

Monthly Review



TWELFTH FEDERAL RESERVE DISTRICT

FEDERAL RESERVE BANK OF SAN FRANCISCO

March 1959

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Review of Business Conditions¹

JUST as the rather halting advances of some sectors last summer raised fears of a "double trough" in the business cycle, the recent reduction in the rate of recovery has caused some reporters to question the sustainability of the current expansion. The further question has been posed as to whether the slowdown portends a setback or is simply a temporary breathing space along an economic plateau of the 1956 variety, when for several quarters, both Gross National Product in real terms and the Federal Reserve Board's Index of Industrial Production did not move more than fractionally. Whether these alternatives are more probable than a continued expansion of business activity is the subject we consider here.

Current statistics, like early election returns, are likely to present a picture at once obscure and misleading. This is particularly true of monthly, weekly, and daily data. The basic interpretative difficulty stems from the unevenness with which individual industries or sectors recede from recession or proceed toward prosperity and are affected by unusual seasonal disturbances. An uneven recovery tempo is a built-in feature of the market economy, and this characteristic complicates the problem of ascertaining whether the most recent symptom is indicative of creaky joints, temporary loss of wind, or rather, a lapse into a trot that still could develop into a full gallop.

The economic performance of the last quarter of 1958 in terms of the income-expenditure patterns of individual sectors as grouped in the Department of Commerce's National Income and Product Accounts, provides an important benchmark from which may be gained perspective for interpreting the more recent, but less comprehensive, statistics pertaining to the first quarter of this year. A sector by sector analysis provides important insights,

particularly into such questions as the probable contribution of the various parts of the economy to changes in aggregate demand. And such analysis may provide the basis for an answer to the question of the recovery's sustainability.

During the fourth quarter, Gross National Product scored its best gain for the year of \$14 billion and reached an all-time high of \$453 billion.² The size of the gain is more impressive when compared with increases of \$3 billion and \$9 billion in the second and third quarters. In real terms, fourth quarter output was only \$2 billion below the peak of the second quarter of 1957.

Where earlier quarters had witnessed partially offsetting changes in the rates at which various economic sectors purchased the national product, the fourth quarter gain was the summation of increases, large and small, in final product outlays by all of the major sectors of the domestic economy. Only the \$1.3 billion decline in net exports of goods and services marred what would otherwise have been an across-the-board increase in aggregate demand.

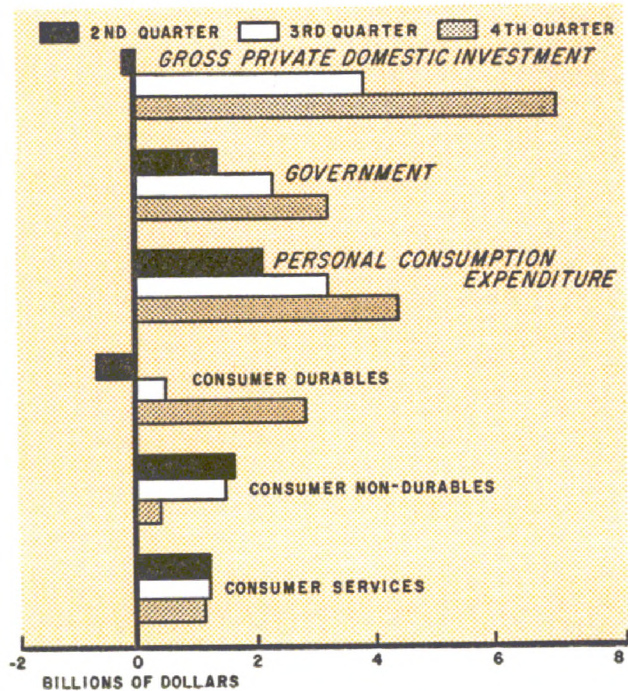
Sales and income

Personal consumption expenditure has been a consistent contributor to the quarterly increases in aggregate demand, but in different quarters the components of the increase have changed markedly. Following earlier declines, consumer durables sales made a small comeback during the third quarter of 1958, then spurred ahead in the fourth while expenditures on nondurables and services were increasing at diminished rates. Indeed, without the fourth quarter increase in durables sales, it is doubtful that total consumer outlay would have maintained its previous rate of increase.

¹ This review focuses on national business developments only. A comprehensive review of 1958 developments in the Twelfth District appeared in our last issue, and we will resume current reporting on the District in the April issue.

² GNP and its components are expressed in seasonally adjusted annual rates in current dollars, unless otherwise specified.

CHART 1
COMPONENTS OF
GROSS NATIONAL PRODUCT
 2ND, 3RD AND 4TH QUARTERS, 1958
 CHANGE MEASURED FROM PRECEDING QUARTER



Retail trade in February was maintained near the December-January levels and up 9 percent from February 1958. Department store sales are estimated at slightly higher than January and over 10 percent ahead of last February when weather in the East was exceptionally unpleasant. Mail order stores report that sales were up sharply in February, with Sears Roebuck running 16 percent ahead of a year ago and Montgomery Ward indicating a similar performance. Despite bad weather in the East, department store sales in the first half of March remained at the high level of the prior two months.

Manufacturers' sales advanced \$600 million in December and another \$100 million in January. Although year-ago comparisons continue to show a relatively greater nondurables than durables recovery, the December and January gains in shipments were based primarily on relatively greater gains in the durable goods sector. Nondurable sales continued their gradual advance in December but failed

to increase further in January. New orders in January showed no change from December as orders for durables, especially metals, rose and nondurables orders declined.

