing the first-half pattern, and U. S. Government deposits dropped even more in response to

Pace of expansion accelerates in time and savings deposits



Note: Other I.P.C. includes time deposits of individuals, partnerships, and corporations, other than savings.
Source: Federal Reserve Board; Federal Reserve Bank of San Francisco

unusually heavy calls on Treasury tax-and-loan accounts. But the pace of expansion accelerated in time and savings deposits, as a heavy savings inflow contributed to a $592-million increase in the overall category. On the other hand, time certificates of deposit declined during the quarter, as new CD's issued during this period failed to offset those maturing around the September 15 tax date. The largest District banks showed relatively little interest in bidding for large-denomination CD's, partly because the New York money market banks offered increasingly higher rates for such deposits, particularly in the latter part of September.

Heavy business borrowing

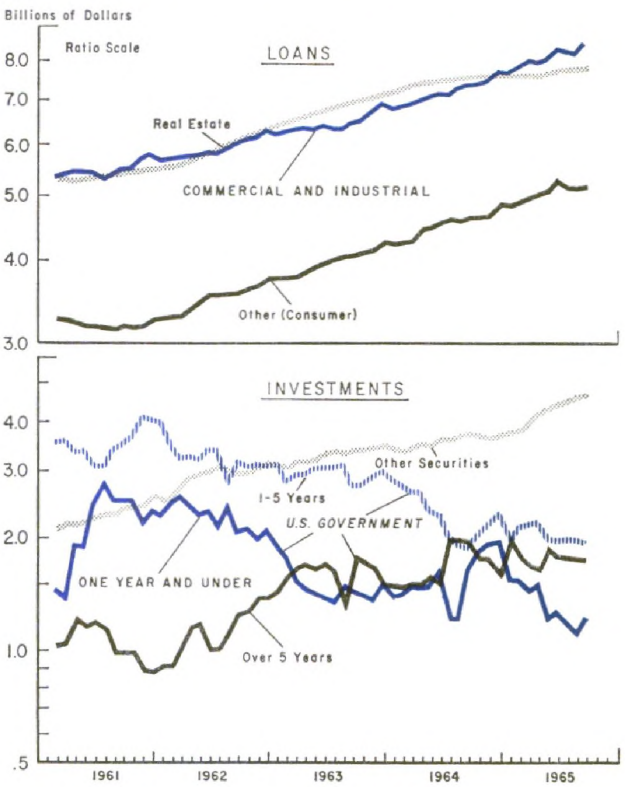
In the loan sector, data supplied by weekly reporting member banks emphasized the importance of business borrowing in the recent bank-credit expansion. (This series, although not seasonally adjusted, is much more detailed and more current than the monthly member-bank series.) Business loans at District weekly reporting banks were up a strong $139 million during the quarter, as most categories showed heavy increases in borrowing. Even so, the Western banks' 1.7-percent quarterly gain lagged behind the 2.9-percent gain recorded elsewhere.

In durable manufacturing, machinery manufacturers recorded a substantial rise in borrowing; in the nondurable field, food-liquor-tobacco processors matched their year-ago pace with a strong seasonal gain. Petroleum processors continued to display a strong demand for credit: this industry is now financing substantial capital expenditures, and it also requires additional operating funds because of sharp increases in military purchases of fuel for aircraft and cargo vessels. District banks during the quarter increased their advances to construction firms (unlike last summer) and conversely reduced their holdings of bankers acceptances (also unlike a year ago).

Higher interest costs

The cost of business loans edged upward during the quarter. In the first half of Sep-

Western banks expand holdings of business loans and other securities



Source: Federal Reserve Bank of San Francisco

SELECTED BALANCE SHEET ITEMS OF WEEKLY REPORTING MEMBER BANKS IN LEADING CITIES

(dollar amounts in millions)

