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Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO
TWELFTH FEDERAL RESERVE DISTRICT

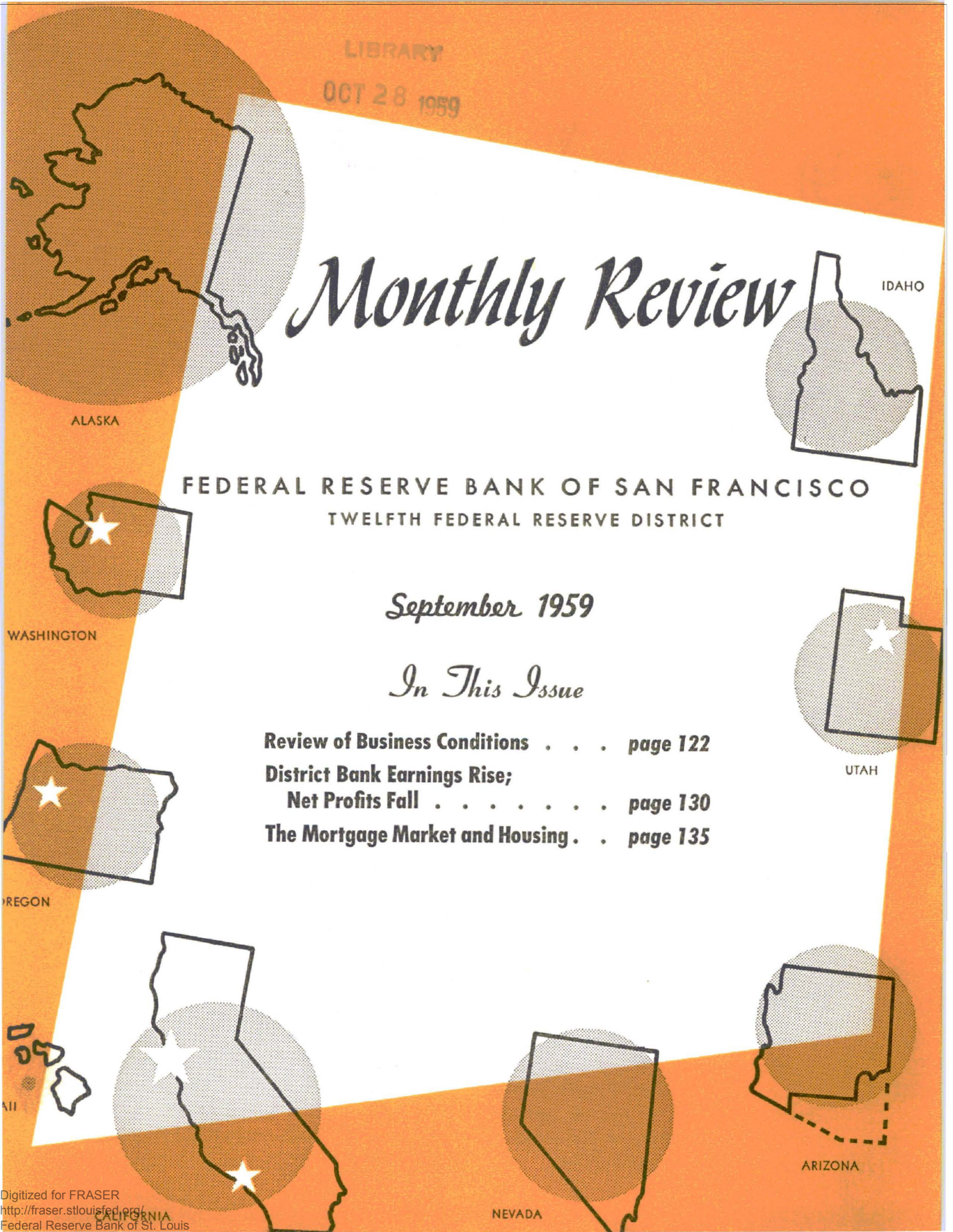
September 1959

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Review of Business Conditions

BANKING developments in August continued to reflect a general expansion of economic activity and appeared to be but little affected by strikes in primary metals. And to a greater extent than in July, changes in banking data also exhibited the effects of increasing monetary stringency. Loans continued the strong advance of recent months, rising from the last Wednesday in July to the last Wednesday in August 1.2 percent nationally and 1.7 percent in this District. The increases extended to all major categories of loans excepting loans to nonbank financial institutions in the District and loans for purchasing and carrying securities in the nation as a whole. However, total loans and investments of weekly reporting banks, which reached a record high level in the nation and in the Twelfth District during July, were at slightly lower levels at the end of August. The reduction in bank holdings of United States Government securities was substantial enough to more than offset the increase in loans. Bank holdings of United States Government securities fell 3.2 percent nationally and 2.7 percent in the District over the month of August. Such holdings have been falling generally since late last year, but there was a moderate increase in holdings, especially of bills, during the first three weeks of July. The sell-off of United States Government securities results from bank efforts to obtain funds for lending to businesses and households. Since their total reserves remained approximately constant over the month, all banks together obtained additional funds for lending by selling investments to depositors. The reluctance of depositors to hold additional investments and the private and public demand for short-term funds have given rise to advancing interest rates. Although long-term rates during August were generally stable or rose slightly, there was considerable pressure on short-term rates, and early in September short-term rates moved up significantly.

Total demand deposits (adjusted) at the end of August were 1.4 percent above the end-of-August figure last year in the nation and 6.7 percent above last year's figure in the District, despite decreases during August. At least for the District, increases during July and decreases during August have characterized movements in total demand deposits for the last few years. District demand deposits of individuals, partnerships, and corporations have remained almost unchanged since June. Total time deposits other than interbank continued to fall in August as mainly business and foreign holders presumably shifted funds into placements with a higher yield. However, savings deposits, the major component of time deposits, continued to rise although at a slower rate than in July.

District debits to demand deposits during August were 15.4 percent above August 1958. Debits for the last three months compared to the same three months in 1958 were up 16.0 percent. For the United States the August-to-August gain was 12.0 percent and the June-August total was 9.9 percent above that period last year.

Steel and copper strikes depress production and employment

The Federal Reserve Board's index of industrial production (seasonally adjusted) lost two points in July and fell four points to 149 in August. The declines can be accounted for by output reductions occasioned by industrial disputes, especially the steel strike, which is estimated to have taken more than 600,000 workers off the job directly and indirectly. The index for durables production dropped from 172 in June to 168 in July and then fell to 159 in August. The minerals index which was 125 in June was only 120 in July and fell further to 119 in August. On the other hand, the nondurables index rose to 146 in July but rose no further in August.

TABLE 1

**SELECTED CONDITION ITEMS OF WEEKLY REPORTING MEMBER BANKS
IN LEADING CITIES, PERCENTAGE CHANGE**

| | July 29, 1959 to August 26, 1959 | | August 27, 1958 to August 26, 1959 | |
|--|--|---------------------|--|---------------------|
| | United States | Twelfth District | United States | Twelfth District |
| ASSETS: | | | | |
| Total Loans Adjusted and Investments | — 0.3 | 0.3 | * | * |
| Loans Adjusted: ¹ | 1.2 | 1.7 | * | * |
| Commercial and industrial loans | 1.4 | 1.0 | * | * |
| Agricultural loans | 2.2 | 2.9 | | 15.3 |
| Loans to brokers & dealers for purchasing & carrying | — 0.1 | 93.7 | 24.7 | 82.1 |
| Other loans for purchasing or carrying | — 0.9 | 3.5 | 11.5 | —14.3 |
| Loans to nonbank financial institutions | 2.5 | 4.7 | * | * |
| Loans to foreign banks | 0.5 | — 7.6 | 22.0 | 23.1 |
| Loans to domestic commercial banks | 4.4 | 8.4 | | |
| Real estate loans | 0.6 | 0.8 | 13.9 | 17.0 |
| Other loans | 1.4 | 3.2 | * | * |
| United States Government Securities: | — 3.2 | — 2.6 | —17.8 | —16.3 |
| Treasury Bills | —13.6 | 22.7 | 54.3 | 32.5 |
| Treasury certificates of indebtedness | —40.8 | —35.8 | —76.3 | —76.1 |
| Treasury notes and United States bonds maturing: | | | | |
| Within 1 year | 17.3 | 12.7 | —12.3 ³ | — 8.2 ³ |
| 1 to 5 years | — 0.6 | — 3.8 | | |
| After 5 years | | 1.8 | | |
| Other Securities | — 1.2 | — 0.8 | — 3.5 | — 8.2 |
| LIABILITIES: | | | | |
| Demand Deposits Adjusted | — 2.3 | — 1.6 | 1.4 | 6.7 |
| Time Deposits Total | — 0.4 | — 0.2 | | 2.8 |

*Not available.

¹Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross.²Combined with loans to foreign banks.³All three maturations combined.

Source: Board of Governors of the Federal Reserve System.

