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ANNUAL REPORT 1984

FEDERAL RESERVE BANK OF SAN FRANCISCO

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The Federal Reserve Bank of San Francisco is one of twelve regional Reserve Banks which, together with the Board of Governors in Washington, D.C., comprise the nation's central bank. The Federal Reserve Bank of San Francisco serves the Twelfth Federal Reserve District, which includes Washington, Oregon, California, Arizona, Nevada, Utah, Idaho, Alaska, Hawaii, Guam and American Samoa.

As the nation's central bank, the Federal Reserve is responsible for determining and carrying out our nation's monetary policy. It also is a bank regulatory agency, a provider of wholesale priced banking services, and the fiscal agent for the United States Treasury.

From the Boardroom

The closing months of 1984 marked the end of the second year of economic recovery for the United States and Twelfth District economies. The robust 5.9 percent growth of the national economy in 1984 was remarkably strong by historical standards for the second year of an economic expansion. Equally impressive was the failure of inflation to pick up despite two years of healthy economic growth. To an important extent, this success was due to the Federal Reserve's continuing program of reducing growth in the monetary aggregates over the last five years.

The economic expansion has been surprisingly strong given the persistence of high inflation-adjusted, or *real*, interest rates that to an important extent could be traced to large ongoing federal budget deficits. These high interest rates, and the related strength of the U.S. dollar overseas, showed up in an uneven pattern of economic development in different sectors of the economy, with industries vulnerable to either of the two factors generally failing to share fully in the economic recovery. Such a pattern also held for parts of the West and, in some instances, showed up in the performance of western banks significantly involved in lending to the affected industries, such as agriculture, real estate, and forest products.

Cuts in personal taxes and added incentives for business provided by the Economic Recovery and Tax Act of 1981 helped to offset much of the impact of high real interest rates on household spending on durables and business expenditures on plant and equipment. Indeed, plant and equipment spending enjoyed the biggest boom since the Korean War, a boom that was attributable in part to a combination of new "high-technology" investment opportunities and the efforts of business to modernize in the face of greater competition from abroad and deregulation at home.

To an important extent, the burden of high interest rates fell heavily on industries strongly reliant on export markets, or that faced significant competition from imports. The link was indirect: high interest rates helped attract a large influx of foreign capital, pushing up the value of the dollar on foreign exchanges and thereby reducing the international competitiveness of U.S. business. As the year wore on, housing began to show signs that it too felt the pinch of higher interest rates, while agriculture struggled with the double burden of a strong dollar, which depressed overseas demand, and high borrowing costs.

The significant deceleration in the rate of economic activity in the second half of 1984 from the heady pace in the first raised fears in some quarters that the recovery would falter in 1985. However, the failure of inflation in 1984 to accelerate significantly as it typically does during an expansion, and the shot-in-the arm given the economy by the fall in interest rates in the latter part of 1984, suggest that the economy will continue to expand in 1985.

The diverse needs of the Twelfth District make special demands on the operations of the San Francisco Reserve Bank in its role in fostering an efficient payments mechanism. In 1984, the Bank implemented Systemwide and District programs to improve the quality and efficiency of its services. These programs included changes in check-depositing deadlines and check-sorting that resulted in an increased availability of funds and a 75-percent reduction in internally generated float. FedLine, a microcomputer-based funds transfer service, was enhanced to allow customers to place orders for currency and coin, while automated clearinghouse services were enhanced on a Systemwide basis with an improved deposit and delivery schedule, automation of paper return items, and expanded electronic capabilities.

The Bank's commitment to meeting the future needs of the District was represented by groundbreaking ceremonies for a new Los Angeles branch facility. The new building will accommodate all existing operational needs and their expansion in the foreseeable future. In 1984, the Bank also expanded its efforts to develop comprehensive disaster contingency plans to guard against the risk of serious financial loss. The plans provide detailed procedures for responding to and recovering from short-term disruptions and for maintaining minimum levels of customer service.

The Bank also pursued a cost-containment program aimed at controlling the costs of certain employee benefits and making broader use of automation. Automation of some services has the added benefit of improving service delivery and meeting the changing needs of depository institutions in innovative ways. Together, cost-containment efforts held the Bank's 1984 expenses within budget, and allowed the Bank to propose a 1985 budget only 5.3 percent higher than that of 1984.

Management benefited greatly during 1984 from the broad-based experience and judgment of the Bank's Board of Directors at its headquarters office and at its four branches. The Directors provided guidance on major management decisions and planning goals. In addition, they supplied information and views on eco-

John J. Balles
President

Caroline Leonetti Ahmanson
Chairman (1984)

Alan C. Furth
Chairman (1985)

Fred W. Andrew
Deputy Chairman (1985)

nomic and financial conditions to support the Federal Reserve's formulation of monetary policy.

We especially appreciate the contributions of Caroline Leonetti Ahmanson, who retired as Chairman of the Board of Directors of the San Francisco Headquarters Office last year following 8½ years of service as a Director in this District. Her energy and devotion to the Federal Reserve System's goals provided an invaluable source of counsel and inspiration to the Bank's management and to its five Boards of Directors. We would like to extend our thanks and appreciation to other directors whose terms ended in 1984: the late Robert A. Young (Chairman of the Board and President, Northwest National Bank, Vancouver, Washington), Bruce M. Schwaegler (President, Bullock's-Bullocks Wilshire, Los Angeles, California), Jack W. Gustavel (President and Chief Executive Officer, The First National Bank of North Idaho, Coeur D'Alene, Idaho), Wendell J. Ashton (Publisher, Deseret News, Salt Lake City, Utah), and G. Robert Truex, Jr. (Chairman, Rainier Bancorporation and Rainier National Bank, Seattle, Washington); and to our Twelfth District Member of the Federal Advisory Council, Joseph J. Pinola (Chairman of the Board, First Interstate Bancorp, Los Angeles, California).

Finally, we wish to express our appreciation to the officers and staff whose efforts and dedication made 1984 an innovative and successful year.

John J. Balles
President

Alan C. Furth
Chairman of the Board

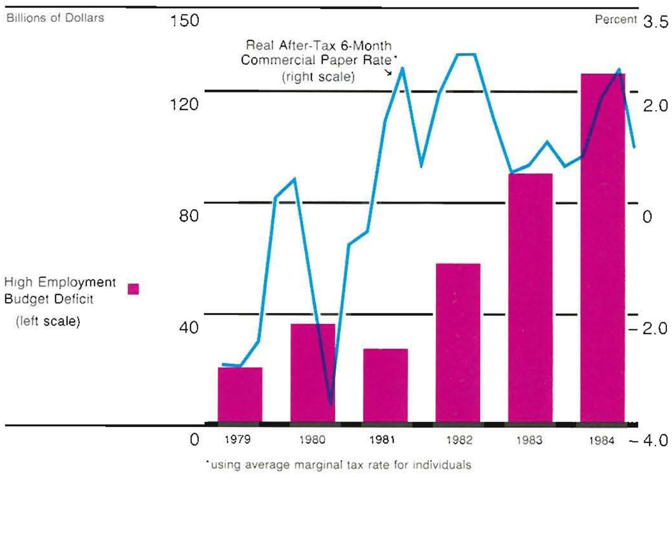
Setting the Pattern

To a large extent, economic events in the Twelfth District in 1984 mirrored the forces shaping the national picture. Last year, the national economy was in the second year of a recovery noteworthy for both its overall strength and its very uneven pattern of development across different sectors. The result of this unevenness was a dual economy in which export and import-competing firms and heavy industry were hurt by a strong dollar and high real interest rates. This dual economy showed up in the Twelfth District where the economic performance of regions with relatively high concentrations of affected industries lagged behind that of other areas. In addition, a tapering-off of national economic growth in the second half of 1984 showed up in the District toward the end of the year.

Federal Deficits and High Real Rates

Between 1981 and 1984, the U.S. federal budget deficit rose from 2.2 percent to 4.8 percent of GNP. By 1984, the deficit was absorbing over half of the net savings of households, businesses, and state and local governments. The failure of the government deficit to shrink during the current economic expansion, which began at the end of 1982, combined with strong private credit demands meant that the aggregate demand for funds greatly exceeded the supply of domestic saving. The result was unusually high levels of real, or inflation-adjusted, interest rates for this stage of a business expansion.

High Employment Budget Deficit
vs. Real After-Tax 6-Month Commercial Paper Rate



*using average marginal tax rate for individuals

The pressure on interest rates became particularly acute in the first half of 1984 as robust 8.3 percent growth in the economy sent many households and businesses into the credit markets to borrow. However, a slowdown in the rapid pace of expansion in the latter half of the year, combined with actions taken by the Federal Reserve to support the economy's transition to a more sustainable rate of activity, allowed interest rates to retreat by year-end to approximately the same levels that prevailed at the beginning of the year.

