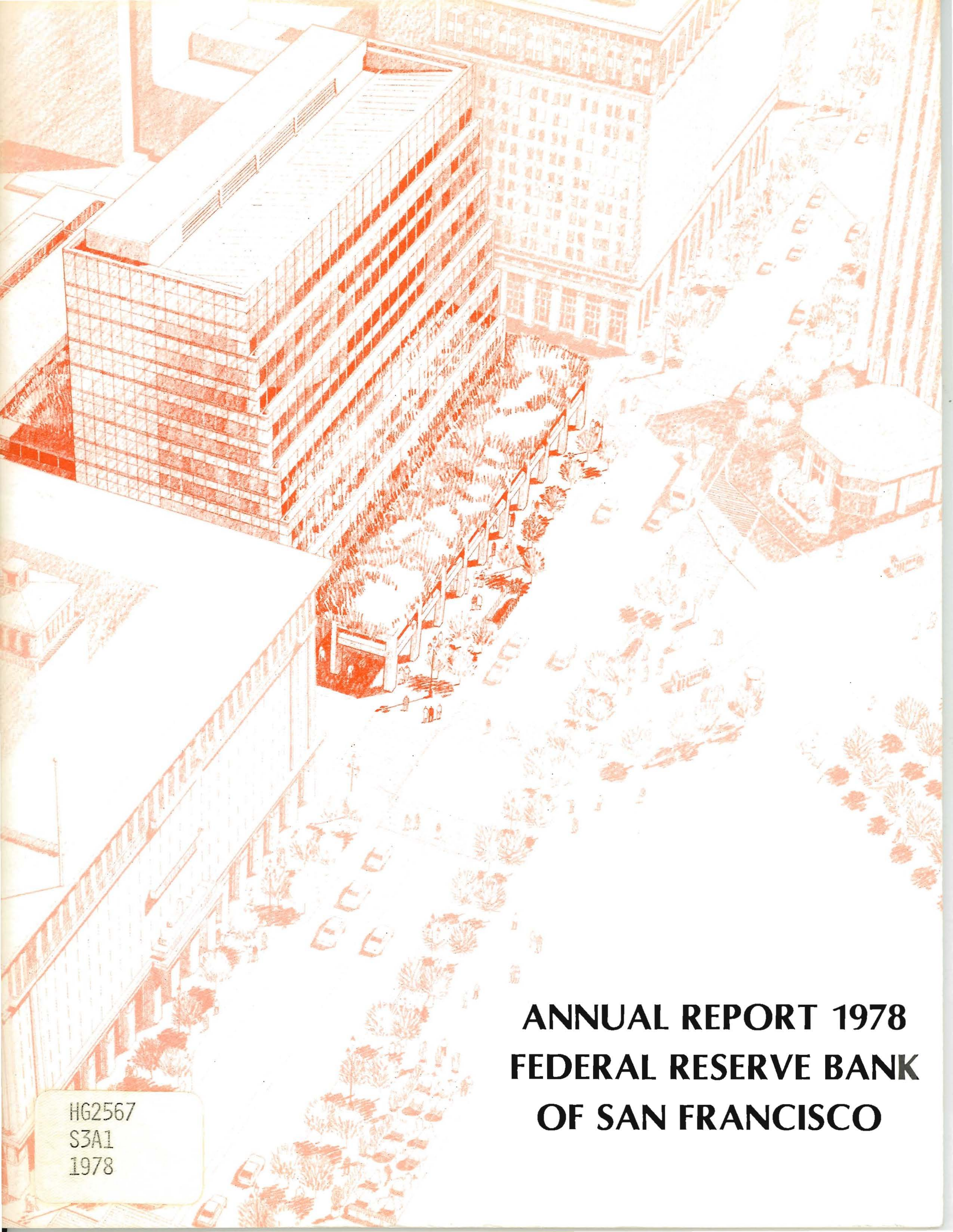


ANNUAL REPORT 1978
FEDERAL RESERVE BANK
OF SAN FRANCISCO

Contents

Front Cover
Proposed design of new headquarters building for the Federal Reserve Bank of San Francisco, to be built near the foot of San Francisco's Market Street. Groundbreaking for the 12-story, 653,000-square foot building is set for 1979.

John J. Balles (left), President
Joseph F. Alibrandi, Chairman of the Board

From the Boardroom

The national and regional economies worked close to the limits of effective capacity during 1978. We welcome the substantial gains in employment and income that accompanied the nation's production of more than $2 trillion of goods and services during the year. However, we remain very concerned about the severe inflation which is undermining the strength of an almost four-year-old business expansion, and which is also undermining the confidence of foreign nations in our ability to deal with this problem.

Financial markets continued in 1978 to reflect the strains of a still-strong, but inflation-wracked, business expansion. Credit generally remained available, with $458 billion (annual rate) raised in the markets during the first three quarters of the year. (Incidentally, this is about 50 percent more than the amount raised as recently as 1976.) But credit became increasingly costly as interest rates soared to record or near-record levels, reflecting tighter policy measures in the midst of growing market pressures, along with the effects of inflation expectations. For example, banks' prime business-lending rate rose from $7\frac{3}{4}$ to $11\frac{3}{4}$ percent over the course of the year.

The Federal Reserve acted aggressively to curb domestic inflation and to stem the decline in the international value of the dollar. In late fall, when the dollar's position had worsened significantly, the Fed took several strong actions — raising its discount rate on member-bank borrowings a full percentage point to a record $9\frac{1}{2}$ percent, imposing supplemental reserve requirements on large time certificates, and participating in a $30-billion support package for the dollar in collaboration with the U.S. Treasury and foreign financial authorities. Federal Reserve actions, plus higher money-market rates, contributed to a late-year slowdown in the growth of the money supply.

The $295-billion regional economy served by the Federal Reserve Bank of San Francisco exhibited all of the pressure symptoms evident elsewhere — and then some. The pace of expansion was significantly faster in the West than in the rest of the nation, following a pattern set early in the decade. For example, Western commercial banks far outpaced other banks with a 17-percent gain in loans and investments, to a year-end total of $155 billion. For the second straight year, this region experienced a phenomenal growth in real-estate financing, and it continued to experience a surge in consumer borrowing and strong credit demands from smaller businesses.

The San Francisco Reserve Bank met the needs of a growing Western economy by providing an expanded amount of Reserve Bank services during 1978. The Bank's personnel handled about 1.4 billion paper checks, plus about 2 billion coins and 1 billion pieces of currency. At the same time, the Bank continued to extend its electronic-payments capability, through such means as automated clearing houses, Government direct-deposit programs, and the Federal Reserve wire-transfer network. The staff continued to work on a five-year automation program, with an eye toward further internal efficiencies as well as improved services for all sectors of the economy.

Bottom line, the San Francisco Reserve Bank once again led the Federal Reserve System in the cost effectiveness of operations, with an aggregate unit cost 15 percent below the System average. Productivity in these operational activities has increased 57 percent since 1974, following the Bank's development of a major program of productivity improvement. But we realize that future productivity gains will depend heavily on the provision of up-to-date equipment and facilities. Thus, we plan to break ground this year for a San Francisco headquarters building which will replace obsolete facilities constructed more than a half-century ago.

Management benefitted greatly during 1978 from the broad-based experience and judgment of the Bank's directors at Head Office and four branches. The directors not only provided guidance on major management decisions and planning goals, but also supplied key information on economic and financial conditions as a support to the Federal Reserve's formulation of monetary policy. Today, 37 public-spirited men and women serve as directors, representing a great variety of economic interests and non-profit organizations from every area of the West.

We are grateful to these individuals, and also to those who completed terms as directors during 1978: Ronald S. Hanson (President and Chief Executive Officer, First National Bank of Logan, Utah) at our San Francisco office; W. Gordon Ferguson (President, National Bank of Whittier, California) and Armando M. Rodriguez (President, East Los Angeles College) at Los Angeles; Sam H. Bennion (President and Chief Executive Officer, V-1 Oil Company, Inc., Idaho Falls, Idaho) at Salt Lake City; and Harry S. Goodfellow (Chairman of the Board and Chief Executive Officer, Old National Bank of Washington) at Seattle. Special mention must be made of Gilbert F. Bradley (Chairman of the Board and Chief Executive Officer, Valley National Bank of Arizona), who completed a third term as this District's representative on the Federal Advisory Council, a key advisory group to the Federal Reserve System. Finally, we wish to express our appreciation to our officers and staff, whose dedication to the efficiency of Bank operations has enabled us to improve our services continually to the financial community and to the general public.

Joseph F. Alibrandi
Chairman of the Board

John J. Balles
President

National Scene

During 1978, the national economy continued to benefit from the longest and strongest peacetime expansion of the past generation. In the process, employment surged while the jobless rolls declined substantially. But the other side of the coin was somewhat tarnished. The strong expansion was accompanied by a severe and accelerating inflation, which was aggravated in turn by an unprecedented decline in the international value of the dollar.

The national economy produced $2.1 trillion worth of goods and services in 1978, although the growth rate (in real terms) moderated somewhat during the year. Real GNP increased almost 4 percent, compared with the previous year's 5-percent gain. Yet the nonfarm business sector of the economy expanded at roughly the same pace in both years. Moreover, the level of output reached in 1978 represented effective full employment, measured in terms of the available reserves of experienced workers and cost-effective plant capacity.

Varying trends

Consumer spending for durable and nondurable goods decelerated during the year. Household disposable income (in real terms) increased about 4 percent, roughly in line with the 1977 increase. But this gain largely reflected an upsurge in employment. Despite heavy reliance on debt financing, consumer buying of big-ticket items rose only moderately, with (for example) a flat trend in the number of auto sales. But surprisingly, housing activity remained on the high plateau reached the year before, in the face of soaring home prices and near-record mortgage rates.

Business fixed investment continued to advance at a strong pace, increasing about 8 percent in real terms. Earlier in the expansion, investment spending had been concentrated in short-lived equipment (especially trucks and autos), but in 1978 the emphasis shifted to construction projects (especially factories and commercial buildings). While showing increased confidence in the future through this growing investment in long-lived projects, business firms also exhibited considerable caution about the near-term outlook by holding inventories firmly in check. Indeed, inventory-sales ratios generally reached the lowest levels of the past fifteen years. Another sign of strength was a sharp, and long-awaited, pickup in export sales.

Industrial production increased more than 5½ percent in 1978, matching the previous year's growth pace. The strongest increases occurred in such categories as business equipment and construction supplies, reflecting the upturn in business investment and the continued boom in housing. By late-year, manufacturing production approached 86 percent of estimated capacity, not far below the 1973 peak, and imposed a heavy strain on usable industrial plant.

Jobs and prices

Similar pressures surfaced in the labor markets. During 1978, more than 3 million more workers found jobs—adding to the unprecedented job-market boom that has generated 11 million new jobs since the early-1975 cyclical trough. In the fall months of the year, the unemployment rate finally fell below 6 percent of the civilian labor force. Moreover, experienced workers were at a premium: the jobless rate for household heads, who comprise the core of the labor force, fell to only 3½ percent, and the volume of help-wanted advertising rose one-fourth higher than the 1977 figure.