Nonagricultural employment at mid-August remained practically unchanged from mid-July at 60.9 million; the rate of total unemployment (seasonally adjusted) rose from 5.1 percent of the civilian labor force in July to 5.5 percent in August. In the District, employment increased less than seasonally although actual unemployment declined. The seasonally adjusted rate of unemployment for Pacific Coast states rose from 4.6 percent in July to 4.8 percent in August. The rate in California fell to below 4.0 percent in July but was 4.1 percent in August. Rates in Washington and Oregon, 7.9 and 6.5 percent respectively in August, remain substantially above the national rate. Manufacturing weekly hours and hourly earnings in July and undoubtedly also in August suffered from the removal of the

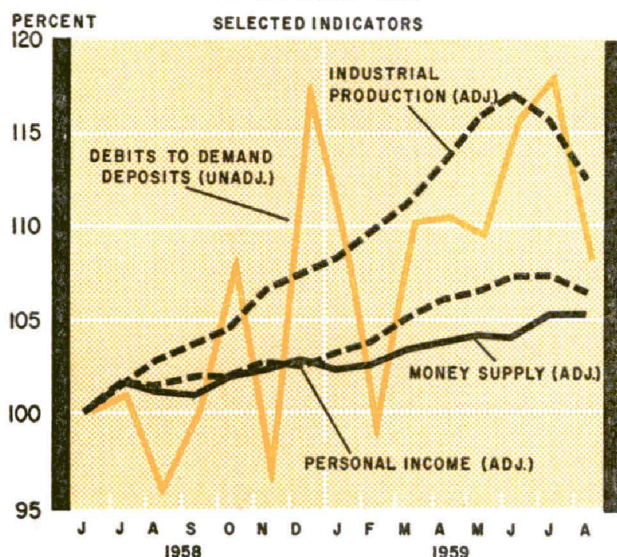
steel workers from the computation of the average.

The lumber industry in Pacific Coast states added 1600 workers to payrolls between mid-July and mid-August, a less than seasonal gain, but production appears to be running ahead of demand. Fir plywood production in second quarter 1959 is reported to have been 37 percent above the second quarter of last year, but orders were only 8 percent higher than last year. Fir plywood prices have been falling for some weeks and by the end of August had dropped to \$68 per 1000 board feet for ½ inch sanded, the lowest price since June 1958. Fir lumber prices began the seasonal decline earlier this year than last.

In metals, steel was almost completely shut down during the month and the copper strike

FEDERAL RESERVE BANK OF SAN FRANCISCO

CHART 1
RELATIVE CHANGES IN INDICATORS
OF AGGREGATE ECONOMIC AND MONETARY
ACTIVITY, UNITED STATES, JUNE 1958
TO AUGUST 1959



Sources: United States Department of Commerce and Federal Reserve Board.

which began on August 10 had spread to about 75 percent of the industry by August 20. At that time neither steel nor copper fabricators seemed to be experiencing substantial material shortages. Fabricators' copper inventories were estimated as equal to two to four months output at the beginning of the strike.

The stocks of steel built up before the strike have been supplemented by imports of steel from abroad.

Aluminum has continued to operate pending settlement of the steel strike, but lead production has been reduced by the copper strike, in particular the strike of American Smelting and Refining which accounts for 40 to 50 percent of domestic lead output.

From mid-July to mid-August defense-related industries employed about 9,500 new workers despite a decline of workers on Pacific Coast manufacturing payrolls. Aircraft employment increased by 1,200, an increase of 3,000 in California being offset by a 1,800 reduction in Washington. Ordnance, instruments, and electrical machinery firms all added workers; the latter industry alone reported a gain of 4,500.

Farm income declines; short-term debt rises

Prices received by United States farmers dropped 0.5 percent during the month ended August 15 and were nearly 4 percent below a year earlier. On the other hand, prices paid by farmers for production items remained un-

TABLE 2
NON-AGRICULTURAL EMPLOYMENT

| | Percent of Total 1957 | | Change from 1957 (Seasonally adjusted mid-month figures) | | | |
|----------------|-----------------------|------------------|---|------------------|---------------|------------------|
| | United States | Twelfth District | April 1958 | | July 1959 | |
| | | | United States | Twelfth District | United States | Twelfth District |
| Manufacturing | 32.2 | 26.3 | 90.8 | 96.5 | 98.8 | 105.4 |
| Mining | 1.5 | 1.2 | 89.4 | 89.1 | 88.0 | 88.2 |
| Construction | 5.4 | 6.3 | 93.4 | 94.7 | 100.0 | 102.4 |
| Transportation | 8.0 | 8.4 | 93.7 | 96.7 | 94.5 | 97.3 |
| Trade | 21.7 | 22.8 | 97.8 | 95.1 | 101.4 | 99.8 |
| Finance | 4.5 | 4.4 | 100.3 | 101.3 | 103.2 | 108.1 |
| Service | 12.1 | 13.1 | 100.3 | 98.1 | 103.8 | 103.5 |
| Government | 14.6 | 17.5 | 102.5 | 105.8 | 106.2 | 112.2 |
| TOTAL | 100.0 | 100.0 | 96.0 | 98.0 | 100.8 | 104.1 |

Sources: United States Department of Labor and state employment agencies, seasonally adjusted by the Federal Reserve Bank of San Francisco.

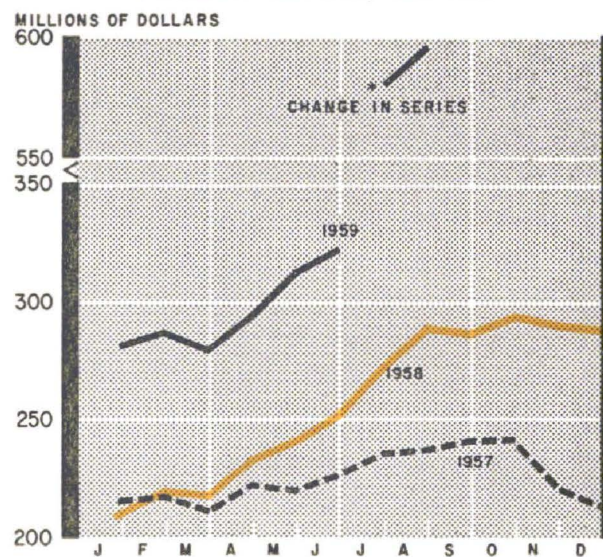
changed during the month preceding August 15 and were higher than last year. The result was a one point decline in the parity ratio from July 15 to August 15, the ratio then standing 6 percent lower than on the same date last year. Over-all, indications continue that net income of farm proprietors will be less this year than last. Income of hired farm workers should be about the same in 1959 as in 1958, an increase in wage rates offsetting a decrease in numbers employed.

The September 1 estimate of 1959 crop production was less than 1 percent below the record output of last year. Increased production of livestock and livestock products indicates that total 1959 farm output may be above last year's. Marketings of livestock, however, are not expected to increase by as much as production owing to an increase in inventories of animals. District crop production, excluding vegetables, will be up almost 5 percent over last year according to this bank's index based on September 1 crop estimates. Some reduction in deciduous fruit prospects occurred since July but output will still be 12 percent larger than in 1958. Our index of total deciduous fruit and nut production is up 13 percent and the cotton production index is 18 percent above last year. Summer fresh vegetable output is slightly above last year but the supply of vegetables for processing will be less.

Pacific Coast states farm employment during the last week in August totaled 709,000 workers, down seasonally from the last week in July according to United States Department of Agriculture estimates. In contrast with farm employment nationally, there were almost as many farm workers on Pacific Coast farms in the last week of August as in the same week last year. Farm wage rates, up 9 percent nationally from July 1, 1958 to July 1, 1959, were up only 2 percent on the Pacific Coast. However, farm wages on July 1, 1959 in Pacific Coast states were considerably higher than nationally, \$1.15 per hour compared to

80 cents per hour. Thus, income of District farm proprietors and farm laborers should be higher in 1959 than in 1958.

CHART 2
AGRICULTURAL LOANS OUTSTANDING,
TWELFTH DISTRICT, 1957-1959



Source: Federal Reserve Bank of San Francisco.

District weekly reporting banks account for about one-fifth of total loans and investments reported by all weekly reporting banks in the nation, but the proportion for agricultural loans is about two-thirds. Making allowance for the fact that agricultural loans reported by the extensive branch banking systems in the Twelfth District reflect agricultural developments more fully than do agricultural loan figures reported by city banks in the rest of the nation, loans to agriculture by weekly reporting banks outside the District rose 0.9 percent during August and were 11.4 percent greater than at the end of August last year. In the District, agricultural loans were up 2.9 percent in August and were 15.3 percent higher than last year. The upturn in District agricultural loans, although much more vigorous this year, was not unseasonably early as compared with previous years.

Retail sales and consumer credit rise

Personal income, \$381.4 billion in August at a seasonally adjusted annual rate, less than

1 percent below July but 5.2 percent over August 1958, a rate of personal saving through the second quarter of 1959 that was less than in 1957, and a relatively low rate of growth in productivity in distribution continue to provide more and more jobs in trade. In the District, employment in trade (seasonally adjusted) was almost unchanged in July from June but was up 3.6 percent over a year ago. As in the nation as a whole, the rate of growth over the year was less than that for total non-agricultural employment. Trade employment in Pacific Coast states increased by 1.1 percent from mid-July to mid-August.

