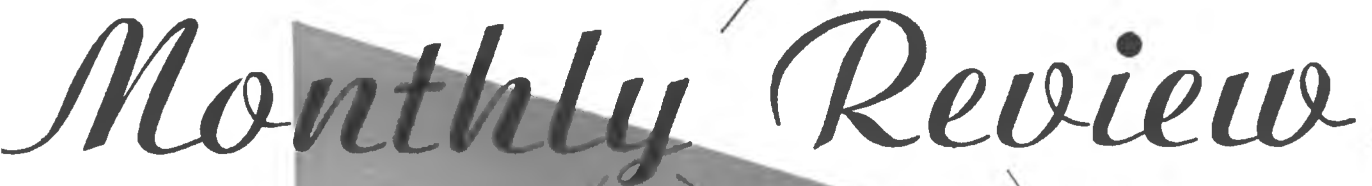

Monthly Review

TWELFTH FEDERAL RESERVE DISTRICT

FEDERAL RESERVE BANK OF SAN FRANCISCO

September 1956

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REVIEW OF BUSINESS CONDITIONS

After a brief hesitation in July the level of total business activity in the Twelfth District rebounded sharply in August and from all indications will rise further in September. The July hesitation was compounded of the direct and indirect effects of the national steel strike, strikes in some other District industries, and a lag in the usual seasonal upswing in the processing of food products owing to late harvests in some areas. These depressing forces were no longer operative in August and significant gains were registered in other lines of activity. Employment in metal and metal product lines rose sharply in August, following the July strike, and job losses were restored in metal fabricating lines where steel shortages had slowed operations. Aircraft employment, which has been rising steadily for the past fourteen months, recorded a sizable gain from July to August in plants in both California and Washington. Most other industrial lines will undoubtedly show gains more or less in keeping with the rise in over-all activity when complete data become available. The major exceptions to this picture of rising levels of economic activity are in residential construction and in the very important District lumber and plywood industries. Recent cutbacks in auto assembly are related to factory shutdowns for new model conversions, and a sharp rebound in jobs may be expected when production of 1957 cars is initiated.

The underlying economic situation would appear to be one of continuing substantial strength. This is evident in both the moderate effect of the steel strike during July and the apparent sharpness of the rebound in August. While shortages of basic steel items have been intensified, there does not appear to have been any significant slowing in the construction of new productive facilities or in intentions to proceed with announced expansion plans. Wage increases negotiated in the steel industry and the subsequent rise in rates of pay in other lines will augment consumer incomes and, barring a radical shift in buying attitudes, will place an upward pressure on retail markets. With business and consumer demands high and rising and with backlogs of needed community facilities growing larger, the existing basic strength of the economy seems likely to continue.

As mentioned earlier, there are two major segments that have shown a significant decline from year-ago levels in activity, which is exceptional in an economy showing such strong expansionary tendencies. The fundamental causes of the lowered level of activity in the two areas, residential construction and lumber and plywood, are the same since it is the level of activity in house building that largely determines conditions in the market for lumber products. Conditions in housing markets have received much attention as the reduction in the rate of new housing starts is nationwide and involves all areas to a greater or lesser degree. The factors most commonly cited as contributing to the lower level of housing activity are mortgage money tightness and sharply increased costs of construction. Money market tightness has grown recently, as evidenced by the continued rise in interest rates, which has further reduced the availability of funds for mortgages — particularly fixed-rate governmentally assisted mortgages. Construction costs also are still rising as wage rates go up and added demands for materials other than lumber cause further price advances.

In an attempt to stimulate the building of new housing the Housing and Home Finance Agency announced, on September 20, some easing in terms for moderately priced homes. This action involved the lowering by 2 percent of the down payment minimum under FHA insured mortgages for houses costing less than $9,000. In addition, the action also made some additional funds available by raising borrowing limits of savings and loan associations from Federal Home Loan Banks and by easing the requirements for the sale of mortgages to the Federal National Mortgage Association (FNMA). Whether or not this easing will actually result in a significant increase in new housing starts will depend largely upon lenders' reactions, and these will take some time to manifest themselves.

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Lumber and plywood markets show increasing softness

The markets for the output of District lumber and plywood mills have shown signs of considerable weakness throughout most of the current year. New order receipts, shipments, and production are all off from last year for the first seven months and prices have slipped markedly for some types and grades. Market weakness stems from the sustained slide-off in the construction of new residential housing throughout the nation. In July, the number of new privately financed nonfarm housing starts was 1.1 million units at a seasonally adjusted annual rate which compares with a rate of 1.4 million units in June 1955, a decline of more than 20 percent. This loss in the number of units put into construction has had a major impact upon the demand for District lumber output. District lumber products are used extensively in new house construction and for some types and grades this use is nearly the sole source of demand.

The three principal lumber producing regions in the District have been affected in varying degrees by the slump in new residential construction. Hardest hit have been the producers of Douglas fir lumber, whose shipments for the first seven months fell 7 percent behind the same period last year. New orders for Douglas fir have fallen even more, 9 percent, while output has declined by the same degree as shipments. Recent official price quotations are unavailable, but industry sources report prices for random length green dimension construction lumber down some 18 percent in early September from prevailing prices in the opening months of the year. Western pine and redwood producers have been somewhat less affected by developments in residential construction nationally. These woods are not used quite so extensively in housing construction alone and in addition are used in housing for doors, cabinets, and decorative purposes. The latter factor is of substantial importance as the pronounced tendency for new house buyers to demand larger houses and higher quality construction, including more extensive use of natural woods, has cushioned the decline in demand to some extent. Redwood shipments in the first seven months were off only slightly from a year ago (less than 1 percent) and western pine shipments fell 5 percent in the same period. Price weakness has not yet been noticeable, although a decline in new orders of 7 percent in western pine and 11 percent in redwood may be indicative that some softness may soon develop.

