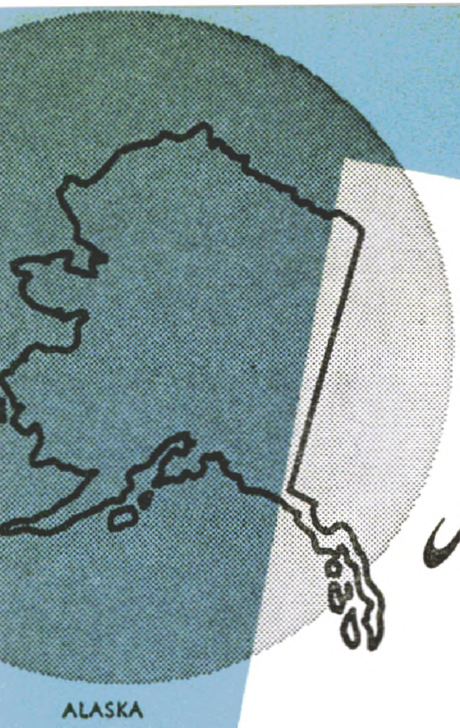
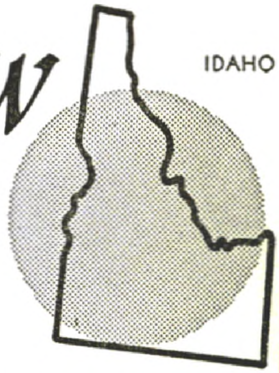
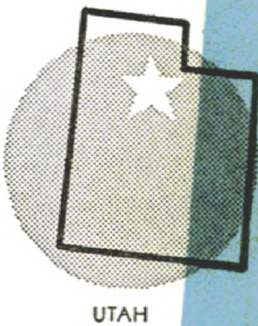


Monthly Review



FEDERAL RESERVE BANK OF SAN FRANCISCO
TWELFTH FEDERAL RESERVE DISTRICT

April 1962



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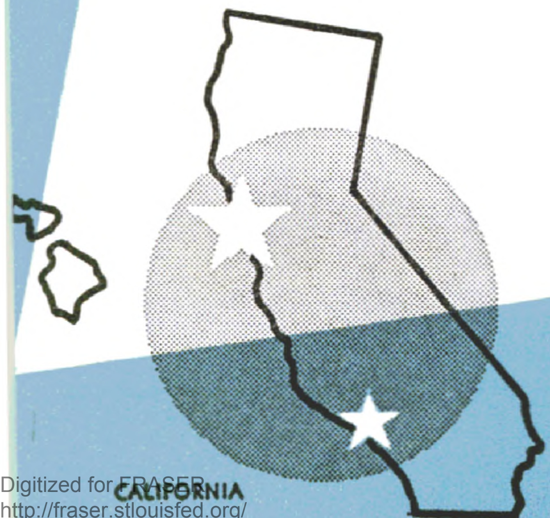

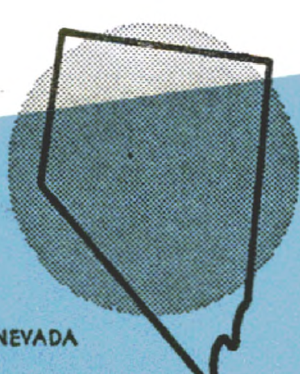

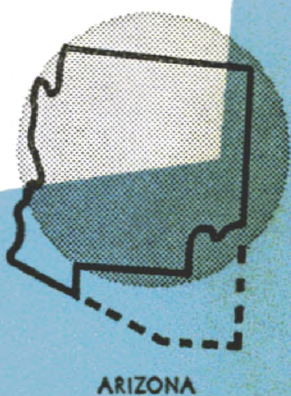

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The Search for Certainty in An Uncertain World

This booklet contains a discussion of the role of gold both in our domestic monetary system and in the international payments system. A description of the evolution of the gold standard, the pound sterling standard, and the dollar standard provides a background against which recent developments affecting our international payments system are discussed.

The booklet is a reprint of four articles which appeared in this Bank's *Monthly Review* during 1961 and early 1962.

Readings in District Banking

This booklet consists of reprints of three articles which appeared in this Bank's *Monthly Review* during 1961. Each article discusses an important aspect of banking activity, both in terms of general principles and with specific reference to the data for Twelfth District banks. The three topics discussed are: (1) the significance of Treasury bills as a type of investment for banks and others, with specific reference to the buying pattern of Twelfth District investors in the weekly bill auctions; (2) the role of Federal funds in our national money market and the important position that Twelfth District banks occupy in the Federal funds market; and (3) the significant role which Twelfth District banks play in international banking.

Copies of both of these booklets are available for classroom use and similar purposes. Requests for copies should be directed to the Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco 20, California.

Review of Business Conditions

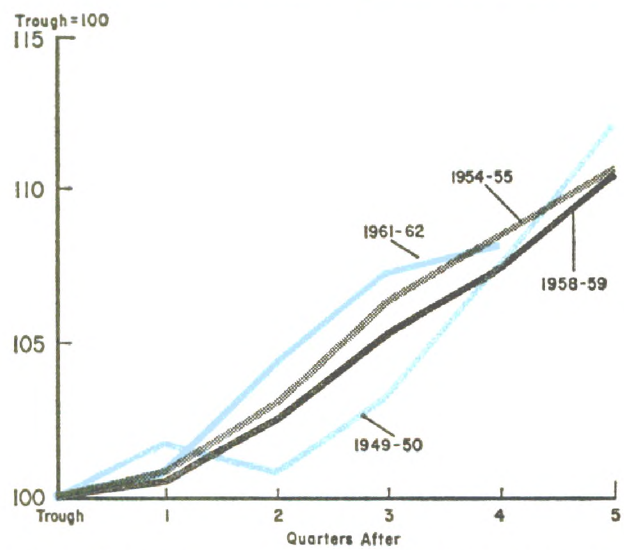
GAINS in over-all economic activity during the first quarter of 1962 advanced the total value of goods and services produced in our economy by $7 billion to a new high of $549 billion on a seasonally adjusted annual rate basis. Increased spending by consumers on services and nondurable goods and by the Federal Government contributed to the expansion, as did the growth in business inventories which had the largest quarterly dollar increase in two years. Consumer spending on durable goods and on residential construction declined from the fourth-quarter level. Marking the end of the first full year of expansion, the rise left gross national product slightly below the expectation of many analysts of a "$550 billion or better" quarter.

