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FEDERAL RESERVE BANK OF SAN FRANCISCO

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Annual Review Issue

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Annual Review 1970

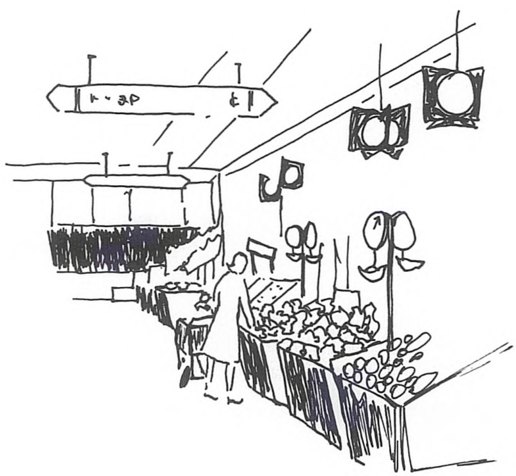
Disappointing Year

The President went to the Commerce Department lobby in mid-December to unveil a new GNP "clock" that heralded the arrival of the first trillion-dollar economy, but not long afterwards, the Department's statisticians announced that GNP (in real terms) had actually declined during 1970. It was just that kind of a year.

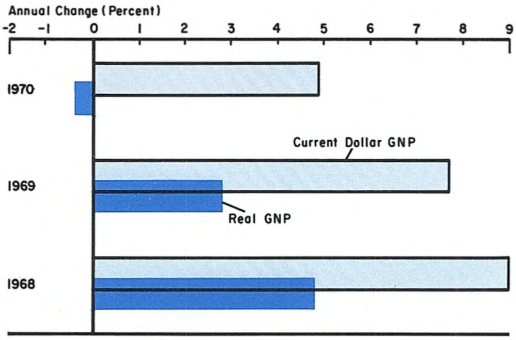
Although total output increased in current-dollar terms, to a $977-billion average for the year, all of that gain was wiped out by a sharp (over 5 percent) rise in prices, so that real output fell about ½ percent. This disappointing year thus exhibited the worst price performance since 1951 and the worst growth performance since 1958. (Unlike 1970, however, 1951 posted a strong increase in real GNP, while 1958 suffered only a modest advance in prices.) The slowdown, moreover, affected the job market, as employment declined and about two million people entered the ranks of the jobless during the course of the year.

The 1970 slowdown was marked by a substantial cutback in defense spending, by the termination of the prolonged plant-equipment spending boom, and by an early-year slump in residential construction. These factors then interacted with a generally retarded pace of consumption spending and of inventory outlays to produce the sluggish tone which characterized the year. The problems of the economy were compounded, too, by last spring's confidence crisis, brought on by the troubles in Cambodia, the campuses, and the commercial-paper market.

A number of major industries encountered difficulties, as can be seen from the 6-percent drop in the industrial-production index between mid-1969 and late 1970. The domestic auto industry suffered from customer indifference and from a protracted strike which left the industry with inflated costs and depleted profits. The steel industry also suffered from sluggish demand and expanded costs and (like the auto industry) felt the impact of low-priced foreign imports. In other lines also, the story was the same. For example, the airlines complained of a shortage of executive travelers, the aerospace industry complained of a lack of airline orders and of a shortage of moon travelers, and the movie industry bemoaned the surfeit of foreign movies and the shortage of American moviegoers.



Disappointing year performs poorly in terms of both prices and growth



Government—offsetting

In the Federal Government sector, nondefense spending grew about 3 percent, to $23 billion, but this was more than offset by a 3-percent drop, to $76½ billion, in defense spending for goods and services. Altogether, Federal purchases declined in dollar terms, and dropped even more in real terms, reflecting a 10-percent jump in the price deflator for this sector. (Such purchases include employee salaries, which rose sharply in early 1970.)

Final Defense Department figures for fiscal 1970 showed reduced outlays for hardware as well as significant manpower reductions, amounting to about 400,000 military and 100,000 DOD civilian workers. Moreover, the shift in the nation's defense posture caused substantial layoffs among workers in the defense-manufacturing industry and related lines, so that DOD cutbacks last year affected over a million workers all told.

State-and-local government spending slowed somewhat during the first half of 1970, but then speeded up again in later months. The recovery was brought about by the increased availability and lower cost of funds, and by the lifting of a Federal freeze on highway construction. For the year, this sector posted its usual 10-percent gain in total spending, to $121 billion, but it also found once again that most of that gain was eaten up by price increases.

Business—flat

Business fixed-investment spending remained fairly flat throughout most of 1970, and then dipped towards year-end as a consequence of the General Motors strike. The average for the year ($102½ billion) was about 3 percent above the 1969 figure—one of the smallest gains of the past decade. In fact, that increase was less than the 5-percent advance in prices in this key sector of the economy.

Activity in this sector was depressed somewhat, as it was in 1969, by the falling operating rate in manufacturing, the rising cost of new plant and equipment, and the general scarcity of funds. In 1970, moreover, a reduced inflow of orders further depressed the operating rate, and a sharp drop in corporate profits made investment expansion more difficult. As a result, plant-equipment spending increased at a far slower pace than expected, and only about half as rapidly as in the previous year. Utilities, airlines, and communications firms all spent heavily for new capacity during the year, but all major durable-goods industries (except machinery) cut back on new equipment and facilities in both current-dollar and real terms.

Businessmen added about $3½ billion to their inventories during 1970—less than one-half the average gain of the several preceding years. Admittedly, businesses as a group did not liquidate their inventories, as they almost always do in periods of business decline. (This was probably due to cautious production scheduling by manufacturers and cautious ordering by retailers and distributors.) The sluggish sales pace nonetheless kept businessmen from ordering heavily—especially in durable-goods lines, where inventory-sales ratios remained high—and this in turn contributed to the general slowdown in activity.

In the foreign-trade sector, net exports of goods and services rose to $3½ billion—almost twice the low 1969 figure but less than half the levels reached during the mid-'60's. These net figures reflected substantial exports of metals, machinery and aircraft, plus very heavy exports of farm products, along with a slight slowdown in the import pace because of the sluggishness in the domestic economy.

Mixed spending

Residential-construction spending dropped 7 percent to below $30 billion, despite a healthy second-half upsurge. Indeed, building activity rose throughout most of the year; as mortgage funds became increasingly available, new starts jumped from a 1.25-million annual rate in the first quarter to a 1.75-billion rate in the fourth quarter of the year. But construction costs continued to rise sharply. The 5-percent rise in the price index for this sector, although below the previous year's advance, helped induce buyers to shift into low-cost homes or rental units, and thus tended to limit the growth of dollar outlays.

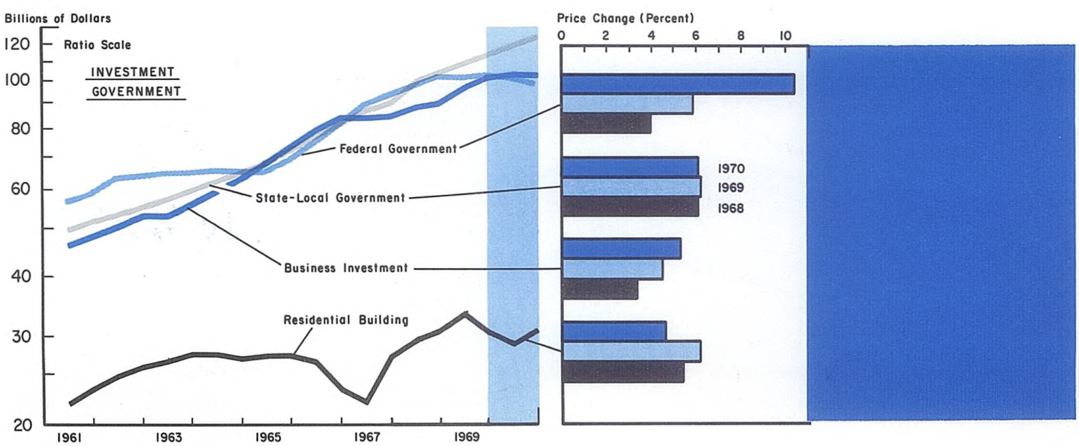
Federal assistance provided a great deal of support to the housing market during the year. Government funds made up considerably more than half of all the mortgage funds supplied during 1970, as Federal agencies borrowed in the open market and bought mortgages from (or made loans to) private lending institutions. In addition, agencies increased their direct subsidies to low-income home-buyers and apartment dwellers, providing backing in this way for over one-fourth of all the "private" starts undertaken during the year.

The auto industry remained weak throughout the wind-up of the 1970 model year, and was then hit by a massive 10-week strike, which cut about one million cars off of production schedules. The domestic industry sold only 7.1 million new cars during 1970—down 16 percent for the year—while foreign-car makers sold 1.2 million —up 15 percent for the year. (Japanese makers alone boosted their sales by 60 percent.) Detroit's answer to the import challenge was to develop several lines of mini-cars, although this approach threatened to cut into the market for larger domestic cars as well as imports.

Cautious spending

Consumers generally increased their spending during the year, but at a rather cautious pace. Durable-goods spending dropped about 1 percent, to $89 billion, largely because of the de-

Twin supports of boom—business investment and Federal government—turn sluggish in 1970



cided weakness in the auto market. Meanwhile, expenditures for nondurable goods rose almost 8 percent, to $265 billion, and spending for a wide range of services increased more than 9 percent, to $263 billion. But even in these sectors—especially services—dollar increases were almost offset by sharp increases in prices. Moreover, consumers saved almost 7½ percent of their take-home pay—an indicator of cautious buying habits that has been matched in only one other year of the past decade.

This air of caution was undoubtedly influenced by the uneasiness in the labor market. Personal income rose by 7 percent, as against 1969's 9-percent figure, and the gain would not have been that large except for a 19-percent jump in transfer payments (social-security and unemployment benefits). Disposable income benefitted in the first half from retro-active increases in Federal pay and social-security benefits, along with the drop in the income-tax surcharge from 10 to 5 percent, but income growth lagged later in the year (despite the end of the surtax) because of weakening employment trends.

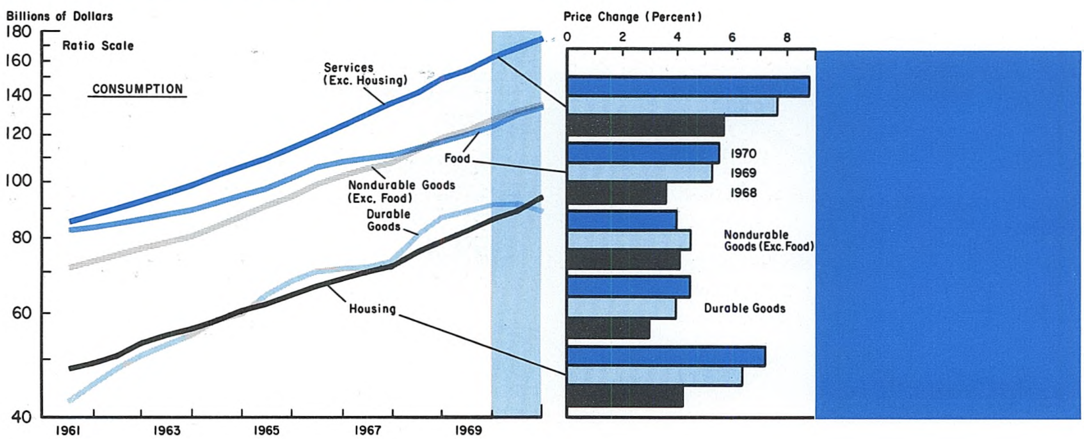
Employment—lagging

Nonfarm employment dropped about 1½ percent from its spring peak to the end of the year, as a surge of cost-cutting led to the closing of inefficient facilities, the curtailment of research projects, and the pruning of advertising budgets. With executives and technicians as well as blue-collar workers joining the jobless rolls, and with increasing numbers of veterans and women workers joining the civilian labor force, the unemployment rate jumped sharply over the course of the year. The jobless rate rose from 3.6 to 6.2 percent between December and December, and averaged about 5 percent for 1970 as a whole.

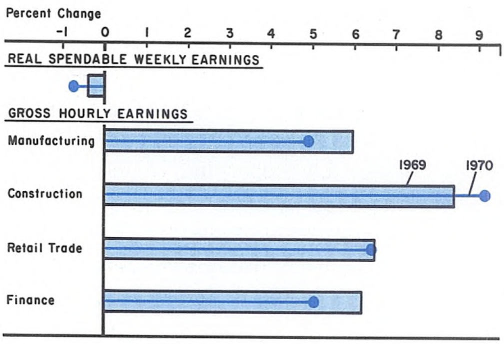
Hourly wage rates continued to rise rapidly, although not quite so rapidly as in 1969. (Construction workers, with a 9-percent average gain, bettered even their sharp 1969 gain, however.) Still, the average worker fared worse in one crucial respect; real spendable weekly earnings declined slightly for the second straight year, reflecting a reduction in the average workweek and an increase in prices.