Sales of new domestic autos in January and February are estimated at 828,000 for the two months. Production exceeded one million vehicles and consequently it is reported that the auto companies have scaled down their sales forecasts to about 5 million for the year. Disturbing factors are apparent consumer price resistance, the unexpected reluctance of persons who have finished paying their 1955 contracts to go back into debt, and the combined appeals of small foreign cars and possible Detroit entries later this year. To maintain perspective, however, we must keep in mind that domestic sales in these two months are 18 percent ahead of last year, that sales in the final third of February were at the highest rate for 1959, and that Chrysler, due to production difficulties, has not yet had its models evaluated by the public.

The Federal Reserve Board's most recent survey of consumers' intentions shows moderate optimism. Expectations are higher than last January and February among those interviewed concerning purchases of houses and new cars, their own earnings, and the general business outlook. This year 61 percent think prices will be higher, compared with 48 percent last year, and only 6 percent look for price cuts as against 13 percent a year ago.

An interesting and significant aspect of the personal sector's income-expenditure pattern is the relatively dampened response of consumer outlays on goods and services to the marked increase in disposable income during the third quarter of last year. This was followed by the unusually bullish behavior of the fourth quarter, when the increased rate of consumer outlays was far in excess of the increased rate of disposable income. In contrast to the third quarter when 50 cents of each additional dollar of disposable income went

into additional personal consumption expenditure, in the fourth quarter each additional dollar was accompanied by \$6.30 in increased consumer expenditure. This implies an equally sharp drop in rates of saving, which is unlikely to persist. In February personal income rose \$1.5 billion to an annual rate 5 percent above the low last February and 3 percent above the prerecession high. The increase was restrained by the rise in personal contributions for social security.

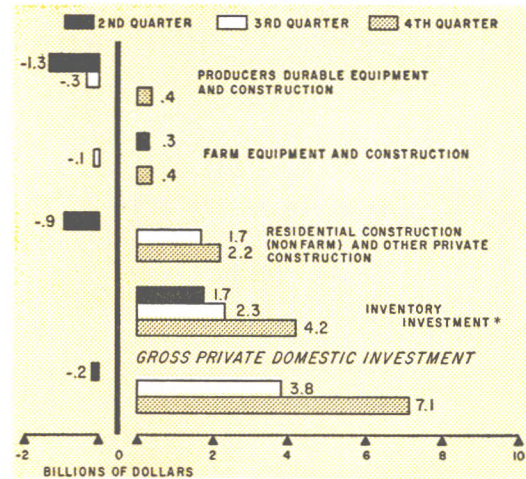
Investment—inventories, plant and equipment, and construction

Changes were striking last year in the relative contributions of the components of Gross Private Domestic Investment; the slight second quarter decline was followed by moderate, then sharp, increases in the third and fourth quarters. While producers' durable equipment and construction expenditures increased slightly in the final quarter, these gains were largely confined to equipment purchases, construction outlays remaining virtually unchanged. For nonfarm durable equipment and construction outlays the slight final quarter gain missed erasing second and third quarter declines by more than a billion dollars.

The increased rates of residential nonfarm construction outlays have been more substantive. After a second quarter decline, these outlays increased about \$2 billion per quarter, and, with the exception of changes in the rate of inventory investment, provided greater support to the rising rate of private capital formation in the third and fourth quarters of 1958.

The swing in inventory investment has been the largest factor in the rise in domestic capital formation. A second quarter reduction in the rate of inventory disinvestment of \$1.7 billion was succeeded by further declines of \$2 and \$4 billion in succeeding quarters. By the last quarter, inventory reduction had ceased altogether. The change in the rate of inventory liquidation from the third to fourth

CHART 2
GROSS PRIVATE DOMESTIC INVESTMENT
AND ITS MAJOR COMPONENTS
2ND, 3RD AND 4TH QUARTERS 1958
CHANGE MEASURED FROM PRECEDING QUARTER



* This reflects reduced rates of inventory liquidation.

quarter accounted for about \$4 billion of the \$13 billion increase in Gross National Product. Most of the inventory dynamics were centered in the manufacturing sector. As typically occurs in a minor cycle, the durable goods industries figured prominently in the inventory swing. But perhaps less typical was the almost equally sharp change in inventories held by nondurable goods manufacturers. Indeed, between these quarters, durable goods manufacturers contributed less to the increased rate of final demand than did nondurables manufacturers, whose switch from liquidation to accumulation accounted for about three-fourths of the net change in manufacturers' inventory investment. Manufacturers' inventories in January rose \$300 million, seasonally adjusted. This was the first rise in 18 months and was entirely concentrated in durables, mainly steel and other metals. The January level of \$49.5 billion is \$3.4 billion below that of a year ago and may indicate a conservative policy toward accumulation since manufacturers' sales are nearly \$2 billion greater and new orders are also running at a higher rate.

Retail inventories increased sharply in the year's final month, despite the most impressive selling gain registered thus far in the recovery. Even with the nearly \$400 million increase in stocks, stock-sales ratios declined from 1.91 to 1.86 in retail durable goods establishments, and from 1.15 to 1.11 in non-durable goods outlets. The combined force of increased sales at manufacturing and trade levels, plus the firm to increasing level of inventories, clearly suggests that the inventory buildup which began last November at the retail level is gradually spreading out. Auto inventories increased further in January as production outran sales. This increase was primarily responsible for the \$100 million advance of retail stocks during that month. Further accumulation is indicated for February and March as hedging against possible strikes in steel, rubber, aluminum, and other products is reportedly leading to moderate inventory rebuilding.