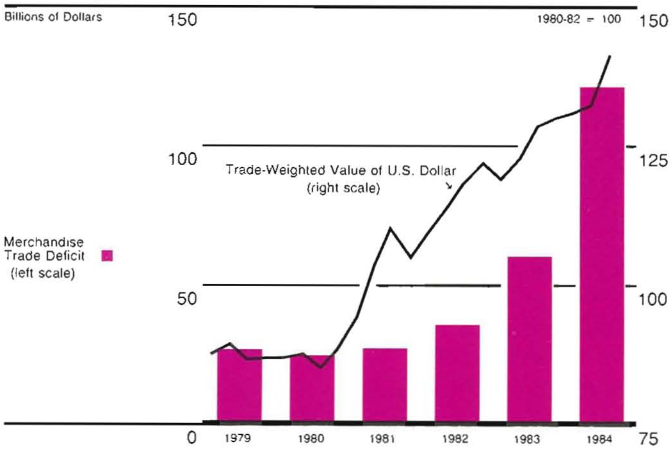
The high interest rates that have been one of the hallmarks of this economic expansion would, by themselves, have significantly displaced, or "crowded out," household and business expenditures sensitive to interest rate costs were it not for some offsetting influences. Last year was the third year of a plan, provided by the Economic Recovery and Tax Act of 1981, to phase in personal income tax cuts that boosted personal disposable incomes. As a result, consumer purchases of durable goods, such as automobiles, remained strong despite high financing costs. Similarly, there is evidence that tax incentives for business provided by the 1981 Act have more or less fully offset the increased costs of issuing debt and equity caused by higher interest rates.

Thus, it seems that the unusual strength in plant and equipment spending in the last two years was more likely due to the combination of new "high-technology" investment opportunities, particularly in the area of electronic equipment, and the need for business to modernize in the face of a more highly competitive atmosphere. The result has been the biggest boom in such spending of any economic expansion in the post-war period.

Crowding out the Foreign Sector

Because of offsetting factors, business investment has remained strong, at least in the aggregate. The sector affected most adversely by the deficit's impact on real interest rates has been the foreign sector, which consists of industries that produce goods for export or that compete with foreign imports. A large U.S. federal budget deficit and high real interest rates, along with this country's political stability and strong economy, have attracted a large influx of foreign capital. The consequent heavy demand for U.S. dollars in foreign exchange markets has driven up the exchange value of the dollar. As a result, U.S. companies have found it difficult to compete abroad at the same time that imported goods have made large inroads into U.S. markets.

Merchandise Trade Deficit vs.
Trade Weighted Value of U.S. Dollar



The trade-weighted value of the U.S. dollar has risen over 50 percent since mid-1980, and it rose 13 percent in 1984 alone. As the dollar has risen, the U.S. merchandise trade balance has deteriorated. Since mid-1980, when the dollar started to rise, the decline in the trade balance has been roughly $100 billion. For 1984, merchandise imports exceeded exports by $123 billion as a strong surge in imports outpaced a modest gain in exports. In addition, demand for U.S. exports has been reduced by relatively weak economic expansions abroad and by the debt burdens of lesser developed countries, which have forced them to cut back on their purchases from the U.S.

Overall

Overall, the economic expansion continued at an extraordinarily strong pace through the first half of 1984. The sharp rise in production was due mainly to a replenishing of real business inventories depleted at a record annual rate during the recession. In the beginning of 1984, businesses were accumulating inventories at a $30 billion annual rate, another record in the post-World War II period. This sharp swing away from a substantial run-off of inventories during the recession accounted for about 30 percent of the increase in production during this expansion. Final sales—that is, GNP excluding inventory investment—have increased at about the same pace in this expansion as in past ones.

The rate of inventory accumulation slowed to a more sustainable pace in the second half of 1984 and contributed to a slowdown in production. In addition, the stimulatory effects of the Reagan Administration's personal income tax cuts on consumption had largely dissipated, while high real interest rates had started to take their toll on purchases of consumer durables and on residential construction. Furthermore, a tremendous surge in imports relative to exports, especially in the third quarter, reflected a substantial deflection of demand away from domestically produced goods. This switch in net foreign demand was four times as large in absolute terms during 1984 as the stimulatory effect of the change in the federal budget deficit.

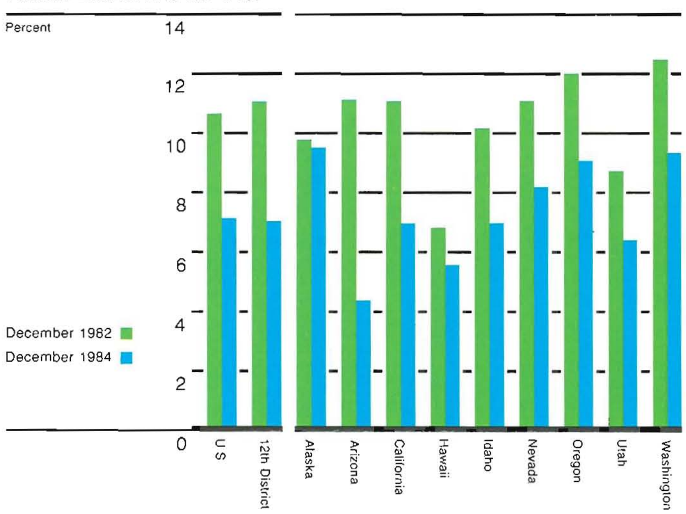
The weakening in overall demand, in conjunction with the first stages of an inventory correction, reduced the growth of real GNP from 8.6 percent in the first half of 1984 to 3.2 percent in the second half. By year-end, there was concern that the economic expansion was ending prematurely. Several signs, however, indicated differently. An increase in inflation typically has preceded the end of past recoveries, but, in the second half of 1984, the inflation rate remained low at around 3.5 percent. Consequently, by year-end, long-term interest rates had fallen approximately 150 basis points from their highs in the summer, and promised to give a boost to interest-sensitive spending, such as housing and capital spending by business. In addition, new building permits for private housing were on the rise, while healthy growth in personal income at year-end raised hopes that household spending would pick up in the months ahead. Most important, growth in real economic activity accelerated in the fourth quarter from its third quarter slowdown.

The Western Regional Economy

Like the national economy, the western economy enjoyed a broad-based, although uneven, expansion in the second year of the recovery. Economic developments in the Twelfth District, as in the nation, were driven mainly by growth in consumer spending and business investment. Highly expansionary fiscal policy, together with its effects on interest rates and the U.S. dollar, shaped the pattern of developments in the District, as did the boom in high-technology capital spending.

Differences in economic performance among the states could be traced to an important extent to differences in their economic make-up. States with industries that relied heavily on government orders or that were part of the high-technology sector generally fared well, whereas states with industries significantly hurt by high interest rates and the strong dollar often suffered by comparison. Also following the national pattern, rapid economic growth in the beginning of 1984 slowed to a more sustainable pace in the second half of the year.

Unemployment Rates—
Twelfth District and the U.S.



Overall Measures of Recovery

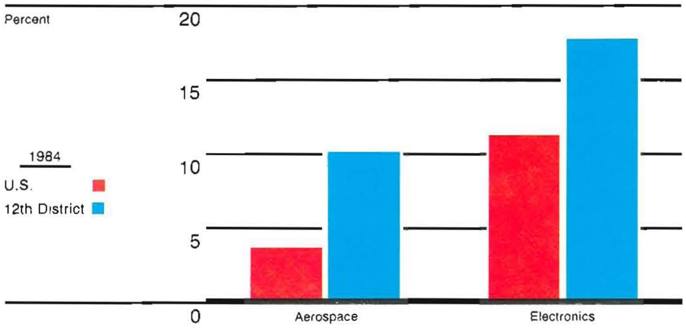
In keeping with its size and economic diversity, the West as a whole enjoyed an unemployment rate roughly equal to that of the nation. There was considerable diversity in unemployment rates among western states, but even so, all of the nine states in the Twelfth District had unemployment rates at year-end below their December 1982 recession levels. The lowest rate at the end of the year was enjoyed by Arizona with 4.4 percent unemployment, while Alaska registered the highest rate at 9.6 percent.

Employment growth also varied widely across the states in the District. The most rapid employment gains were made in Utah and Arizona with annual growth rates of 9.6 and 8.1 percent respectively. In contrast, employment continued to grow sluggishly in Oregon and Washington. Growth in housing activity, another important barometer of regional conditions, also varied across states although it improved in most instances over 1983. The number of housing permits issued increased most rapidly in Arizona and California and registered the slowest growth in Oregon and Idaho.

Sources of Strength

As in 1983, the prominence of the aerospace and electronics industries added vigor to a state's recovery. Both increased consumer spending and increased defense spending have buoyed the demand for these sectors' products. California, which received 23 percent of all prime defense contracts in 1984, benefited most from the continued strength of defense spending. Employment in the aerospace industry in California rose by 7.2 percent in 1984, and employment in the electronics industries also increased sharply. The economies of Oregon, Utah and Washington received boosts from aerospace and electronics manufacturing activity as well. In fact, the strength of these sectors was crucial in offsetting some of the continued weakness in the important forest products industry of the Pacific Northwest region.

Aerospace and Electronics Employment as a Proportion of Total Manufacturing Employment—U.S. and Twelfth District



As was true for the nation as a whole, the general increase in consumer and business spending early last year also was a source of strength in the western economy. Employment in the services and trade industries rose an average 5.0 percent from mid-1983 to June 1984 and was particularly important to the economies of Arizona, Utah and California. In Hawaii, for example, increases in tourism helped to offset the depressed pineapple and sugar industries.

Rapid rates of spending on consumer durables and new housing in the first half of 1984 also were sources of strength in the western economy, as they were in the national economy. In Arizona, construction activity was a particularly important contributor to the state's employment growth, which ranked as the most rapid in the nation in 1984. Toward year-end, however, key indicators such as automobile sales and housing starts signalled that the economic slowdown observed nationally was occurring in the West as well.

