MONTHLY REVIEW

BUSINESS CONDITIONS IN THE TWELFTH FEDERAL RESERVE DISTRICT

Federal Reserve Bank of San Francisco *August 1, 1940*

THE increase in district industrial production evident in May was, on the whole, extended in June. As in earlier months of the year, considerable irregularity was evident in levels of operation and in the extent of the changes in output of the several industries. Reflecting the rise in industrial production, employment and payrolls at district manufacturing establishments advanced in June and were near the highest post-depression levels.

INDUSTRY

Industries which derive their demand chiefly or to an important degree from domestic and foreign armament requirements continued to be markedly stimulated and to show the greatest gains over operating rates prevailing a year earlier. Thus activity in the aircraft and shipbuilding industries increased further in June and the steel and metal-working industries maintained the high operating rates of other recent months. Mining and smelting of copper, however, declined slightly in June.

Building and construction remain a major factor supporting the current level of industrial activity. The value of new residential building permits taken out in the district in June declined from May by the usual seasonal amount, and consequently the adjusted index remained unchanged at 60 percent of the 1923-1925 average, as compared with an average of 62 percent for the first four months of the year and 55 percent for the full year 1939. The greatest percentage gains over the past year have been in Oregon and Washington, with a smaller increase in northern California and with practically no change in southern California where marked expansion in residential building came earlier than in other sections of the district. Nonresidential building permits increased sharply in June to the highest level for many months, owing chiefly to an advance in private industrial construction.

Reflecting active operations in building and construction, output of industries supplying materials for these lines remained at the high levels of the preceding month or gained moderately. On a daily average basis new lumber orders were somewhat smaller in June than in May, but late in the month and in early July they increased considerably. Lumber production increased further in June, and the seasonally adjusted index advanced to 90 percent of the 1923-1925 average, the highest since February. On the other hand, output of cement, which usually rises considerably from May to June, remained unchanged from the May level, which was, however, a record for recent years.

Among other industries, the assembly of automobiles was well maintained in June despite the approaching end of the model year. New automobile registrations were larger in California in June than in any month since the payment of the soldiers' bonus four years ago. The pulp and paper industry continues to operate at near-capacity rates and output of electric power made a new high record in June. In the petroleum industry both the production of crude oil and refinery activity have fluctuated within narrow limits for a number of months, while the amount of oil in storage has not changed significantly. Owing principally to a decline in Japanese takings, the physical volume of offshore shipments in the first six months of the year was 17 percent lower than in the like period of 1939, but the reduction has been approximately counterbalanced by a rise in the domestic movement. The active fruit canning season in California began in June. Both the cherry and the apricot packs were smaller this season than the average of recent years, while the combined pack of the two principal spring vegetables, spinach and asparagus, was about the same as last year, an increase in the asparagus pack offsetting a decline in spinach. War conditions continue to curtail severely the export of canned foods.

AGRICULTURE

The spread of the war in Europe during recent months has resulted in closing practically all continental European markets to exports from the United States with disturbing consequences to district producers of a number of agricultural products. Excluding cotton, which has been subject to special factors, value of exports of all farm products from the United States had declined in May to only 27 percent of the monthly average for the ten years 1921-1930, and since May additional European ports have been closed to international commerce.

During the decade of the twenties substantial and expanding foreign demand was an important factor encouraging large increases in acreage and production of a number of farm products in the Twelfth District. Reductions in that demand after about 1930 reflected both the world-wide business depression and increasingly restrictive import and exchange regulations adopted by numerous countries. Thus even prior to the outbreak of the European war the problem of adequate commercial markets for a number of agricultural products important in the Twelfth District had developed, and this problem has been increasingly accentuated since last August. Except for comparatively small shipments to other American republics and to Canada, outlets for many of these products have become restricted to the domestic market.

While the domestic commercial market for agricultural products has improved in recent months, the shift to what is largely a domestic market basis contains the threat of reduced incomes for producers of a number of district farm products. Among the more important of these are fruits, which in the past have been sold abroad in substantial amounts in fresh, dried, or canned form, malting barley, hops, beans, and wheat and flour.

