Federal Reserve Bank of San Francisco
Annual Report 1980

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John J. Balles
President

Caroline Leonetti Ahmanson
Deputy Chairman

Cornell C. Maier
Chairman

From the Boardroom

The year just past was one of the most difficult and most challenging that the Federal Reserve System has experienced since its founding two-thirds of a century ago. The 1980 environment was difficult because the nation suffered severe ups-and-downs in business activity during the year, along with a continuation of the worst peacetime inflation in its history. Yet 1980 also provided hope for the future, because Congress in March passed new legislation designed to create greater competition in financial markets and to provide the Federal Reserve with stronger weapons for its continuing struggle against inflation.

The national economy produced $2.6 trillion worth of goods and services in 1980—roughly the same amount, in real terms, as during 1979, despite the very sharp decline in business activity in the spring months of the year. The overall stability of real output was doubly remarkable, in view of the serious problems affecting some of the nation's basic industries, such as steel, autos, and home construction. Despite these problems, some areas of the country showed modest growth in activity during 1980—especially the massive nine-state area served by the Federal Reserve Bank of San Francisco. This area accounted for one-sixth of the national output, and again grew faster than the rest of the nation, as it has throughout the entire past decade.

The Federal Reserve System encountered difficulties in its struggle against severe inflation, as prices increased 9 percent according to the broad measure of GNP price change—and increased considerably faster according to the more widely reported consumer-price index. This situation reflected the Federal Reserve's problem of being "the only game in town" in the absence of parallel tightening actions from government fiscal policy. Following an operating technique adopted in October 1979, the Fed tried to limit money growth during 1980 by controlling the quantity of bank reserves rather than by tightly pegging the cost of bank reserves. Money growth fluctuated substantially during the year, in a volatile atmosphere characterized by continued inflation and by severe swings in business activity and interest rates. Nonetheless, the System was successful by year-end in bringing standard money-growth measures close to the targets announced early in the year.

A new financial era opened in March, when the President signed into law the Depository Institutions Deregulation and Monetary Control Act of 1980. This pathbreaking piece of legislation, among other things, will promote greater equity and improved monetary control by extending reserve requirements to all depository institutions with transaction (check-type) accounts and nonpersonal time deposits. In addition, it will promote greater efficiency in financial markets, by providing access to Federal Reserve services, at explicit prices, for all depository institutions subject to reserve requirements.

Implementation of the Monetary Control Act meant a massive increase in workload for the Federal Reserve Bank of San Francisco. Today, our institution serves not only its original basic constituency of 147 member banks, but also several thousand other banks and thrift institutions throughout the West. In 1980, many Bank departments became involved in carrying out the provisions of the new legislation, under the supervision of a senior-management group called the MCA Policy Committee. Bank personnel designed systems to handle the new pricing and billing functions, developed computer programs to perform these new functions and to process reports from a sharply expanded constituency, developed plans for broader access to credit facilities, restructured reserve accounts, and created staffing plans to meet all these new operating burdens.

Management benefited greatly during 1980 from the broad-based experience and judgment of the Bank's directors at Head Office and four branches. The directors provided guidance on major management decisions and planning goals, especially in regard to the implementation of the MCA legislation. In addition, they supplied key information on economic and financial conditions as support to the Federal Reserve's formulation of monetary policy. Today, 37 public-spirited men and women serve as directors, representing a great variety of economic interests and non-profit organizations from every area of the West. And in the future, we hope to obtain useful guidance on implementation of the MCA program from an advisory group drawn from our expanded constituency.

We are grateful to all these individuals, and also to those who completed terms as directors during 1980. We owe a great debt of gratitude to these former directors: Chairman Loran L. Stewart (Director, Bohemia Inc.) and Kenneth Smith (General Manager, Confederated Tribes of Warm Springs) at our Portland office; Robert E. Bryans (Chairman of the Board, Walker Bank and Trust Co.) and Mary S. Knox (Chairman of the Board, Idaho State Bank) at our Salt Lake City office; and Chairman Lloyd E. Cooney (President and General Manager, KIRO-Radio and TV) and Rufus C. Smith (Chairman of the Board, The First National Bank of Enumclaw) at our Seattle office. Finally, we wish to express our appreciation to our officers and staff, whose dedication to the efficiency of Bank operations in 1980 enabled us to expand and improve our services to the financial community and to the general public.

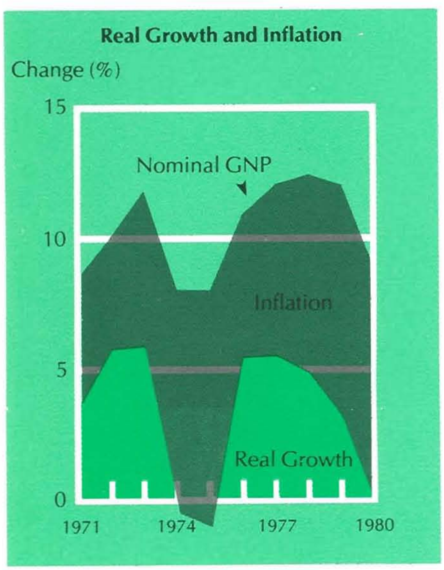
Cornell C. Maier
Chairman of the Board

Caroline Leonetti Ahmanson
Deputy Chairman

John J. Balles
President

February 1, 1981

National Scene



The new decade began badly for the national economy. The economy produced $2.6 trillion worth of goods and services in 1980, as gross national product (adjusted for inflation) roughly matched the preceding year's total. But that seeming stability masked severe gyrations in business activity over the course of the year. The first quarter was marked by a speculative upsurge in commodity prices; the second quarter was marked by a near-record quarterly decline in real output, and that was followed by a modest recovery in the second half of the year. Throughout it all, rapid inflation and wildly fluctuating interest rates undermined the strength of the economy.

Many analysts referred to 1980 as a recession year, but many industries showed few signs of recession—and the same was true of certain sections of the country, especially the Sunbelt states of the South and West. The reverse was true elsewhere, however, especially in the Snowbelt states of the Northeast and Central regions. Indeed, some observers used the term "depression" to describe the plight of autos, steel, housing, agriculture, and other key sectors of the national economy. But those weaknesses were largely offset by an upsurge in activity in the energy industry, not to mention defense manufacturing and office construction.

Sluggish Demand

Consumer spending, which accounts for two-thirds of total GNP, remained flat overall (in real terms), but buyers reduced spending sharply in some areas because of wariness about future income prospects. Households recorded less than a one-percent gain in real disposable income—the weakest performance of the past half-decade. Also, made cautious by rising prices and fears of future inflation, they boosted their savings rate a half-percentage-point higher than in the preceding year, to 5.7 percent of income. Another sign of caution was a reduction in credit usage; during the second quarter in particular, consumers responded to Federal Reserve selective credit restraints by cutting back on all types of consumer credit, in the sharpest such reduction on record.

Big-ticket items, especially autos, felt the full impact of this cautious buying attitude. Domestic motor-vehicle sales plummeted 25 percent in 1980 to about 8.7 million units—the lowest level in almost two decades. That sales decline reflected all the factors noted above as well as others peculiar to the industry—such as the high cost of autos and gasoline, plus a continued consumer preference for small foreign models. Residential-housing activity also declined sharply as builders started work on only 1.3 million new homes—down 25 percent for the year and not much more than half the 1978 level.

Business fixed investment fell about 3 percent (in real terms) from the record 1979 level. This weak performance could have been expected in view of all the negative factors affecting corporate decision makers, such as the sluggish performance of sales and corporate earnings, not to mention the record costs of corporate borrowing. Business firms also reduced their inventories somewhat, especially after midyear, but their earlier cautious inventory-purchase attitudes made it unnecessary for them to reduce stocks drastically, as they had to do during the 1975 recession. In the government sector, real spending remained relatively flat (for the third straight year) at the state-and-local level, but continued to increase at the Federal level under the spur of a growing defense build-up.

The foreign trade sector represented by far the strongest element in the GNP statistics, however, as exporters recorded a 10-percent jump in business (in real terms). The nation's current account moved close to balance during the year, on the basis of this strong export performance and a continued rise in income from U.S. overseas investments. The exchange value of the dollar surged early in the year, and again after midyear, reflecting the strengthening of the payments position as well as the attractiveness of high interest rates to foreign investors.

Weak Output and Employment

Industrial production declined almost 4 percent for the year, but the fortunes of individual industries varied significantly. Production of consumer durable goods dropped 12½ percent, headed by the near-collapse of auto manufacturing, whereas production of consumer nondurable goods remained stable for the year as a whole. Business-equipment output increased slightly, while defense-equipment output rose 4½ percent and headed even higher at year-end. In contrast, farm-equipment production dropped 15 percent, in response to a sharp drop in demand from the nation's hard-pressed farmers. A severe drought, the Russian grain embargo—and above all, a one-third increase in production expenses over a two-year period—pushed the farm sector deeply into the red. As a result, net farm income (in real terms) dropped roughly 30 percent for the year.

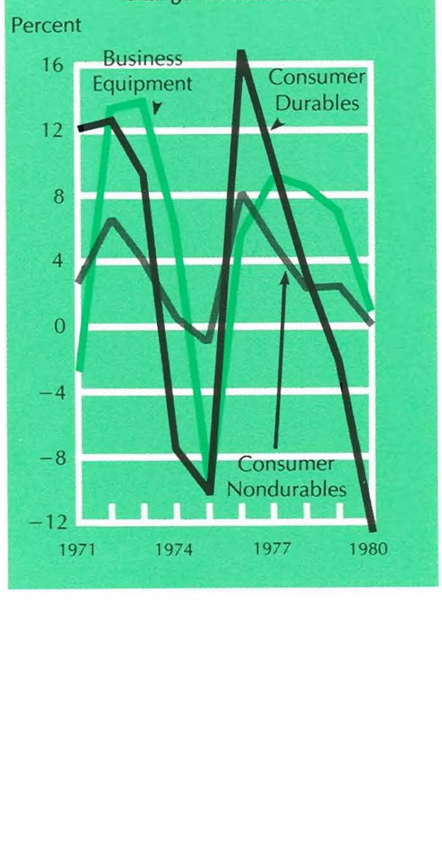
Employment actually increased slightly in 1980, as a second-half gain of almost a million jobs offset a steep early-year decline. These figures reflected a tendency—evident throughout the last several years—for industries to expand by adding labor rather than capital, because of such factors as a sharp increase in investment costs relative to wages. But the combination of heavy staffing and sluggish output spelled trouble for productivity, as output per hour actually dropped for the third straight year. (With labor compensation rising sharply, unit labor costs increased again at near double-digit levels, thus putting heavy pressure on prices.) Still, these developments helped limit the rise in the unemployed share of the labor force; the jobless rate averaged 7.1 percent for the year, but this was less than generally expected. Meanwhile, more than 58 percent of the adult population held jobs during 1980—a figure exceeded only during the 1978-79 peak of the boom.

