Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO
TWELFTH FEDERAL RESERVE DISTRICT

October 1960

In This Issue

Review of Business Conditions

"Newton saw the apple fall,
but he didn't see who threw it."

So goes the popular doggerel summarizing the observations leading to the law of gravity, whose popular formulation runs:

"What goes up, must come down."

Some business observers, who use Newtonian mechanics to interpret the business scene, take this principle to be a fair shorthand statement of the business cycle. To business analysts of this persuasion, the economy's current sideways progress along an elevated plain necessarily appears to be an ominous interlude between the "what goes up" and the "must come down." Although postwar cyclical experience suggests to these analysts that the current upswing is past its prime and the recent plateau a prelude to a general downturn, other aspects of the economy's recent performance have not been fully appreciated.

The "plateau" stage in the business cycle

When an economic contraction does occur along with its painful and unsettling effects, it also acts to correct some of the imbalances and maladjustments created or intensified in the preceding upswing. In a sense, then, a recession may work part of its own cure. But imbalances and maladjustments of various kinds exist in all stages of the business cycle, within and between firms, industries, sectors, and entire economies as well, if the world is within our purview. Similarly, corrective processes are continually taking place.

During the last several months of comparative stability in overall business activity, a major correction in inventory positions has been taking place. Inventory accumulation has been reduced from an annual rate of $11 billion in the first quarter to approximately zero in the third quarter. It is reasonable to conclude, therefore, that less weight can now be accorded to this one imbalance which has been a key source of weakness in the past.

In the postwar business cycles experienced so far, economic upswings did not culminate in business situations in which the economy was poised on a knife edge between sharp advance and slashing decline. In the cycle of the 'fifties, for example, the slashing decline appears to have been avoided through strong underlying growth potential and by the strength of important sources of demand which did not reinforce the downward spiral precipitated by more volatile factors in the economy. In the 1957-58 recession, industrial production fell 14 percent, a decline which in the cycle of another day would have left an indelible mark on personal income, but disposable personal income fell less than 1 percent. In the 1953-1954 recession, such income never did decline. A significantly looser linkage between volatile factory and mine output and consumer spending power tended to offset and check the cumulative effects of a general downswing.

How effective these and other checks, offsets, and balances will be in the next downswing is not a question to be easily answered and certainly not within the confines of a brief review of current business and financial developments. What this note can do is to put the consumer of business reports on his guard against easy assumptions that the patterns of the past must be rigorously superimposed on the future.

Nonfarm employment up less than seasonally

Reflecting mainly layoffs at automobile and supplier plants and steel mills, nonfarm employment in the nation registered a substantially smaller than seasonal expansion from mid-July to mid-August. Further gains were recorded in trade, finance, and government employment, while declines occurred in service industries and agriculture. A decline of 200,000 in the number of unemployed was below seasonal expectations and pushed the unemployment rate to 5.9 percent of the labor force, compared with 5.4 percent in July.

After adjustment for seasonal factors, employment in manufacturing establishments has fallen steadily since May. With factory payrolls edging lower, monthly gains in personal income have been getting increasingly smaller. August's rise of $300 million, seasonally adjusted annual rate, was the smallest since February and amounted to only a fraction of the average rises recorded in the May-July period.

District unemployment rate parallels national rise

The employment situation in the Twelfth District continued to show signs of weakness in August. While nonagricultural employment rose slightly, total civilian employment fell, and unemployment increased in both California and Washington. The seasonally adjusted rate of unemployment in California rose from 5.3 percent of the labor force in July to 5.8 percent in August; Washington had a similar increase from 8.6 percent in July to 9.1 percent in August. However, the rate of insured unemployment (not seasonally adjusted) moved downward in California along with the national average. It also fell in all the remaining District States except Washington, Utah, and Arizona. The rate in the latter two states was still considerably below the national average, while the rate for Washington was higher.

Seasonally adjusted nonfarm employment rose slightly in August in both California and Washington. There were increases in all the major industry categories of both states except for mining, which remained unchanged, and manufacturing and transportation, which fell.

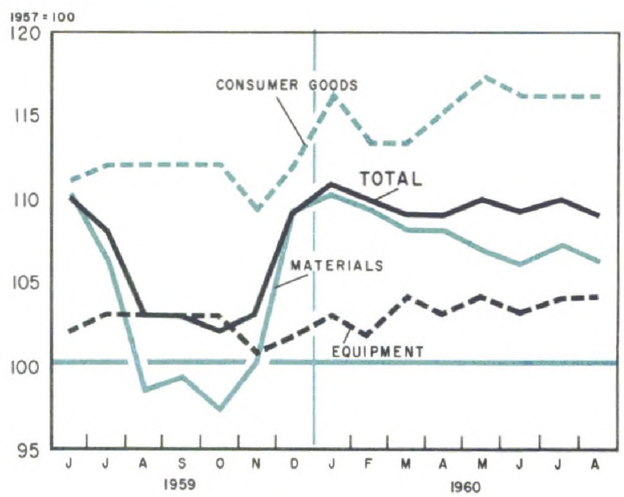
The decline in the number of California workers engaged in manufacturing was partly explained by the behavior of the food canning and processing industry, which failed to show its usual seasonal increase in August due to late harvesting this season. Employment in durable goods industries remained unchanged as the gains resulting from the settlement of a strike in missile plants and an increase in electrical equipment employment were offset by a further cutback in aircraft and a drop in auto assembly, pending model changeovers.

For the District as a whole, a persistent slackening in the lumber and aircraft industries, unmatched by increases in any of the other major industries, contributed to a somewhat lessened rate of growth in nonfarm employment for the first seven months of 1960, compared with the corresponding period in 1959. The seasonally adjusted gains were 2.3 percent and 3.0 percent, respectively.

Industrial production continues to teeter-totter

Business observers, who have little enough to cheer about these days, may have been cheated out of such an occasion last month when the preliminary industrial production index for July, showing no change from the prior month, was subsequently revised up-

Total industrial production remains at stable level



NOTE: Data is seasonally adjusted.
Source: Board of Governors of the Federal Reserve System.

ward from 109 to 110 percent of the 1957 average. The preliminary August figure, however, showed a minor decline back to 109 percent. Small changes in the index are not too important in themselves, but the recent seesawing is aptly symbolic of a type of behavior characterizing a good many of the economic indicators these days.

