Rebuilding Liquidity

In the first quarter of 1967, large commercial banks in the Twelfth District recorded an $837-million increase in total bank credit, in sharp contrast to a large decline in the early 1966 period. In further contrast to their early 1966 experience, these banks reduced their outstanding loans and directed their funds into securities, thus rebuilding liquidity positions which had deteriorated during two years of rapid loan expansion.

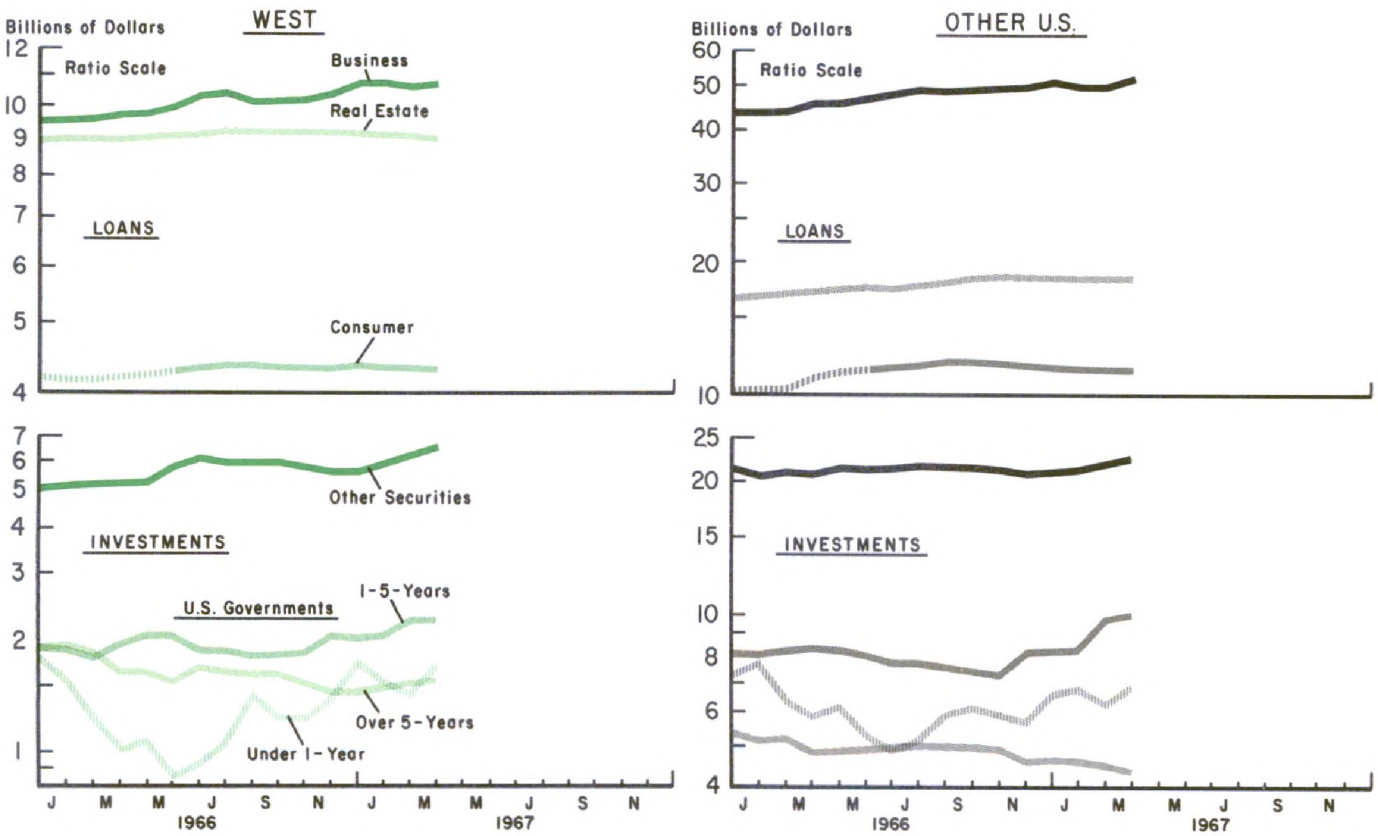
All major loan categories (except loans to brokers and dealers) either declined or showed only nominal increases for the first three months of 1967. A $355-million reduction in total loans adjusted compared with an increase of $262 million in the first quarter of 1966.

During this period, large District banks added $303 million to their Treasury security holdings and even more ($764 million) to their municipal portfolios. Over two-thirds of the increase in Governments went into issues maturing in one to five years, with the remainder invested in longer-term issues; almost one-half of the increase in municipals went into warrants and other short-term issues. This broad expansion across the maturity range added a needed cushion to banks' security portfolios.

Weakening business demand?