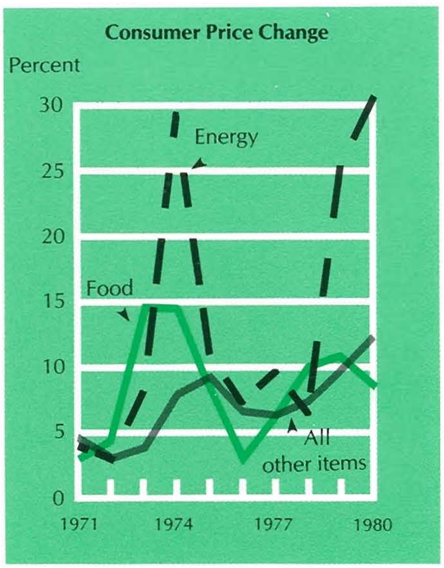
Price Shocks

The national and international economies were severely affected during 1980 by the effects of the second "oil shock"—the 1979-80 increase of almost 150 percent in the average price of OPEC oil. Like the previous shock of the 1973-74 period, the recent price hikes acted as a giant worldwide sales tax, raising prices and draining off purchasing power that would otherwise have been available for purchases of other goods and services. Soaring OPEC prices helped boost costs throughout the U.S. economy and discouraged business investment, contributing to the productivity slowdown noted above.

The oil shock's impact tapered off in the second half of the year, but it left consumers with energy bills almost two-thirds higher than they were just two years ago. As that shock waned, another shock arose because of poor growing conditions in this country and abroad, which sent food prices soaring in the second half of the year. The continued upsurge in labor costs throughout industry, and above all, the pres-

Change in Production





sures on monetary policy generated by yet another massive Federal deficit ($60 billion in fiscal 1980)—added to the various shocks to create severe inflationary pressures throughout the year.

Prices increased about 9 percent for the year, according to the GNP "deflator," the broadest measure of price change. The increase in inflation was several percentage points higher when measured by the more widely reported consumer-price index, but that increase was overstated because of the CPI's treatment of home-purchase and mortgage-interest costs (which are not directly included in the GNP deflator). In any event, the 1980 price performance was the worst since the inflationary upsurge of the mid-1970's. And for the first time since that dismal period, 1980 witnessed a small decline in the average individual's well-being, as measured by the yardstick of real disposable per capita income.

Policy Problems

The Federal Reserve encountered difficulties in its struggle against the severe inflation, reflecting the Fed's problem of being "the only game in town" in the absence of parallel tightening actions from government fiscal policy. Following a change in operating techniques adopted in October 1979, the Fed tried to limit money growth during 1980 by controlling the quantity of bank reserves rather than by tightly pegging the cost of bank reserves (the Federal-funds rate). Market participants had trouble adjusting to this new operating environment, however, which implied a broader range of interest-rate fluctuations according to changes in business and credit conditions. Indeed, interest rates followed a roller-coaster course, rising to historic highs during the speculative boom of early 1980, falling sharply in the spring period, and then rising to new peak levels in the late fall months.

The Federal Reserve's policy actions made headlines on several occasions during the year. In mid-March, amidst fears of runaway inflation and a possible liquidity crisis, the Fed (at the Administration's request) imposed a credit-restraint program to curb money and credit growth. This program included a 9-percent limit on each bank's loan expansion, a 3-percentage-point discount rate surcharge on large banks which borrowed frequently at the Fed's discount window, and a 2-percentage-point increase in marginal reserve requirements on large CD's and other "managed liabilities" of large banks—plus a 15-percent special deposit on increases in certain types of consumer loans. The Fed terminated the credit-restraint program around midyear as business activity weakened. However, the Fed then followed more traditional techniques of monetary restraint after a summer-period upsurge in money growth. It acted by restricting the availability of bank reserves through its open-market operations, by raising its discount-rate again to a record 13 percent, and by reimposing a surcharge on frequent discount-window borrowing.

The Fed was only moderately successful in curbing money growth in the face of sharp changes in inflation expectations and wide fluctuations in credit demands. The growth rate of the narrow M-1A aggregate (currency plus bank demand deposits) by year-end was within the Fed's announced target range of 3½-to-6 percent growth. But the growth in the broader aggregates, M-1B and M-2, reached or slightly exceeded the upper bounds of their respective target ranges, reflecting the rapid rise of certain interest-sensitive liabilities included in the aggregates. M-1B includes M-1A plus other checkable deposits (primarily the so-called ATS and NOW acounts), and M-2 includes M-1B plus small time and savings accounts, money-market mutual-fund shares, and certain other liabilities.

Volatile Credit Markets

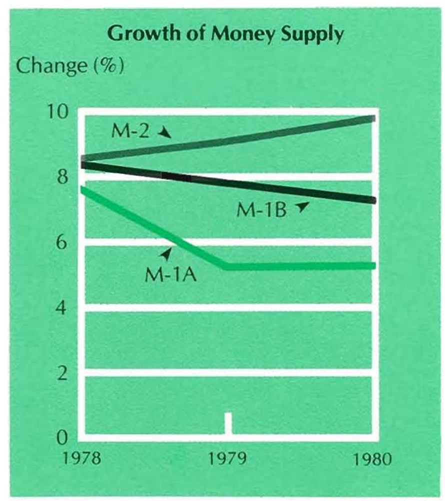
Total funds raised in 1980's financial markets fell below the previous year's total, according to preliminary estimates, because of the record cost of credit and a recession-induced decline in overall credit demand. Nonetheless, the public sector's share of the total increased substantially during the year. The Federal debt grew at least twice as fast as in 1979, as inflation and recession pressures boosted Federal spending and forced the Treasury to step up the pace of its fund-raising efforts. State and local governments were also more active in debt markets, especially through increased sales of tax-exempt mortgage revenue bonds. Federally-sponsored agency debt, by contrast, grew more slowly than in 1979.

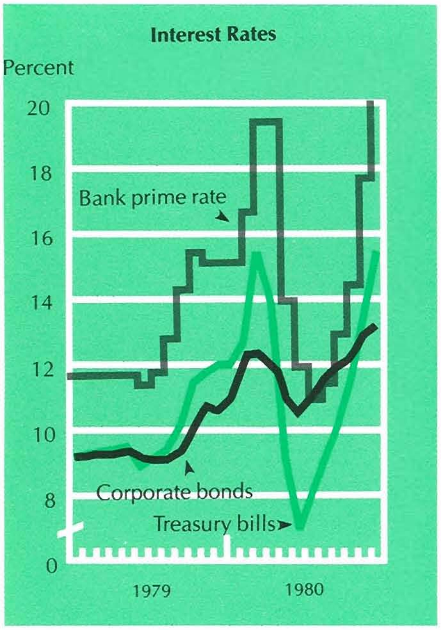
In the private sector, corporate businesses raised roughly the same amount of funds as in 1979, primarily in the long-term end of the market. In fact, corporate long-term debt grew by a record amount in 1980—more than half again as much as in 1979—despite widespread fears about the "disappearance" of the bond market. New cash offerings of corporate equities also grew rapidly during the year. In contrast, the mortgage and consumer-debt markets showed considerable weakness, reflecting the collapse of consumer housing and auto demand, as well as the impact of the credit-restraint program and the drying up of savings inflows at mortgage-lending institutions.

Financial growth patterns reflected not only the wide swings in business activity, but also the wide swings in interest rates which led to new record highs at the spring and fall peaks. The yield curve traced by instruments of gradually increasing maturity remained inverted for much of the year—a typical inflation phenomenon—as short-term rates rose above long-term rates during the spring and fall periods. The prime business-loan rate rose from 15¼ percent in January to 20 percent in March, fell to 11 percent in August, and then rose again to 21½ in December. Similarly, corporate Aaa-rated bond rates rose from 11½ percent in January to 14 percent in March, fell to 11 percent in June, and rose again to over 14 percent in December. Corporate-borrowing patterns shifted strongly in response to these sharp fluctuations. Businesses relied heavily on short-term borrowings during the several episodes of sharply rising rates, but they issued massive amounts of long-term debt when rates fell in the spring months, in an effort to "lock in" their cost of funds and reduce their reliance on short-term financing. Mortgage borrowing followed a similar stop-and-go pattern, as rates rose to a record 18 percent in the spring, dropped to 12 percent in the late summer, and then approached the earlier peak around year-end.

Sluggish Bank Credit

Bank credit increased only about 9 percent in 1980—far below the growth of the 1978-79 period—and much of that growth was concentrated in new securities investment rather than new loans. The loan slowdown largely reflected a massive runoff of consumer loans—down 5 percent for the year—as consumers avoided taking on new





debt even after the midyear termination of the credit-restraint program. Business loans, in contrast, grew at a relatively healthy 11-percent pace over the year, despite a decline in this category during the spring recession period. Business loans expanded rapidly in the fall, as many banks offered financing to firms that couldn't find funds in the corporate-bond market—and additionally, offered sub-prime loan rates to many firms in an attempt to compete with the commercial-paper market. Banks' real-estate loans increased almost 8 percent during the year—and in fact increased most rapidly in those several crunch periods when many savings-and-loan associations ran out of funds to lend on home mortgages.

Funds for financing this bank-credit expansion were costly to come by, because of the continuing shift of funds from "core" deposits (demand and passbook-savings deposits) to more expensive sources acquired at market-determined interest rates. The most rapid (15½ percent) growth occurred in small-denomination time deposits, which included the popular 6-month and 30-month money-market certificates. Banks also relied heavily on large-denomination ($100,000 and over) time deposits, especially in those several tight-money periods when they actively sought lendable funds.