Under these conditions the various Federal programs of aid to agriculture that have been developed in recent years are being retained and in some cases extended. The "stamp" plan of distribution to those on relief, by which various foods are made available to families whose purchases are restricted by their lack of purchasing power, is being expanded. A number of staple farm products, including dried beans, butter, eggs, flour, oranges, prunes, raisins, and rice, and several fresh vegetables produced in important quantities in the Twelfth District have been declared "surplus" commodities and growers of these products are expected to benefit by the extension of the plan. Non-recourse loans will again be made this year on barley, corn, cotton, rye, and wheat, which will tend to place a "floor" below which prices to producers will not fall. Subsidies will again be paid on wheat and flour exported and will enable growers in the Pacific Northwest to compete in foreign markets still available to them. In addition, the Federal Government will continue to purchase various farm products for diversion to "non-competitive" commercial channels, an example of which in the past has been the purchase of walnuts for shelling and sale in that form.

Output of most district crops will show only small changes from harvested tonnages of the previous two years, according to July 1 estimates. Only the apricot crop is substantially smaller than in 1939 and considerably below the average of recent years. Rainfall since the early spring, however, has been below normal and conditions are reported to be approaching drought proportions in some parts of the Pacific Northwest and of Utah and Idaho. Range conditions have deteriorated in recent weeks, and growth of field crops has been sufficiently retarded to cause some reduction in earlier output estimates.

Banking and Credit

Total loans of all district member banks increased moderately in the second quarter of 1940 to $1,968,215,000 on June 29, and at that figure were about unchanged from the $1,966,868,000 outstanding on December 31, 1939. Loans of weekly reporting member banks in the larger district cities declined approximately $15,000,000 during the first half of the year, while loans through banks in the smaller cities and outlying areas increased by about that amount. Investments of all district member banks in United States Government obligations increased $22,580,000 during the second quarter but on June 29, 1940 were $45,025,000 lower than at the end of 1939. Holdings of obligations of states and political subdivisions, however, were $25,791,000 larger at the mid-year than six months earlier and a small increase also took place in other securities.

After increasing sharply in the preceding six months to the record figure of $740,177,000 on June 19, member bank reserve balances in the Twelfth Federal Reserve District declined in the five weeks ending July 24 to $715,568,000. This decrease was traceable largely to withdrawal by the United States Treasurer of $43,741,000 from accounts with depository banks and the shift of the funds to the Treasurer's account with the Federal Reserve Bank of San Francisco, and to cash receipts of $21,600,000 from sales in the district of 2½ percent Treasury bonds dated July 22. The total allotment in this issue to banks and other investors in the district amounted to $46,500,000 of which $24,900,000 was paid for in deposit credit by subscribing banks.

Despite the decline in reserve balances of member banks in recent weeks, excess reserves of those banks in late July approximated $250,000,000 out of the total of $715,568,000 of reserve funds. This total of excess reserves was about $100,000,000 larger than a year earlier.

Rates of interest at which member banks have made commercial loans over the past year have remained about unchanged. Rates charged customers on such loans made during the first half of June by banks in the five larger district cities averaged 3.76 percent. This compares with 3.83 percent in March 1940, 3.67 percent in the first half of December 1939, and 3.71 percent in the first half of September 1939. These are averages of the rates charged on new loans and renewals, the several rates first being weighted according to the dollar amounts of the loans made at each rate.

While the average rate on new commercial loans and renewals made during the first two weeks of June was 3.76 percent, actual rates charged ranged from ½ of 1 percent to 12 percent. In the accompanying table, the dollar amounts of new loans and renewals made at the several rates are shown for member banks in the five cities from which data are currently collected.

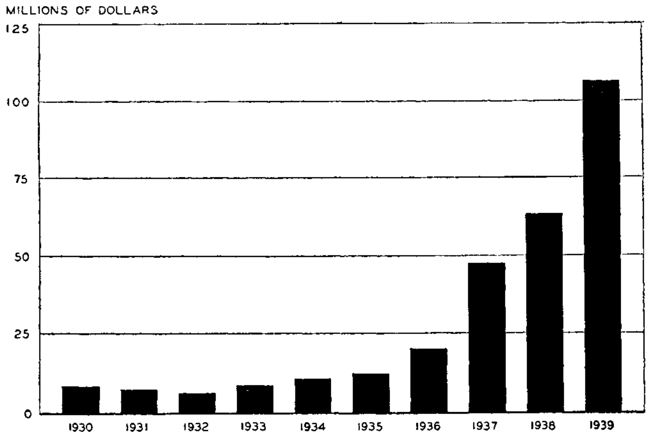
New Commercial Loans and Renewals Made by Member Banks Grouped According to Rates of Interest Charged
(000 omitted)