Department store sales rose 1 percent in the United States and 7 percent in the District during the four weeks ended August 29 compared with the same four weeks last year. The gain for the first eight months of 1959 compared with the first eight months of 1958 was 7 percent for the United States and 10 percent for the District. On both comparisons the Twelfth District had the highest increases of all Federal Reserve Districts in the country. Within the District, metropolitan areas with the largest gains in department store sales this year to date compared with last year are San Jose and Sacramento; those with the slowest rates of growth are Seattle and Spokane.

Bank lending by weekly reporting banks to wholesale and retail trade firms in the District increased slightly during August and at the end of the month was 13.0 percent above August 1958. "Other loans," principally loans to consumers, were up during the month of August 2.3 percent in the District and 1.0 percent in the United States exclusive of the District, but comparisons with a year ago are not possible because of a basic change in the report on July 1. This expansion is associated with the high August rate of automobile sales. On July 31, 1959 delinquency rates on every major category of commercial bank consumer loans both in the United States and the District were under those of July 31, 1958 despite the

rapid rate of increase in such credit. However, rates on personal loans and home appliance loans were higher at the end of July than at the end of June for the United States and the District. In addition, delinquency rates on bank-purchased automobile loans were somewhat higher in the District.

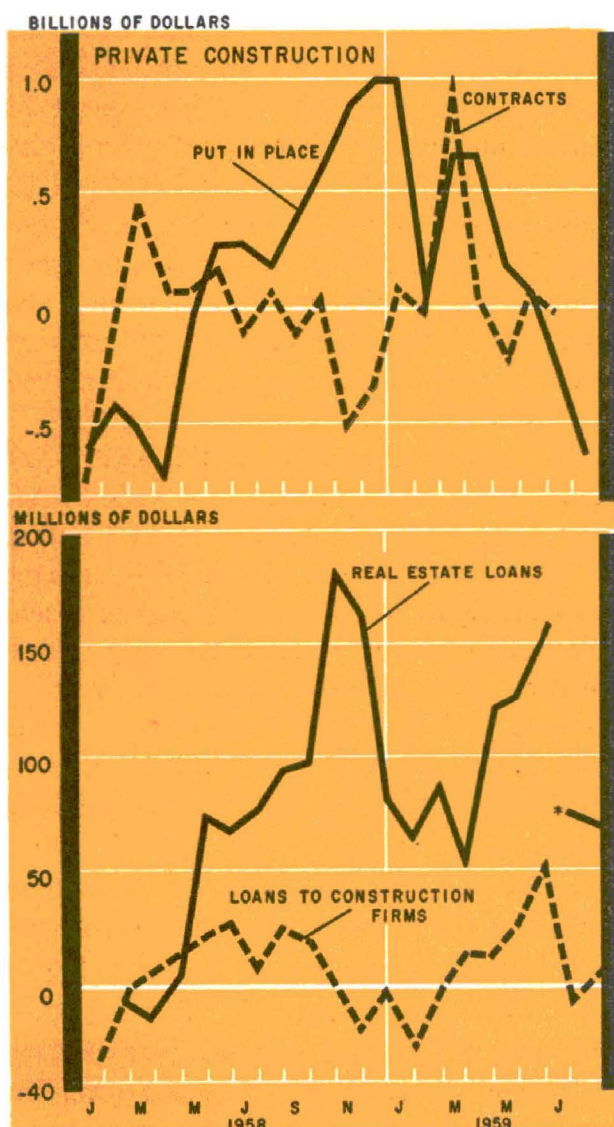
Construction slows

Private new United States construction put in place, which was down 0.5 percent in July from June, fell 1.5 percent from July to August on a seasonally adjusted basis. Nearly all of the decline from July to August was in residential construction. Public construction put in place was slightly less in August than in July. However, public and private are still 14.6 and 8.6 percent, respectively, above last year. The volume of construction contracts awarded in the United States in July was about what it had been in June, but in the District the value of contracts awarded was down 8.8 percent. As compared with a year ago, total construction contracts were up 1.4 percent in the United States but down 4.5 percent in the District; public works and utilities were down substantially in both. National construction employment, virtually unchanged from June, was 3.9 percent greater in July than in July a year ago. In the District, however, construction employment was up in July over a year ago by only 1.0 percent.

Real estate loans by weekly reporting member banks were almost unchanged at the end of August from the end of July both in the United States exclusive of the Twelfth District and in the Twelfth District. District loans to construction firms by banks that report such figures declined during July both in the District and the nation. In August loans outstanding rose by more in the District than in the entire country; in other words, such loans continued to decline in the United States exclusive of the Twelfth District. Logically, real estate loans should lag construction loans

just as construction put in place lags contracts. With rising interest rates and construction costs, the seasonal slackening of building activity, and some indications of at least temporary satiation of demand for residential housing, the declines in construction loans can be expected to show up eventually in real estate loans.

CHARTS 3 AND 4

RELATIVE CHANGES IN CONSTRUCTION
ACTIVITY AND LENDING, UNITED STATES,
JANUARY 1958 TO JULY 1959

*Revision of series.

Note: Construction put in place is estimated by the United States Department of Commerce in part from reported construction contract awards.

Sources: United States Department of Commerce, F. W. Dodge Corporation, and Federal Reserve Board.

The responsiveness of residential construction activity to governmental action is indicated by the 90.0 percent District increase in FHA appraisal requests in June and the 61.9 percent decrease in such requests in July after the new FHA mortgage insurance terms had gone into effect. The new terms specified stricter construction standards. The changes for the entire United States were a 57.6 percent increase in June and a 51.8 percent decrease in July.

Business investment rises

According to the third quarter survey by the Securities and Exchange Commission of business plant and equipment spending intentions, firms in the United States plan purchases of plant and equipment in the second half of 1959 that will bring the annual total to \$33.3 billion, 9 percent above the 1958 total. The latest survey reveals an upward revision of spending of \$700 million over the survey results of three months ago. Actual second quarter spending was \$32.5 billion at a seasonally adjusted annual rate, compared with a projected \$32.3 billion. Third quarter planned spending is \$34.3 billion, compared to the earlier forecast of \$33.4 billion and fourth quarter planned spending is \$35.3 billion.

Second quarter 1959 after-tax profits of 180 manufacturing corporations, totaled by the Federal Reserve Board, were 97.9 percent above second quarter 1958. Profits of corporations in durable goods industries rose 138.8 percent, automobile companies faring best of all with a gain of 439.6 percent. Profits of nondurables producers were up 49.0 percent. Profits of railroad companies increased by smaller amounts, 10.3 and 20.4 percent, respectively.

Given the volume of investment which business has actually undertaken this year and the in-flow of funds from operations, corporations have not been under strong pressure to resort to external finance. Estimated net proceeds

from security issues for new capital for the first three quarters of 1959 are 79 percent of the amount in the same period last year and 71 percent of the amount in the first three quarters of 1957. Reflecting the change in relative costs of acquiring new capital, a higher proportion was raised from stock offerings this year. The volume of stock offerings has increased somewhat since last year but bond sales have been much less. A higher proportion of new capital this year is for working capital purposes, a development consonant with the proportion of business investment that has gone into inventory accumulation.

Stock prices, rising at a slower rate this year than last, generally fell through August, and yields consequently were up somewhat from the low level reached at the end of July. Apart from the usual mythological explanations for the break, there were some indications that large institutional investors, responding to the higher yields obtainable from bonds, were not placing funds in stocks at the rate they have been in the past. Stock market credit was down just slightly in July from June. Dealer credit was somewhat lower and bank loans for purchasing and carrying securities decreased 1.5 percent during July in the United States and fell an additional 0.5 percent during August. In the District these loans are a minor part of total loans and the District figure is a small part of the national figure and, consequently, the District volume of loans for purchasing and carrying securities is subject to erratic large percentage changes. The decline in the national figure is accounted for by the reduction in bank loans to brokers and dealers for carrying other than United States Government securities.

New government issues continue in volume

The volume of state and local issues in the third quarter of 1959 is estimated to be less than last quarter and below the third quarter of last year. However, the figure for the first

three quarters combined is slightly ahead of last year and well above 1957. Sales of state and local issues in the District have been dominated by a few large issues and the trend consequently is not clear. The July 1959 total of \$359.5 included a \$195 million Grant County Public Utility District issue. The \$44.1 August 1959 sum included \$26 million of Los Angeles School District bonds.

The last issue mentioned ran into some buyer resistance and at the beginning of September the unsold balance was being sold at yields up as much as 25 basis points from the original offering yield. In general, however, prices of outstanding tax exempts rallied in July and remained stable during most of August nationally and apparently also in the District. The Staats' average of yields on 19 outstanding California municipal bonds fell from 3.85 percent (the highest for the year) at the beginning of July to 3.67 percent at the beginning of August. The index did not vary until the last week of August when it moved back to 3.85 percent.

The Federal debt at the end of fiscal 1959 stood at \$284.8 billion, up \$8.4 billion from a year earlier, and an excess of \$3.3 billion in expenditures over receipts in July brought the debt figure up to \$288.8 billion. Fiscal 1959 reports are available for only a few District states. California, with the aid of a forward shift in the collection of insurance taxes and a pickup in business activity, managed to close fiscal 1959 with a general fund surplus of almost \$7 million. Nevada had a \$15 million surplus on June 30, 1959. Oregon ran down its unappropriated general fund surplus from \$48.5 million at the beginning of the last fiscal biennium to \$31 million on June 30, 1959, but an attempt to raise income taxes failed and the issue must face the voters in November 1960. Washington, with general fund deficits for several years, ended fiscal 1959 with one (\$6 million) smaller than expected.

