

Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO

JANUARY 1, 1942

ACTUAL participation of this country in the world-wide conflict calls for more complete mobilization of the nation's economic resources than has already been attained, and dictates that decisions as to the use of those resources shall be made primarily in terms of the effect upon the country's military strength. The limiting factors in each instance must be only the extent of human and physical resources available and the relative importance of their alternate uses. Fortunately, the defense program in the United States had been underway long enough and had attained sufficient proportions by December so that the creation of a war economy does not involve a complete about-face but rather an acceleration of progress in the direction already started upon.

War is no longer the primary concern only of those in the armed forces and those directly engaged in armament manufacture. To place the nation on a full wartime basis will require that substantial adjustments be made throughout the economy. Shifts in employment of men and in use of machines may be expected to attain considerable proportions, and both a reduction in consumption and an alteration of consumption patterns may also be anticipated. In the process, temporary unemployment may be experienced by many individuals while a number of firms may be forced to curtail or cease operations, and some seemingly arbitrary interference with individual decisions is inevitable.

In the Twelfth District, further expansion of industrial production under the stimulus of war will be reflected primarily in intensified efforts to increase the flow of those products already dominant in defense production in the area: ships, planes, and nonferrous metals. More shipways and additional plants will be constructed, and existing facilities will be converted more completely to war production. The threat to and uncertainty surrounding imports of strategic minerals increases the need for further domestic production of these items where possible. In large measure, increases in the output of chromite, mercury, tungsten, and copper will occur in the Twelfth District which produces most of the current domestic supplies of those minerals.

The district demand for industrial labor will be increased both through the completion of new plants and through the greater utilization of existing industrial facilities brought about by additional shifts and a longer work week. Difficulties which have appeared recently in obtaining skilled metal workers and trained foremen will become more numerous. Men released from plants forced to curtail or cease operations for lack of materials and equipment are becoming a significant local source of war industry labor, especially in Pacific Coast industrial areas where they are able, in many cases, to shift em-

ployment without changing residence. Migration to the coast states continues, but is reported to be on the decline.

The proximity of the war in the Pacific is expected to affect the location in the district of new industrial plants. Military strategy apparently will dictate that some new plants, which might otherwise be located on the coast, be placed further inland, a consideration that may give further impetus to industrial developments in the intermountain area. To be sure, industrial activity related to war will continue to expand on the coast but military considerations affecting plant location are being given even greater weight than they were a month ago.

Heavier burdens are being put upon western rail and shipping facilities. Additional ships are being shifted from coastal and intercoastal runs. This further diversion of shipping will affect principally the movement of oil and lumber. The combination of higher freight costs and possible car shortages may limit somewhat the flow of these products to more distant markets for civilian use. In the petroleum industry, overshadowing possible difficulties in supplying some markets with oil, however, is the increased demand upon California wells and refineries arising out of military and naval operations in the Pacific. A petroleum conservation program drawn up by the Industry Production Committee for California has been approved by the Petroleum Coordinator and is to be put into effect immediately. Expansion of facilities for the production of aviation gasoline is a pressing need, and steps are being taken to accomplish this.

The pattern of economic conditions emerging in recent months indicates that the district economy already was in process of being altered markedly under the stimulus of the defense effort prior to the outbreak of war. Many aspects of economic activity in this area which may be expected to become more pronounced under war conditions, including the establishment of new plants, the dominance of aircraft and shipbuilding, high levels of activity in mining and in metal production, and the dislocation of less essential activity, were clearly visible in November and earlier.

In November, a further but small increase took place in district factory employment and payrolls, allowing for seasonal influences. These gains reflected continued expansion of defense activity which more than offset declines elsewhere. Employment in the aircraft and shipbuilding industries in November again rose most rapidly, despite difficulties encountered in obtaining sufficient numbers of skilled workers. Steel mill operations remained at or near capacity and the mining and smelting of nonferrous metals continued at the high levels of the past several months. Petroleum production and refining were well maintained, but activity in this industry from

the inception of the defense program through November had shown only relatively small gains. Lumber production declined in November but the decrease was of no more than seasonal proportions. Both new and unfilled lumber orders, however, were further reduced. Capacity operation of pulp mills was not sufficient to keep unfilled orders in that industry from increasing. The manufacture of certain metal products, including electrical machinery and cooking, plumbing, and refrigerating equipment, declined.