Plywood producers are facing roughly the same situation as are the operators of the lumber mills. Price weakness is more pronounced for plywood than for lumber generally. In the third week of September the price (per thousand square feet) of the so-called index grade (¼ inch interior) fell to $67, which is $21 below the price this grade commanded last spring. Plywood prices have typically been extremely volatile in the past and apparently are undergoing another sharp swing. A considerable part of this volatility stems from the fact that the industry does not maintain producers' stocks that could serve as a buffer against wide shifts in demand. In addition, capacity may have expanded beyond the ability of the market to absorb the large new supplies within the recent range of prices.

Reversal of inventory and price trends in District petroleum

The District petroleum industry has been plagued for a long time with recurrent imbalances in stocks of refined petroleum. The industry currently appears to have completed its most recent full cycle of inventory change. In the late summer of 1954 total petroleum stocks reached an unusually high level, which resulted in a break in prices in June and July of that year. The demand for West Coast fuel oils was expanded sharply as the result of reduced prices and the severe weather in the eastern states in the winters of 1954-55 and 1955-56. This outward movement of petroleum (largely residual fuel oils) continued in some measure through the first quarter of the current year. Since the first quarter of this year, however, stocks have been increasing, although in moderate amount. Prices have firmed and in July were nearly 12 percent ahead of July last year and were almost 16 percent above the low point reached in late 1954.

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The volume of crude oil imports has continued to expand at a fairly rapid pace. In the first six months of this year crude oil imports reached a rate of 153,000 barrels per day compared with 75,000 barrels per day during the corresponding six months of 1955. This doubling in the rate of crude oil importation reflects in part the opening late last year of the new refining facilities in Washington that utilize crude oil from Canada. Imports to this area are likely to continue to grow as additional refining facilities now under construction are brought into operation. In the absence of the development of substantial new crude oil production (particularly high gravity) within the District, added imports will also be needed to satisfy the growing markets resulting from the vast industrial expansion and population advance in all District states. Since technical processes for refining the predominantly heavy crudes produced in this District are not subject to rapid change, imports of light crudes from areas outside the District will still be needed to secure a balanced supply of refined products.

The current crisis over the Egyptian nationalization of the Suez Canal will have only a remote effect upon the Twelth District petroleum industry. It is conceivable, however, that some added demand for local oil supplies will be felt. This will come through the increased shipment of oil from the Gulf Coast areas and Middle Atlantic states to European countries, leaving a possible shortage for consumers in the eastern United States. While producers in these areas are likely to increase production somewhat to accommodate European needs, there is some possibility of California producers being called upon to supply more oil to markets in the eastern states, especially should the weather in that area be colder than average during the coming fall and winter seasons. This would be a factor in delaying any excessive build-up of residual fuel oil stocks by District producers and would alleviate the severity of the recurrent cycle in inventories mentioned earlier.

Nonferrous metals exhibit mixed trends

The demand for District output of all the nonferrous metals continues exceedingly strong. This is not surprising in view of record industrial production and the sharp increase in business expenditures for new plant and equipment. Employment in District nonferrous metal mines is substantially above year-ago levels even after allowance is made for the effect of strikes which interrupted activity during the summer of 1955. District mine production of recoverable copper and lead in the first 7 months of this year was up 14 and 1 percent respectively from the identical period last year. Zinc production in terms of recoverable metal was off some 5 percent, reflecting in part the long-term trend toward a lower metallic content of a given volume of ore.

Prices, contrary to the general rising trends in activity at District mines and mills, show somewhat divergent trends as between particular metals. Aluminum producers in mid-September were receiving 27.1 cents per pound for the primary metal, which compares with 24.4 cents per pound at the same time a year ago. Lead and zinc prices, up only one cent and one-half cent per pound respectively from last year, have been steady with no indication of pressures developing for a change either up or down. The price of copper, however, has shown a fairly sharp decline since June, which has lowered the per pound quotation from 46 cents to 40 cents by mid-September. It should be recalled that much of the rise in copper prices between January 1955 and June of this year, from 30 cents per pound to 46 cents per pound, was induced by supply shortages following major labor disputes here in the District as well as in other domestic and foreign operations. The pressure stemming from uninterrupted world production was the primary cause of the July break in prices and the subsequent downward movement since then. However, recent new labor difficulties in the large copper mines in Northern Rhodesia, combined with some disruption of normal ore movements stemming from the Suez Canal dispute, are factors adding strength to copper prices currently. Whether or not this combination of events will create sufficient pressure to cause the price to rise once again will depend upon the duration of the interruption to the normal flow of the metal into productive and distributive free world channels.

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Recent Developments in the Money and Capital Markets

During the late spring and early summer, our economy seemed to have come to a halt in its long postwar expansion. With interest rates and stock prices dropping, with industrial production and profits easing off, with new housing starts on the decline and inventories building up to ever higher levels, some people began to wonder if the long postwar boom and inflation had begun to falter. Today it seems clear that this was only a momentary pause and that the basic movement of the economy is still upwards. Inflationary pressures and possible boom-period excesses, rather than any likelihood of a recession, appear to remain the chief dangers ahead, at least for the immediate future.

It may be of interest to consider both the reasons for this change in outlook and the nature of the problems that monetary policy currently has to deal with. A review of recent developments in the money and capital markets will provide a convenient starting point for the analysis.

The money market

Total outstanding loans of commercial banks increased about $4 billion during the first half of 1956, nearly three-fourths of the increase or $2.9 billion being in the form of business loans. The months of March and April alone saw an increase of about $2.7 billion in total bank loans by commercial banks. As a result of this large demand for credit, money market rates soared in April to their highest levels since the early 1930's. During May and June, the increase was about $2.3 billion; but during July there was a decline of about $0.2 billion. This decline undoubtedly reflected the steel strike as well as the normal summer lull in business activity. Since the latter part of July there has been a pronounced increase in loans to business, amounting probably to well over $600 million. The end of the steel strike and the beginning of the usual fall pickup in business activity probably share responsibility for this increase, but there has also been another important factor, which will be discussed below; namely, business borrowing for capital expansion purposes. Reflecting these changes in borrowing, short-term interest rates declined appreciably between April and July and then rose sharply during the late summer to new highs.