Into August and September, the trend, or rather cross-trends, of advances, declines, and stability continued to be reflected in the components of the index of factory and mine output. Iron and steel production continued downward in August. In early September, mill operations failed to record normal seasonal gains, but by mid-month the actual operating rate, 53 percent of capacity, exceeded the scheduled rate for the first time in three months. Production of fabricated metal products, machinery, home goods and apparel, and consumer staples also fell slightly in August. On the other hand, August output of automobiles was curtailed less than usual by model changeovers, and production schedules indicated an additional seasonal rise in September. The business equipment and mineral fuels groups showed no significant change from the previous month.

District steel production continues to decline

Western States steel production was lower in August than in July, adding another month to the persistent declines so far this year. August production was only about 60 percent of the relatively high output of January. While the operating rate in the West for July was higher than in the entire United States, the rate for August fell below the national average, despite the fact that the national average was also falling. However, some improvement in the western rate is reported for early September. In contrast to the weekly rates of 47-49 percent of capacity prevailing in August, production in the first two weeks of September was at the 52-53 percent level and was scheduled at 54 percent for the third week of September. The improvement in the District rate reflects, in part, the receipt of a large order for pipe for the transmission of natural gas.

Nonferrous metal markets quiet

The Twelfth District is a major domestic source of supply for nonferrous metals, and the markets for them have been comparatively quiet. Although consumer demand for copper continued to be slow, custom smelters held the price at 33 cents a pound until early October despite the fact that copper was selling below 30 cents in the London market. The resulting differential exceeded the normal spread of 2-2½ cents a pound between domestic and foreign prices. The possibility of a strike at Chilean mines and continuing strife in the Congo were cited as key factors in support of that price level. The continued slowness of consumer demand for copper and the excess of world production over demand has led two major Rhodesian producers to consider a production cutback, and a large United States producer has also said that output will have to be curtailed if the present overproduction continues.

Domestic brass mill operators, on the other hand, have asserted that the current price for copper hampers them in their competition with foreign producers who have the advantage of both lower labor costs and lower copper prices. The demand for the products of the brass industry has continued to be slow with mill order backlogs low and shipments exceeding new orders.

The demand for lead and zinc has also been comparatively sluggish. Producers' stocks of lead on a worldwide basis are high and continue to exert pressure on the market.

Construction indicators hold out some promise

Although the value of new construction put-in-place in the nation declined further in

August to \$54.5 billion on a seasonally adjusted basis, three key indicators of future activity in the residential sector turned up. Housing starts, applications for FHA commitments, and requests for VA appraisals showed gains. These are obviously encouraging signs, but it is questionable whether the underlying demand factors are presently strong enough to support a sharp turnaround in residential building. The 8 percent pickup in housing starts in August must be considered in the light of the unexpectedly low figure reported for the previous month.

Lumber prices dip; plywood prices firm

Douglas fir prices, relatively stable throughout August, began to slip during the first two weeks of September. Some of this decline is seasonal as a drop in lumber demand generally occurs after Labor Day. However, the relatively high levels of inventories were also a factor. The price stability throughout August was attributable, in part, to the curtailment of production. Although lumber output rose seasonally, it was below the level of August of last year. Despite this, inventories were reduced only slightly during the month, and new orders showed little improvement, falling below production for the first time since May. Under these conditions, the seasonal drop in demand that began in early September led to some reduction in prices.

Plywood prices continued to strengthen. By mid-September, ¼ inch sanded plywood panels moved to \$68 on price lists. This firmness in prices was related to the successful production curtailment program rather than to any major change in demand. There is a general feeling reported within the industry that some form of curtailment will be continued throughout the year.

Mixed signs in District mortgage market

The results of the most recent Federal Housing Administration survey of FHA mortgage prices in secondary market transactions in the West indicate that the price of these mortgages rose during August for the third consecutive month. On September 1, prices for immediate delivery of 5¾ percent new home mortgages with 25 year maturities and 10 percent or more downpayment averaged \$97.1 per \$100, compared with \$96.8 on August 1. Despite this bidding up of prices, there is little evidence of a significant increase in the volume of funds being invested in FHA-insured mortgages. District applications for FHA mortgage insurance on new housing fell 15 percent in July and were 35 percent below the corresponding month last year. Later data covering the nation as a whole indicate these applications increased during August but by only a small amount.

The secondary market operations of the Federal National Mortgage Association in the District increased during July, partly as a result of the increase in purchase prices announced by the Association early in June. During August, the Association added less to its secondary market portfolio than in July. The flow of savings into District savings and loan associations continues as a positive factor. The increase in savings accounts of these associations during July was 22 percent above the corresponding month of a year ago. The cumulative gain for the first seven months of this year now exceeds that in the same period last year by 22 percent.

July farm income above 1959, but prospects weaken

Returns obtained by the nation's farmers during July exceeded those received during July 1959, reflecting the sharp increase in wheat production. The flow of funds to District farmers from the sale of their products in July also was larger than a year earlier. Little significance, however, can be attached to this increase because it reflects the later maturity this year of deciduous fruit crops in California than in 1959. If it were not for

TWELFTH DISTRICT CROP PRODUCTION INDEXES

(1947-49=100)

	1959	Estimated 1960
Fresh Vegetables	130.5	126.6
Melons	129.7	108.5
Processing Vegetables	169.1	177.8
Deciduous Fruits	97.1	90.9
Citrus Fruits[1]	104.0	n.a.
Field Crops	140.7	137.8
Nuts	135.4	115.8
ALL CROPS[2]	132.9	129.2

[1]Season begins with the bloom of the year shown and ends with completion of harvest the following year.
[2]Does not include citrus.
n.a. Not available.
Source: United States Department of Agriculture, *Crop Production*.

the increased marketings of crops in California, District farm income in July would have been lower instead of higher than in 1959. Crop returns were lower in all other District States, and receipts from the sale of livestock and livestock products were smaller in all District States.

