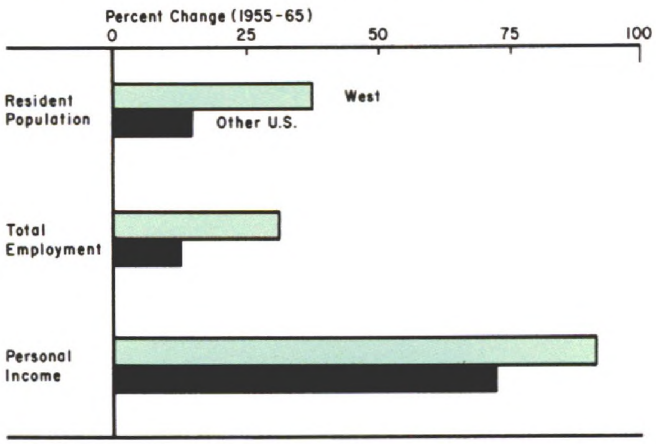
Changing Loan Profile

IN 1966, as business loans soared and mortgage funds dwindled, the allocation of bank credit among the various sectors of the economy became a subject of widespread interest. But to gain perspective on these recent shifts in credit flows, the longer-run trends in bank loan portfolios should also be examined. Such an analysis is particularly relevant for Western banks in view of their very rapid growth in the preceding decade — growth which sharply enhanced their position nationally as suppliers of bank credit.

What were the major factors affecting bank-credit growth and loanable-funds allocation in the West during the 1955-65 period? Obviously, banks in Twelfth District states, like their counterparts in other sections of the country, were influenced in their lending policies by recessions and expansions and by the attendant shifts in monetary and fiscal policies — including, in recent years, actions related to the nation's unfavorable balance-of-payments position. Structural changes in deposit composition also played a significant role in shaping bank lending policies. In addition, competition intensified from a wide range of fast-growing nonbank financial institutions — particularly in the fields of real-estate and consumer loans.

Major economic indicators rise more sharply in West than elsewhere



Shift toward the West

But over and above these factors, Western banks faced credit demands stemming from a high rate of population growth, mainly due to net in-migration; a large expansion in employment; and a sharp rise in personal income. For the decade as a whole, these measures of economic activity in the nine states of the District rose at a faster rate than in the rest of the nation — a reflection of the accelerated industrialization then taking place in the West.

As the decade progressed, the annual rate of increase of the civilian population gradually slowed — from 4.1 percent in 1955 to 2.6 percent in 1965 — but still, in each year, the gain for the Western states exceeded the annual growth rate in the rest of the nation. Moreover, total employment grew more rapidly in the West than elsewhere in every year of the decade, and personal income increased at a faster pace in every year except 1965. Thus, for the period as a whole, population increased 37 percent in the West and only 15 percent elsewhere, while employment rose by 31 as against 12 percent, and income by 92 as against 72 percent.

Not surprisingly, then, insured commercial banks in District states exhibited a faster rate of growth in total loans over the decade than did their counterparts in the rest of the nation — 171 vs. 144 percent, respectively. However, the faster lending pace at Western banks was accompanied by wider year-to-year fluctuations, particularly around cyclical turning points. Nevertheless, the annual June-to-June percentage increase in total loans (less loans to banks) fell below the gain recorded else-

where in only three years — 1958, 1961, and 1965.

For one very significant category, business loans, 1965 was the only year in which District banks failed to exceed the national rate of gain. The pace of consumer lending was faster than in the rest of the nation in all but three years (1957, 1961, and 1965). On the other hand, Western banks failed to match the national pace in mortgage financing in seven of the ten years under review.