The magnitude of these changes may be better appreciated by considering some individual interest rates. That on outstanding Treasury bills, for instance, which had risen to a 14-year high of 2.76 percent in April and then dropped to as low as 2.24 percent in July, reached a new high of 2.95 percent on September 19. The rate on 90-day bankers' acceptances, which dropped 1/8 percent in June, recovered this the following month and then tacked on another 3/8 percent in August to reach 2 7/8 percent. The rate on 4-6 months prime commercial paper reached 3 3/8 percent in May, dropped to as low as 3 1/8 percent in July, and then rose to 3 1/2 percent. Ninety-day time money, which was 3 1/4-3 1/2 percent in April has risen 3/4 percent since then. The prime bank rate, which was 3 1/2 percent early in the year, was raised 1/4 percent at the end of April and another 1/4 percent last month to 4 percent, the highest level since the early 1930's. The other money market rates have generally followed one of these two patterns this year—either a persistent rise or else an increase until April, followed by a small decline, and then a resumption of the rise during the late summer.

Federal Reserve policy actions have been guided by these major developments in the money markets, although with adjustments to meet customary variations in reserve needs of a seasonal or temporary nature. The general policy of credit restraint that the System had pursued during the previous 12 months was continued through the summer. However, reserves were supplied to the banking system in June and again late in August to meet seasonal needs for additional credit (including the demand for tax payment purposes in June). The volume of member bank rediscounting increased rather sharply around the beginning of August and has

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since leveled off at roughly the average for the past year. Excess reserves of member banks dropped to $448 million on September 5, which is nearly as low as they ever go. However, in the succeeding two weeks they were above $700 million, largely as the result of an increase in float.

The capital market

Long-term interest rates in the capital market generally fluctuate much less than the short-term rates in the money market, and the spread between the two sets of rates has greatly narrowed during the past two years. Nevertheless, their patterns of movement have been fairly similar. In April most of the long-term rates reached their highest levels since 1953 and were nearly as high as they were in the early 1930's. They sagged a bit during May and June but then resumed their rise and by August were at new highs. For instance, the average effective yield on United States Government bonds callable in 12 years or more, after rising early in the year to a high of 3.12 percent in April, dropped to 2.97 percent in June. It has risen almost steadily since then, reaching a level of approximately 3.25 percent during the middle part of September. Moody's index of Aaa corporate bond yields rose from 3.07 percent in March to 3.31 percent early in May, remained close to that level for two months, and then soared to 3.6 percent in September. The effective rates on new bond issues have been going up too, of course. In recent weeks new issues by large corporations have generally carried tabs of 4 percent or more; for example, $73 million in debentures of the Pacific Telephone and Telegraph Company sold at a 4.23 percent yield in August, and $30 million in debentures of the Associates Investment Company will pay 4½ percent.

The rising interest rates in the capital market reflect a shortage of savings relative to the growing demand for long-term funds. Some corporations have been deterred from issuing new bonds by the prevailing high interest rates. Among the announced issues that have been cancelled or postponed recently have been $30 million by the Consolidated Natural Gas Company, $20 million by Wilson and Co., and $40 million by Southern California Edison Co. Still others have been reduced in amount before being offered to the public. In some cases, firms that have withdrawn proposed bond issues have been able to obtain the needed funds from banks instead. In other cases, however, there have probably been cancellations or postponements of expansion plans for which the funds had been intended.

One of the most significant recent monetary developments has been the tendency for corporations needing funds for capital expansion to obtain them from banks rather than through security issues. Bank loans are normally for much shorter periods than bond issues, of course, and do not enable the borrowers to complete long-term investment programs. Nevertheless, the borrowing firms hope and presumably expect that conditions will ease in the capital market soon, enabling them to issue bonds at more favorable rates and then repay their bank loans. Data on the volume of bank lending for plant and equipment expenditures are not available, but the amount is probably considerable.

Despite the high interest rates, new corporate security issues reached a record high of $3.0 billion during the second quarter of 1956. Of this amount, $2.3 billion consisted of bonds and notes (the remainder being common or preferred stock), which was about the same as in the fourth quarter of last year and the third quarter of 1954, but considerably more than in any other recent quarter. This figure of $3.0 billion may be compared with one of $2.2 billion for the previous quarter and $2.4 billion during the second quarter of last year. Preliminary figures for July and August indicate that around $2.2 billion in new capital was raised through security offerings, about 22 percent more than during July and August of last year. New issues continued at a high level during September.

Expenditures on plant and equipment

These developments in the financial and money markets have been closely connected, of course, with the level of business activity and in particular with business expenditures.

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Business expenditures on plant and equipment have been one of the principal props of our present boom. Such expenditures amounted to about $7.5 billion during the first quarter of 1956, as compared with $5.8 billion during the first quarter of last year. For the second and third quarters of this year, they have been estimated by the Securities and Exchange Commission and the Department of Commerce at $8.9 and $9.6 billion respectively. During the comparable periods of last year, they amounted to $7.0 and $7.4 billion. For the entire year 1956, the total is expected to come to around $35 billion, an increase of some $6 billion from last year's record level. Most of this increase has been in the field of manufacturing, although all other main branches of the economy have shared in it to some extent, too.

The greater part of plant and equipment expenditures is financed out of the internal resources of business firms, that is, out of retained earnings and depreciation allowances, and hence does not directly involve the capital market. Nevertheless, during the first half of this year nearly $3 billion out of the $16.6 billion in new plant and equipment expenditure was financed through security issues. An additional $2.2 billion was raised in this way for working capital, debt retirement, and other purposes. Of this total of $5.2 billion, $4 billion was in the form of bonds and notes, the remainder being stock. In addition, more than $3 billion in new state and municipal bonds was sold. The volume of debt issues, therefore, is large enough to have an appreciable effect on expenditures. Any serious curtailment of such financing would very likely curtail expenditures too, unless the funds could be raised from alternative sources.

Another type of business expenditure which depends to an important extent on borrowing is inventory accumulation. Total inventories in manufacturing and trade have been increasing steadily (on a seasonally adjusted basis) since the beginning of last year. At the end of July 1956 they amounted to $85.7 billion, an increase of $6.5 billion or 8.2 percent in the past year. This increase in inventories is probably greater than is warranted by the increase in business activity. To some extent it undoubtedly reflects the speculative accumulation of goods in anticipation of higher prices. Since fluctuations in inventory holdings provide one of the main sources of instability in our economy, their excessive expansion through the use of bank credit is undesirable.