Demand for short-term funds is strong

It is reasonable to have assumed that the strikes in primary metals would have the effect of releasing funds to unaffected sectors of the economy. As holders of steel and copper stocks sold and worked off their inventories and repaid bank loans used to finance their holdings, the funds would become available for lending to firms in other industries, households, and governments. Whatever volume of funds was released during August, it evidently was not great enough to prevent the prices of money from rising. The United States three-month new issue bill rate, 3.01 at the beginning of August, was up to 3.89 at the end and went to 4.17 percent on September 18. The major commercial bank prime rate was lifted to 5 percent in early September and for awhile was 1.5 points above the Federal Reserve rediscount rate. Beginning in the second week of September Federal Reserve Banks raised their commercial bank lending rate from 3.5 to 4.0 percent.

Member bank reserves on a daily average basis were \$116 million less during the last

TABLE 3

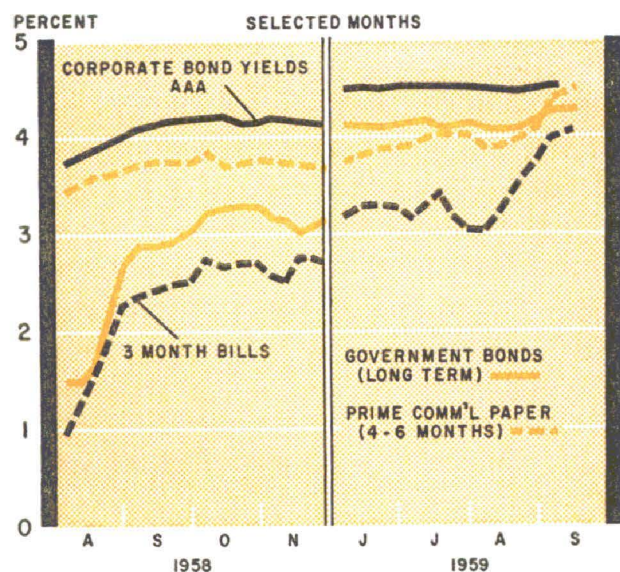
CHANGES IN FACTORS AFFECTING RESERVES, UNITED STATES

(millions of dollars)

| | July 29, 1959 to August 26, 1959 | August 27, 1958 to August 26, 1959 |
|--|--|--|
| Reserve Bank Credit: | | |
| United States Government | | |
| securities | 114 | 1,316 |
| Acceptances | — 6 | — 12 |
| Loans, discounts, and advances | 51 | 67 |
| Float | — 48 | 93 |
| Total | 111 | 2,068 |
| Gold Stock | — 36 | —1,486 |
| Treasury Currency Outstanding | — 8 | 72 |
| Net change in factors increasing reserves | 68 | 655 |
| Money in Circulation | 61 | 702 |
| All Other Accounts | 121 | — 109 |
| Net change in factors decreasing reserves | 183 | 594 |
| Member Bank Reserves: | | |
| Required reserves | —191 | 166 |
| Excess reserves | 75 | — 105 |
| Net change in reserves | —116 | 60 |

Source: Board of Governors of the Federal Reserve System.

CHART 5
INTEREST RATE STRUCTURE,
UNITED STATES, 1958 AND 1959



Source: Federal Reserve Board.

week of August than during the last week of July and were only \$60 million above the last week of August 1958. This has occurred in spite of an increase of Federal Reserve credit of \$111 million between the last week of July and the last week of August and an increase of \$2,068 million since last year. Extensions of Reserve Bank credit during August were offset by decreases in gold stock and Treasury currency and increases in currency in circulation and other items reducing reserves. The result of Federal Open Market and rediscount operations in August was an increase in excess reserves of \$75 million, \$50 million of which reflected additional member bank borrowings and \$25 million of which was a reduction in net borrowed reserves.

District Bank Earnings Rise; Net Profits Fall

IN the first six months of 1959 net current earnings (total earnings minus total expenses) of all member banks in the Twelfth District were \$210.4 million, the highest of the decade.¹ However, the record net current earnings did not blossom into full flower as record net profits; net profits, both before and after income taxes, were lower than in the first half of 1958, when they reached a record level. The smaller net profits in the first half of 1959 primarily reflect bank sales of securities on a falling market. In the first six months of 1959 Twelfth District member banks reduced their total holdings of securities by \$660 million, of which \$576 million were United States Government securities. This is the reverse of bank portfolio activity in the first half of 1958 when banks increased their holdings of government securities by over \$1 billion and their holdings of other securities by more than \$400 million.

The two opposing patterns of portfolio activity reflect the divergent economic trends of the two periods. The first half of 1958 was a period of recession, of declining demand for business loans, and of falling interest rates. The first half of 1959 was a period of economic expansion, of mounting demand for all types of loans, and of rising interest rates. Thus in the first half of 1958 the dwindling loan opportunities and falling interest rates naturally caused banks to turn to the securities market as a profitable outlet for their surplus funds. Conversely, in the first half of 1959, rising interest rates concurrent with rising loan demand made it appear profitable for banks to shift their funds from securities to loans even when this required sales of securities which had been acquired at the higher price levels

prevailing earlier. Twelfth District member bank loans increased nearly \$1.5 billion during the first six months of 1959, whereas their loans increased only \$15 million during the first six months of 1958.

Both earnings and expenses rise

During the first half of 1959 earnings were greater in all categories than the corresponding 1958 earnings. Earnings on loans accounted for three-quarters of the net increase in total earnings for the first half of 1959 over the first half of 1958; in both periods earnings on loans accounted for about two-thirds of total earnings. While all categories of earnings at Twelfth District member banks were higher than in the first half of 1958, all categories of expenses likewise rose. For all Twelfth District member banks, salary and wage payments totaled 10.2 percent more in the first half of 1959 than in the first half of 1958, thus rising at a faster rate than the number of employees, which was 8.8 percent higher.

The amount of interest paid on time deposits increased 8 percent. Other expenses increased about 20 percent, one factor being the increased interest payments. Twelfth District banks paid over three times as much in interest on borrowed money for the first six months of 1959 as in the first six months of 1958. The changes in the Federal Reserve discount rate served to increase the cost of bank borrowing; in the first half of 1958 the discount rate fell from 3 percent to 1¾ percent, while in the first half of 1959 the discount rate rose from 2½ percent to 3½ percent. Furthermore, during the first half of the year, borrowing by member banks in the Twelfth District, as in the nation, was at a much higher level in 1959 than in 1958.

The percentage increase in both total earnings and total expenses over first-half 1958

¹New member banks in Alaska and Hawaii, included for the first time, accounted for under 1.5 percent of the District total for categories ranging from net current earnings to capital accounts.

TABLE 1

**EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS
SIX MONTHS ENDING JUNE 30, 1959**

| | Millions of Dollars | | | Percent Change from First Half of 1958 | | | |
|---|---------------------|--------------|--------------|--|--------------|--------------|--------------------------------|
| | All Member Banks | 13 Largest | Other | All | 13 Largest | Other | All Member Banks United States |
| Earnings on loans | 436.8 | 353.1 | 83.7 | +14.7 | +12.6 | +24.9 | +9.7 |
| Interest and dividends on | | | | | | | |
| Government securities | 100.4 | 78.2 | 22.2 | +10.6 | +8.0 | +164.3 | +10.6 |
| Other securities | 31.2 | 24.5 | 6.7 | +8.0 | +6.1 | +15.5 | |
| Service charges on deposit accounts | 52.2 | 41.4 | 10.8 | +7.2 | +6.2 | +11.3 | |
| Trust department earnings | 18.1 | 15.4 | 2.7 | +17.5 | +17.6 | +17.4 | |
| Other earnings | 26.6 | 19.7 | 6.9 | +6.4 | +2.6 | +19.0 | |
| TOTAL EARNINGS | 665.3 | 532.3 | 133.0 | +12.9 | +10.8 | +22.0 | +9.4 |
| Salaries and wages | 174.4 | 137.8 | 36.6 | +10.2 | +8.8 | +16.2 | |
| Interest on time deposits | 159.0 | 132.2 | 26.8 | +8.2 | +6.6 | +17.0 | |
| Other expenses | 121.5 | 94.0 | 27.5 | +19.5 | +18.7 | +22.2 | |
| TOTAL EXPENSES | 454.9 | 364.0 | 90.9 | +11.8 | +10.3 | +18.2 | +9.9 |
| Net current expenses | 210.4 | 168.3 | 42.1 | +15.2 | +11.8 | +31.2 | +8.6 |
| Net recoveries and profits | | | | | | | |
| (—losses) ¹ | | | | | | | |
| On securities | —27.9 | —18.2 | —9.7 | | | | |
| On loans | —11.7 | —8.9 | —2.8 | | | | |
| All other | —3.0 | —2.4 | —0.6 | | | | |
| TOTAL NET RECOVERIES AND PROFITS | —42.6 | —29.5 | —13.1 | | | | |
| Net profits before income taxes | 167.8 | 138.8 | 29.0 | —21.0 | —21.0 | —21.2 | —33.6 |
| Taxes on net income | 71.6 | 58.6 | 13.0 | —29.7 | —31.9 | —17.2 | —40.6 |
| Net profits after taxes | 96.2 | 80.2 | 16.0 | —13.1 | —10.5 | —24.2 | —27.8 |
| Cash dividends declared | 53.2 | 44.3 | 8.9 | +7.3 | +5.0 | +20.3 | +6.2 |
| Undistributed profits | 43.0 | 35.9 | 7.1 | —29.6 | —24.3 | —48.2 | |
| Number of banks | 171 | 13 | 158 | | | | |

¹ Including transfers to (—) and from (+) valuation reserves.