There is little reason to suppose that inventory investment will play as dynamic a role in coming months as in previous quarters. Apart from periods when the economy is descending into, emerging from, or merely musing around in the trough, net inventory investment tends to be roughly proportional to the growth of business activity. Although accumulations against strike threats undoubtedly will give some spark to an inventory boom in particular industries, there have appeared no indications that producers and traders are generally repudiating a policy of conservative restocking.

Plant and equipment expenditures levelled out in the second half of 1958 after a sharp drop in the first half. GNP figures for the fourth quarter show an increase of nearly \$800 million over the third, almost entirely in expenditures for durable equipment. The recently released Securities Exchange Commission-Department of Commerce survey of anticipated capital expenditure indicates, on an an-

nual rate basis, a first quarter rise of \$1.2 billion, and a further increase in the second quarter of \$900 million. These increases would put capital outlays for the first half of the year 6 percent higher than in the last half of 1958 (seasonally adjusted). The gains are expected to be concentrated in manufacturing, gas utilities, and nonrail transportation, primarily airlines, with other major groups planning to spend at about the 1958 rates.

The value of work put in place in February was \$3.5 billion, putting new construction activity (on a seasonally adjusted annual basis) at \$54.4 billion. This represents a slight gain over January, but the gain was substantially smaller than December's and thus conforms to a pattern in evidence for several months, in which each gain is significantly smaller than that of the previous month. The January gain, which was several times February's, was itself only half that recorded in December, and one-third the size of the October increase. This pattern, implying a leveling in construction activity, is consistent with Department of Commerce estimates which put construction for the year 1959 at \$52.3 billion, somewhat below current rates.

Year-ago comparisons for the January-February period show both private and public construction contributing strongly to the 9 percent increase in value of work put in place, with sharp over-the-year increases in spending on residential buildings, military facilities, and highways shoring up more moderate gains in other sectors and more than offsetting the 35 percent over-the-year decrease in outlays on private industrial plant. Following a ten-month rise, private housing starts declined more than seasonally in January and fell again in February to an annual rate of 1,320,000. The momentum of construction underway and of financial commitments made suggests a high level for some months to come, despite increasing signs of restriction in the mortgage markets.

Industrial production

Another point was added to the Federal Reserve Board's Index of Industrial Production in January. But for the temporary bulge caused by resurgent automobile production in November, January's increase would have been the sixth successive one-point gain. In February the strong pick-up in production of construction materials and steel and other metals, and the high level of auto production advanced the seasonally adjusted index another point, to 144 percent of the 1947-49 average. Measured against the two- to four-point increases characteristic of the earlier recovery months, these recent gains, however steady, inevitably cause commentators to question the buoyancy of the recovery. Where the first signs of one-pointitis caused fears of a setback, the present small but steady one-pointers are more frequently interpreted as symptomatic of a near-term plateau.

It may be that the economy is moving toward a reduced rate of growth, in which aggregative statistical measures such as the industrial production index will not manifest the restless energy of earlier months. But a prognosis of relative economic quiescence cannot be based on the facts thus far. During 1955, Gross National Product (in 1957 prices) advanced \$32 billion above the annual rate for 1954. Yet during 1955 the average point-per-month increase in the Index of Industrial Production was exceeded only three times, and during two months the index actually failed to advance. Over the year the average monthly increase was one-half that registered during the final three months of 1954.

From our experience with the index in previous cycles we may reasonably expect that the two- to four-point gains are characteristic only of early recovery months and that even the current one-point increases may not invariably occur. We are not justified in interpreting the recent slowdown as symptomatic

CHART 3

FEDERAL RESERVE BOARD INDEX OF INDUSTRIAL PRODUCTION AND GROSS NATIONAL PRODUCT, 1957 DOLLARS
QUARTERLY AVERAGES, 1958 1ST QUARTER = 100



of the nearness of a plateau of the late 1956 or early 1957 variety. Rather, recent experience suggests that the explosive gains of earlier months are peculiar to the first stages of recovery when highly volatile manufacturing industries give vent to the energies that have been suppressed more severely than those of less cyclically sensitive sectors. These manufacturing sectors, representing about one-third of the output measured by GNP, are the most sensitive to changes in aggregate demand. It is not surprising, then, that the cyclical fluctuation measured by the Index of Industrial Production tends to be significantly larger than that measured by the change in GNP (in constant prices).

During periods when industrial production, as measured by the Federal Reserve Board Index, is slackening its pace, it is particularly important to assess the meaning of small month-to-month changes that frequently amount to merely fractional percentage changes in the total index. This can be done by examination of the behavior of particular industrial groupings, into which are compressed the 175 monthly series making up the index. During a general advance a one-point

increase in the index may be the summation of general advances by all or most industries; the net result of moderately offsetting changes among industries; or the product of a substantial advance by a few very important industries against a background of virtually unchanging activity among most others.

Although the total index gained no more in January than in December, the more recent one-point increase was indicative of a broader industrial advance than occurred in December. Only two durable goods industries failed to register gains in January; this compares favorably with the six which failed to register gains in December. Of those that advanced, most equalled or exceeded the gains registered in December. The manufacturing and mining industries failing to maintain their December levels accounted for only 22 percent of the total. In December, industries accounting for fully 48 percent (weighted by value added) of the index failed to equal their month-before levels. In January, the principal gains registered by durable goods manufacturers occurred in electrical machinery (5 percent) and primary metals (2 percent). In summary, the January index's duplication of December's one-point gain appears to include a number of developments which markedly distinguish the general advances of the two months. Particularly important is the fact that durable goods production gained more in January than it did the month before, despite the decline in auto assemblies. Nondurable goods industries, following a month-long halt, have resumed expansion, and within both manufacturing sectors the breadth of advance is encouraging.