District farm income prospects appear to have weakened since July. For example, market prices of major District farm products were generally lower during the first two weeks of September than during the comparable 1959 period. In addition, crop output in the District, as shown in the accompanying table, is expected to be lower than during 1959. District crop marketings are heaviest during the last half of the calendar year.

Union efforts to organize farm workers in California continue. The effectiveness of these efforts hinges primarily on rulings by the State Director of Employment that labor disputes do exist when pickets appear at selected farms. Issuance of such a ruling precludes the use of foreign labor on the farms covered by the ruling. In the week ending September 10, the State Department of Employment reported a temporary hired labor force of 198,000 on California farms. Approximately 59,000 of these employees were foreign workers.

Retail sales in the nation remain at previous level

Total retail sales throughout the nation in August held at the seasonally adjusted July volume of $18.2 billion. Automobile sales rose slightly, while sales at department stores and most other retail outlets declined. Although sales of consumer durables continued to run behind the year-ago level, the latest survey of consumer attitudes reveals no further deterioration in consumer buying intentions. Despite the survey results, most hard goods merchants probably feel that consumers are showing an ominous restraint. The relatively small increases in outstanding consumer credit in July and August may also indicate increasing caution on the part of consumers.

District retail trade continued to slide

Several major indicators of District retail trade have shown declines, according to the latest data available. In July, retail sales for the Twelfth District[1] dropped 3.5 percent and 5.4 percent, respectively, from the corresponding month- and year-ago levels. The largest decline occurred in automotive sales which were off 15 percent from June, a month when car dealers made special promotional efforts to work off car inventories. In July, automobile registrations in the District lagged those of a year ago by 8 percent. New passenger car registrations in California during the first 28 days of August suggested that a further substantial decline had occurred since July, which may bring the total for the full month 20 percent below August 1959.

Department store sales for August and the first part of September also indicated a lessening in consumer expenditures in the District. August department store sales were 3 percent below the corresponding period a year ago, and the first two weeks of September

[1]Stores of firms operating 1-10 stores at the time of the 1954 Census of Business.

also showed declines. Sales so far this year in Oregon and Washington have been running below those of a year ago, reflecting the fact that personal income in Oregon and Washington through July of this year had increased only nominally, compared with other District States, except Alaska. For the District as a whole, department store sales showed practically no change from last year's pace.

Business investment tapering off

The most recent SEC-Department of Commerce survey of capital spending plans indicates that a leveling is occurring. Estimated outlays in the third quarter have been reduced by $600 million on a seasonally adjusted basis from the earlier anticipation published in June. This year's outlays for plant and equipment are now expected to total $36.4 billion, down $1.1 billion from the amount forecast last November. Many observers think that this change in expectations may mark the end of the two-year boom in fixed capital outlays.

Inventory investment in July declined on a seasonally adjusted basis. Although this was the first month in 1960 showing actual liquidation, runoffs were generally confined to industries which had previously shown the greatest slackening in rates of accumulation.

Yields on District municipal securities decline

A moderately heavy volume of new municipal bonds was marketed in the District during August and September, and the market encountered the sharp price movements that affected the bond markets generally in this period. Municipal bond yields fell sharply in August. Staat's index of yields on 19 California bonds fell from 3.60 percent at the beginning of August to 3.40 percent by mid-month. However, this level proved unsustainable, and the index climbed back to 3.52 percent by mid-September. New issues of $5 million or larger totaled $96 million in August, with the largest flotations coming to market at the height of the bond price spurt in the last week of the month. Some new bonds sold slowly at yields which were the lowest obtainable since 1958, and a moderately heavy list of new offerings for September contributed to the decline in bond prices that took place during the first half of September. The estimated volume of new District issues ($5 million or larger) was $120 million for that month.

Banks invest in securities as loan expansion levels off

From the end of June through September 21, total bank credit[1] extended by weekly reporting member banks in the United States increased $3,386 million, with a gain in security holdings accounting for all but $520 million of the increase. During the same period, total bank credit at District reporting member banks rose $491 million; a $585 million increase in security holdings more than offset a decline in loans outstanding.

In the four-week period since August 24, the overall reserve position of banks eased measurably, reflecting the lowering of reserve requirements for central reserve city banks and increased allowances in computing vault cash as part of reserves. In both the nation and in the Twelfth District, there was a rise in lending and a large increase in demand deposits in the week preceding the September 15 quarterly tax date.

In the period from August 24 through September 21, total loans at weekly reporting member banks in the District expanded $78 million, but almost all of the gain occurred in the week of September 14 when tax borrowing occurred. The absence of a tax anticipation bill maturing in September may have resulted in somewhat higher bank borrowing by business firms. In addition, brokers and

[1] Exclusive of loans to domestic commercial banks and after deduction of valuation reserves.

CHANGES IN SELECTED BALANCE SHEET ITEMS OF WEEKLY REPORTING MEMBER BANKS IN LEADING CITIES

(dollar amounts in millions)

	Twelfth District				United States			
	From August 24, 1960 to Sept. 21, 1960		From Sept. 23, 1959 to Sept. 21, 1960		From August 24, 1960 to Sept. 21, 1960		From Sept. 23, 1959 to Sept. 21, 1960	
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
ASSETS:								
Total loans and investments	+277	+ 1.24	+455	+ 2.05	+2,544	+ 2.41	+3,691	+ 3.53
Loans and investments adjusted[1]	+238	+ 1.07	+416	+ 1.89	+2.382	+ 2.28	+3,411	+ 3.30
Loans adjusted[1]	+ 78	+ 0.52	+961	+ 6.82	+1,432	+ 2.11	+4,302	+ 6.63
Commercial and industrial loans	+ 38	+ 0.73	+486	+10.27	+ 675	+ 2.18	+2,196	+ 7.48
Real estate loans	— 18	— 0.35	— 51	— 0.97	— 1	— 0.01	+ 94	+ 0.75
Agricultural loans	+ 12	+ 1.82	+ 79	+13.30	+ 31	+ 3.07	+ 113	+12.16
Loans for purchasing and carrying securities	+ 13	+ 6.53	+ 59	+38.56	+ 516	+16.49	+ 380	+11.64
Loans to nonbank-financial institutions	+ 7	+ 0.85	+188	+29.47	+ 160	+ 2.76	+ 490	+ 8.95
Loans to domestic commercial banks	+ 39	+14.94	+ 39	+14.94	+ 162	+12.26	+ 280	+23.28
Loans to foreign banks	+ 6	+ 3.11	+ 20	+11.17	+ 21	+ 3.13	+ 49	+ 7.61
Other loans	+ 21	+ 0.71	+213	+ 7.71	+ 5	+ 0.03	+1,048	+ 7.43
U. S. Government securities	+140	+ 2.65	—360	— 6.23	+ 842	+ 3.10	— 369	— 1.30
Other securities	+ 20	+ 1.05	—185	— 8.78	+ 108	+ 1.14	— 522	— 5.15
LIABILITIES:								
Demand deposits adjusted	+ 85	+ 0.79	—249	— 2.23	+ 560	+ 0.96	—1,079	— 1.79
Time deposits	+ 86	+ 0.78	+ 98	+ 0.89	+ 357	+ 1.07	+1,290	+ 3.99
Savings accounts	+ 46	+ 0.50	— 5	— 0.05	n.a.	n.a.	n.a.	n.a.