Note: Twelfth District figures for 1959 include data for new member banks in Alaska and Hawaii. Figures for 1959 and 1958 include data for banks absorbed during the six-month period.

figures was greater for Twelfth District member banks than for all member banks in the nation. Moreover, in the District total earnings showed a greater percentage increase than did total expenses, while in the nation the reverse was true. Total earnings for all member banks in the United States rose only 9.4 percent, while total expenses rose 9.9 percent; this compares with a 12.9 percent rise in total earnings for Twelfth District member banks and an 11.8 percent increase in total expenses.

Net current earnings of all Twelfth District member banks for the first six months of 1959 were \$27.7 million higher than in the 1958 period. This represented a gain of 15.2 per-

cent for all Twelfth District member banks, compared with a gain of only 8.6 percent for all member banks in the United States.

Losses on securities cut bank profits

However, net profits before income taxes for Twelfth District member banks fell almost 30 percent below those of the 1958 period; the first-half figure for 1959 was \$167.8 million. The difference was largely due to a net loss of \$27.9 million taken on securities (including transfers to and from valuation reserves), whereas in the first half of 1958 the banks realized a net gain of \$51.1 million on securities transactions. Banks which trade securities

acquired at higher prices for securities with similar maturities selling at lower prices can use the capital losses realized in their transactions as offsets against current income; if the lower-priced securities acquired in replacement are later sold on a rising market, the profits are taxed as capital gains. However, the losses on securities transactions by District banks during the first half of 1959 stem from outright sale on a falling securities market rather than from replacement transactions guided by income tax considerations. The pressure of loan demand and limited reserves required liquidation of securities at a loss.

Earnings on loans at Twelfth District member banks were 14.7 percent higher in the first half of 1959 than in the corresponding 1958 period. Thus the relative gain in loan earnings was more than one-third greater than the relative gain in loan volume. The ratio of loan earnings to loan volume will show an increasingly favorable trend as the loans made at the present higher interest rates gradually form a larger proportion of total loans outstanding. The absolute growth in loan earnings resulting from higher interest rates and a larger loan volume will also be a positive factor toward higher net profits.

Net profits after taxes were \$96.2 million for all Twelfth District member banks, or 13 percent less than in the first half of 1958. However, the relative decline in the District was less than half the 28 percent decline for all member banks in the nation. Cash dividends declared by all Twelfth District member banks were 7 percent higher in the first half of 1959 than in 1958, but undistributed profits were 30 percent lower.

Banks increase loans as economy expands

Table 2, which shows the principal resource and liability items of Twelfth District member banks, illustrates the three main changes characterizing the first six months of 1959: a very large increase in loan volume, a substantial

decrease in security holdings, and an increase in time deposits almost matched by a decrease in demand deposits, so that there was very little net change in total bank deposits. Real estate loans, which increased by the greatest dollar amount of any loan category, accounted for almost one-third of the net increase in loans outstanding during the period, reflecting a first-half construction rate well above that of 1958. Commercial and industrial loans increased 6.9 percent in the first half of 1959, in contrast to a contraction of 5.7 percent in the first half of 1958; commercial and industrial loans outstanding at mid-1959 were almost \$700 million greater than at mid-1958. The contrast in the level of bank lending to business in the two periods is explained by the timing of the business cycle. In the first half of 1958, the index of industrial production fell to a low of 126 in April and had only recovered to 132 by June; industrial production continued to climb and by June 1959 had

TABLE 2
**PRINCIPAL RESOURCE AND LIABILITY
ITEMS OF ALL MEMBER BANKS IN THE
TWELFTH DISTRICT**

| | (In millions of dollars) | | |
|---------------------------------------|--------------------------|------------------------------|-------------------|
| | June 10 1959 | Dec. 31 1958 ^r | Percent Change |
| Loans and investments | 25,174 | 24,344 | + 3.4 |
| Loans and discounts net | 15,306 | 13,816 | +10.8 |
| Commercial and industrial loans | 5,410 | 5,061 | + 6.9 |
| Agricultural loans | 706 | 587 | +20.3 |
| Real estate loans | 5,760 | 5,279 | + 9.1 |
| Loans to individuals | 2,773 | 2,482 | +11.7 |
| United States Government obligations | 7,429 | 8,005 | — 7.2 |
| Treasury bills | 217 | 495 | —56.2 |
| Treasury certificates of indebtedness | 619 | 882 | —29.8 |
| Treasury notes | 1,443 | 1,511 | — 4.5 |
| United States bonds | 5,150 | 5,116 | + 0.7 |
| Other securities | 2,439 | 2,523 | — 3.3 |
| Total assets | 30,791 | 30,272 | + 1.7 |
| Demand deposits | 15,342 | 15,685 | — 2.2 |
| Time deposits | 12,455 | 12,082 | + 3.1 |
| Total deposits | 27,797 | 27,766 | + 0.1 |
| Capital accounts | 1,952 | 1,877 | + 4.0 |

^rRevised.

Note: Twelfth District figures for 1959 include data for new member banks in Alaska and Hawaii. Figures for 1959 and 1958 include data for banks absorbed during the six-month period.

reached a post-war peak of 155. National income, which had fallen in the first half of 1958, was also at a record rate in the first half of 1959. Loans to individuals increased almost 12 percent during the first six months of 1959, as growing consumer income and optimism led to renewed willingness to assume debt for durable consumer goods. These loans helped raise bank earnings, since consumer loans usually carry above-average interest rates.

Although agricultural loans accounted for only 8 percent of the total increase in loan volume, their rate of increase was the greatest of any loan category; the volume of agricultural loans outstanding in June was one-fifth higher than at the beginning of the year. Factors causing expansion of agricultural loans in the District were the large increase in the number of feeder cattle, some switch from fall plantings to spring plantings (as from wheat to cotton), the expense of thinning the bumper fruit crop, and the fact that fruit farmers started the year low in funds because of last year's poor crop.

Bank security holdings contract as loans rise

While during the first half of 1959 District banks increased their loans by 11 percent (\$1,490 million), they decreased their holdings of United States Government securities by 7 percent (\$576 million) and decreased their holdings of other securities, which include those of states and political subdivisions, by 3 percent (\$84 million). Virtually all of the decrease in District bank holdings of United States Government securities was concentrated in the short-term area, being about evenly divided between Treasury bills and Treasury certificates of indebtedness. There was also some decrease in holdings of Treasury notes, while net holdings of United States bonds rose slightly.

District bank holdings of United States securities at the end of December 1958 were the highest since the end of 1954, when a reces-

sion-induced upswing in holdings carried them to the highest peak of the decade. Under the stimulus of a vigorous expansion in commercial and industrial activity in the first half of 1959, banks drew down their unusually large holdings of securities to increase their liquidity in order to accommodate rising loan demand. Bankers operated in the context of a sustained and rising loan demand, accompanied by a weakening of the Government securities market under the pressure of rising interest rates generated by high loan demand, and the pressure of a record peace-time fiscal deficit necessitating Treasury financing through a large volume of short-term issues.

Total bank deposits show little change

The seasonal fall in demand deposits at District member banks was nearly counterbalanced by the rise in time deposits, although in June demand deposits were nearly \$3 billion greater than time deposits. In the first half of 1958 time deposits rose swiftly by \$1 billion; from mid-1958 to mid-1959 time deposits have experienced a fluctuating but gradual net increase, the growth in the first half of 1959 being about one-third of that in the first half of 1958. With time deposits now at the high level of \$12.5 billion, and with most banks paying the maximum allowable interest rate of 3 percent, payment of interest on time deposits now rivals wages and salaries as a major expense of banks. At mid-1959 time deposits were one-fourth greater than three years earlier, yet the interest paid on time deposits during the first half of 1959 was double that paid in the first half of 1956.

Largest banks show smallest decline in net profits

In the first half of the year, net current earnings of the 13 largest banks in the District were 11.8 percent higher than in the first half of 1958, while those of other member banks increased 31.2 percent. However, the fortunes changed after deduction of losses and

taxes; net profits after taxes of the 13 largest member banks fell 11 percent below first-half earnings in 1958, while those of other member banks fell doubly hard—24 percent. The slower rate of increase in earnings of the largest banks in the first half of 1959 followed a much higher rate of increase in 1958; in the first half of 1958, net current earnings of the largest banks rose 13.2 percent above the first-half earnings of the preceding year, while those of other member banks fell 3.3 percent.