	Twelfth District				U. S. Minus Twelfth District		
		Net Change				Net Change	
	Outstanding 9/29/65	Third Quarter 1965 Dollars	Third Quarter 1965 Percent	3rd Qtr. 1964 Percent	Outstanding 9/29/65	3rd Qtr. 1965 Percent	3rd Qtr. 1964 Percent
ASSETS							
Loans adjusted and investments	$33,794	+363	+1.09	+ 2.38	$124,983	— 0.02	+2.17
Loans adjusted	24,321	+234	+0.97	+ 2.73	87,433	+ 0.68	+1.57
Commercial and industrial loans	8,293	+139	+1.70	+ 0.92	39,824	+ 2.93	+3.48
Real estate loans	7,829	+117	+1.52	+ 1.09	14,183	+ 5.55	+4.49
Agricultural loans	1,046	— 2	—0.19	+ 2.18	577	+ 3.40	—1.96
Loans to nonbank financial institutions	1,663	+ 29	+1.77	+ 2.62	8,491	+ 3.59	—4.93
Loans for purchasing & carrying securities	392	— 43	—9.89	+97.83	5,061	—27.52	—7.15
Loans to foreign banks	311	— 9	—2.81	— 6.54	1,244	— 1.03	—9.12
Other loans (mainly consumer)	5,197	+ 7	+0.13	+ 1.16	19,943	+ 1.66	+2.04
Total securities	9,473	+129	+1.38	+ 1.53	37,550	— 1.61	+2.64
U. S. Government securities	4,799	— 81	—1.66	+ 0.45	18,031	— 6.93	+2.65
Other securities	4,674	+210	+4.70	+ 3.14	19,519	+ 3.86	+4.23
LIABILITIES							
Demand deposits adjusted	12,316	+101	+0.83	+ 1.99	51,817	+ 0.44	+1.64
Total time and savings deposits	20,318	+350	+1.75	+ 1.52	55,958	+ 3.92	+2.95
Savings	14,868	+410	+2.84	+ 2.32	29,451	+ 2.73	+2.05
Other time	2,731	+ 2	+0.07	+ 6.34	18,272	+ 5.00	+2.62

tember, leading metropolitan District banks charged an average rate of 5.19 percent—14 basis points above the June average—on short-term business loans. But this third-quarter increase made up for only about half of the decline in rates which occurred between last September and this June.

District banks, like those elsewhere, adopted a more selective lending approach in recent months, making the 4½-percent prime rate applicable on a declining proportion of their business-loan volume (45 percent in September vs. 57 percent in June). Banks raised their rates for practically every loan-size category, but the higher rates charged on the largest category ($1 million and over) accounted for the major part of the increase in the overall average rate.

District banks during recent months also granted more long-term loans—those with maturities of over one year. The number of new long-term loans accounted for 3.3 percent of all loans in the September survey—the highest proportion since data of this type were first collected five years ago. But rates on new long-term loans moved up 17 basis points during the quarter, to 5.42 percent.

Bank lending to consumers apparently dropped behind the hot first-half pace during the summer quarter, but this slackening may be only apparent. The quarterly increase probably would have been greater than the reported gain if adjustments had been made for the timing of auto model changeovers. But even so, auto financing continued as a major source of bank-credit demand during the summer period.

Ample mortgage money

The Western mortgage market remained amply supplied with funds as the demand for mortgages slackened during recent months. But there was little evidence of any substantial surplus of funds, so borrowing conditions and terms remained relatively stable during this period.

The savings inflow continued stronger at the banks than at the S & L's—roughly a 2.8-

percent quarterly gain in savings deposits of weekly reporting banks versus a 2-percent gain in savings balances of Federally insured associations. Some associations have offset their slower savings growth with increased borrowings from Federal Home Loan Banks, but the increased costs of such borrowing and the Home Loan Bank Board's continued admonitions advising restraint should tend to reduce the flow of funds from that source.

In view of the continued existence of excess housing in many Western communities, lenders have continued to expand their mortgage portfolios rather modestly. District weekly reporting banks recorded a $117-million gain in mortgage holdings during the summer quarter, and S & L's increased their holdings by $474 million. (Banks actually stepped up their mortgage-lending pace during this period, but detailed first-half data suggest that they are interested at least as much in commercial-industrial mortgages as they are in residential.) During this quarter, too, foreclosure rates declined and interest rates moved sideways, but rates later tended to stiffen somewhat. —*Ruth Wilson*