n.a. Not available.
[1] Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross.
Source: Board of Governors of the Federal Reserve System and Federal Reserve Bank of San Francisco.

dealers required increased bank financing to carry their higher inventories of Government securities during the weeks just prior to the tax date when demand for Treasury securities slackened. Commercial and industrial loans rose $38 million in this four-week period, the second increase in business loans since June. Food processors increased their borrowing seasonally by $50 million; loans to trade firms turned up as is usual in the fall, expanding $30 million, with retail trade accounting for 75 percent of the increase. Public utilities and transportation companies reduced their bank debt $25 million, a continuation of the decline in the preceding four-week period. A gain of $21 million in consumer loans failed to bring this category up to the mid-year level, indicating the slower tempo of consumer expenditures since June. Agricultural loans at District reporting member banks climbed to $80 million above the year-ago level, as farmers increased their bank debt by another $12 million. Real estate loans, on the other hand, declined $18 million, dropping the total volume of outstanding real estate loans $50 million below the level at this time last year.

Weekly reporting member banks in the District had an increase of $178 million in time deposits in August and another $78 million in the first three weeks of September. While demand deposits adjusted declined at reporting member banks in August, they rose sharply in the first two weeks of September as a result of preparation for quarterly tax payments on the 15th. In the week of September 21, there was a decline of $151 million, offsetting a large part of the gain of the preceding two weeks.

As loan expansion has leveled off and banks have had free reserves and increased deposits, they have invested in United States Government securities. July was the first month since April in which District weekly reporting member banks showed a net increase in their Government security portfolios. Additional large amounts were acquired in August, and the trend continued with net additions of $140 million in the four weeks since August 24. Bank holdings of other securities also rose during this period.

District Member Banks Earnings Rise in Wake of Loan Expansion

Since mid-year, the loan expansion which started in 1959 appears to be tapering off, at least temporarily, and the volume of loans outstanding at member banks in the Twelfth Federal Reserve District has shown no increase over the June level. At the same time, total deposits, including time deposits, have continued to rise after the sharp drop early in 1960, and District member banks have been making net additions to their investment portfolios, a change from the large reductions in 1959 and the first quarter of 1960. The Federal Reserve System during 1960 progressively eased the rein on bank credit until, by mid-year, banks again had free reserves. Further action by the Federal Reserve System in reducing reserve requirements in late August and early September plus a reduction in the discount rate was accompanied by a cut by large city banks in the prime rate on business loans from 5 to 4½ percent in the latter part of August. These changes in the banking environment provide a background for discussing loan developments so far this year and earnings experience of District member banks in the first half of 1960.

Record profits for District member banks

In the first half of this year, member banks in the Twelfth Federal Reserve District reaped the benefits of their record loan expansion in 1959. Earnings on loans soared 22 percent above the first six months of 1959 to establish an all-time high of $532 million. The rise was accounted for by both a higher volume of loans outstanding and a higher average rate of return on loans. The increase was more than sufficient to offset both a decline in earnings on securities and an increase in total expenses. Net current earnings (total earnings minus expenses) of District member banks were one-fifth more than in the first half of last year. As a result of higher net earnings and smaller net losses on securities, net profits, both before and after taxes, rose above the first six months of 1959 and surpassed the previous record set in the first half of 1958. Table 1 shows earnings and expenses of District member banks for the first half of 1960 and 1959, and Table 2 gives the earnings ratios for the two periods.

Faster rate of gain for smaller banks

The percentage gain in loan earnings was not so great for the 13 largest member banks in the District as for all other District member banks. This was due to a smaller percentage increase in loans outstanding at the larger banks. The divergence in the earnings pattern for the two groups was particularly pronounced with respect to earnings on securities. The larger banks registered an 18 per-

TABLE 1

EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS, SIX MONTHS ENDING JUNE 30, 1960

(millions of dollars)

				Percent Change from First Half of 1959		
	All Member Banks	13 Largest	Other	All Member Banks	13 Largest	Other
Earnings on loans	532,005	441,205	90,800	+21.8	+18.9	+ 37.8
Interest and dividends on						
Government securities	87,257	66,750	20,507	—13.1	—17.6	+ 6.2
Other securities	30,265	23,593	6,672	— 2.9	— 5.2	+ 6.4
Service charges on deposit accounts	58,739	46,764	11,975	+12.5	+10.6	+ 21.2
Trust Department earnings	20,038	17,530	2,508	+10.5	+ 9.4	+ 19.1
Other earnings	27,765	20,833	6,932	+ 4.5	+ 1.5	+ 13.1
Total earnings	756,069	616,676	139,394	+13.6	+11.0	+ 27.2
Salaries and wages	196,538	158,928	37,610	+12.7	+10.8	+ 21.3
Interest on time deposits	161,773	134,851	26,922	+ 1.7	— 0.4	+ 13.5
Other expenses	143,016	113,248	29,767	+17.7	+14.7	+ 30.7
Total expenses	501,325	407,028	94,297	+10.2	+ 7.8	+ 22.0
Net current earnings	254,744	209,648	45,096	+21.1	+17.6	+ 40.0
Net recoveries and profits (—losses)[1]						
On securities	—15,149	—14,761	— 388			
On loans	—15,846	—13,053	—2,793			
Others	— 2,405	— 2,059	— 347			
Total net recoveries and profits (—losses)[1]	—33,400	—29,873	—3,528			
Net profits before income taxes	221,343	179,775	41,568	+31.9	+23.3	+ 89.1
Taxes on net income	106,932	89,105	17,826	+49.3	+43.7	+ 85.4
Net profits after taxes	114,412	90,670	23,742	+18.9	+ 8.2	+ 91.1
Cash dividends declared	56,728	48,490	8,238	+ 6.6	+ 5.4	+ 13.9
Undistributed profits	57,684	42,180	15,504	+34.2	+11.6	+198.1

