tary and civilian demand. Future capacity requirements also gained attention, as the start-up of a 76,000-ton potline at Bellingham launched a new primary producer into the industry.

Western copper producers expanded output during the quarter to help meet the severe copper shortage, and the Administration also worked to this end by releasing 100,000 tons of stockpile metal. Nonetheless, pressures on the domestic producers' price, currently 36 cents a pound, intensified when Chile raised its export price from 62 to 70 cents a pound, in a move designed to bring Chilean quotes into line with prices charged by Zambian and Congo producers. But the foreign supply situation—and prices—began to ease by mid-August. —*Regional Staff*

Regional Exuberance

THE Western financial scene was eventful, to put it mildly, in the spring and early summer months. Amid a national environment of increasing monetary pressures, rising interest rates, and intensified competition for deposits, Twelfth District weekly reporting banks expanded their security holdings by more than $400 million—and their loans by close to $1 billion—during the April-June quarter. Moreover, they increased their total deposits by $835 million during this period (daily average basis), even in the face of April's record monthly decline in private time deposits. But more surprisingly, District banks had a $6-million net *free* reserve position, while in contrast, banks elsewhere recorded net *borrowed* reserves of $330 million (daily average basis).

Under the impact of extremely heavy business credit demands, regional lending activity accelerated; District bank loans increased almost 4 percent in the second quarter on the heels of a 1-percent first-quarter gain. And in practically all categories, the lending pace in both quarters was above the strong 1965 pace.

On the factory floor

In the first half of 1966, durable-goods manufacturers borrowed at twice their year-ago pace, and thereby accounted for the largest part of the overall gain in business loans. In particular, borrowing was very substantial in the transportation equipment, fabricated metals, and machinery categories, because of heavy defense demand in those industries.

Nondurable-goods manufacturers also increased their borrowings; food processors recorded an unseasonally small second-quarter loan decline, and petroleum processors meanwhile expanded their borrowings heavily. (The oil industry has now increased its outstanding bank debt by two-thirds over the past year.) The miscellaneous category, which includes mostly service firms, also recorded a sharp expansion during the quarter.

In the face of these strong credit demands as well as the rising cost of bank funds, business-loan rates moved to a postwar peak during the quarter. In early June, District metropolitan banks charged an average rate on short-term loans of 5.89 percent—84 basis points above the year-ago level and 27 basis points above the earlier (June 1960) peak. The June survey reflected the two earlier (December and March) increases in the rate charged to prime business borrowers. However, that survey preceded the late-June and mid-August hikes in the prime rate, so if another survey were made today it would undoubtedly show an even higher level of rates.

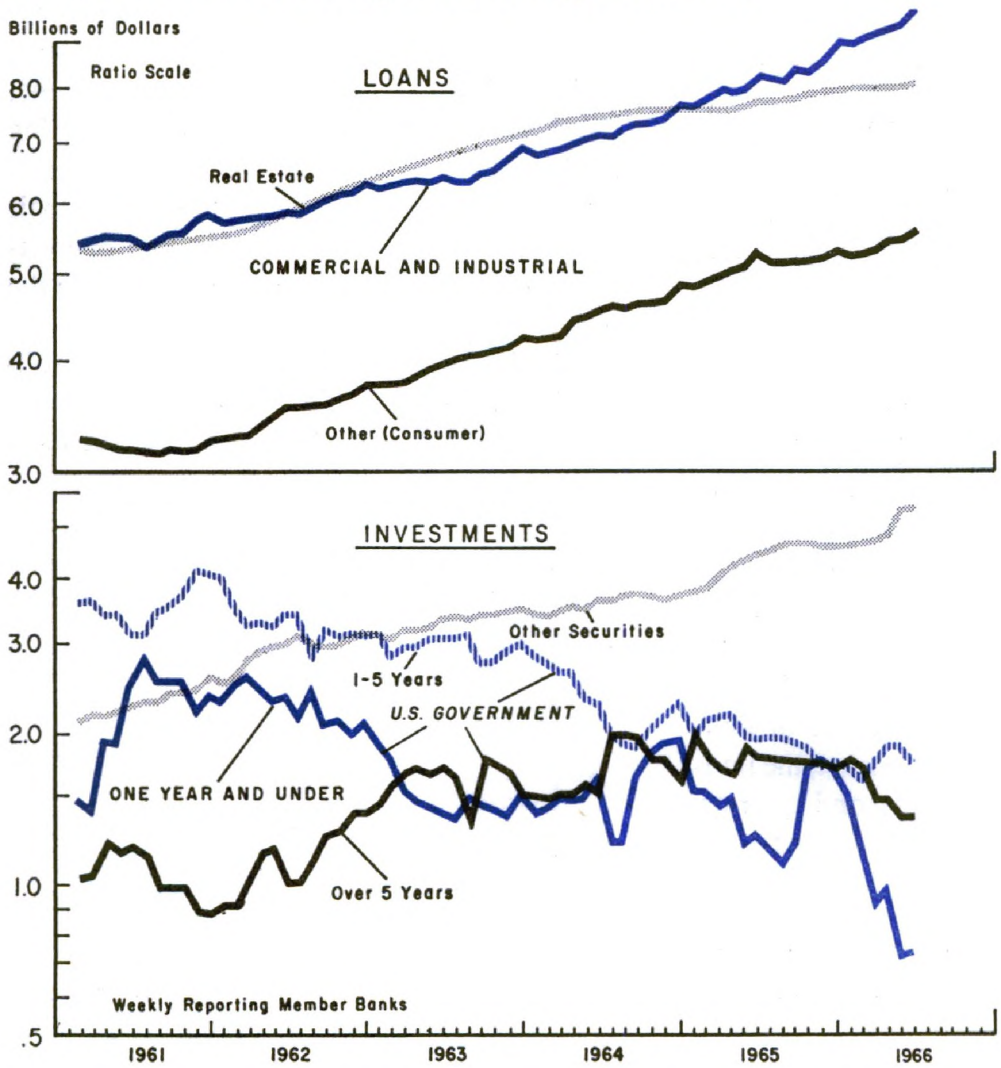
Although the business sector dominated the credit picture, other bank-lending activities also expanded during the spring quarter. Mortgage loans increased more rapidly than in the year-ago period, and ten times more rapidly than in the first quarter of 1966. Consumer loans also outpaced the rather nominal first-quarter gain, in part because individuals needed funds to meet their April income-tax payments.