The boom in business capital spending nationwide during this recovery also is reflected in the District's economic performance. Districtwide employment gains of 2.5 percent in manufacturing were registered over the first half of the year, a rate only slightly below that of 1983, and nonresidential construction activity continued at high levels throughout 1984, particularly in Hawaii, Idaho and Nevada.

Areas of Weakness

Despite the generally good health of the western economy, there were some markedly weak areas. Agriculture, for example, suffered from the combined effects of continued high interest rates, the international strength of the dollar, and domestic and worldwide gluts in the markets for some products. Although interest rates declined toward the end of 1984, many western farmers were having difficulty with debt burdens they had accumulated over the past several years. The Federal Land Bank reported the highest rate of farm loan delinquencies in California in thirty years, and as many as 15 percent of California farmers left the industry in the past year. Weak foreign markets and the continued strength of the dollar overseas sharply reduced the demand for many of the West's key agricultural products. The value of California farm exports in 1984 fell to $3.0 billion from $3.3 billion in 1982 and $4.2 billion in 1981.

Farm problems have been compounded by unusually large harvests for some crops, most notably raisins, grapes and almonds. The combination of weak demand and abundant supply of some crops depressed net farm income in most of the states in the District. In California, the deterioration in agriculture has caused as much as a 40-percent decline in certain agricultural land prices. In Idaho and Utah, however, net farm income weathered the difficult economic conditions and posted increases in 1984.

The wood products industry in the West also has remained weak. Although home construction and other uses of wood products have grown significantly since the 1981-1982 recession, product prices remain depressed because of weak export markets. Special regional circumstances also limit the recovery of this industry. Pacific Northwest producers face higher stumpage, labor and transportation costs compared to producers in the southeastern United States. They also suffer from proximity to Canadian producers, whose competitiveness has been helped by the weakness of the Canadian dollar. As a result of these competitive disadvantages, production of some wood products at the end of 1984 remained below the levels of 1979.

The weakness in the wood products industry significantly detracted from the economic performance of Oregon and Washington in 1984. Despite strength in other industries in these states, the overall performance in both was lackluster. Oregon and Washington had the second and third highest unemployment rates in the Twelfth District and the slowest overall growth in employment during the year.

The mining industry, concentrated mostly in the intermountain states and Nevada, also was affected by low prices and foreign competition. The decline in inflation over the past two years has sharply reduced the demand for the "inflation-hedge" metals, gold and silver. The subsequent fall in their prices has made much gold and silver mining in the West uneconomical. Copper mining continued to be plagued by weak world demand aggravated by a decline in international competitiveness due to the strong dollar.

Despite the weakness in both mining and forest products, the economies of the intermountain states have been among the best performing in the District. In Utah, for example, the dampening effects of these weak sectors were more than offset by broad-based strength in the manufacturing and service industries and the general stimulus provided by defense expenditures. Indeed, Utah enjoyed the third highest rate of employment growth in the nation during the first half of 1984.

The weakening of the OPEC cartel and the decline in world demand for oil were major causes of the continued poor performance of the Alaskan economy. Alaska depends strongly on oil revenues, to the extent that each one dollar decline in the price of a barrel of crude oil results in a decline of about $150 million in state revenues. For the state as a whole, employment growth in 1984 remained above national and District averages, and the unemployment rate, although still very high, remained stable in 1984.

The Outlook

Because the western economy is highly diversified, its overall performance next year should reflect that of the nation. Recovery should therefore continue, albeit at a slower pace. Some signs of a slowdown were evident before the end of 1984, but they did not indicate that the District's economy was heading toward a recession. This interpretation is reinforced by healthy Christmas retail sales activity and continuing declines in unemployment rates at year-end.

The decline in short-term and long-term interest rates that occurred in the second half of 1984 will stimulate spending in the interest-rate sensitive sectors of consumer durables and housing. A strong revival in housing demand would be particularly welcome in the Pacific Northwest because it would provide the necessary basis for a broad and sturdy recovery there. Recent passage of federal legislation affecting timber contracts on public lands also should help by reducing the average cost of harvested timber.

Disbursements from existing defense contract commitments should strengthen the aerospace and electronics industries through 1986. Other high technology industries also can be expected to grow through the next two years. But the U.S. dollar's continued high value in foreign exchange markets will threaten to erode even the overseas demand for electronics products, and eventually cause some jobs in these industries to be moved to other countries.

Agriculture also should be healthier in 1985 as the lower level of interest rates stemming from declines in the latter half of 1984 help relieve the current debt burden on farming operations. Export demand for agricultural products would recover if foreign currencies regained some of their strength in relation to the U.S. dollar. Whether this occurs will depend importantly on the outcome of efforts to reduce the federal budget deficit. In any event, 1985 will be a critical year for western farmers generally, and California farmers in particular, as many farms already are in poor financial condition.

The economy of the Twelfth District should remain one of the most dynamic in the U.S. economy in 1985. Unlike much of the country, the western region does not depend on older, more vulnerable heavy industry. Rather, it harbors the largest concentration of high technology enterprise in the world and a diversity of other manufacturing, agricultural and raw materials industries. Such diversity gives the West the capacity to continue to grow through 1985.

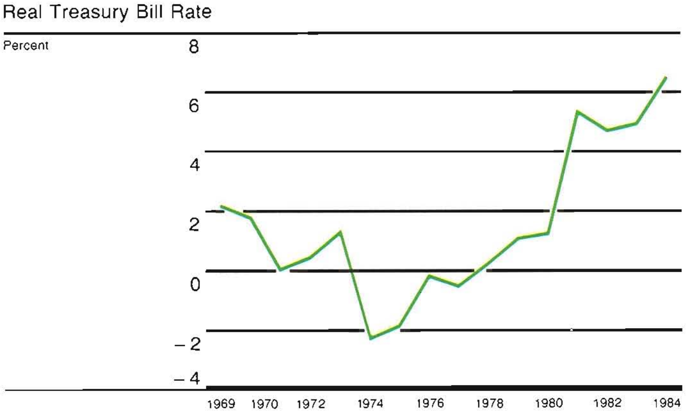
As a group, western banks posted their first year-over-year increase in aggregate earnings since 1980. Nevertheless, just as in the last few years, their profitability remained well below the national banking industry because of large loan losses suffered by a few large banks. Moreover, the unevenness of economic expansion which has characterized the current national and regional recoveries showed up in mixed performances across western banks in 1984.

The major drag on earnings for the banking industry, both nationally and in the West, continued to be related to asset quality. A business expansion normally brings an improvement in bank loan quality by the end of its second year as it boosts the financial positions of bank borrowers. But despite an economic expansion that is strong by historical standards and which is now entering its third year, a significant improvement in the quality of bank assets does not seem imminent. One of the key reasons for this is the unevenness of the economic recovery in the District, a phenomenon shared with the national economy and shaped by some of the same developments—a reduction in inflation, a persistence of high real interest rates and a strong dollar.

High Interest Rates and a Strong Dollar

The current expansion's high level of real interest rates has increased the real debt burden of many U.S. firms and raised the likelihood of defaults. It also has complicated the international debt repayment situation both directly by adding to the interest cost of financing debts and indirectly by being one factor that has driven up the foreign exchange value of the dollar.

Real Treasury Bill Rate



Because much of international debt is denominated in dollars, a stronger U.S. dollar means a higher debt repayment burden to a borrowing country in terms of its *own* currency.

This problem is particularly acute for lesser developed countries (LDCs) with substantial amounts of international debt. Because a solution to the economic problems of LDCs seems unlikely in the near future, large banks probably will be plagued for some time by their outstanding loans to these nations.

The strong dollar also has contributed to weakness in several important segments of the domestic economy and thereby affected bank loan quality. It has curbed the overseas sales of many domestic firms while creating stiff competition for domestic industries competing against imported products. Reductions in international competitiveness, attributable in part to the strong dollar, have weakened many export and import-competing industries in the West as elsewhere in the nation.

The strong dollar along with high real interest rates have contributed to the unusually high default rates on bank loans to the troubled steel, mining and manufacturing industries, as well as to the agricultural and forest products industries. In a similar way, persistent weakness in the markets for petroleum products will continue to produce problems with loans to the energy industry. Furthermore, in many of the areas dominated by these depressed industries, both consumers and smaller businesses have suffered as well. Even a robust economy is not likely to improve the prospects of repayment by some firms in these industries unless the dollar loses some of its strength in international markets.

Problems with loan quality varied widely across banks in the West. For many, increases in provisions for loan losses due to bad loans resulted in weakened earnings, while for some, they resulted in actual losses. Size, composition of loan portfolios, and location each played an important role in determining banks' loan quality. Multinationals were hurt by their problem LDC loans, while energy lenders continued to suffer from over-investment in the domestic petroleum industry. In California, some larger banks were also hurt by heavy losses on real estate and agricultural lending. In Oregon, the smaller banks, lending in local markets, were hardest hit by the extended weakness in the forest products industry. Also, loan losses related to real estate were instrumental in the failure of several small western banks.