The increase in total earnings at the 13 largest banks was only half that of the other member banks, or 11 percent compared with 22 percent. On the other hand, the advance in total expenses at the 13 largest banks was well under half that of other District member banks, or 12 percent compared with 31 percent. Earnings of the 13 largest banks relative to the first half of 1958 were well below those of other District member banks in all major categories except trust department earnings, which were nearly equal. The greatest disparity was in interest earned on United States Government securities; earnings of the 13 largest banks rose only 8 percent (\$5.8 million), while those of other member banks rose 164 percent (\$13.8 million). During the six-months period, the largest banks liquidated a greater proportion of their holdings of Government securities than did other banks.

Although the relative increase in total expenses at the 13 largest banks was less than half the increase at other member banks, the reverse was true in the first half of 1958. In both cases, the difference in the increase in total expenses is largely accounted for by the difference in the rates of increase in salaries and wages and in interest paid on time deposits; rising costs in these areas appear to have hit the largest banks first.

District earnings ratios above national ratios

Earnings ratios of member banks in the Twelfth District were higher than those of

member banks in the nation as a whole except for a slight national lead in return on Government securities. Both in the District and in the nation, earnings ratios in the first six months of 1959 were higher than in the first six months of 1958 with respect to return on loans, return on Government securities, and the ratio of current earnings to capital accounts. Earnings return on loans was bolstered by rising interest rates during this period. The quarterly survey of interest rates at leading Twelfth District banks showed that one-third of all short-term business loans made in the first half of December 1958 carried interest rates under 4.5 percent; in the first half of June 1959, less than 1 percent of such loans had interest rates below 4.5 percent.

Comparison of the return on loans to the return on Government securities illustrates the relative gross profitability of bank lending over bank investment. Yet yields on securities were also rising during the first half of 1959; the yield on 91-day Treasury bills increased 0.55 percent and the yield on 3-5 year Government

TABLE 3
EARNINGS RATIOS OF MEMBER BANKS

| | (percent ratios) | | |
|---|--------------------|--------------------|-------------------------|
| | First Half 1959 | First Half 1958 | Increase or Decrease |
| UNITED STATES | | | |
| Return on loans | 5.4 | 5.3 | +0.1 |
| Return on Government securities | 2.7 | 2.6 | +0.1 |
| Current earnings to capital accounts | 17.7 | 17.2 | +0.5 |
| Net profits after taxes to capital accounts | 7.6 | 11.2 | —3.6 |
| TWELFTH DISTRICT | | | |
| Return on loans | 6.1 | 5.8 | +0.3 |
| Return on Government securities | 2.6 | 2.4 | +0.2 |
| Current earnings to capital accounts | 22.1 | 20.4 | +1.7 |
| Net profits after taxes to capital accounts | 10.1 | 12.4 | —2.3 |
| Distributed profits to capital accounts | 4.5 | 6.8 | —2.3 |

Note: Twelfth District figures for 1959 include data for new member banks in Alaska and Hawaii. Figures for 1959 and 1958 include data for banks absorbed during the six-month period.

issues increased 0.66 percent. The net result of bank loan and investment activity was that the increase in the return on Government securities in the first half of 1959 over that of the first half of 1958 was almost as great as the comparative increase in return on loans.

The ratio of current earnings to capital accounts in the Twelfth District was 1.7 percentage points higher in the first six months of 1959 than in the first six months of 1958; this was more than three times the national gain. In contrast to the higher ratio of current earnings to capital accounts, the ratio of net profits after taxes fell both in the District and in the nation, though the District decline was the smaller. In the District, the ratio of net profits after taxes to capital accounts (i.e., the return on the investment in banking) was 10.1 percent, compared with 12.4 percent in the first half of 1958, and was only slightly higher than the 1957 ratio of 9.5 percent which is the lowest return recorded in the half-year series.

The fall in the ratio of net profits to capital accounts was to be expected in view of the notable decrease in net profits after taxes, both in the nation and in the District. Another factor is the \$75 million growth in capital accounts of Twelfth District member banks during the first six months of 1959; this represents a 4 percent increase in capital accounts.

In the post-war years, the Twelfth District has enjoyed economic growth at a rate which has out-paced the national average. This is reflected in the fact that Twelfth District member banks increased the volume of their loans outstanding by 10.8 percent during the first half of 1959, more than double the national increase of 5.2 percent. Since the District banks also enjoyed a higher gross return on loans than the national average, it may be concluded that banking activity in the Twelfth District during the first half of 1959 compared very favorably with the national picture.

The Mortgage Market and Housing

THE substantial upsurge in residential construction that started in the third quarter of 1958 contributed significantly to the recent economic recovery. Growth in residential building was mainly responsible for boosting private outlays for total new construction to a record \$24.8 billion in the first eight months of this year. The 947,000 privately financed nonfarm dwelling units started throughout the nation in that period fell short by 27,000 of the record established in the first eight months of 1950, but this volume was 18,000 units above the corresponding period of 1955, the second highest year, and 31 percent above the year-ago level. The high level of new construction has also been accompanied by an active demand for existing houses. The growth in mortgage credit, consequently, has been unusually large. Mortgages outstanding on nonfarm one-

to four-family houses rose approximately \$7 billion in the first half of this year. This is the largest semi-annual increase on record and compares with the gain of \$10 billion for all of 1958.

Although the current volume of residential construction is at or near record levels in both the Twelfth District and the nation, the growing tightness in the mortgage market has created both an expectation and some evidence that the pace of home building may decline in the months that lie ahead. Large-scale residential builders typically operate with commitments for mortgage financing that have been obtained some months in advance of actual construction. Building activity, therefore, reacts with some lag to changes in interest rate levels and in the availability of credit. This was clearly evident in 1958 when credit

ease was greatest in the first half of the year, but the spurt in housing starts was most pronounced in the second half of the year. Similarly, the effect upon residential building activity of the diminished availability of funds and the accompanying rather sharp and continuous increase in interest rates this year has not yet made itself fully evident, since many builders still have mortgage financing commitments that were obtained earlier when credit conditions were easier. As the supply of these commitments is used up, new financing will be more costly and perhaps more difficult to obtain.

In the first eight months of 1959, privately financed housing starts throughout the nation averaged 1,379,000 units (seasonally adjusted annual rate), significantly below the two-month average of 1,430,000 units for November-December 1958, a level exceeded in only one prior month, December 1954. Since April, the number of housing starts has declined for four successive months to a seasonally adjusted annual rate of 1,340,000 in August, 94,000 below the April level. Contracts awarded for residential construction have behaved somewhat differently than housing starts. They dipped from April to May on a seasonally adjusted basis, rose in June and maintained that level in July, but dropped off again in August to the May level. Another national indicator—privately financed expenditures on new nonfarm residential construction—exhibited a moderate downtrend in July and August on a seasonally adjusted basis, with the greater decline occurring in July. This contrasts with a continuous rate of advance in those expenditures during the year ended June 1959.

Data for the Twelfth District show similar evidences of a change in pace in residential building. The number of dwelling units authorized by building permits in the Twelfth District declined 15 percent from May to June and 10 percent from June to July. Oregon was the only state to show an increase in both

months. The dollar volume of contracts awarded for residential construction was 3 percent less in June than in May, with only Oregon and Washington showing increases. This was the first monthly decline in this series since last November. A further decline of 7 percent occurred from June to July, with a 14 percent drop in California being largely responsible. Arizona, Oregon, Utah, and Washington had significant increases in July, however.

The decreases registered in certain indicators of housing activity for the nation and the District have been of such recent origin that they do not furnish conclusive evidence of a turning point in residential construction activity. Sporadic monthly declines occurred in several of these series during the past year only to be followed by renewed upsurges. Developments in the mortgage and capital markets need also to be considered further in order to obtain a firmer evaluation of the current situation.

Competing credit demands large

The record growth of about \$7 billion in mortgage loans outstanding on one- to four-family nonfarm houses during the first half of this year came at a time when other types of credit demands were also large and increasing. Since these demands have tended to outrun the supply of funds, interest rates rose sharply, with long-term rates reaching the highest levels in a quarter of a century or more.

Mortgages must compete with numerous other demands for funds and these have been large this year. Sales of municipal securities totaled nearly \$5.7 billion in the first eight months of 1959, only slightly below the record amount in the year-ago period. The volume of corporate security sales, while below the levels of recent years, amounted to about \$6.1 billion. The United States Treasury, usually a liquidator of debt in the first half of the year, increased its indebtedness by \$2 billion. A further increase of \$5.6 billion occurred in

July and August. Largely as a consequence of substantial inventory accumulation in the second quarter, business loans at commercial banks rose by \$1.7 billion in the first half of this year, an amount significantly exceeded in the corresponding period of only two postwar years—1955 and 1956. The rate of increase slowed down in July but moved upward again in August as seasonal loan demands began to rise. Owing primarily to sharply improved automobile sales, consumer instalment credit rose \$2.6 billion in the first seven months of this year—the record was \$2.9 billion in the corresponding period of 1955.