Developments within and ancillary to the automobile and steel industries hold the key to the industrial pace for the next few months. With glass shipments again flowing into assembly plants, automobile production at most manufacturers reached normal operating levels by the end of February. Despite reduced operations at some plants, production in the

first week of March, at a rate of 134,000, was 6,000 assemblies higher than the previous week. Production for the year thus far is running about 200,000 units ahead of output for the same period of 1958. While a further cut-back is scheduled at Buick, Chrysler's production should increase significantly.

Partly because February output was well below scheduled operations, production schedules for March were raised about 25,000 above the originally scheduled 550,000 assemblies. If plans are realized, first quarter output will be 100,000 in excess of original schedules. Production goals for the second quarter have also been adjusted upward, by approximately 100,000 cars (to 1,450,000 units). This increase is best interpreted to reflect a moderate inventory buildup as a hedge against expected summer strike-stifled steel shipments. Since sales estimated for the year have not been similarly scaled up, increased production during the first half of the year implies output borrowing against the second half.

The full fury of an inventory buildup hit the steel industry in February, and despite sharply increased operating rates (above 100 percent at some mills) shipments could not begin to match the avalanche of new business. With increasing numbers of new orders unrelieved by proportionate output increases, mill backlogs have climbed precipitously in recent weeks and mills and furnaces which have been on standby for months are being rushed into operation.

Although steel customers began as early as January to put aside steel for the arid summer months when mills may shut down, the first rather timid overtures in this direction were swiftly followed by a rush for steel. The intensity of the order boom caught some mills with their furnaces down. Swelling backlog books rapidly forced allocation systems into effect at many mills. So far tonnage has been shortest for users of sheet and strip, and sheet mills in some cities have already pushed op-

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eration to full capacity. The swift buildup of new orders has been interpreted to reflect, in part, the failure of steel customers to gauge adequately the strength of their own January sales. Thus some January production, originally destined for empty cupboards, was siphoned off by unexpectedly large sales. With a summer steel shutdown a possibility, fabricators finding inventories not building up as planned have tended to push the purchase button and pad original orders as much as 50 to 100 percent. Coming at a time when a normal cyclical inventory buildup is just starting, hedge buying of this magnitude practically precludes the possibility that mill backlogs will be worked down to customers' satisfaction, even if operating rates reach 100 percent before the end of the second quarter. Operating rates increased rapidly through February and in the first week of March output was scheduled at 89.5 percent of industry capacity.

Employment

Seasonal factors dominated the employment-unemployment picture for January and February. A reduced employment level is normal for January following the laying-off of temporary Christmas help. After adjusting for normal seasonal factors, nonfarm employment rose slightly in January and the unemployment rate held firm through February at about 6.1 percent. On a seasonally adjusted basis, it would appear that most manufacturing industries demonstrated little change. Durables employment advanced slightly, based primarily on advanced activity in electrical equipment machinery industries. Employment in nondurables establishments edged down. On an overall basis, nonfarm employment, up 950,000 from the recession low, is still 1.5 million below the 1957 peak. On the other hand, Government employment, which is included in these figures, is 400,000 in excess of the 1957 peak.

Apparently, much of the cyclical strength in what job recovery exists has been concentrated in contract construction and trade. These did substantially better than manufacturing industries as a whole. Hourly earnings of factory workers remained unchanged in January and February, but a normal seasonal reduction in the factory workweek lowered weekly earnings of factory production workers. Long-term unemployment (15 weeks or more), expressed as a percentage of the civilian labor force, remained almost unchanged at about 2 percent for the third month. This figure has fallen substantially since last April but continues to be significantly higher than levels prevailing even at the bottom of previous postwar recessions.

Prices

While industrial prices continued to advance in recent weeks, especially for metals, prices of farm and food products declined further. As a result, the overall wholesale price index has changed little. The consumer price index similarly has been stable, ranging over only 0.2 points since last June. The rise in January of 0.1 to 123.8 is within this range and resulted from a rise in food prices, mainly fruits, vegetables, and meats. Recent developments in the supply of hogs and livestock suggest that retail meat prices may soon move down again significantly.

The index of sensitive wholesale prices has received more than usual attention recently. Its downward movement, in evidence in December and January, continued through February, but at a much reduced rate. Near the end of the month the total index was down less than 0.5 percent from the beginning of the month. The foodstuff index continued downward through mid-February but held firm the following week, while the "industrials" index, despite sharp (but offsetting) changes for some commodities, held near to January and February levels.

Since sensitive commodity prices frequently herald inflationary tendencies, the February calm has produced a number of interesting interpretations. Some see in the lull an implication of inner inflationary turbulence, because sensitive prices ordinarily decline in February. Other interpretations see in stable prices a sign that the recovery is running on yesterday's momentum and is fast threatening to slacken speed. A less colorful, but perhaps more reasonable, view is that one cannot derive precise cyclical clues from sensitive price movements in periods of only a few weeks' duration. Even the industrials index, which is expected to mirror cyclical developments, has been dominated by sharp downward movements of one or two commodities. The decline in this index in mid-February was due almost entirely to successive reductions in the price of a single item—lead scrap. Other reductions were few and insignificant. Although the index was falling, industrial prices generally held firm or advanced.

Overall evaluation

The business situation is continuing to show clear signs of further advance. The moderate gains in production and employment (the stimulus received from high output of auto-

mobiles and metals is partly due to expirations of labor contracts later this year) have also been associated with moderate price developments. On the one hand we have a fair degree of consumer optimism, reflected in a high volume of retail sales; and on the other more moderate inventory accumulation despite liquidation in 1958 and possible strikes later this year. Within the price structure there are crosscurrents of advances in prices of manufactured goods, stability of many nondurable goods prices, advances in many raw materials prices, and continued declines in farm prices. These general developments reflect considerable uncertainty in the intermediate-term outlook.