Meanwhile, District weekly reporting banks expanded their total security portfolios even while increasing their loans. But this increase was due entirely to continued heavy purchases of municipals and Federal-agency issues; banks continued to reduce their holdings of governments, although to a smaller degree than earlier in the year.

At the teller's window

Yet, despite all these events on the asset side, the most dramatic developments continued to unfold in the deposit sector. At the beginning of the spring quarter, many large banks (particularly in California) began to offer higher rates to individual savers on deposits held in the form of savings certificates and similar instruments. Many of these banks soon found their interest costs rising 25 percent for the same funds, since the immediate impact of the new rate offer was a massive shift of deposits out of passbook savings (with a 4-percent maximum permissible rate) into time certificates (with new rates of 5 percent or more).

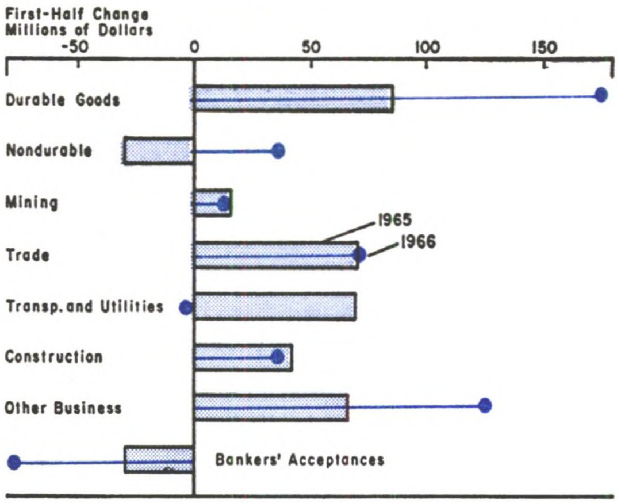
Banks accelerate lending pace, especially in business loans, but continue selling short-term governments



In April, District banks suffered a substantial decline in passbook savings, because of the higher rates available on certificates but also because of the normal seasonal withdrawals for income-tax purposes. In May and June, banks continued to lose passbook-savings funds, but (unlike April) they recorded offsetting gains on other time certificates of individuals, partnerships, and corporations.

District banks were especially ef-

Durable-goods firms borrow
at twice year-ago pace



fective in expanding their issuance of large-denomination ($100,000 and over) time certificates of deposit. At midyear they had $2.1 billion in outstanding CD's—exceeding Chicago-area banks for the first time, and holding second place only to New York banks, which tend to dominate the CD market. Moreover, District banks exhibited a much smoother maturity pattern than other banks, which suffered substantial runoffs over the June dividend and corporate-tax dates.

Tighter or easier?