Stable Bank Earnings

Bank earnings in 1980 exceeded the 1979 peak, according to preliminary evidence, despite the impact of record interest rates on both sides of banks' balance sheets. Wholesale (commercially oriented) banks experienced a large increase in operating income because, with their substantial floating-rate loan base, prime-rate increases raised the return on a sizable portion of all their assets. But by the same token, they experienced dramatic increases in the cost of funds, because of their heavy reliance on short-term, interest-sensitive liabilities. Retail (consumer oriented) banks experienced almost the reverse situation. Because their assets were heavily concentrated in fixed-rate mortgage and consumer loans, they failed to receive higher returns on the bulk of their portfolios when rates increased. But because their deposits were heavily concentrated in fixed-rate "core" deposits, they generally experienced smaller increases in interest costs—except for those cases where funds shifted out of such deposits into certificates bearing market-determined interest rates.

On balance, increases in banks' operating income generally outpaced increases in their cost of funds. Still, results varied widely for individual banks because of their different responses to 1980's unsettled credit-market conditions. The net interest spread—the difference between the rate of return on assets and the rate needed to cover the cost of funds—narrowed severely for many banks during the early-year crunch, and again during the similar period in late fall. Nonetheless, the banking industry generally coped very well with 1980's highly volatile credit markets.

Western Business

The Western economy experienced a mediocre year in 1980, suffering first a sharp (but brief) recession and then a faltering recovery toward year-end. (This region, the area served by the San Francisco Federal Reserve District, includes all nine states west of the Continental Divide—see map, page 23.) Some industries missed all the suffering, but others—especially housing-related industries—felt the full impact of all the negative forces operating on the national economy. And at year-end, inflation-bloated interest rates promised further problems for at least the early part of the new year.

Still, business activity in these Western states remained somewhat stronger than in the "Snowbelt" states of the Northeast. Much of this relative strength stemmed from continued heavy in-migration from other parts of the country and other parts of the world. According to 1980 Census data, the West gained 23 percent in population over the past decade—more than twice the gain recorded elsewhere. The region's 37.7 million people—whether they arrived by car, plane, or stork—represent a strong underpinning of demand in the 1980's as in the 1970's. Those people also mean additional political power, because the reapportionment required by the 1980 Census will mean two new Congressional seats for California, and one new seat each for Washington, Oregon, Arizona, Nevada and Utah.

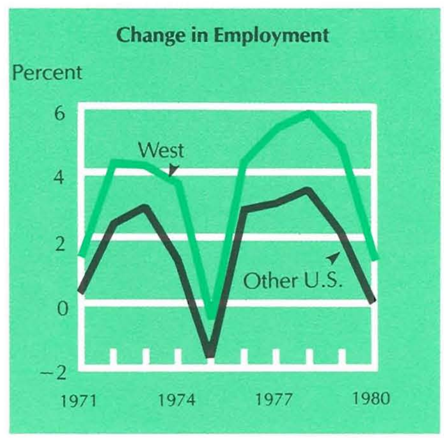
Modest Gains

Civilian employment in this nine-state area rose almost 1½ percent in 1980—an increase of roughly 200,000 jobs—to reach about 16.2 million (annual-average basis). That job expansion, however, represented only a fraction of the gains recorded during the 1976-79 boom. But in terms of jobs as well as population, the West continued to outpace the rest of the nation, as it has done since the early 1970's. (In this recession-and-recovery year, civilian employment elsewhere in the nation barely matched the 1979 average). Employment gains still were modest throughout regional industries; even in stronger industries, such as aerospace, the job expansion was considerably weaker than in earlier years.

Reflecting this spotty job performance, regional unemployment rates increased considerably during 1980, although a sharper increase elsewhere raised the national rate above the regional figure for the first time in years. California's jobless rate, for example, rose from 6.2 to 6.8 percent between 1979 and 1980, whereas the national rate jumped from 5.8 to 7.1 percent (on average) during the year. For more than a decade, California's jobless rate had hovered one or two percentage points above the national rate, because of heavy in-migration (which bolstered the size of the labor force) and problems with key regional industries. That situation changed by the end of the '70's as the state increasingly outperformed the national economy. Indeed, throughout 1980, the California jobless rate lagged far below the 10-percent figure reached in the 1975 recession.

Personal income in the West increased 11 percent in 1980, to about $385 billion. But households lost ground in real terms, because of a sharp acceleration in consumer prices. The consumer-price index increased about 13½ percent at the national level, but by several percentage points more in California because of the greater underlying housing demand in that area. In both cases, the increases were overstated because of the overweighting of housing costs in the price index—but they remained in double digits even after adjustment for that factor.

Retail sales, in real terms, consequently remained flat (or worse) throughout the region, especially in autos and housing-related goods. Consumer credit-card buying, which had been held in check by the credit-restraint program during the second quarter, rebounded after midyear but then softened again during the fall months. And in December, many retailers resorted to pre-Christmas sales to attract scarce customers and to



avoid paying high interest rates on unwanted inventory.

Western governmental agencies also had to pull in their belts, because of a recession-caused slowdown in tax revenues and the impact of the various tax-and-spending limitations adopted by regional voters over the past several years. For example, California's state government had eased the fiscal squeeze on other units by using up budget surpluses of $3.7 billion during the 1978-80 period, but it now faces an empty larder as it enters 1981, which will make future tax increases and/or service cutbacks almost inevitable in that state. Alaska, in contrast, with its state ownership of oil lands, parceled out some of its unexpected wealth by repealing state income taxes for the 1979-84 period and declaring a cash dividend for all Alaska residents except new arrivals.

Industrial Performance

Some Western industries, especially aerospace-equipment manufacturing, recorded sales and employment gains during 1980, although most of the strength was concentrated in the early part of the year. Orders for commercial aerospace products slowed during the second half because of the impact of the national recession. Orders for commercial jet transports fell off sharply, reflecting the decline in passenger traffic and the soaring fuel costs which affected the world's airlines. Civilian orders for electronic equipment also slowed as business firms and private households spent less on computers, communication equipment and electronic games.

Defense and space business remained strong throughout the year, however, as Western firms received a growing share of the Federal government's expanding military and space outlays. Ongoing programs receiving more funding included the cruise-missile program, which moved from the development to the production stage during the year. Controversy meanwhile erupted over the Pentagon's selection of Utah and Nevada as probable sites for the immense shelter-and-roadway system needed for the deployment of the MX missile.

The regional steel industry suffered a year of decline. Two major regional producers began to close down high-cost production and fabricating facilities, leading to a 20-percent decline in raw production for the year. Foreign producers, benefiting from this shutdown, thus increased their share of the Western market from 34 to 43 percent. But the size of the market still declined, because of a slowdown in industrial building, residential construction, and housing-related markets. In contrast, the Northwest aluminum industry suffered from supply problems which made it difficult to keep pace with heavy demand. Aerospace-related demand for aluminum remained relatively strong, but production suffered from the Northwest's prolonged dry spell, which forced recurring cutbacks in power supplies from Federal hydroelectric facilities.

The Western copper industry experienced the ill effects not only of the recession but also of a summer-long strike. Early in the year, producers benefited from the speculative buying fever that sent copper prices—along with gold and silver prices—soaring upward on the New York and London commodity exchanges. Refined-copper prices jumped a spectacular 40 percent in early January, to a near-record $1.40 a pound, but by year-end fell below the original level as the housing and auto slumps dried up demand for the metal. The Western silver-mining industry also experienced the unsettling effects of a speculative bubble and ensuing collapse in prices. The average producer price quadrupled in 1979 and then almost doubled again in early 1980, to reach a record $48 an ounce—but then fell precipitously, and after considerable fluctuations, reached about $15 at year-end. Still, the price upsurge spurred a flurry of exploration and development work at a number of mining locations, especially the century-old diggings in the Coeur d'Alene district of Idaho.

Energy Developments

Regional petroleum consumption declined during 1980, partly because of the recession, but also because of the price upsurge that followed in the wake of the Iranian revolution. Western utilities and industrial plants reduced their demand for fuel oil, taking advantage of the increased availability of clean-burning natural gas. But gasoline and diesel-fuel consumption fell even more sharply as higher pump prices persuaded drivers to reduce their consumption per vehicle. Still, Western crude-oil production increased sharply for the fourth straight year, reflecting the late-1979 boost in Alaskan pipeline capacity (and flowthrough) from 1.2 to 1.5 million barrels per day. The import share of the regional market continued dropping to 20 percent—from 48 percent at the 1976 peak—as Western refineries substituted more and more Alaskan oil for imports.

The continuing program to decontrol wellhead prices encouraged the highest level of drilling activity since the mid-1950's. In California, with its concentration of heavy-gravity petroleum, the removal of heavy-oil price controls triggered a number of "tertiary" recovery projects to extract oil remaining in old wells after conventional methods. Higher prices also spurred a flurry of activity in new areas such as the Overthrust Belt, a 2,300-mile ribbon of tortured geology extending along the Rocky Mountains from Canada to Mexico. Thus far, about one billion barrels of oil and 10 trillion cubic feet of gas have been discovered in that area, and some experts believe that it contains even more energy wealth than Alaska's Prudhoe Bay.

Synthetic fuels appeared closer to commercial development, partly because of soaring prices of conventional fuels, and also because of the government's authorization of $88 billion in loan guarantees and subsidies over the 1980-95 period to spur synfuel commercialization. The first large-scale production may come from the huge oil-shale deposits of the Green River formation in Colorado, Utah and Wyoming—oil deposits which, while immensely difficult to extract, may almost match the entire world's proven oil reserves. Meanwhile, several pipelines in the planning stage moved closer to realization during 1980. The Canadian government approved the construction of a pipeline system to bring Alaskan North Slope gas across Canada to the Northwest states, while the U.S. government approved a pipeline to transport Alaskan oil between the Puget Sound and Minnesota.

Construction Scene

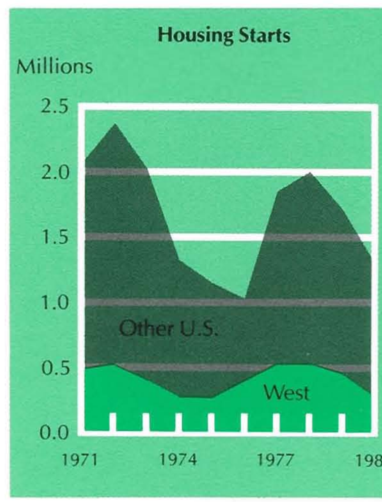
An office-building boom represented the strongest element in the 1980 construction picture, as Los Angeles, Seattle, San Francisco and other regional centers reported a burst of activity in this sector. Historically low vacancy rates, increased office-building investment values, and inflation expectations all contributed to the boom, which was national and not just regional in scope. In an attempt to keep the boom going in the face of record high interest rates, many institutional lenders became developers themselves by taking ownership positions in joint-venture projects.