Although current rates of business, personal, and Government spending might suggest a cumulative expansion through at least the spring months, the outlook depends to a great extent on such volatile factors as business inventory and consumer durables spending. In view of the state of consumer expectations, and the stage of the recovery, both consumer durable goods outlays and business inventory spending are capable of quick break-outs on either the high or low side and such developments would significantly alter the present moderately optimistic business outlook.

1958 Member Bank Earnings

DECEMBER 31, 1958 rang down the curtain on the most profitable year in history for District member banks. New records were set both by the total earnings of \$1,206.8 million and by the 23.4 percent increase in net profits after taxes, which boosted the latter to \$205.7 million. (Table 1) Earnings rose 7.7 percent, expanding at a more moderate rate than expenses, which increased 9.1 percent over the year. In absolute terms, however, earnings went up \$86.6 million, trailed by an increase of \$69.3 million in total expenses. These figures gain added interest when viewed against the backdrop of varied business developments which took place throughout the year—recession, recovery, and the beginnings of new growth.

Total District bank credit outstanding on December 31, 1958 reached a record \$24,338 million, which was \$2,400 million above a year earlier; investments, which expanded \$1,769 million over the previous year-end, accounted for well over one-half the gain in total bank credit. (Table 2) In the face of a depressed demand for loans during the early months of 1958 when the recession was still seeking a trough, banks turned to securities to broaden the source of their earnings. From February until August bank securities holdings rose rapidly, but they levelled off with the strengthening of the recovery as earning prospects and increased demand in the loan market attracted more bank funds.

TABLE 1
EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS, 1956-58

	(In millions of dollars)			Percent Increase 1957-58
	1956 ^r	1957 ^r	1958 ^p	
Earnings on loans	651.6	733.8	778.9	6.1
Interest and dividends on				
Government securities	153.0	162.7	183.4	12.7
Other securities	43.9	51.5	60.4	17.3
Service charges on deposit accounts	74.7	89.6	97.6	8.9
Trust Department earnings	28.9	32.6	34.4	5.5
Other earnings	42.7	50.0	52.1	4.2
Total earnings	994.8	1,120.2	1,206.8	7.7
Salaries and wages	287.7	311.4	328.0	5.3
Interest on time deposits	163.9	258.3	296.6	14.8
Other expenses	177.5	191.8	206.2	7.5
Total expenses	629.1	761.5	830.8	9.1
Net current earnings	365.6	358.8	376.1	4.8
Net recoveries and profits				
(—losses) ¹				
On securities	— 28.3	— 17.6	+ 54.6	
On loans	— 35.8	— 26.5	— 40.3	
Others	— 4.2	— 6.0	— 5.4	
Total net recoveries and profits	— 68.2	— 50.1	+ 8.8	
Net profits before income taxes	297.4	308.6	385.0	24.8
Taxes on net income	133.2	141.9	179.3	26.4
Net profits after taxes	164.2	166.7	205.7	23.4
Cash dividends declared	90.2	96.2	100.9	4.9
Undistributed profits	74.0	70.5	104.8	48.7

^rRevised.

^pPreliminary.

¹Including transfers to (—) and from (+) valuation reserves.

TABLE 2
**PRINCIPAL RESOURCE AND LIABILITY ITEMS OF ALL MEMBER BANKS
 IN THE TWELFTH DISTRICT, 1957 and 1958**

(In millions of dollars)

	Dec. 31 1957 ^F	Dec. 31 1958 ^P	Dollar Increase	Percent Increase
Loans and investments	21,938	24,338	2,400	10.9
Loans and discounts, net	13,181	13,812	631	4.8
Commercial and industrial loans	4,996	5,060	64	1.3
Agricultural loans	481	583	102	21.2
Real estate loans	4,830	5,278	448	9.3
Loans to individuals	2,480	2,481	1	0.0
U. S. Government obligations	6,620	8,003	1,383	20.9
Treasury bills	387	495	108	27.9
Treasury certificates of indebtedness	603	882	279	46.3
Treasury notes	1,127	1,511	384	34.1
U. S. Bonds	4,503	5,115	612	13.6
Other securities	2,137	2,523	386	18.1
Total assets	27,760	30,264	2,504	9.0
Demand deposits	14,692	15,681	989	6.7
Time deposits	10,681	12,077	1,396	13.1
Total deposits	25,374	27,758	2,384	9.4
Capital accounts	1,765	1,877	112	6.3

^FRevised.

^PPreliminary.

Earnings and earning assets top previous years

Twelfth District member banks invested an additional \$1,383 million in United States Government obligations in 1958, bringing the total to over \$8 billion. Almost one-half the 1958 increase was in holdings of United States bonds, which rose \$612 million after declining a million dollars in 1957. Member bank holdings of Treasury bills, certificates of indebtedness, and notes also rose substantially above the 1957 levels. Earnings on these Government securities reached \$183.4 million—a gain of 12.7 percent over 1957. Other securities holdings, which include obligations of states and political subdivisions, went up 18 percent to \$2,523 million, thereby increasing bank earnings in this type of investment to \$60.4 million, 17.3 percent above 1957. The average rate of return on Government securities remained almost the same, as the low interest yields of the early part of 1958 were offset by higher rates in the second half of the

year; on other securities the rate was lower as banks took large amounts of state and local issues offered early in the year in response to lower rates in the money market.