Deregulation

This recovery is the first in 50 years to occur during a period in which depository institutions have been free from interest ceilings on most deposit accounts. Deposit-rate deregulation has come essentially in two stages—first, on large-size business deposits in the late 1960s and early 1970s, and second, on retail consumer deposits in the late 1970s and early 1980s. This deregulation has altered the way the financial and real sectors are affected by the business cycle. For example, deregulation of deposit rates means that regulated depository institutions are no longer vulnerable to financial disintermediation when market rates rise above ceiling levels. Thus, deregulation has eliminated the periodic shortages of loanable funds that used to occur when rates rose above ceiling levels, and thereby has ensured a good availability of bank loans and credit despite high interest rates. Not only has the economy benefited from the increased availability of bank credit during these episodes, but banks themselves are now able to compete much more effectively with financial institutions not subject to interest ceilings, such as money market funds, insurance companies, and the U.S. Treasury.

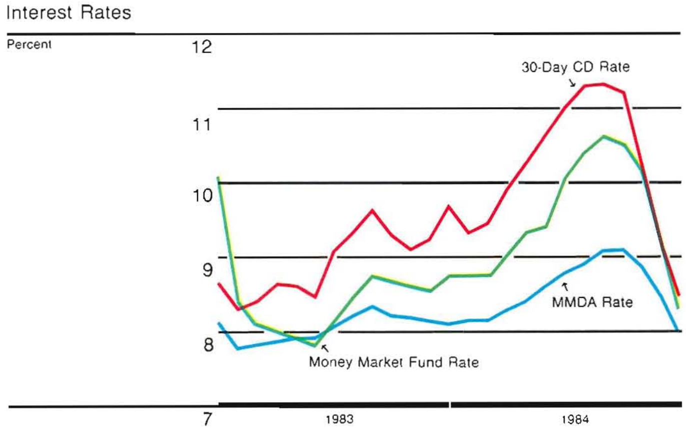
Under deposit-rate ceilings on retail accounts, banks and thrifts attracted core deposits, such as passbook savings, checking, and NOW accounts, by paying both explicit interest at the ceiling rate and by offering depositors a multitude of added conveniences and free or underpriced services, such as free checking privileges and extensive branch office networks. In theory, this sort of noninterest or nonprice competition would be less efficient than direct competition using interest rates because depositors on average would value these additional services at less than their cost. Thus, under deposit deregulation, the explicit interest cost of attracting retail deposits would rise while the noninterest cost would decline as banks and thrifts cut back on some underpriced services and high-cost branches and begin charging explicitly for other services.

Particularly in the competitive bank and thrift markets that prevail in the West, it is likely that the rise in explicit interest costs actually would be less than the decline in noninterest costs. The total combined interest and noninterest costs might actually decline with deposit deregulation, although there could be a costly adjustment period. Therefore, a subtle but very important impact of deposit-rate deregulation is that it has offered the prospect of lowering the total cost of attracting retail deposits, particularly in competitive markets.

Deposit deregulation has had still another important impact. Under the previous system of ceiling rates on retail deposits, large banks with access to national or international financial markets had substituted wholesale deposits, such as unregulated large CDs (that is, those over $100,000), for retail deposits. This response also was not as cost-effective in attracting deposits as direct price competition for retail deposits would have been. The shift from wholesale CDs to retail Money Market Deposit Accounts (MMDAs) that followed deposit deregulation appears to have had a beneficial impact on the earnings of large banks. It improved their competitive position for retail deposits in relation to their unregulated competitors, such as the money market funds, and allowed them to compete more efficiently against other banks for deposits.

The forces of deregulation were most evident in the pricing of MMDAs—ceiling-free, insured, short-term retail accounts offering limited check-writing privileges, and not subject to a reserve requirement on personal accounts. With the MMDA, institutions were able to attract large quantities of funds (currently over $400 billion nationally), thus allowing large banks in particular to reduce their need for more expensive wholesale liabilities, such as large CDs. During 1984, rates paid on MMDAs, which total over twenty percent of western banks' domestic deposits, were well below those paid on large CDs and rates paid by competing money market funds. While this pricing strategy for MMDAs tended to limit the total quantity of MMDA balances, it also resulted in a significant cost savings for many banks. Thus, banks' overall deposit versus lending interest margins widened as they took advantage of the lower costs of deposits.

Interest Rates



With the ability to engage in direct price competition, banks reduced nonprice forms of attracting deposits. They began to raise explicit fees for some previously underpriced banking services and to eliminate or cut back on others. The decline in some nonpriced services resulted in cost savings that were supplemented by increased fee income from the explicit pricing of other services. Both changes contributed to lowering the noninterest costs of attracting deposits.

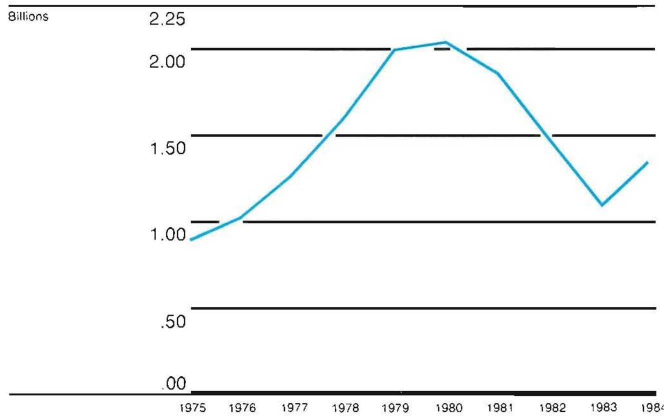
One negative effect of deregulation on bank earnings has been the adjustments some banks have had to make in shifting from nonprice to price competition. For example, deregulation reduced the value of branches in attracting retail deposits and therefore imposed additional costs associated with reducing the number of such offices on banks, especially those with large branch networks. These losses associated with adjusting to a deregulated environment may have had short-run negative effects on some banks' earnings, but there is little evidence that the costs of deregulation have substantially offset deregulation's positive effects on lowering total deposit costs and increasing fee income. The upturn in bank earnings and the rate at which new banks formed in the Twelfth District last year suggest that deregulation has not had a widespread or lasting adverse impact on the industry. On the contrary, the impact appears to have been positive.

Performance

Much of the improvement in aggregate western bank earnings resulted from a slight improvement in net interest margins—the difference between interest earned on assets and interest paid on liabilities. Moreover, in the aggregate, dollar earnings also benefited from a moderate expansion in banks' assets despite a slight reduction in their foreign assets.

Because of the unevenness of the current economic expansion, asset growth varied considerably across banks. The most rapid expansions were in some smaller institutions that chose to increase their real estate and consumer lending. Consumers were eager to borrow, even at historically high real rates, to finance acquisitions of autos, other consumer durable goods and housing that had been postponed over the last several years. Weak loan demand from the corporate sector during much of the second half of 1984 slowed loan growth at the larger banks and led them to place more emphasis on their lending to the household sector.

Aggregate Net Income
Twelfth District Banks



In addition, declining interest rates during the second half of 1984 had a positive impact on bank earnings because loan rates temporarily lagged behind the decline in funding costs and because some banks still held substantial amounts of long-term fixed rate loans.

Together, these positive factors offset the continued need to build up loan loss reserves, and resulted in an increase of over 30 percent in western banks' aggregate net income for 1984 (net of extraordinary gains or losses). While earnings were well above 1983's depressed $1.1 billion level, they were still far below the record $2.0 billion earned in 1980. For western banks in the aggregate, and for many individual institutions in the West as well, returns on equity and assets still are below the national averages. However, the turnaround in profitability in 1984 is important considering that banks probably will continue to face credit quality problems despite the advanced stage of the recovery. Improved earnings are essential if western banks are to generate much needed additions to their capital, and to continue to build cushions against potential losses.

Supervision, Regulation and Credit

Developments in this Reserve Bank's supervisory, regulatory and credit activities in 1984 confirmed the generally improving, although still spotty, condition of western banks and banking organizations. The balance sheets and earnings of individual banks reflected weaknesses in housing, energy, and certain agricultural products, while international loans created difficulties for multinational banks. Overall, most institutions experienced rising earnings and higher levels of capital, although poor loan quality and the economic sectors that did not share fully in the recovery harmed some institutions.

The majority of weaker banking organizations did not warrant classification as problem institutions, but a small number required special supervisory attention. At the end of 1984, supervisory actions were outstanding or in process at 27 state member banks and bank holding companies out of a total of 350 such institutions under this Bank's supervision. In addition, federal or state authorities closed 12 District commercial banks, compared to 10 in 1983. Most of these were small banks that failed because of problem real estate and agricultural loans.

The lingering effects of the recession also were evident in record activity at the discount window. During 1984, both the number of loans granted and the number of borrowers reached new highs. The Bank extended 2,300 loans to 132 depository institutions, compared to 1,234 loans to 108 institutions in 1983. Furthermore, the number of institutions with liquidity problems that borrowed under the extended credit program increased to 25 from 18 in 1983. A discount rate that was lower than market interest rates throughout 1984 also encouraged borrowers to seek temporary accommodation at the Federal Reserve. With the prospect that their borrowing needs would grow through the year, institutions pledged $25.4 billion in collateral by year-end—up from $18.5 billion in 1983.

Close cooperation with other federal and state regulators remained a key element in this Bank's effective supervision of western depository institutions. The Bank continued successfully to coordinate examinations of state member banks and offices of foreign banks on a joint or alternating basis with various state banking authorities, and scheduled bank holding company inspections to coincide, where possible, with the examination of the lead bank subsidiary by other federal agencies or the states. Cooperation extended to the implementation of formal corrective actions and the review of applications, and has resulted not only in more effective supervision, but also economies in staffing and reductions in the burdens of examination for institutions.