The value of nonresidential construction initiated in November increased sharply over that of recent months, owing in large measure to a \$91,000,000 contract for iron and steel making facilities. Also swelling the total were contracts of \$10,000,000 and \$9,400,000 for alumina reduction plants, of \$22,000,000 for an aluminum reduction plant, of \$5,500,000 for an aluminum extrusion plant, of \$12,000,000 for magnesium manufacturing and fabricating plants, and of \$9,000,000 for copper production facilities. New residential building was maintained at the October level, but private residential building, excluding an \$8,000,000 life insurance company housing project in San Francisco, continued to decline.

In the field of retail trade, sales of new automobiles declined in November and remained well below the levels of a year earlier. Dealers continued to add to their inventories but the uncertainty of their position was increased by the further reductions in maximum production quotas ordered by OPM.

The decline in department store sales of the preceding two months was halted in November. Sales rose moderately over October levels and the increase continued through the first week of December, but was checked abruptly upon the outbreak of hostilities. Although cur-

rent year-period comparisons are influenced by strike conditions in several large reporting stores, the data nevertheless clearly reflect the pervading influence of war. The year-period gain in the Twelfth District amounted to 23 percent for the week ending December 6, but in the following week sales were 4 percent below those of a year ago—despite the rush for blackout materials along the Pacific Coast, the area in which the decline was most pronounced. Sales recovered somewhat in the week ending December 20, but were up only one percent over a year ago.

Agriculture

The impact of war upon the agricultural situation in the Twelfth District apparently will not involve any abrupt changes in the production pattern already evident for 1942. Production goals for next year under the long-term agricultural program developed by the United States Department of Agriculture had already been geared to the defense effort, including aid to overseas nations now allies of the United States. Actual war will accentuate demands upon agriculture, but changes in production as a result of this country's participation in the conflict will likely be in degree rather than in direction.

The pattern for agricultural production in 1942, outlined prior to December 7, involves substantial adjustments in output of a number of products. In general, they embrace enlarged production of the more concentrated foods high in nutritive value and curtailment in output of wheat and cotton. Largest increases in output of farm products important in the Twelfth District are scheduled for dairy products, eggs, cattle, sheep, and tomatoes and other vegetables for canning. Some increase in output of sugar beets is also in prospect. Production goals for most of the more important deciduous and citrus fruits, however, are the same as or smaller than most recent crops, and goals for cotton and wheat production in 1942 and 1943 call for appreciable curtailment in production. For wheat, the proposed decrease for next year amounts to 18 percent, from 5,079,000 acres in 1941 to 4,170,000 acres, with a further reduction of 9 percent to 3,791,000 acres in 1943.

A basic consideration in any appraisal of the effect of the present conflict upon the local agricultural situation is that generalizations based upon the experience in the last war should not be made without recognizing the marked differences between conditions then and now. This point is well illustrated by the wheat situation. In the last war the allied governments were insistent that heavy imports of this grain from the United States were

Production and Employment—

Index numbers, 1923-1925 average=100	With Seasonal Adjustment			Without Seasonal Adjustment		
	1941		1940	1941		1940
	Nov.	Oct.	Nov.	Nov.	Oct.	Nov.
Industrial Production¹						
Manufactures (physical volume)						
Lumber	112	112	96	107	122	91
Refined oils	—	—	—	174	184	170
Cement	177	169	132	177	195	132
Wheat flour	94	97	121	103	115	133
Minerals (physical volume)						
Petroleum	—	—	—	99	99	92
Lead (U. S.) ²	—	119	113	—	119	114
Copper (U. S.) ²	152	150	143	156	154	147
Construction (value)						
Residential building permits ³						
Twelfth District	100	82	79	93	83	74
Southern California	65	88	62	66	92	63
Northern California	155	59	96	137	58	85
Oregon	39	71	42	31	73	34
Washington	213	111	167	185	92	146
Intermountain states	93	112	90	81	114	79
Public works contracts	—	—	—	502	572	487
Miscellaneous						
Electric power production	286	273	248	271	273	234
Factory Employment and Payrolls⁴						
Employment						
Pacific Coast	199	196	138	202	205	140
California	246	237	160	252	248	164
Oregon	146	150	114	145	156	113
Washington	134	139	106	134	144	106
Payrolls						
Pacific Coast	261	256	145	261	271	145
California	321	307	169	324	323	171
Oregon	188	200	113	184	214	111
Washington	169	178	111	168	191	109

¹Daily average.

²Prepared by Board of Governors of the Federal Reserve System. (1935-1939 = 100).

³Includes figures from 197 cities and Los Angeles County, unincorporated.