Compensation per manhour rose about 7 percent for the year, and because of lagging productivity in the early part of the year, most of this increase was reflected in rising unit labor costs. But thereafter, the existence of excess capacity and the slackness in labor markets permitted a more rapid rise in output than in inputs of resources, through increased usage of the most

Consumer spending remains high except in durable-goods lines, but prices continue to accelerate



Workers get substantial pay hikes, but their real take-home pay declines



efficient facilities and the most efficient workers. This development helped reduce the impact of rising wage rates on unit labor costs, although in such pace-setting industries as trucking and auto manufacturing, not to mention construction, wage increases far exceeded current productivity gains in 1970.

Prices—still rising

The sluggishness of business demand, the improvement in unit labor costs, and some improvement in food (especially meat) supplies—all contributed to easing price pressures in the middle quarters of 1970. (The concentration of Federal pay increases in the early months of the year also affected the implicit GNP deflator.) According to the GNP deflator—a measure of price trends covering all major sectors of the economy—prices rose at a 6½-percent annual rate during the first quarter, then eased off to about a 4½-percent rate during the spring and summer quarters, and jumped to more than a 5½-percent rate in the final months of the year.

One complicating factor on the wage-price front was the bunching of multi-year labor contracts during 1970, since this development all but guaranteed a number of very substantial wage increases affecting large numbers of workers. Major union contracts negotiated last year covered about 5 million workers whose demands had been swollen by the severe inflationary inroads occurring during the life of their expiring contracts—and by the expectation of more of the same. The substantial wage settlements which characterized 1970 reflected the forces created by the multi-year bargaining pattern, which more than offset the counterforces generated by the sluggish pattern of business activity.

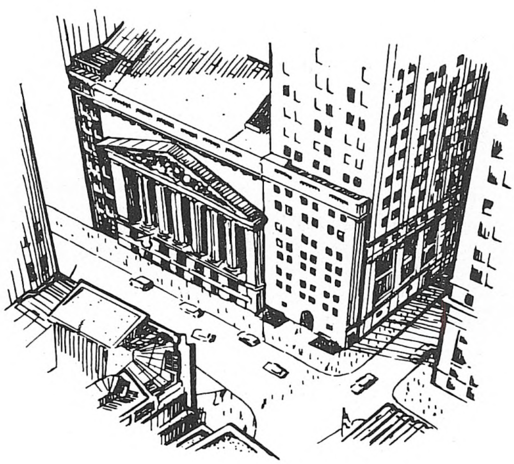
Wage and price pressures of this sort led the Administration to move towards a "jawboning" anti-inflationary strategy, in the form of two "inflation alerts" issued in the latter part of the year by the Council of Economic Advisers. (Many public and private opinion leaders argued for an even more forceful Government effort—guidelines—to guide private wage and price decisions into a non-inflationary path.) In its analyses, the Council found fault with a number of recent wage and price actions—for example, the wage (and price) increases in the auto industry, the Presidential emergency board's recommendation in the railroad industry, the Texas Railroad Commission's limitation on petroleum output, and the large and continuing increases in construction-industry costs.

Towards year-end, CEA Chairman McCracken commented that the economy was still "going through the worst of both worlds" of inflation and stagnation. In 1971, however, he stated that it should be "moving into the best of both worlds," as prices responded to the earlier set of deflationary policies and as unemployment yielded to the new expansionary forces building up in the economy.

Turnabout in Policy

Public policymakers encountered a great deal of difficulty in 1970 trying to offset inflationary price trends and deflationary production trends at one and the same time. As the year progressed, however, both monetary and fiscal policy moved increasingly towards ease—in an effort to control the worsening business slowdown, in the hope that increased output would also contribute to price moderation, and in the belief that most of the pressures of excess demand had already been overcome by the restrictive policies of 1969.

The Federal budget veered sharply from an $11½ billion rate of surplus in the first half of 1969 to almost a $14-billion deficit in the second half of 1970 (national-income basis). At that level, the deficit was larger even than the one recorded during the 1967-68 fiscal crisis, prior to the imposition of the income-tax surcharge.

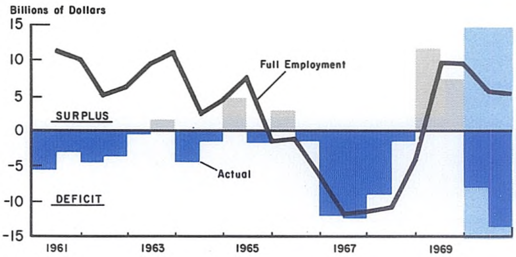


There was one important difference between the two periods, however. The deficit of 1967-68 worked to stimulate an already overheated economy, while the 1970 deficit developed primarily as a result of sluggish economic conditions.

This difference was at the heart of the increasing popularity of the "full-employment" budget—a concept that helped to sell the 1964 tax cut and has more recently been used as an argument for an anti-recessionary fiscal stance. In the present context, if revenues (and some expenditures) had been recalculated to show the fiscal impact under conditions of full utilization of resources, 1970 would have posted a restrictive budget surplus of over $5 billion rather than its actual $11-billion deficit. In contrast, 1967 recorded roughly a $12-billion deficit—and 1969 roughly a $10-billion surplus—on either the actual or the hypothetical full-employment basis.

According to former CEA Chairman Arthur Okun, the fiscal "furnace" can go into operation either because the economy has been chilled by an economic slowdown or because the spending thermostat has been turned up. Cooling-off of the economy does the trick automatically—by curtailing tax receipts as private incomes are depressed and as capital losses are incurred, and by boosting expenditures in the form of higher unemployment compensation. Inflationary setting of the thermostat, on the other hand, results from conscious decisions to increase expenditure programs or to cut taxes. The 1970 budget deficit came about because of the first of these two types of situation.

At full employment, 1970 would have yielded surplus rather than deficit



Creating a deficit

Actual budget receipts dropped 2½ percent in 1970, as the economy felt the effects of the business slowdown and as the income-tax surcharge came to an end at midyear. (In addition, the 1969 tax-reform act lightened the tax burden for low-income households and increased personal exemptions at midyear.) Personal-income tax receipts declined about 5 per cent to $91 billion, while corporate profits tax receipts dropped about 10 percent to $35 billion. In contrast, social-security taxes rose about 6 percent to $49 billion, reflecting earlier increases in tax rates along with the continuing high level of wage employment.

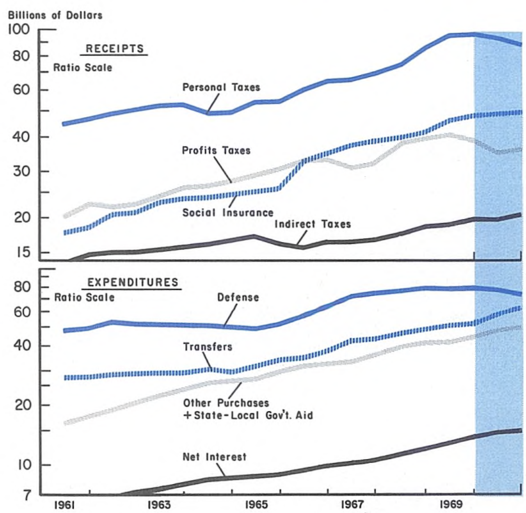
Budget expenditures rose 5½ percent as a result of diverse spending trends in the economy. (Expenditures rose only 2 percent in 1969, but about 15 percent annually between mid-'65 and mid-'68.) Defense spending fell about 3 percent to below $77 billion, but on the other hand, social-security and other transfer payments jumped about 20 percent to $62 billion, partly reflecting a 15-percent increase in social-security benefits, and civilian-agency purchases and grants increased about 10 percent to $48 billion. Thus, as the Administration constantly reiterated, the budget represented a substantial shift of resources out of defense and into civilian activities.

Unwinding a squeeze

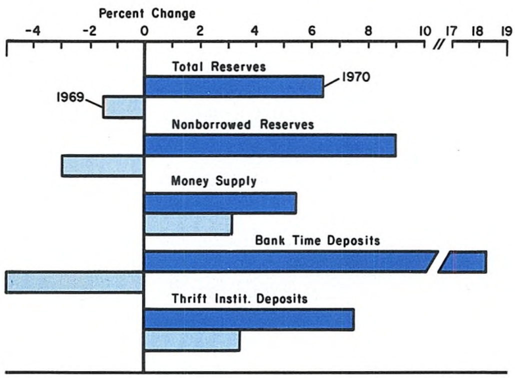
Monetary policy, like fiscal policy, attempted to deal last year with the opposing problems of rising unemployment and rising prices. However, monetary policy also had to face up to the difficult problems created by a severe financial squeeze—probably the worst crisis in the financial markets since the 1930's. Some observers may not have been impressed—especially those who noted only the relatively modest drop in business activity—but to others, the serious financial dislocations which became evident during the 1969-70 period were frightening indeed.

To counteract the evidence of economic slowdown—and for a time in the spring and early summer some serious financial problems—the Federal Reserve significantly eased its policy stance during 1970. Member-bank total reserves increased about 6½ percent and nonborrowed reserves rose about 9 percent (annual-average basis), whereas both of these measures of bank lending power declined somewhat during 1969. The money supply increased almost 5½ percent

Actual '70 budget features lower revenues and higher spending



Monetary aggregates attest to distinct easing of monetary policy



in 1970, as against a 3-percent gain in 1969, and it grew especially fast when most necessary, in the near-crisis atmosphere of the spring and early summer months. In addition, bank time deposits jumped 18 percent, as against a 5-percent decline in 1969, and thrift institutions also reported a substantial increase in deposits.

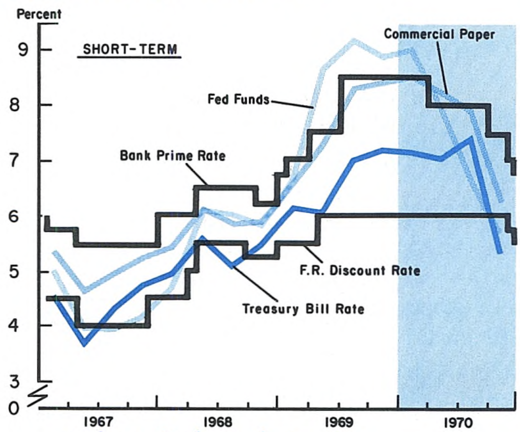
Moving towards ease

Monetary policy began to ease almost from the outset of the year. The Federal Open Market Committee—the System's chief policy group—instructed its operating manager in January to seek a modest growth in the money supply and bank credit. Thereafter, "moderate" was generally substituted for "modest" in these directives, and in the turbulent financial conditions of the spring months, the Committee directed that operations should be conducted "with a view to moderating pressures on financial markets."

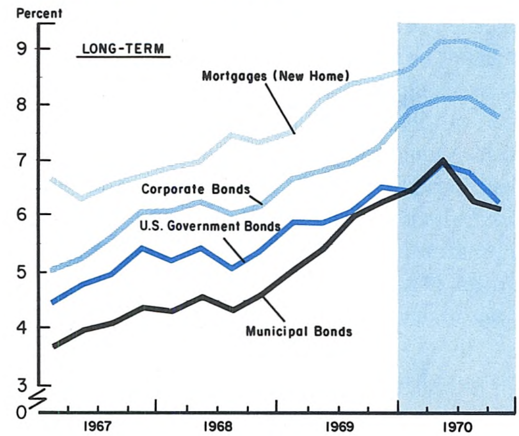
Early in 1970, the Reserve Board raised ceiling interest rates that banks are allowed to pay on various types of time and savings deposits. Around midyear, the System took several steps to ease money-market pressures resulting from the Penn Central insolvency. In late June, the Board suspended rate ceilings on short-term deposit certificates of $100,000 or more—thus giving banks the freedom to bid for funds in the market and to make loans available to necessitous borrowers—and the System permitted member banks to borrow from their Reserve Banks if necessary for them to accommodate credit-worthy customers refinancing maturing commercial paper.

Other policy shifts followed on later in the year. In August, the Board imposed reserve requirements on the commercial-paper indebtedness of bank affiliates—thus inducing the banks to reduce those liabilities—and in October it freed a certain amount of reserves by reducing requirements (from 6 to 5 percent) on bank

Money-market rates fall precipitously in late 1970



. . . and capital-market rates lag not too far behind



time deposits of \$5 million or more. In November, the Board took several steps to strengthen the inducement for American banks to retain their Eurodollar liabilities and thus moderate the pace of repayment of Eurodollar borrowings. Finally, towards year-end, the Reserve Banks reduced their discount rate in two steps from 6 to 5½ percent.

Coming down from the peak

The easing trend of policy, along with the sluggish tone of business activity, led to spectacular declines in interest rates. By year-end, money-market rates fell precipitously from the historical highs reached last winter and the secondary peaks of last spring. Treasury-bill rates fell below 5 percent in December, in sharp contrast to the 8-percent figure reached briefly in late 1969. Commercial-paper rates fell below 6 percent, after reaching 9 percent around the first of the year, while the Federal-funds rate dropped below 5 percent, in contrast to the 9-percent figure attained last winter.

Long-term interest rates, which had previously remained close to last spring's peak levels, also participated in the late-year decline. Treasury-bond yields fell to 6 percent in December, as against last spring's 7-percent level. Municipal-bond yields dropped to about 5½ percent, also in contrast to last spring's rates in the 7-percent range. And despite heavy capital-market demands, even Aaa corporate-bond rates responded to the downward economic and policy pressures, falling to about 7½ percent by year-end, or about 1 percent below peak levels.