The Supervision, Regulation and Credit Department has a long-term objective, established in 1983, of improving the efficiency and quality of internal administrative functions. In 1984, it made significant strides toward automating its administration with the use of new computer technology. On-line storage and retrieval of collateral information for the credit function were implemented, and automation projects affecting the planning of examinations, examination records, and budgeting and management reports are in process. Other programming enhancements expedited the processing of regulatory reports filed by District institutions and strengthened financial surveillance and analysis systems. These projects have improved the Bank's access to data and its ability to analyze the condition of supervised institutions.

Regulatory changes by the Federal Reserve System, as well as simplified application procedures, facilitated expansion by bank holding companies into such fields as securities brokerage, foreign exchange services and futures markets in 1984. Generally, banking organizations approached these activities with caution, although there was one striking exception—they rushed to form so-called "consumer banks." Such banks have bank charters, but they do not offer *both* demand deposits and business loans. By dropping one or the other activity, they cease to be "banks" for purposes of the Bank Holding Company Act and become nonbank subsidiaries (hence the name "nonbank banks"), free from the barriers against interstate bank acquisitions. At year-end, this Reserve Bank had received over 50 applications by District bank holding companies to establish such limited-purpose banks in 21 states plus the District of Columbia. The Board of Governors recently approved consumer bank applications in other Districts with expressed reluctance, but the future of these subsidiaries is unclear because of pending Congressional action, favored by the Board, to restrict them.

The composition of bank holding company applications reflected this push to form nonbank banks. In addition, there was a sharp jump in the number of notices filed under the Change of Bank Control Act. This Act requires individuals or groups of individuals to obtain approval prior to purchasing shares in banks or bank holding companies that affect the control of those organizations. In 1984, 25 change of control notices were processed, compared to 4 the previous year. In contrast, fewer new bank holding companies were formed.

District banks also expanded their international operations more cautiously in 1984 in view of the unsettled outlook for international lending. The applications for new offshore lending activities fell both in number and significance as banks exploited opportunities for financing trade instead. The long-run economic potential of Pacific Basin trade encouraged growth in the number of Edge Act international banking offices in the Twelfth District. These offices specialize in trade-related banking transactions. Foreign banks' operations in the District also continued to grow, with the number of their branches and agencies increasing to about 150. Trade prospects also encouraged the expansion of Export Trading companies. By year-end, 9 were operating in the District and another had been approved. These companies were authorized by Congress in 1982 to promote U.S. exports by providing specialized trade support services and financing beyond those permitted to Edge Act corporations and U.S. banks.

The Federal Reserve's supervisory and regulatory responsibilities also include consumer education and protection. In 1984, the San Francisco Reserve Bank's consumer affairs staff continued its outreach activities by hosting two conferences for Neighborhood Housing Services and providing speakers for seminars and classes on consumer regulation for consumer groups and commercial bank training programs. Most consumer complaints involving state member banks in 1984 concerned equal credit opportunities, although a growing number involved allegations of unauthorized withdrawals from automatic teller machines. To assist examiners in future evaluations of member bank programs under the Community Reinvestment Act, the Bank began to prepare a series of Community Profiles in 1984. These profiles are studies of demographic, ethnic, and housing patterns in metropolitan areas in the Twelfth District. Information from them will be made available to banks, governments and development groups for use in their own planning. Profiles of Phoenix and Salt Lake City were completed in 1984.

Bank Administration

During 1984, the Federal Reserve Bank of San Francisco consolidated the delivery of certain wholesale banking services and internal operations with the goal of improving their quality and efficiency. In addition, it developed and refined several products to meet the continually changing needs of the banking industry. A cost-containment program was directed primarily toward controlling the costs of certain employee benefits and implementing an extensive automation strategy.

The Bank continued a multi-year project of disaster contingency planning to ensure that critical customer services are maintained in emergencies. Perhaps the most prominent example of the Bank's commitment to the efficient delivery of financial services was the start of construction on a new building for the Los Angeles Branch. The new facility is planned to meet the needs of the surrounding financial community for decades to come.

Cost-Containment

In 1984, the Bank developed a cost-containment strategy based on a reconfiguration of employee benefits and an intensified drive toward efficiencies from automation. The long-term strategy adopted for controlling employee benefit costs emphasizes treatment alternatives and encourages preventive health care. Treatment alternatives such as outpatient surgery and home health care should reduce the frequency and length of hospital admissions and thereby enable the Bank and its employees to realize lower medical premium costs.

The District's automation strategy exploits economies of scale by standardizing and centralizing large production systems for several services. Furthermore, it stresses the use of microcomputers within operating departments as complementary alternatives to higher cost data center facilities. For example, the conversion of check processing to identical systems in all five Reserve Bank offices in 1984 reduced program maintenance costs and allowed for stronger contingency backup. Processing for the Automated Clearing House facilities at the Portland, Salt Lake City and Seattle offices will be centralized in San Francisco in early 1985. In the Accounting area, both General Ledger and Billing Processing have been centralized in San Francisco in preparation for the new Integrated Accounting System which will be installed in all Federal Reserve Banks beginning in late 1985.

The program to restructure the Bank's telecommunications network, begun in 1980, was completed in 1984. This project resulted in the consolidation and sharing of telephone lines between the District's five offices and on-line depository financial institutions, thereby substantially reducing telecommunications costs associated with current and future growth of the network.

Overall, the San Francisco Bank's cost-containment efforts held 1984 expenses to $120.5 million (within budget) and allowed the Bank to propose a 1985 budget only 5.3 percent higher than that of 1984.

Disaster Contingency Planning

In 1984, the Twelfth District expanded its major multi-year effort to develop practical, well-tested, and comprehensive disaster contingency plans. These plans will promote staff safety and ensure that valuable items are protected. In addition, they guard against the risk of serious financial loss both to the Bank and Bank customers by specifying procedures to maintain minimum levels of customer service.

Operating departments with critical Reserve Bank functions have specified detailed procedures for response to and rapid recovery from short-term service disruptions. The overall Bank plan also will establish procedures for recovery from an emergency, such as provisions for emergency communications, back-up power for essential banking and building services, emergency medical care, and food storage. Twelfth District contingency plans for recovery from long-term service disruptions affecting the computer center (such as might be experienced during a major earthquake) will be initiated in 1985 in conjunction with Systemwide automation contingency efforts.

Proposed new Los Angeles building

Facilities Planning

Constructing a new building for the Los Angeles Branch was the chief focus of facilities planning efforts in 1984. The outdated Los Angeles facility, built in 1929 and expanded in 1953, cannot accommodate all existing operations, some of which are housed in nearby rented spaces.

The Board of Governors approved the conceptual design for the Los Angeles building project in December 1983; the project architect is Daniel L. Dworsky. Construction funding was approved in July 1984, and Swinerton and Walberg, Inc. was engaged as the general contractor. Groundbreaking ceremonies were held last September on the building site adjacent to the existing facility.

The new building, scheduled for completion in 1986, will accommodate all existing operational needs and their expansion in the foreseeable future. It will have a back-up source of power and other systems critical to maintaining the delivery of services during emergencies. In sum, the new facility will help the Branch meet the challenges of supplying efficient banking services to one of the nation's fastest growing communities.

Automation Efforts

The strategic objectives of the Bank's automation program support the Federal Reserve's multiple roles in making and implementing monetary and regulatory policy and in improving the efficiency of the payments mechanism through cost-effective services. Automation efforts therefore fall into several categories, including contributions to Systemwide efforts, internal enhancements to make service delivery both more efficient and responsive, and innovative programs to satisfy the changing needs of depository institutions.

Resource sharing efforts within the Federal Reserve's Systemwide automation program involve planning, testing, developing and implementing standard automated systems, the costs of which are shared by Reserve Banks. As represented by the Bank's involvement in the joint development (with the Board of Governors) of the Banking Statistics (STAT) application, these efforts continued to command a significant share of Bank resources last year. STAT, with initial availability planned for 1985, is an automated system designed to process data collected from depository institutions.

The choice of the San Francisco Bank by the Board of Governors to co-develop STAT testifies to the Bank's leading role in the System's resource-sharing automation program. This role dates back to the Bank's development of the first resource-shared application, SHARE, for automated securities handling. In 1984, the SHARE system was installed at three additional Reserve Banks, bringing the total to seven Banks at year-end; it is expected to be in production Systemwide (except at the New York Reserve Bank) in 1985. Direct participation in System automation efforts was complemented by the continued active participation of senior management in two national committees that set the long-range direction of Federal Reserve automation programs.

Other Systemwide automation efforts included implementation of Contemporaneous Reserves Reporting (CRR) in early 1984 and extensive systems planning and testing to support the installation of new Funds Transfer, Customer Information, Automated Clearing House (ACH) and Integrated Accounting System (IAS) software in 1985. The transition to new IAS software constitutes a multi-year, Systemwide effort that will standardize accounting systems at the same time that it centralizes the District's accounting system in the San Francisco headquarters office. The result should be improved accounting integrity over the Bank's assets and liabilities.