The strong business expansion was marred, however, by an unanticipated acceleration in the inflation rate, which now threatens to mark the 1970's as the most inflationary decade in the nation's peacetime history. Consumer prices increased 9 percent over the course of the year, compared with a rise of less than 7 percent in the preceding year. Early-year farm disasters pushed consumer food prices skyward, and the rapidly depreciating dollar made many foreign products more expensive—typified by the late-year announcement of a 14½-percent increase in OPEC oil prices for 1979. Wage-push inflation worsened

because of a 9-percent jump in the business sector's unit labor costs, brought about by weakening productivity in the face of soaring increases in labor compensation. More basically, the worsening of the inflation problem reflected the continuation of heavy Federal deficit spending, as well as the related difficulty of reducing money-supply growth to levels compatible with the achievement of long-run price stability.

Dollar problems
The dollar's decline represented probably the least expected, and most disheartening, development of the year. Prior to November, the trade-weighted value of the dollar had dropped about 15 percent from the year-before level, and far more steeply against the yen, the mark and the Swiss franc. The 15-percent decline, by itself, may have added as much as 2 percentage points to the past year's rise in consumer prices. Actually, the nation's trade accounts improved significantly over this period, with the trade deficit in the fall months being not much more than half the first-quarter peak. Despite that and other signs of improvement, foreign investors sold dollars heavily during 1978, apparently out of fear that U.S. inflation would get out of control.

Policymakers moved in several ways to confront the inflation problem throughout the year, and especially during the fateful final weeks of October. To reduce cost-push pressures, the Administration announced a set of wage and price guidelines, designed to put a 7-percent lid on annual wage increases and (essentially) a 6-to-6½ percent lid on annual price increases. To reduce deficit-financing pressures, the Administration emphasized its determination to cut the Federal budget deficit to about $30 billion in fiscal 1980 from the $49-billion figure reached in fiscal 1978. These measures failed to attract support in international financial markets, however, so policymakers adopted a stronger stance on November 1, with a $30-billion package of dollar-propping measures and a tighter anti-inflation credit policy.

Monetary policy
The Federal Reserve took action during 1978 to moderate the growth of the monetary aggregates, and in addition, to stem the decline in the exchange value of the dollar. The System raised the discount rate — the rate charged by Federal Reserve Banks on member-bank borrowings — in a series of steps between January and October, from 6 to 8½ percent, and then boosted the rate to a record 9½ percent on November 1. At the same time, the Fed imposed a 2-percent supplemental reserve requirement on all large domestic time deposits and on certain other bank sources of funds.

These central-bank actions, plus higher money-market rates, contributed to a late-year slowdown in the growth of the major aggregates — M_1 (currency plus bank demand deposits) and M_2 (currency plus all bank deposits except large negotiable CD's). But while M_2's 8-percent growth fell within the target range announced by the Fed early in the year, M_1's 7-percent growth exceeded the upper limit of its range.

Financial growth
Total funds raised in financial markets expanded substantially during the year, but with variations in different sectors of the market. Net Treasury borrowings fell significantly below earlier projections, due to both an increase in government receipts and a shortfall in expenditures. Furthermore, heavy foreign investment in Treasury issues reduced the share of the deficit which had to be financed by domestic financial markets. In contrast, net offerings by Federally sponsored agencies tripled over their 1977 levels, reflecting heavy borrowing by housing-related agencies. Corporations were less active in the capital markets than they had been during the earlier stages of the expansion, but they again relied heavily on the commercial-paper market for funds. Consequently, banks failed to win back all of the ground which they had lost earlier to these other competitors for corporate business.

Short-term interest rates rose more than three full percentage points during the course of the year, with the sharpest increase occurring after the November 1 credit-tightening moves. Treasury bill yields rose at a slower pace because of heavy foreign purchases. But rates on Federal funds, large CD's and commercial paper all rose sharply, to levels not far below the record highs experienced in mid-1974. Banks attempted to maintain their profit margins by raising the prime rate for their best corporate borrowers 15 times during the year, to a near-record 11¾ percent — up four percentage points over a year ago.

Long-term bond rates increased gradually over much of the year — but then accelerated in the fourth quarter. The much faster rise in rates on shorter maturities produced an inverted yield curve beyond six to nine months, indicating more favorable investors' expectations about the long-run than about the short-run inflation outlook. Meanwhile, with housing activity still booming, prime mortgage-loan rates rose as high as 10¾ percent at some banks, and in some states exceeded legal usury ceilings.

Expanding bank credit
Commercial-bank credit provided financial support for the expanding U.S. economy with an 11-percent increase for the year, and the loan component accounted for over nine-tenths of the total increase. Business-loan activity became more broadly based than it had been earlier in the expansion, as the large money-center banks (primarily

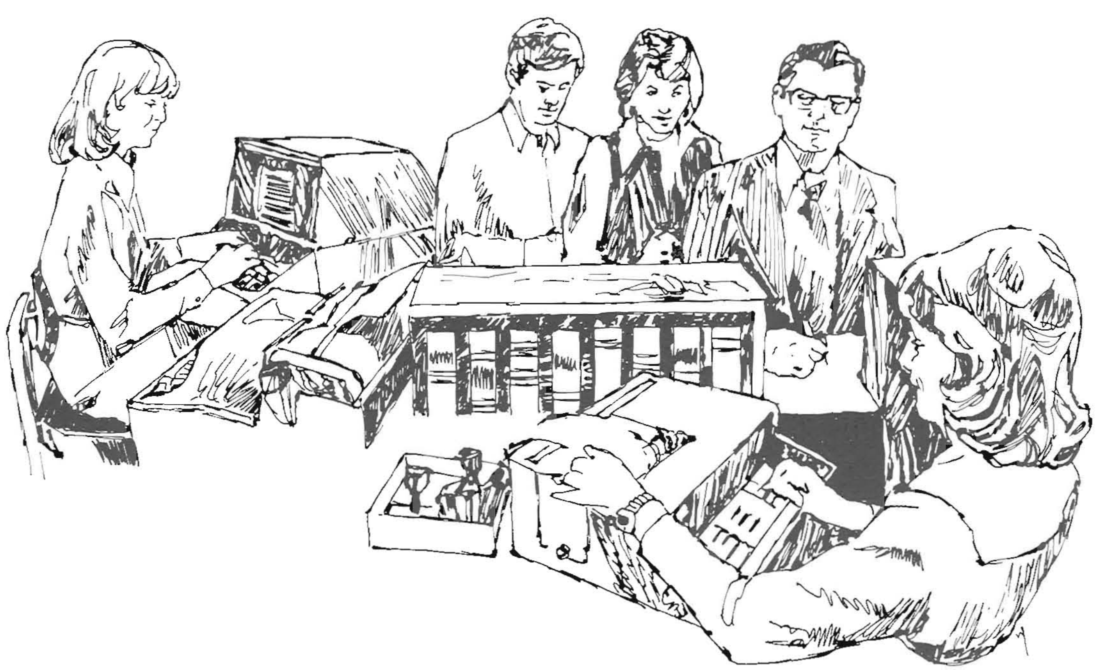
in New York) at long last joined the regional banks in meeting corporate-loan demand. With consumer borrowing pressures still heavy, banks practically matched their strong 1977 gains in both mortgage and instalment-credit lending. Banks again reduced their portfolios of Treasury securities, but offset this somewhat by adding to their holdings of Federal agency and municipal securities.

Increases in both demand and time deposits provided funds for the rapid expansion in bank credit. But banks obtained about two-fifths of the gain in the latter category from large CD's, despite the sharply higher rates they had to pay on these money-market instruments. Two noteworthy deposit innovations occurred following Federal Reserve approval — the initiation of automatic transfers from savings accounts, and the linking of the six-month time-certificate rate to the six-month Treasury-bill rate. Both of these innovations enhanced banks' ability to retain funds in this period of sharply rising money rates.

Bank earnings

According to preliminary data, bank profits reached a new peak in 1978. The large increase in earning assets, heavily weighted toward mortgage and consumer loans, boosted income from interest payments. Banks generally maintained a profitable spread between their return on loans and their cost of funds, by making quick adjustments in loan rates whenever money-market rates increased. This was particularly true in the latter part of the year.

On the other hand, bank earnings suffered from a shift from less costly sources of funds (those subject to deposit-rate ceilings) to more expensive sources acquired at accelerating money-market rates. Savings deposits increased only modestly in comparison with the previous year's $18-billion increase, partly because many savers in the second half of the year transfered their funds to the new T-bill certificates, which were not subject to rate ceilings. These certificates became a relatively costly source of funds late in the year, when Treasury-bill and other money-market rates skyrocketed. Again, as in earlier high-rate periods, banks relied heavily for funds on large CD's, which increased by $22 billion — twice the previous year's gain. These funds became even more costly in November, when the 2-percent supplemental reserve requirement became effective. Another late-year cost increase came about because of the implementation of the automatic-transfer accounts, which involved heavy start-up costs in addition to the 5-percent interest expense on individual funds that formerly had been held in interest-free checking accounts.



Western Business

The Western economy experienced a boom year in 1978, measured by rapidly falling unemployment rates as well as rapidly rising employment and income statistics. (This region, which is served by the San Francisco Federal Reserve District, includes all nine states west of the Continental Divide—see map, page 14.) The pace of expansion was much faster in this region than in the rest of the nation, following a pattern set even before the beginning of the present cyclical expansion.

Population growth stimulated economic growth, as about 600,000 new residents boosted the regional population to nearly 35 million in 1978. This phenomenon represented the continuation of a long-term westward shift of the nation's population—a shift which has become especially evident during the present decade. Between 1970 and 1978, migration accounted for almost half of the region's total population gain of 4.3 million, creating double-digit growth in almost every Western state. California, the largest, was an exception in the early years of the decade, but growth has now speeded up there also. In 1978, California added 400,000 new residents with migration accounting for three-fifths of that total—the largest inflow in over a decade.

More jobs, more income

Civilian employment in this nine-state area jumped about 6 percent—an unprecedented increase of roughly 900,000 new jobs—to reach a new peak of 15.3 million. Employment gains were substantial in practically every industry—especially construction, aerospace-equipment manufacturing, trade and services. The only exception was the government sector, where employment remained flat because of tight fiscal controls at every level, typified by California's Proposition 13 slash in property-tax revenues.

Reflecting this very active job market, unemployment declined from 7.5 percent of the civilian labor force in 1977 to about 6.7 percent in 1978. The improvement was evident in almost every Western state. Indeed, the strong expansion brought the rate down to about 6.0 percent by year-end, almost closing the wide gap that had persisted between the regional and national jobless rates for more than a decade.

Personal income increased more than 12½ percent to about $295 billion in 1978. Much of the gain was eaten away by inflation, as consumer prices rose more than 8 percent during the year—but the result was still a solid gain of more than 4½ percent in real income. The consumer buying pace was rather uneven during much of 1978, but evidently quickened during the Christmas season. New-car registrations increased for the third straight year, but the gain was somewhat modest in relation to the gains of the 1976-77 period.