[1]Including transfers to (—) and from (+) valuation reserves.
Source: Federal Reserve Bank of San Francisco.

cent drop in earnings on Government securities and a 5 percent decline in earnings on other securities. All other District member banks showed a 6 percent rise in earnings both on Governments and on other securities. In addition, since large banks typically keep more fully invested, they were required to sell relatively more Government securities to finance their loan expansion than the small banks. Consequently, the security losses of larger banks were also comparatively greater.

Expenses in every category rose relatively more for the group of smaller District member banks than for the 13 largest banks in the first six months of 1960. Because of the greater gain in total earnings, however, the percentage gain in net current earnings was so much greater than for the larger banks that net profits after taxes rose 91 percent above the first half of 1959, compared with an 8 percent gain in net profits after taxes for the 13 largest banks. Table 1 gives a comparison of earnings and expenses items for the two groups.

Loan expansion to mid-year fell short of 1959 pace

The loan expansion of District banks in 1959 and the first half of 1960 not only produced record profits but also affected the

TABLE 2

EARNINGS RATIOS OF TWELFTH DISTRICT MEMBER BANKS

(percent ratios)

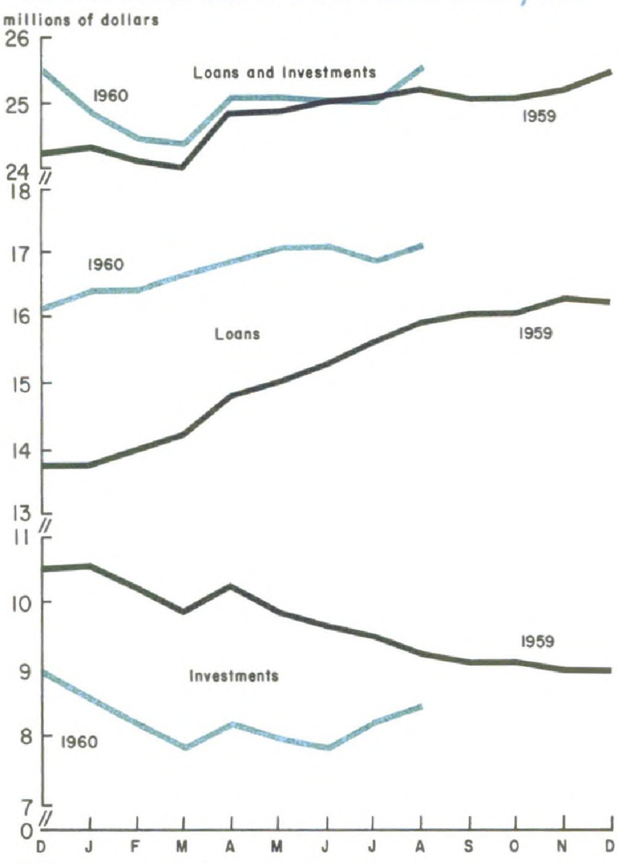
	First Half 1960	First Half 1959	Increase or Decrease
Return on loans	6.4	6.1	+0.3
Return on Government securities	2.9	2.6	+0.3
Current earnings to capital accounts	24.7	22.1	+2.6
Net profits after taxes to capital accounts	11.1	10.1	+1.0

NOTE: Capital accounts, loans, and Government securities items on which ratios are based are averages of Call Report data on December 31, 1959, March 15, and June 15, 1960; and December 31, 1958, March 12, and June 10, 1959.
Source: Federal Reserve Bank of San Francisco.

current lending capacity of banks. After making a record-breaking volume of loans in 1959, Twelfth District member banks had a temporary breathing spell in the first quarter of 1960 as seasonal repayments slowed down the rate of loan expansion. In the second quarter, credit demand again gained momentum. For the first half of 1960, total loans outstanding rose $594 million. While this is a sizable increase, it is dwarfed in comparison with the loan expansion of over 2½ times that amount in the first half of 1959. The accompanying chart shows the trend of total bank credit, total loans, and investments from January 1959 through August 1960 at all District member banks.

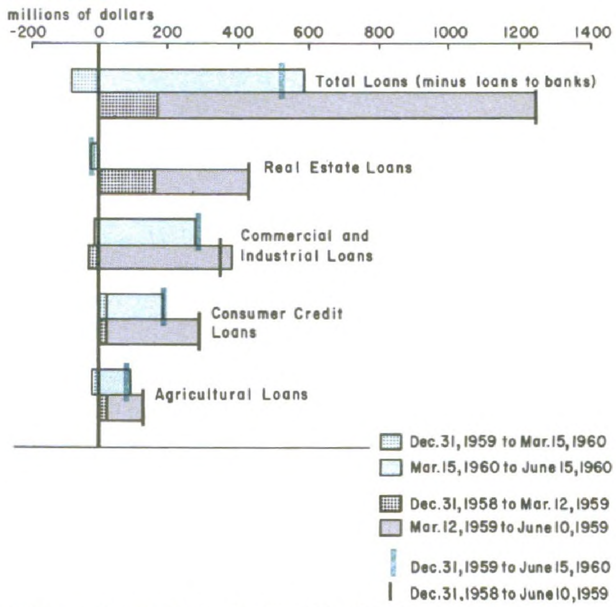
In order to examine the behavior of loans by type for all member banks in the District, it is necessary to use Call Report data. In 1959, from January through June 10, a Call Report date, District member banks had a record increase of $1,250 million in total loans (minus loans to banks), with all but a seventh of the increase occurring in the period from the March 12 Call Report to June 10. This year the loan increase from January through the June 15 Call Report date was $514 million, less than half of last year's amount, and all of the rise occurred after the March 15 Call Report, the earlier months

Loans constituted increasing proportion of total bank credit until mid-year



*All member banks in the Twelfth District.
Source: Federal Reserve Bank of San Francisco.