By the end of this turnabout year, not only had interest rates come down, but the liquidity positions of banks and other financial institutions (along with business firms generally) had been rebuilt, and a much more tranquil atmosphere prevailed in the nation's financial markets. Reflecting on the policy role in this development, Federal Reserve Chairman Burns recently said, "Market participants have come to realize that temporary stresses and strains in financial markets could be alleviated without recourse to excessive rates of monetary expansion."

Going further, however, Chairman Burns pointed out that monetary and fiscal measures had proven insufficient to overcome the unique set of problems prevailing in 1970, and he suggested a guidepost-style incomes policy as an addition to the usual array of policy weapons. "Monetary and fiscal policies can readily cope with inflation alone or with recession alone, but within the limits of our national patience they cannot by themselves now be counted on to restore full employment, without at the same time releasing a new wave of inflation."

Turnabout in Finance

The way it began, 1970 looked as though it might well be a repeat of 1969—a year of considerable strain in the nation's credit markets—but in the last analysis 1970 turned out to be somewhat of an improvement over the previous year. According to preliminary Federal Reserve flow-of-funds estimates, the total volume of funds raised by non-financial sectors rose about $9 billion to $95 billion, with this gain reversing a decline of like magnitude in tight-money 1969.

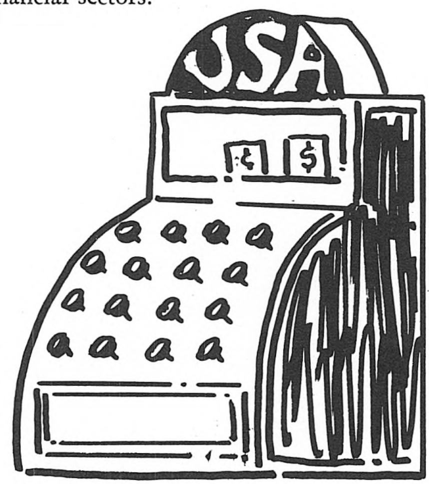
Business credit demands remained fairly strong (at least early in the year), largely because of a continuing high level of fixed-investment outlays, while the Federal government's shift from surplus to deficit led to a sharp increase in demands from that sector. Federally-sponsored credit agencies and state-and-local governments also stepped up their borrowings. Households, on the other hand, moderated the pace of increase in both their current expenditures and borrowings, and as a result, sharply raised the level (and rate) of savings out of disposable incomes. They thus provided the "surplus" needed to finance the deficits of the business and public sectors.

As the year came to a close, businesses in particular moderated the pace of their spending, partly under the influence of the General Motors strike. Credit demands eased substantially, and near-record flows of business and household savings into depositary-type institutions helped reduce borrowing costs and promised relief to the hard-beset homebuilding industry.

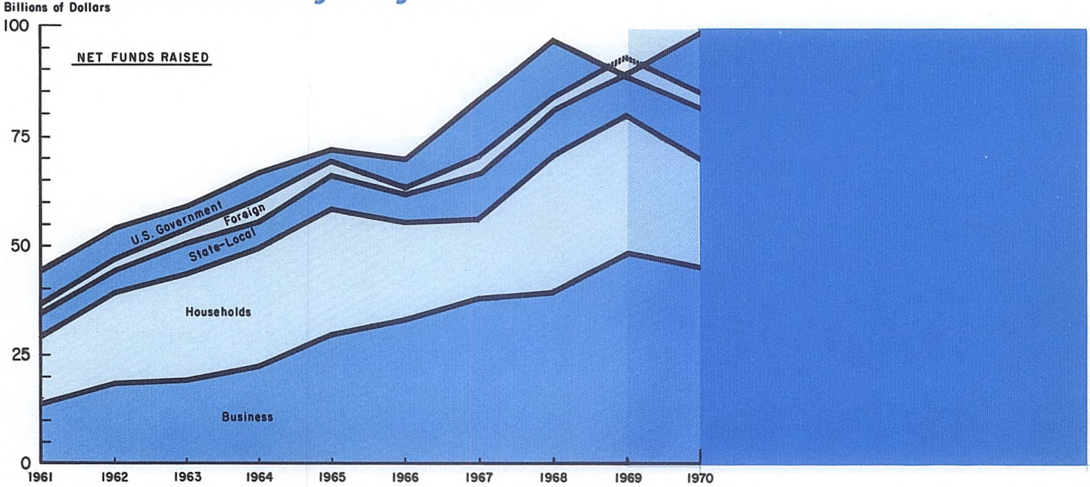
Business credit demands expand

Following a sharp rise in 1969, capital expenditures by the nation's businesses eased slightly in 1970, to $110 billion. This shift reflected a sharp reduction in the rate of inventory accumulation and an only modest rise in plant-equipment spending.

The volume of fixed-investment expenditures still remained high, even while levelling off, and in conjunction with a $10-billion decline in profits and an attendant reduction in internal cash flow, led to continued heavy demands for external financing. On balance, nonfinancial businesses raised some $45 billion in the nation's credit markets in 1970, down slightly from the previous year—but still the second largest volume on record—and accounted for just under one-half of the total funds raised by all nonfinancial sectors.



Credit demand is strong in business sector—and even stronger in government



Although the volume of business borrowings declined slightly, its composition changed drastically. Borrowings from the nation's banks, the traditional source of short-term credit, rose by only about $3 billion, compared with a $13-billion gain the previous year. This slowdown helped persuade banks to reduce their "prime" lending rate five times over the course of the year, from a record 8½ percent early in March to 6¾ percent in December. The volume of business trade credit also rose at a slower pace than in 1969 ($8 billion, as against an $11-billion gain).

On the other hand, the volume of long-term debt and equity financing (mostly the former) rose by a record $26 billion, up from only $16 billion the previous year. In part, the heavy volume of corporate debt offerings was designed to help finance the continuing high level of investment expenditures. But as the year progressed, the proceeds of long-term offerings were utilized increasingly to repay costly bank borrowings. (As late as August, over 40 percent of new commercial-bank short-term business loans carried rates of 8½ percent and more, while only about 1 percent carried a rate less than 8 percent.) In addition, some businesses used the proceeds of bond offerings to reduce their outstanding commercial paper, because of the crisis in that market brought on by the Penn Central bankruptcy. Corporate commercial paper rose by $8 billion in 1969 and by an additional $5 billion through mid-1970, then declined slightly by year-end.

Government demands also rise

The turnabout of the Federal sector from surplus to deficit was the most distinctive feature of 1970's credit-market story. From a net supplier of funds in 1969, the Federal sector became a net borrower of funds, with the Federal Reserve System, the nation's commercial banks, foreign entities and households acquiring the bulk of the Government's debt offerings. In addition, government-sponsored but nonbudget-supported credit agencies raised about $9 billion in funds in the markets, roughly the same amount as in 1969. About two-thirds of the offerings represented borrowings by the Federal National Mortgage Association, which were used to purchase mortgages in the secondary market as a means of providing support to the home-building industry.

For their part, state and local governments experienced a pattern of higher revenues, expenditures and borrowings—a pattern much like that of previous years. Tax receipts and grants-in-aid from the Federal government rose by about $14 billion to $132 billion, while current expenditures plus transfer payments rose by $12 billion to $136 billion. To help finance the resulting deficit and to build up depleted working capital, and also to take advantage of declining borrowing costs in the latter part of the year, municipal treasurers substantially expanded the volume of municipal-debt offerings during 1970. On balance, the volume of funds raised by state-and-local authorities rose about $3 billion to a record $12 billion.

Household credit demands ease

Households in 1970 played their traditional role of providing a surplus of funds out of disposable incomes with which to finance the net deficits of other sectors. (In the flow-of-funds accounts, data for personal trusts and non-profit organizations are included with household data.) After-tax incomes rose by $50 billion, far surpassing 1969's $40-billion increase. But while disposable incomes rose more rapidly, current outlays rose at a slightly less rapid pace, by about $40 billion. Consequently, personal savings rose sharply, by some $13 billion to $51 billion.

Household debt also rose, but the gain, at $25 billion, was less than 1969's $32-billion increase, and even then largely reflected a belated pickup in home-mortgage financing as mortgage funds became more available towards year-end. Moreover, consumer instalment credit rose much less rapidly than in 1969, largely because of the decline in auto purchases.

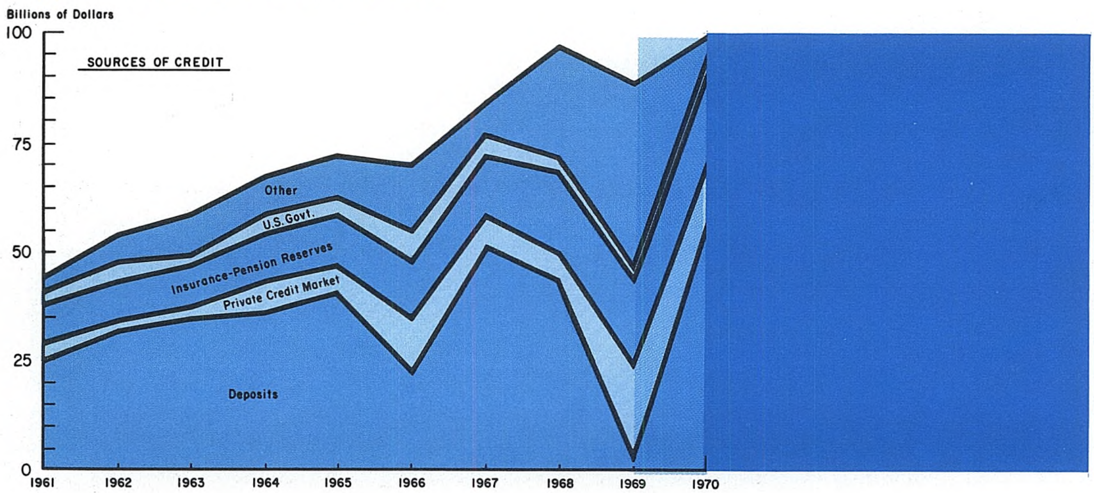
The bulk of consumers' increased savings went into interest-bearing accounts at commerical banks and other depositary-type institutions—altogether, a $34-billion gain, compared with $11 billion in 1969. Contractual allocations to insurance and pension-fund reserves absorbed an additional $20 billion of household savings, while acquisitions of credit-market instruments—government and municipal obligations, mortgages, corporate and foreign bonds—absorbed the remainder.

Shifting roles for intermediaries

The shifting patterns of receipts, expenditures, borrowings and savings by the various sectors of the economy were reflected in the changing asset and liability profiles of the nation's financial institutions. Commercial banks in particular felt the impact of these shifts, but thrift institutions and insurance companies were affected also.

Commercial banks posted a record $40-billion

Deposits account for over half of funds supplied to credit markets in 1970



rise in total deposits, partly in response to a progressive expansion in reserves brought about by a policy of greater monetary ease. While $7 billion of the overall gain occurred in such highly liquid categories as demand deposits and currency, the bulk of the increase (some $33 billion) ended up in interest-bearing accounts. Most of the increase occurred after mid-year, primarily in higher-yielding, large-denomination CD's; but consumer-type time accounts and traditional passbook savings also showed appreciable gains, as the rates offered by the banks became increasingly attractive in the face of a steady decline in yields on competitive market instruments.

The provision of funds by banks and other depositary institutions—total deposits plus currency—which had accounted for hardly any of the $88 billion supplied to the credit market in 1969, made up over half of the $95 billion supplied in 1970. Commercial banks garnered the lion's share of the deposit gain, with a $40-billion net flow contrasting sharply with the previous year's $11-billion *outflow*. But non-bank intermediaries, such as mutual-savings banks and savings-and-loan associations, also bettered their previous year's performance; the S&L's $11-billion net savings gain was almost triple that realized during 1969.

Changing roles for lenders

With their primary source of funds—deposits—increasing dramatically after mid-year, commercial banks were able to pay off a good portion of the non-deposit funds which they had acquired at great expense during 1969 and early 1970 as a means of financing loan demands in the face of heavy deposit outflows. "Imports" of Euro-dollars and proceeds from the sale of commercial paper, which had reached a combined total of $21 billion early in the year, were reduced to about half that level by year-end, and borrowings from the Federal Reserve Banks also were reduced significantly over the course of the year. Banks thus supplied $31 billion to the nation's credit markets in 1970, or more than double the 1969 volume. For their part, non-bank financial institutions supplied about $39 billion—only moderately above the 1969 figure.