Tax revolt

A widespread tax revolt strongly affected the region's political economy during 1978. At the June election, California's electorate voted overwhelmingly for Proposition 13, a ballot measure involving a $7-billion reduction in property-tax receipts—a sum amounting to almost one-fifth of the total revenues raised by all levels of California government. At the November election, tax- or spending-limitation measures appeared on the ballot in five other Western states, and the measures passed in all of them except Oregon.

Despite Proposition 13's apparent popularity throughout the nation, the circumstances surrounding that measure were almost unique to California. A major contributing factor was a high and growing state-local tax burden during a period when similar burdens were levelling off in other states. A second factor was a substantial shift in the distribution of property-tax burdens towards home-owners, at a time when inflation already was causing budgetary problems for many households. And a third factor was the emergence of a massive state-government surplus in the months preceding California's June election.

Proposition 13 achieved two of its objectives—property-tax reduction and state-surplus liquidation. However, its initial impact on public-expenditure growth was rather modest, largely because the state government provided more than $4 billion in direct assistance to local governments out of its surplus funds. In its first year of operation, Proposition 13 is reducing the level of public expenditures by roughly 2½ percent. According to some analysts, its future impact could be even less, because of the continuing build-up in the state government's budget surplus, the highly responsive character of the state's revenue system to economic-growth trends and to inflation, and probably also a surprisingly strong growth in property-tax revenues.

Partial farm recovery

After two solid years of drought and depressed livestock prices, Western farmers and ranchers began to profit in 1978 from green pastures and brim-full reservoirs. According to preliminary estimates, total farm sales exceeded the 1977 figure by almost 5 percent. Net farm income grew at about the same pace, since the drought's demise helped ease some exceptionally high operating costs for a number of farm enterprises. Massive exports helped boost the Western farm community, as dollar depreciation made its products exceedingly attractive in world markets.

The livestock industry provided the brightest news on the agricultural front, as producers found themselves in the trough of the cattle cycle, with reduced supplies but with rapidly rising prices. Some of the cattle-price rise came with the compliments of Midwest hog producers, who failed to expand output as they had originally intended. Thus a 4-percent decline in beef output, paralleled by virtually no growth in pork output, sent Western cattle prices soaring 33 percent above 1977's low levels. Net income from ranching operations also benefitted from the wet weather, which dramatically improved pasture and range conditions, and thereby reduced the need for high-cost feed and watering operations.

Western wheat farmers also found welcome relief from the drought, as their output and per-acre yields rebounded sharply from 1977 levels. Total wheat production nationwide dropped about 12 percent, with farmers elsewhere cutting back on their acreage, and Western farmers thus sold more wheat at prices which averaged about one-fourth higher than a year before. Western fruit growers meanwhile produced somewhat less, but earned substantially higher prices on the products they sent to market in 1978. (For example, grower prices for oranges ran about 32 percent above 1977 levels.) Cotton production fell considerably, but in this case prices also slid, under pressure from the large stocks left over from the previous year's harvest.

Agricultural land prices in the West increased almost 10 percent, reflecting the recovery in the regional industry's fortunes. Indeed, a number of factors were involved, such as the break in the prolonged drought, climbing livestock and specialty-crop prices, population pressures on rural land, and the general atmosphere of inflation. These pressures were most intense in California, where farmland prices jumped 13 percent during the year.

Housing—still strong

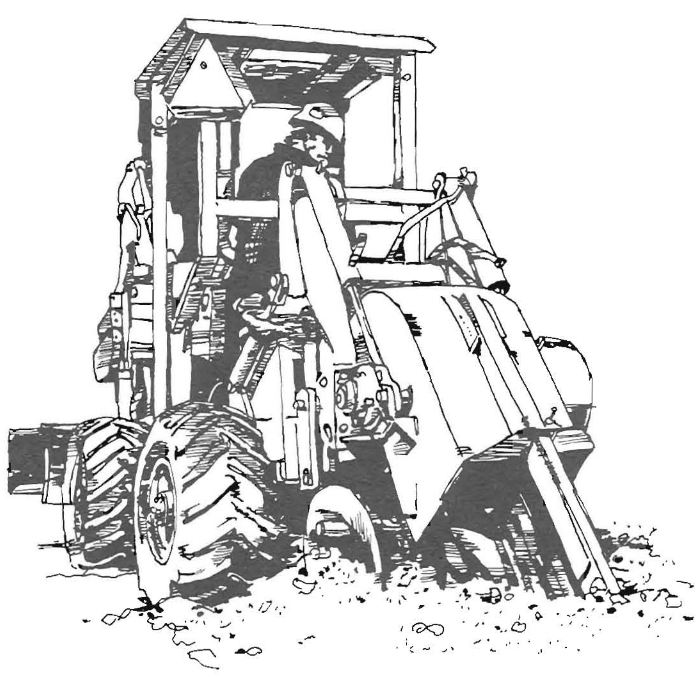
The Western housing boom continued in 1978, as new starts and new building permits roughly matched the peak levels attained the year before. Through most of the year, the pace of permit activity actually ran slightly ahead of 1977's peak figure of 473,000 housing units. The speculative buying pressures which had marred the earlier stages of the boom were mostly lacking, expecially in California. Even so, demand and cost pressures pushed the median price of new homes to $64,900 at midyear – 22 percent above the mid-1977 level. Western home prices, which roughly paralleled national prices prior to 1975, by 1978 were 16 percent higher than home prices elsewhere.

Demand pressures remained high, partly because of the low level of vacancies in for-sale and rental housing, and also because of the widespread belief that buying a home represented the best inflation hedge. Financing problems arose as the year wore on, reflecting the high cost and decreasing availability of mortgage money. However, lending institutions had more funds available than they might have expected for a tight-money period, at least partly because of their newly-granted ability to offer savings certificates at rates tied to Treasury-bill rates.

A massive boom in nonresidential building accompanied the continued strength of home-building, and these developments together placed heavy pressures on the regional lumber industry. Timber shortages meanwhile forced a 3-percent reduction in Western lumber production for the year, and thus forced domestic builders to turn increasingly to foreign suppliers to meet their requirements. Not surprisingly, softwood lumber prices climbed almost without interruption, to practically double the average level reached during the 1974 recession. In the pulp-and-paper segment of the industry, producers also raised prices sharply – partly because of strengthening demand, and partly because of a second-half tightening of supply caused by a prolonged strike at Pacific Northwest mills.

Busy factories

Western manufacturing production expanded at a faster-than-national pace, sparked by considerable strength in durable-goods manufacturing. In particular, the aerospace-equipment manufacturing industry recorded its strongest sales gains in years, which spurred a 14-percent increase in industry employment over the course of the year. (Still, aerospace employment remained about 20 percent below its Vietnam-war peak.) The main stimulus came from the world airline industry, which responded to the rapid



growth of passenger traffic by placing large orders for both the present and the next generations of jets. In this regard, Boeing's 757 and 767 planes launched the nation's first new commercial-jet manufacturing programs in a decade. Defense and space business also increased, along with consumer demand for electronic products.

Western steel demand rose sharply, due to the strong pickup in non-residential-building and heavy-engineering projects as well as the continued rise in consumer-goods markets. But foreign producers increased their share of the Western market from 34 to 40 percent, despite the introduction of the "trigger price" mechanism designed to blunt just such an import drive. Regional steel producers thus benefitted only partially from the sharp increase in demand, recording a 7-percent rise in production for the year as a whole.

The Northwest's aluminum industry benefitted fully from the upsurge in demand from aerospace and other industries. Moreover, it recovered well from its earlier supply problems, as winter rains brought an end to drought-related shortages of hydro power. The regional copper industry, in contrast, continued to operate its mines and refineries far below capacity, in an effort to cope with a worldwide problem of excess supplies. Refinery shipments to U.S. fabricators rose only about 5 percent for the year, and remained far below the 1974 peak. However, producers were able to boost their price for the refined metal steadily over the course of the year, because of the umbrella provided by the devaluation of the dollar, which raised the foreign producer price in dollar terms.

Petroleum situation

The improved weather situation also helped bring about slight declines in Western production and consumption of refined petroleum products, because regional utilities were able to increase their reliance on hydro power and thus reduce their usage of fuel oil during the year. But not surprisingly, industrial and transportation demands for petroleum rose significantly. Regional production of crude oil increased sharply for the second straight year as more Alaskan oil flowed through the pipeline, and the import share of the Western market thus fell to 26 percent. (It had been 48 percent at the 1976 peak.) In fact, Alaska in 1978 became the nation's third-largest oil producer, being outranked only by Texas and Louisiana.

Western refineries were able to absorb only about half of the North Slope's production of 1.1 million barrels/day, after allowing for supplies from other Western fields, the refineries' product mix, and their technical capability for processing high-sulphur Alaskan crude. This situation has created a debate over the best means of utilizing the Alaskan oil that is surplus to West Coast needs. Producers now ship most of this surplus oil by tanker to the Gulf and East Coasts via the Panama Canal. But more efficient alternatives are under consideration, such as pipelines that would transport oil either from Port Angeles, Washington or Long Beach, California to refineries farther East. Some industry leaders have proposed a swap arrangement with Japan – under which surplus Alaskan oil would be exported to Japan, while an equivalent amount of Japan-bound oil would be diverted to the East and Gulf Coasts – but that alternative has been criticized for running counter to the national goal of energy self-sufficiency.

Slower pace in 1979?

At year-end, most observers foresaw a slower pace of business activity in 1979, if only because of the pressures generated by shortages of trained manpower and usable industrial capacity throughout the regional economy. But the West once again seems likely to outpace the national economy, on the basis of the strength expected in such regional specialties as aerospace and agriculture – industries which boast attractive products that can sell well in both domestic and overseas markets.

Construction activity might remain stable, with the weakening trend in the housing sector being offset by the growing strength of factory and office construction. Some sectors seem bound to weaken, especially government spending in the wake of Proposition 13 and a host of other budget-tightening measures. But overall, the Western economy appears capable of extending the expansion into a fifth consecutive year.

Western Banking

The pace of banking, like the pace of general business activity, expanded much more rapidly in the West than elsewhere during 1978. Total loans and investments reached $155 billion at year-end, for a 17-percent increase — half again as large as the gain recorded in the rest of the nation. A $23-billion loan increase accounted for this entire bank-credit gain, as total investment portfolios remained even with a year ago. Throughout most of the year, banks were able to meet the record loan demand with funds generated from deposit inflows and maturing assets, rather than by selling or running-off securities. But late in 1978, in response to the increasing restrictiveness of monetary policy, banks reduced their security holdings, or at least their holdings of Treasury securities.