If some downward revision of expectations for the remainder of the year now seems appropriate, it is worth emphasizing that the recent shortfall in gross national product was more in the area of expectations than performance. Through the end of 1961 gross national product in real terms (that is, measured in constant prices) advanced at a noticeably swifter pace than in comparable periods of earlier postwar recoveries. The diminished rate of growth in the first quarter of this year reduced the over-all rate of advance to approximately that of the corresponding periods of prior postwar recoveries, as indicated on the accompanying chart.

To the extent that weaknesses occurred in monthly economic indicators, they appear to have been concentrated early in the first quarter and some strengthening has occurred since. Industrial production and personal income, both relatively comprehensive indicators of month-to-month developments, lost ground in January but advanced in each of the following two months. In March, production gains were widespread among consumer goods, business equipment, and materials. Total retail sales, which had lagged for two months after November, also rose in February and March on a seasonally adjusted basis. The dollar volume in March (seasonally adjusted) exceeded the November peak, according to preliminary data.

Less encouraging has been the behavior of construction activity. Private housing starts on a seasonally adjusted basis declined for four consecutive months through February. March, however, brought a sharp rise—23 percent above the February level. Unusually adverse weather earlier this year in some sections of the nation, including parts of the Twelfth District, may have been partly responsible for a more than seasonal decline in housing starts at that time. Total expendi-

Rate of expansion of real gross national product compares favorably so far with that in prior recoveries



Note: The data plotted on this chart show the percentage increases in gross national product, measured in constant prices, from the lowest quarter of gross national product in each recession through subsequent quarters of recovery.
Source: United States Department of Commerce and Council of Economic Advisers.

tures on new construction, both private and public, declined rather sharply in February but rose 1 percent in March. For the quarter as a whole, expenditures on new construction, seasonally adjusted, were 3 percent below the fourth quarter of 1961 and only 3 percent above the year-ago level.

Recent changes in unemployment and employment, while favorable, have not shown as much strength as some of the other indicators already mentioned. Both unemployment and the unemployment rate continued to fall through March, but neither decline represented very significant improvement. Figures covering long-term unemployment (15 weeks or more) and "hard-core" unemployment (27 weeks or more) showed rises from mid-February of 53,000 and 31,000, respectively, but the increases were less than seasonal. Perhaps even more disquieting was the figure showing the civilian labor force in March at 314,000 under the level of March 1961. This contrasts sharply with the increase in the labor force which would have been expected on the basis of age distribution and other population characteristics in a year of economic expansion.

Pacific Coast unemployment up in March

The seasonally adjusted rate of unemployment in the Pacific Coast States rose to 5.8 percent of the civilian labor force in March, from 5.6 percent in February. In contrast, the national rate of unemployment in March edged down to 5.5 percent from 5.6 percent in the preceding month. The increase in the Pacific Coast States reflected both a slight rise in the labor force and a small decline in total employment, even though nonfarm wage and salary employment rose fractionally. However, in spite of the March increase, the number of jobless workers in the Pacific Coast States was still 16 percent below a year ago, while the total number of employed was about 2.6 percent greater than in the same month of 1961. According to preliminary data for these States, the small addition to nonagricultural wage and salary employment in March reflected increases in every major industry except construction and manufacturing, which registered slight declines. The decline in construction employment occurred in Oregon and Washington where unfavorable weather conditions slowed outdoor activity. Within the manufacturing sector, divergent movements were evident; a substantial gain in electrical equipment and slight gains in primary and fabricated metals, machinery, and printing and publishing failed to offset sizeable declines in food and kindred products and lumber and wood products and a moderate loss in transportation equipment. In the latter industry, Pacific Coast aircraft employment dropped slightly as the result of continued layoffs in California, concentrated in the San Diego area, which more than offset increased employment in Washington.

District employment records small increase in February

District nonfarm wage and salary employment rose by 15,600, or 0.2 percent, on a seasonally adjusted basis in February, with small gains in the manufacturing, trade, finance, services, and government sectors more than offsetting declines in mining, transportation, and construction. As a result of these declines, District employment in mining remained slightly under the level of the same month a year ago, and transportation employment was unchanged from February 1961. Employment in the construction industry, however, still posted a 2 percent gain on a year-to-year basis, in spite of the greater than seasonal decline in February (1 percent) brought about by severe midwinter weather. An increase in February of 0.4 percent in District manufacturing employment was concentrated in the Pacific Coast States. On a year-to-year basis, District manufacturing employment, which accounts for 25 percent of total District nonfarm wage and salary employment, recorded a 5.4 percent gain. This was the largest increase realized by a major industry sector and was primarily responsible for the 3.7 percent gain in total District nonfarm employment during the year.

While District nonfarm employment on a seasonally adjusted basis recorded a slight increase in February, the number of District workers drawing unemployment compensation under regular State programs also increased on a seasonally adjusted basis to 286,000 from 280,000 in January. This increase interrupted a succession of monthly declines dating from July 1961, which was the peak month for the District. This increase reflected, almost in its entirety, higher unemployment in California stemming from weather-induced layoffs in construction, layoffs in the food-processing industry, and a continued decline in aircraft payrolls. An additional factor was the availability in California of a new quarter's wage credits for purposes of unemployment insurance. In March, the number of District workers drawing unemployment compensation registered a smaller decline than is usual for the month, so that on a seasonally adjusted basis the number of such workers rose to 297,000.

Although there were no changes during February in the classification of the fifteen major labor market areas in the District by the Bureau of Employment Security, an important change occurred in March with the reclassification of Los Angeles-Long Beach from an "area of substantial unemployment" (6.0 to 8.9 percent of the labor force) to an "area of moderate unemployment" (3.0 to 5.9 percent of the labor force).

Retail sales maintain high level

During January, sales of Group I retail stores[1] in the Twelfth District were 21 percent above the same month a year ago. The increase was shared by all types of stores, although the automotive dealers had the largest gain. Available data on department store sales and new car registrations indicate that retail activity during February and March was also at a high level. During February, the index of department store sales in the Twelfth District reached a record high, equal to 177 percent of the 1947-49 base period after seasonal adjustment. The preliminary seasonally adjusted index of department store sales for March remained at the February level. For the first quarter of the year, department store sales in the District, including an adjustment for the different timing of Easter, were about 9 percent above the year-ago quarter. Some of the increase reflects operations of newly opened department stores and expanded operations of existing stores within the District. It is difficult to evaluate their actual importance inasmuch as these new stores would attract sales away from other stores. However, by excluding the sales operations of those stores without comparable year-ago data, the first quarter of the year still showed an increase of 5 percent. For the nation as a whole, department store sales during the first three months of the year were 6 percent above the year-ago quarter, with the index of sales reaching a record high after seasonal adjustment during the month of March.