Earnings from loans and discounts rose only 6.1 percent this year compared to a 12.4 percent increase during 1957. In 1958 the average level of loans and discounts stood 3.8 percent higher than during the previous year. Contributing greatly to the \$45.1 million gain in earnings was the substantial increase in outstanding real estate loans (which generally carry a higher rate of return than do business loans). Such loans increased by \$448 million (9.3 percent) from the end of 1957 to December 31, 1958. There were several factors which funnelled the larger share of funds into real estate loans: money market rates were down in the first half of the year; minimum downpayment requirements on VA-guaranteed and FHA-insured loans were reduced; and since December 1957 Federal National Mortgage Administration authority has been

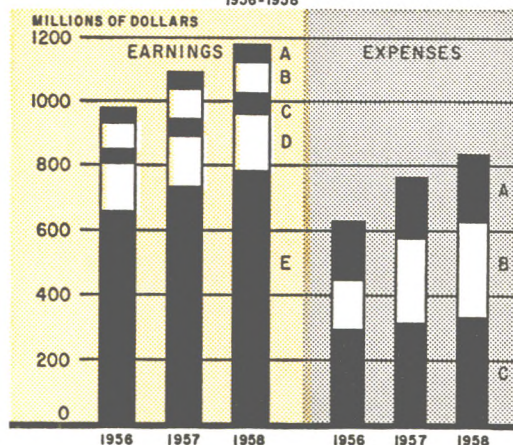
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increased \$375 million in order to broaden the market for the repurchase of mortgages.

Commercial and industrial loans at Twelfth District member banks rose \$64 million this year compared with a \$366 million gain in 1957. Until July they fell slightly, then recovered and showed a 4.8 percent increase at the end of the year over December 1957. Most of this gain was in loans to firms which follow a seasonal borrowing pattern, such as food processors, commodity dealers, and sales finance companies. Reflecting the prevailing prosperity of the farm sector of the economy, agricultural loans rose \$102 million in 1958, an increase of over 20 percent. Loans to individuals accounted for \$170 million of the total \$565 million growth in loans in 1957. In 1958 such loans grew by only \$1 million, reflecting, in part, heavy repayments of consumer debt.

The fact that smaller banks enjoyed a higher rate of return on loans than did larger banks does not mean that they charged higher rates

CHART 1
EARNINGS AND EXPENSES OF
MEMBER BANKS
1956-1958



Note: The Earnings categories are: A, All other; B, Charges on deposit accounts; C, Interest and dividends on other securities; D, Interest on United States Governments; E, Earnings on loans. The Expenses categories are: A, All other; B, Interest on time deposits; C, Wages and salaries.

TABLE 3

**RATIOS TO CAPITAL ACCOUNTS AND
RATES OF RETURN ON EARNING
ASSETS—TWELFTH DISTRICT
MEMBER BANKS, 1956-1958**

Ratios to capital accounts	1956	1957	1958
Net current earnings			
All banks	22.8	20.9	20.8
13 largest	23.0	21.1	21.1
Other	21.6	19.9	19.1
Net profits after taxes			
All banks	10.2	9.7	11.3
13 largest	10.6	9.7	11.2
Other	8.4	9.7	11.9
Rates of return on loans			
All banks	5.5	5.7	5.9
13 largest	5.4	5.6	5.8
Other	6.0	6.0	6.4
Rates of return on Government securities			
All banks	2.3	2.5	2.5
13 largest	2.3	2.5	2.5
Other	2.3	2.5	2.3

Note: Capital accounts, loans, and Government securities items on which ratios are based are averages of Call Report data on December 31, 1957, June 23, 1958, and September 24, 1958.

for comparable loans. (Table 3) Capital and surplus place an upper limit on the size of loans which can be extended, for one thing, and smaller loans generally bear higher rates. An examination of the loan portfolios of these smaller banks would also show that they carry a higher proportion of real estate loans and consumer loans, which bear higher rates than do those to business.

The third major source of member bank earnings in 1958 was service charges on demand deposit accounts. Income from this source, which rose 8.9 percent above 1957, is dependent on the amount and utilization of deposits and on the rate charged. The high of \$97.6 million received by member banks in 1958 was the result of a 6.7 percent increase in the amount of demand deposits outstanding. No significant changes in the rate structure of service charges have been reported. However, analyses of the activity of larger accounts resulted in some reclassifications and in the application of service charges which reflect more accurately the movement of funds through the accounts.

High expenses bite into profits

Along with the increase in every item of earnings there was a rise in each item of expenses, which reached a total of \$830.8 million. (Chart 1) Proportionately, the largest increase was the 14.8 percent gain in interest payments on time deposits. While this represents a significant rise in the cost of banking, it is only one-fourth as large as the increase in interest paid on time deposits in 1957 over 1956. The volume of time deposits grew 13.1 percent in 1958, which accounts for the major part of the growth of interest expense as the rates remained relatively unchanged. Salaries and wages, always the largest expense item in bank operations, rose only 5.3 percent, the smallest increase in several years. Other expenses (including rent, heat, light, postage, taxes other than on income, publicity, and fees and commissions for nonemployees) rose 7.5 percent.