Sharp loan expansion

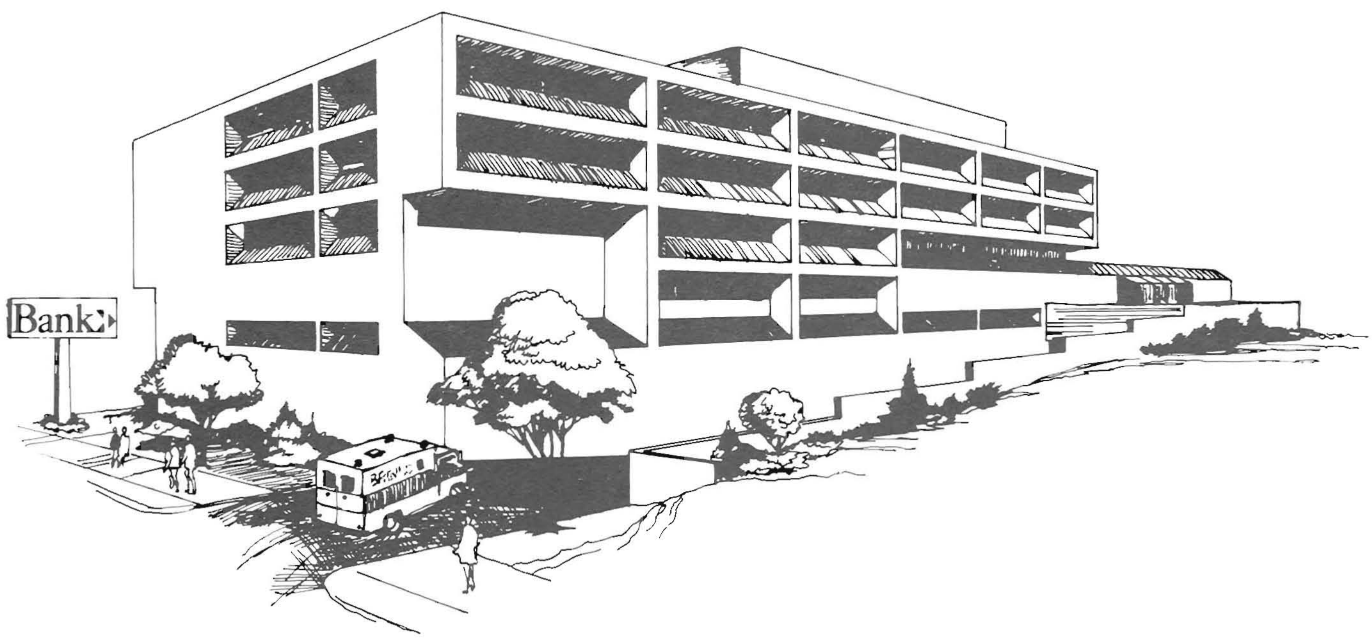
Business loans increased by a strong 15 percent, despite a near-record prime rate, an increasingly restrictive monetary policy, and only moderate demand by the banks' large corporate customers. (Here as elsewhere, large firms continued to rely heavily on the capital and commercial-paper markets for funds.) The strength in this market again came from the small and medium-sized firms that are much more dependent on bank financing than are the large corporate borrowers. Most industry groups borrowed heavily during the year, but loan growth was especially brisk in the construction, trade, services and durable-goods manufacturing sectors.

A massive 29-percent increase in mortgage loans accompanied the Western construction boom, as credit availability remained greater than in other periods of high interest rates. The strong pace of business activity helped support a favorable environment for housing, and this trend was reinforced by borrowers' expectations that home prices and mortgage rates had nowhere to go but up. Lending activity was strong not only in single-family housing, but also in commercial real estate and (especially) construction and land-development projects. At year-end, mortgage loans reached $43 billion, at which point they constituted 34 percent of total loan portfolios.

Consumer instalment loans increased almost as rapidly as mortgage loans, although consumers entered the year with a historically high ratio of instalment debt to personal income. Strong increases occurred in auto financing and home-improvement loans, and also in check-credit and credit-card loans.

New deposit sources

Banks financed their soaring loan volume by generating about $17 billion in new deposits, for a 12-percent gain over the year. About half of the deposit growth came from large time certificates (CD's), as inflows from other sources lagged. This heavy reliance on CD funds became most evident in the second quarter, when many savers withdrew funds in search of higher yields in the open



market, and again in the fourth quarter, when an increasingly restrictive monetary policy affected deposit flows.

Banks were able to counter disintermediation – the outflow of funds into money-market instruments – when they received Federal Reserve authorization to issue six-month money-market certificates with rates tied to the six-month Treasury-bill rate. These certificates became an important source of funds in the latter part of the year – although a relatively expensive source because money-market rates eventually rose well above the rates on the consumer-type deposits that they replaced. A second major deposit innovation, automatic-transfer accounts, in contrast did not represent a significant new source of funds. These accounts involved a shift of customers' funds from other types of deposits, mainly demand balances, into savings accounts that are tied to checking accounts.

Large Western banks also relied heavily on increased borrowings during the year. Banks' net Federal-funds purchases (borrowings) exceeded $700 million on a daily-average basis – double the year-before level. Also, member-bank borrowings reached $52 million on a daily-average basis – about one-third higher than the 1977 figure. This represented the highest level of activity at the Reserve Bank's discount window since the tight-money period of 1974.

Average required reserves rose almost $1 billion over the year, mainly because of the boom-related expansion of deposit activity, but also because of the late-year imposition of supplemental reserve requirements on large domestic funds, including CD's. However, reserve requirements were only slightly affected by the reduction, and subsequent removal, of the reserve requirement on U.S. bank borrowings from their foreign branches.

Record earnings

The bottom line for 1978, according to early estimates, was a record level of Western bank earnings. Operating income rose substantially over the year because of record loan volume, coupled with record or near-record levels of interest rates. Many banks nationwide profited by maintaining substantial spreads between their average return on assets and their average cost of funds. But Western banks also benefitted from their retail orientation, because their loan portfolios contained a high proportion of high-yielding consumer and mortgage loans, while their liabilities were heavily concentrated in low-yielding savings deposits.

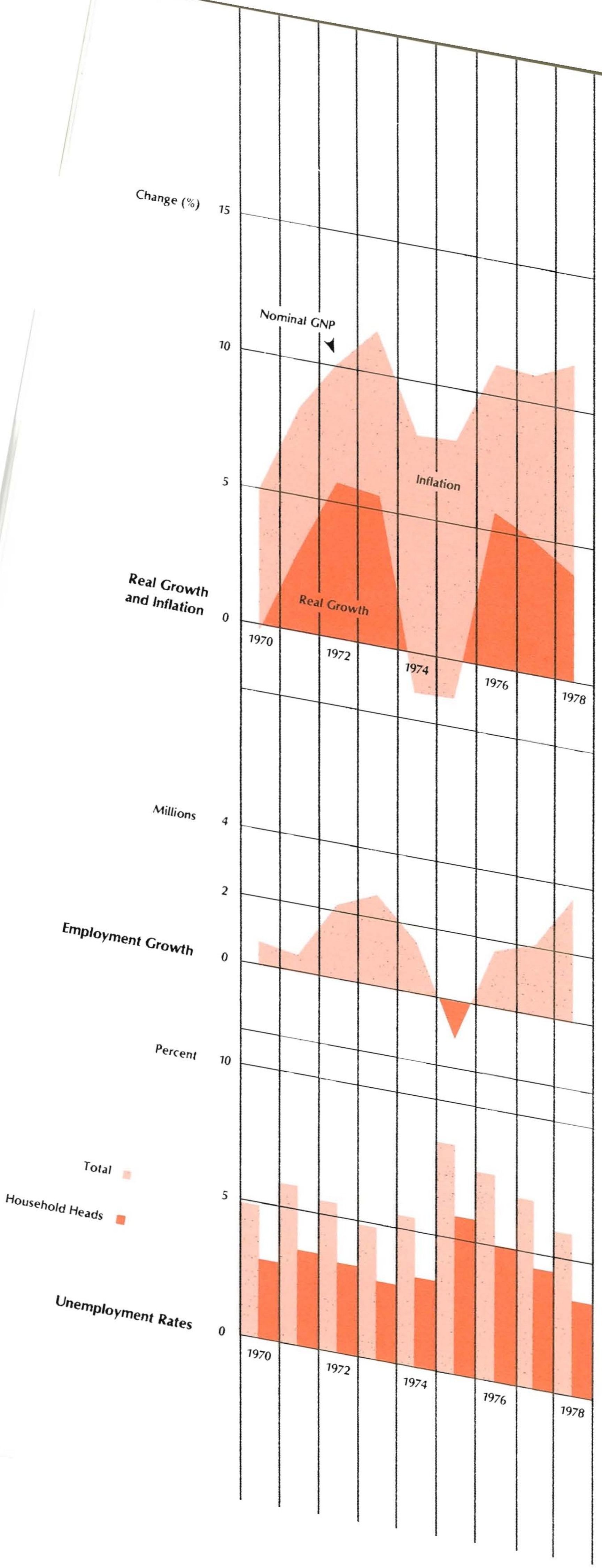
Yet banks everywhere had to contend with skyrocketing increases in the cost of funds during the year. Rates rose sharply on large CD's, and also on Federal funds. Again, by year-end, rates on the new six-month T-bill certificates rose significantly above the rates paid on consumer-type time and savings deposits, the gap widening to more than 4 percentage points between the new certificates and consumer passbook accounts.

Divergent '79 trends

Most Western bankers anticipate a fairly strong earnings performance in 1979, although perhaps not quite up to the 1978 standard. Some warning signs are on the horizon. The record lending pace has reduced liquidity levels for some banks, so that they may adopt a less expansionary stance in the new year. Also, the uncertainties in the economic outlook will force many institutions to put aside more funds for potential loan losses, which would tend to curtail earnings.

Business-loan demand may continue relatively strong, especially if large corporate borrowers turn to the banks for more financing because of the growing difficulty of obtaining funds from other sources. On the other hand, there may be some weakening of household borrowing, which has been the mainstay of the Western banking community for the past several years. Mortgage-loan demand should almost certainly subside, following two years of record housing demand and the recent jump in mortgage-loan rates. Consumer instalment-loan demand also could weaken, given the heavy burden of individual debt and the consumer's growing caution about the business outlook.

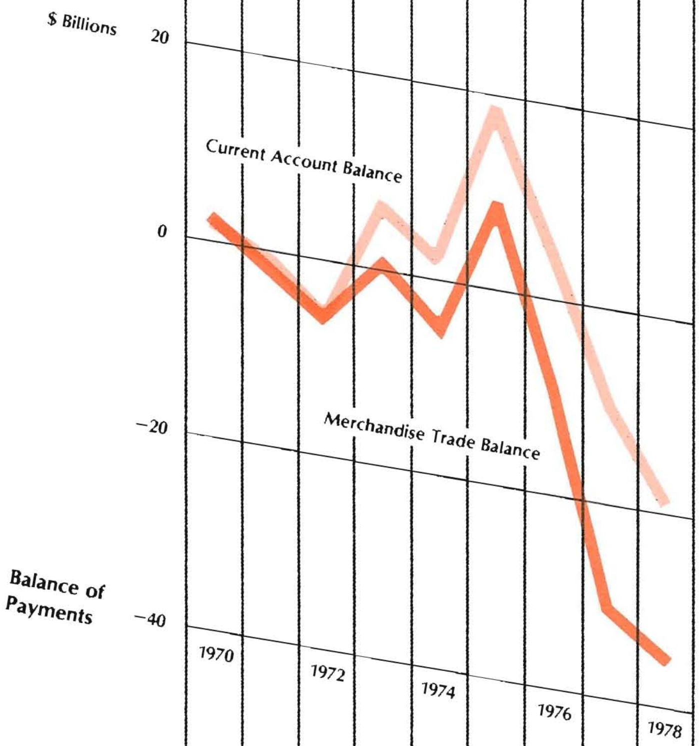
In this environment, CD funds should continue to be a major source of bank resources. These funds are likely to remain expensive, however, partly because of the high level of interest rates paid on such volatile deposits, and partly because of the supplemental reserve requirement now imposed on them. Banks meanwhile might avoid serious problems of disintermediation if they remain willing and able to pay market rates for the six-month T-bill certificates. In addition to these and more traditional sources, banks will have a new source of available funds – the Treasury tax-and-loan account program, which permits them to borrow excess Treasury deposits at a rate tied to the Federal-funds rate. And in the last analysis, Western banks may again profit from a faster-than-national expansion of business activity, and hence from a broader scale of lending opportunities than their national counterparts can expect.