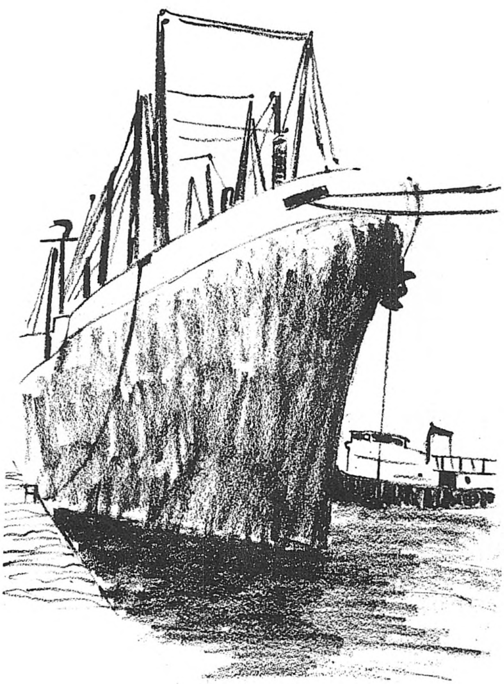
The allocation of bank funds also shifted significantly from year to year, reflecting the shifting pattern of credit demands in the various sectors of the economy. Business loans, which had risen by about $11 million annually during the 1965-69 period, increased by less than $3 billion in 1970. (Bank loans thus accounted for only 5 percent of business' external financing in 1970, as against a 30-percent share in the preceding period.) Only 3 of 22 major industries exceeded their 1969 borrowing pace in 1970, and only 10 of them increased their borrowings at all.

Commercial-bank mortgage lending, although speeding up by year-end, increased by only $2 billion in 1970, as against 1969's $5-billion figure. Commercial banks thus supplied less than 10 percent of all mortgage funds during the year, or only half the average of the preceding five-year period. (However, these figures understate the actual volume of loans made, partly because of sales out of portfolio to other investors, such as FNMA.) The volume of consumer-loan extensions also moderated—the net gain amounted to less than $2 billion—but the banks' share of consumer financing held steady at about 37 percent of the total.

In contrast to this moderate loan expansion, commercial banks substantially increased their investment portfolios in 1970. Commercial banks financed the greater part of the deficit incurred by the Federal sector, with a $7-billion expansion of their government-security portfolios, as against an $11-billion net reduction in 1969. Similarly, banks added some $14 billion to their portfolios of municipals and agency issues—a new record, in sharp contrast to a small net reduction in 1969. These portfolio changes enabled banks to improve their liquidity positions considerably over the course of the year.

Surface Calm

As a whole, the international economy enjoyed a quietly successful year in 1970. The major innovations of the 1960's—Special Drawing Rights, the two-tier gold mechanism, and European integration—continued to progress smoothly. Nonetheless, there were a number of significant pressures that, if continued unchecked, could at some future time disrupt the progress that has been made towards achieving a well-integrated and prosperous world economy. These problems include a disappointingly large U. S. payments deficit, increasing protectionist sentiment in this country, rising nationalism in the less-developed countries, and potentially large economic shifts in the war-torn Far East.



Diverse payments trends

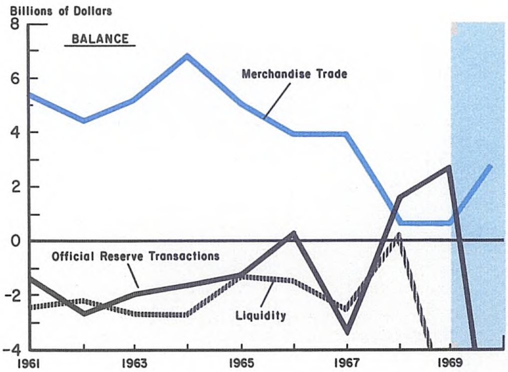
The U.S. balance of payments was in deficit in 1970, to the tune of almost $4 billion on the liquidity basis and almost $10 billion on the official-settlements basis. (The 1969 comparisons were a $7-billion liquidity deficit and a $2½-billion plus official-settlements surplus.) A number of diverse trends help account for these conflicting totals; nonetheless, it is clear that the balance of payments definitely remains in the red. For example, the substantial liquidity deficit is quite large in comparison to pre-1969 experience.

The best news in the balance-of-payments sector was provided by the merchandise-trade accounts, which went from a 1969 surplus of somewhat less than $1 billion to an estimated 1970 surplus of over $2½ billion. Most of the improvement came in the early part of the year; the second half did not live up to expectations because of the auto strike and a slowdown in jumbo-jet exports. The remainder of the current account was also in surplus, helped along by the reduction in interest payments to foreigners which developed as U.S. banks shifted out of Eurodollar borrowings.

On the capital account, direct investment abroad continued on a large scale, offset to some extent (as a result of U.S. capital controls) by borrowings abroad. Corporations increasingly borrowed at the short end of the market, thus adding to U.S. liquid liabilities. But meanwhile, U.S. banks began to reduce Eurodollar liabilities to their overseas branches, and this trend accelerated with the Federal Reserve's suspension of ceilings on large short-term domestic CD's. The resulting dollar claims ultimately fell on the exchange markets, and foreign central banks, fulfilling their responsibilities as buyers of last resort, added substantially to their dollar stocks —over \$5 billion in the January-September period alone.

While the good news in the balance of payments—the trade surplus—may have some element of permanence, the bad news—the outflow of short-term capital—may be only a transitory phenomenon. The U.S. has consistently led the downward trend in interest rates in the last year, which means that at any one time interest-rate differentials tend to favor foreign centers and encourage interest-sensitive capital outflows.

Another large deficit posted in nation's balance of payments



Quotas—Rx or dangerous drug?

One of the most hotly debated measures of 1970 was the Congressional proposal to impose quotas on shoes, synthetic textiles, and perhaps other items as well. The House bill died in the Senate in the dying days of the 91st Congress, but it may be revived in some form in the 92nd Congress. Critics (including most economists) argued that it was especially dangerous to experiment with protectionist measures—which tend to invite retaliation in kind—at a time when the U.S. trade balance was still endangered. The President and Congress will be forced to weigh the competing claims of foreign policy and U.S. consumer interests on the one hand against those of certain domestic manufacturers and their employees on the other.

In the area of capital controls, few changes occurred during 1970. New Commerce Department rules amounted to a slight liberalization in permitted direct investment, but these were mostly for the purpose of simplifying reporting requirements rather than for liberalizing U.S. investment. The interest-equalization tax remained on the books for the eighth year, and with the latest request for its renewal, it appeared to be joining the company of such "temporary" fiscal measures as auto and telephone excise taxes.

Calm at the center

By and large, 1970 was a successful year for both the International Monetary Fund and the World Bank. For the Fund, the past year saw a substantial increase in quotas—from \$21.3 to \$28.4 billion—and the first year of operation of the Special Drawing Rights (SDR's). The Bank continued with its aggressive expansion program. The two-tier gold arrangement continued to work well and demonstrated its strength and survival qualities in the face of roughly an 8-percent average premium on private as compared to official gold.

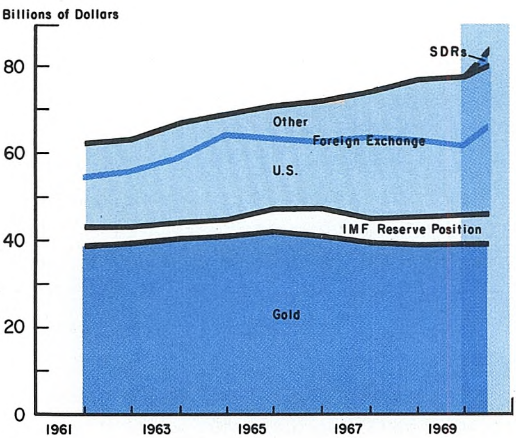
The initial allocation of SDR's was generally well-received, and the second allocation was made at the beginning of 1971. During 1970, about 25 percent of the 3.4 billion units of SDR's changed hands. Some Europeans felt that an essential condition had not been duly observed—that is, that the U.S. attain payments equilibrium prior to the initial issue of SDR's. This dispute may present obstacles to the next allocation decision, due before the end of 1972, unless the U.S. balance-of-payments situation improves by then. On the other end, the less-developed countries are still pressing to have SDR's tied more closely to development assistance.

The concern to improve adjustment performance was reflected in continuing discussions about greater (though limited) exchange-rate flexibility. The Executive Directors of the Fund published a report in late August which reviewed various proposals for a limited increase in rate flexibility, including: a slight widening of the current 1-percent legal margins, and floating exchange rates as a transitional measure when a new parity cannot be immediately chosen. A major theme in the report was the desirability of prompt adjustment of par value in cases of fundamental disequilibrium.

The World Bank Group made loans and investments of $2.3 billion in fiscal 1970—a sharp expansion from $1.0 billion in 1968. When Robert McNamara assumed the presidency of the World Bank, he pledged to double the Bank Group's operations over the 1969-73 period, and in his report to the Governors at Copenhagen, he reported that this goal was being met on schedule.

The gold marketing agreement between the IMF and South Africa, which was concluded at the end of 1969, added an additional dimension

Initial allocation of SDR's adds to world reserves



to the two-tier gold system. This system, once considered fragile and temporary, continued to demonstrate its stability during 1970, even though the free-market price of gold ranged from $34.75 to a high of $39.01. The price remained at or near its *de facto* floor until the latter half of August, at which point it began to rise quite sharply. This increase failed to disturb the international financial markets, however, and observers began to envision the development of a true commodity market in gold, similar to the one developed for silver in the late 1960's.

Europe—unsteady progress

Inflation and labor troubles garnered most of the European headlines in 1970. While these problems were quite serious, they did not preclude further progress towards underlying economic goals. In particular, the U.K. international position improved. With the balance of payments favorable, reserve assets increased by $300 million over the year, and repayments of stabilization debt were quite substantial, including a reduction in the U.K.'s indebtedness to the IMF of more than $300 million.

On the other hand, a closer look at the U.K. balance of payments (available only for the first three quarters) seems to justify the fear expressed in some government circles that sharply rising wages were eroding the U.K.'s competitive position. The visible balance deteriorated steadily over this period, going from a surplus of nearly $200 million in the first quarter to a deficit of like amount in the third quarter. The current-account surplus correspondingly declined from about $500 million to about $175 million. The fourth quarter may have witnessed a reversal of these unfavorable trends, but the improvement in this period was partly due to an uncomfortably large inflow of interest-sensitive short-term capital, which prompted the Government to restrict overseas borrowing by U.K. residents in early 1971.

A long-term British goal—membership in the European Economic Community—appeared several steps closer with the decline of French opposition. Many details must still be settled before the U.K. can be admitted, but at least there is a feeling of progress on this most important front. An unspoken precondition to the success of these negotiations is the maintenance of external equilibrium by the U.K.

The Common Market itself enjoyed a fairly good year, despite continued political difficulties in Italy. The 1969 realignment of parities appeared to produce greater equilibrium in European payments, and some progress was made towards ultimate currency unification, despite French misgivings on this score.

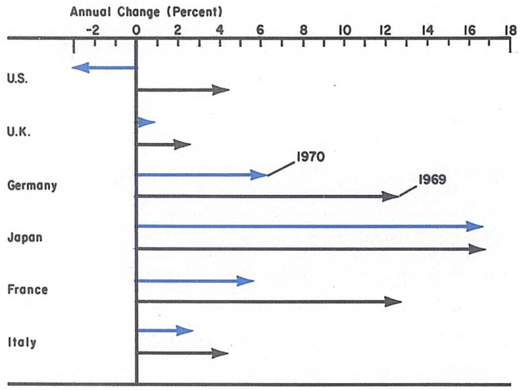
In Canada, meanwhile, the first half of 1970 was characterized by a heavy buildup of reserves, due to unusually large current-account surpluses combined with capital inflows. At the end of May, the Canadian government suspended the par value of the Canadian dollar for the time being, and let the rate more or less float freely. In fact, the authorities have since found it necessary to intervene on the selling side, and Canadian reserves have continued to show strength, though the rate has not maintained the upward momentum shown in the first half of the year.

Japan—another good year

The Japanese economy chalked up another sensational year in 1970. GNP approached the $200-billion mark, and the balance-of-payments surplus of $1.3 billion, while far below the 1969 performance, indicated continued external strength. Exchange reserves expanded to nearly $4.4 billion, and the IMF quota increase entitled Japan to appoint an Executive Director—a status more in keeping with Japan's economic power.

Japanese economic activity levelled off in the last half of 1970, industrial production declining 2 percent from July to November. Monetary policy was relaxed to stimulate the economy, but the authorities remained concerned about rapidly rising consumer prices and wage gains in excess of productivity. The more optimistic projections foresee continued rapid expansion for Japan for

Japan again outpaces other leaders in industrial production



the remainder of this century, but the concern for growing environmental pollution and the need to shoulder a heavier defense burden may possibly slow the rate of growth.

Pacific—withdrawal pains

Southeast Asia and the Southwest Pacific became increasingly aware last year of the fact that an independent policy decision taken anywhere in the world will have repercussions practically everywhere. Pacific areas in particular felt the aftershocks of two major Western decisions: the U.S. decision to reduce its military presence in the area and the British decision to retreat from the Commonwealth to the Common Market.

The U.S. decision now creates economic problems for Asian countries that were involved only peripherally in the Vietnam conflict. These countries find themselves losing U.S. military-procurement contracts, direct U.S. military aid, and spending by U.S. personnel formerly stationed there or on "R&R." The impact may be felt most severely by Thailand, but it could also affect some countries, such as Korea and Taiwan, that have recently scored remarkable gains in GNP and export growth.

In the case of Korea, the slowdown in U.S. procurement coincides with a threat of U.S.

quotas on Korean textiles. For Thailand, dollar receipts from U.S. troops and U.S. military-assistance programs are declining at the same time that the "green revolution" is cutting into the export market for Thailand's staple export, rice. For the Philippines, reduced U.S. spending may only accentuate the islands' other economic and political problems, which have already led to an inflationary crisis and a *de facto* devaluation of the peso (via a floating rate) in 1970.