⁴Excludes fish, fruit, and vegetable canning.

Distribution and Trade—

Index numbers, 1923-1925 average=100	With Seasonal Adjustment			Without Seasonal Adjustment		
	1941		1940	1941		1940
	Nov.	Oct.	Nov.	Nov.	Oct.	Nov.
Retail Trade¹						
Automobile sales (number) ²						
Total	—	—	—	71	79	146
Passenger	—	—	—	64	69	144
Commercial	—	—	—	136	184	169
Carloadings (number) ²						
Total	109	100	97	110	118	98
Merchandise and misc.	125	114	106	125	138	106
Other	89	82	86	91	92	88

¹Department and furniture store indexes, customarily shown in this table, are in the process of revision.

²Daily average.

imperative, yet on the basis of domestic consumption no exportable surplus was being produced in this country. Faced with these demands, wheat production was stimulated largely through the guarantee of high minimum prices, and acreage rose from 46,787,000 acres in 1917 to 73,700,000 acres in 1919. In the Twelfth District the increase was from 4,219,000 acres in the earlier year to 5,962,000 acres in 1919. In direct contrast to conditions in 1917, the United States at the present time is heavily supplied with wheat. At current rates of consumption and export, supplies are reported to be sufficient to last until 1943 even without additions from the 1942 crop. Exports from the country as a whole for the 12 months ending August 1941 amounted only to 7,879,000 bushels, or less than 4 percent of the 1914-1918 annual average of 241,573,000 bushels. Of course, the rapidly changing international situation may alter the volume of exports in the near future, but it should be noted that continental European markets, so important during the last war, are now entirely cut off from trade with this country.

Banking and Credit

An immediate and significant financial development induced by the outbreak of hostilities was the marked increase in purchases by the public of defense savings bonds. Total Twelfth District sales of these securities in the week ending December 13, the last period for which complete data are available and the first full week of war, totaled \$6,461,800 compared with an average of \$4,603,800 in the preceding four weeks. Sales of the Series E bonds, purchasable only by individuals, jumped to \$4,290,100 in the week ending December 13, almost twice the average of \$2,310,700 for the preceding four weeks.

During the three weeks ending December 22, the principal changes evident in the condition statements of weekly reporting member banks largely constituted a continuation of the trends of the recent past. For over two years prior to December 7, these banks had experienced an active demand for loans, particularly for commercial and industrial purposes, and had added considerably to their investments in Government obligations. In the past three weeks, loans for commercial and industrial purposes increased \$14,000,000 further to \$511,000,000 on December 24. Loans to finance transactions in securities and in real estate continued about unchanged as did advances in the "other" loan classification. Loans in this last classification consist largely of personal loans and of loans secured by consumers durable goods, repayable in installments, and have been maintained in recent months at the high level attained last August, immediately prior to the effective date of regulation of consumer installment credit. Investments in Government securities increased \$53,000,000 in the three week period, largely reflecting participation of district city member banks in the December 15 financing of the United States Treasury. Total allotments made on local subscriptions submitted by banks and other investors to the \$1,000,000,000 additional offering of the 2½ percent bond issue of 1967-72 and to the \$500,000,000 offering of a new issue of 2 percent bonds of 1951-55 amounted to \$82,833,000. It is interesting to compare the coupon rates on these issues, which were substantially oversubscribed, with the rates on the first major financing by the United States Government in the

last war. The First Liberty Loan issue, floated in 1917, consisted of bonds callable in 15 years and maturing in 30 years, and carried a rate of 3½ percent.

Reflecting the expansion in loans and investments of the past two years and also the heavy net disbursements of the United States Treasury in this area, adjusted demand deposits of district member banks increased substantially. On December 3 of this year, adjusted demand deposits of city member banks had increased \$248,000,000 over the total of a year earlier. The volume of these deposits fluctuates rather widely over short periods of time and in the three succeeding weeks they decreased slightly. This decrease reflected a variety of influences including seasonal collections of taxes by local governments and the deposit of a large share of these collections in time accounts. In addition, payments by investors other than banks for subscriptions to Government securities, both defense savings bonds and the December 15 market issues, and heavy withdrawals of cash by the public for Christmas shopping and other purposes were important factors.