Profits after taxes set highest mark

For the first time since 1954, member bank earnings were supplemented by net recoveries and profits on securities and loans and transfers from valuation reserves. Losses, charge-offs, and transfers to valuation reserves, all connected with securities transactions, went from \$25 million in 1957 to \$49 million in 1958. However, the offsetting items of recoveries, profits, and transfers from valuation reserves changed from only \$8 million in 1957 to \$103.6 million in 1958, of which over \$90 million was profits from the sale of securities. Most of this profit-taking on securities sales came about in the first half of the year, when the sharp decline in interest rates sent a premium securities bearing higher coupon rates. The net amount of \$54.6 million was added to bank earnings from securities dealings. Losses, charge-offs, and transfers to valuation reserves in the loan department and miscellaneous losses, which amounted to

TABLE 4
PERCENT CHANGES IN SELECTED
EARNINGS AND EXPENSE ITEMS OF
TWELFTH DISTRICT MEMBER BANKS
BY SIZE GROUPS, 1957-58

	All	13 largest	Others
Earnings on loans	6.1	7.0	2.3
Interest and dividends on			
Government securities	12.7	17.8	— 4.2
Other securities	17.3	14.4	31.1
Service charges on deposit accounts	8.9	10.3	3.7
Trust department earnings	5.5	5.1	8.2
Other earnings	4.2	9.4	—10.9
Total earnings	7.7	9.2	1.8
Salaries and wages	5.3	6.6	0.5
Interest on time deposits	14.8	15.6	10.7
Other expenses	7.5	9.0	2.7
Total expenses	9.1	10.4	3.9
Net current earnings	4.8	6.6	— 3.0
Net profits before income taxes	24.8	26.8	16.0
Taxes on net income	26.4	31.8	3.0
Net profits after taxes	23.4	22.6	26.8
Cash dividends declared	4.9	3.6	12.1
Undistributed profits	48.7	52.5	37.8

\$45.7 million, largely offset this gain, leaving a net \$8.8 million in earnings from recoveries and profits.

Taxes on net profits rose slightly in 1958 to \$179.3 million or 46.6 percent of net income. Profits after taxes were \$205.7 million, a 23.4 percent increase over the previous year, compared with a 1.3 percent increase between 1956 and 1957. As Table 3 shows, the ratio of net profits (after taxes) to capital accounts rose. However, the ratio of net current earnings to capital accounts fell very slightly from 20.9 in 1957 to 20.8 in 1958 due to the fact that banks added \$112 million to their capital accounts. Net current earnings, before the addition for profits, recoveries, and transfers from valuation reserves, went up only 4.8 percent in contrast to the 6.3 percent increase in capital accounts.

Cash dividends soared to new heights in 1958, reaching \$100.9 million. However, this was only 49.1 percent of net profits after taxes compared to the 57.7 percent disbursed to

stockholders in 1957. Undistributed profits rose \$34.3 million in 1958 compared with a decrease of \$3.5 million in 1957.

District profits parallel nation's while earnings pull ahead

A look at preliminary earning figures for all member banks in the nation reveals that the increase in costs producing the new high in District bank expenses was the same as that for all member banks in the nation—both show a 9.1 percent increase in expenses. Earnings in the District rose more than those for the whole country, 7.7 percent versus 5.1 percent. Net current earnings in the nation fell 1.6 percent, however, while District banks

recorded an increase of 4.8 percent. The increase in earnings both on loans and on securities was proportionally more in the District than in the nation. The reverse was true of recoveries, profits, and transfers from valuation reserves. A 350 percent expansion in the profits from securities transactions and from recoveries and transfers from reserves at member banks in the nation brought net profits at member banks up by approximately the same percent as those in the District despite the smaller nationwide increase in earnings. The increase in cash dividends for member banks in the nation as a whole was 7 percent over 1957, compared with 4.9 percent for District member banks.

The following Alaska banks have become members of the Federal Reserve System, effective April 1, 1959:

- The First National Bank of Anchorage, Anchorage
- National Bank of Alaska in Anchorage, Anchorage
- Alaska National Bank of Fairbanks, Fairbanks
- First National Bank of Fairbanks, Fairbanks
- The First National Bank of Juneau, Juneau
- First National Bank of Ketchikan, Ketchikan

The City National Bank of Anchorage, Anchorage, has been a member of the Federal Reserve System since April 15, 1954; hence, with the addition of the six banks listed above, all national banks in the State of Alaska are now members of the Federal Reserve System.

While all national banks in the United States are required to be members of the Federal Reserve System, membership is optional for national banks in a dependency or insular possession outside the continental United States. The Federal Reserve Act provides that every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System.

BUSINESS INDEXES — TWELFTH DISTRICT¹

(1947-49 average = 100)

Year and month	Industrial production (physical volume) ²						Total nonagri-cultural employment	Total mfg employment	Car-loadings (number) ²	Dep't store sales (value) ²	Retail food prices ^{3, 4}	Waterborne foreign trade ^{4, 5}		
	Lumber	Petroleum ³		Cement	Steel ²	Copper ²						Electric power	Exports	Imports
		Crude	Refined											
1929	95	87	78	54	...	105	29	...	...	102	30	64	190	124
1933	40	52	50	27	...	17	26	...	...	52	18	42	110	72
1939	71	67	63	56	24	80	40	60	57	77	31	47	163	95
1949	100	99	103	100	97	93	108	99	97	94	98	100	85	121
1950	113	98	103	112	125	115	119	103	105	98	107	100	91	137
1951	113	106	112	128	146	116	136	112	121	100	112	113	186	157
1952	116	107	116	124	139	115	144	118	130	100	120	115	171	200
1953	118	109	122	130	158	113	161	121	137	100	122	113	140	308
1954	116	106	119	132	128	103	172	120	134	96	122	113	131	260
1955	121	106	122	145	154	120	192	127	143	104	132	112	164	308
1956	120	105	129	156	163	131	210	134	152	104	141	114	195	443
1957	107	101	132	149	172	130	224	138	157	96	141	118	230	575
1958	106	94	124	158	141	116	228	137	154	89	142	123	...	...
1958														
January	107	100	122	135	132	126	223	137	154r	94	132	121	163	393
February	105	97	114	112	134	128	221	136	153r	86	135	121	149	358
March	104	95	119	112	139	125	226	136	153r	87	137	123	160	422
April	97	94	119	129	132	120	218	135	151r	87	142	125	171	445
May	103	93	124	176	139	106	227	136r	151r	90	142	124	193	468
June	100	93	123	178	140	101	234	137r	153r	90	143	124	190	617
July	102	92	127	179	112	79	232	138r	153r	84	140	124	180	602
August	109	93	128	179	132	91	232	138r	155r	92	148	123	181	513
September	109	93	129	179	148	119	228	138	155r	94	140	123	178	607
October	113	93	130	186	152	132	238	139r	156r	81	141	123	174	712
November	114	93	127	159	168	139	231	140r	158r	91	149	124	...	545
December	119	93	124	165	165	129	236	140r	159r	97	147	123	...	...
1959														
January	120	92	125	161	169e	139	...	141	161	98	150	123	...	...