Monetary policy

Events of the past few months have thus made it clear that we are still in a period of strong inflationary pressures. With the economy operating at nearly full employment and with its productive resources already taxed to the limit in most fields, any further large increases in expenditures will be reflected not in increased production but in higher prices. A rising price level is undesirable, of course, on several grounds: It eats away the real value of savings and fixed incomes; it disturbs the social order by benefiting some groups and individuals and injuring others; it tends to give businessmen an exaggerated impression of prosperity and profits, leading them to make over-optimistic plans for new investment. Our present monetary policy, therefore, is concerned mainly, as it has been during the past year, with the need for restraining inflationary pressures.

The immediate aim of such policy is to hold down over-all expenditures to the level of available supplies, which in some fields are inadequate to meet all current demands. As has been noted, a large and in recent months increasing amount of expenditures has been financed through borrowing—either from banks or in the capital market. If such borrowing can be limited, it may be possible to hold down spending sufficiently to prevent further price rises. This does not necessarily mean that total expenditures should be reduced; it will probably suffice to restrain the rate of increase somewhat. Exactly how much credit the economy needs to keep functioning at a high level of activity but without inflation, over-investment, or speculative excesses cannot be determined in advance. However, there are no clear indications that credit has been unduly restricted so far. The available evidence—the rise in prices, the continued rapid increase in lending, both by banks and others, and in new capital expenditures, the

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maintenance of a high level of employment and output—all point to the continuance of inflationary tendencies. This situation may, of course, change. If it does, our monetary policy would have to be adjusted promptly. The monetary authorities must remain constantly on the alert to detect basic economic changes or the imminence of such changes.

The Federal Reserve System has the primary responsibility in the field of monetary affairs. The System, however, exerts its influence directly in the limited area of bank credit, which only indirectly influences the capital market and other aspects of the money market. There are, however, close connections between the money market and the capital market. Although the former is a short-term and the latter a long-term market, they are nevertheless alternative sources of funds for some borrowers and alternative outlets for funds of some lenders; and, if left unrestrained, bank credit might be expanded to meet credit demands in excess of current savings. Changes in the relative interest rates and availability of funds in the two markets will lead borrowers and lenders to move from one to the other. Consequently, by restraining the expansion in bank lending and permitting interest rates to rise in the money market, the System can affect developments in the capital market to a considerable extent. For the System to supply additional credit resources in amounts adequate to keep interest rates down in the face of excessive demands would inevitably lead to price inflation.

One way of combating inflationary pressures is for the Federal Reserve System to reduce bank reserves through open market sales. During the past year, open market operations have played a rather passive but nonetheless important part in the anti-inflation program. The System's portfolio of Government securities is today just about the same size as it was a year ago. However, since the demand for credit has considerably increased, holding the supply fairly constant has acted to tighten credit conditions and raise interest rates.

Changes in the rediscount rate have perhaps been used more actively and deliberately as a means of combating inflation during the past year and a half. Six general raises have occurred within this period, bringing the rate up from 1½ percent to 3 percent. Raising the rate which the banks must pay when they borrow from the Federal Reserve Banks normally leads them to raise the rates which they charge to their customers, thereby possibly discouraging some borrowers. However, this may not entirely prevent inflationary excesses from developing. During a boom period, a great many business opportunities are or seem to be so promising that a small rise in interest rates will not discourage them. But if the rates continue to climb, eventually they are bound to reach a level where much borrowing will be postponed in the hope that they will soon drop. The considerable number of proposed bond offerings that have been withdrawn recently indicate that such results are being obtained.

There has been some discussion lately as to whether the credit situation has been tight because of the actions of the Federal Reserve System or because of natural market forces. Raising the rediscount rate does not in itself reduce the supply of loanable funds unless the banks decide to do less rediscounting as a result. If the banks have been unable recently to meet all demands for credit, it is not because the System has curtailed their ability to lend but because the demand has been increasing. With the banks' excess reserves down to about what seems like a practical minimum, no further substantial increase in bank lending is likely unless the Federal Reserve provides them with additional reserves.

There are at least four reasons why the demand for bank credit has been growing recently: (1) The long-run growth and development of the economy which may be expected to require a gradual, but continuing, increase in bank lending of several percent each year; (2) seasonal factors, which normally necessitate a substantial rise in credit during the late summer and fall; (3) the pickup in business activity in many industries, following the end of the recent steel strike; (4) continuance and even intensification of the postwar boom, which has been responsible for increased expenditures on plant and equip-

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ment, inventories, housing and many other types of consumer expenditures as well as for a growing need for working capital. While the first three of these factors may be considered normal and desirable, the fourth one raises the danger of possible excesses. History shows that when an economic boom goes too far and too fast, there will eventually be a collapse and a period of painful readjustment.

The problem facing the Federal Reserve System today, therefore, is how to permit sufficient increase in credit to meet normal seasonal and growth needs without at the same time allowing inflationary and speculative excesses to develop. Unfortunately, a complete solution to this problem is always difficult. It is conceivable that credit may be excessive in certain sectors of the economy and insufficient in others. For instance, in recent months the housing market has been hampered by a shortage of mortgage money and many short-term borrowers have had difficulty in obtaining bank loans, while at the same time considerable amounts of bank credit have been used to help finance the rise in plant and equipment expenditures. Indeed, some concern has been voiced recently over this use of short-term bank loans for long-range investment purposes. A potential danger in this situation is that if capital expansion is permitted to proceed too rapidly relative to the demand for consumer goods, businessmen may find themselves some day with excess productive capacity on their hands. In that case, there would probably be a sharp drop in expenditures on new plant and equipment, which could set off a general decline in business activity.

In the absence of selective credit controls, the Federal Reserve System does not have the power (except with respect to purchases of securities on margin) to direct credit into or away from particular sectors of the economy in order to keep them developing in harmony with each other. Whether or not it would be desirable to give the System such power is a much-debated question and one that is currently under study with respect to one important type of loans, those to consumers.