A second undertaking of the Bank's automation program has been to support Bank efforts to upgrade and expand electronic access for customers throughout the Twelfth District. The basic components of this project are the increased use of microcomputers and the use of updated communications technology. In 1984, the Bank completed the new state-of-the-art intradistrict communications network, SPINE, which expands electronic access capabilities and allows the Bank to contain communications costs. During the latter part of 1984, a major project was begun to upgrade data communications, software and security features for the Bank's micro-computer based "FedLine" service, including the implementation of more comprehensive and reliable data encryption. In addition, the Bank prepared to provide electronic access to its Automated Clearing House services via dial-up telephone connection by early 1985. A major computer upgrade program for the Branch offices of the San Francisco Reserve Bank and a project to standardize the processing of commercial checks throughout the District were other efforts successfully completed in 1984.

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March 1, 1985

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Financial Services

Bruce H. Thompson
Asst. Vice President
Securities Services

John H. Wong
Cash Services Officer

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M. Tim
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Financ

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and
Chief Executive Officer

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Gul Gidwani
Assistant
General Auditor

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Chief Operating Officer

and Product Management

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Oren L.Christensen
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New Building Programs

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Robert M. McGill
Senior Vice President

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Financial Services

Richard L. Rasmussen
Vice President
Administration

Brent M. Duxbury
Asst. Vice President
Administrative Services

Hector M. Martin
Vice President
Operations

Charles L. Huffstetler
Asst. Vice President
Cash Services

Ross G. Ashman
Asst. Vice President
Payments Services

Theodore A. Schroeder
Securities Services Officer

Management Committee
(From left to right)
Michael J. Murray, Senior Vice President
Richard T. Griffith, First Vice President and Chief Operating Officer
Thomas C. Warren, Executive Vice President
John J. Balles, President and Chief Executive Officer

Services to Government Agencies

The Federal Reserve Bank of San Francisco is an important provider of fiscal and financial services to the United States Treasury and the public. Fiscal services include issuing government securities and savings bonds, and financial services include check collection and funds transfers for government agencies, the processing of electronic payments and food coupons, and securities safekeeping.

With branches in Los Angeles, Salt Lake City, Portland and Seattle, the San Francisco Reserve Bank provides fiscal agent services to nine western states, including Alaska and Hawaii. Relatively high interest rates in 1984 increased the attractiveness of Treasury securities and led to a 35-percent increase in the commercial book-entry Treasury bill sales. In addition, the Bank's intensive efforts to improve the efficiency of its savings bond services fostered an increase in the number of bonds issued that included a 14-percent increase in the number issued for corporate payrolls.

The Federal Reserve Banks are the chief agents for relaying government transfer payments, such as social security payments, to individuals. These payments are made primarily through electronic transfers and/or Treasury checks. Electronic payments through the Automated Clearing House (ACH) and "Fedwire" have grown in recent years and the upward trend continued in 1984. Last year, government payments constituted 38 percent of the Systemwide ACH volume. Reserve Banks also collect, sort, cancel, and truncate Treasury checks after circulation. Within the System, the San Francisco Bank is the largest processor of government checks in the United States, handling nearly 100 million such checks in 1984.

Another major government service provided by Reserve Banks is the distribution and recirculation of fit currency to depository financial institutions. The San Francisco Reserve Bank, with the second highest cash processing volume in the Federal Reserve System, uses high-speed processing machines to count, sort, cull and verify currency deposits. The Bank currently is working with other Reserve Banks to develop even more efficient and effective "second generation" currency processing equipment. In addition, the District is studying ways to automate various administrative and clerical cash operations, and is exploring more efficient ways to dispose of residue from destroyed unfit currency. For the cash customer, the San Francisco Bank published a *Cash Services Customer's Guide* to help Twelfth District depository institutions prepare currency orders and shipments, and joined with other Reserve Banks in establishing standards that would accommodate a wider range of cash orders.

In 1984, the unique circumstances surrounding the Games of the XXIII Olympiad created the need to meet increased currency demands in the Los Angeles area. The Los Angeles Branch of the San Francisco Reserve Bank formed a Task Force working with local banks and government agencies to ensure sufficient supplies of high quality currency for automated teller machines near the Olympic Stadium and the Olympic Village. The Task Force also worked with the Olympic Organizing Committee to study requirements for armored cash transportation and security precautions. These cooperative efforts successfully met the needs of the international event.

Priced Payments Services

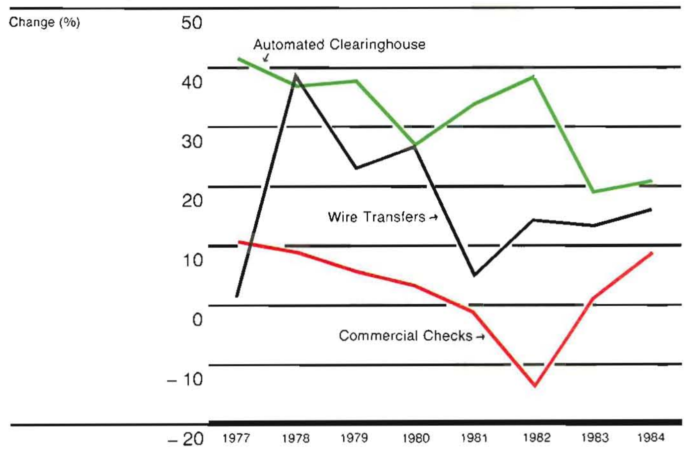
Through the Monetary Control Act (MCA) of 1980, Congress sought to promote greater competition in financial markets through deregulation and greater efficiency in the payments mechanism. It did the latter by requiring all Federal Reserve Banks to provide open access to payments services at explicit prices for all depository institutions subject to reserve requirements and to set prices to fully recover the direct and indirect costs of these services. The Federal Reserve Bank of San Francisco has responded to the mandate by pursuing efficiencies from automation and by continually improving the quality of its services in response to the needs of the financial community in the nine western states it serves.

The Twelfth District encompasses a highly populous and diverse area with a population of 38 million people spread over five time zones. To learn of and respond to the needs of more than 4,000 depository institutions, the District Financial Services unit conducts market research and Districtwide service information programs. The District Product Management group, working with operations and automation staff, translates these needs into new or enhanced products. As a direct result of this program, a net increase of about 300 new customer relationships were established in 1984, and approximately 1,000 institutions in the Twelfth District now use Reserve Bank services.

Check Services

The San Francisco Reserve Bank handles the largest volume of checks of any Reserve Bank in the Federal Reserve System. As a result, it aggressively pursues improvements in service levels and quality. In 1984, as part of a Systemwide plan, the Bank implemented later check deposit deadlines to improve the availability of funds. In addition, the Bank implemented the High Dollar Group Sort service as part of a Systemwide effort to accelerate the collection of checks and offer customers significant opportunities to obtain improved check availability and reduce transportation costs. Also, an enhanced national monitoring system to track delivery and credit performance on individual cash letters improved the Bank's ability to optimize check transportation arrangements as well as to assign check float to institutional depositors.

Growth of Payments Services



By emphasizing improvements in the quality of check services that, for example, reduced internally generated float by 75 percent, the San Francisco Reserve Bank was able to hold the cost of check services steady throughout 1984. This commitment to price stability and rigorous cost-control will ensure a continuation of current product prices through 1985 with no more than minor adjustments.

The Twelfth District's broad range of demographic and geographic conditions, in conjunction with its time differences from eastern money markets, has dictated the most complex check transportation requirements in the System. In 1984, the Bank extended its transportation capability by joining with the System's Interdistrict Transportation Service (ITS) in delivering check collection services. The use of ITS charter service improved the availability of funds on many checks payable in other Federal Reserve Districts.

Funds Transfer

The Reserve Bank's online Funds Transfer service continued to grow in 1984 especially with the increasing popularity of its microcomputer-based service—FedLine. The total number of customers using FedLine doubled in 1984 to approximately 800.

Initially, the major goal of FedLine was to allow a wider range of subscribers to transfer funds directly through the Federal Reserve's communications system—Fedwire. During 1984, the Bank expanded FedLine's capabilities further to allow customers to place orders for currency and coin. In addition, the terminal device used for leased line electronic access was changed to a microcomputer for compatibility with FedLine and to provide better service. In early 1985, depository financial institutions will also have the option to receive electronic information on cash letters, debits, credits and adjustments, as well as daily accounting information, through a new service, "FedLine-UpDate."

Automated Clearing House

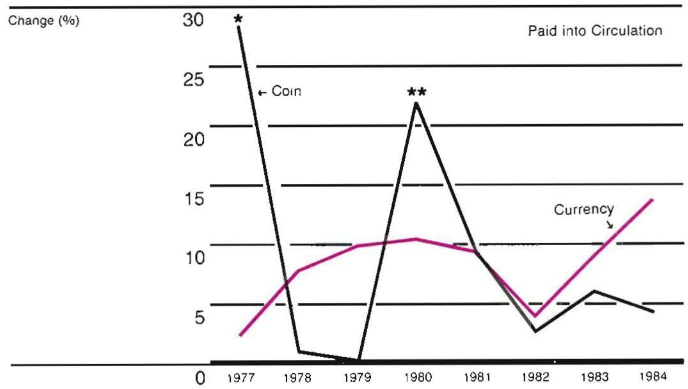
The bank's Automated Clearing House (ACH) facility remained an important and rapidly growing service in 1984. ACH consists of the exchange and delivery of electronic payments items. While incentive pricing has been employed as a means to encourage rapid growth in this electronic service, the cost recovery target for this service has increased annually. In 1984, the service was priced to recover 60 percent of expenses. By 1986, the Federal Reserve System plans to have phased in full cost recovery for ACH service. In cooperation with local Automated Clearing House Associations, the Bank continues to identify opportunities for stimulating wider acceptance of efficient electronic payments and for facilitating the entry of private sector processors into ACH service.