In contrast, the Western housing market, which had already weakened in 1979, almost collapsed in 1980. Housing starts in the Western census region dropped to about 280,000 units in 1980, as against 460,000 units in 1979, because of severe financing problems in the spring and again in the late-fall months. On the other hand, powerful economic and demographic factors continued to stimulate housing demand—and these factors suggest the probability of a strong recovery whenever financing problems can be overcome. Many households find housing investment attractive because of rising inflation expectations coupled with the favorable tax treatment of housing. Moreover, the West's strong economic-growth prospects stimulate in-migration and family formation, further amplifying demand. Despite financing problems, therefore, many areas of the West have continued to experience larger price increases than the 8-to-10 percent increases experienced nationwide. Financing constraints also have been less stringent in the West, with the development of "creative financing" schemes by many mortgage-lending institutions. But in the end, their efforts in 1980 were severely handicapped by soaring mortgage rates and sharply reduced saving flows.

The nationwide housing slump took a severe toll on the Western lumber industry, forcing a 17-percent cut in production and heavy layoffs on the heels of more moderate declines in the 1978-79 period. The cutback was aggravated by declines in other important lumber markets, including nonresidential construction. Softwood-lumber prices thus fell 23 percent below their fall-1979 peak by the following spring, and recovered only partway by year-end. The industry also suffered from the Mount St. Helens eruption, which downed about one billion board-feet of timber, of which about half may not be salvageable. The pulp-and-paper segment of the industry, in contrast, recorded modest gains in sales and employment until markets began to weaken late in the year.

Farm Developments

Western farmers and ranchers, like their urban cousins, were hard-pressed to keep up with inflation in 1980. According to preliminary reports, net farm income weakened substantially during the year, as soaring production costs outpaced an 11-percent increase in farm-marketing receipts. Prices for farm products generally lagged, because of large harvests and recession-weakened



consumer demand, although the Western industry benefited from drought-caused shortages elsewhere in the country. The export trade remained strong, however, because of heavy foreign demand for the West's wheat, cotton, and specialty crops.

Harvests throughout the region generally were on the high side. Grape production approached record levels, despite a harvest-time strike, and citrus growers recorded bumper crops which sharply depressed orange prices. Sugarbeet growers benefited from strong worldwide demand—which sharply increased prices, thus offsetting the poor profits recorded in the several preceding years. Potato prices doubled over year-before levels at the height of the summer shortage caused by the Eastern drought. Northwest crops (except for cherries) generally benefited from favorable growing conditions, and this helped offset losses from the Mount St. Helens eruption—which in any case were far less than originally reported.

Cattlemen began to move onto the upside of the cattle cycle. Early in the year, many ranchers continued to reduce their herds, thus putting downward pressure on beef prices. But as the year advanced, they began to hold cattle off the market and expand their herds, and beef prices rose correspondingly. Dairymen meanwhile reported a fairly profitable year, because of growing demand for dairy products.

While the West benefited from drought problems elsewhere, it continued to make long-range plans to overcome its own long-term water shortages, especially through California's adoption of a $5-billion water-development package. The centerpiece of the package was a planned peripheral canal to connect the Sacramento River directly with the 444-mile-long California aqueduct that carries Northern California water to the farms and cities of semi-arid Southern California. The legislation also authorized major dam and other water-development facilities that are designed to meet Southern California's needs through the remainder of this century.

Somber Outlook

On balance, 1980 turned out to be a mediocre year for the Western economy, and 1981 could be more of the same. Western households, like their national counterparts, have tightened their belts under the spur of inflation and a tight policy response, and this could mean weakness in consumer markets for at least the early part of the year. Also, Western metals industries are likely to continue suffering from sluggish demand in both national and international markets. And increasingly expensive energy could again spell trouble for the West's key tourist industry and other industries as well.

Still, the West seems certain to outpace the rest of the U.S. economy in 1981, as it has in other recent years. This region, because of its resource base, will continue to play the dominant role in the nation's search for a solution to its energy problems. Similarly, because of the presence here of a major aerospace industry, it will continue to play the dominant role in the nation's search for a stronger defense posture. Overseas demand for the region's farm products and high-technology products, especially in the expanding Pacific Basin countries, should provide further underpinning for the regional economy.

Western Finance

Western banks experienced a moderate expansion in their loans and investments during 1980. Despite substantial buffeting by recession and inflation forces, the relative strength of the Western economy provided banks with ample (but expensive) funds and ready lending opportunities.

Western banks generated ample funds to meet loan demand through much of the year, but had to pay record high market rates to do so. With those funds, they increased outstanding bank credit by nearly $14 billion—an 8-percent gain—and loans accounted for $13 billion of the increase. Business-loan demand was relatively strong during 1980, although it was also very erratic. Real-estate loans also expanded through most of the year, despite record mortgage rates during the spring months and again at year-end. In contrast, consumer loans weakened even prior to the imposition of the credit-restraint program, and never recovered from their sharp spring run-off.

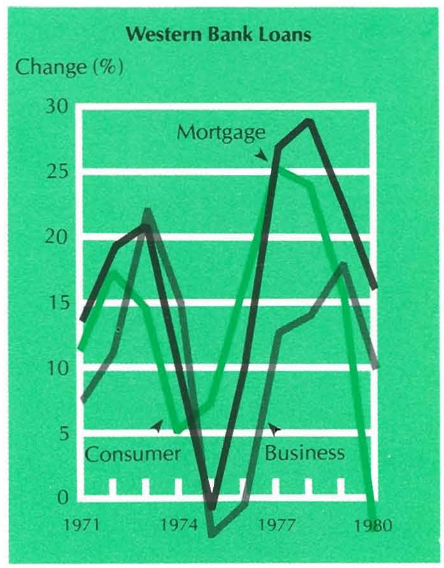
Commercial banks nationwide faced extremely volatile market conditions during most of 1980, and Western banks were no exception. Interest rates reached record levels in the spring, and exceeded those levels in December, so that banks had trouble maintaining normal spreads between their average return on assets and their average cost of funds. Demand for bank loans varied with the sharp fluctuations in the economy, along with the shifting developments in the bond market and the commercial-paper market. When these markets weakened, banks became the primary source of funds for many corporate borrowers.

Lending Fluctuations

Business-loan activity fluctuated widely, but for the year as a whole, Western banks added nearly $6 billion (a 14-percent increase) in business loans to their portfolios. During the winter, and again late in the year, many large firms sharply increased their bank borrowing after postponing long-term bond issues in the face of record bond rates. In those periods also, many large firms that normally rely on the commercial-paper market for short-term funds increased their bank borrowings as the spread narrowed between the prime rate and commercial-paper rate, and as banks became more aggressive about making sub-prime loans. In contrast, business-loan demand slackened abruptly during the second quarter, under the impact of the early-spring upsurge in the prime rate, the special credit-restraint program, and the late-spring resurgence of the bond and commercial-paper markets.

Mining and petroleum firms were heavy borrowers during the year, reflecting the regional and national emphasis on energy exploration and development. Lending to construction firms weakened, not surprisingly, because of the sharp decline in housing and other construction activity. But the wholesale and retail trades also were relatively light borrowers during 1980, because of the second-quarter sales decline and their year-long efforts to bring inventories under control.

Banks' mortgage lending continued to expand, however, as other institutions dropped out of the market because of lack of funds. In fact, bank real-estate loans increased by nearly $8 billion (15 percent) and once again became the fastest growing loan component. (Still, that increase fell well below the strong gains of the 1977-79 period.) Mortgage lending slowed down during the second quarter, in response to record 18-percent mortgage rates, but activity increased again as funds became available at lower rates in the summer and early-fall months.



Western consumers, in contrast, actually paid down their bank consumer-loan debt by nearly $1 billion during the year. Like their counterparts elsewhere, Westerners tightened their belts because of recession and inflation fears, record borrowing costs, and (in the spring period) direct credit restraints. Auto and home-improvement financing felt the brunt of these cutbacks.

Available (But Expensive) Funds

Western banks found ample funds to finance their credit expansion. Deposits rose by nearly $16 billion, just under 1979's record increase. However, the deposit mix shifted away from low-cost "core" deposits and towards more expensive instruments paying market-determined rates. Non-deposit sources of funds—also relatively expensive—provided an additional $2 billion in new funds, which was significantly less than in other recent years.

Large-denomination time deposits ($100,000 and over) increased nearly $8 billion. But consumer-type time deposits also became an important source of funds—with a $6-billion inflow from six-month money-market certificates alone—which was necessary because savings deposits provided no net increase in funds over 1979 levels. In addition, savings deposit flows became extremely volatile, rising and falling in response to the sharp movements in the differential between the 5¼-percent ceiling rate on passbook savings and the much higher rates paid on alternate savings instruments (money-market certificates, Treasury bills, and mutual-fund shares).

Rising Earnings

Earnings of Western banks apparently rose modestly in 1980, according to preliminary data, although maintaining earnings growth and profitability was difficult in such a volatile environment. Sharp rate fluctuations, narrowed spreads, and differences in (wholesale or retail) lending orientation affected earnings in diverse ways. Western banks, with their heavy retail orientation, apparently lagged behind the earnings increases posted by their money-center counterparts. Still, most regional banks weathered the year's instability without difficulty, and entered 1981 in relatively good shape. In this, they differed from many thrift institutions which were more heavily involved with the weakened housing industry.

Banks' operating income expanded because of the moderate expansion in bank credit—especially floating-rate business loans—and the record level of rates in effect during much of the year. But many retail-oriented banks found themselves holding relatively large portfolios of fixed-rate loans, either long-term mortgages or intermediate-term consumer loans. Their interest spreads narrowed—and their profits declined—as the returns on such assets lagged in the face of soaring costs of funds.

Interest expense surged for both deposit and nondeposit sources as banks paid record market rates to generate new funds. This meant increased reliance on expensive variable-rate consumer deposits and large-denomination time deposits. The increase in interest costs reflected not only the record rates paid on these funds, but also the continuing shift by consumers from low-cost core deposits (demand and savings deposits) to variable-rate certificates.