Looking southward, observers see the British re-orientation as a major source of anxiety. Australia and New Zeland have long been substantial exporters of agricultural produce to the United Kingdom, but this flow is likely to be cut severely when Britain enters the EEC, in 1973 or whenever. The Australian economy may be able to shake off this loss, because of its increasing diversification and its recent mineral boom, but New Zealand will undoubtedly suffer because of its heavy dependence on meat and butter exports to the U.K. (New Zealand's agricultural efficiency can be measured by the fact that it can profitably land high-quality butter in England at a price equivalent to about 20 cents a pound.) Unless by some miracle the U.S. market is opened to it when the British market is reduced, New Zealand will be caught in a severe balance-of-payments "crunch."

The economic record of 1970, considering the many sources of disturbance in the world economy, indicated that decisions made in 1968 and 1969 had helped reduce tensions in the international payments system. However, inflationary difficulties continued in both the industrial and non-industrial countries, and the U.S. balance-of-payments deficit provided evidence of underlying strains which threaten the continuation of expansion under conditions of economic stability.

Unbalanced Year

The Western economy followed the national trend during 1970—downward. Fortunately, as the year came to a close, Westerners could detect some hopeful signs in the outlook, such as a welcome upturn in the homebuilding industry. Unemployment was still increasing, however, due in large part to the continuing weakness in the crucial aerospace sector.

Personal income continued to increase in Twelfth District states, although at a somewhat slower rate than in 1969, when it rose almost 9 percent. Income advanced at close to the 1969 pace in the first half of the year, but the pace then slackened in the second half, in line with the aerospace slump and the general lethargy in the economy.

Nonfarm employment declined 0.5 percent in the District, in contrast to the slight (0.9 percent) increase posted elsewhere in the nation, on an annual-average basis. Gains made during the year in the distribution, services, and government sectors were not sufficient to offset widespread declines in manufacturing and construction. The employment decline, along with an increase in the Western labor force, brought about a sharp rise in unemployment rates. In California, the jobless rate jumped from 4.5 to 7.1 percent over the course of the year, and elsewhere in the West, the rate rose from 4.4 to about 7.0 percent. Elsewhere in the nation, the increase over the year was from 3.4 to about 5.6 percent. (The state of Alaska stationed several people at the Seattle airport to warn travellers that there were no job openings in Alaska either.)

Aerospace continues weak

Much of the West's employment decline was due to the continued weakness of the aerospace sector. Aerospace manufacturing firms cut 120,000 workers from their payrolls during 1970, in a third consecutive year of progressively greater cutbacks. Over the three-year period these firms laid off some 207,000 workers, thus reducing the workforce to 549,000—the lowest level of the past 6 years. California accounted for most of the layoffs, but the percentage decline was much greater in Washington—a 52 percent reduction over this period, as against a 24-percent decline

for California. In Washington, such nonproduction workers as scientists, engineers, and office personnel accounted for roughly half of those who were laid off, but in California, layoffs were much heavier among production workers than among nonproduction workers.

Weakness in military, space, and civilian markets all contributed to the 1970 reductions in District aerospace employment, but the space and civilian markets were particularly weak. Procurement awards from the National Aeronautics and Space Administration dropped about 20 percent between the summer quarter of 1969 and the comparable period of 1970. Moreover, District firms last year accounted for only about 20 percent of total space-agency awards, in contrast to the 50-percent share held during the early years of the space program.

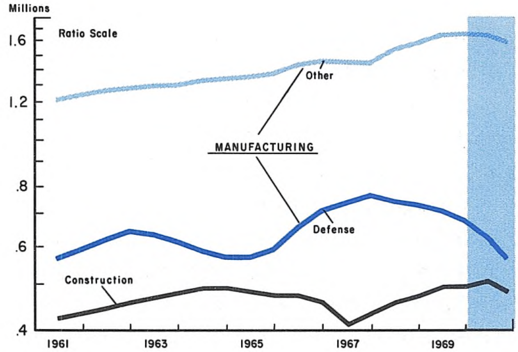
The financial difficulties of commercial airlines weakened the market for commercial jet aircraft. New orders for the new generation of jet aircraft came in at a slow pace, while some old orders were cancelled and others deferred. Moreover, some aircraft producers were hampered by internal financial problems stemming from work on the C5A and other military projects.

Defense prime-contract awards to District firms matched the year-before totals during the first three quarters of the year, whereas defense contracts nationally dropped about 7 percent over the period. Thus, District firms increased their share of DOD awards slightly during the year, to over 24 percent.

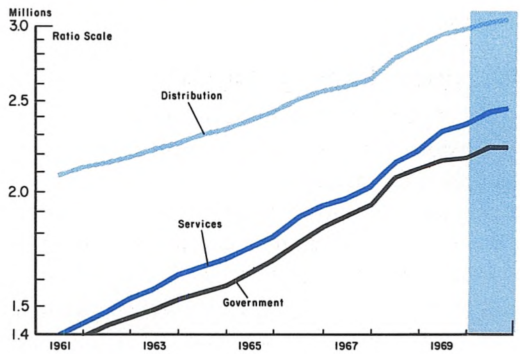
Housing speeds up

Following a sharp first-quarter drop, Western housing starts gradually began to pick up momentum, and by December reached a 473,000-unit annual rate—the highest figure for any month since 1963. For the year as a whole, homebuilding totaled some 319,000 units, only a shade below the 1969 figure, while shipments of mobile homes provided an additional 46,000 units—the same as in 1969.

West shows weakness in both manufacturing and construction



. . . along with slower growth pace in other major industries



This was an impressive performance, in view of the general slackness of business activity, as well as the shortage of funds and high mortgage rates which bedeviled the mortgage-lending industry earlier in the year. There were sharp to moderate declines in homebuilding activity in certain areas—especially the aerospace centers of Seattle and Southern California. On the other hand, homebuilding in Northern California gained about 15 percent, and areas such as Phoenix, Salt Lake City, Las Vegas and Boise registered gains ranging from 20 to over 60 percent.

In the West as a whole, the housing mix was about evenly divided between single-family and multiple units. (The latter accounted for about 53 percent of all new units in the West, compared with about 40 percent elsewhere.) Generally, Western vacancy rates remained close to record low levels, although some increases were evident towards year-end. Meanwhile, construction costs continued to rise, and this led contractors to reduce the size of units so as to keep in check the cost of finished dwellings.

Total construction activity, in dollar terms, declined about 5 percent in 1970, primarily because of a drop in California activity (F.W. Dodge data). Residential contract awards decreased about 1 percent over the year, and nonresidential awards (commercial and manufacturing buildings, and the like) dropped by about 15 percent from 1969's record pace. Contracts for heavy construction, in contrast, rose about 8 percent to a new record.

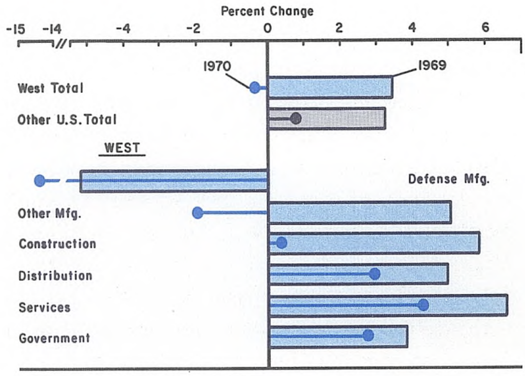
Forestry, farming sluggish

The Western lumber industry, affected by the slowdown in residential construction, suffered its second consecutive annual decline in production and employment. Orders at the mills fell sharply during the first quarter because of the nationwide housing slump, and continued to lag even when housing staged its second-half comeback, as wholesalers met most of the increased demand from their inventories.

Lumber prices fluctuated within a narrow range, in contrast to the ups and downs of the previous year. The softwood-lumber price index drifted lower through July—reaching a level 30 percent below the peak of March 1969—and remained near that level through year-end. Softwood plywood prices followed a similar course, and as a result, lumber and plywood prices by December were down to levels prevailing before the sharp upsurge of late '68-early '69.

District farmers received a record volume of returns from marketings in 1970, as receipts increased modestly from 1969 to about \$7.5 billion. Crop receipts were held down by a decline in output of processing vegetables and an even sharper drop in production of deciduous fruits. But in the livestock sector, higher prices helped bolster returns, primarily in the first half of the year. Elsewhere in the nation, farm returns increased at a somewhat faster pace because of sharply higher gains in crop receipts.

Total employment declines in West, while rising slightly elsewhere



Net income of District farmers apparently declined last year, as production expenses outran the rise in cash receipts. In recent years, production expenses have increased roughly 3½ to 7 percent annually. And as another indicator of a sluggish farm economy, farmland values declined in the West last year, in California for the first time since 1953.

Metals in the doldrums

District steel producers cut back production about 5 percent from 1969's record pace, to just over 6.7 million tons for the year. The Western market was affected by the slowdown in nonresidential construction, but also by a worrisome increase in foreign imports, which edged upward to a record 2.9 million tons, or almost one-third of the Western market. In contrast, imports nationwide dropped by 7 percent during the year.

Despite the weakness in demand, domestic producers raised prices on practically every major steel product during the course of the year. In

Where the Cutbacks Hurt

Seattle-Everett. Aerospace-manufacturing facilities, which at the 1968 peak employed 109,000 workers—roughly one-fifth of all nonfarm workers in the area—have now cut their workforce by more than half. Roughly 60 percent of these unemployed workers were laid off during the past year. Largely because of these cutbacks, the unemployment rate soared from 5 percent to 12 percent over the course of the year, and the rate would have been considerably higher if discouraged workers who dropped out of the area's labor force had continued to look for work.

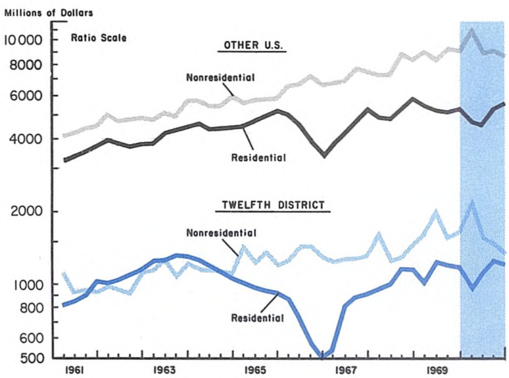
Los Angeles-Orange County. Aerospace firms have reduced their payrolls from 440,000 to 312,000 since the peak of the boom, and 64,000 of the laid-off workers were released last year. Since the aerospace peak, unemployment in the area, which normally has one-eighth of its nonfarm workforce working in aerospace, has jumped more than 120,000. In 1970, however, the slump tended to widen, as the increase in unemployment in all industries outran the number of newly released aerospace workers, and the jobless rate rose from 4 to 7 percent over the year.

San Diego. Aerospace firms laid off about 15 percent (7,000) of their workforce last year. The blow was not so severe as elsewhere, since aerospace accounts for only about one-tenth of the region's nonfarm workforce. But these layoffs helped boost the unemployment rate from 4 to 6½ percent over the course of the year.

San Jose. Aerospace employment has dropped by almost 14 percent (11,000) since the peak of the boom in this highly concentrated center of the industry. (About one-fifth of all nonfarm workers were employed by this industry at the peak.) With a 9-percent cutback during 1970, the jobless rate jumped from about 4½ to 7½ percent over the year.

San Francisco-Oakland. Aerospace firms have laid off about 20 percent of their workforce (5,000) since the 1969 peak, but this has not unduly affected the diversified Bay Area, which employs less than 2 percent of all workers in aerospace. Still, recent cutbacks have helped boost the jobless rate from 4 to almost 6 percent over the past year.

Residential building improves sharply while nonresidential turns down



February and June prices rose on sheet products; in March on structural shapes and plates; in April on bars, blooms, and billets; and in October on tin mill products. These increases boosted the price index for steel-mill products 6.4 percent for the year.

Producers of copper and other nonferrous metals watched their market situation change dramatically, from shortage to surplus, during 1970. In the case of copper, this reversal was reflected in sharp price increases early in the year and subsequent reductions as demand slowed both here and abroad.

Domestic producers raised their refined-copper price 4 cents a pound in January and another 4 cents in early April. These increases brought the price to 60 cents a pound, 58 percent above the level prevailing at the end of the 1967-68 mine strike. But the copper price on the London Metal Exchange—the quotation upon which foreign producers base their selling price—dropped below the U.S. producer price in early August for the first time in seven years, and its continued weakness led domestic producers to roll back their price from 60 to 56 cents a pound in late October and to 53 cents in early December.

Lead and zinc producers experienced a reversal of the sharp price upsurge of 1969, also as a consequence of declining demand. Between July and December, lead producers lowered the price in four stages, from 16½ to 13½ cents a pound. In August, the price of prime Western-grade zinc fell by one-half cent, to 15 cents a pound. Producers in these industries, along with copper producers, continued to reduce prices in early 1971.