In the case of reserve balances of district member banks carried with the Reserve Bank and the factors that affect these balances, no significant departure from their course during recent months attributable to the outbreak of war was evident during the three weeks ending December 24. The aggregate of these balances rose from a daily average of \$579,300,000 in August 1939 to \$961,100,000 in November 1941. The major factor in this increase was the large net disbursements in the area by the United States Treasury which necessitated substantial transfers of funds from other sections of the country to the Twelfth District. These net disbursements substantially exceeded the principal drains made upon local banking reserves during the period which consisted of a net outflow of funds because of interdistrict commercial and financial transactions and an increased demand of the public for currency. The expansion in reserve balances was more than sufficient to keep pace with increasing reserve requirements incident to the growth in deposits, and excess reserves rose from a daily average of \$143,400,000 in August 1939 to \$323,700,000 in October 1941. The increase in reserve requirements ordered by the Board of Governors of the Federal Reserve System, effective November 1, reduced excess reserves by about \$100,000,000 but the excess averaged \$254,600,000 in November.

While member bank reserve balances over the past two years have increased substantially, the rise has been frequently interrupted for short periods, and in the past three weeks they declined slightly. Net United States Treasury disbursements in the district were smaller than in most other like periods recently, largely reflecting increased collections. These larger collections were traceable principally to fourth quarter income tax payments and to payments for allotments to Treasury bonds issued December 15. During this same period member bank reserves were drawn upon to meet an accelerated expansion in demand of the public for currency, a development at least partly seasonal in character. As a result of these two factors, and of a continued net outflow of funds in connection with interdistrict commercial and financial transactions, district member bank reserve balances on December 24 totaled \$943,000,000, moderately lower than the \$973,000,000 reported three weeks earlier.

Summary of National Business Conditions

Released December 20, 1941—Board of Governors of the Federal Reserve System

INDUSTRIAL activity was maintained at a high rate in November and the first half of December and distribution of commodities continued in large volume. Our entry into the war was reflected in a sharp advance in the prices of some commodities, some decline in security prices, and further curtailment of non-military production.

PRODUCTION

Volume of industrial output was sustained in November at the high rate of the previous two months, although a decline is usual at this season. The Board's adjusted index advanced from 163 to 167 percent of the 1935-39 average. In armament and munitions industries, activity continued to increase and in most other lines volume of output was maintained or declined less than seasonally.

Output of materials, such as steel and nonferrous metals, was maintained at about capacity. In the automobile industry activity increased, reflecting larger output of both military and civilian products, and at lumber mills and furniture factories activity declined less than seasonally. At cotton and rayon textile mills activity rose to new record levels, and at woolen mills the high production rate of other recent months was maintained. Less than seasonal declines in output were indicated for shoes and manufactured food products.

Crude petroleum production increased further in November. Bituminous coal production declined somewhat owing to temporary shutdowns at some mines during November, and anthracite production was curtailed as a result of warm weather in some areas and the existence of considerable stocks of coal. Iron ore shipments continued in large volume until the shipping season closed in December; during 1941 about 80 million tons of ore were brought down The Lakes as compared with the previous record of 65 million tons in 1929.

Following a declaration of war by this country in early December further steps were taken to curtail output of nondefense goods using critical materials. Output quotas for passenger cars and household appliances were greatly reduced and cessation of output of some other products was ordered as of the end of January. Also, the production and sale of new automobile tires and tubes for civilian use were halted temporarily.

Value of construction contracts awarded in November declined sharply from the high level of other recent months, according to figures of the F. W. Dodge Corporation. Awards for privately-financed construction decreased more than seasonally and contracts for publicly-financed projects also declined following a continued large volume of awards since last spring.

DISTRIBUTION

Volume of retail trade increased in November following some decline in the previous month. Department store sales, as measured by the Board's seasonally adjusted index, advanced to 115 percent of the 1923-25 average as compared with 105 in October and 116 in September. Larger sales in November were also reported by variety stores. Sales of automobiles increased somewhat, according to trade reports, but, as in other recent months, new car sales were smaller than output and dealers' stocks rose further. In the second week of December department store sales rose less than seasonally, particularly in the coastal regions.

Freight-traffic on the railroads continued in large volume in November and the first half of December. Grain shipments increased considerably and loadings of miscellaneous merchandise, which includes most manufactured products, were maintained at the high level reached several months earlier. Coal loadings declined somewhat, owing in part to temporary shutdowns at some mines. Shipments of most other classes of freight decreased less than is usual at this season.

COMMODITY PRICES

Following the entry of the United States into the war, prices of grains, livestock, and foods rose sharply. Prices of most industrial materials traded in the organized markets, being limited by federal regulation, showed little change. Further measures to curb advances in wholesale prices were soon announced for wool, shellac, and such imported foods as cocoa, coffee, pepper, and fats and oils.