Change and Competition

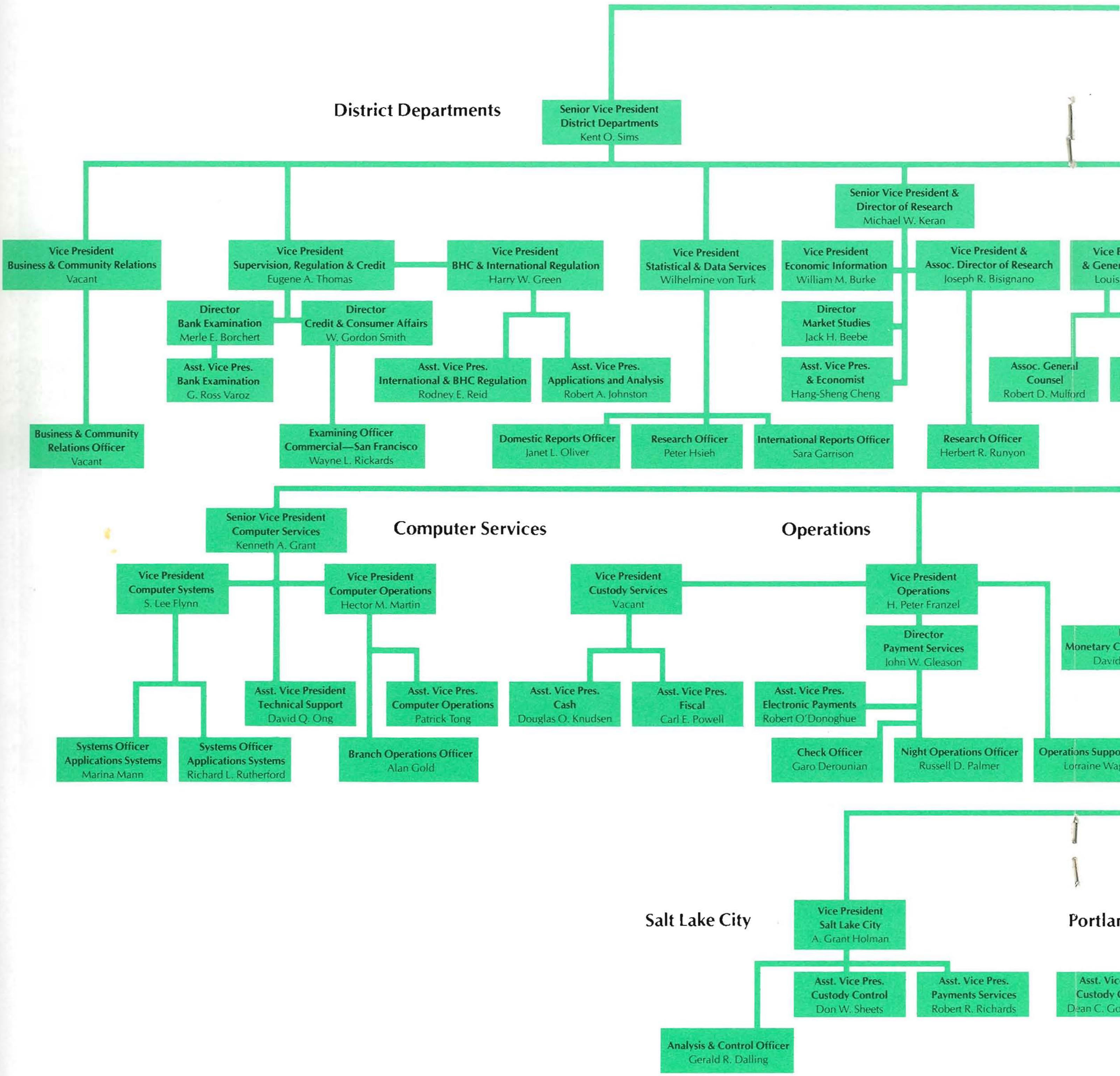
The new year opens a new era in Western banking and finance, in the wake of the legislative changes described in the next section. The nationwide authorization of interest-bearing NOW accounts has made it possible for thrift institutions to become direct competitors for consumers' transaction (checking-type) deposits. With broadened lending powers, thrifts also have the opportunity to compete with commercial banks in the credit-card and consumer-loan areas as well. All of these competitive factors can dampen bank-earning growth in coming years.

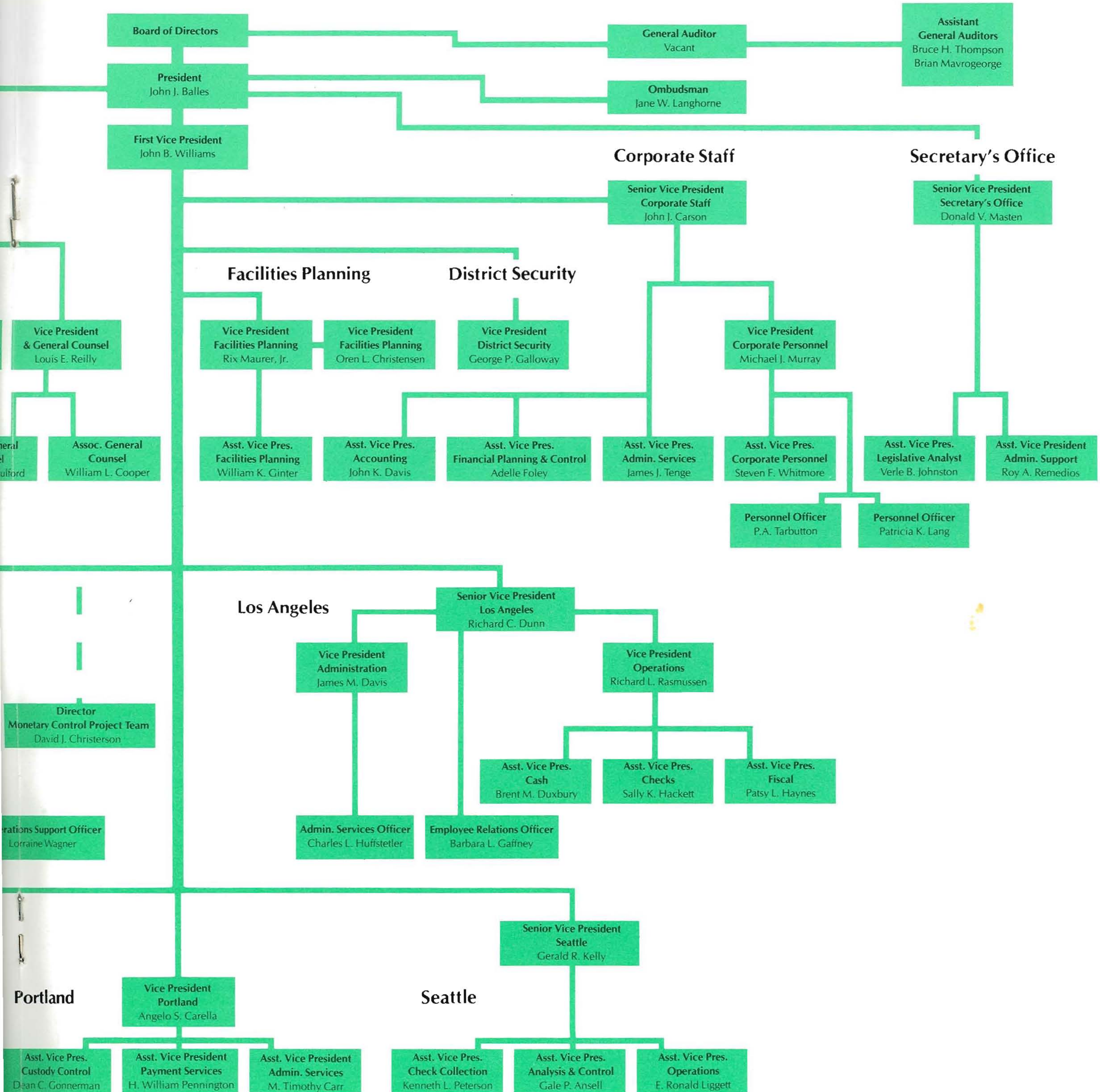
Western banks enter 1981 with a significant locational advantage, since their domestic operations are concentrated in one of the strongest regions of the country. With any substantial drop in interest rates, they would also benefit from improved margins on their mortgage and consumer-loan portfolios. Still, the cost of funds may remain high—and earnings depressed—because of continued fluctuations in interest rates, increased reliance on variable-rate deposits, and competition from other financial institutions.

Management Committee
(Shown from left to right)
Kent O. Sims, Senior Vice President, District Departments
John B. Williams, First Vice President
John J. Balles, President
John J. Carson, Senior Vice President, Corporate Staff

Federal Reserve Bank of San Francisco
Organization Chart

February 1, 1981




Board of Directors
General Auditor Vacant
Assistant General Auditors Bruce H. Thompson Brian Mavrogeorge
President John J. Balles
Ombudsman Jane W. Langhorne
First Vice President John B. Williams
Corporate Staff
Secretary's Office
Senior Vice President Corporate Staff John J. Carson
Senior Vice President Secretary's Office Donald V. Masten
Facilities Planning
District Security
Vice President & General Counsel Louis E. Reilly
Vice President Facilities Planning Rix Maurer, Jr.
Vice President Facilities Planning Oren L. Christensen
Vice President District Security George P. Galloway
Vice President Corporate Personnel Michael J. Murray
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Assoc. General Counsel William L. Cooper
Asst. Vice Pres. Facilities Planning William K. Ginter
Asst. Vice Pres. Accounting John K. Davis
Asst. Vice Pres. Financial Planning & Control Adelle Foley
Asst. Vice Pres. Admin. Services James J. Tenge
Asst. Vice Pres. Corporate Personnel Steven F. Whitmore
Asst. Vice Pres. Legislative Analyst Verle B. Johnston
Asst. Vice President Admin. Support Roy A. Remedios
Personnel Officer P.A. Tarbutton
Personnel Officer Patricia K. Lang
Los Angeles
Senior Vice President Los Angeles Richard C. Dunn
Vice President Administration James M. Davis
Vice President Operations Richard L. Rasmussen
Director Monetary Control Project Team David J. Christerson
Asst. Vice Pres. Cash Brent M. Duxbury
Asst. Vice Pres. Checks Sally K. Hackett
Asst. Vice Pres. Fiscal Patsy L. Haynes
rations Support Officer Lorraine Wagner
Admin. Services Officer Charles L. Huffstetler
Employee Relations Officer Barbara L. Gaffney
Senior Vice President Seattle Gerald R. Kelly
Portland
Vice President Portland Angelo S. Carella
Seattle
Asst. Vice Pres. Custody Control Dean C. Gonnerman
Asst. Vice President Payment Services H. William Pennington
Asst. Vice President Admin. Services M. Timothy Carr
Asst. Vice Pres. Check Collection Kenneth L. Peterson
Asst. Vice Pres. Analysis & Control Gale P. Ansell
Asst. Vice Pres. Operations E. Ronald Liggett

Branch Operations
(Shown from left to right)
H. Peter Franzel, Vice President, Operations
Angelo S. Carella, Vice President, Portland
Gerald R. Kelly, Senior Vice President, Seattle
Richard C. Dunn, Senior Vice President, Los Angeles
A. Grant Holman, Vice President, Salt Lake City

Western Central Bank

During 1980, the operations of the Federal Reserve Bank of San Francisco began to change dramatically, in response to several historic financial and legislative developments. At the same time, the Reserve Bank continued to provide central-bank services—in the area of checks, coin, currency, fiscal agency, and electronic fund transfers—for a regional economy which again grew at a faster pace than the rest of the nation. The Twelfth District, which is served by five Reserve Bank offices (San Francisco, Los Angeles, Portland, Salt Lake City and Seattle) is the largest Federal Reserve District in terms of both geographic size and industrial activity. It includes the states of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah and Washington, plus the territories of Guam and American Samoa, with a total population of 37.7 million people.