Automotive sales in the nation were also at a high level during February and March—about 25 percent above the same months of 1961. During February, daily average new car registrations in California reached 2,094, which was up substantially from the January

[1]Stores of firms operating 1-10 stores at the time of the 1958 Census of Business.

level of 1,930 per selling day though still running behind the last three months of 1961. When compared with the early part of 1961, the selling rate for both January and February of this year was significantly higher. A sharp pickup occurred in March, with daily sales averaging 2,480 in the first 27 days of the month. This was the highest rate for any month since March 1960.

District construction down in February

The value of total construction contracts awarded in the District during February amounted to $571 million, representing a decline of 9 percent below January and a decline of 1 percent below February a year ago. About half of the decline from January reflected a reduction in contracts let for residential construction, and reduced awards for nonresidential and heavy engineering construction accounted for an equal proportion of the remainder. As compared with February 1961, all of the decline in District awards was accounted for by heavy engineering contracts and, specifically, by a sharp reduction (70 percent) in contracts let for utilities. Nonresidential construction awards were slightly above the same month a year ago due to an increase in the value of contracts let for hospital and recreational facilities. An almost equal increase in the value of contracts let for apartments and 1- and 2-family houses contributed to a 21 percent increase in District awards for residential construction. In contrast to developments in the District, total construction contracts let in the nation during February recorded a slight increase from January, while in relation to February of 1961, all major categories of construction awards recorded substantial gains. However, the letting of contract awards is subject to erratic month-to-month changes and not too much significance should be attached to the divergent movement of District and national construction awards in February.

Contract awards are a measure of prospective rather than of current construction activity. As indicated by the number of private housing starts (after seasonal adjustment), current residential construction activity in both the District and the nation declined in February. Severe weather, particularly very heavy rains in Southern California, was an important factor contributing to the reduced activity in both the District and the nation.

In conformity with trends in the nation, District mortgage markets eased somewhat during February. A primary factor contributing to this development was the continued vigorous flow of savings into District financial institutions. The net increase in shares of District savings and loan associations was maintained at a high level, topping the growth realized during the same month a year ago. For their part, District commercial banks also recorded substantial gains resulting from higher interest paid on savings and time deposits following modification of Regulation Q. During the first two months of the year, the increase in the supply of mortgage funds in the District outpaced the amount of mortgage lending. According to preliminary information, a continued strong growth in the supply of mortgage funds occurred in March, pointing toward keener competition in the lending of these funds by District financial institutions. In addition to a reported slight decline in rates on conventional loans, easing conditions in District mortgage markets are reflected in the price for Federally insured mortgages. Discounts on these mortgages were slightly smaller in February and apparently declined substantially in March.

Lumber production, prices up

Following a moderate increase in January, Douglas fir production again rose in February and in board feet reached a level 8 percent above output in the corresponding period a year ago. Largely as the result of reduced orders by Eastern buyers, new orders declined from January to a level below current production but still were 12 percent above the level of orders in February 1961. Demand increased somewhat in March notwithstanding the influence of bad weather and delayed construction activity in consuming areas early in the month; however, new orders again fell below production and also were below the level of new business received in March 1961.

After declining in January, Western pine production picked up in February and reached a level 15 percent above the same month a year ago. New orders also recorded strong gains, rising 10 percent above January and 39 percent above the level of new business in February 1961. Orders reportedly were maintained at a high level in March and contributed to a further strengthening of prices. Although prices for green fir dipped slightly in March, higher prices for dry fir and, in particular, for pine species, boosted Crow's average lumber price per thousand board feet to $75.88 at month-end. This represented an increase of 81 cents during March and an increase of $2.36 since the first of February.

Mixed market demand for District metals

Fluctuations in weekly steel production in the District and the rest of the nation during the months of February and March mirrored the changing sentiments of steel producers and consumers concerning the outcome of the steel industry's labor contract negotiations. Both Western and national steel production advanced in February up to the week ended February 17 and then declined until the week ended March 3. Over the four-week period extending from February 3 to March 3, the national and District steel production indexes (1957-59 = 100) had declined 3.5 and 1.7 percent, respectively. The weakening of the steel market in late February was due to hesitation among many customers to order more steel until the outcome of the negotiations became more certain.

The breakdown of the contract talks by March 2 and the influence on the national index of a 14 point rise in the Cleveland district contributed to the advance of both indexes in the week ended March 10. In the remaining three weeks of March, the national and Western indexes moved in opposite directions; the national index rose successively, while the Western index declined. Reflecting increased confidence that contract talks would not result in a strike, many steel consuming firms were reluctant to place heavy orders during these weeks. While this sentiment should have resulted in a lull in the market, the national index continued to rise through March as mills kept pouring steel at a fairly high rate to meet heavy shipment schedules and as seasonal demands increased.

Copper producers and smelters report that demand for copper held up well in March and that sales were steady at a "good" level. March shipments of refined copper probably exceeded the amounts delivered in February. Prices for copper in the more sensitive markets here and in London have remained unusually steady for the past several months, so far riding out turmoil in the Congo, political and labor unrest in Northern Rhodesia, and the possibility of a strike by Chilean workers at a major copper producing firm in that country. Although foreign demand for copper fell a bit in March, the relative stability of the metal's price in London is reported to have resulted from purchases and sales by some foreign producers to stabilize the market. Copper for immediate delivery closed Friday, March 30, at the equivalent of about 29.375 cents a pound, up from 29.34 cents a week earlier.

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

(dollar amounts in millions)