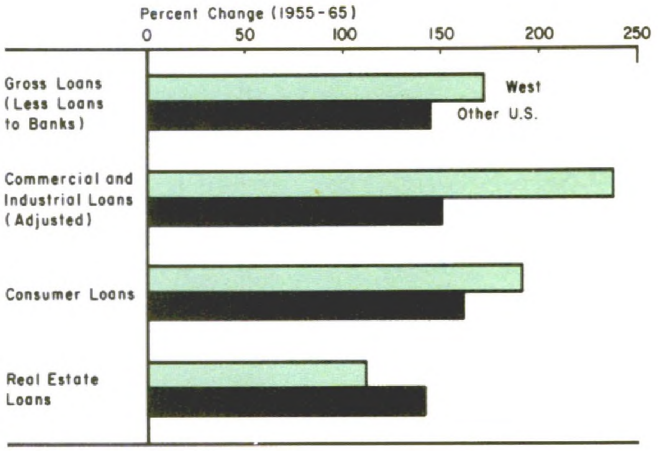
Before the effects of this rapid loan expansion on the composition of bank loan portfolios are examined, it should be noted that the structure of loan portfolios traditionally changes rather slowly over time. The magnitude of outstanding loans at commercial banks is so large that any reallocation of funds must be relatively great to bring about a significant percentage change in any single loan category's share of total outstandings. Most real-estate loans, for instance, have relatively long maturities and — except when they are sold out of portfolio to institutional investors — continue to be carried in banks' portfolios for many years.

In addition, at any given point in time, banks' freedom to allocate their loan funds among categories of borrowers is restricted by past commitments. Business lending, for example, is sometimes subject to lines of credit negotiated at earlier dates, while revolving credit agreements and other forms of loan arrangements also deprive bankers of some of their autonomy over the timing of loans. Other customer relationships, as well, tend to inhibit banks from making abrupt or large shifts from their existing pattern of loan allocation.

Shift toward business loans

Notwithstanding these limiting factors, heavy demand for bank credit from the burgeoning industrial and commercial sector brought about a marked shift in Western

Faster loan growth in West reflects faster economic gains



bank loan portfolios in the 1955-65 period. Banks normally give business loans a high priority for available loan funds because of such collateral benefits as compensating balances and service fees, even though the rate of return per se may be less favorable on business loans than on other types of loans.

During this period of strong business demand for credit, then, Western banks channelled an increasing proportion of their loanable funds into financing the plant-equipment expenditures and the larger inventories needed to meet the demands of a rapidly expanding economy. As a result, business loans at insured commercial banks in the nine Western states more than tripled in dollar volume from June 1955 to June 1965.

How did this expansion of business credit affect the composition of loan portfolios? In June 1955, commercial-industrial loans constituted 30 percent of Western bank loan portfolios; by June 1965, they made up 37 percent of the total. (The latter figure is adjusted to include some loans to nonbank financial institutions which prior to 1959 were classified in the commercial-industrial loan category.) In contrast, the business-loan share at banks in the rest of the nation increased only one percentage point, from 40 to 41 percent, over the same period.

The rise in the business-loan share at District banks was not constant over the decade, but in the two recessions of the decade, the secular trend was strong enough to offset most if not all of the normal cyclical weakness. The sharpest rise in the business-loan share occurred between mid-1955 and the 1957-58 recession. Then, except for seasonal increases each December, the proportion declined very slightly until the 1959 cyclical expansion. The 1960-61 recession again brought a leveling off (but no decline) which continued until the sharp upturn in 1965.

Shifting pattern?