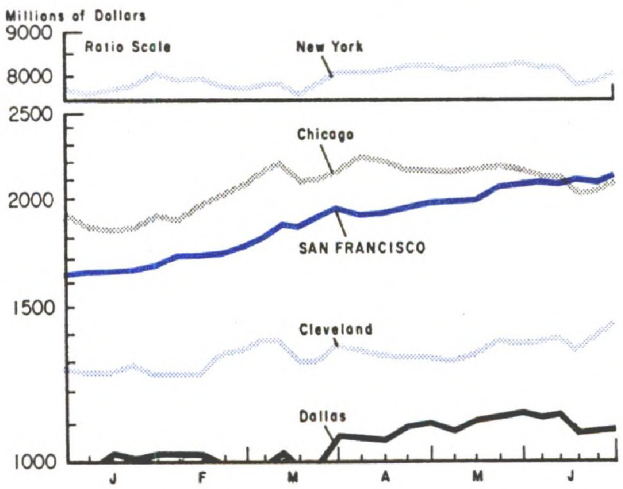
Despite the strength of credit demands and the tightening of monetary policy, regional banks paradoxically maintained an easier reserve position in the April-June period than in the preceding quarter. In the first quarter, District member banks were net borrowers of funds at the Federal Reserve discount window, and were also net borrowers of funds from other banks through purchases of Federal funds (reserves held on deposit at the Federal Reserve Bank). In the second quarter, District banks shifted to a free-reserve position, as their excess reserves exceeded their borrowings from the Federal Reserve by $6 million (daily-average basis), and major District banks also became net lenders to other banks through sales of Fed funds.

This easier reserve position, in the face of a much tighter position elsewhere, can be explained by the much stronger deposit inflow at District banks. These banks increased their total deposits by $835 million during the quarter (daily average basis); they thus accounted for almost one-fourth of the nation's quarterly gain in deposits, although they normally hold only one-sixth of the national total. After securing large amounts of business-type time deposits in the first quarter, District banks benefited from a substantial inflow of consumer-type time-deposit funds in May and June. In addition, these banks recorded a small increase in demand deposits in the second quarter, at a time when banks elsewhere were losing $400 million in such deposits.

But the figures on bank reserve positions were only part of the story, since other measures pointed to increasingly severe strains on bank liquidity. Between January and June, the loan-deposit ratio of weekly reporting banks rose from 71 to 73 percent—the tightest figure since the 1920's. Meanwhile, their ratio of short-term governments to deposits dropped from 4.7 to 2.1 percent—close to the tight-money low reached five years ago.

District banks also face a liquidity problem by virtue of holding substantial amounts of time deposits of state-local governments—

West second only to New York
in issuing large-denomination CD's



in fact, about one-fourth of the U. S. total. Most District states require 110 percent collateral for such deposits in the form of specified types of securities. And with the higher amount of such deposits outstanding this year, this requirement immobilizes from $2.2 to $2.6 billion in securities, and thus precludes those securities from being used for other collateral purposes or from being liquidated for loan-expansion purposes.

For all these reasons, and now for other reasons as well, banks will find their elbow room somewhat limited in coming months. The new change requiring 6-percent reserves on non-passbook time deposits (in excess of $5 million) will affect District banks more than other banks because they hold a relatively large volume of such deposits—about one-fifth of the national total. The new change decreasing the effective rate on "multiple maturity" time deposits will weaken banks' competitive position vis-a-vis savings-and-loan associations and other investment outlets, which are now offering rates higher than the time-deposit ceilings. So the banks, faced with a liquidity squeeze, rising costs of acquiring funds, and prospective losses on securities sales—and now faced also with higher reserve requirements and lower ceilings on rates they are permitted to pay for funds—will find it difficult to maintain the high profit margins which showed up in their early-1966 reports.

No mortgage money?

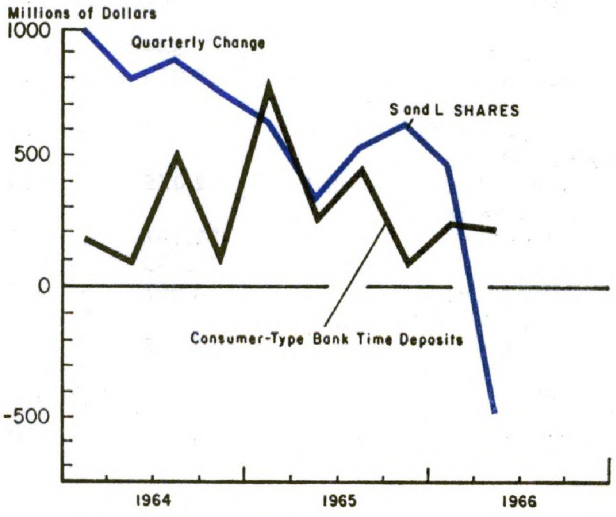
Even so, the problems of the banks continue to be eclipsed by the problems of the S&L's. In the spring quarter, District associations were forced to contend with a reversal of their normal savings inflow; in fact, in the April-May period their withdrawals exceeded their deposits by a whopping $578 million.