	Twelfth District				United States			
	From Dec. 27, 1961 to Mar. 28, 1962		From Mar. 29, 1961 to Mar. 28, 1962		From Dec. 27, 1961 to Mar. 28, 1962		From Mar. 29, 1961 to Mar. 28, 1962	
	Dollars	Percent	Dollars	Percent	Dollars	Percent	Dollars	Percent
ASSETS:								
Total loans and investments	+100	+ 0.38	+2,533	+10.67	—1,216	— 0.99	+9,790	+ 8.78
Loans adjusted and investments[1]	—148	— 0.57	+2,348	+10.00	—1,518	— 1.25	+9,523	+ 8.66
Loans adjusted[1]	+ 99	+ 0.61	+ 955	+ 6.20	— 539	— 0.72	+4,392	+ 6.31
Commercial and industrial loans	— 78	— 1.35	+ 287	+ 5.32	+ 94	+ 0.29	+ 811	+ 2.52
Real estate loans	+100	+ 1.83	+ 285	+ 5.40	+ 221	+ 1.65	+ 893	+ 7.02
Agricultural loans	+ 55	+ 7.46	+ 153	+23.94	+ 52	+ 4.09	+ 193	+17.09
Loans for purchasing and carrying securities	+ 43	+ 19.55	+ 72	+37.70	— 347	— 7.13	+1,415	+45.59
Loans to non-bank financial institutions	— 47	— 5.34	+ 89	+11.95	— 510	— 8.32	+ 592	+11.76
Loans to domestic commercial banks	+248	+120.98	+ 185	+69.03	+ 302	+20.01	+ 267	+17.29
Loans to foreign banks	0	0	+ 48	+24.87	+ 35	+ 5.33	+ 10	+ 1.47
Other loans	+ 49	+ 1.52	+ 54	+ 1.68	+ 81	+ 0.48	+ 647	+ 3.97
U. S. Government securities	—460	— 6.42	+ 781	+13.18	—2,033	— 5.94	+2,695	+ 9.13
Other securities	+213	+ 8.35	+ 612	+28.44	+1,054	+ 8.61	+2,436	+22.44
LIABILITIES:								
Demand deposits adjusted	—779	— 6.31	+ 274	+ 2.43	—4,114	— 6.20	+ 596	+ 0.97
Time deposits	+747	+ 5.57	+1,948	+15.94	+3,583	+ 8.64	+7,557	+20.15
Savings accounts	+423	+ 3.94	+1,321e	+13.41e	+1,539	+ 5.12	n.a.	n.a.

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

Petroleum refining operations steady

American Petroleum Institute weekly reports indicate that West Coast refining activity was maintained at about 75 percent of capacity during the first half of March, close to the average rate during February. Although refining operations have been consistently above year-ago levels for the last several months, increased demand has kept stocks of most major refined products at or below the earlier levels. During the four weeks ended March 23, crude oil production in California was down 4 percent from a year ago; for the United States as a whole, output was maintained at the year-ago rate. Nationally, output rose in April compared to a year ago, while it fell in California.

Sharp reduction in prospect for District crop acreage

Over 2 million acres of District crop land are scheduled for idleness in 1962 under various Government programs to remove land from crop production. Crop acreage in the District was little affected by the emergency Feed Grain Program in 1961 because the crops included in the program—corn and grain sorghum—are of little importance in the District. With the addition of barley to the Feed Grain Program this year, however, District farmers have indicated that they intend to divert 670 thousand acres of farm land from barley production. Furthermore, participation in the new Wheat Program for 1962 indicates a wheat acreage diversion in the District of about 1 million acres.

A reduction in District crop acreage is also indicated by the March 1 planting intention reports released by the United States Department of Agriculture, but it is not nearly so large a reduction as that indicated by the prospective participation in the Wheat and Feed Grain Programs. The difference may be even greater when the final reports on participation in the various programs have been tabulated. In addition to field crops influenced directly by farm programs, a 10 percent reduction in acreage is in prospect for potatoes following the low prices received for the 1961 crop. Increased plantings are scheduled for a few major crops in the District, with the largest increases indicated for the production of sugar beets, rice, and hay.

Total loans show quarterly gain, but business loans fell

After a relatively heavy loan demand in December, member banks in the Twelfth District started the new year with the usual January loan decline as seasonal repayments exceeded new loans by $130 million.[1] This loss, however, was more than offset by a gain in February of $111 million and a further increase of $172 million in March as the normal demands for credit were augmented by borrowing to meet mid-March tax payments. Thus, District member banks ended the first quarter of 1962 with a net loan increase of $153 million. This is a slightly larger gain than in the first quarter of 1960 and contrasts with a decline in the corresponding period of 1961.[2] Country banks contributed one-half the dollar amount of the quarterly increase in loans, which meant for them a gain of 2.89 percent in loan volume compared with only a 0.48 percent increase for the reserve city banks.

The weekly reporting member banks in the District had a net reduction of $78 million in business loans in the first quarter. The amount of tax borrowing by business over the mid-March tax date was about half that of last year and was insufficient to offset the large seasonal repayments in January which reflected, in part, the unusually high rate of business borrowing in November and December. For banks which report business loans classified by industry, there was a net decline of $68 million in borrowings of nondurable goods manufacturers, principally the result of a $76 million seasonal reduction in the bank debt of food, liquor and tobacco companies. The dominant factors in a $13 million decline in loans to durable goods manufacturers were a $25 million decrease in the category "other durable goods" and a partially offsetting increase of $14 million in the bank debt of machinery manufacturers. Loans to commodity dealers fell seasonally, by $23 million, in contrast to a $10 million rise in borrowing by retail trade firms. The other large reduction was in loans to transportation, communications, and other utilities firms which dropped $21 million. Borrowing by "other business" (mainly services) registered a net gain of $11 million for the quarter.

Higher interest rates on District business loans in March

In spite of the lower volume of business loans, the average rate charged by District banks on short-term business loans rose to 5.39 percent in the first half of March, according to the latest quarterly interest rate survey conducted by this Bank. This was 14 basis points above the 5.25 percent average rate in the first half of December 1961. Moreover, it was the largest quarterly change since September 1960 when rates declined sharply as a result of the drop in the prime rate. The average rate on business loans of over one year maturity also rose. While loans made at the current prime rate of 4½ percent constituted 28 percent of the total dollar volume of short-term loans made during the first 15 days in March, this proportion was down

[1] Total loans after adjustment to exclude loans to domestic commercial banks and deduction of valuation reserves.
[2] After adjustment for inclusion of former nonmember banks in the series.

from one-third of the total in December 1961. A combination of factors may have brought about these rate increases. Banks in the District shared the general optimistic outlook for a marked upturn in business activity in the latter part of the first quarter. Because of their proportionately larger holdings of time to total deposits, District banks were particularly conscious of the need to increase earnings to offset rising costs resulting from the recent increase in rates paid on savings and time deposits. In addition, the seasonal decline in demand deposits was particularly heavy in the first two months of the quarter, placing District banks under some reserve pressure during part of this period.