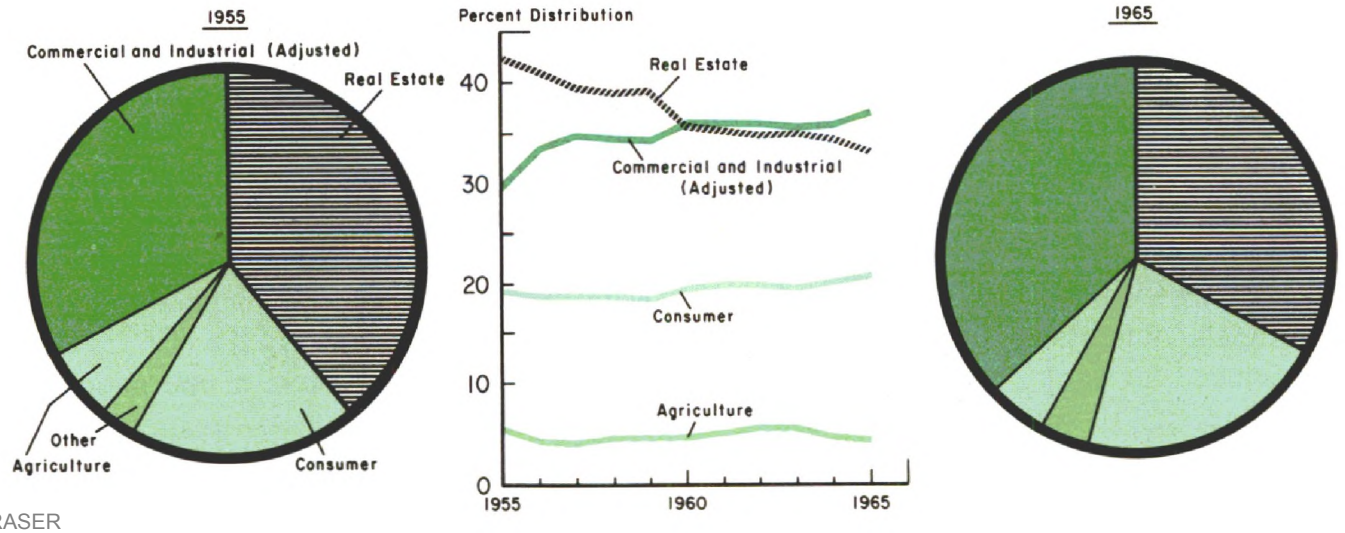
Over the decade, then, Western banks allocated larger amounts of credit to business borrowers, both in absolute terms and relative to other types of borrowers. In 1965 and 1966, these banks continued to divert a higher percentage of their loan funds to business, but, for the first time in ten years, their rate of business-loan expansion did not exceed the national rate of increase — in fact, it fell substantially below the headlong pace which characterized developments elsewhere.

Does this signify a reversal of the pattern of faster business-loan growth in the West? The ratio of business to total loans is now more nearly comparable to the national ratio — in contrast to the situation a decade ago, when the ratio was 10 percentage points lower. With some abatement in the rapid secular growth which characterized the past decade, the recent strong uptrend in the business share of total loan funds at Western banks may moderate somewhat. This could mean that business lending patterns of Western banks may reflect cyclical movements more closely than heretofore. It could also mean that their business lending patterns may more closely resemble that of their colleagues — allowing, of course, for some difference in the West's industrial and commercial mix.

Decline in mortgage share

By 1960, business loans were the largest single component of Western banks' portfolios — exceeding real-estate loans for the first time on record. Despite their declining share, however, mortgages have continued to account for a major part of total portfolios. Willingness to invest in mortgages — a relatively long-term asset — has gone hand-in-hand with active solicitation of personal savings deposits — ordinarily a relatively stable category of bank deposits. Thus, high percentages of real-estate loans and of passbook savings have long been a hallmark of Western banking.

Commercial-industrial loans now dominate District-bank loan portfolios, while mortgage-loan share declines steadily over decade



In June 1955, real-estate loans made up 42 percent of the loan total at District insured commercial banks, in contrast to a 23 percent share at banks elsewhere. In the 1955-65 decade, Western banks doubled their mortgage holdings, but even this rate of gain did not keep pace with the rate of total loan expansion. As a consequence, by June 1965 real-estate loans accounted for just under one-third of Western banks' total loans. Meanwhile, the percentage for other banks remained relatively unchanged, at around 23 percent.

A number of factors contributed to the declining proportion of bank loan funds allocated to mortgage credit—including a downturn in the building cycle in the last several years of the decade. A slowdown in population growth was accompanied, at least in the last several years, by problems of overbuilding in many Western areas. As a result, banks became more selective in their mortgage lending policies, especially in areas of overbuilding. During much of this period, moreover, interest-rate differentials became less favorable to residential mortgages—particularly FHA and VA mortgages, where adjustments in rate ceilings tended to lag the upward movement in money-market rates. Furthermore, banks faced intense competition

Cost of Business Borrowing

The Federal Reserve's quarterly business-loan survey was revised at the beginning of 1967, reflecting revisions in timing, in the sample of reporting banks, and in reporting procedures. After adjustment for data revisions, the survey showed the first decline in interest rates at Western banks in almost a year.