In the meantime, the Federal Reserve System must try to regulate the over-all amount of credit in such a way as to avoid either a general excess or a general deficiency, hoping that the free workings of the economy will direct this credit into the proper channels. To provide just the right total amount of credit will require a constant and careful attention to changes in the economic currents, a determination to be guided by those currents rather than by political pressures or particular interests, and avoidance of a rigid or doctrinaire attitude.

Personal Income in the Twelfth District, 1955

ANNUAL estimates of personal income by state recently published by the Department of Commerce indicate the strength of the Twelfth District economy during the 1955 recovery and boom.[1] Total personal income in the District reached $42 billion in 1955, about 8 percent above 1954, as compared with a 7 percent rise in the country as a whole. As shown in Table 1, all states in the region shared to varying degrees in the rise. Nevada had the largest percent increase (13 percent) in the region and one of the largest nationally. Washington and Idaho both registered 4 percent gains, the smallest in the District. Personal income in California increased 8 percent.

Quarterly estimates of personal income compiled by the California Department of Finance indicate a continued upward trend in that state's income during the first half of 1956. (California accounted for about seven-tenths of total District income in 1955.) California personal income, seasonally adjusted at annual rates, rose 6 percent in the first quarter and 9 percent in the second quarter, relative to 1955. The sub-

[1] This article is based primarily upon the estimates which appear in the United States Department of Commerce, *Survey of Current Business*, August 1956, pp. 8 ff. For a more complete review of employment and output developments underlying the changes in personal income in 1955, see the February 1956 issue of the *Monthly Review*, pp. 18-29.

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stantial increase in the second quarter of this year was accounted for by increases in all major types of income. Wage and salary receipts showed the largest rise. Proprietors' income made only a moderate gain, reflecting a continued decline in farm income which was more than offset by a rise in nonfarm proprietors' income.

Both the District and national increases in total personal income in 1955 reflect a decline in farm income which was more than offset by an increase in nonfarm income. The percentage decline in farm income in the District was significantly smaller than in the country as a whole. At the same time, non-farm income increased relatively more in this region than nationally. Government income disbursements, as well as wage and salary payments by major industries, also showed larger percentage increases in the District.

Per capita personal income in the District was 14 percent above the national average in 1955, but the 1954-55 rise in District per capita income (4 percent) was smaller than the national increase (5 percent). The slower growth of District per capita income, in spite of a greater than national rise in total personal income, reflects the offsetting influence of more rapid population growth in this area. District population increased by 4 percent during 1955, while the nation's population increased by only 2 percent. Table 2 shows that Arizona was the only state in which per capita income declined, and this, too, reflects a substantial rise in population. California had the largest percentage rise in the District and was the only state which matched the national percentage increase.

District has smaller percent decline in farm income than nation

Farm income in the nation declined by 5 percent from 1954 to 1955, but the District decline was only 1 percent. However, there was a great deal of variation among the states. Arizona farmers, registering the largest relative decline in the District, experienced an 18 percent drop in their incomes. Washington farm income was down 9 percent, while Idaho and Utah showed substantially smaller declines. California farm income, on the other hand, rose 3 percent. Farm

TABLE 1
PERSONAL INCOME
TWELFTH DISTRICT AND UNITED STATES, 1954-1955
(in millions of dollars)

Area	1954	1955	Percent change 1954-55
Arizona	1,486	1,588	+ 7
California	27,148	29,438	+ 8
Idaho	861	895	+ 4
Nevada	506	572	+13
Oregon	2,903	3,090	+ 6
Utah	1,146	1,238	+ 8
Washington	4,963	5,179	+ 4
Twelfth District	39,013	42,000	+ 8
United States	284,747	303,391	+ 7

Source: United States Department of Commerce, *Survey of Current Business*, August 1956.

incomes in Oregon and Nevada showed no change from 1954 to 1955.

The District decline in net farm income from 1954 to 1955 was marked by practically no change in gross cash farm receipts and an increase in farm production costs. In general, decreases in farm prices of crops, livestock and livestock products, and a small decline in crop output were offset by a substantial rise in the output of livestock and livestock products. Moreover, the price of beef cattle, one of the region's more important farm commodities, declined only slightly on the Pacific Coast. Some of the larger declines in crop output reflect the pressure of acreage allotments and marketing quotas during the year—District food grain output (especially wheat and rice) was 12 percent lower than in 1954 and cotton output dropped 19 percent. Owing in part to more favorable growing conditions, output of fresh vegetables and deciduous fruits increased substantially in 1955. Slaughter of beef, sheep, lambs, and hogs also rose significantly.

These developments in vegetables, deciduous fruits, and beef cattle account in large part for the rise in farm income in California. From 1954 to 1955, California cash receipts from livestock showed no change, while cash receipts from crops (especially truck crops, peaches, walnuts, etc.) rose significantly. On balance, total cash receipts from farm marketings in California rose 4 percent in 1955.

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Nonfarm income shows larger percent gains in District than in nation

Nonfarm income rose 8 percent in the Twelfth District and 7 percent in the nation from 1954 to 1955. All major areas of nonfarm income showed stronger gains in this region than in the nation generally. Movements among the District states, however, were markedly dispersed. Arizona and California were the only states that had larger relative gains in all major sources of income than the nation.

Government income disbursements in the District during 1955 increased 6 percent, compared with 5 percent nationally. Arizona showed the largest percent gain (13 percent) and California was second (6 percent). Utah's relative increase (3 percent) in government receipts was the smallest in the region.

Manufacturing wage and salary disbursements showed the largest percent increase among major industries in the District. Manufacturing payrolls increased 13 percent in this region and only 9 percent nationally. Arizona again showed the largest relative gain (23 percent). California wage and salary receipts, which account for nearly three-fourths of the District total, increased 13 percent in 1955. All other District states had 12 percent increases.

Available data indicate that the increase in District manufacturing payrolls reflects substantial rises in most types of industrial production.