Rates Charged	San Francisco	Los Angeles	Portland	Seattle	Salt Lake City	Total Five Cities
0 to .99 percent	$ 110	$ 0	$ 0	$ 392	$ 250	$ 752
1 to 1.99 percent	4,145	2,769	25	810	150	7,899
2 to 2.99 percent	1,133	520	277	463	313	2,706
3 to 3.99 percent	5,252	1,296	179	874	170	7,771
4 to 4.99 percent	3,737	1,876	1,420	2,123	164	9,320
5 to 5.99 percent	1,268	1,458	1,901	3,391	629	8,647
6 to 6.99 percent	492	991	946	2,385	320	5,134
7 to 7.99 percent	0	185	23	352	56	616
8 percent and over	0	0	4	56	70	130
Total	$16,137	$9,095	$4,775	$10,846	$2,122	$42,975

Financing the District Aircraft Industry

As a result of the avalanche of orders since the beginning of the European war and in anticipation of the requirements of the huge domestic program of national defense, the district aircraft industry has increased production to substantially the limits permitted by existing facilities and is currently engaged in doubling the floor space of its plant. The extent of this increase is indicated by the marked rise in number of persons employed by the industry. In June of this year around 40,000 wage earners were employed at aircraft and aircraft parts factories in the Twelfth District, compared with about 28,000 at the end of 1939 and 14,000 at the end of 1938. This large gain in employment has been accompanied by expansion in plant, floor space of the major district manufacturers having been increased to 4,786,000 square feet by mid-1940 from 4,421,000 at the end of 1939 and 3,289,000 on December 31, 1938. Despite the expansion in operations of the industry, unfilled orders reported by the principal firms have increased sharply, amounting to $519,000,000 at the mid-year, more than double the figure of $235,000-000 reported at the end of 1939 and six times as large as the $85,000,000 reported on December 31, 1938.

In addition to the increase that has already taken place over the past year, most major district producers of aircraft have announced plans for further large expansion in plant. When announced programs are completed, floor space of the principal manufacturers will approximate 8,100,000 square feet. Capital expenditures involved in additions to plant so far this year and currently scheduled for the near future will approximate $12,000,000 as a minimum.



SALES OF FIVE PRINCIPAL TWELFTH DISTRICT AIRCRAFT MANUFACTURERS

The manufacture of aircraft has become one of the district's major industries only within the past few years. The accompanying chart of the annual value of sales, identical with the value of deliveries in this industry, of the district's five largest producers shows the extent to which the industry's growth has occurred since 1936. Not all of these five producers have been in operation throughout the period covered by the chart, and their sales are included only for the period during which they have operated in the district. At the beginning of the period (1930) two major plants were in operation in the district, one new company was established in 1932, and two removed to California from the East in 1935. Since January 1, 1936, however, all five have been in operation in the district. Within the past year, two other district plants have attained the status of major producers but the value of their sales, which to date has been small, has not been included in the chart.

The sharp increase in operations of the five principal district producers since 1936 has imposed a large increase in the financial requirements of these enterprises. The following tabulation summarizes the aggregate financial expansion of the five concerns and reveals that commercial credit, including bank loans, has figured in this expansion to but a relatively small extent.

	Gross Investment in Fixed Assets	Total Assets	Net Worth	Long-term Debt*	Bank Loans*
Dec. 31, 1936	$7,619,900	$29,156,300	$22,426,100	$ 64,000	$2,116,000
Dec. 31, 1937	10,138,700	42,802,000	27,108,700	0	6,435,000
Dec. 31, 1938	11,977,800	49,402,100	34,797,100	1,250,000	4,036,000
Dec. 31, 1939	15,914,000	82,014,800	42,482,700	460,700	4,046,000

*Long-term debt consists largely of bank loans having maturities of one year or more. Bank loans totals (column on right) include that part of long-term debt represented by bank loans.