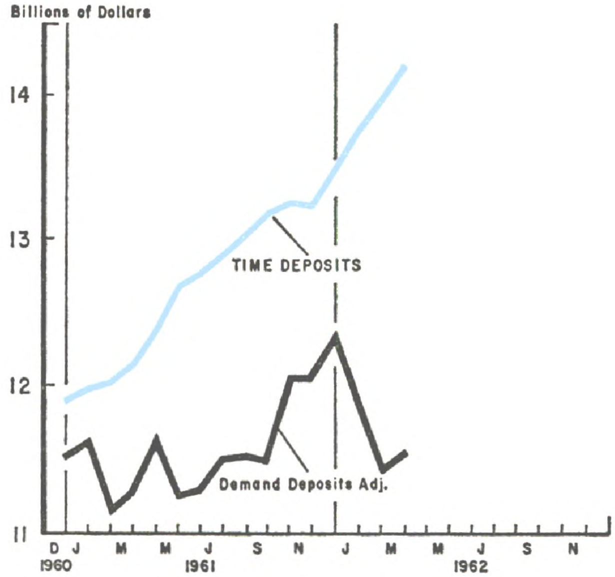
Real estate loans support quarterly loan gain

While business loans declined in the first quarter, weekly reporting banks increased their holdings of real estate loans $100 million, in contrast to reductions in the first quarter of the last several years. Gains in consumer loans, loans to brokers and dealers and to others for purchasing and carrying securities, and agricultural loans also contributed to the over-all loan increase in the first quarter. The gain in agricultural loans, however, was due mainly to bank acquisition of Commodity Credit Corporation loans. Although nonbank financial institutions increased their bank debt over the March tax payment period, there was a quarterly net decline in borrowings by this group.

Portfolios of United States Government securities reduced; other security holdings increase

Both reserve city and country banks in the District reduced their holdings of United States Government securities in the first quarter. Data for weekly reporting member banks indicate that the reduction occurred in Treasury bills and in notes and bonds in the 1-5 year maturity range—all other categories

Time deposits of District banks increased sharply in first quarter of 1962



Note: Data are for Twelfth District weekly reporting member banks. Time deposit data from February 1961 through September 1961 have been adjusted to exclude loan funds of a national retailer temporarily held as time certificates of deposit. Demand deposits adjusted are total demand deposits other than domestic commercial interbank and United States Government, less cash items in process of collection.

showed increases. Part of the reduction in the intermediate-terms was a result of bonds dropping into the within-one-year category, and some was due to the Treasury refunding operations during this period. At the same time, District banks made net additions to their holdings of other securities, largely state and municipals, including housing authority bonds. This switch, particularly pronounced at the larger banks, was the result of the desire to hold higher paying investments as an offset to increased expenses. For all District member banks, the net reduction in total investment holdings for the first quarter was about 2.5 percent.

Larger than seasonal decline in demand deposits adjusted, while time deposits rose

As previously mentioned, a more than usual seasonal decline in demand deposits adjusted,[1] over 6 percent, placed member banks in the District in a relatively tight reserve position during part of the first quarter. Both in January and February, District banks were on balance net purchasers of Federal funds and not until March, when the decline in demand deposits was reversed, were they net sellers. In addition to causing borrowing through the purchase of Federal funds, the deposit decline contributed to the banks' reductions of security holdings. In contrast to demand deposits, both savings and time deposits rose sharply throughout the first quarter, including a contraseasonal gain in January. The sizable 5.4 percent increase in total savings and time deposits was due in large part to the payment of higher interest rates permitted on such deposits under revised Regulation Q. Reserve city banks had a slightly higher percentage gain in total savings and time deposits than the country banks, but both groups were able to attract new savings.

Municipal bond market strengthens

The market for municipal bonds was stronger during the first quarter of 1962 than in preceding months. Demand for tax-exempt investments was given a special stimulus by the change in Regulation Q last December and by the sluggish expansion of commercial bank loans since then. Commercial banks in search of investment income stepped up their purchases of the shorter maturities of new bonds, particularly since February, and provided the main support for absorption of the unusually large supply of bonds marketed in the first quarter. Competition for the supply of new issues put downward pressure on yields. At the end of March, yields averaged about ¼ percent lower than at the beginning of the year, according to the *Bond Buyer's* index.

This national picture was reflected in District bond sales during this period. District rates declined slightly less than the comparable national rates; *Staat's* index of California bonds declined to 3.20 percent at the end of March from 3.37 percent in early January. Large bond sales of State and local governments in the District amounted to about $350 million in the first three months of 1962, compared with $205 million in the same period last year. January and February calendars held the bulk of these new issues. Weekly reporting member banks in the District showed a net gain of about $250 million in their holdings of "other securities" (principally municipals) during the quarter. Most of the gains occurred after mid-February.

[1] Total demand deposits excluding deposits of banks and United States Government deposits and less checks in process of collection.

Net Profits of District Banks Declined in 1961

NET profits of Twelfth District member banks fell in 1961 from their year-ago peak, despite a record high in total earnings. The percentage rise in total expenses from 1960 to 1961 was almost double that of gross earnings, and consequently net current earnings were nearly 5 percent below the 1960 level. The major factor contributing to the increase in expenses was a rise of approximately 20 percent in interest paid on time deposits. Savings deposits, which tend to increase during the first stages of recovery, continued to expand well into the cyclical upswing as many District banks initiated the practice of paying interest on savings accounts on a daily basis in order to attract additional funds. Although total earnings on loans of District banks were only 2 percent larger than in 1960, earnings

EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS

(millions of dollars)

	1959	1960r	1961p
Earnings on loans	938.6	1,079.3	1,122.9
Interest and dividends on			
U. S. Government securities	196.1	181.7	224.2
Other securities	63.4	61.6	71.0
Service charges on deposit accounts	106.4	118.8	126.6
Trust Department earnings	39.8	43.6	50.1
Other earnings[1]	55.9	55.9	62.6
Total earnings[1]	1,400.2	1,540.9	1,657.4
Salaries and wages[2]	369.1	411.7	439.5
Interest on time deposits	323.9	331.9	406.3
Other expenses	249.7	289.5	324.3
Total expenses	942.7	1,033.1	1,170.1
Net current earnings	457.5	507.8	487.3
Net recoveries and profits (—losses)[3]			
On securities	— 81.1	— 4.7	+28.0
On loans	— 38.4	—39.7	—58.1
Others	— 3.6	— 9.4	— 5.5
Total net recoveries and profits (—losses)	—123.1	—53.8	—35.6
Net profits before income taxes	334.4	454.0	451.7
Taxes on net income	138.6	204.6	207.4
Net profits after taxes	195.8	249.4	244.3
Cash dividends declared	110.4	119.2	130.2
Undistributed profits	85.4	130.2	114.1

r Revised.
p Preliminary
[1] Includes rental income.
[2] Includes wages and salaries of building personnel.
[3] Including transfers to (—) and from (+) valuation reserves.
Note: The volume of assets and of earnings and expenses of Twelfth District member banks was affected more than usual in 1961 by mergers of nonmember banks with member banks. The figures shown in this table are data for member banks only in each respective year, without adjustment for the effects of these mergers. For analytical purposes, the percent changes cited in the text are based on estimates which attempt to adjust the data for 1960 and 1961 to a roughly comparable basis so far as the effects of the 1961 mergers are concerned.

from interest and dividends on securities rose almost 20 percent in 1961. This is in sharp contrast to the experience of District banks in 1960 when earnings from securities declined 15 percent from the year-ago figure. The general condition of monetary ease that prevailed throughout 1961 permitted Twelfth District banks to rebuild their liquidity positions from the low level reached at the peak of the business cycle in the spring of 1960.