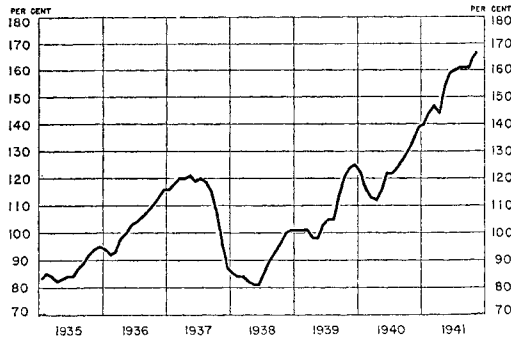
Retail food prices, as measured by the Bureau of Labor Statistics index, increased 1½ percent further from the middle of October to the middle of November to a level 18 percent above a year ago. Indications are that retail prices of both foods and other commodities continued to rise in December.

BANK CREDIT AND GOVERNMENT SECURITY MARKETS

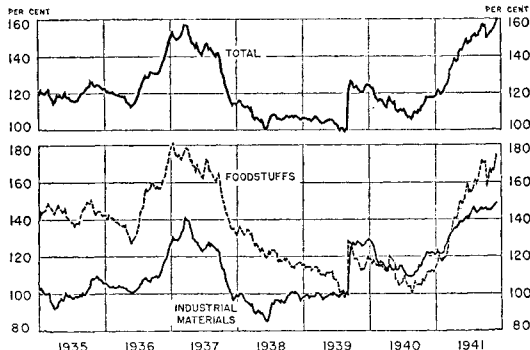
Total loans and investments at banks in leading cities continued to advance during November and the first two weeks of December, owing mostly to increased holdings of Government securities at banks outside New York City. Commercial loans, after showing little net change in November, again increased sharply in the first two weeks of December.

Excess reserves increased through most of the period as a result of Treasury expenditures from Reserve Bank balances, but declined sharply on December 15 when these balances were replenished in connection with the issue of 1.6 billion dollars of Government securities. Money in circulation has continued to increase.

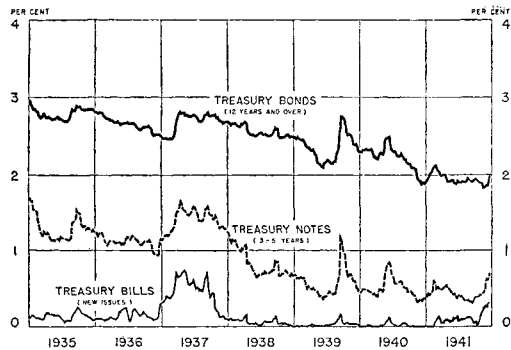
The yield on 2½ percent United States Government bonds of 1967-72, which reached a record low level of 2.32 percent on November 5, advanced somewhat in November and, after the entry of the United States into the war, rose to 2.50 percent. The yield on Treasury notes of December 1945 advanced to 0.93 percent on December 17, compared with 0.62 percent on September 15, and the rate on three month bills rose to .295 percent.



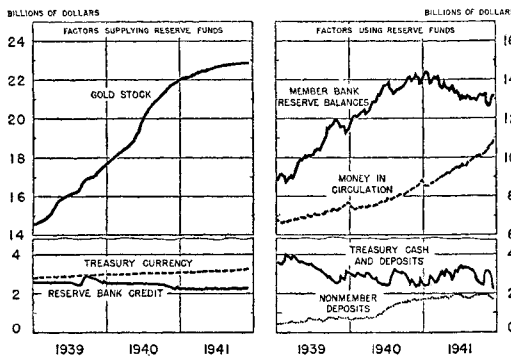
INDUSTRIAL PRODUCTION
Federal Reserve index of physical volume of production, adjusted for seasonal variation, 1935-39 average=100. By months, January 1935 to November 1941.



WHOLESALE PRICES OF BASIC COMMODITIES
Bureau of Labor Statistics' indexes based on 12 foodstuffs and 16 industrial materials. August 1939=100. Thursday figures, January 3, 1935 to December 11, 1941.



MONEY RATES IN NEW YORK CITY
Weekly averages of daily yields of 3- to 5-year tax-exempt Treasury notes, Treasury bonds callable after 12 years, and average discount on new issues of Treasury bills offered within week. For weeks ending January 5, 1935 to December 13, 1941.



MEMBER BANK RESERVES AND RELATED ITEMS

Wednesday figures, January 4, 1939 to December 10, 1941.