The 1980 combination of high inflation and high interest rates created an expanded workload for many of the Bank's operating departments, not to mention an increased demand for policy analyses by the Bank's research economists. The fiscal department, for one, came under heavy pressure at times from large crowds of individual investors who wanted to take advantage of the record-high interest rates available on government securities. Throughout the spring months, the Bank's staff implemented the Special Credit Restraint program that the Federal Reserve had unveiled on March 14 as part of the government-wide drive to curb speculative inflationary pressures. The Bank's statistical-services department, for example, thereafter became heavily involved in the implementation of reporting procedures for nonbank consumer lenders, who were subject to a special deposit requirement under the credit-restraint program.

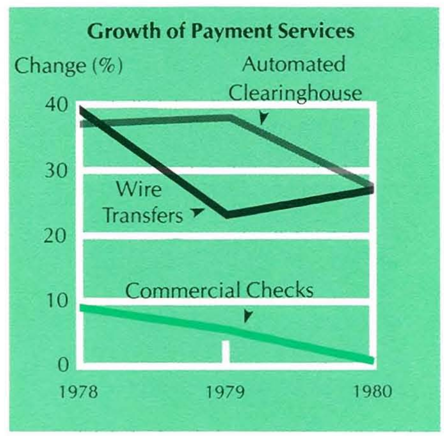
Creation of MCA

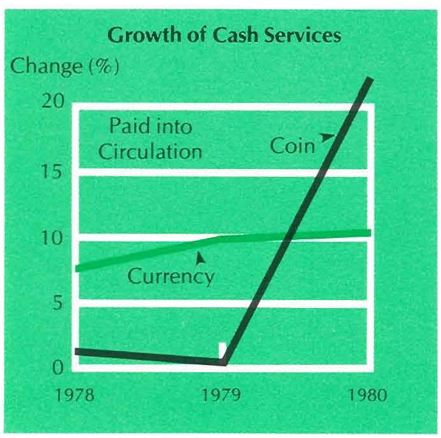
All of these developments were overshadowed by the major operational changes generated by the Depository Institutions Deregulation and Monetary Control Act (MCA), which was signed into law by the President on March 31. The path-breaking Monetary Control Act was Congress' answer to a number of pressures which had distorted the nation's financial structure in recent decades—such as widespread financial innovations, shifting competitive patterns, severe inflationary pressures, and a related upsurge in interest rates.

Through the MCA, Congress promoted greater competition in financial markets, primarily by providing for the phase-out of deposit interest-rate ceilings and a broadening of asset and payment powers of banks and thrift institutions. Congress also promoted greater equity and improved monetary control by extending reserve requirements (following a phase-in period) to all depository institutions with transaction (check-type) accounts and non-personal time deposits. This step helped to solve the problem of declining Federal Reserve membership, by reducing the cost of reserve requirements for member banks and imposing similar reserve requirements on all insured depository institutions. Moreover, Congress promoted greater efficiency in financial markets, by providing access to Federal Reserve services, at explicit prices, for all depository institutions subject to reserve requirements.

Implementation of MCA

To implement the MCA, which is perhaps the most important piece of financial legislation since the passage of the Federal Reserve Act in 1913, the San Francisco Reserve Bank established an MCA Policy Committee. This committee is responsible for reviewing plans and proposals, and for making the decisions required to keep the implementation moving forward smoothly and on schedule. Even prior to passage of the act, the Bank formed a Pricing and Access Project Team, with the responsibility for examining the potential impact of pending legislative proposals. The Project Team later took on the added responsibility of coordinating implementation of the act's provisions on a District-wide basis.





Many Bank departments became involved in carrying out the provisions of the new legislation during the course of the year. They designed systems to handle the new pricing and billing functions, developed computer programs to perform these new functions and to process reports from a sharply expanded constituency, developed plans for broader access to credit facilities, restructured reserve accounts, and created staffing plans to meet all these new operating burdens. In addition, a price-administration group took over responsibility for analysis and reporting of data related to charges for Federal Reserve services.

To facilitate understanding of the MCA and its implementing regulations, the Bank conducted an extensive two-phase orientation effort for its new constituents. The first phase of the program included 35 general-information "outreach" meetings held in 25 major cities throughout the District. In addition, 54 detailed technical seminars were held in 10 District cities, covering such subjects as reporting, maintenance of reserves, and pass-through requirements. In support of this face-to-face contact, the Bank established MCA Information Desks at each office to receive and direct inquiries from new constituents to persons prepared to handle their specific questions.

Implementation Schedule

The Federal Reserve revised its implementation plans several times during the course of the year in response to comments solicited from the financial industry and the public. However, considerable progress was evident by year-end. The San Francisco Reserve Bank, instead of serving only 147 member banks, soon will be dealing with several thousand banks and thrift institutions. Institutions with $15 million or more in total deposits began reporting reserves on a weekly basis in November 1980, and smaller institutions ($2 million to $15 million in deposits) began reporting quarterly in January 1981. A number of very small institutions with deposits of less than $2 million (primarily credit unions) will be exempt from reporting and reserves-posting requirements until May 1981. Non-member institutions will phase-in their new reserve requirements over an eight-year period, while present member banks will phase-down to lower levels of requirements over a four-year period.

Pricing and access to various Fed services are being phased-in over a year-long period, rather than being introduced all at once, to facilitate an orderly transition to the requirements of the legislation. Pricing will begin early in 1981 for wire transfer and net settlement services. Sometime after midyear, charges will be levied for check clearing and collection, and for automated clearinghouse services, although certain limited facilities will be available to new constituents at the beginning of the year. Pricing will begin in late 1981 for purchase and sale of securities, safekeeping and transfer of securities, and noncash collection services, and pricing will begin early in 1982 for coin- and currency-transportation services.

In the credit area, a Federal Reserve task force has developed procedures for administering the discount window in an environment characterized by a much larger number of account relationships and different types of financial institutions. In order to manage this situation effectively, the Reserve Bank has made arrangements for off-premises custody of virtually all of the collateral that its new constituents will post with the Reserve Bank. In addition, the Bank has centralized the administration of loans extended by all five offices in its San Francisco headquarters office.

Supervisory Developments

In the supervisory area, bank examinations and bank holding-company inspections during 1980 confirmed the generally healthy condition of the institutions supervised by this Reserve Bank. During the year, the General Accounting Office (GAO) conducted a review of procedures used to monitor commercial-bank compliance with the Treasury Department's recordkeeping and reporting regulations. This review, part of a broad GAO evaluation of the effectiveness of Federal bank-regulatory agencies, has involved field work in San Francisco and three other Federal Reserve Districts.

Supervisory personnel implemented several initiatives designed to improve efficiency and strengthen examination procedures. These included hosting two conferences on the subject of international examinations. One conference concerned the examiner's role in evaluating "country risk"—the debt-management problems of individual countries—and the second involved discussions with other Federal and state regulatory agencies concerning the Uniform Report of Examination developed by the Federal Financial Institutions Examination Council. Bank staff also improved the examination coverage of Edge Act corporations (firms involved in international trade and finance) by establishing working relationships with the internal-audit teams sent to review Edge corporations by their parent firms located outside this District. In the trust area, Bank staff conducted a joint examination with personnel of the Securities and Exchange Commission (SEC), to compare operating procedures of depository trust institutions with standards defined by the SEC.

The consumer-affairs staff conducted examinations at all state-member banks, and also at about one-fifth of their branches, in line with an expanded System-wide program designed to achieve broad-based compliance with consumer-protection laws and regulations. The Reserve Bank received numerous individual consumer complaints against commercial banks, but none of the complaints required the Bank to resort to its enforcement powers to compel remedial action. In addition, the staff received several thousand requests for information from the general public, many of them in response to a series of Bank-produced public-service announcements on consumer regulations, which were shown on a number of television stations in the District.

Computer Developments

The Bank continued to implement a long-range automation plan during 1980. This plan calls for District-wide standardization of processing for most operations, and the centralization of some activities. Under the plan, all five offices are tied together via a modern computer network controlled from the San Francisco data center. In 1980, the staff installed a standard accounting system in all branches, in a major step toward standardizing District systems. To accommodate the increasing level of automation over the next several years, computer personnel installed a new computer in the San Francisco data center, and made plans to upgrade computers in Los Angeles and Seattle during the first part of 1981. This upgrading was doubly necessary because of the heavy workload created by implementation of the new MCA programs.

Data-processing and fiscal personnel continued work on the automation of a Treasury-securities inventory and transfer system (called SHARE). San Francisco is the lead district on this project, which on completion in 1981 will provide a standardized on-line database servicing 13 offices in the Kansas City, St. Louis and San Francisco districts.

Payments Services

In 1980, as in earlier years, electronic-payments systems continued to expand rapidly. While check-processing activity increased only one percent, wire funds-transfer volume jumped 27 percent, as District member banks sent several trillion dollars through the Federal Reserve's wire-transfer system during the year. Moreover, a sharp 27-percent gain in volume occurred at automated clearinghouses (ACHs), which move funds by electronically-transmitted payment instructions that take the place of paper checks. To accommodate rapid volume growth and improve operational controls, the Bank consolidated its wire-transfer function in San Francisco during the year. ACH personnel meanwhile installed new software to provide for an automated reconcilement system as a means of reducing operational errors.