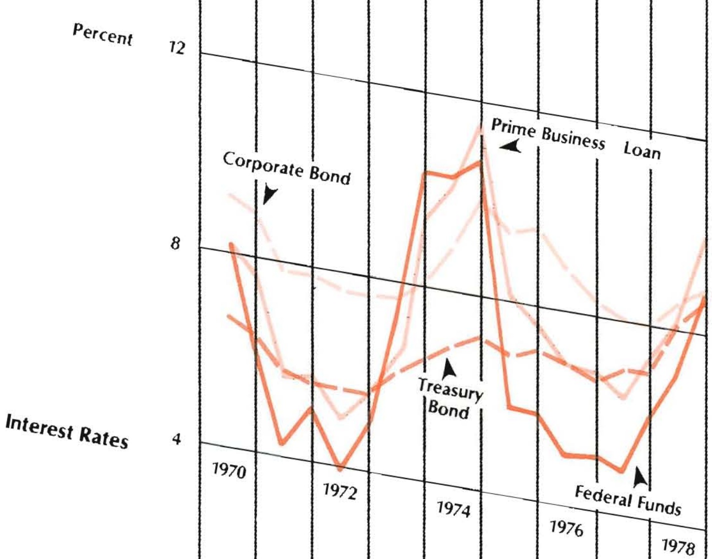
The National Scene—In Brief

The national economy produced $2.1 trillion worth of goods and services in 1978, although with some moderation in the economic growth rate. But the strong expansion was marred by an unanticipated price upsurge. Farm disasters, a rapidly depreciating dollar, and sagging worker productivity all contributed to the problem. More basically, the worsening of inflation reflected the continuation of heavy Federal deficit spending, as well as the related difficulty of reducing money-supply growth to levels compatible with long-run price stability.

The level of output reached last year represented effective full employment, measured in terms of available reserves of experienced workers and cost-effective plant capacity. With an unprecedented job-market boom, about 11 million new jobs were created over the course of the 1975–78 expansion. The unemployment rate continued to decline in 1978. Indeed, experienced workers were at a premium, measured by the low jobless rate for household heads, who comprise the core of the labor force.

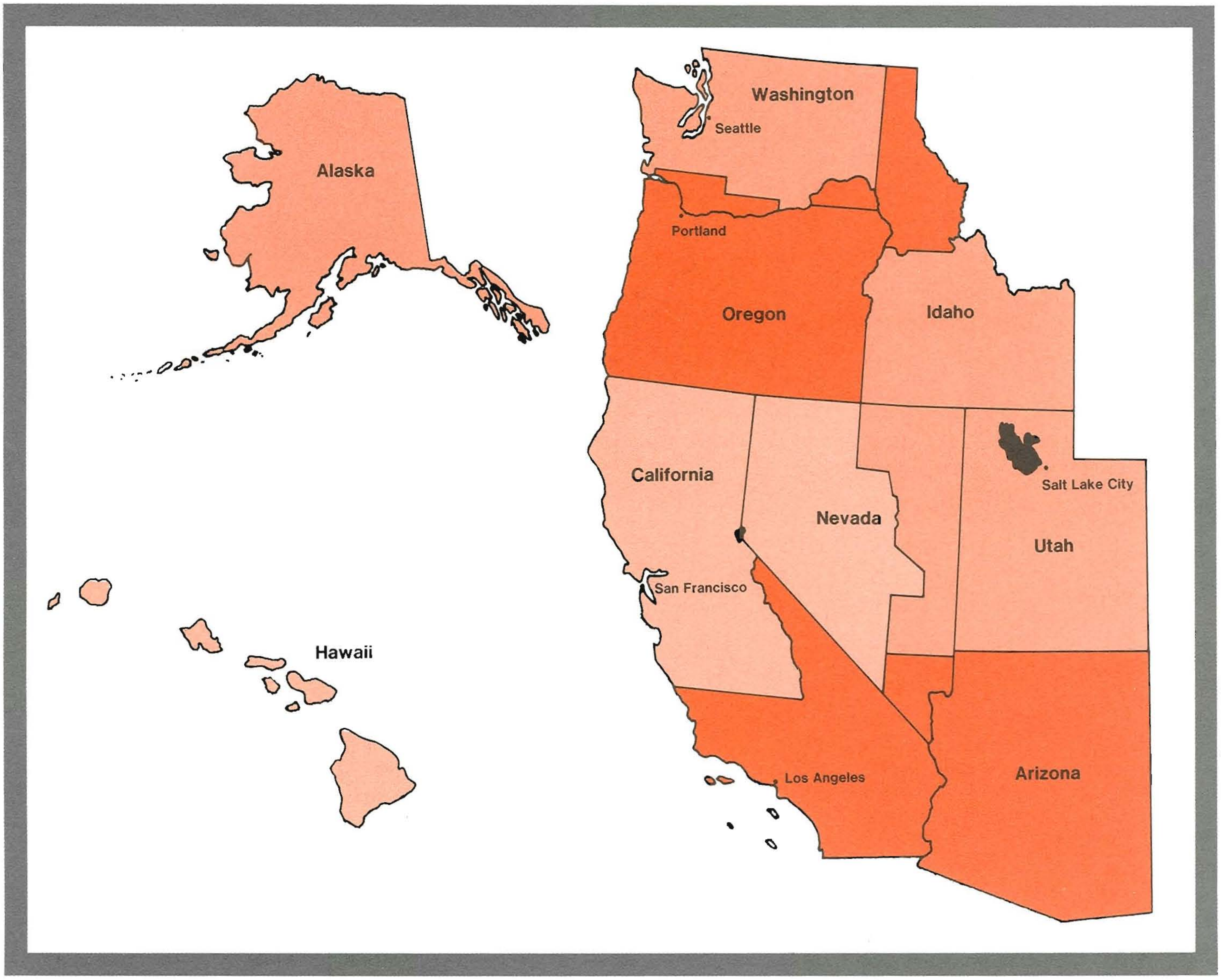


Prior to November's policy-tightening measures, the trade-weighted value of the dollar had dropped about 15 percent from the year-before level, and far more steeply against the yen, the mark and the Swiss franc. The U.S. balance of payments declined for 1978 as a whole, but strengthened noticeably after a steep early-year decline. Despite that and other signs of improvement, foreign investors sold dollars heavily during the year, apparently out of fear that U.S. inflation would get out of control.



Financial markets continued to reflect the strains of a still-strong, but inflation-wracked, business expansion. Credit generally remained available during the year—but credit became increasingly costly as interest rates soared to record or near-record levels. These higher rates reflected tighter policy measures in the midst of growing market pressures, along with the effects of inflationary expectations.

Twelfth Federal Reserve District

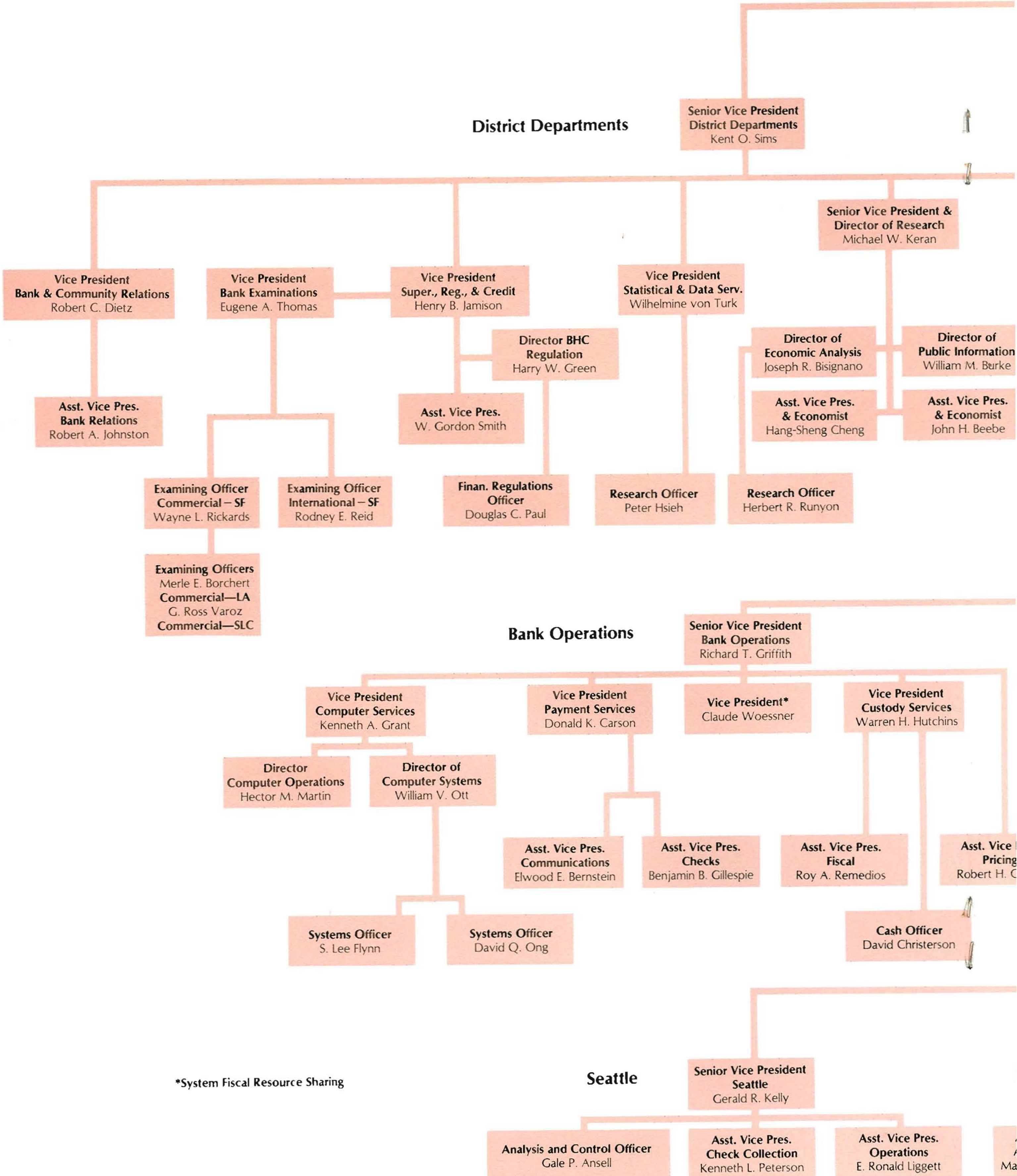


Management Committee
(Shown from left to right)
Richard T. Griffith, Senior Vice President, Bank Operations
John J. Balles, President
Kent O. Sims, Senior Vice President, District Departments
John B. Williams, First Vice President
John J. Carson, Senior Vice President, Corporate Staff