The volume of assets and of earnings and expenses of Twelfth District member banks was affected more than usual in 1961 by mergers of nonmember banks with member banks. For analytical purposes, the percentage changes cited in the text are based on estimates which attempt to adjust the data for 1960 and 1961 to a roughly comparable basis so far as the effects of the 1961 mergers are concerned. For this reason, these percentage changes differ from the changes that could be calculated from the dollar amounts shown in the tables, since the latter are the actual data for member banks in each of the two years with no estimates introduced to place the two years on a more comparable basis.

Lagging demand limits rise in loan earnings

The small percentage increase in earnings from loans realized by District banks in 1961 differs considerably from the experience in 1960 when the dollar rise in returns on loans accounted for almost the entire gain in total earnings. Loan demand lagged throughout the first six months of 1961, a typical pattern for the recession trough and the first phase of recovery in a business cycle. However, owing to the mildness of the recession, banks in both the Twelfth District and the nation did not experience the sharp decline in business borrowing characteristic of previous periods of cyclical decline. This behavior partly accounts for the failure of the prime rate on short-term business loans to fall below the 4½ percent level established in August 1960. Business loans, which constitute about one-third of the total loan volume of member banks in the District, rose in the first half of 1960 and then remained relatively stable until the fourth quarter of 1961. Nearly all the 6 percent rise in commercial and industrial loans during 1961 occurred during the last three months of the year.

Real estate loans, which also make up about one-third of the loan portfolios of District member banks, picked up gradually throughout 1961 and had risen 4 percent by the end of the year, reflecting an increase in both residential and nonresidential construction. This compares with a net decline of 2 percent in such loans during 1960.

During the first few months of 1961, consumers chose to increase their liquidity, as is evidenced by the increase in personal savings, and made repayments on their instalment loans at District banks at a faster pace than they borrowed. However, loans to finance purchase of automobiles, which comprise about 40 percent of loans to individuals by District banks, increased about 3 percent in the last quarter of 1961, following the unveiling of the new models in October. Other consumer loans outstanding also showed moderate gains during the latter part of the year, experiencing a somewhat more than customary seasonal gain as a consequence of a record volume of Christmas buying.

PRINCIPAL RESOURCE AND LIABILITY ITEMS OF ALL MEMBER BANKS

TWELFTH DISTRICT, 1960 and 1961
(millions of dollars)

	Dec. 31, 1960	Dec. 31, 1961p
Loans[1] and investments	26,361	29,430
Loans and discounts, net[1]	17,102	18,348
Commercial and industrial loans	5,868	6,330
Agricultural loans	772	902
Real estate loans	5,886	6,287
Loans to individuals	3,368	3,526
U. S. Government obligations[2]	6,864	8,202
Treasury bills	693	1,266
Treasury certificates of indebtedness	271	308
Treasury notes	1,922	3,125
U. S. Bonds[2]	3,978	3,503
Other securities	2,395	2,880
Total assets	33,086	37,101
Demand deposits	16,808	18,482
Time deposits	13,163	15,211
Total deposits	29,971	33,693
Capital accounts	2,204	2,522

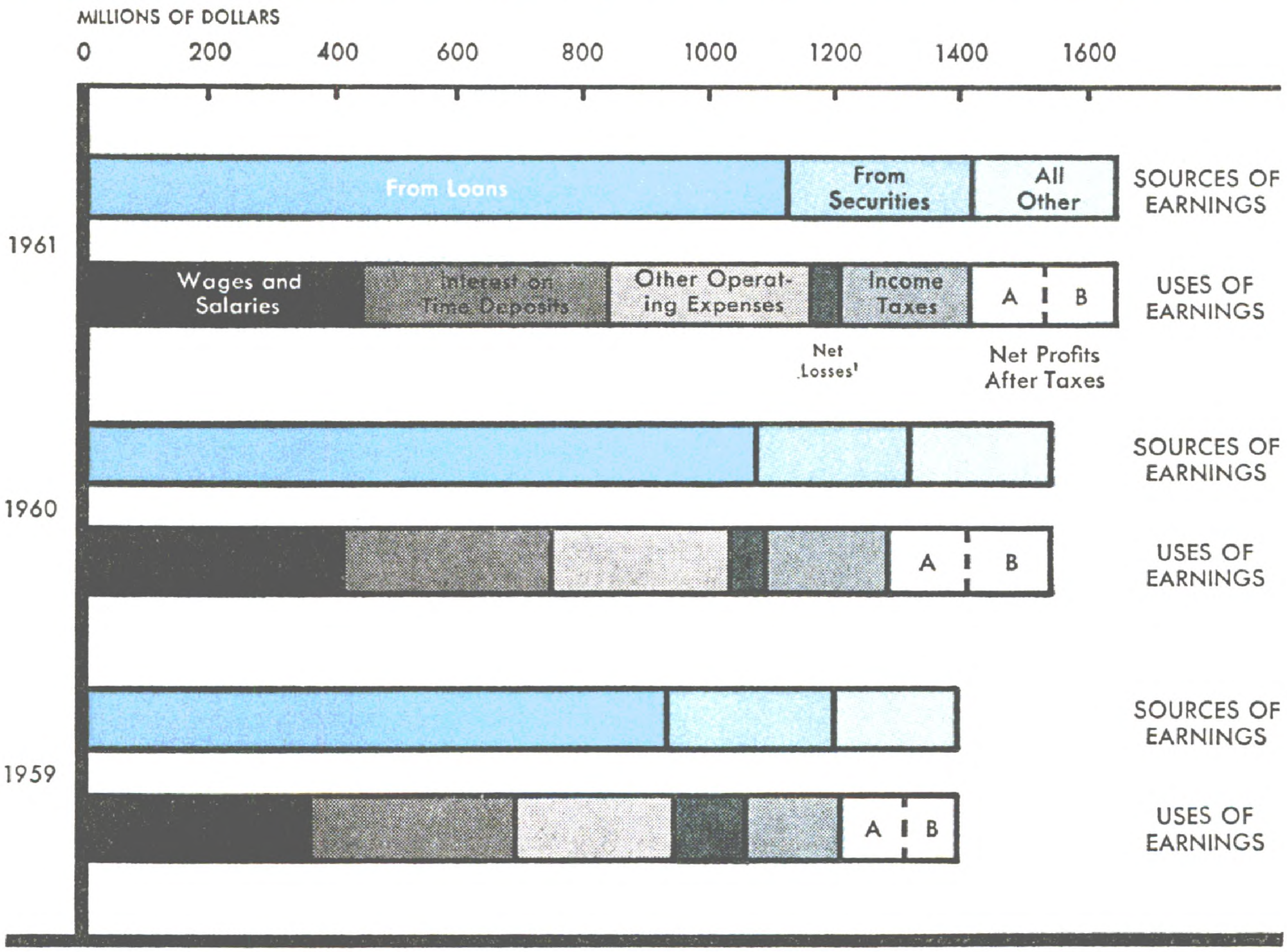
p Preliminary.
1 Total loans minus valuation reserves. Those selected loan items which follow are reported gross.
2 Includes obligations guaranteed by the United States Government.
Note: The volume of assets and of earnings and expenses of Twelfth District member banks was affected more than usual in 1961 by mergers of nonmember banks with member banks. The figures shown in this table are data for member banks only in each respective year, without adjustment for the effects of these mergers. For analytical purposes, the percent changes cited in the text are based on estimates which attempt to adjust the data for 1960 and 1961 to a roughly comparable basis so far as the effects of the 1961 mergers are concerned.