Although the investment in fixed assets increased by only about $8,000,000 between the end of 1936 and the end of 1939, the increase in total assets amounted to about $53,000,000. The difference is accounted for chiefly by the increase in funds tied up in work in progress and in

Distribution and Trade—

Index numbers, 1923-1925 average=100	With Seasonal Adjustment 1940 June	1940 May	1939 June	Without Seasonal Adjustment 1940 June	1940 May	1939 June
Retail Trade						
Department store sales (value)*						
Twelfth District	97	99	97	88	95	88
California	94	96	98	84	90	87
Los Angeles	84	88	89	73	81	77
Bay Region	103	102	105	93	96	95
San Francisco	97	93	98	87	86	88
Oakland	117	127	125	106	123	112
Pacific Northwest	103	103	96	97	99	89
Portland	104	103	96	100	100	92
Seattle	104	106	98	95	99	89
Spokane	98	97	87	91	81	81
Salt Lake City	90	101	86	80	110	76
Department store stocks (value)†	62	62	63	59	63	60
Furniture store sales (value)*‡	80	89	76	77	80	73
Furniture store stocks (value)†‡	73	76	66	74	79	67
Automobile sales (number)*						
Total	—	—	—	158	135	112
Passenger	—	—	—	154	128	106
Commercial	—	—	—	199	208	171
Carloadings (number)*						
Total	89	88	84	96	89	90
Merchandise and misc.	102	100	96	108	94	101
Other	72	73	69	80	82	76
Intercoastal Traffic (volume)						
Total	58	73	71	56	72	69
Eastbound	48	61	63	44	57	58
Westbound	93	114	101	97	124	105

*Daily average. †At end of month. ‡1929 average = 100.

Production and Employment—

Index numbers, 1923-1925 average=100	With Seasonal Adjustment 1940 June	1940 May	1939 June	Without Seasonal Adjustment 1940 June	1940 May	1939 June
Industrial Production*						
Manufactures (physical volume)						
Lumber	90	87	83	102	100	95
Refined oils	—	—	—	160	157	164
Cement	124	134	110	141	141	126
Wheat flour	114	126	158	100	110	139
Minerals (physical volume)						
Petroleum	—	—	—	94	93	92
Lead (U. S.)†	..	72	70	..	70	71
Silver (U. S.)†	..	111	107	..	108	105
Construction (value)						
Residential building permits‡						
Twelfth District	60	60	56	63	69	58
Southern California	65	64	64	65	72	64
Northern California	51	53	47	51	61	48
Oregon	47	41	32	51	49	35
Washington	63	57	49	69	78	53
Intermountain states	79	80	50	123	112	78
Public works contracts	—	—	—	213	153	187
Miscellaneous						
Electric power production	233	223	208	250	227	223
Factory Employment and Payrolls§						
Employment						
Pacific Coast	124	121	108	125	123	110
California	143	139	121	143	139	121
Oregon	109	104	102	114	108	106
Washington	93	95	85	97	99	89
Payrolls						
Pacific Coast	123	121	107	126	124	110
California	142	139	120	145	141	122
Oregon	102	99	97	107	106	102
Washington	94	94	85	98	98	90

*Daily average.
†Prepared by Board of Governors of Federal Reserve System.
‡Includes figures from 197 cities and Los Angeles County, unincorporated.
§Excludes fish, fruit, and vegetable canning.

liquid resources, an increase which has necessarily accompanied the enlarged scale of operations. In the manufacture of aircraft a period of several months ordinarily elapses between the start of production and the delivery of the finished plane.

The balance sheets of the companies reveal that commercial credit has played only a small role in financing the sharp increase in activity. Bank loans, which were comparatively small in 1936, have not increased materially; open market loans have not been employed; and long term credit has been of negligible importance in financing the industry's expanding operations. Funds to finance current production are obtained principally by requiring the purchasers of planes to make deposits and progress payments on almost all contracts, thus obviating the need for credit.

The sources of funds to finance the expansion of $53,-000,000 in assets of the five companies during the three years from December 1936 to December 1939 are shown in the accompanying table.