The price of silver trended downward for the second consecutive year, under the influence of a slowdown in industrial demand and heavy inventory liquidation by speculators. The decline occurred even though the U.S. Treasury removed an important source of supply by discontinuing sales of the metal on November 10. The New York dealer price advanced to $1.93 an ounce in February, but dropped to $1.61 an ounce by late June under the impact of heavy speculative selling induced by the stock-market slump. After another flurry, it headed downward again to a yearly low of $1.57 an ounce in December.

At year-end, Congress passed legislation calling for the minting of 150 million 40-percent silver dollars bearing the likeness of President Eisenhower. But to the disappointment of silver producers, the bill also prohibited the minting of additional Kennedy half-dollars and provided that the 46 million ounces of silver required for the Eisenhower coin be supplied from excess metal in the U.S. stockpile.

Pacific Northwest aluminum producers raised the price of ingot in mid-April by 4 percent—from 28 to 29 cents a pound—and boosted the price of selected fabricated products accordingly. But a slowdown in shipments and a buildup in producers' inventories led to widespread discounting from list prices as the year progressed. In the fall, producers shut down some potlines to bring output closer into balance with demand, and as a result, the regional industry's operating rate fell to 90 percent of capacity by year-end.

Petroleum refining activity failed to exceed the 1969 level, according to preliminary data—making 1970 the first zero-growth year of the past decade. District production of crude oil meanwhile increased slightly, because of rising Alaskan output, but refiners continued to rely heavily on imports for their crude supplies. Expansion of Alaskan supplies has been delayed by opposition to construction of the North Slope pipeline by conservation groups and native land claimants. Development of off-shore supplies in Southern California has also been inhibited by environmental problems related to oil-drilling activity.

At year-end, the West rejoiced in the housing recovery, and looked beyond that for signs of a nationwide upturn strong enough to support the region's raw-material producing industries. But for a long-lasting recovery, substantial improvement in the West's aerospace industry seemed essential, and few signs of this could be read from the recent depressed level of military and civilian orders.

INDEXES OF INDUSTRIAL PRODUCTION—TWELFTH DISTRICT

(1957-59=100)

INDUSTRIAL PRODUCTION	1962	1963	1964	1965	1966	1967	1968	1969	1970
Copper	127	128	129	140	146	98	126	162	177
Lead	105	103	96	93	118	97	86	83	82
Zinc	101	98	93	89	96	87	76	75	63
Silver	105	103	102	115	129	101	101	120	122
Gold	86	86	85	116	135	104	98	127	131
Steel Ingots	100	117	132	138	140	136	142	145	138
Aluminum	107	118	135	150	165	195	204	251	250
Crude Petroleum	96	97	97	102	112	122	139	141	145p
Refined Petroleum	111	112	115	120	122	128	138	145	145p
Natural Gas	127	144	148	147	158	147	154	153	146p
Lumber	98	98	108	105	102	96	106	102	100
Douglas Fir Plywood	140	155	167	174	167	156	168	159	168
Canned Fruit	121	108	141	109	135	103	132	141	110
Canned Vegetables	106	95	100	97	113	114	121	92	99
Red Meat	112	115	126	126	130	129	131	134	120
Sugar	113	120	138	137	132	116	136	143	130
Creamery Butter	119	103	103	96	85	105	118	120	149

Corrective Year

During 1970, Western banks were able to repair some of the imbalances in their assets and liabilities created by the severe credit tightness of 1969. The most important improvement was a 20-percent gain in time deposits, which far exceeded the rate of outflow in the preceding year. An easier monetary policy, a decline in money-market rates, and a liberalization of rate regulations on time deposits provided the climate for this rapid growth.

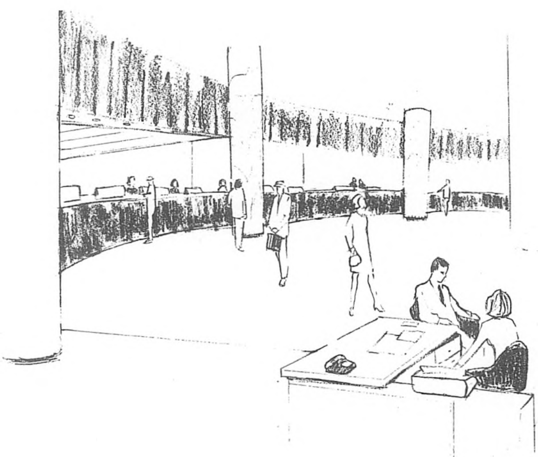
Total deposits at Twelfth District commercial banks increased 14 percent—just short of $8 billion, and well above the 8½-percent growth rate posted by commercial banks elsewhere in the nation. District banks used these funds to expand total credit by 10 percent ($6 billion) and to reduce their Eurodollar borrowings and their use of funds obtained from bank holding companies. Elsewhere, bank credit increased by 7 percent during 1970.

Shift toward balance

On the asset side of their balance sheets, Western banks scored a major improvement by replenishing their portfolios of short-term securities, which had been severely depleted in 1969. Total security holdings increased 28 percent ($4 billion), with the dollar gain being about evenly divided between U.S. Government and other securities. Meanwhile, as credit demand slackened, the expansion in loan portfolios was limited to a 4-percent ($2 billion) rate of increase.

According to balance-sheet data, business loans increased almost 5 percent in 1970. But these balance-sheet data *overstate* by 100 percent the volume of business lending, since in late 1970 the banks reacquired a large volume of loans previously sold to their holding companies. In addition, mortgage lending was not as responsive to the easier monetary policy and rapid time-deposit growth as might have been expected; mortgage loans on District-bank balance sheets increased only 1 percent over the course of the year. However, the banks sold a relatively large number of mortgages out of portfolio to other investors, including affiliated mortgage-investment companies, so that balance-sheet data *understate* the volume of mortages originated during the year. Consumer instalment credit at Western banks also expanded very little in 1970, reflecting the sluggish state of the economy and rising unemployment, which made consumers increasingly reluctant to add to their indebtedness.

In contrast to 1969, when they had to search hard for new sources of funds to finance strong loan demand, banks in 1970 were able to return to more traditional sources of funds. With the removal of rate ceilings on short-maturity CD's at mid-year, banks were able to increase sharply



their issuance of such deposits. Savings and consumer-type time deposits, as well as public deposits, also rose during the course of the year. In addition, Western banks recorded a higher level of private demand deposits than in 1969.

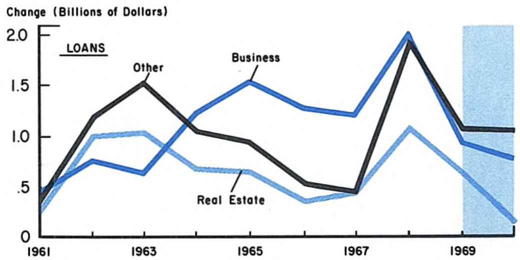
Liquidity positions of banks improved as readjustments occurred in their balance sheets. The loan-deposit ratio at large District banks moved down from a record high of 79.6 percent at the end of 1969 to 74.0 percent in December 1970. (But this ratio, even when adjusted to include Eurodollar deposits, still exceeded the level reached during the tight-money period of 1966.) The ratio of short-term U.S. Government and municipal securities to deposits also improved sharply, rising from 3.4 to 6.3 percent over the course of the year.

The factors that determine bank earnings showed mixed trends in 1970. District banks were able to reduce their high-cost Eurodollar borrowings substantially, but the average interest rate they paid on time deposits was much higher than in 1969. Still, to the extent that they substituted domestic deposits for Eurodollar liabilities, they reduced their net interest cost. On the income side, the prime rate on business loans was cut five times during the year, but the average rate of return on loans still remained above the 1969 average. Yields on security portfolios also declined, but security income improved because of sharply expanded portfolios. Most District banks reported higher earnings in 1970 than in 1969, but there were wide variations among individual banks—and in contrast to the previous year, most major District banks posted smaller gains than their counterparts elsewhere.

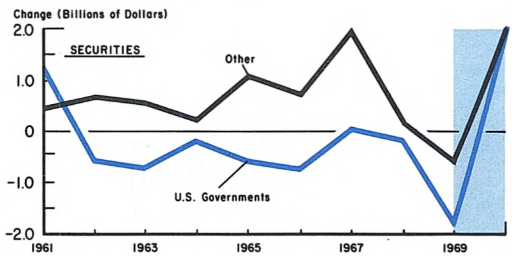
Shift toward ease

Required reserves maintained by District member banks at the Federal Reserve Bank increased only $107 million above the prior year's average during 1970 (daily-average basis), despite the substantial year-to-year growth in deposits. Lower requirements in the first half of the year, due to a reduced level of deposits,

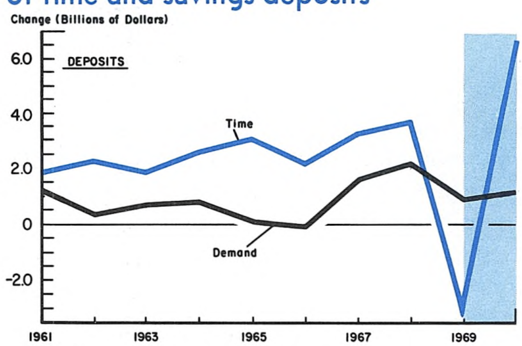
Western banks exhibit sluggish loan demand in 1970



. . . along with sharp turnaround in security portfolios



. . . and massive inflow of time and savings deposits



partially offset the higher level of reserves later required because of the second half's heavy deposit inflow. Also, the 1-percentage point cut in reserve requirements against time deposits in excess of $5 million, which was effective in October, effectively meant a 3-percent reduction in required reserves after that date.

In October, banks became subject to a reserve on their use of funds obtained through bank-related commercial paper; initially, this meant about a 2-percent increase in required reserves, but the amount of this supplemental reserve declined rapidly as bank holding companies ran off their commercial paper. The reserve on liabilities due to foreign branches (mainly Eurodollar borrowings) also declined sharply in the latter part of the year as District banks reduced their Eurodollar borrowings.

District banks' discounting at the Federal Reserve Bank dropped to $72 million in 1970—one-third below the daily average for the prior year. Net borrowed reserves reached a high of $138 million in the first quarter, and then declined to just over $40 million in the next two quarters, but with the continued easing of policy, banks posted net free reserves of $6 million in the final quarter of the year. For 1970 as a whole, average net borrowed reserves of District banks dropped 49 percent below the 1969 average—in sharp contrast to a reduction of only 29 percent for all member banks.

Although District member banks substantially reduced their borrowing from the Federal Reserve, large banks increased their borrowing through interbank purchases of Federal funds. Fed-funds sales to dealers increased from the unusually low 1969 level, but banks' net Fed-funds purchases on *total* transactions averaged $450 million as against the previous year's $38 million. Several factors accounted for this increased reliance on Fed-funds borrowing—the much lower cost and greater availability of such funds, and the substitution of this source of funds for Eurodollar liabilities and for funds obtained from bank-related commercial paper.

Deposit overflow

The most favorable development of 1970 was the turnaround in time-deposit flows. Most District banks took advantage of the higher ceiling rates authorized by January's revision in Regulation Q to offer new types of savings instruments in the longer-maturity ranges. However, savings deposits of individuals did not rise at Western banks until after the April income-tax deadline. Then, households began to save more—influenced by higher offering rates on consumer-type savings instruments and the desire for greater liquidity in the face of growing unemployment and economic uncertainties—and the heavier inflow continued throughout the rest of the year.

Large District banks posted a $2-billion gain in large-denomination negotiable CD's during 1970. Both corporate and foreign deposits rose in the first half of the year, but the big surge occurred after mid-year, when the removal of the ceiling on large CD's in the 30-89 day maturity range permitted banks to become competitive in bidding for short-term funds. CD issuance became even more attractive in late September, when banks sought new sources of funds because of the imposition of reserve requirements on funds obtained from bank-related commercial paper. Toward the end of the year, the inflow of CD money was so substantial that offer rates on such deposits were significantly reduced, in line with rate reductions on other money-market instruments.

The 1970 increase in public time deposits matched the large CD gain, as a contra-seasonal rise in the third quarter was followed by a record inflow in the final quarter of the year. Massive second-half issuance of muni bonds, along with a more favorable differential between bank deposit rates and yields on alternate investments, contributed to this record increase in public deposits.

Net demand deposits of District member banks declined in the first half but remained above the year-ago level throughout the last six months of 1970, with a very sizable increase in December. The lower first-half level reflected a reduction in U.S. Government demand deposits; private deposits remained above the 1969 level throughout the year.