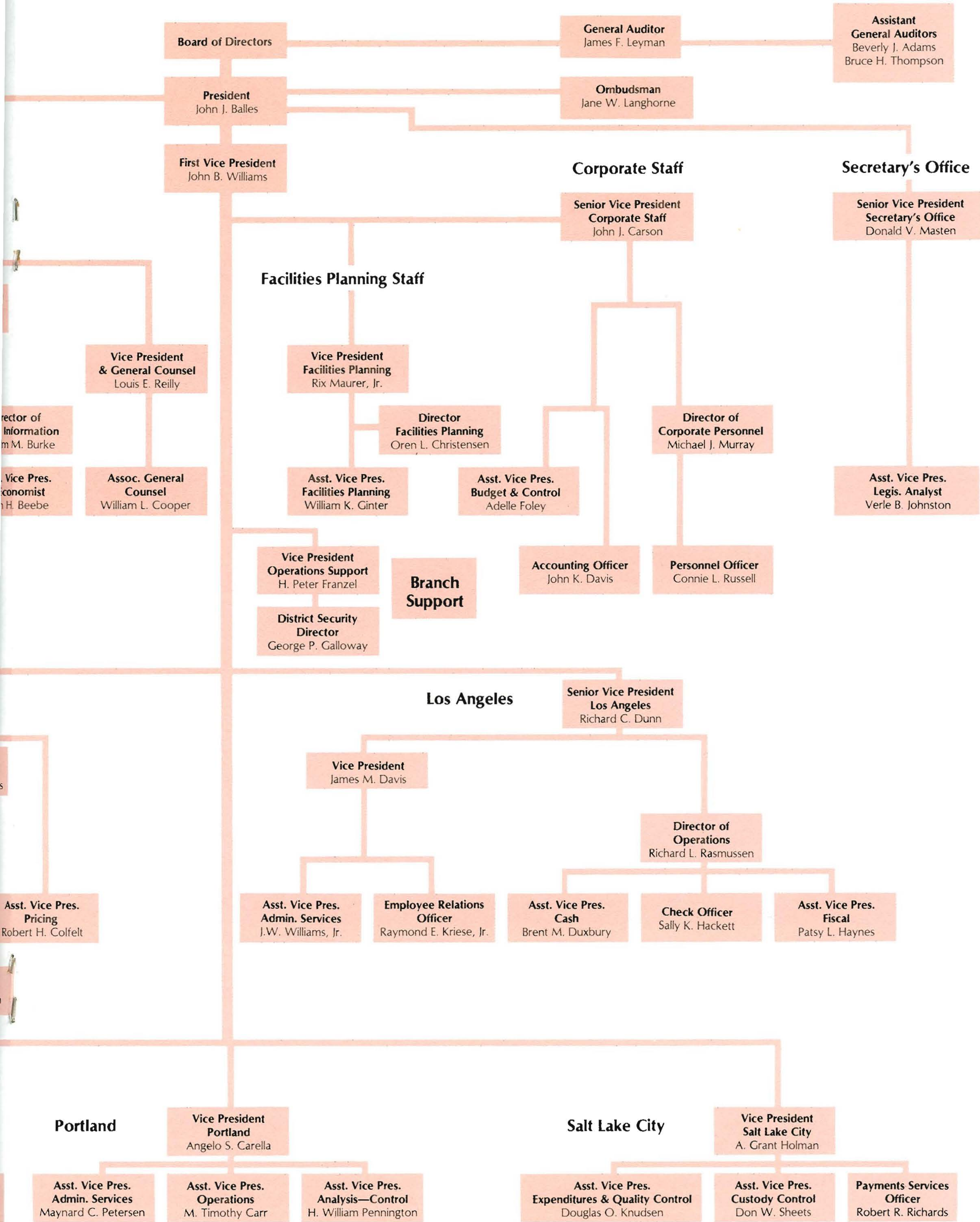
Federal Reserve Bank of San Francisco

Organization Chart

February 2, 1979



*System Fiscal Resource Sharing


Board of Directors
General Auditor James F. Leyman
Assistant General Auditors Beverly J. Adams Bruce H. Thompson
President John J. Balles
Ombudsman Jane W. Langhorne
First Vice President John B. Williams
Corporate Staff
Secretary's Office
Senior Vice President Corporate Staff John J. Carson
Senior Vice President Secretary's Office Donald V. Masten
Facilities Planning Staff
Vice President & General Counsel Louis E. Reilly
Vice President Facilities Planning Rix Maurer, Jr.
rector of Information m M. Burke
Director Facilities Planning Oren L. Christensen
Director of Corporate Personnel Michael J. Murray
Vice Pres. conomist H. Beebe
Assoc. General Counsel William L. Cooper
Asst. Vice Pres. Facilities Planning William K. Ginter
Asst. Vice Pres. Budget & Control Adelle Foley
Asst. Vice Pres. Legis. Analyst Verle B. Johnston
Vice President Operations Support H. Peter Franzel
Branch Support
Accounting Officer John K. Davis
Personnel Officer Connie L. Russell
District Security Director George P. Galloway
Los Angeles
Senior Vice President Los Angeles Richard C. Dunn
Vice President James M. Davis
Director of Operations Richard L. Rasmussen
Asst. Vice Pres. Pricing Robert H. Colfelt
Asst. Vice Pres. Admin. Services J.W. Williams, Jr.
Employee Relations Officer Raymond E. Kriese, Jr.
Asst. Vice Pres. Cash Brent M. Duxbury
Check Officer Sally K. Hackett
Asst. Vice Pres. Fiscal Patsy L. Haynes
Portland
Vice President Portland Angelo S. Carella
Salt Lake City
Vice President Salt Lake City A. Grant Holman
Asst. Vice Pres. Admin. Services Maynard C. Petersen
Asst. Vice Pres. Operations M. Timothy Carr
Asst. Vice Pres. Analysis—Control H. William Pennington
Asst. Vice Pres. Expenditures & Quality Control Douglas O. Knudsen
Asst. Vice Pres. Custody Control Don W. Sheets
Payments Services Officer Robert R. Richards

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

Western Central Bank

During 1978, the Federal Reserve Bank of San Francisco provided expanded central-banking services, in the areas of checks, coin, currency, fiscal agency, and electronic funds transfers, for a regional economy which continued to grow faster than the rest of the nation. The Twelfth District, which contains five Reserve Bank offices – in San Francisco, Los Angeles, Portland, Salt Lake City and Seattle – is the largest Federal Reserve District in terms of both population and geographic size. It includes the states of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah and Washington, plus the territories of Guam and American Samoa – and serves 35 million people and 522 banks with a total of 6,457 banking offices.

The Reserve Bank's scope of operations in 1978 reflected the large size of its service area. For example, Bank staff handled about 1.4 billion paper checks, not to mention 2.0 billion coins and 1.0 billion pieces of currency. At the same time, the Bank continued to extend its electronic-payments capability, through such means as automated clearing houses, Government direct-deposit programs, and the Federal Reserve wire-transfer network. District member banks transferred $7.9 trillion throughout the country over the Fed Wire network. The staff continued to work on a five-year automation program, with an eye toward further internal efficiencies as well as improved services for commercial banks and the general public.

Membership developments

Declining membership became a problem for the San Francisco Reserve Bank, and for the Federal Reserve System generally. In this District, six state-chartered banks became members, and nine banks went off the membership rolls, mostly because of mergers with other banks. The System nationwide experienced a net loss of more than 50 member banks during the year. As these numbers suggest, it has become increasingly difficult to maintain membership with the existing system of reserve requirements.

The Federal Reserve submitted a package of legislative proposals to Congress in July, which was designed to bring about greater competitive equality among financial institutions by reducing the net cost of System membership. In particular, the Fed proposed to pay interest on required-reserve balances held by member banks at Federal Reserve Banks. (Member banks, unlike nonmember banks, at present earn no return on their required reserves.) The Fed also asked Congress to impose universal reserve requirements on transactions balances held by all financial institutions – such as so-called NOW accounts as well as demand deposits – as a means of equalizing competition among all depository institutions with third-party payment powers. In return, nonmember institutions would gain access to Federal Reserve clearing services. Finally, in November, the System released a preliminary schedule of prices for Federal Reserve check-clearing and automated clearing-house services, which would be implemented after appropriate steps have been taken to alleviate the problem of declining membership.

Congressional leaders plan to take up membership legislation early in the new session. Meanwhile, the San Francisco Reserve Bank is continuing to inform banks of the value of System membership and to respond to their needs by discovering banks' problems and helping to solve them. To this end, bank-relations personnel in 1978 provided technical advisory services for member banks, cost-of-membership studies for potential members, and a series of seminars on economic and financial developments for bank and business audiences. In addition, the Reserve Bank continued to offer member banks a functional-cost analysis program, which takes advantage of the Federal Reserve's unique ability to construct regional and national peer-group comparisons from accounting data supplied by its members.

Supervisory responsibilities

In the area of supervision and regulation, the Reserve Bank prepared to take on the new responsibilities which were conferred by the International Banking Act of 1978. The legislation extended Federal control over the branches and agencies of foreign banks operating in this country, and over foreign-bank controlled commercial-lending companies that are engaged in banking activities. The act empowered the Federal Reserve to impose mandatory reserve requirements on Federally-chartered branches and agencies of foreign banks – and on State-chartered branches and agencies whose parent banks hold $1 billion or more in worldwide assets. The branches holding reserves would gain access to Federal Reserve services. Also in the international area, the Reserve Bank made a statistical early-warning system an integral part of its bank-examination procedures, as a means of identifying potential defaults or rescheduling of external debt in countries where District banks have substantial financial assets.

The Reserve Bank's staff completed the development of a new bank-rating system for describing and communicating the results of bank examinations to the Federal Reserve Board of Governors. The previous rating system included only capital adequacy, asset quality and management in its composite rating. The new system has added earnings and liquidity, in order to provide a better measure of the condition of the bank under examination. With minor modifications, some version of the new bank-rating system has been adopted by each of the Federal bank-regulatory authorities. The Reserve Bank also continued to operate a computerized financial-monitoring system, which provides for continuous review of financial developments between on-site examinations in institutions under its supervision.

The examination staff completed annual on-site inspections of selected domestic bank holding companies and their nonbank subsidiaries. Every effort was made in each case to schedule the Federal Reserve's inspection of the holding company concurrent with the examination of a subsidiary bank or banks. This policy minimizes examination costs for related institutions undergoing examination, and provides a useful division of labor among regulatory agencies in cases where the Federal Reserve is not the primary regulator of the subsidiary bank.