Business-loan data are now collected in the first fifteen days of the second (rather than the third) month of each quarter. This shift in timing keeps the survey from being influenced by the heavy borrowing associated with quarterly corporate-tax dates. The new survey sample includes 13 banks (and 25 banking offices) in Los Angeles, San Francisco, Seattle, and Portland—the same universe to be used in the national release for Western banks. (The old survey covered 19 Western banks.) The new survey collects data for three business-loan categories—short-term loans, revolving-credit loans (which in this District are mainly short-term), and long-term loans (those with over-one-year maturities).

For the first 15 days of February, the 13 reporting banks reported a 6.29-percent average rate on $238 million of new short-term business loans, a 6.24-percent average rate on $457 million of loans made under revolving credit agreements, and a 6.28-percent average rate on $11 million of long-term loans. Despite the larger dollar volume of loans made under revolving credit agreements, there were only 1,473 such loans made in the February survey period, as against 2,304 short-term loans.

The combined rate on all reported loans with maturities of one year or less was 6.28 percent—about 6 basis points below last December's rate after adjustment for revisions in survey data. But only 42 percent of the dollar volume of such loans made in the first half of February carried the prime rate of 5¾ percent or less, whereas 53 percent of the December total bore the then-prevailing prime rate of 6 percent.

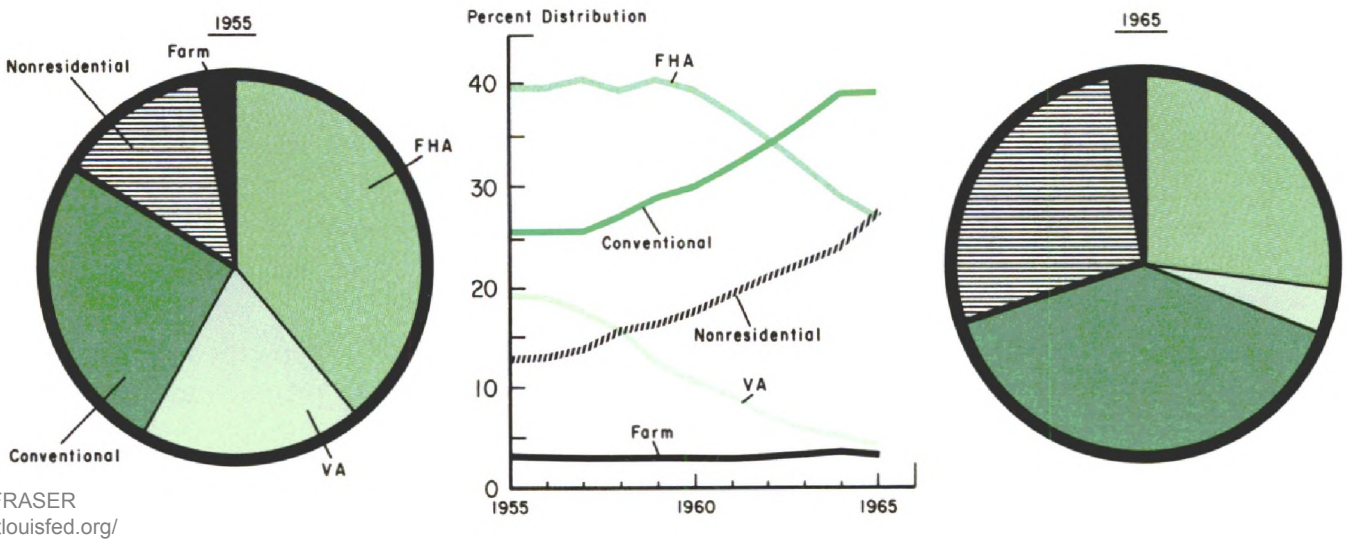
from savings and loan associations, which increasingly impinged upon the banks' share of the market for real-estate loans, and, in addition, attracted increasing amounts of individual savings funds.