In the first quarter, Western businessmen exhibited weaker loan demand than their counterparts elsewhere. District business-

Strong expansion of bank credit centered in security investment . . . District banks show weaker business-loan demand than other banks

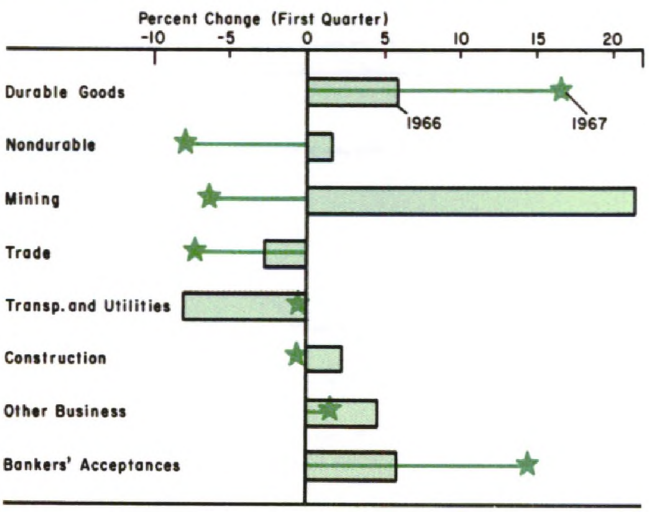


loan demand expanded in March, because of borrowing to meet mid-month corporate tax payments, but this increase was relatively weak, leaving outstandings at the end of March at the same level as at year-end. In contrast, the March expansion in business borrowing in the rest of the nation was substantial enough to raise outstanding business loans almost 3 percent above the year-end level of outstandings.

Despite the slackening in regional credit demand, the net increase in borrowing by durable goods manufacturers was four times greater than in the first quarter of last year. Machinery manufacturers accounted for the major part of this increase, but loans to transportation-equipment manufacturers also rose, reflecting the high level of both defense and non-defense production. On the other hand, food-liquor-tobacco processors recorded a greater-than-seasonal debt repayment, and thereby brought about a net decline in loans to non-durable goods manufacturers. In addition, trade firms reduced their outstanding loans by a greater amount than in the comparable 1966 period.

Consumers in the West, as elsewhere in the nation, reduced their bank-held instalment debt during the early months of 1967.

Durable-goods firms account for most business-loan demand



New credit extensions were no higher than a year ago in the field of auto financing, but continued along a rising trend line in the field of other consumer goods.

Improving mortgage demand?

The Western mortgage market began to show signs of life during the first quarter, as evidenced by a rise in savings-and-loan mortgage commitments. But outstanding mortgage loans continued to decline at both banks and S&L's.

At District banks, a $179-million first-quarter decline in outstanding real-estate loans was nearly three times greater than the preceding quarter's decline. This figure may overstate the decline in new mortgage activity, however, since renewed interest in mortgage purchases by insurance companies and other institutional lenders probably increased the volume of mortgages sold by District banks out of their own portfolios.

For their part, District S&L's sustained a $100-million decline in outstanding mortgage loans, almost all occurring in the first month of the period. This decline took place in the face of a sharp $780-million net savings inflow, and despite an almost 50-percent increase in new loan commitments over the three-month period.

The lag in lending was accompanied by a sharp rise in S&L repayments of advances and other borrowings from the Federal Home Loan Banks — some $540 million, or three-fourths of the entire net amount borrowed last year. But the lag in lending also reflected a hesitancy on the part of prospective borrowers — a hesitancy perhaps induced by some doubts as to the future course of the economy generally, and by expectations of a further easing in price and non-price terms of borrowing. Evidence of easing was apparent in a first-quarter decline of about 25 basis points in conventional rates for both

SELECTED ITEMS FROM WEEKLY CONDITION REPORT OF LARGE BANKS IN THE TWELFTH FEDERAL RESERVE DISTRICT

(dollar amounts in millions)

	TWELFTH DISTRICT				U.S. MINUS TWELFTH DISTRICT		
		Net Change				Net Change	
	Outstanding 3/29/67	First Quarter 1967 Dollars	First Quarter 1967 Percent	First Quarter 1966 Percent	Outstanding 3/29/67	First Quarter 1967 Percent	First Quarter 1966 Percent
ASSETS							
Loans adjusted and investments[1]	$41,097	+ 837	+ 2.08	− 1.75	$147,968	+ 1.35	+ 0.72
Loans adjusted[1]	28,969	− 355	− 1.21	+ 0.95	104,058	− 1.31	+ 1.18
Commercial and industrial	10,712	+ 9	+ 0.08	+ 2.41	51,250	+ 2.67	+ 4.26
Real estate	9,062	− 179	− 1.94	+ 0.48	18,069	− 1.04	+ 2.12
Agricultural	1,167	+ 7	+ 0.60	− 2.38	657	− 2.81	− 1.77
To non-bank financial institutions	1,404	− 211	−13.07	− 3.02	8,208	−14.96	− 2.34
For purchasing and carrying securities	797	+ 119	+17.55	+25.00	5,845	− 2.79	− 8.26
To foreign banks	265	− 32	−10.77	− 5.41	1,130	−11.79	− 3.69
Consumer instalment	4,325	− 55	− 1.26		11,436	− 0.93	
To foreign governments, etc.	120	− 4	− 3.23		962	− 8.73	
All other	1,614	+ 6	+ 0.37	+ 0.47	8,970	− 3.37	+ 0.14
Total securities	12,128	+1,192	+10.90	− 8.65	43,910	+ 8.24	− 5.16
U. S. Government securities	5,553	+ 303	+ 5.77	−18.67	21,217	+ 8.51	− 9.00
Obligations of states and political subdivisions	5,674	+ 764	+15.56		19,988	+ 7.86	
Other securities	901	+ 125	+16.11	+ 2.57	2,705	+ 8.98	− 1.35
LIABILITIES							
Demand deposits adjusted	13,916	− 300	− 2.11	− 3.13	58,925	− 3.25	− 5.03
Total time deposits	25,992	+1,343	+ 5.45	+ 1.61	70,141	+ 7.93	+ 4.09
Savings	15,023	− 96	− 0.63	− 0.43	32,075	− 0.06	− 0.33
Other time, I.P.C.	7,241	+1,177	+19.41	+21.53	26,798	+16.83	+12.43
States and political subdivisions	2,703	+ 117	+ 4.52	− 9.85	6,544	+14.55	+ 5.53
(Neg. CD's $100,000 and over)	3,032	+ 682	+29.02	+18.02	16,267	+22,38	+ 5.80