Modest loan expansion

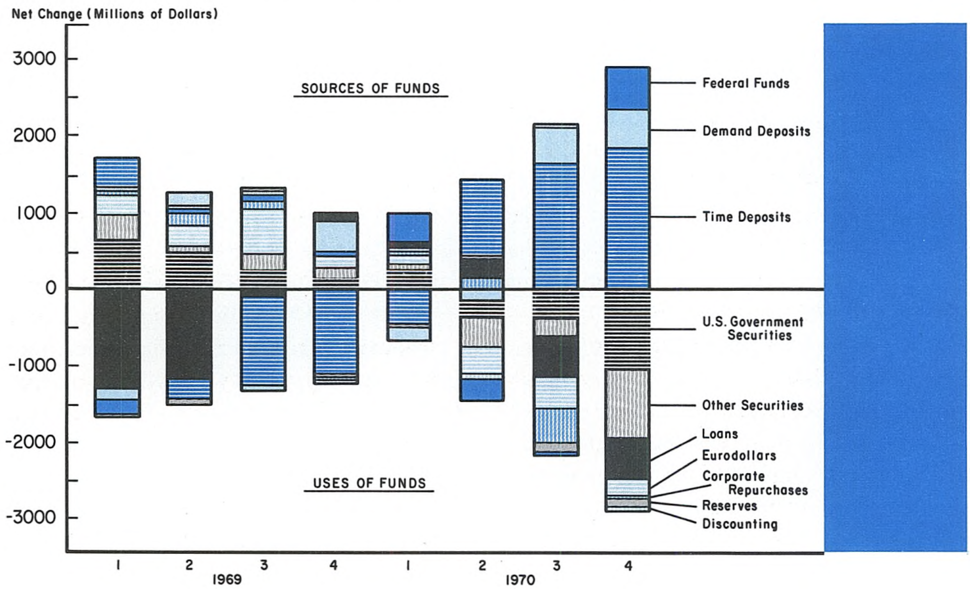
After adjustment to *include* loans sold outright, the volume of outstanding business loans

Reshuffling Sources and Uses

The correction of imbalances created in 1969 is most readily revealed by an examination of the shifts which occurred in banks' sources and uses of funds in 1970. (Data unadjusted for seasonal variation.) In the first quarter, large District banks posted a $1-billion net expansion in funds, with the pattern resembling that of the previous year. Time-deposit disintermediation continued, although at a greatly reduced pace from 1969, and banks also had a seasonal outflow of demand deposits. Deposits, normally a source of funds, thus became a use of funds during this period. Meanwhile, loans and securities were falling, and these traditional uses of funds became sources of funds, along with increased borrowings of Federal funds and Eurodollars.

In the second quarter, the expansion in funds reached $1.5 billion, as time deposits became a source of funds for the first time since first-quarter 1969. A further reduction in loans, and an increase in borrowings under corporate repurchase agreements, provided added funds. Together these funds were used to increase securities holdings, to reduce Fed-funds and Eurodollar borrowings, and to meet a further payout of demand deposits.

In the third quarter, these large banks shifted back to a more traditional pattern of sources and uses of funds. Large increases in demand and time deposits, particularly the latter, provided a $2-billion expansion in funds. Banks used these funds to repay borrowings (Eurodollars, repurchase agreements, and Federal funds), to meet higher reserve requirements, and to build up their portfolios of loans and securities. In the fourth quarter, deposits expanded at an even faster rate, and together with increased Fed-funds borrowing, provided $2.9 billion in new funds. The largest percentage of these funds was invested in securities; allocations also were made to expand loan portfolios, to reduce borrowings in Eurodollars and under repurchase agreements, and to meet higher reserve requirements.



remained above 1969 levels throughout 1970. The business-loan pace, modest as it was, was faster at Western banks than at other commercial banks (on both bases)—most notably in December, when District banks posted a gain in contrast to a decline elsewhere.

Durable-goods manufacturers were 1970's largest borrowers—particularly manufacturers of primary metals and transportation equipment. On the other hand, most nondurable-goods processors, except in the chemical and food-liquor-tobacco categories, reduced their bank-held debt. Retailers, utilities, and builders were other large borrowers. In the latter part of the year, District banks also added substantially to their holdings of bankers acceptances.

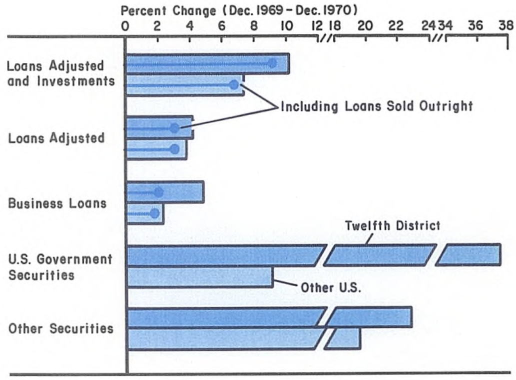
In contrast to the relatively slow business-loan pace, nonbank financial institutions sharply stepped up their borrowings at commercial banks in June and July as a result of the commercial-paper crisis. Their borrowings continued above the 1969 level throughout the third quarter, and were particularly heavy again in December.

Consumer demand for instalment credit at District banks was relatively soft during 1970, largely because of a drop in auto loans. Indeed, consumers made net repayments during the first two quarters of the year. No significant increase in instalment loans occurred until the final quarter, and even then, the increase was well below normal.

Shift in mortgage markets

Mortgage-lending activity lagged behind the 1969 pace during 1970, largely because of the sharp reduction in mortgage-loan commitments necessitated by 1969's heavy savings outflows—and despite 1970's rising tide of savings inflows. Large District banks posted a nominal $80-million gain in outstanding real-estate loans, substantially below the $500-million gain of the preceding year. Savings-and-loan associations in District states meanwhile expanded their mortgage portfolios by close to $2 billion, or about $86 million below the 1969 figure. But as the late-year flood of savings inflows continued, the S&L's boosted their loan commitments accordingly, to a near record $730 million by the end of December.

Bank credit rises faster in West than elsewhere, with security buildup



In reversing their unhappy deposit experience of the previous year, both banks and S&L's posted substantial gains in savings and other consumer-type deposits, amounting to almost $2 billion for the large banks and over $1.8 billion for the S&L's in District states. These shifts reflected the increasing attractiveness of the rates offered on savings and certificate accounts by those institutions; at the beginning of the year, Treasury bills offered a much higher (300-basis point) return than S&L passbook-savings accounts, but by year-end the spread had shifted in favor of S&L accounts by 20 basis points.

The sharp turnaround in savings and the subsequent turnaround in mortgage-lending activity were accompanied by a decline in mortgage rates in the regional industry. The average contract rate on conventional new-home loans drifted from a record high of 9.40 percent to just under 9 percent between the early winter months and October, and then dropped to 8.40 percent by the first of the new year.

Further adjustments?

Banks were successful in 1970 in repairing much of the erosion caused by the events of tight-money 1969, but in 1971 they are faced with a new erosion problem—that of earnings. January and February witnessed four successive reductions in the prime rate, for a cumulative decrease of a full percentage point. Several major West Coast banks attempted to offset these cuts by reducing offering rates on certain savings-deposit instruments; generally, this amounted to a rollback to 5 percent, from 5½ and 5¾ percent, of rates on savings instruments with maturities of one year and over. In addition, banks posted further cuts in offering rates on large-denomination CD's.

Because of their large proportion of time deposits to total deposits, Western banks are very vulnerable to high interest costs on time deposits when loan and security yields are declining. Thus, after their frantic search in 1969 and early 1970 to replace deposits lost through disintermediation, Western banks are now attempting to retard the current high rate of deposit inflow, and meanwhile are actively seeking new loans instead of rationing loan funds. Nevertheless, in relation to a year ago, banks started the new year with a much better balance in their assets and liabilities, as well as a better cushion of reserves to meet any foreseeable contingencies.

SELECTED ASSET AND LIABILITY ITEMS OF WEEKLY REPORTING LARGE BANKS

(dollar amounts in millions)

	TWELFTH DISTRICT				OTHER U.S.
	Outstandings	Net Change			Net Change
	Dec. 30, 1970	Dec. 31, 1969 to Dec. 30, 1970		Dec. 31, 1968 to Dec. 31, 1969	Dec. 31, 1969 to Dec. 30, 1970
		Dollars	Percent	Percent	Percent
Loans gross adjusted[1] and investments	$54,985	+5,118	+ 10.26	— .52	+ 5.81
Loans gross adjusted[1]	39,507	+1,721	+ 4.55	+ 4.96	+ 1.92
Commercial and industrial loans	15,172	+ 607	+ 4.17	+ 6.16	— .79
Real estate loans	11,133	+ 78	+ .71	+ 4.66	+ 1.20
Agricultural loans	1,298	— 24	— 1.82	+ 5.69	0
Loans to nonbank financial institutions	1,995	+ 128	+ 6.86	+ 1.21	+ 3.36
Loans for purchasing or carrying securities:					
To brokers and dealers	1,653	+1,162	+236.66	—77.90	+ 27.87
To others	208	— 68	— 24.64	+19.69	— 14.26
Loans to foreign banks	158	— 110	— 41.04	+ 3.36	+ 18.16
Consumer instalment loans	5,613	+ 18	+ .32	+ 8.27	+ 7.87
All other loans	2,277	— 70	— 2.98	+ .85	+ .64
Total investments	15,478	+3,397	+ 28.12	—14.49	+ 19.21
U.S. Government securities	6,238	+1,659	+ 36.23	—23.43	+ 12.90
Obligations of states and political subdivisions	7,666	+1,156	+ 17.76	— 7.63	+ 19.72
Other securities	1,574	+ 582	+ 58.67	— 9.99	+ 58.86
Total deposits (less cash items)	53,168	+6,039	+ 12.81	— 4.82	+ 9.84
Demand deposits adjusted	17,714	+ 159	+ .91	+ 3.15	— 4.01
Time and savings deposits	33,544	+5,791	+ 20.87	— 9.77	+ 24.43
Saving deposits	15,258	+ 387	+ 2.60	— 6.63	+ 3.19
Other time IPC	12,296	+3,207	+ 35.28	— 6.90	+ 43.31
Deposits of states and political subdivisions	4,594	+1,959	+ 74.35	—31.53	+114.51
(Neg. CD's $100,000 and over)	4,324	+1,967	+ 83.45	—39.19	+154.04
Capital accounts	4,168	+ 140	+ 3.48	+ 5.37	+ 4.83
Total assets/liabilities and capital accounts	68,433	+5,137	+ 8.12	+ 2.01	+ 6.15

[1]Total loans minus loans to domestic commercial banks

Checklist of 1970

CALIFORNIA

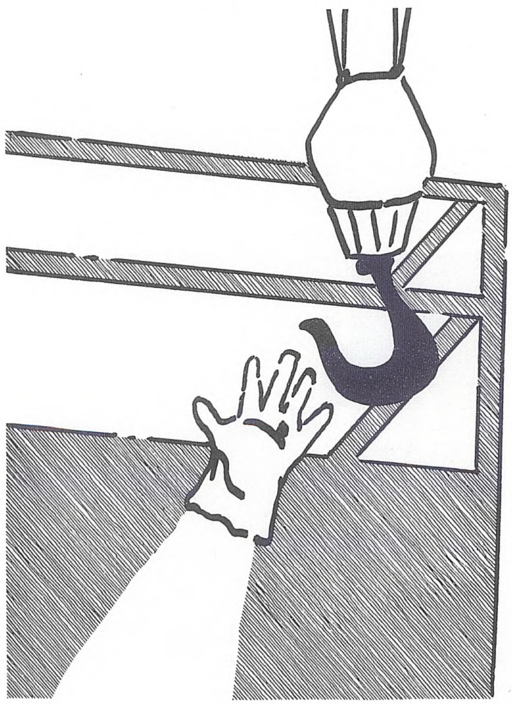
Aerospace: The aerospace industry continued to suffer from cutbacks in both military and commercial spending, but a few new projects were scheduled during the year. One major new project was a $1.8-billion research-and-development contract for the Air Force B-1 bomber; total spending could eventually total as much as $13 billion. In addition, $318 million was allocated for the production of Poseidon missiles. The Air Force signed contracts for $79 million for P3C patrol aircraft. Some $182 million was scheduled for the Minuteman III weapon system, and $167 million for the S-3A weapon system. The initial $23-million contract for the Freedom Fighter (F-5) aircraft was awarded to a California firm.

In the space sector, some $29 million was added to the NASA contract for launch-operations support for the Saturn program. In another extension, $50 million was awarded for the development of a nuclear rocket engine for NASA and the AEC. A $38-million order will provide for designing, building, and testing the Pioneer spacecraft for Jupiter flights.

Metals: A $20-million cold-rolled mill, capable of producing 85,000 tons of coils annually in widths up to five feet, came on stream during the year at a Fontana steel plant. Another feature of the $35-million expansion program underway at that facility was an installation to control sintering-plant stack emissions.

A Torrance titanium facility also scheduled a modernization and expansion program. The project will triple the plant's present production capabilities, including the ability to produce titanium ingot in weights up to eight tons.

Forest Products: Forest-products capacity expanded with the opening of a $5-million sawmill at Oroville and the completion of a $4-million building program at a Korbel redwood mill. Construction continued on an unusual sawmill at Fortuna, which is designed to process smaller-than-normal redwood and Douglas-fir logs; the mill will open late in 1971 with an annual capacity of 40 million board-feet. A major forest-products firm scheduled construction of a $6-million particleboard plant at Ukiah; it will have an annual production potential of 85 million square-feet, and will utilize 130,000 tons of sawmill and plywood plant residues which pre-



viously would have been burned or discarded. Also, a $10-million particleboard plant was scheduled at Martell; upon completion in 1972, it will have an annual capacity of 115 million square-feet. And in Modesto, a $22-million paper-products plant will begin operation late this year with 350 employees.