The flow of savings deposits was one of the crucial determinants of banks' mortgage activity during this period. The ratio of real-estate loans to savings has fluctuated within a rather narrow range of 52 to 58 percent, but has been drifting downward since mid-1964. Meanwhile, the ratio of real-estate loans to total time deposits has been declining even more rapidly, primarily as a reflection of the issuance of an increasing volume of large-denomination negotiable time certificates of deposit. These deposits are much more volatile than savings or smaller-denomination time certificates and, therefore, are not suitable for investment in long-term assets such as mortgages.

The flow of savings and time deposits, particularly savings, will continue to be a prime determinant in the mortgage-lending policies of Western banks. However, the shift toward more interest-sensitive deposits, especially large-denomination CD's, places restrictions on the amount of such deposits that banks can prudently use for long-term mortgage investment. Furthermore, the West's expanded commercial-industrial sector should continue to require a large share of available loan funds. Thus, mortgages may not account for as large a share of total bank-loan portfolios as they did in earlier years — at least not unless the inward flow of migrants begins to accelerate again, and thereby creates a stronger underpinning for the regional housing industry.

Over the decade, major shifts also occurred within Western banks' mortgage portfolios — reflecting, in part, general trends in the national mortgage market. In June 1955, residential mortgages made up 84 percent of total real-estate loans, but 10 years later they accounted for only 70 percent of the total. And, within the residential sector, conventional mortgages increased rapidly in importance, from less than one-third of outstandings in 1955 to nearly 60 percent in 1965. Real-estate loans insured by the Federal Housing Administration declined from 50 percent to 38 percent of the total, and loans guaranteed by the Veterans Administration dropped from 23 percent to less than 6 percent. Rate ceilings on Federally guaranteed mortgages, which were not competitive with other loan rates during much of this period, plus some limitations on the availability of funds, led banks generally to favor higher-

Conventional residential mortgages account for almost half of mortgage portfolios, as FHA-VA share sharply declines



yielding conventional mortgages.

While residential mortgages lost some of their dominance, mortgages secured by commercial and industrial properties increased in importance. These mortgages, which comprised 13 percent of Western banks' real-estate loans in June 1955, represented 27 percent of the total in mid-1965 — only 2 percent below the proportion elsewhere in the nation. As in the case of business loans, this shift in mortgage lending reflected the strong secular expansion in Western industrial and commercial activities.

Stability in consumer share

Consumers nearly tripled the amount of their borrowing from Western banks over the decade but, nonetheless, their share of total loan funds increased only one percent — from 19 to 20 percent. Despite the slackened pace of Western population growth in the latter part of the decade, the upward trend in consumer loans was fairly steady during this ten-year span except for the two recession periods. The increase in consumer lending was substantially greater in the West than nationally, but the general pattern of consumer-loan distribution followed a similar course. Thus, factors affecting consumer borrowing behavior nationally appeared to be determinant in the West as well.

The shifts which developed in the consumer-credit market during this period were much less pronounced than the shifts which occurred in mortgage lending. Automobile financing declined in importance but continued to account for the largest proportion (45 percent) of consumer loans, while other instalment credit and single-payment loans increased their share of the total. The recent proliferation of bank credit-card programs may lead to an accelerated expansion in the instalment-credit field. However, since automobile financing still accounts for the bulk of consumer loans, fluctuations in car sales will continue to be the pivotal factor in the rate of bank credit extended to the consumer sector.

Stability in farmers' share

In the last ten years, agricultural lending by Western banks increased at almost twice the national rate but, nevertheless, agricultural loans declined slightly as a percent of Western loan portfolios. The greatest variation occurred in bank holdings of loans guaranteed by the Commodity Credit Corporation. Part of this fluctuation was due to the one-day measurement as of Call dates, for maturities of these loans vary somewhat from year to year depending upon the timing of crop financing. Furthermore, banks frequently sell their CCC loans prior to maturity if the rate of return on these loans becomes non-competitive with yields on alternative types of investments. Other loans to farmers, after allowing for seasonal adjustments, remained fairly steady as a percent of total loans throughout this period.

The withdrawal of farm acreage due to the expansion of urban and suburban developments, which in the last decade nearly offset new acreage brought under irrigation, can be expected to continue in the future. Increased costs of farm operations and more intensified farming, however, may offset any reductions in farm borrowing due to any net withdrawal of land from agricultural production — at least in the near future.

—Ruth Wilson