BANKING AND CREDIT STATISTICS — TWELFTH DISTRICT

(amounts in millions of dollars)

Year and month	Condition items of all member banks ⁶				Bank rates on short-term business loans ⁸	Member bank reserves and related items				Bank debits Index 31 cities ^{9, 12} (1947-49 = 100) ²	
	Loans and discounts	U.S. Gov't securities	Demand deposits adjusted ⁷	Total time deposits		Factors affecting reserves:					Reserves ¹¹
						Reserve bank credit ⁹	Commercial ¹⁰	Treasury ¹⁰	Money in circulation ⁹		
1929	2,239	495	1,234	1,790	...	- 34	0	+ 23	- 6	175	42
1933	1,486	720	951	1,609	...	- 2	- 110	+ 150	- 18	185	18
1939	1,967	1,450	1,983	2,267	...	+ 2	- 192	+ 245	+ 31	584	30
1951	7,866	6,463	9,937	6,777	3.66	- 21	-1,582	+1,983	+ 189	2,269	132
1952	8,839	6,619	10,520	7,502	3.95	+ 7	-1,912	+2,265	+ 132	2,514	140
1953	9,220	6,639	10,515	7,997	4.14	- 14	-3,073	+3,158	+ 39	2,551	150
1954	9,418	7,942	11,196	8,699	4.09	+ 2	-2,448	+2,328	- 30	2,505	154
1955	11,124	7,239	11,864	9,120	4.10	+ 38	-2,685	+2,757	+ 100	2,530	172
1956	12,613	6,452	12,169	9,424	4.50	- 52	-3,259	+3,274	- 96	2,654	189
1957	13,178	6,619	11,870	10,679	4.97	+ 31	-4,164	+3,903	- 83	2,686	203
1958	13,812	8,003	12,729	12,077	4.88	- 89	-3,558	+3,645	+ 63	2,658	209
1958											
February	13,002	6,884	11,305	10,992	...	+ 12	- 427	+ 298	+ 17	2,520	203
March	12,860	7,075	11,225	11,183	4.95	- 62	- 180	+ 253	+ 11	2,530	198
April	12,979	7,605	11,570	11,406	...	+ 43	- 391	+ 371	- 2	2,574	206
May	12,977	7,546	11,292	11,530	...	+ 11	- 203	+ 154	+ 90	2,456	193
June	13,197	7,632	11,278	11,724	4.81	- 59	- 409	+ 531	+ 22	2,494	212
July	13,142	7,670	11,744	11,779	...	+ 52	- 384	+ 302	+ 4	2,474	211
August	13,356	7,984	11,774	11,817	...	+ 2	+ 15	+ 193	+ 46	2,621	204
September	13,350	7,827	11,860	11,776	4.80	+ 4	- 378	+ 157	- 31	2,451	210
October	13,419	7,846	12,176	11,836	...	0	- 517	+ 726	+ 57	2,612	215
November	13,591	8,026	12,395	11,725	...	+ 48	- 305	+ 398	+ 31	2,727	208
December	13,812	8,003	12,729	12,077	4.95	- 54	- 542	+ 518	- 11	2,658	239
1959											
January	13,897	8,099	12,508	12,037	...	+ 11	- 517	+ 389r	- 109	2,656	226
February	14,022	7,735	12,210	12,018	...	+ 20	- 948	+ 774	- 91	2,602	234

¹ Adjusted for seasonal variation, except where indicated. Except for department store statistics, all indexes are based upon data from outside sources, as follows: lumber, California Redwood Association and U.S. Bureau of the Census; petroleum, cement, and copper, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; electric power, Federal Power Commission; nonagricultural and manufacturing employment, U.S. Bureau of Labor Statistics and cooperating state agencies; retail food prices, U.S. Bureau of Labor Statistics; carloadings, various railroads and railroad associations; and foreign trade, U.S. Bureau of the Census. ² Daily average. ³ Not adjusted for seasonal variation. ⁴ Los Angeles, San Francisco, and Seattle indexes combined. ⁵ Commercial cargo only, in physical volume, for Los Angeles, San Francisco, San Diego, Oregon, and Washington customs districts; starting with July 1950, "special category" exports are excluded because of security reasons. ⁶ Annual figures are as of end of year, monthly figures as of last Wednesday in month. ⁷ Demand deposits, excluding interbank and U.S. Gov't deposits, less cash items in process of collection. Monthly data partly estimated. ⁸ Average rates on loans made in five major cities. ⁹ Changes from end of previous month or year. ¹⁰ Minus sign indicates flow of funds out of the District in the case of commercial operations, and excess of receipts over disbursements in the case of Treasury operations. ¹¹ End of year and end of month figures. ¹² Debits to total deposits except interbank prior to 1942. Debits to demand deposits except U.S. Government and interbank deposits from 1942. e—Estimated. r—Revised.