Construction: Building of office and residential complexes highlighted the construction scene. In El Segundo, plans were announced for a $65-million industrial and office project, as well as for a $250-million high-rise commercial development. A $100-million apartment and office complex got underway in Emeryville, while San Marin started a $50-million commercial and residential complex. Pacific World, described as a cluster of international trade and culture "villages", got underway near Anaheim at a cost of $125 million.

Ground was broken for a $40-million undersea cable plant at San Diego, which will initially employ 350 employees and may eventually employ 1,500. In another field, some $20 million was invested in the Magic Mountain amusement park under construction at Valencia.

Public Utilities: A Southern California water district completed a $31-million, 3.5-mile-long tunnel which will eventually deliver Northern California water to the Southland under the California Water Plan. Another major utility announced that it will spend $470 million in 1971 to keep pace with the growing demand for energy in northern and central California. Of that total, some $87 million will go for increasing gas supply and distribution facilities; delivery of Canadian gas from Alberta fields will rise from 815 million to 980 million cubic-feet daily. In San Luis Obispo County, construction progressed on a 1.1-million kilowatt nuclear unit which will go into operation in 1973.

Transportation: Long Beach opened the first step of its shoreline-development program with its mile-long Queen's Way Bridge, built at a cost of $13 million. San Francisco approved an eight-year, $192-million development plan for its airport.

In the area of water transportation, some $20 million was allocated for rebuilding and enlarging the Port of Los Angeles ship-building facilities. Stockton started construction of a $3½-million container terminal, and Oakland completed a $2½-million expansion of its containerization shipping facilities. A San Diego firm signed a $180-million contract to build the largest container ships in the world.

PACIFIC NORTHWEST

Aluminum: A major metals company purchased the power rights and plant site for an aluminum reduction plant at Warrenton, Oregon. Despite recent production cutbacks in the industry, the company plans to build a 150,000-ton smelter on the property; on completion in the fall of 1973, it will obtain low-cost power under contract with the Bonneville Power Administration. Construction meanwhile progressed on a 40,000-ton potline at a Troutdale, Oregon, smelter, and on a 100,000-ton reduction plant at Goldendale, Washington. These three projects will raise annual production capacity in the Northwest from 1.4 million tons in 1970 to 1.7 million tons by 1974, more than double the 1965 level.

Forest Products: A new $40-million pulp and paper mill, incorporating the latest technology in air-and-water-quality systems, opened at Halsey, Oregon. The mill employs 500 persons and produces 15 carloads of tissue, towels, and napkins daily. Other Oregon pulp and paper producers made substantial efforts to improve the environment. An Oregon City mill placed in operation the largest single industrial water-pollution control system yet installed in Oregon, as part of a $10-million pollution-control program to improve the quality of the Willamette River. An Albany mill completed a $4½-million wastewater treatment facility as part of a $14-million modernization and expansion program. Construction began on a $6½-million chemical-recovery and pollution-abatement project at a Salem mill.

The eight kraft-pulp manufacturers in Washington estimate that they will spend $60 million over the next few years in improving environmental quality. A major forest-products firm announced expected expenditures of more than $1 billion over the next four years in a comprehensive program involving mills, timber holdings, forest management, and increased production of paperboard, pulping and building materials.

Aerospace: Washington's major aerospace firm received two important contracts during the year. The first involved $148 million for initial production of a short-range attack missile (SRAM). The second was for production of an advanced airborne-warning and control-system aircraft. This project could total $2 billion if all 42 aircraft scheduled under the program are produced.

Construction: Residential complexes highlighted the construction scene in Oregon. Work started on a $12-million planned housing development in Hillsboro. A $12-million, 28-story condominium for downtown Portland came off the drawing boards, while a $4-million convention and resort center was planned for a site near Warm Springs. Three high-rise condominium towers costing $19 million became a part of the Portland Urban Renewal area plan. And construction began on a $125-million "new town" development north of Corvallis, which will eventually include homes, apartments, townhouses, a convention center and shopping mall.

In other major construction projects, plans were announced for a multi-million-dollar commercial complex at Capitol Lake, Washington, while Tacoma General Hospital embarked on a $25-million, 10-year expansion program. The Indians of Warm Springs Reservation announced plans to spend $4-million for a new convention center at the Kah-Nee-Ta resort. A major automobile manufacturer started construction on a $3-million parts depot and office building in Beaverton, Oregon. In the transportation field, the Seattle-Tacoma International Airport announced a $115-million expansion and modernization program.

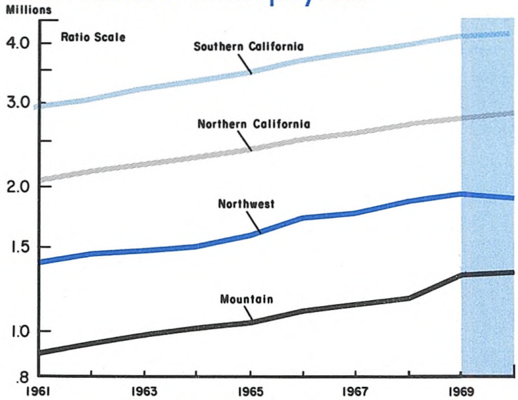
Utilities: A joint public-private venture was initiated to build the $105-million Lower Granite Dam on the Snake River in Washington. Work began on a second generating unit for the $200-million Centralia, Washington, steam-electric plant; each unit has a generating capacity of 700,000 kilowatts and will tower 233 feet. A gas company announced expansion projects, totaling $23 million, for a pipeline in Oregon and Washington and various compressor projects. A Portland firm opened a 7-million-gallon, $3½-million liquified natural-gas plant, the only one of its kind in the Northwest.

MOUNTAIN STATES

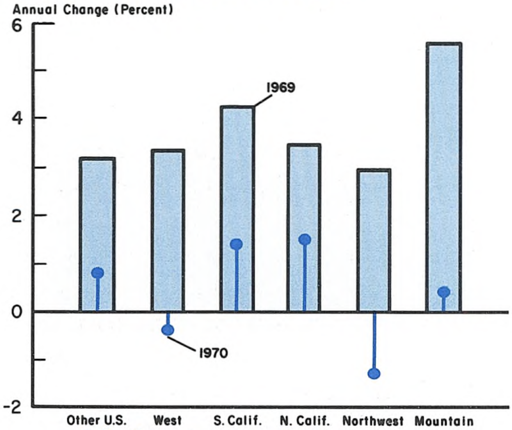
Copper: Two new copper facilities began operating in Arizona: an open-pit mine and mill complex, capable of producing 65,000 tons of copper per year, southwest of Tucson; and a $5-million refinery with an annual production capability of 7,000 tons of electrolytic-grade copper, west of Prescott. Under development in Arizona were: the Metcalf mine, with a capacity of 50,000 tons per year; the Lakeshore ore body on the Papago Indian Reservation south of Casa Grande; and a program to double the capacity of the concentrator at Superior. An $80-million expansion program proceeded at San Manuel, which will raise annual production from 40,000 to 60,000 tons and involve the building of a 200,000-ton $34-million refinery.

In Utah, a major copper producer awarded new contracts for the construction of two multi-million-dollar copper recovery plants at Magna. Each of the plants will be capable of recovering up to 80 tons of copper concentrate a day from approximately 54,000 dry tons of mine waste. Also, a copper and steel fabricator announced plans to build a $7-million wire and cable mill at an as yet undesignated location.

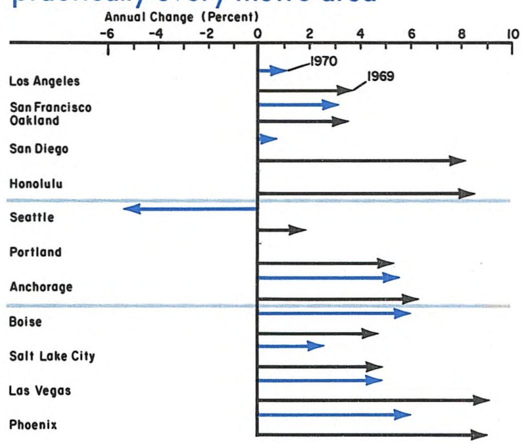
Ten million workers listed on Western firms' payrolls



. . . despite sluggish activity in all sections of the West



. . . with slower growth in practically every metro area



Magnesium: Seven years of research on methods for tapping the mineral wealth of Utah's Great Salt Lake came to fruition with the opening of a $30-million brine-processing plant, capable of producing up to 500,000 tons of magnesium chloride, 240,000 tons of potassium sulfate, and 150,000 tons of sodium sulfate annually. To obtain this output, the facility each year will process close to 2.5 million tons of crude precipitated solids in a vast complex of solar evaporation ponds in the northeastern portion of the lake.

Construction continued, meanwhile, on a $70-million reduction plant on the southwestern shore of the lake. This facility will be capable of recovering 45,000 tons of magnesium, 81,000 tons of liquid chloride, and 48,000 tons of gypsum annually when it comes on stream late in 1971.

Lead: The Bunker Hill lead smelter near Kellogg, Idaho, began to install $6½-million worth of pollution control equipment. A recently installed sintering plant will replace 10 ore-roasting machines installed decades ago, and a new sulfuric-acid plant will be used in conjunction with the sintering machines to reduce sulfur dioxide emissions by an estimated 85 percent.

Silver: Silver producers in the Coeur d' Alene district of Idaho worked vigorously to expand supplies, in anticipation of a boost in demand following termination of U. S. Treasury silver sales. At the Sunshine mine, work began on a $3-million refinery. Progress was made on a new shaft to explore and develop ore bodies associated with the Syndicate fault. Work continued to deepen shafts at the Galena, Crescent, Lucky Friday, Star-Morning, and Summit mines, while exploration drilling and soil sampling began at several new locations.

Utilities: Construction continued on the $750-million Kaiparowits Power development in Kane County in Southern Utah; together with another private power plant to be built in the Four-

Corners areas in New Mexico, it will help supply power to the Central Arizona Reclamation Project and to the growing Los Angeles market. A major Utah utility announced plans to construct a thermo-electric power plant in Carbon County, with the first 450-megawatt unit set for completion in 1974. In Arizona, a $328-million electric generating plant continued under construction near Page, and a major utility scheduled installation of nine gas-turbine generators for the Phoenix area at a cost of $64 million.

Construction: A $60-million building program at the University of Utah reached the halfway mark; on completion it will include six new classroom buildings, a medical library, and various housing facilities. Other major construction projects planned for Utah include a new hospital for South Salt Lake City, plus a $3-million motel and a 25-story, $31-million office building in downtown Salt Lake City. In Arizona, the Tucson International Airport scheduled a $2½ million expansion of its terminal facilities.

ALASKA AND HAWAII

Petroleum and Gas: A petroleum refinery with a capacity of 15,000 barrels per day, along with a 40,000-kilowatt power plant, was scheduled for construction near Fairbanks, Alaska; the complex will cost some $44 million and should be in operation by the fall of 1972. However, many of the oil industry's North Slope development plans have been suspended awaiting action on the Trans-Alaska pipeline.

Forest Products: Echo Cove, about 40 miles south of Juneau, was selected as the site for a $75-million pulp and sawmill complex. The facility will supply a Tokyo-based paper company with $600-million worth of Alaskan pulp and lumber over a 15-year period.

Mining: A San Francisco-based mining and transportation concern opened negotiations to obtain the necessary financing and marketing outlets for the construction of a $130-million iron-ore mining complex on the Snettisham Peninsula, near Juneau. In another Alaskan venture, a leading steel producer made plans for extensive coal prospecting in the Cape Beaufort area; according to U. S. Bureau of Mines studies, these coal deposits are among the few in the world known to have good coking qualities. In addition, nonferrous metals exploration increased, particularly in the Copper River Valley —the center of Alaska's most sizeable copper-mining operations in past decades—and the Chignik area of the Alaska Peninsula.

Construction: Construction of new hotels continued at a high pace throughout Hawaii, even though the state contained more than 31,000 hotel rooms at year-end. Major resort and residential projects, either planned or completed, included a $14-million complex at Wailoloa-South Kahala; the first phase of a $180-million residential resort at Keauhou-Kona; a $10-million resort-commercial development in the Kona region; a complex of residential sites, golf courses, an airstrip and marina at Kaalualu Bay in the Ka'u District; and a $37-million, 40-story complex of 1,208 hotel rooms on Hawaii.

Plans were completed for an $11-million, 34,000-seat stadium on the island of Hawaii. On Maui, newly constructed facilities include a rum distillery, a processing plant for Hawaiian fruit juices, and small processing plants for food and sportswear.

Transportation: During 1970 a 720-foot container ship was added to the San Francisco-Honolulu trade; the $20-million vessel reduces the travel time between the two ports and can carry up to 1,016 dry and refrigerated containers and 160,000 cubic feet of conventional cargo. On the island of Hawaii, a $20-million airport was completed near Kailua.

This annual-review issue was edited by William Burke and Karen Rusk. Principal contributors to this issue included: William Burke (U.S. business; monetary-fiscal policy); Verle Johnston (credit markets; construction and mortgage markets); Richard Gorin (international); Ruth Wilson (District banking); Adelle Foley, Yvonne Levy, Karen Rusk, Donald Snodgrass, and Joan Walsh (District business); R. Mansfield (chartwork); Janis Wilson (artwork). The *Monthly Review* is published by the Bank's Research Department: J. Howard Craven, Senior Vice President.

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