The consumer-affairs staff conducted examinations at all state-member banks, and also at many of their branches, as part of a System-wide program designed to achieve broad-based compliance with consumer-protection laws and regulations. In addition, the staff offered all member banks the services of specially trained examiners for on-site educational and advisory work in this field. The Reserve Bank received about 500 individual consumer complaints against commercial banks, and processed more than 100 such complaints which were related to institutions for which it is the primary supervisor. This workload is likely to increase substantially in 1979 as the Federal bank regulatory agencies assume new responsibilities under the Community Reinvestment Act. Congress passed this legislation as a means of encouraging banks and thrift institutions to meet the credit needs of all credit-worthy borrowers in their communities.

Planning for the future

In a key development, the Reserve Bank completed plans for a new San Francisco headquarters building, to be built on a site near the foot of the city's Market Street. The Bank's present headquarters building, constructed in the early 1920's, is inadequate for meeting the requirements of present-day banking operations. The new 12-story, 653,000-square foot building is designed to meet the District's needs into the 21st century. The conceptual-design phase of the project was virtually completed by year-end, and groundbreaking is scheduled for 1979, with completion around early 1982.

During 1978, the Bank restructured responsibilities within its San Francisco Office, primarily by forming a Bank Operations Division under Senior Vice President Griffith. The new division encompasses three functions – custody, payments and computer services. This organizational alignment complements the recent formation of District committees for each major operating activity, with representation from each office. Senior officers in San Francisco who have accountability for these major activities provide District-level coordination. The senior officers of the Bank Operations Division also have day-to-day responsibilities at the San Francisco office. Consequently, the Bank now has a central focus of accountability for each major District operation.

The Computer Services Group moved into the second phase of a five-year automation plan, installing essential hardware and software components in accordance with the Bank's basic strategy of centralized on-line processing. Moreover, 1978 saw the beginning of a number of major system-development efforts, which should greatly increase the Bank's level of automation into the 1980's. These efforts, among others, encompassed the Treasury tax-and-loan system, the savings-bond issuing system, the publications mailing list, and the securities-transfer facility.

Payments activities

In check-processing activities, Bank staff handled about 1.4 billion paper checks during the year – a substantial 6-percent increase. This District continued to lead the System in the cost effectiveness of check processing. In addition, this Bank significantly improved the quality of operations, reducing internal errors and delays in processing.

In one major move, the Bank implemented the Treasury-mandated government-check truncation program. ("Truncation" involves shipping magnetic tapes and microfilm copies of checks, instead of the original paper checks in bulk, to the Treasury computer-operations center.) This was a massive undertaking, since this District processes the largest volume of government checks in the System – 134 million in 1978.

In electronic payments activities, District member banks settled $7.9 trillion through the Federal Reserve's wire-transfer system – a sharp 25-percent increase over 1977. In addition, the San Francisco District continued to lead the rest of the country as the largest processor of electronic automated-clearinghouse items. This facility replaces checks and permits automatic payroll deposits as well as bill paying. In a major step forward, this Bank and other Reserve Banks participated in the development of a nationwide network which links up some 9,400 banks and 1,500 thrift institutions that are currently members of automated clearinghouse (ACH) associations, along with some 6,000 customer corporations. The 35 ACH's now in operation – one private and the rest Federal Reserve facilities – consist of computers which clear and sort payments instructions recorded on magnetic tapes. The new system requires no new facilities, but instead makes intensified use of existing Federal Reserve computers and wires.

Despite the increase in the use of checks and electronic transfers, the Reserve Bank continued to handle massive amounts of coin and currency, receiving and counting 2.0 billion coins and 1.0 billion pieces of currency during the year. The Bank instituted several major efficiencies in the cash activity during the year. Under one new program, commercial banks deposit excess fit currency in sealed plastic bags, so that the currency can then be paid without the need for Reserve Bank verification and sorting. Under a second program, the Mint now delivers large shipments of coin directly to ordering commercial banks; this makes it unnecessary for the Reserve Bank to participate in the actual physical shipments, and in many cases significantly shortens the transportation routes. The Bank also implemented a cash-management program, which provides for transferring excess fit currency of particular denominations, or excess amounts of unverified currency, from offices with surpluses to offices with shortages. These measures permit maximum use of currency-sorting resources on a District-wide basis, and also help reduce backlogs of unverified currency at all offices.

Fiscal activities
In its role as fiscal agent for the U.S. government, the Reserve Bank continued to handle substantial amounts of paper — in the form of savings bonds, marketable Treasury securities, and food stamps — while achieving new efficiencies through computer handling of securities. During the year, the Bank introduced a program which, through statistical-sampling techniques, permitted substantial efficiencies in the processing of food coupons. Also, the Bank implemented the new Treasury-mandated tax-and-loan investment program, whereby the Treasury earns interest by investing its operating cash balances, while paying fees for certain services which it formerly received free from financial institutions. The Bank was also designated the lead bank, on a joint computer resource-sharing project with the Kansas City and St. Louis Districts, to develop a major new system to handle the increasing volume of government-security purchases, sales, transfers and account holdings.

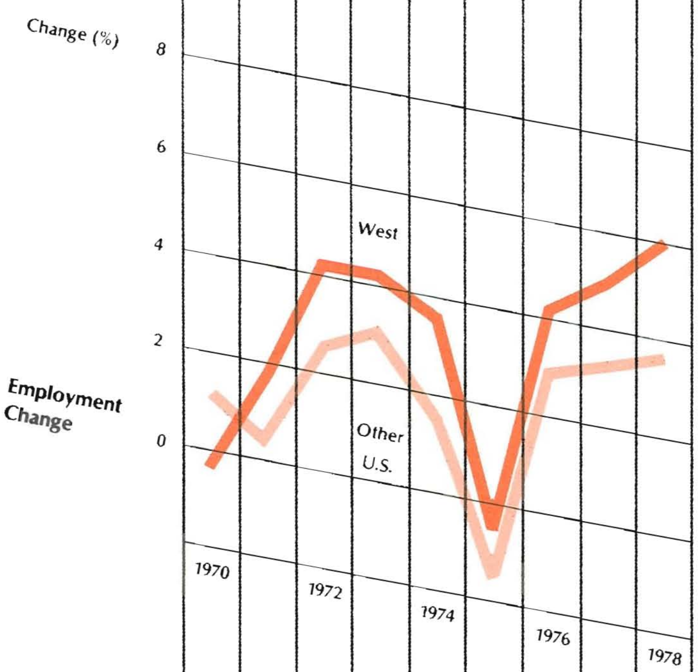
As for the bottom line, the San Francisco Reserve Bank continued to lead the Federal Reserve System in the cost effectiveness of operations, with an aggregate unit cost 15 percent below the System average. Productivity (output per worker-hour) in these operational activities has increased 57 percent since 1974, following the Bank's development of a major program of productivity improvement. And despite substantial increases in workload, the Bank's staff over the past decade has increased only 3 percent.

SUMMARY OF OPERATIONS

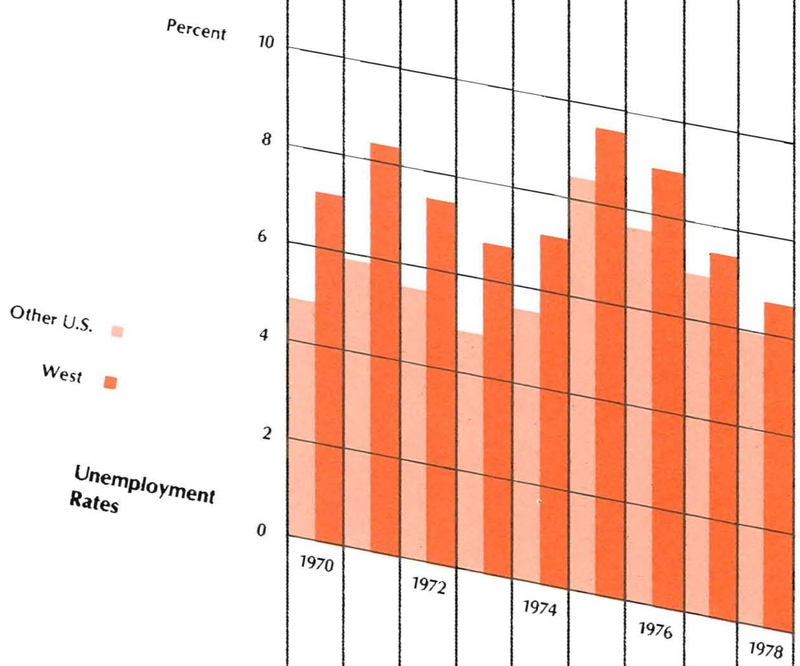
	Value (millions)		Number (thousands)	
	1977	1978	1977	1978
Currrency and Coin				
Currency received and counted	$ 10,995	$ 9,707	1,140,466	952,601
Coin received and counted	265	263	1,785,684	1,996,005
Collections				
Check Collections				
Commercial checks	452,403	560,461	1,178,298	1,246,573
Government checks**	68,596	71,389	129,394	133,595
Return items	5,649	6,836	15,043	17,943
Noncash Collections	5,293	5,911	165	240
Discounts and Advances				
Total discounts and advances	8,511	12,073	355*	914*
Number banks accommodated	N/A	N/A	43*	60*
Fiscal Agency				
Savings Bonds & Savings Notes	1,651	2,228	27,791	28,427
Other Treasury Issues	956,022	1,069,843	649	330
Other Fiscal				
Currency verified and destroyed	2,172	2,176	354,269	343,992
Food stamps received and processed	992	929	256,569	263,684
Electronic Funds Transfer				
Wire transfers	6,298,889	7,871,412	2,093	3,009
Automated clearinghouse	N/A	N/A	2,159	3,084
Government deposits	N/A	N/A	15,158	21,155