Supplies of funds for mortgages down

The supply of funds available for investment in mortgages and other types of long-term obligations comes primarily from current savings, and particularly from that portion which is placed in financial institutions. This year the aggregate growth in savings accounts at major types of mortgage lending institutions has been substantially smaller than it was a year ago, although the experience in this regard has varied considerably according to type of lender. Data through the first six months of this year indicate that the savings accounts at savings and loan associations increased \$3.4 billion, 10 percent more than in the corresponding period of 1958. Their mortgage holdings rose \$3.7 billion, 60 percent more than a year ago. Assets of life insurance companies increased \$3.0 billion, about one-tenth more than last year. The \$800 million increase in their mortgage holdings was 3 percent less than last year, however. Rising yields on corporate and municipal securities apparently were attractive to life insurance companies since they increased these investments significantly more than in the corresponding period of 1958.

In contrast, the growth in time deposits at commercial banks and mutual savings banks has been much smaller this year than in 1958. The \$2.3 billion increase in time deposits at

commercial banks in the first eight months of this year compares with the exceptionally large gains of \$6.6 billion and \$4.1 billion in the corresponding periods of 1958 and 1957, respectively.¹ Excluding those two years, however, only two other postwar years, 1954 and 1946, had eight-month gains roughly equal in size to that which occurred this year. Commercial banks increased their real estate loans \$2.1 billion in the first eight months of this year, an amount about equal to the record rise in the corresponding period of 1955 and about twice as large as the year-ago increase. The \$700 million increase in time deposits at mutual savings banks was three-fourths as large as a year ago, and the \$1.1 billion rise in their holdings of mortgage loans was also somewhat less.

In the Twelfth District, banks and savings and loan associations have had changes in their savings accounts and real estate loans similar to those which occurred nationally. Time deposits at District member banks rose about \$435 million in the first six months of this year, less than half of the unusually large increase a year ago and very similar to the experience nationally. They declined about \$140 million in the succeeding two months, however. Their mortgages outstanding increased more than \$600 million in the first eight months of this year, accounting for nearly one-third of the increase at commercial banks in the country as a whole. Savings accounts at District savings and loan associations rose approximately \$1 billion, 12 percent more than in the corresponding period of 1958. Their real estate loans increased about \$1.2 billion, nearly double the gain of a year ago.

The failure of time deposits to grow as rapidly this year as last at commercial and mutual

¹Data for commercial banks and mutual savings banks have been affected in 1959 by the merger of one large mutual savings bank into a commercial bank and by the inclusion of banks in Alaska and Hawaii in the commercial bank series. In comparing changes in time deposits and real estate loans in 1959 with those in 1958, adjustments for these changes in the series have been made so that the comparisons are more accurate.

savings banks reflects a variety of influences. The marked improvement in business conditions has encouraged people to spend more freely this year. This is evidenced by the fact that savings as a percent of personal disposable income averaged slightly less in the first half of 1959 than in the corresponding period of 1958. The substantially higher level of yields available on marketable debt obligations diverted some time deposits into them, and the generally bullish tone of the stock market may also have attracted funds that might otherwise have gone into savings accounts at banks. Comparisons of the behavior of two broad categories of holders of time deposits have only recently become available on a continuing basis for weekly reporting member banks in the Twelfth District and in New York City. These data indicate that savings deposits of individuals rose between early July and early September, while other holders drew down their balances and probably invested them mainly in short-term Treasury securities. Since savings and loan associations typically pay a higher return on savings accounts than do banks, the flow of funds into them has been less affected by the improved attractiveness of other types of investment.

Interest rates have risen as a consequence

The large demand for funds by consumers to buy houses and automobiles, by business firms to increase inventories and build plant and equipment, and by governmental units of all types has pressed heavily upon the available supply, and as a consequence interest rates have risen rather sharply. Table 1 indicates that in August 1959 market yields on long-term United States Government securities and on corporate and municipal bonds ranged roughly from 0.7 to 1.0 percentage point above their levels in May 1958, the month before interest rates started to rise sharply. During the same period, average market yields on Federal Housing Administration

TABLE I
**YIELDS ON LONG-TERM SECURITIES
AND MORTGAGES**

| | (percent per annum) | | Increase |
|-------------------------------------|---------------------|----------------|-----------------|
| | May 1958 | August 1959 | 1958 to 1959 |
| U. S. Government long-term bonds | 3.1 | 4.1 | 1.0 |
| State and local bonds, Aaa | 2.7 | 3.4 | 0.7 |
| Corporate bonds, Aaa | 3.6 | 4.4 | 0.8 |
| FHA mortgages | 5.4 | 5.7* | 0.3 |
| Conventional first mortgages | 5.6** | 5.9† | 0.3 |

*September 1, 1959. **July 1, 1958. †July 1, 1959.

Note: The security yields are monthly averages of daily figures. The FHA mortgage yields are computed from field office opinions about private secondary market bids published by the Federal Housing Administration for FHA-insured 5¾ percent new-home mortgages with a 25-year maturity and 10 percent down payment. The computation of the yield assumes that the actual life of the mortgage is 12 years. The conventional mortgage rates are average rates published by the Federal Housing Administration.

loans and interest rates on conventional mortgages rose only about one-third of a percentage point in the country as a whole. In the West, which typically has higher mortgage interest rates, the increase on conventional loans was one-half of 1 percent. As a consequence of the much greater increase in yields on other types of investments, mortgages have become relatively less attractive to lenders who have free choices between alternative uses for their funds.

Acknowledging the rise in the level of money market rates, the Federal National Mortgage Association made on September 12 the second reduction in less than a month in the price that it will pay in the secondary market for government-backed mortgages. The last reduction of one and one-half points was brought about by the interest rate of 5.26 percent that FNMA had to pay on its recent offering of \$150 million of debentures to provide funds for the purchase of mortgages. Later in September the Federal Housing Administration raised the allowable interest rate on FHA mortgages by one-half point to 5¾ percent. This brings the contractual rate of interest into fairly close line with the current effective yield upon better-type FHA mortgages on new houses. Since some lenders are reluctant to deal in FHA mortgages at a discount, mortgages made at the new, higher rate

may have a better over-all reception in the investment market.

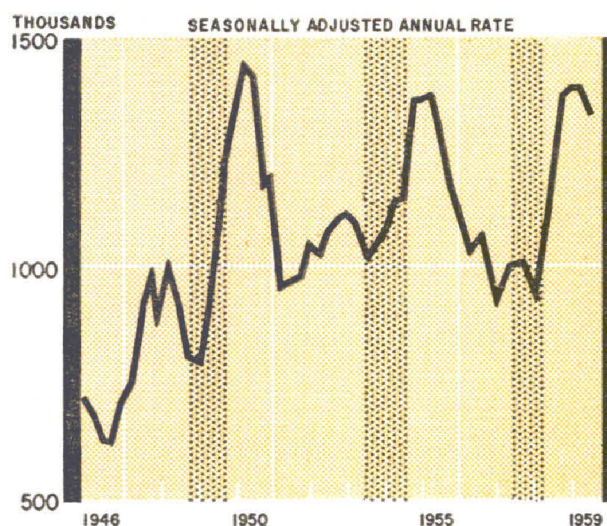
Twelfth District mortgage market particularly affected

The smaller investment in mortgages this year than last by mutual savings banks and life insurance companies has special significance for the Twelfth District, and particularly for California. Owing to the large influx of population, California has been the leading state in the nation in terms of housing starts, having accounted for about 16 percent of the national starts in each of the last five years. To finance this large volume of building it is necessary to rely heavily upon funds from Eastern investors, particularly mutual savings banks and life insurance companies. Their lessened activity in the mortgage market this year placed a relatively greater strain upon local lenders to finance the high level of building activity. To meet the demand, some lenders found that their mortgage holdings increased much more rapidly than they had anticipated. Consequently, about mid-year a more restrictive lending policy became evident as lenders tried to develop a better balance between mortgages and other types of investments in their portfolios. This special pressure in California (and to some extent in other parts of the Twelfth District as well) and the typical lag in the response of housing starts to changes in interest rate levels and in the availability of funds may exert a restraining influence upon District residential construction activity in the months that lie ahead. The decline in building permits and contract awards mentioned earlier may therefore continue.

In the postwar period the construction industry has assumed some of the characteristics of a contra-cyclical industry. This is in part due to the statutory limits placed upon government-guaranteed mortgages and the sometimes considerable lag in changing these rates in the light of changing money market conditions. Thus, early in a recovery money

flows readily into the mortgage market, for the yields here offer a better return than alternative investments. But as the recovery burgeons into expansion, the money resources as well as the physical resources of the economy approach full employment. The competition for funds from businesses which desire to lay up stocks of inventories and to expand plant capacity becomes more intense. Since the prospective return on these outlays seems to permit the payment of the higher interest rates necessary to outbid other requests for funds, lenders are more receptive to demands for funds from this quarter. With this process currently going on, construction activity, although maintaining a relatively high level, is likely to recede from the peak reached earlier in the economic expansion as funds and resources flow into other sectors of the economy. Some reduction in the rate of residential construction may also lead to some lessening in the cost-price pressures which have been evident in the building materials and construction field.

CHART 1
NEW PRIVATE NONFARM DWELLING UNITS
STARTED, QUARTERLY AVERAGES



Note: The shaded areas represent periods of economic recession, running from peak to trough according to dating by the National Bureau of Economic Research. The periods are November 1948 to October 1949, July 1953 to August 1954, and July 1957 to April 1958.

Source: *Construction Review*, July 1959, United States Departments of Commerce and Labor.