On a national scale, the ACH service was enhanced significantly by an improved Systemwide deposit and delivery schedule, new ACH software, the automation of paper return items, and substantially expanded electronic capabilities.

Cash and Securities Services

Despite growth in alternative payments services, cash requirements throughout the Twelfth District were substantial in 1984. The Federal Reserve circulates new Federal Reserve notes, withdraws unfit bills from circulation, and accommodates transfers of currency among financial institutions. Coin also is collected, counted and redistributed by the Federal Reserve System. While the transportation of currency and coin is priced, processing and related activities are provided as a government service. The quality of currency has been improved through the use of new high speed Currency Verification, Counting and Sorting (CVCS) machines that not only increase sorting speed but also provide for consistent control and adherence to standards for

Growth of Cash Services



*Does not include weighed coin, so 1977 figure is not comparable.
**Change in mint shipments.

fit currency. The improved quality of currency helps accommodate the cash dispensing requirements of automated teller machines now abundant in the Twelfth District.

Many Reserve Banks have elected to terminate their direct involvement in cash transportation. The San Francisco Bank, however, has opted to continue offering the service in the Twelfth District in response to increased customer demand. Since the inception of cash transportation pricing in 1982, the number of locations reached by the San Francisco Reserve Bank's cash delivery network has grown continuously.

This Bank provides a variety of securities services to financial institutions in the Twelfth District, including transferring of book-entry securities, purchase and sale of government securities, and collection of noncash items. The pricing of System services for book-entry securities has prompted continuing initiatives to reduce costs, including an evaluation of the effectiveness of centralizing the Twelfth District's service at San Francisco. In 1984, the bank's securities services staff collaborated with the Federal Reserve Bank of Minneapolis in an effort to improve the payment process for noncash collections sent to paying agents in the Twelfth District. This joint effort resulted in greater efficiency and a reduction of float.

Branch Operations
(Shown from left to right, standing)
David J. Christerson, Vice President, San Francisco Branch
E. Ronald Liggett, Vice President, Salt Lake City
Gerald R. Kelly, Senior Vice President, Seattle
Richard C. Dunn, Senior Vice President, Los Angeles
Angelo S. Carella, Senior Vice President, Portland
(seated)
H. Peter Franzel, Senior Vice President, District Operations
A. Grant Holman, Senior Vice President (Retiring), Salt Lake City

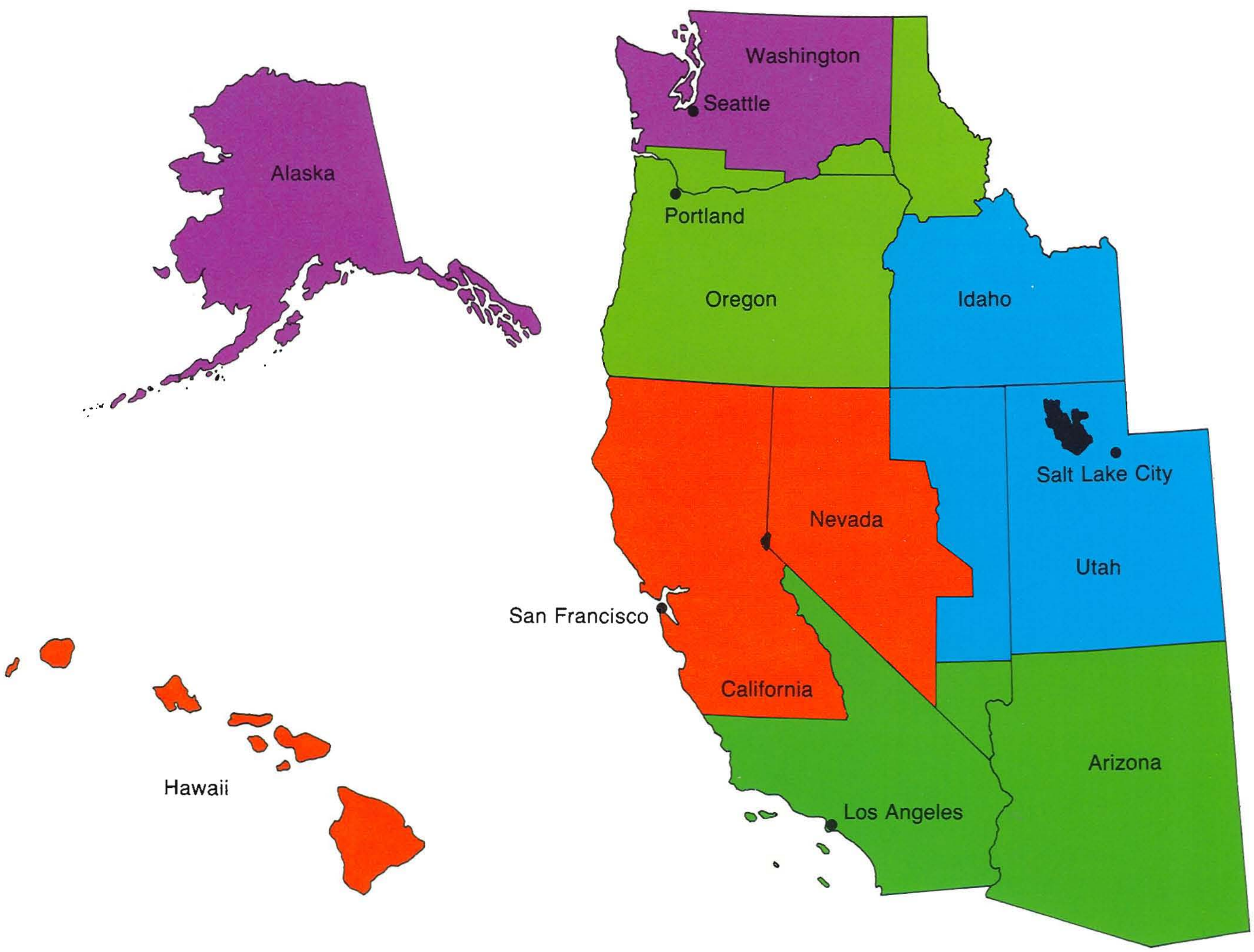
Summary of Operations

	Volume (thousands)			
	1981	1982	1983	1984
Custody Services				
Cash Services				
Currency paid into circulation	1,700,557	1,767,236	1,925,085	2,188,831
Coin paid into circulation	4,649,901	4,779,409	5,078,150	5,302,832
Securities Services				
Savings Bonds original issues	1,136	995	1,235	1,549
Savings Bonds redemptions processed*	402,885	339,820	285,420	279,342
Other Treasury original issues	232	182	116	138
Food coupons processed	318,497	313,761	333,512	310,450
Payments Mechanism Services				
Check Processing Services				
Commercial checks processed	1,393,822	1,210,143	1,226,778	1,337,350
Fine sort bundles processed*[1]	1,201,909	2,619,403	3,367,031	509,560
Government checks processed	103,154	101,310	96,136	95,548
Return items processed	22,431	23,952	24,707	25,580
Electronic Funds Transfer Services				
Wire transfers processed	5,143	5,882	6,674	7,757
Automated clearinghouse transactions processed	55,483	76,944	91,838	111,408
Discounts and Advances				
Total discounts and advances*	1,821	1,281	1,234	2,348
Number of financial institutions accommodated*	106	105	108	136

*Number (not in thousands)

[1]Reported in packages beginning in 1984.

Twelfth Federal Reserve District



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Vice Chairman
Santa Fe Southern Pacific Corporation
and President, Southern Pacific Company
San Francisco, California

Deputy Chairman
Fred W. Andrew
Chairman of the Board, President and
Chief Executive Officer
Superior Farming Company
Bakersfield, California

Carolyn S. Chambers
President
Chambers Cable Com., Inc.
Eugene, Oregon

Rayburn S. Dezember
Chairman, President and Chief Executive Officer
Central Pacific Corporation
and Chairman, American National Bank
Bakersfield, California

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

Donald J. Gehb
President and Chief Executive Officer
Alameda Bancorporation and
Alameda First National Bank
Alameda, California

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Chairman, President and Chief Executive Officer
Willamina Lumber Company
Portland, Oregon

Togo W. Tanaka
Chairman
Gramercy Enterprises, Inc.
Los Angeles, California

George H. Weyerhaeuser
President and Chief Executive Officer
Weyerhaeuser Company
Tacoma, Washington

Directors of the Federal Reserve bring management expertise to the task of overseeing Reserve Bank operations. They provide information on key economic developments in various areas of the District, complementing the Bank's internal research. In addition, Board members give advice on the general direction of monetary policy, especially with regard to the Bank's discount rate.