Table 2

Per Capita Personal Income
Twelfth District and United States, 1954-1955
(in dollars)

Area	1954	1955	Percent change 1954-55
Arizona	1,598	1,577	—1
California	2,170	2,271	+5
Idaho	1,440	1,462	+2
Nevada	2,387	2,434	+2
Oregon	1,762	1,834	+4
Utah	1,504	1,553	+3
Washington	1,964	1,987	+1
Twelfth District	2,033	2,110	+4
United States	1,767	1,847	+5

Source: United States Department of Commerce, *Survey of Current Business*, August 1956.

Judging from employment data, aircraft production and automobile assembly operations increased significantly in 1955. Steel ingot production rose from its 1954 recession level almost to its 1953 peak. Iron ore production showed a sizable increase above its 1954 recession level. Nonferrous metal output also rose substantially in the District. Despite a significant work stoppage in the industry, lumber production in 1955 was higher than in 1954. District canners experienced a record production year, combined with higher prices to offset higher costs.

Wage and salary disbursements in trade and service industries increased 11 percent in the District, in comparison with an 8 percent increase nationally. All states in the District had larger relative increases in trade and service payroll disbursements than the nation, but Nevada showed the largest gain (27 percent). This was a major factor in explaining that state's rise in total personal income.

Despite fluctuations in building activity—particularly residential building—during the year, wage and salary receipts in contract construction in the District increased 11 percent over 1954. This compares with a 7 percent increase nationally. Construction in the region was marked by a continuation of the early 1954 upswing and the beginning of a downswing in the late summer of 1955. Building activity was further depressed near the end of 1955 by a work stoppage in the Los Angeles area. All District states, except Washington, shared in the District increase. Construction payrolls in Washington fell 6 percent. Utah had the largest percentage rise in the region (34 percent). Construction payrolls in both California and Arizona increased 14 percent.

In conclusion, the slightly larger percentage increase in total personal income in the District than in the nation during 1955 is explained by (1) particular economic developments during the year; (2) differences in economic structure between the District and the nation; and (3) to some extent, the significantly larger rate of population growth in this region than in the country as a whole. The smaller rate of decline in farm income in the District than in the nation is largely accounted for by the fact that although,

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in general, prices of the more important farm commodities produced in the region declined only slightly during the year, the output of many of them rose. The larger than national percentage increase in District nonfarm income reflects, in part, developments in the more important regional industries—aircraft, food and kindred products, construction, and trade and services.

Net Profits of District Member Banks Rise

During the first half of 1956 Twelfth District member banks made net profits after taxes of $88.4 million. This represents an increase of 19.5 percent over the net profits earned in the first six months of 1955, and is the largest amount for any half-year period since semi-annual income data for all District member banks were first compiled in 1948. The record profit reflected mainly a substantial rise in operating earnings that was not offset by a commensurate rise in expenses or net losses, charge-offs, and transfers to valuation reserves. The banks' provisions for taxes on net income also contributed toward the retention of larger profits by member banks, since taxes (though higher than in the first half of 1955) did not increase at as fast a rate as net profits before taxes.

Substantial increase in earnings on loans

Total operating earnings of District member banks reached a record high of $480 million during the first six months of 1956, an amount $56.4 million or 13 percent greater than the previous high in the first half of 1955. The substantial growth in earnings on loans, $52.2 million, accounted for almost the entire increase in total earnings. Earnings from this source reflect both a rise in the average holdings of loans and a generally higher interest rate structure. Commercial and industrial loans, which more readily reflect the general fluctuations in interest rates than do real estate loans, represented a larger proportion of the increase in loans outstanding than was the case in the preceding year. With their demand for funds continuing the upward trend which began in the latter half of 1955, businesses brought their total outstanding debt at member banks to an all-time high level. According to weekly reports from a selected group of leading banks in the District, the most pronounced growth in outstanding debt was made by the metals and metal products producers, public utilities and transportation companies, and wholesalers and retailers. Real estate and consumer loans also rose considerably above the year-ago period.

The continued high level of demand for funds by individuals and businesses, coupled with a policy of monetary restraint on the part of the Federal Reserve System, resulted in a rising interest rate level. Surveys of interest rates on business loans made in March and June indicated that there was a fairly large increase in interest charges on short-term business loans, and it seems reasonable to assume that some other types of loans were also affected. As a reflection of the movement in interest rates and the continued growth in those types of loans that ordinarily carry a higher rate of interest, the rate of return on loans in the District was almost one percent above that for the comparable period last year.

Although the rate of return on United States Government securities was also higher this year than last, the continued reduction in bank holdings of all types of Government securities resulted in an absolute decline in earnings from this source, the first such decrease in five years. In addition to an increase in interest rates on newly acquired securities, there was a shift in the distribution of the member banks' security holdings which helped to increase the rate of return. Longer-term security holdings, while smaller in absolute amounts, were relatively more important than in the year-ago period.

"Other earnings" of member banks showed a moderate increase in the District. While comparisons for each type of earnings are not available, a compilation for the fourteen largest banks[1]

[1] The comparison is made between fifteen banks in 1955 and fourteen in 1956 because two of the fifteen largest banks merged in early 1956 to form one bank. Adjustments have been made for the effects upon the data of this merger and others which involved the fifteen largest banks with respect to the percentage changes cited in this article and in Table 1.

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gives some indication of the probable trends in the "Other earnings" categories. The largest dollar gain occurred in charges on demand deposit accounts. This resulted primarily from an increase in the average level of demand deposits, though a small part may have been accounted for by a rise in the charges levied against the account holders. Trust departments also experienced a substantial rise in returns compared with the year-ago period, indicating a growth in trust accounts. Earnings on securities other than United States Government securities (primarily state and municipal issues) was one of the two categories to show a decline. As in the case of earnings on United States Government securities, these smaller earnings reflect a reduction in average holdings rather than a decline in the rate of return.

Operating expenses rose less than total earnings

Total operating expenses, while rising above the first half of 1955, did not increase at as fast a rate as total earnings. Consequently, net current earnings had a greater percentage rise (14.2 percent) than did earnings. Detailed expense data were compiled only for the fourteen largest banks. These data indicate that the average amount of compensation paid to officers and employees has continued its post-World War II growth and that the number of employees and officers has increased. The other major expense item, interest on time and savings deposits, has also grown considerably, primarily as the result of higher deposits. The largest percentage increase, however, occurred in interest on borrowed money. This represents money borrowed from the Federal Reserve Bank in the form of discounts on loans and funds borrowed from other banks. Daily average borrowings from the Federal Reserve Bank by Twelfth District member banks were substantially above the year-ago first-half figure as banks borrowed to expand their loan portfolios and maintain their reserve position. These increased borrowings plus the higher discount rates charged by the Federal Reserve Bank and the higher charges for interbank loans by commercial banks account for the sharp increase in this expense category.