Substantial rise in earnings on securities

In sharp contrast to the decline in earnings on both United States Government and other securities sustained by Twelfth District member banks in 1960, returns on securities in 1961 comprised approximately 50 percent of the dollar increase in total earnings. The average rate of return of 2.96 percent on United States Government securities in 1961 was higher than the 2.89 percent average rate of the previous year, despite the fact that relatively high yields on securities prevailed during the first few months of 1960. However, early in 1960 loan demand was strong, and banks had little inclination to add to their securities holdings. As loan demand slackened after midyear, banks purchased securities at higher prices than had prevailed earlier.

From mid-1960 through most of 1961, interest rates on short-term Government securities remained relatively stable with yields above 2 percent. This stability reflected the efforts of both the Federal Reserve System and the Treasury to discourage outflows of liquid funds seeking higher returns abroad and to foster conditions of ease in the domestic money market. Banks found it advantageous to invest more heavily in the shorter term bills and certificates in order to remain liquid in expectation of rising needs for loanable funds. Purchases of long-term Government securities fell off gradually during the year as member banks elected instead to supplement their investment portfolios with higher yielding municipal and corporate bond issues. Such purchases occurred in substantially increased volume in December after banks had decided to increase the rates paid on time and savings deposits, effective January 1, 1962.

Larger returns from securities major source of increased bank earnings in 1961



A—Cash dividends declared.
B—Undistributed profits.
[1] Net losses on securities and loans including transfers to and from valuation reserves.
Note: Owing to changes in the "Report of Earnings and Dividends" form submitted by member banks in 1961, some adjustments have been necessary to provide classifications comparable to those of previous years. The 1961 wage and salary figures for this chart have been adjusted to include wages and salaries of building personnel; in addition, rental income is included in the "all other" earnings figures.
Source: Federal Reserve Bank of San Francisco.

Earnings from service charges on deposit accounts at Twelfth District member banks grew approximately 5 percent during 1961, chiefly attributable to an 8 percent gain in demand deposits during the year. However, such charges still made up the same percentage of total earnings as they had in 1960. In addition, trust department earnings rose both in dollar volume and as a percentage of total earnings.

Large increase in interest payments on time deposits

A larger relative increase in expenses than in earnings resulted in a decline in net operating earnings of District member banks during 1961. Confronted with keen competition from savings and loan associations, which pay higher rates of return on shares, most banks initiated the policy of paying interest on savings deposits on a daily basis during the second quarter of the year. This arrangement, coupled with a continued high level of personal saving, accounted for the 13 percent growth in time deposits at District member banks during 1961. Not only did the banks pay an effective rate of interest closer to the 3 percent ceiling, but they also incurred larger costs in their bookkeeping operations. The result was that the dollar increase in interest paid to depositors absorbed almost three-fourths of the net dollar gain in total earnings. This was decidedly different from the experience in 1960, when interest paid on time deposits showed the smallest rise of the expense categories. During the first three months of that year, District banks lost a sizable amount of time deposits as individuals chose to invest instead in United States Government securities and savings and loan institutions which offered higher rates of return. Although time deposits did rise during the following nine months, the rate of increase was not nearly so great as that of 1961.

Total wage and salary payments to employees, the largest single expense item of

EARNINGS RATIOS OF TWELFTH DISTRICT MEMBER BANKS

(percent ratios)

	1960[r]	1961	Increase or decrease
Return on loans	6.4	6.3	—0.1
Return on U. S. Government securities	2.9	3.0	+0.1
Current earnings to capital accounts	24.1	20.6	—3.5
Net profits after taxes to capital accounts	11.9	10.3	—1.6

[r]Revised.
Note: Capital accounts, loans, and Government securities items on which ratios are based are averages of Call Report data as of December 31, 1959, March 15, June 15, October 3, and December 31, 1960; and December 31, 1960, April 15, June 30, September 27, and December 31, 1961.

District member banks, rose substantially during the year, despite the increasing use of automation in routine operations. This was due, in part, to opening of new branch offices by the larger banks and to salary and wage increases during the year. Other expenses of District banks, which include costs of building and equipment maintenance, interest on borrowed money, and benefits to employees, also rose during 1961.

Sale of securities added to bank profits

For the first time since 1958, banks realized net recoveries and profits on securities. Stable interest rates and a sustained market demand for securities enabled banks to obtain profits on issues which had been previously purchased at lower prices. Many of the larger banks took advantage of the relatively high market price of bonds at the beginning of 1961 to switch to short-term securities at a profit with little loss in earnings.

Offsetting the gain in profits from securities were net losses on loan transactions, including transfers to valuation reserves. These losses, coupled with lower net current earnings, left District member banks with net profits before taxes at a level 2 percent below that of 1960. Taxes on 1961 net income of the 13 largest banks in the District were nearly the same as the previous year's despite lower net current earnings, since these banks realized substantial capital gains on securities. However, the smaller banks as a group incurred a 6 percent increase in taxes, with the result that they had a 5 percent decline in profits after taxes compared with the 3 percent decrease experienced by the 13 largest banks in the District.