Loan increase drops below 1959 record



*All member banks in the Twelfth District. Figures based upon Call Report Data.
Source: Federal Reserve Bank of San Francisco.

having registered a small decrease (see chart). Loan expansion for the first part of this year was well below the $834 million increase in the corresponding period of 1956, which was also the second year of an upswing in business activity.

Accompanying the sharply declining volume of residential construction this year, real estate loans at District member banks dropped $12 million in the first 5½ months. In 1959, on the other hand, residential building was booming and real estate loans climbed rapidly, increasing $427 million in the comparable period. While conventional real estate loans increased slightly this year, both FHA and VA insured loans held by District member banks declined.

As opposed to the divergent real estate loan activity in the two periods, business loans followed somewhat the same pattern in 1960 and 1959. A nominal decrease in the first two months was followed by net expansions of $274 and $347 million, respectively, in the mid-March to mid-June period. Table 3 shows the net changes in business loans by industry, based on a sample of weekly reporting banks in the District. The largest net reductions during the first six months of this year were made by food, liquor, and tobacco processors and by commodity dealers. Both of these groups normally make substantial loan repayments during the first half of the year. The reduction of $91 million in loans to commodity dealers, however, was double the decline in the same period in 1959. This was due mainly to the fact that commodity dealers had borrowed twice as much as usual in the latter half of 1959 to finance greatly increased cotton inventories resulting from a change last year in the cotton support program. Then, in 1960, as inventories were sold off, they repaid their larger than normal bank debt. Just the opposite situation prevailed in the metals and metal products industry, which accounted for the largest net increase in business loans, as they borrowed heavily in the first half of 1960 to finance the rebuilding of their inventories which had been depleted in the last half of 1959 by the steel strike. The $106 million rise in bank borrowing by this group was about 40 percent greater than the increase in the corresponding period last year when the industry was also accumulating inventories in expectation of the steel strike. The overall expansion in bank credit by trade was approximately the same in both periods, but retail trade accounted for two-thirds of the amount this year instead of one-half as in 1959. Part of the increased borrowing by retail trade was to finance higher inventories, particularly in the durable goods sector where automobile inventories were at a level substantially above 1959.

Personal income and consumer spending were elements of strength in sustaining the high level of economic activity during the first part of 1960. As personal income goes up, consumer credit also tends to rise, and this was reflected in the increase of $193

TABLE 3

CHANGES IN COMMERCIAL AND INDUSTRIAL LOANS BY INDUSTRY

(millions of dollars)

Business of Borrower	January to June 1960	January to June 1959
Manufacturing and mining:		
Food, liquor, and tobacco	—117.5	—101.2
Lumber and forest products	+ 4.2	— 7.3
Textiles, apparel, and leather	+ 14.1	+ 7.7
Metals and metal products	+105.8	+ 72.9
Petroleum, coal, chemicals, and rubber	— 4.6	— 10.5
Other manufacturing and mining	+ 31.5	+ 16.9
Trade:		
Wholesale	+ 26.6	+ 39.0
Retail	+ 62.8	+ 41.5
Commodity dealers	— 91.2	— 55.7
Public utilities and transportation	+ 78.0	+ 51.9
Construction	+ 9.7	+ 14.3
All other types of business	+ 55.4	+ 71.1

NOTE: Based on sample of weekly reporting member banks in the Twelfth District.
Source: Federal Reserve Bank of San Francisco.

million in consumer loans at District member banks from the first of the year through mid-June. This represents a 6 percent increase, compared with a 12 percent increase in consumer loans in the comparable period of last year. Automobile instalment credit accounted for one-half the increase in bank-held consumer instalment loans this year and was concentrated mainly in the March-June period, reflecting the relatively high level of automobile sales in those months. During the same period, a sharp rise also occurred in single payment loans. As a result, 90 percent of the total increase in loans to finance consumer expenditures occurred in the second quarter.

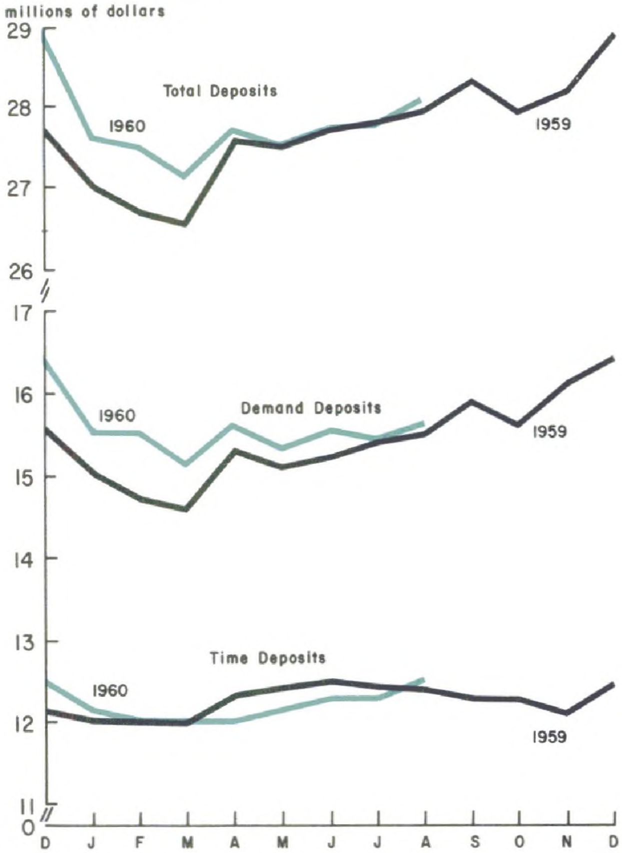
Farmers reduced their bank credit at member banks by $18 million in the first two months of 1960, compared with a $25 million increase in the corresponding period of 1959. CCC loans, as usual at this time of year, dropped to a nominal amount, and other loans to farmers also fell. From March to mid-June, the increase of $95 million in agricultural loans was approximately the same as in 1959.