In check-processing activity, Bank staff handled 1.5 billion paper checks during the year—a significant deceleration from earlier growth patterns. However, drastic changes in deposit schedules shortened check-processing times and increased pressure on equipment and staff resources. The Bank began to develop a major automation project in the low-speed processing function—which handles nonmachinable deposits and checks rejected for poor encoding, mutilation, improper size, etc.—to replace labor-intensive procedures. Reduction of float (checks credited prior to receiving payment) received high priority during the year, especially in view of the requirement to price float under the Monetary Control Act.

Cash, Fiscal Activities

Despite the increase in check usage and the rapidly accelerating growth in electronic payments, the Reserve Bank continued to handle substantial amounts of coin and currency in 1980. Altogether, it paid 4.9 billion coins and 1.6 billion pieces of currency into circulation during the year. Efficiency in the cash function improved with the installation of more high-speed currency-sorting machines, of which six are now in operation at various District locations. Each machine has an optimum feed rate of 1,200 notes a minute, and is capable both of detecting counterfeits and of destroying, on line, those notes which do not meet fitness standards. To improve production capabilities as well as the quality of currency in circulation, the San Francisco and Los Angeles offices both started second-shift processing on the new equipment during the year.

In its role as fiscal agent for the U.S. Government, the Reserve Bank handled substantial amounts of public-debt instruments in the form of savings bonds, marketable Treasury securities and food stamps. Activity in marketable securities increased 52 percent in volume, reflecting strong investor interest in the record-high rates offered on such issues. Moreover, volume rose because of an increase in the redemption of savings bonds, which paid a considerably lower rate of interest than marketable securities. During this same period, the Treasury Department recalled all Series E and H savings-bond stock for replacement with Series EE and HH bonds. This process, which involved reconcilement with over 8,800 issuing agents, was a major effort spanning the entire year.

These developments caused severe processing backlogs during the first half of the year. The backlogs were overcome by midyear with additional trained staff and enhancements to automated systems. The summer decline in interest rates provided time to react to the rapidly changing securities market. As rates again surged upward in late fall, the Bank was better positioned to cope with significant increases in volume.

Improved Productivity

Throughout the year, the Bank's management struck an appropriate balance between cost-effectiveness of operations and quality of output. The San Francisco Reserve Bank rated second in the System in cost effectiveness, with aggregate unit costs 7 percent below the System average. Productivity (output per worker hour) in these operational activities has increased 74 percent in the past six years, thus helping to offset the sharply rising costs of salaries, material and equipment. Meanwhile, as a result of a quality-improvement program initiated three years ago, the Bank ranked among the System leaders in quality of performance, as measured by reductions in errors and processing times on various operational tasks.

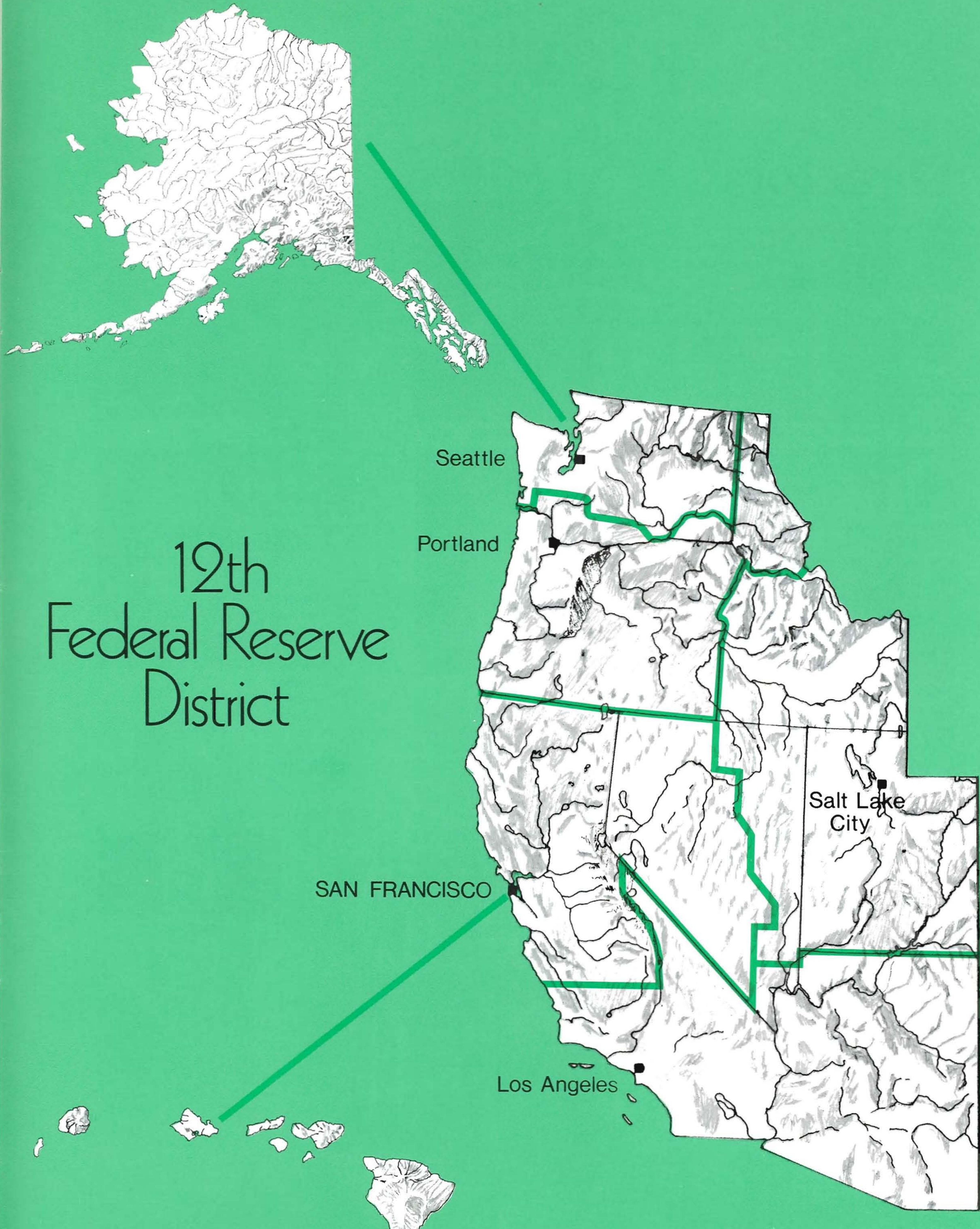
Lastly, as a means of assuring the effectiveness of future operations, the Bank began construction of a 12-story 653,000-square-foot headquarters building on San Francisco's Market Street. The present headquarters building was built in the 1920's and is small and inefficient from the standpoint of 1980-style banking operations; indeed, with recent increases in workload, the bank's headquarters operations now are spread over five separate buildings. Groundbreaking ceremonies for the new building were held in March 1980, and in early 1981, the steel framework began to rise. The new facilities are scheduled for occupancy in late 1982, ready to assist the Bank in providing a growing number of central-banking services to its expanded constituency of Western financial institutions.

Summary of Operations

	Volume (thousands)			
	1977	1978	1979	1980
Custody Services				
Cash Services				
Currency paid into circulation	1,187,814	1,281,416	1,407,894	1,556,278
Coin paid into circulation	3,943,437	3,991,280	4,007,145	4,895,306
Fiscal Agency Services				
Savings Bonds original issues	1,449	1,547	1,563	1,327
Savings Bonds redemptions processed	515,257	447,625	437,053	446,717
Other Treasury original issues	24	59	150	231
Food coupons processed	257,735	263,684	223,232	274,058
Payments Mechanism Services				
Check Processing Services				
Commercial checks processed	1,178,298	1,283,807	1,358,985	1,373,421
Government checks processed	110,992	117,237	109,761	99,096
Return items processed	15,043	17,956	20,225	21,391
Electronic Funds Transfer Services				
Wire transfers processed	2,248	3,123	3,847	4,883
Automated clearinghouse transactions processed	17,137	23,512	32,448	41,298
Discounts and Advances				
Total discounts and advances*	355	914	1,318	1,092
Number of financial institutions accommodated*	43	60	59	67
Noncash Collections Services	164	225	193	297

*Number (not in thousands)

12th Federal Reserve District



Directors

The Federal Reserve carries out its central-banking functions through a nationwide network of 12 Federal Reserve Banks and their 25 branches, under the policy guidance, coordination and general supervision of the Board of Governors in Washington, D.C. The Head Office of the Federal Reserve Bank of San Francisco has a nine-member Board of Directors. Each of the Bank's other offices at Los Angeles, Portland, Salt Lake City and Seattle has a seven-member board.

Federal Reserve directors bring management expertise to the task of overseeing Reserve Bank operations. They also provide first-hand information on key economic developments in various areas of the District, complementing the Bank's internal research efforts. In addition, Board members give advice on the general direction of monetary policy, especially with regard to the Bank's discount rate. The Head Office Board has specific responsibility for initiating changes in the discount rate, subject to review and approval by the Board of Governors.