In the three-year period, 1937, 1938, and 1939, net profits of these five companies totaled $18,866,600. Dividends of $12,325,200 were paid, and $6,541,400 was retained in the business. New equity capital was increased $12,976,200. Of this amount, $3,500,000 was obtained through the sale by one of the companies of its ownership of an airline. The balance of approximately $9,000,000 was obtained from the sale of common stock by three of the other four companies directly to shareholders, to domestic underwriting syndicates for public distribution, and in one instance to a syndicate of foreign bankers. The relatively small item of $539,000 was set up as reserves out of gross profits. In the aggregate these items, all representing an increase in the net worth of the concerns, contributed $20,056,600 to finance the acquisition of assets.

Customers' contract deposits and advances contributed $19,462,500 in funds to finance the increase in assets. Notes payable, evidencing borrowings almost entirely from banks, increased $1,882,200, adding by that amount to funds available for the acquisition of assets. Other liabilities, consisting principally of bills payable and accrued expenses, increased $11,457,200. For simplicity, these latter items may be interpreted as current unpaid bills and items not yet due and payable, for which values have already been received and included among assets.

Sources of Funds to Finance Acquisition of Assets of Five Aircraft Manufacturers in the Twelfth District

(December 31, 1936–December 31, 1939)

Profits retained in business	$ 6,541,400	
New equity capital	12,976,200	
Increase in reserves	539,000	
Total increase in net worth		$20,056,600
Increase in:		
Notes payable	$ 1,882,200	
Customers' contract deposits and advances	19,462,500	
Accounts payable and accrued expenses	11,360,000	
Miscellaneous liabilities	97,200	
Total increase in liabilities		$32,801,900
Total increase in net worth and liabilities or in funds employed		**$52,858,500**

During the current year, two companies have raised substantial amounts of new capital through the sale of common stock. With respect to expansion programs now under way or announced for the near future, most of the companies have announced that no new financing is contemplated, the necessary funds being available either from working capital or from customers' contract deposits and advances.

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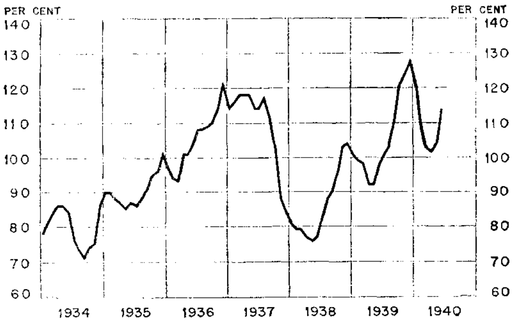
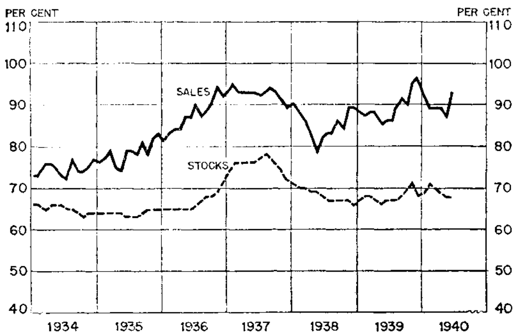
Supplement *Federal Reserve Bank of San Francisco* *August 1, 1940*



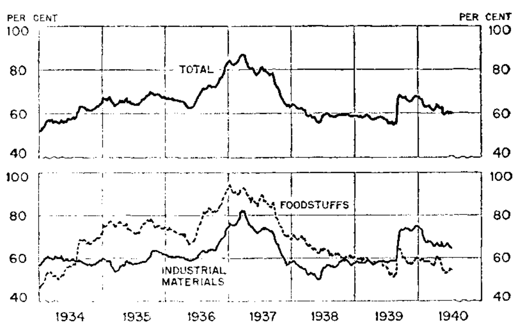
INDUSTRIAL PRODUCTION

Index of physical volume of production, adjusted for seasonal variation, 1923-1925 average=100. By months, January 1934 to June 1940.



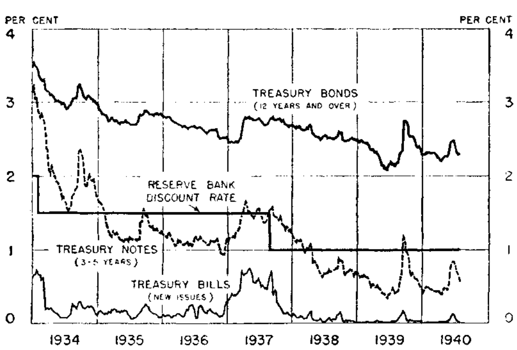
DEPARTMENT STORE SALES AND STOCKS

Indexes of value of sales and stocks, adjusted for seasonal variation, 1923-1925 average=100. By months, January 1934 to June 1940.