TABLE 1

SELECTED EARNINGS AND EXPENSE ITEMS OF MEMBER BANKS
TWELFTH DISTRICT AND UNITED STATES, JANUARY-JUNE, 1955 AND 1956

	Twelfth District					United States percent change
	All banks		Percent change			
	1st half 1956p (in millions)	1st half 1955 (in millions)	All	14 largest	Other	All banks
Earnings on loans[1]	298.9	246.7	+21.2	+22.5	+15.6	+22.5
Interest on Government securities	78.3	79.8	— 1.9	— 3.9	+ 6.3	— 0.5
Other earnings	102.8	97.1	+ 5.9	+ 4.5	+11.9	+ 8.9
Total earnings	480.0	423.6	+13.3	+13.4	+13.0	+14.6
Total expenses	304.5	269.9	+12.8	+12.6	+13.6	+12.7
Net current earnings	175.5	153.7	+14.2	+14.7	+11.9	+17.5
Total recoveries and profits	14.0	11.7	....	....	....	....
Total losses and charge-offs	28.4	25.0	....	....	....	....
Net recoveries and profits	—14.4	—13.3	....	....	....	....
Profits before income taxes	161.1	140.4	+14.7	+16.0	+ 9.1	+10.4
Taxes on net income	72.7	66.4	+ 9.5	+10.8	+ 3.9	+ 7.7
Net profits after taxes	88.4	74.0	+19.5	+20.4	+14.6	+12.8
Cash dividends declared[2]	42.6	39.4	+ 8.1	+ 7.9	+ 9.8	+ 9.1
Undistributed profits	45.8	34.6	+32.4	+36.1	+18.1	+16.3

[1] United States loan earnings figures include service charges and other fees on loans; Twelfth District figures include interest and discount only. Service charges and fees on loans in the Twelfth District are included in "Other earnings."
[2] Figures include common stock dividends only.
p Preliminary.

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Other charges against income show only moderate rise

Net current earnings of District member banks during the first half of 1956 were reduced by $14.4 million through net losses, charge-offs, and transfers to valuation reserves. Those banks which use valuation reserves built up their reserves to compensate for possible losses on their larger volume of loans and to offset possible losses on sales of securities during a period of falling security prices. In addition to transfers to valuation reserves there were the actual losses which occurred as the banks sold off some of their holdings of securities. However, because there was also a growth in the amount of recoveries, profits, and transfers from valuation reserves this year, the net losses, charge-offs, and transfers to valuation reserves were only $1.1 million higher than last year.

Provision for state and federal income taxes also increased by only a moderate amount. Because tax items had a slower rate of increase than did net profits before taxes, realized net profits grew at a faster rate than did total earnings (19.5 percent above the first six months of 1955). Net profits after taxes were at what was undoubtedly a record level in this District, although actual figures for the comparable six-month periods prior to 1948 are not available.

Member banks declared dividends of $42.6 million (48 percent of their net profits) and retained $45.8 million. This is in contrast to the prior year when they paid out 53 percent of their profits in dividends. The net return on capital—the ratio of net profits after taxes to average total capital accounts—increased approximately 1 percent. This increase is a direct result of the rise in net profits, inasmuch as the average capitalization of member banks is greater this year.

Net profits greater for larger-size banks

The fourteen largest banks fared better than the smaller banks with respect to their profit position. Net profits after taxes for the larger banks were 20.4 percent above those made in the first half of 1955 compared with a 14.6 percent gain for the smaller banks. This difference in the growth of net profits after taxes between

Table 2

Earnings Ratios of Member Banks
Twelfth District and United States
(percent ratios, annual basis)

	First half 1956	First half 1955
United States		
Return on loans	4.89	4.68
Return on Government securities	2.29	2.01
Current earnings to capital accounts	18.02	16.20
Net profits after tax to capital accounts	8.38	7.85
Dividends declared to capital accounts	3.88	3.76
Twelfth District		
Return on loans	5.92	5.09
Return on Government securities	2.29	2.07
Current earnings to capital accounts	22.27	21.32
Net profits after tax to capital accounts	11.22	10.26
Dividends declared to capital accounts	5.41	5.46

the large and small banks reflects the different experience of these two groups with respect to expenses and to net losses, charge-offs, and transfers to valuation reserves. Total expenses of the smaller banks grew at a faster rate than for the larger banks, thus offsetting the increase in earnings to a greater extent than in the case of the larger banks. The increase in net losses, charge-offs, and transfers to valuation reserves on loans and securities realized by all District member banks as a group was accounted for by the smaller banks. The fourteen largest banks had the same net loss in these accounts this year as last.

This year both the larger and smaller banks retained one-half or more of their net profits after taxes. In the first half of 1955, however, the larger banks paid out more than half of their profits in the form of dividends. The smaller banks, on the other hand, paid out less than half.

Net profits increased more in the District than in the nation

While in the nation as a whole the experience of member banks was generally the same as for the District, there were some differences in the magnitudes of change. Nationally, the percentage increase in total operating earnings was larger, reflecting a greater rate of growth in earnings on loans and "Other earnings" and a smaller decline in earnings on Government securities. The rate of return on loans rose by a

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smaller amount nationally than in the District; but because of a larger increase in average loan holdings in the nation as a whole, earnings on loans increased at a faster rate than in the Twelfth District. Total expenses increased by about the same percentage as they did in the District so that net current operating earnings increased more in the nation. However, a more favorable experience in net losses, charge-offs, and transfers to valuation reserves in the District resulted in a greater gain in net profits than occurred nationally.

The distribution of profits was the same nationally as in the Twelfth District. Dividends declared amounted to 48 percent of net profits after taxes. The ratio of profits after taxes to average total capital accounts in the nation increased; but, as is customary, it remained considerably below that of the District.