Furth


Andrew


Chambers

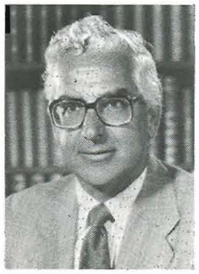

Dezember


Eccles


Gehb


Hampton

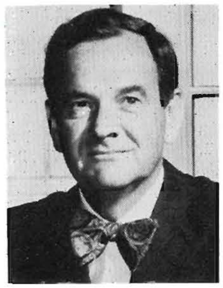

Tanaka


Weyerhaeuser

Federal Advisory Council Member
G. Robert Truex, Jr.
Chairman
Rainier Bancorporation and
Rainier National Bank
Seattle, Washington

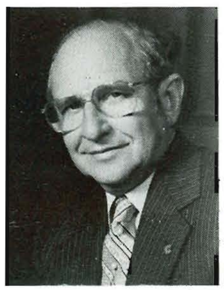
Los Angeles

Chairman of the Board
Richard C. Seaver
President and Chief Executive Officer
Hydril Company
Los Angeles, California

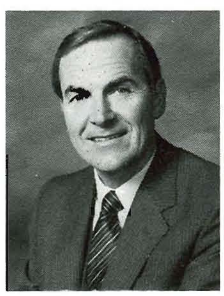


Thomas R. Brown, Jr.
Chairman of the Board
Burr-Brown Corporation
Tucson, Arizona

Lola McAlpin-Grant
Attorney
Inglewood, California

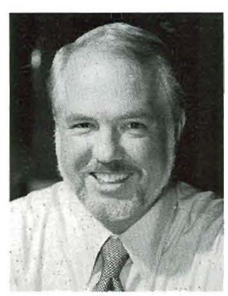


Robert R. Dockson
Chairman and Chief Executive Officer
CalFed, Inc.
Los Angeles, California



Harvey J. Mitchell
President and Chief Executive Officer
Escondido National Bank
Escondido, California

Bram Goldsmith
Chairman and Chief Executive Officer
City National Bank
Beverly Hills, California

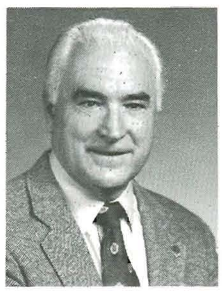


William L. Tooley
Chairman
Tooley & Company, Investment Builders
Los Angeles, California

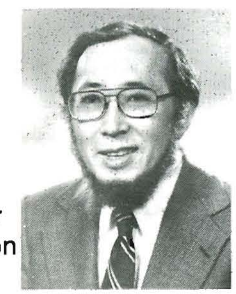
Portland

Chairman of the Board
Paul E. Bragdon
President
Reed College
Portland, Oregon

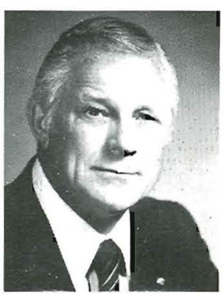
Herman C. Bradley, Jr.
President and Chief Executive Officer
Tri-County Banking Company
Junction City, Oregon



John A. Elorriaga
Chairman and Chief Executive Officer
United States National Bank of Oregon
Portland, Oregon



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



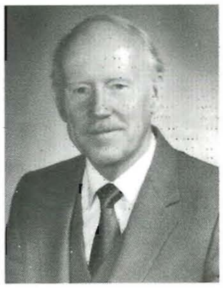
G. "Johnny" Parks
Northwest Regional Director
International Longshoremen's &
Warehousemen's Union
Portland, Oregon

Sandra A. Suran
Partner
Suran and Company
Beaverton, Oregon

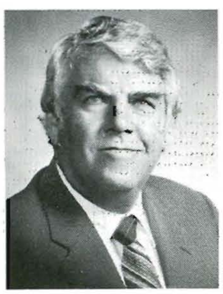
G. Dale Weight
Chairman and Chief Executive Officer
Benjamin Franklin Savings and
Loan Association
Portland, Oregon

Salt Lake City

Chairman of the Board
Don M. Wheeler
President
Wheeler Machinery Company
Salt Lake City, Utah

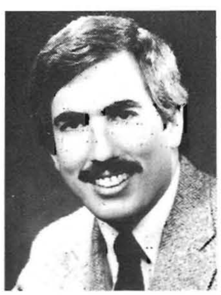


John A. Dahlstrom
Chairman of the Board
Tracy-Collins Bank and Trust Company
Salt Lake City, Utah



Fred C. Humphreys
Chairman, President and
Chief Executive Officer
The Idaho First National Bank
and Moore Financial Group
Boise, Idaho

Lela M. Ence
Executive Director
University of Utah Alumni Association
Salt Lake City, Utah



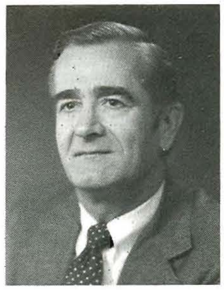
David Nimkin
Financial Development
Coordinator/Consultant
Neighborhood Housing Services
of America, Inc.
Salt Lake City, Utah

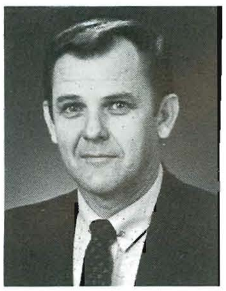
Albert C. Gianoli
President and Chairman of the Board
The First National Bank of Ely
Ely, Nevada

Robert N. Pratt
Former President
White River Shale Oil Corporation
Salt Lake City, Utah

Seattle

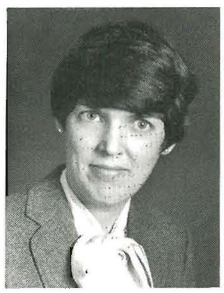
Chairman of the Board
John W. Ellis
President and Chief Executive Officer
Puget Sound Power & Light Company
Bellevue, Washington





Lonnie G. Bailey
Executive Vice President
Farmers and Merchants Bank
of Rockford
Spokane, Washington

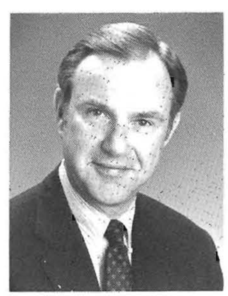
John N. Nordstrom
Co-Chairman of the Board
Nordstrom, Inc.
Seattle, Washington



Carol Birkholz
Managing Partner
Laventhol & Horwath
Seattle, Washington

W. W. Philip
Chairman, President and
Chief Executive Officer
Puget Sound Bancorp
Tacoma, Washington

Byron I. Mallott
President and Chief Executive Officer
Sealaska Corporation
Juneau, Alaska



William S. Randall
President and Chief Executive Officer
First Interstate Bank
of Washington, N.A.
Seattle, Washington

Comparative Statement of Account

(Thousands of Dollars)

	December 31, 1983	December 31, 1984
Assets		
Gold certificate account	$ 1,182,000	$ 1,318,000
Special Drawing Rights certificate account	518,000	518,000
Other cash	81,178	94,148
Loans to depository institutions	23,305	23,700
Federal Agency obligations	1,096,249	1,075,682
United States Government securities:		
Bills	8,345,211	9,108,176
Notes	8,107,233	8,364,689
Bonds	2,639,318	2,942,780
Total United States Government securities	19,091,762	20,415,645
Total loans and securities	20,211,316	21,515,027
Cash items in process of collection	1,477,963	692,624
Bank premises	106,422	110,613
Operating equipment	30,350	31,319
Other assets:		
Denominated in foreign currencies	608,520	589,744
All other	438,043	690,995
Interdistrict Settlement Account	1,273,952	1,368,923
Total assets	25,927,744	26,929,393
Liabilities		
Federal Reserve notes	19,930,151	21,048,999
Deposits:		
Total depository institutions—reserve accounts	4,009,671	4,412,694
Foreign	24,750	24,600
Other deposits	52,001	57,996
Total deposits	4,086,422	4,495,290
Deferred availability cash items	1,130,877	517,175
Other liabilities	298,710	356,949
Total liabilities	25,446,160	26,418,413
Capital Accounts		
Capital paid in	240,792	255,490
Surplus	240,792	255,490
Total liabilities and capital accounts	25,927,744	26,929,393

Earnings and Expenses

(Thousands of Dollars)

	December 31, 1983	December 31, 1984
Current Earnings		
Discounts and advances	$ 9,111	$ 6,446
United States Government securities	1,910,065	2,122,735
Foreign currencies	45,176	35,618
Income from services	52,361	63,526
All other	1,443	1,865
Total current earnings	2,018,156	2,230,190
Current Expenses		
Total current expenses	114,474	120,473
Less reimbursement for certain fiscal agency and other expenses	8,485	8,979
Net expenses	105,989	111,494
Cost of earnings credit	4,554	8,799
Profit and Loss		
Current net earnings	1,907,613	2,109,897
Additions to current earnings		
Profit on sales of United States Government securities (net)	2,656	6,207
All other	35,545	0
Total additions	38,201	6,207
Deductions from current net earnings		
Loss on foreign exchange transactions (net)	75,289	74,590
All other	0	447
Total deductions	75,289	75,037
Net additions (+) deductions (−)	−37,088	−68,830
Assessments by Board of Governors		
Board Expenditures	−11,734	−13,406
Federal Reserve currency cost	−16,143	−20,624
Net earnings before payments to United States Treasury	1,842,648	2,007,037
Dividends paid	13,949	14,816
Payments to United States Treasury (interest on FR notes)	1,811,539	1,977,523
Transferred to surplus	17,160	14,698
Surplus January 1	223,632	240,792
Surplus December 31	240,792	255,490

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 84125

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 Karen Rusk; graphics designed by William Rosenthal; edited by John L. Scadding and Gregory J. Tong. Assistance provided by Economic Research; Supervision, Regulation and Credit; District Operations; Accounting; Personnel; and Computer Services.

Federal Reserve Bank of San Francisco
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San Francisco, California 94120

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