FEDERAL RESERVE BANK OF SAN FRANCISCO
BUSINESS INDEXES AND BANKING AND CREDIT STATISTICS—TWELFTH DISTRICT¹
(Indexes: 1947-1949 = 100. Dollar amounts in millions of dollars)

| Year and month | Industrial production (physical volume) ² | | | | | | | Total nonagricultural employment | Total mfg employment | Car-loadings (number) ³ | Dep't store sales (value) ² | Retail food prices ^{3, 4} | Bank rates on short-term business loans ⁵ |
|----------------|--|------------------------|------------------|------------------|--------------------|---------------------|----------------|----------------------------------|----------------------|------------------------------------|--|------------------------------------|--|
| | Lumber | Petroleum ² | | Cement | Steel ² | Copper ² | Electric power | | | | | | |
| | | Crude | Refined | | | | | | | | | | |
| 1929 | 95 | 87 | 78 | 55 _r | ... | 103 _r | 29 | ... | ... | 102 | 30 | 64 | .... |
| 1933 | 40 | 52 | 50 | 27 | ... | 17 | 26 | ... | ... | 52 | 18 | 42 | .... |
| 1939 | 71 | 67 | 63 | 56 | 24 | 80 | 40 | 60 | 57 | 77 | 31 | 47 | .... |
| 1949 | 100 | 99 | 103 | 100 | 97 | 93 | 108 | 99 | 97 | 94 | 98 | 100 | .... |
| 1950 | 114 | 98 | 103 | 112 | 125 | 115 | 119 | 103 | 105 | 98 | 107 | 100 | .... |
| 1951 | 113 | 106 | 112 | 128 | 146 | 116 | 136 | 112 | 121 | 100 | 112 | 113 | 3.66 |
| 1952 | 115 | 107 | 116 | 124 | 139 | 115 | 144 | 118 | 130 | 100 | 120 | 115 | 3.95 |
| 1953 | 116 | 109 | 122 | 131 _r | 158 | 113 | 161 | 121 | 137 | 100 | 122 | 113 | 4.14 |
| 1954 | 115 | 106 | 119 | 133 _r | 128 | 103 | 172 | 120 | 134 | 96 | 122 | 113 | 4.09 |
| 1955 | 122 | 106 | 122 | 145 | 154 | 120 | 192 | 127 | 143 | 104 | 132 | 112 | 4.10 |
| 1956 | 120 | 105 | 129 | 156 | 163 | 131 | 210 | 134 | 152 | 104 | 141 | 114 | 4.50 |
| 1957 | 106 | 101 | 132 | 149 | 172 | 130 | 224 | 138 | 157 | 96 | 140 _r | 118 | 4.97 |
| 1958 | 106 | 94 | 124 | 158 | 142 _r | 116 | 228 | 137 | 154 | 89 | 142 | 123 | 4.88 |
| 1958 | | | | | | | | | | | | | |
| July | 106 | 92 | 127 | 179 | 111 _r | 79 | 232 | 138 | 153 | 84 | 141 | 124 | .... |
| August | 108 | 93 | 128 | 179 | 134 _r | 91 | 232 | 138 | 155 | 92 | 149 _r | 123 | .... |
| September | 108 | 93 | 129 | 179 | 149 _r | 119 | 228 | 139 | 155 | 94 | 140 | 123 | 4.80 |
| October | 111 | 93 | 130 | 186 | 152 | 132 | 238 | 139 | 156 | 81 | 141 | 123 | .... |
| November | 112 | 93 | 127 | 159 | 169 _r | 139 | 231 | 140 | 158 | 91 | 149 | 124 | .... |
| December | 117 _r | 93 | 125 _r | 165 | 164 _r | 129 | 236 | 140 | 159 | 97 | 147 | 123 | 4.95 |
| 1959 | | | | | | | | | | | | | |
| January | 119 | 92 | 125 | 161 | 168 | 136 | 238 | 141 | 161 | 98 | 150 | 124 | .... |
| February | 115 | 92 | 126 | 142 | 187 | 138 | 242 | 141 | 162 | 93 | 155 | 123 | .... |
| March | 112 | 92 _r | 128 | 171 | 192 | 140 | 249 | 142 | 163 | 97 | 155 | 123 | 4.97 |
| April | 112 | 92 | 130 | 178 | 213 _r | 144 | ... | 142 | 164 | 94 | 153 | 123 | .... |
| May | 116 | 92 | 128 | 188 | 221 _e | 148 | ... | 142 | 163 | 101 | 154 | 123 | .... |
| June | 109 | 93 | 128 | 186 _r | 205 _e | 138 | ... | 143 | 164 _r | 95 | 161 | 123 | 5.21 |
| July | 116 | 92 | 136 | ... | 75 _e | 118 | ... | 143 | 165 | 88 | 161 | 123 | .... |

| Year and Month | Waterborne Foreign Trade Index | | | | | | Condition items of all member banks ⁶ | | | | Bank debits index 31 cities ¹² (1947-49 = 100) ² |
|----------------|--------------------------------|-----------|--------|---------|-----------|--------|--|-----------------------|---------------------------------------|---------------------|--|
| | Exports | | | Imports | | | Loans and discounts | U.S. Gov't securities | Demand deposits adjusted ⁷ | Total time deposits | |
| | Total | Dry Cargo | Tanker | Total | Dry Cargo | Tanker | | | | | |
| 1929 | 190 | 150 | 247 | 124 | 128 | 7 | 2,239 | 495 | 1,234 | 1,790 | 42 |
| 1933 | 110 | ... | ... | 72 | ... | ... | 1,486 | 720 | 951 | 1,609 | 18 |
| 1939 | 163 | 107 | 243 | 95 | 97 | 57 | 1,967 | 1,450 | 1,983 | 2,267 | 30 |
| 1949 | 85 | 87 | 81 | 121 | 118 | 199 | ..... | ..... | ..... | ..... | ... |
| 1950 | 91 | 80 | 108 | 137 | 141 | 88 | ..... | ..... | ..... | ..... | ... |
| 1951 | 186 | 194 | 175 | 157 | 136 | 660 | 7,866 | 6,463 | 9,937 | 6,777 | 132 |
| 1952 | 171 | 200 | 129 | 199 | 137 | 1,836 | 8,839 | 6,619 | 10,520 | 7,502 | 140 |
| 1953 | 140 | 137 | 145 | 308 | 157 | 4,224 | 9,220 | 6,639 | 10,515 | 7,997 | 150 |
| 1954 | 132 | 139 | 123 | 260 | 163 | 2,803 | 9,418 | 7,942 | 11,196 | 8,699 | 154 |
| 1955 | 164 | 176 | 149 | 308 | 183 | 3,594 | 11,124 | 7,239 | 11,864 | 9,120 | 172 |
| 1956 | 199 | 258 | 117 | 449 | 197 | 7,029 | 12,613 | 6,452 | 12,169 | 9,424 | 189 |
| 1957 | 229 | 306 | 123 | 575 | 213 | 10,008 | 13,178 | 6,619 | 11,870 | 10,679 | 203 |
| 1958 | 174 | 210 | 123 | 537 | 213 | 8,986 | 13,812 | 8,003 | 12,729 | 12,077 | 209 |
| 1958 | | | | | | | | | | | |
| August | 181 | 222 | 121 | 513 | 180 | 9,195 | 13,356 | 7,984 | 11,774 | 11,817 | 208 |
| September | 178 | 212 | 130 | 607 | 195 | 11,330 | 13,350 | 7,827 | 11,860 | 11,776 | 212 |
| October | 174 | 207 | 127 | 712 | 221 | 13,516 | 13,419 | 7,846 | 12,176 | 11,836 | 217 |
| November | 178 | 201 | 145 | 545 | 235 | 8,633 | 13,591 | 8,026 | 12,395 | 11,725 | 213 |
| December | 170 | 218 | 101 | 762 | 231 | 14,589 | 13,812 | 8,003 | 12,729 | 12,077 | 224 |
| 1959 | | | | | | | | | | | |
| January | 237 | 243 | 228 | 504 | 263 | 6,799 | 13,897 | 8,099 | 12,508 | 12,037 | 218 |
| February | 153 | 181 | 144 | 694 | 210 | 13,375 | 14,022 | 7,735 | 12,210 | 12,018 | 235 |
| March | 209 | 204 | 217 | 652 | 378 | 7,810 | 14,176 | 7,436 | 12,228 | 12,003 | 244 |
| April | 168 | 190 | 138 | 600 | 273 | 9,101 | 14,768 | 7,739 | 12,874 | 12,301 | 241 |
| May | 158 | 178 | 131 | 576 | 272 | 8,482 | 15,000 | 7,511 | 12,520 | 12,399 | 231 |
| June | ... | ... | ... | ... | ... | ... | 15,328 | 7,329 | 12,589 | 12,517 | 235 |
| July | ... | ... | ... | ... | ... | ... | 15,617 | 7,096 | 12,945 | 12,390 | 242 |
| August | ... | ... | ... | ... | ... | ... | 15,924 | 6,932 | 12,797 | 12,378 | 241 |

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, California Redwood Association and U.S. Bureau of the Census; petroleum, cement, and copper, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; 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. e—Estimated. r—Revised.