Head Office

Chairman of the Board and Federal Reserve Agent
Cornell C. Maier
Chairman, President and Chief Executive Officer
Kaiser Aluminum & Chemical Corp.
Oakland, California

Deputy Chairman
Caroline Leonetti Ahmanson
Chairman of the Board
Caroline Leonetti Ltd.
Hollywood, California

Alan C. Furth
President
Southern Pacific Company
San Francisco, California

Frederick G. Larkin, Jr.
Chairman of the Executive Committee
Security Pacific National Bank
Los Angeles, California

Ole R. Mettler
President & Chairman of the Board
Farmers & Merchants Bank of Central California
Lodi, California

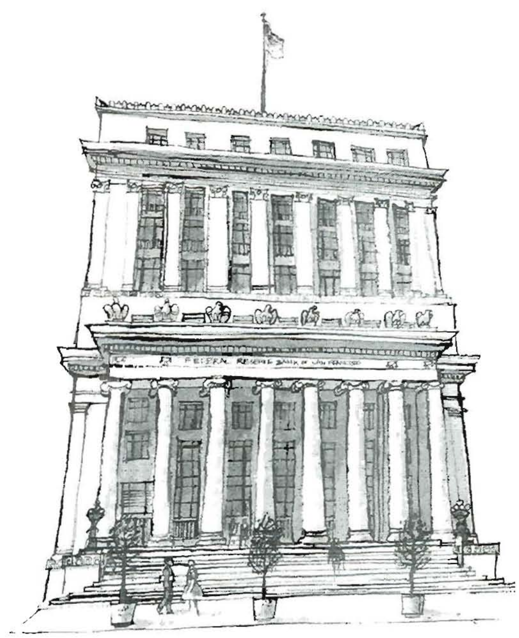
Clair L. Peck, Jnr.
Chairman of the Board
C.L. Peck Contractor
Los Angeles, California

Malcolm T. Stamper
President
The Boeing Company
Seattle, Washington

J.R. Vaughan
Senior Member
Richards, Watson, Dreyfuss & Gershon
Los Angeles, California

Robert A. Young
Chairman of the Board and President
Northwest National Bank
Vancouver, Washington

Federal Advisory Council Member
Chauncey E. Schmidt
Chairman of the Board, President and Chief Executive Officer
The Bank of California, N.A.
San Francisco, California



Maier

Ahmanson

Furth

Larkin

Mettler

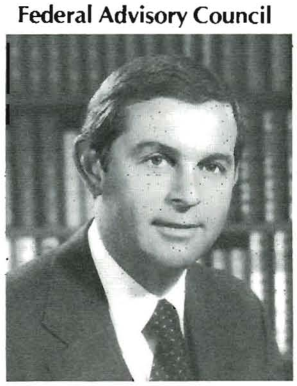
Peck

Stamper

Vaughan

Young

Federal Advisory Council



Schmidt

Los Angeles

Chairman of the Board
Harvey A. Proctor
Chairman of the Board
Southern California Gas Company
Los Angeles, California

Fred W. Andrew
President
Superior Farming Company
Bakersfield, California

James D. McMahon
President
Santa Clarita National Bank
Valencia, California

Bram Goldsmith
Chairman of the Board
City National Bank
Beverly Hills, California

Harvey J. Mitchell
President
First National Bank of San Diego County
Escondido, California

Lola McAlpin-Grant
Assistant Dean
Loyola Law School
Los Angeles, California

Togo W. Tanaka
President
Gramercy Enterprises
Los Angeles, California

Portland

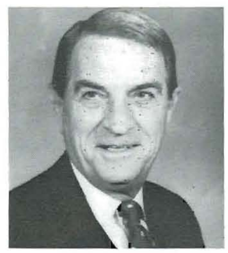
Chairman of the Board
John C. Hampton
Chairman of the Board and President
Willamina Lumber Company
Portland, Oregon

Merle G. Bryan
President
Forest Grove National Bank
Forest Grove, Oregon

Jack W. Gustavel
President and Chief Executive Officer
The First National Bank of North Idaho
Coeur d'Alene, Idaho

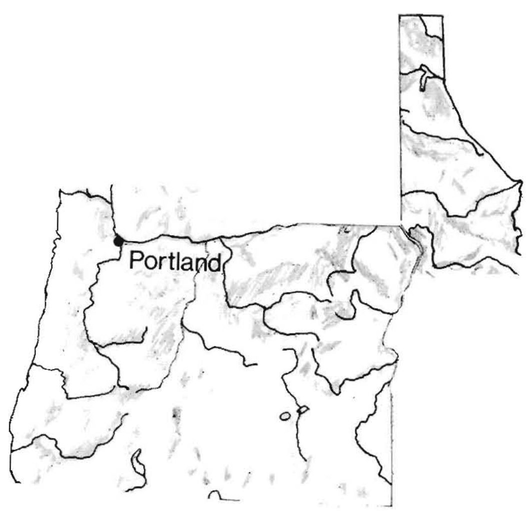
Jean Mater
Vice President
Mater Engineering, Ltd.
Corvallis, Oregon

William S. Naito
Vice President
Norcrest China Company
Portland, Oregon



Phillip W. Schneider
Former Northwest Regional Executive
National Wildlife Federation
Portland, Oregon

Robert F. Wallace
Chairman of the Board and President
First National Bank of Oregon
Portland, Oregon



Salt Lake City

Chairman of the Board
Wendell J. Ashton
Publisher
Deseret News
Salt Lake City, Utah

Spencer F. Eccles
President and Chief Operating Officer
First Security Corporation
Salt Lake City, Utah

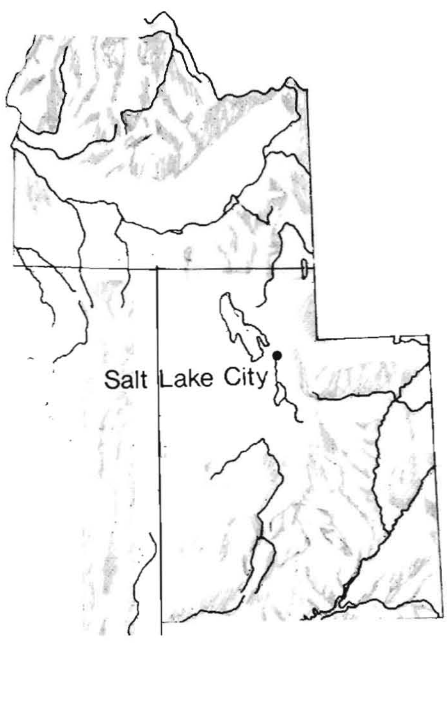
Robert A. Erkins
Geothermal Agri/Aquaculturist
White Arrow Ranch
Bliss, Idaho

David P. Gardner
President
University of Utah
Salt Lake City, Utah

Albert C. Gianoli
President and Chairman of the Board
First National Bank of Ely
Ely, Nevada

Fred H. Stringham
President
Valley Bank and Trust Company
South Salt Lake, Utah

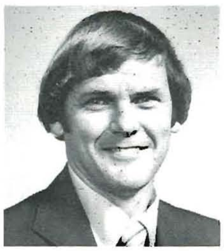
J. L. Terteling
President
The Terteling Company, Inc.
Boise, Idaho



Seattle

Chairman of the Board
George H. Weyerhaeuser
President and Chief Executive Officer
Weyerhaeuser Company
Tacoma, Washington

Merle Adlum
President
Puget Sound District Council,
Maritime Trades Dept. AFL-CIO
Seattle, Washington



Lonnie G. Bailey
Executive Vice President
and Chief Operating Officer
Farmers and Merchants Bank of Rockford
Opportunity, Washington

C. M. Berry
President
Seafirst Corporation and
Seattle-First National Bank
Seattle, Washington

Douglas S. Gamble
President and Chief Executive Officer
Pacific Gamble Robinson Company
Seattle, Washington

Donald L. Mellish
Chairman of the Board
National Bank of Alaska
Anchorage, Alaska

Virginia L. Parks
Vice President for Finance and Treasurer
Seattle University
Seattle, Washington

Comparative Statement of Account

(Thousands of Dollars)

	December 31, 1979	December 31, 1980
Assets		
Gold certificate account	$ 670,016	$ 1,253,000
Special Drawing Rights certificate account	211,000	293,000
Federal Reserve notes of other Federal Reserve Banks	0	0
Other cash	60,642	64,883
Loans to Member Banks:		
Secured by United States Government & Agency obligations	36,500	55,025
Other eligible paper	0	0
Other paper	84,100	2,700
Federal Agency obligations	1,080,827	1,185,528
United States Government securities:		
Bills	5,952,159	5,926,467
Notes	7,432,314	7,965,458
Bonds	1,914,520	2,291,565
Total United States Government securities	15,298,993	16,183,490
Total loans and securities	16,500,420	17,426,743
Cash items in process of collection	3,778,141	827,166
Bank premises	11,105	42,508
Operating equipment	10,497	11,127
Other assets:		
Denominated in foreign currencies	349,962	794,379
All other	459,492	552,056
Total assets	22,051,275	21,264,862
Liabilities		
Federal Reserve notes	13,193,695	14,219,242
Deposits:		
Total Member bank—reserve accounts	7,290,498	6,044,474
United States Treasurer—general account	337,362	0
Foreign	42,159	56,604
Other deposits	121,199	28,683
Total deposits	7,791,218	6,129,761
Deferred availability cash items	193,520	237,572
Other liabilities	508,166	289,759
Total liabilities	21,685,599	20,876,334
Capital Accounts		
Capital paid in	182,338	194,264
Surplus	182,338	194,264
Total liabilities and capital accounts	22,051,275	21,264,862
Contingent liability on acceptances purchased for foreign correspondents	0	0

Earnings and Expenses

(Thousands of Dollars)

	December 31, 1979	December 31, 1980
Current Earnings		
Discounts and advances	$ 12,644	$ 12,977
United States Government securities	1,323,391	1,664,860
Foreign currencies	9,684	18,630
All other	43	159
Total current earnings	1,345,762	1,696,626
Current Expenses		
Total current expenses	71,031	86,389
Less reimbursement for certain fiscal agency and other expenses	6,582	6,681
Net expenses	64,449	79,708
Profit and Loss		
Current net earnings	1,281,313	1,616,918
Additions to current earnings		
Profit on sales of United States Government securities (net)	0	0
Profits on foreign exchange transactions	0	15,283
All other	1,081	2,365
Total additions	1,081	17,648
Deductions from current net earnings		
Loss on foreign exchange transactions (net)	515	0
Loss on sales of United States Government securities (net)	20,272	26,590
All other	920	3,641
Total deductions	21,707	30,231
Net additions (+) deductions (−)	− 20,626	− 12,583
Assessments for expenditures of Board of Governors	− 7,330	− 9,880
Net earnings before payments to United States Treasury	1,253,357	1,594,455
Dividends paid	10,330	11,192
Payments to United States Treasury (interest on Federal Reserve notes)	1,212,926	1,571,337
Transferred to surplus	30,101	11,926
Surplus January 1	152,237	182,338
Surplus December 31	182,338	194,264

San Francisco Office
P.O. Box 7702, San Francisco, California 94120

Los Angeles Branch
P.O. Box 2077, Terminal Annex, Los Angeles, California 90051

Portland Branch
P.O. Box 3436, Portland, Oregon 97208

Salt Lake City Branch
P.O. Box 30780, Salt Lake City, Utah 84130

Seattle Branch
P.O. Box 3567, Terminal Annex, Seattle, Washington 98124

This report was prepared by the staff of the Federal Reserve Bank of San Francisco: produced by William Burke and Karen Rusk; graphics designed by William Rosenthal; copy written by William Burke, Barbara Bennett, Gary Zimmerman, Yvonne Levy, Robert Jacobson, and Randall Pozdena.