* Actual figures
** Including postal money orders

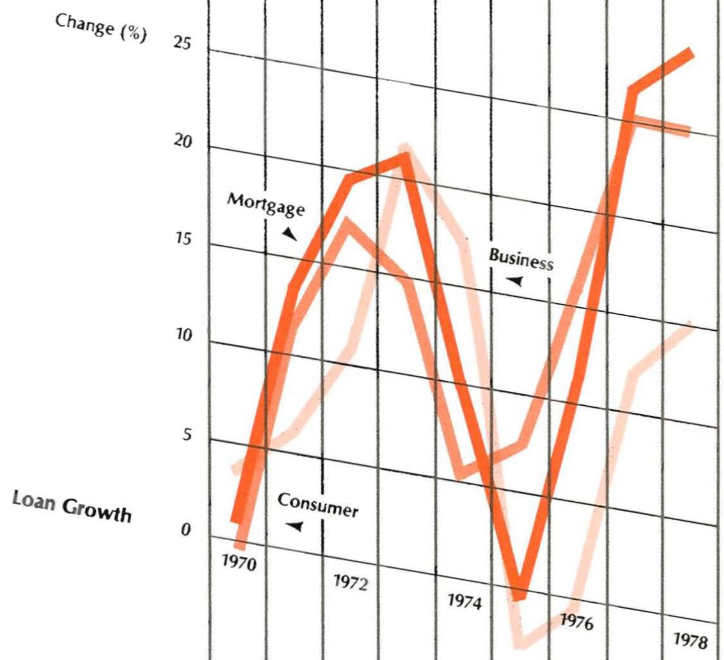
The Regional Scene—In Brief



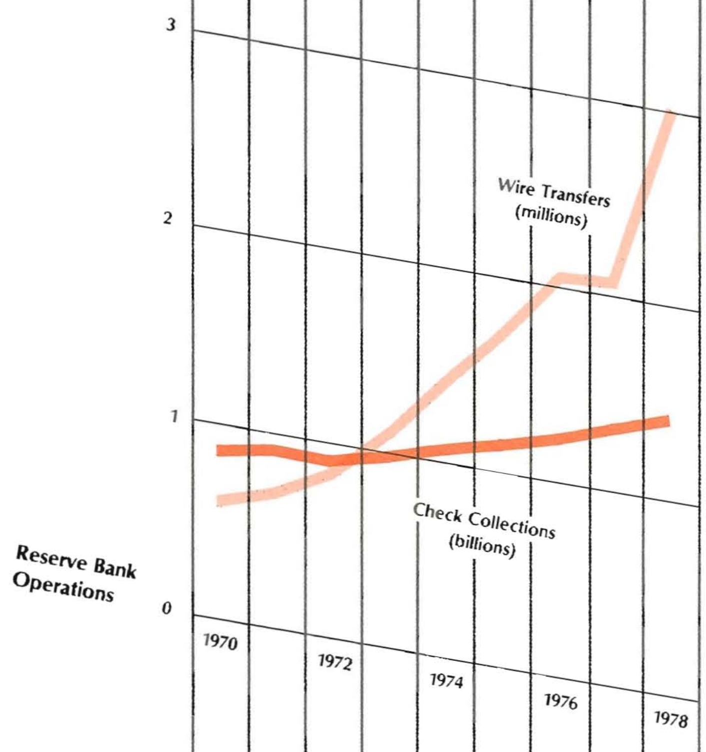
Civilian employment in the West jumped about 6 percent—an unprecedented increase of roughly 900,000 new jobs—to reach a new peak of 15.3 million. Employment gains were substantial in almost every industry—with the notable exception of the government sector, where employment remained flat because of tight fiscal controls at every level. The pace of expansion was much faster in this region than in the rest of the nation, following a pattern set even before the beginning of the present cyclical expansion.



Reflecting the active job market, unemployment dropped from 7.5 percent of the civilian labor force in 1977 to about 6.7 percent in 1978. The improvement was evident in almost every Western state. The strong expansion brought the rate down to about 6.0 percent by year-end, almost closing the wide gap that had persisted between the regional and national jobless rates for more than a decade.



The pace of banking, like the pace of general business activity, expanded much more rapidly in the West than elsewhere during 1978. Business loans increased 15 percent, despite a near-record prime rate, an increasingly restrictive monetary policy, and only moderate demand by the banks' large corporate customers. But for the second straight year, the household sector accounted for the major part of the overall loan increase, as both mortgage and consumer loans increased by one-fourth or more.



The Federal Reserve Bank of San Francisco met the needs of a growing Western economy, with its 35 million people, by providing an expanded amount of Reserve Bank services during 1978. For example, the Bank's staff handled 1.4 billion paper checks, 2.0 billion coins and 1.0 billion pieces of currency, along with 3.0 million wire transfers of funds. In volume, check collections totalled \$639 billion, and member-bank transfers of funds over the Fed Wire network totalled \$7.9 trillion.

Directors

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

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

San Francisco

Chairman of the Board and Federal Reserve Agent
Joseph F. Alibrandi
President and Chief Executive Officer
Whittaker Corporation
Los Angeles, California

Cornell C. Maier, **Deputy Chairman**
President and Chief Executive Officer
Kaiser Aluminum & Chemical Corp.
Oakland, California

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

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

Dorothy Wright Nelson
Dean and Professor of Law
University of Southern California Law Center
Los Angeles, California

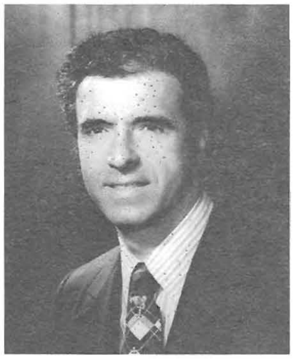
Clair L. Peck, Jnr.
Chairman of the Board
C. L. Peck Contractor
Los Angeles, California

Malcolm T. Stamper
President
The Boeing Company
Seattle, Washington

J. R. Vaughan
Chairman, President and Chief Executive Officer
Knudsen Corporation
Los Angeles, California

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

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



Alibrandi

Maier

Larkin

Mettler

Nelson

Peck

Stamper

Federal Advisory Council

Vaughan

Young

Schmidt


Ahmanson


Jellison


McMahon


Mitchell


Pinola


Proctor


Tanaka

Los Angeles

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

Fern Jellison
General Manager
Social Services Department
City of Los Angeles
Los Angeles, California

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

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

Joseph J. Pinola
Chairman and Chief Executive
Officer
Western Bancorporation
Los Angeles, California

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

Togo W. Tanaka
President
Gramercy Enterprises
Los Angeles, California

Portland

Chairman of the Board
Loran L. Stewart
Director
Bohemia, Inc.
Eugene, Oregon

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

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

Jean Mater
Partner and General Manager
Mater Engineering
Corvallis, Oregon

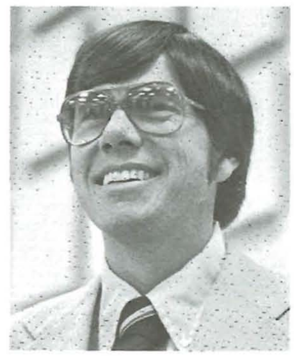
Phillip W. Schneider
Northwest Regional Executive
National Wildlife Federation
Portland, Oregon

Kenneth Smith
General Manager
The Confederated Tribes of
Warm Springs
Warm Springs, Oregon

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

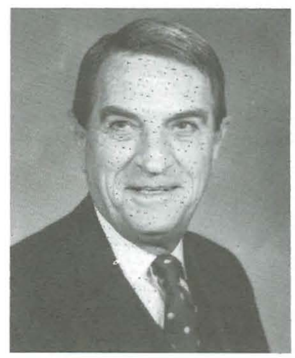
Stewart

Bryan



Gustavel

Mater



Schneider

Smith

Wallace

Ashton

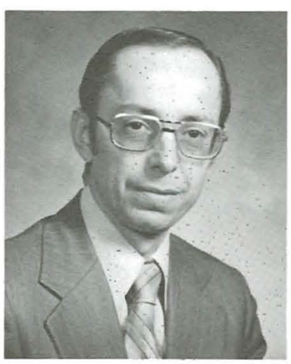
Bryans

Erkins

Gardner

Knox

Stringham



Terteling

Salt Lake City

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

Robert E. Bryans
Chairman of the Board and
Chief Executive Officer
Walker Bank & Trust Company
Salt Lake City, Utah

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

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

Mary S. Knox
Chairman of the Board
Idaho State Bank
Glenns Ferry, Idaho

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

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

Seattle

Chairman of the Board
Lloyd E. Cooney
President and General Manager
KIRO-Radio & Television
Seattle, Washington

Merle Adlum
Vice President
Seafarers International Union
of North America AFL-CIO
Seattle, Washington

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

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

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

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

Rufus C. Smith
Chairman of the Board
The First National Bank
of Enumclaw
Enumclaw, Washington

Cooney

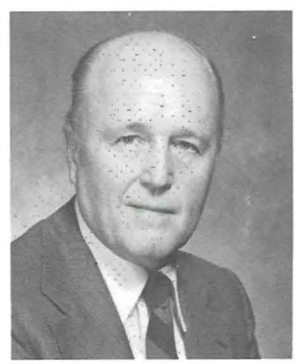
Adlum

Berry

Gamble

Mellish

Parks



Smith

COMPARATIVE STATEMENT OF ACCOUNT

(Thousands of Dollars)

	December 31, 1977	December 31, 1978
Assets		
Gold certificate account	$ 1,298,964	$ 1,299,982
Special Drawing Rights certificate account	149,000	152,000
Federal Reserve notes of other Federal Reserve Banks	0	0
Other cash	30,140	31,312
Loans to Member Banks:		
Secured by United States Government and Agency obligations	4,950	214,500
Other eligible paper	25,000	38,100
Other paper	0	0
Federal Agency obligations	1,055,187	1,046,745
United States Government securities		
Bills	5,479,183	5,589,142
Notes	6,658,969	7,272,340
Bonds	1,166,537	1,652,506
Total United States Government securities	$13,304,689	$14,513,988
Total loans and securities	$14,389,826	$15,813,333
Cash items in process of collections	1,644,649	2,031,377
Bank premises	9,166	9,698
Operating equipment	7,436	8,555
Other assets:		
Denominated in foreign currencies	2,567	224,700
All other	$ 1,515,692	$ 1,507,133
Total assets	$19,047,440	$21,078,090
Liabilities		
Federal Reserve notes	10,921,664	12,132,792
Deposits:		
Member bank – reserve accounts	6,050,317	7,102,592
United States Treasurer – general account	730,366	594,391
Foreign	38,047	28,378
Other deposits	82,766	64,451
Total deposits	$ 6,901,496	$ 7,789,812
Deferred availability cash items	778,065	559,035
Other liabilities	157,019	291,977
Total liabilities	$18,758,244	$20,773,616
Capital accounts		
Capital paid in	144,598	152,237
Surplus	144,598	152,237
Total liabilities and capital accounts	$19,047,440	$21,078,090
Contingent liability on acceptances purchased for foreign correspondents	0	0

EARNINGS AND EXPENSES

(Thousands of Dollars)

	December 31, 1977	December 31, 1978
Current earnings		
Discounts and advances	$ 2,091	$ 3,895
United States Government securities	907,143	1,091,753
Foreign currencies	379	270
All other	20	53
Total current earnings	$909,633	$1,095,971
Current expenses		
Total current expenses	$ 61,863	$ 66,460
Less reimbursement for certain fiscal agency and other expenses	5,295	6,044
Net expenses	$ 56,568	$ 60,416
Profit and loss		
Current net earnings	$853,065	$1,035,555
Additions to current earnings:		
Profit on sales of United States Government securities (net)	0	0
Profits on foreign exchange transactions	0	0
All other	$ 2,436	$ 685
Total additions	$ 2,436	$ 685
Deductions from current net earnings:		
Loss on foreign exchange transactions (net)	$ 20,201	$ 70,795
Loss on sales of United States Government securities (net)	6,607	17,262
All other	193	239
Total deductions	$ 27,001	$ 88,296
Net additions (+) deductions (−)	−24,565	−87,611
Assessments for expenditures of Board of Governors	− 6,575	− 7,488
Net earnings before payments to United States Treasury	821,925	940,456
Dividends paid	8,419	8,881
Payments to United States Treasury (interest on Federal Reserve notes)	$804,272	$ 923,936
Transferred to surplus	$ 9,234	$ 7,639
Surplus January 1	135,364	144,598
Surplus December 31	144,598	152,237

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