District member banks made substantial loans to brokers and dealers for financing and carrying Government securities in mid-April at the time of the Treasury financing. Credit was again extended in sizable volume in mid-June, in large part to finance dealer purchases of securities from business firms needing cash for tax payments.

Deposit decline accelerates rise in loan-deposit ratio

District member banks faced 1960 with some limitations on their ability to expand further their loan portfolios. In spite of the large volume of loans made in 1959, deposit growth at District member banks was only $1.5 billion, just two-thirds of that in 1958. Of particular concern to the banks was a slackening in the rate of growth of time deposits from 13 percent in 1958 to 3 percent in 1959 as substantial amounts of corporate and individual savings, attracted by higher rates of return, were channeled into Government securities, savings and loan associations, and other investments. As the rapid loan expansion at District member banks in 1959 outpaced deposit growth, the ratio of loans to deposits moved up steadily over the course of the year from 52.7 percent at the end of December 1958 to 60.1 percent at the end of 1959. For reserve city banks the ratio increased from 53.3 to 61.1 percent and for country member banks from 48.8 to 54.8 percent.

Time and demand deposits decline in first quarter



*All member banks in the Twelfth District.
Source: Federal Reserve Bank of San Francisco.

In the first half of 1960, District member banks had a net loss in total deposits. The decline of $1 billion offset most of the gain made the preceding year. Savings and time depositors continued to shift their funds to other investments, and time deposits dropped $449 million (3.6 percent) in the first quarter of 1960. There was a net increase in the second quarter, but it fell short of the prior loss, and at the end of June, time deposits were still $175 million lower than at year-end. The combination of the deposit loss and further loan expansion pushed the loan-deposit ratio of District member banks to 64.3 percent at the end of June 1960.[1] This was far above the ratios of 49.8 and 55.5 percent existing in 1955 and 1956, respectively, also years of heavy loan expansion. It was also well above the loan-deposit ratio of 58.5 percent for all member banks in the United States in June 1960.[2] The loan-deposit ratio of country member banks in the District as of the end of June 1960 was 59.4 percent, compared with that of 51.7 percent for all country member banks in the United States. Reserve city banks in the District also had a loan-deposit ratio above that of all other reserve city banks in the country, 65.1 percent, compared with 61.9 percent. Only central reserve city banks in New York had a higher loan-deposit ratio, 67.4 percent, than reserve city banks in the Twelfth District.

Bank loan rates remain high as other interest rates slide

The continuation of loan expansion in the first half of 1960 along with the rapid rise in the already high loan-deposit ratio contributes to an explanation of the failure of bank loan rates to decline when open market money rates dropped sharply during this period. Any seller who is running low on stock and has no way of immediately replenishing his supply does not lower his price when demand remains high. District banks were in this situation during the first part of 1960 and pursued selective loan policies, showing preference for customers of long-standing. As a result, average interest rates on short-term business loans made by District banks[1] did not decline from December 1959 to June 1960. Three-fourths of the dollar volume of short-term business loans made by banks included in the interest rate survey of June 1960 carried rates in excess of 5 percent. District member bank earnings reports show that the average rate of return on loans of all types in the first six months of 1960 was 6.4 percent, compared with 6.1 percent in the first half of 1959. The prime loan rate—the rate applicable to businesses with the highest credit rating—which had been raised to 5 percent in September 1959, was not lowered until the latter part of August 1960.

[1] The loan-deposit ratios for June are based on figures for all District member banks as of the last Wednesday of the month; year-end ratios are based on Call Report data.

[2] The differential between the loan-deposit ratio of all member banks in the United States and member banks in the Twelfth District increased in the year and a half ending June 1960 from 3.2 percentage points to 5.8 percentage points.

Lower investment portfolios reduce security earnings

While District member banks in the first half of 1960 had record earnings on loans, their earnings on securities dropped $100 million below the same period in 1959. Since the average rate of return to banks on their Government security holdings was 0.3 percent higher in the first half of the year in 1960 than in 1959, the 13 percent decrease in earnings was due solely to a reduction in security holdings. Bank investment portfolios, which had been built up substantially during the recession of 1957-58, were drawn down in 1959 when banks needed additional funds to meet the heavy demand for loans. Over one-half of the $1.5 billion net decline in Government security holdings in 1959 was through run-offs and sales of short-term obligations as banks were reluctant to incur the larger losses which could result from selling intermediate- and long-term Governments at the low prices prevailing in 1959. In the first six months of 1960, banks continued to draw down their investment portfolios of Govern-

[1] According to the quarterly surveys of interest rates made by the Federal Reserve Bank of San Francisco which cover 23 leading District banks and include 32 banking offices in 5 major cities.

ments in order to further expand their loans. Again, the largest decrease occurred in short-term securities. Total Government security holdings dropped $935 million in the first six months of the year, but all of the decline took place in the first quarter. The turnabout in bank investment in Government securities which started in the second quarter has continued on after mid-year.

Increased liquidity since mid-year enhances banks' ability to meet credit needs

Member banks in the Twelfth District had at mid-year record loan portfolios bearing relatively high rates of interest. Earnings data reflected the profitability of their position. At the end of August 1960, the volume of outstanding loans was at approximately the June level. In the corresponding months last year, loans at District member banks expanded $696 million despite the nationwide steel strike. There was a continuation in July and August of the deposit growth which started in the second quarter of 1960, with time deposits increasing $177 million in the two-month period. As a result, the loan-deposit ratio of member banks in the District in August was 63.3 percent, down from the high of 64.3 percent in June. In sharp contrast to 1959, District member banks in July and August made net additions of $565 million to their holdings of United States Government obligations, reflecting the diminished loan demand, their higher volume of deposits, and some desire to rebuild liquidity.

In the fourth quarter of the year loan demand normally rises as business firms borrow to finance inventories incident to Christmas buying, and, at that time, banks also face heavy currency outflows. The growth in deposits and in security holdings of District member banks since mid-year has increased their liquidity and this should enhance their ability to meet these seasonal needs for funds.