Correction: In Table 2 on page 99 of the August 1956 MONTHLY REVIEW, the subheading "Farms, consumer, etc." under the heading "Other" should read "Transportation, communication, etc."

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BUSINESS INDEXES—TWELFTH DISTRICT[1]

(1947-49 average=100)

Year and month	Industrial production (physical volume)[2]							Total nonagricultural employment	Total mf'g employment	Car-loadings (number)[2]	Dep't store sales (value)[2]	Retail food prices[3, 4]	Waterborne foreign trade[3, 5]	
	Lumber	Petroleum[3] Crude	Petroleum[3] Refined	Cement	Lead[3]	Copper[3]	Electric power						Exports	Imports
1929	95	87	78	54	165	105	29	....	....	102	30	64	190	124
1933	40	52	50	27	72	17	26	....	....	52	18	42	110	72
1939	71	67	63	56	93	80	40	....	55	77	31	47	163	95
1947	97	100	98	96	94	106	90	99	100	106	99	96	129	81
1948	104	101	100	104	105	101	101	102	102	100	104	103	86	98
1949	100	99	103	100	101	93	108	99	97	94	98	100	85	121
1950	113	98	103	112	109	113	119	103	105	97	105	100	91	137
1951	113	106	112	128	89	115	136	112	120	100	109	113	186	157
1952	116	107	116	124	86	112	144	118	130	101	114	115	171	200
1953	118	109	122	130	74	111	161	121	137	100	115	113	140	308
1954	112	106	119	133	70	101	172	120	134	96	113	113	131	260
1955	122	106	122	145	73	117	192	125	141	104	122	112	164	307
1955														
July	119	106	128	157	71	40	191	125	141	99	123	113	171	368
August	123	106	127	160	67	91	196	126	142	106	122	111	189	349
September	118	106	132	159	70	128	196	126	141	107	126	112	174	363
October	116	105	129	155	72	131	197	126	142	104	126	112	152	348
November	110	106	123	128	67	128	206	128	145	98	125	112	143	325
December	123	106	120	130	63	119	198	128	146	98	123	112	164	328
1956														
January	129	106	130	135	70	134	199	129	146	107	130	112	136	354
February	125	106	128	145	77	129	204	130	146	99	124	111	126	323
March	117	105	128	149	77	131	219	130	146	103	128	112	150	395
April	119	105	122	160	82	140	203	130	146	105	131	113	175	397
May	118	105	129	173	74	135	211	131	147	107	122	113	183	519
June	117	105	125	161	81*r*	135*r*	215	132	148	105	126	114	....	....
July	115	105	132	....	78	110	212	132	148	102	132	115	....	....

BANKING AND CREDIT STATISTICS—TWELFTH DISTRICT

(amounts in millions of dollars)

Year and month	Condition items of all member banks[6]				Bank rates on short-term business loans[8]	Member bank reserves and related items					Bank debits index 31 cities[3, 12] (1947-49=100)[2]
						Factors affecting reserves:					
	Loans and discounts	U.S. Gov't securities	Demand deposits adjusted[7]	Total time deposits		Reserve bank credit[9]	Commercial[10]	Treasury[10]	Money in circulation[9]	Reserves[11]	
1929	2,239	495	1,234	1,790	......	− 34	0	+ 23	− 6	175	42
1933	1,486	720	951	1,609	......	− 2	− 110	+ 150	− 18	185	18
1939	1,967	1,450	1,983	2,267	......	+ 2	− 192	+ 245	+ 31	584	30
1947	5,358	7,247	8,922	6,006	......	− 302	− 510	+ 698	− 206	2,202	95
1948	6,032	6,366	8,655	6,087	......	+ 17	+ 472	− 482	− 209	2,420	103
1949	5,925	7,016	8,536	6,255	3.20	+ 13	− 930	+ 378	− 65	1,924	102
1950	7,093	6,415	9,254	6,302	3.35	+ 39	−1,141	+1,198	− 14	2,026	115
1951	7,866	6,463	9,937	6,777	3.66	− 21	−1,582	+1,983	+ 189	2,269	132
1952	8,839	6,619	10,520	7,502	3.95	+ 7	−1,912	+2,265	+ 132	2,514	140
1953	9,220	6,639	10,515	7,997	4.14	− 14	−3,073	+3,158	+ 39	2,551	150
1954	9,418	7,942	11,196	8,699	4.09	+ 2	−2,448	+2,328	− 30	2,505	168
1955	11,124	7,239	11,864	9,120	4.10	+ 38	−2,685	+2,757	+ 100	2,530	172
1955											
August	10,392	7,407	11,163	9,021	......	− 23	− 253	+ 200	+ 8	2,415	177
September	10,559	7,375	11,312	9,054	4.17	+ 17	− 148	+ 276	+ 18	2,541	173
October	10,665	7,487	11,465	9,067	......	− 43	− 245	+ 174	+ 15	2,417	171
November	10,931	7,238	11,665	9,005	......	+ 46	− 81	+ 205	+ 18	2,575	181
December	11,115	7,298	11,876	9,084	4.25	+ 8	− 434	+ 417	+ 17	2,530	183
1956											
January	11,193	7,143	11,794	9,070	......	+ 84	− 322	+ 136	− 99	2,554	188
February	11,323	6,819	11,233	9,095	......	− 87	− 76	+ 95	− 7	2,488	179
March	11,476	6,731	11,112	9,103	4.34	+ 71	− 178	+ 188	+ 35	2,516	183
April	11,669	6,730	11,530	9,099	......	+ 82	− 270	+ 371	− 7	2,578	190
May	11,837	6,566	11,144	9,139	......	− 22	− 233	+ 217	+ 47	2,498	182
June	12,030	6,482	11,262	9,294	4.44	+ 5	− 405	+ 341	+ 32	2,404	186
July	12,157	6,396	11,392	9,233	......	− 6	− 143	+ 240	− 8	2,519	197
August	12,173	6,439	11,356	9,286	......	+ 4	− 315	+ 247	− 103	2,565	201

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

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