WHOLESALE PRICES OF BASIC COMMODITIES

Indexes compiled by the United States Bureau of Labor Statistics, 1926 = 100. By weeks, 1934 to week ending July 11, 1940.



MONEY RATES IN NEW YORK CITY

For weeks ending January 6, 1934, to July 13, 1940.

National Business Conditions—Board of Governors

VOLUME of industrial production increased rapidly during June and rose somewhat further in the first half of July. Distribution of commodities through retail and wholesale markets and by rail continued active.

Production

The Board's seasonally adjusted index of industrial production advanced from 106 in May to 114 in June. In that month, as in May, increases in activity were most marked in the iron and steel and textile industries where declines earlier in the year had been greatest.

Steel ingot production rose from 60 percent of capacity at the beginning of May to 87 percent in the latter part of June and was maintained at about that level in the first three weeks of July. Production of coke and pig iron showed similar sharp increases and iron ore shipments down the Lakes were at near-capacity levels. Demand for steel was general as most domestic steel-consuming industries were operating at high rates. Exports of steel, which had declined in April, rose to earlier high levels in May and June, amounting to about 10 per cent of steel-producing capacity.

Automobile production, which had begun to decline in May, continued to decrease in June and the first half of July reflecting in large part seasonal influences. Retail sales of automobiles were in large volume and dealers' stocks of new and used cars declined from the high levels prevailing earlier.

In the textile industry there was a further sharp advance in activity at woolen mills, and at cotton mills output was reduced less than seasonally. Rayon production was maintained at earlier high levels while at silk mills activity remained near the unusually low rate reached in May.

Coal production continued in large volume during June, but output of crude petroleum declined in the latter part of the month, owing to reduced production in Texas fields.

Value of construction contract awards showed little change from May to June, according to F. W. Dodge Corporation figures for 37 eastern states. Awards for private residential building decreased more than seasonally, following a sharp rise in May, and contracts for private nonresidential building also declined. Contracts for public construction increased further in June, owing in part to expansion in the construction of army and navy air bases.

Distribution

Department store sales in June were maintained at the May level, although usually there is a considerable decline, and the Board's seasonally adjusted index advanced to 93 as compared with 87 in May and a level of about 89 earlier in the year. Sales at variety stores showed little change from May to June, continuing at the advanced level that has prevailed since the beginning of the year. In the early part of July department store sales declined seasonally from the June level.

Freight-car loadings increased further in June. Shipments of coal and miscellaneous merchandise continued to expand and loadings of coke, which usually decline at this season, showed a substantial rise.

Commodity Prices

Prices of a number of industrial materials, particularly steel scrap, copper, rubber, and silk, declined from the middle of June to the middle of July. Wheat prices also showed decreases in this period, while prices of livestock and products advanced owing partly to seasonal influences.

Agriculture

Production of major crops this season, according to the July 1 report of the Department of Agriculture, may be slightly lower than last season. Tobacco production will be sharply reduced from last year, when the crop was unusually large. Domestic supplies of wheat and other field crops as well as of vegetables and fruit are expected to show little change from last season. Indicated hog production this year will be about 10 percent smaller than last year.

Bank Credit

Total loans and investments at reporting member banks in 101 leading cities increased during the five weeks ending July 10, chiefly as a result of increases in holdings of short-term United States Government obligations and in commercial loans. Holdings of United States Government bonds and loans to security brokers and dealers declined.

The monetary gold stock increased by $885,000,000 in this five-week period, the largest gold acquisition for any corresponding period on record. This inflow of gold was reflected in a growth of $310,000,000 in foreign bank balances with the Federal Reserve banks and in increased deposits and reserves of member banks. On July 10, excess reserves of member banks amounted to $6,833,000,000.

Government Security Market

Prices of Government securities, which had advanced sharply in June, showed further increases after July 8 when the Treasury announced a new bond issue for cash subscription. Between June 10 and July 15 the price of the 1960-65 bonds rose about three points, and the yield on this issue declined from 2.52 percent to 2.34 percent as compared with 2.26 percent at the year's peak in prices on April 2.