BANKING AND CREDIT STATISTICS AND BUSINESS INDEXES—TWELFTH DISTRICT[1]

(Indexes: 1947-1949 = 100. Dollar amounts in millions of dollars)

Year and Month	Condition items of all member banks[2]: Loans and discounts	U.S. Gov't securities	Demand deposits adjusted[3]	Total time deposits	Bank debits index 31 cities[4,5]	Bank rates on short-term business loans[6]	Total nonagri-cultural employ-ment	Total mf'g employ-ment	Car-loadings (number)[5]	Dep't store sales (value)[5]	Retail food prices[7,8]
1929	2,239	495	1,234	1,790	42	....	...	...	102	30	64
1933	1,486	720	951	1,609	18	....	...	...	52	18	42
1939	1,967	1,450	1,983	2,267	30	....	60	57	77	31	47
1950	......	......	......	......	...	....	103	105	98	107	100
1951	7,866	6,463	9,937	6,777	132	3.66	112	121	100	112	113
1952	8,839	6,619	10,520	7,502	140	3.95	118	130	100	120	115
1953	9,220	6,639	10,515	7,997	150	4.14	121	137	100	122	113
1954	9,418	7,942	11,196	8,699	153*r*	4.09	120	134	96	122	113
1955	11,124	7,239	11,864	9,120	173*r*	4.10	127	143	104	132	112
1956	12,613	6,452	12,169	9,424	190*r*	4.50	134	152	104	141	114
1957	13,178	6,619	11,870	10,679	204*r*	4.97	138	156	96	140	118
1958	13,812	8,003	12,729	12,077	209	4.88	138	154	89	143	123
1959	16,537	6,673	13,375	12,452	237	5.36	143	163	93	157	123
1959											
September	15,978	6,717	12,850	12,365	240*r*	5.54	144	163	87	157	123
October	16,010	6,702	12,963	12,316	243*r*	....	144	161	71	158	123
November	16,252	6,651	13,133	12,138	243*r*	....	145	164	91	155	123
December	16,537	6,673	13,375	12,452	240*r*	5.71	145	165	98	158	123
1960											
January	16,354	6,304	12,971	12,111	248*r*	....	146	167	99	157	124
February	16,388	5,976	12,493	12,017	243*r*	....	147	167	92	159	123
March	16,660	5,707	12,553	11,986	242*r*	5.72	147	167	95	157	123
April	16,933	5,999	12,810	12,042	254*r*	....	148	166	95	159	126
May	17,104	5,813	12,290	12,142	255*r*	....	148	164	95	153	125
June	17,131	5,738	12,298	12,277	255*r*	5.73	148	163	85	153	125
July	16,895	5,967	12,608	12,253	260*r*	....	148	163	81	159	126
August	17,142	6,303	12,579	12,454	249	....	149	162	85	155	125
September *p*	16,922	6,335	12,591	12,545	252	....	...	...	...	...	...

Year and month	Industrial production (physical volume)[5]: Lumber	Petroleum[7]: Crude	Petroleum[7]: Refined	Cement	Steel[7]	Copper[7]	Electric power	Waterborne Foreign Trade Index[9,10]: Exports: Total	Exports: Dry Cargo	Exports: Tanker	Imports: Total	Imports: Dry Cargo	Imports: Tanker
1929	95	87	78	55	...	103	29	190	150	247	124	128	7
1933	40	52	50	27	...	17	26	110	...	...	72	...	...
1939	71	67	63	56	24	80	40	163	107	243	95	97	57
1950	114	98	103	112	125	115	120	91	80	108	142	145	103
1951	113	106	112	128	146	116	136	186	194	175	163	140	733
1952	115	107	116	124	139	115	145	172	200	129	206	142	1,836
1953	116	109	122	131	158	113	162	141	138	146	314	163	4,239
1954	115	106	119	133	128	103	172	133	141	123	268	166	2,912
1955	122	106	124	145	154	120	192	165	178	149	313	187	3,614
1956	120	105	129	156	163	131	209	201	261	117	459	219	7,180
1957	106	101	132	149	172	130	224	231	308	123	582	216	10,109
1958	107	94	124	158	142	116	229	176	212	123	552	218	9,096
1959	116	92	130	174	138	99	253	186	221	135	682	283	11,083
1959													
August	111	92	136	175*r*	11	76	255*r*	196	265	97	654	254	11,074
September	113	92	132	166*r*	13	36	255*r*	171	217	107	678	269	11,344
October	115	91	132	170*r*	15	40	250*r*	231	289	150	702	261	12,206
November	117	91	133	165*r*	148	43	257	148	202	71	807	290	14,284
December	129	91	131	163*r*	212	40	260*r*	209	266	128	858	302	15,333
1960													
January	127	90	130	156*r*	197	67	265*r*	229	296	134	958	277	18,687
February	127	90	127	173*r*	206	116	263*r*	230	271	172	720	259	12,719
March	120	91	131	165*r*	183	134	271*r*	287	316	246	607	296	8,707
April	113	91	137	182*r*	162	141	265*r*	240	287	172	811	286	14,484
May	112	91	136	167*r*	164	144	271*r*	251	330	139	771	289	13,341
June	101	91	132	170*r*	158*p*	142	270	243	288	180	...	...	...
July	104	91	138	149*r*	134	129	...	...	...	...	...	...	...
August	...	...	...	164	121*p*	...	...	...	...	...	...	...	...

[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] Annual figures are as of end of year, monthly figures as of last Wednesday in month. [3] Demand deposits, excluding interbank and U.S. Government deposits, less cash items in process of collection. Monthly data partly estimated. [4] Debits to total deposits except interbank prior to 1942. Debits to demand deposits except U.S. Government and interbank deposits from 1942. [5] Daily average. [6] Average rates on loans made in five major cities, weighted by loan size category. [7] Not adjusted for seasonal variation. [8] Los Angeles, San Francisco, and Seattle indexes combined. [9] Commercial cargo only, in physical volume, for the Pacific Coast customs districts plus Alaska and Hawaii; starting with July 1950, "special category" exports are excluded because of security reasons. [10] Alaska and Hawaii are included in indexes beginning in 1950. *p*—Preliminary. *r*—Revised.