[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 28, 1966 — March 29, 1967 and from December 29, 1965 — March 30, 1966.

new and existing homes. But even after falling to 6.80 percent, rates in the Western region were still substantially above the year-ago level of 6.55 percent.

Time deposits rise sharply

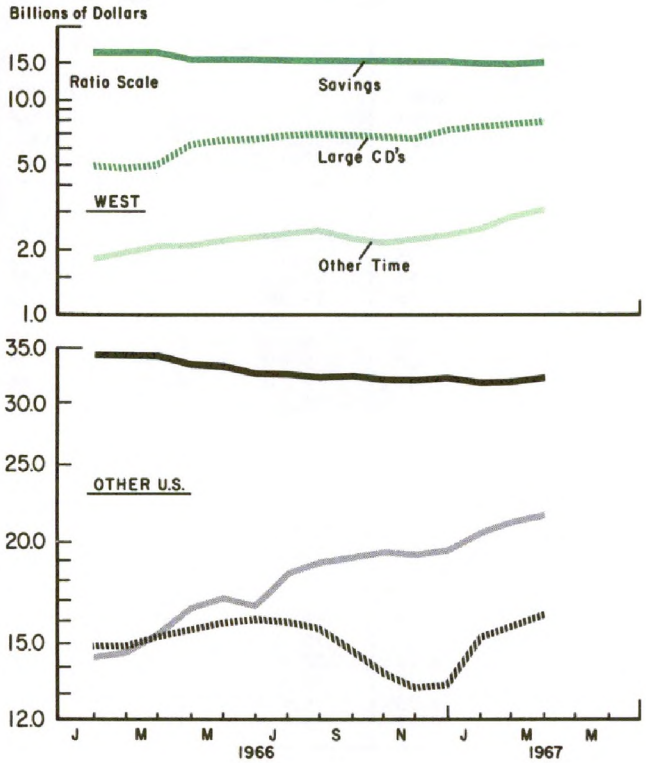
Large District banks posted a lower level of demand deposits (daily average basis) in the first quarter of the year than in January-March 1966. On the other hand, they recorded a gain of over $1 billion in total time and savings deposits — nearly three times as much as in the comparable period last year. But within this category, savings deposits declined $96 million as depositors continued to shift funds to higher-yielding consumer time certificates.

Although offering rates were reduced, yields on large-denomination CD's became more competitive with other money market instruments in early 1967, and outstanding CD's thus rose to a record high of $3 billion at Western banks by the end of March. Western banks again showed only a minor reduction in CD's over the March 15 corporate-tax date, in contrast to the substantial fluctuation recorded by Eastern banks. The competitively attractive yields on time certificates also stimulated a contra-seasonal increase in time deposits held by states and other political subdivisions.

Borrowed funds support expansion

A significant portion of the relatively large first-quarter expansion in District bank credit was financed through borrowed funds. In fact, Twelfth District banks moved against the national trend in reserve behavior, shifting from net *free* reserves of $5.4 million in fourth-quarter 1966 to net *borrowed* reserves of $3.5 million in first-quarter 1967 (daily average basis).

Depositors continue placing funds into "other time" deposits



Furthermore, a major shift occurred in their "basic" reserve position — excess reserves less discounting and less net borrowing through Federal-funds transactions.

The seven major District banks in the national Fed-funds sample borrowed $587 million through net purchases of Fed funds in the January-March period, in contrast to purchases of about $60 million in the year-ago period (daily average basis). About 85 percent of these funds were then lent to securities dealers. The remaining Federal funds, plus discounts of $33 million from the Federal Reserve Bank (daily average basis) and borrowings from corporations under repurchase agreements, were used by these banks to meet their reserve requirements and for investment in securities. In this way, District banks used borrowed funds, along with funds obtained through deposit expansion, to effect the high first-quarter rate of credit growth.

—Ruth Wilson and Verle Johnston

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