The outflow of funds admittedly was small in relation to the associations' total deposits of $26 billion, but it severely affected the Western mortgage market, since the S&L's savings inflow normally represents a large part of the funds available for new mortgage loans. Moreover, several other important sources of funds for the regional housing market also tended to dry up during the quarter; S&L mortgage-loan repayments declined, and their mortgage participation sales to associations elsewhere diminished to a trickle.

The industry consequently took in its belt during the spring and summer months. A number of California associations declared a moratorium on new loans, and most associations throughout the District tightened their lending policies. Loans closed during the April-May period dropped to $777 million—more than one-third below the year-ago pace—and the backlog of loan commitments contracted by almost one-half, and thereby led to gloomy predictions concerning future loan volume.

In an effort to retain savings, associations began to offer higher rates for deposits in late June and early July. The new rates generally ranged between 5 and 5½ percent—the most common being 5¼ percent—and many associations offered an extra ½ percent on three-year maturity plans. As a consequence, the July savings outflow was less than predicted, and was considerably less than the outflow experienced elsewhere.

S&L's contend with reversal
of normal savings inflow



In view of all these developments, mortgage funds became both increasingly scarce and increasingly expensive in recent months. Interest rates on conventional mortgages reached 6.80-6.90 percent in July, in contrast to the 6.10-6.15 percent rate prevailing in the District until last fall. Moreover, discounting of government-backed mortgages continued to grow, even though the Federal Housing Administration and the Veterans Administration raised their rates to 5.75 percent early in April in an attempt to restore the traditional relationship of government-backed rates to conventional rates.

With limited funds available for its market-support operations, the Federal National Mortgage Association reduced its purchases of government-backed mortgages during the second quarter. FNMA purchases in the Western region declined from $98 million in March to $64 million in May. And by limiting its purchases of mortgages to those of $15,000 or less, the agency severely limited its role in the Western market, since few mortgages on new homes meet that criterion in this region. So all in all, Western mortgage financing promised to continue in the doldrums for some time to come.

—Ruth Wilson and John Booth

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 6/29/66	Second Quarter 1966 Dollars	Second Quarter 1966 Percent	First Quarter 1966 Percent	Outstanding 6/29/66	Second Quarter 1966 Percent	First Quarter 1966 Percent
ASSETS							
Loans adjusted and investments[1]	$35,485	+1,410	+ 4.14	— 1.94	$134,194	+ 3.56	— 0.86
Loans adjusted[1]	26,261	+ 982	+ 3.88	+ 0.83	98,305	+ 5.56	+ 1.13
Commercial and Industrial loans	9,521	+ 475	+ 5.25	+ 2.42	46,271	+ 6.14	+ 4.30
Real estate loans	8,096	+ 152	+ 1.91	+ 0.20	15,420	+ 3.33	+ 2.12
Agricultural loans	1,071	+ 43	+ 4.18	— 2.74	604	— 2.58	— 2.52
Loans to non-bank financial institutions	1,721	+ 78	+ 4.75	— 2.78	9,913	+10.45	— 2.74
Loans for purchasing and carrying securities	497	+ 26	+ 5.52	+25.94	6,271	+12.71	— 7.97
Loans to foreign banks	253	— 19	— 6.99	— 5.88	1,252	— 2.11	— 3.62
Other loans (mainly consumer)	5,549	+ 231	+ 4.34	+ 0.21	20,728	+ 1.86	+ 0.06
Total securities	9,224	+ 428	+ 4.87	— 9.11	35,889	— 1.56	— 5.61
U.S. Government securities	3,835	— 253	— 6.19	—19.19	16,440	— 5.44	— 9.41
Other securities	5,389	+ 681	+14.46	+ 1.93	19,449	+ 1.99	— 1.84
LIABILITIES							
Demand deposits adjusted	12,075	— 399	— 3.20	— 3.48	53,086	— 1.36	— 5.19
Total time and savings deposits	22,047	+ 812	+ 3.82	+ 1.53	60,819	+ 1.76	+ 4.22
Savings	14,043	— 911	— 6.09	— 0.72	29,061	— 3.63	— 0.47
Other time, I.P.C.	4,907	+1,479	+43.14	+23.62	22,607	+ 9.04	+12.16
(Neg. CD's $100,000 and over)	2,125	+ 194	+10.05	+19.42	15,618	+ 2.33	+ 5.40

[1]Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross.
Note: Quarterly changes are computed from December 29, 1965 - March 30, 1966 and from March 30, 1966 - June 29, 1966.
Source: Board of Governors of the Federal Reserve System; Federal Reserve Bank of San Francisco.