Rate of return on capital declined in 1961

The ratio of net profits after taxes to capital accounts declined from 11.9 percent in 1960 to 10.3 percent in 1961.[1] Although net profits after taxes fell about 4 percent from the previous record year, Twelfth District members banks, nevertheless, elected to pay approximately 8 percent more in dividends to their stockholders than in 1960. However, due entirely to the increase in capital accounts during the year, the ratio of cash dividends to capital declined from 5.63 percent in 1960 to 5.51 percent in 1961. While in the previous year banks plowed back 52 percent of their net profits, only 47 percent was retained in 1961.

Net profits of all member banks in nation rose in 1961

Total earnings of all member banks in the United States in 1961 were $286 million larger than in 1960, according to preliminary estimates. This was a 3 percent increase compared with a 5 percent rise in Twelfth District member bank gross revenue. The average rate charged on loans by member banks declined more during 1961 in the nation than in the Twelfth District. However, the volume of loans outstanding expanded more in the nation than in the District, with the result that both all member and Twelfth District banks realized about the same percentage gain in returns from loans.

The 8 percent rise in earnings from United States Government securities realized by all member banks was less than half as large as the 20 percent gain of Twelfth District member banks. This reflects principally the efforts of District banks to rebuild their investment portfolios which had been reduced substantially more in 1960 than had those of other member banks.

In 1961 the rise in expenditures of Twelfth District member banks was higher than the 7.4 percent increase of all member banks. Even though net current earnings of all member banks in 1961 were 4 percent lower than in 1960, net profits after taxes were 1.4 percent higher, due to smaller net losses on nonoperating transactions than in 1960. Although Twelfth District banks had a decline in net profits during 1961, the ratio of net income to average total capital accounts remained higher for the District, 10.3 percent versus 9.5 percent for all member banks. Moreover, the percentage increase in dividends paid by District banks in 1961 was nearly the same as the 7.8 percent rise for the nation as a whole.

[1] These ratios are based on member bank data for each of the two years and do not reflect any estimates introduced to adjust for the effects of mergers in 1961.

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, 7] Loans and discounts	U.S. Gov't securities	Demand deposits adjusted[3]	Total time deposits	Bank debits index 31 cities[1, 4]	Bank rates on short-term business loans[6, 7]	Total nonagricultural employment	Total mf'g employment	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
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	4.09	121	134	96	122	113
1955	11,124	7,239	11,864	9,120	173	4.10	127	144	104	132	112
1956	12,613	6,452	12,169	9,424	190	4.50	134	154	104	141	114
1957	13,178	6,619	11,870	10,679	204	4.97	139	161	96	140	118
1958	13,812	8,003	12,729	12,077	209	4.88	138	153	89	143	123
1959	16,537	6,673	13,375	12,452	237	5.36	146	165	94	157	123
1960	17,139	6,964	13,060	13,034	253	5.62	150	165	88	156	125
1961	18,499	8,278	14,163	15,116	270	5.46	152	163	87	175	127
1961											
March	17,517	6,916	12,860	13,754	273	5.48	150	161	83	160	127
April	17,637	7,436	13,222	13,999	266	....	150	160	88	164	127
May	17,632	7,393	12,865	14,289	265	....	151	162	81	153	127
June	17,578	7,571	12,935	14,371	268	5.50	152	163	85	162	126
July	17,504	7,935	13,206	14,492	267	....	152	162	86	167	126
August	17,779	7,863	13,212	14,656	262	....	152	164	84	157	125
September	18,028	7,955	13,317	14,786	277	5.45	153	165	87	170	126
October	17,901	8,190	13,901	14,867	291	....	153	166	99	164	127
November	18,212	8,182	13,944	14,874	265	....	154	167	100	165	126
December	18,499	8,278	14,163	15,116	293	5.42	154	167	92	175	127
1962											
January	18,646	8,082	13,671	15,448	294	....	155	169	100	166r	127
February	18,622	7,820	13,163	15,647	289	....	156	169	99	177r	128
March	18,906	7,776	13,235	15,939	...	....	156p	169p	97	177	...

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[7, 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
1951	113	106	112	128	146	116	136	186	194	175	162	140	733
1952	115	107	116	124	139	115	145	171	201	130	204	141	1,836
1953	116	109	122	131	158	113	162	141	138	145	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	166	178	149	314	187	3,614
1956	120	105	129	156	163	131	209	201	261	117	459	201	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	564	221	9,504
1959	116	92	130	174	138	99	252	188	223	138	686	263	11,699
1960	110	91	134	161	154	129	271	241	305	149	808	269	14,209
1961	109	92	140	169	171	136	...	...	...	...	...	...	...
1961													
February	100r	91	134	176	152	134	276	248	362	95	666	233	11,985
March	103	92	131	178	162	137	285	264	363	124	952	252	19,268
April	114	92	135	168	172	133	283	261	331	163	759	286	13,139
May	111	92	143	169	191	143	285	265	331	171	865	292	15,856
June	111	91	143	188	187	143	289	224	290	128	767r	289r	13,223r
July	110	91	143	157	183	124	293	271r	365r	138	1,026r	297	20,025
August	111	91	140	160	180	107	300	247	322r	140r	805r	277r	14,586r
September	111	92	142	163	174	138	295	217	317	76	841r	277	15,542
October	110	92	144	171	181	149	310	209	310	67	872	307	15,613
November	113	92	144	182	167	147	305	256	331	148	756	264	13,573
December	106	92	141	152	167	145	...	...	...	...	...	...	...
1962													
January	105	90	139	165	184	143	...	...	...	...	...	...	...
February	...	92	140	153	187	...	...	...	...	...	...	...	...

Adjusted for seasonal variation, except where indicated. Except for banking and credit and department store statistics, all indexes are based upon lata from outside sources, as follows: lumber, National Lumber Manufacturers' Association, West Coast Lumberman's Association, and Western 'ine Association; petroleum, cement, and copper, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; lectric power, Federal Power Commission; nonagricultural and manufacturing employment, U.S. Bureau of Labor Statistics and cooperating state gencies; retail food prices, U.S. Bureau of Labor Statistics; carloadings, various railroads and railroad associations; and foreign trade, U.S. Department f Commerce. [2] Annual figures are as of end of year, monthly figures as of last Wednesday in month. [3] Demand deposits, excluding nterbank and U.S. Government deposits, less cash items in process of collection. Monthly data partly estimated. [4] Debits to total deposits xcept interbank prior to 1942. Debits to demand deposits except U.S. Government and interbank deposits from 1942. [5] Daily average. Average rates on loans made in five major cities, weighted by loan size category. [7] Not adjusted for seasonal variation. [8] Los Angeles, an Francisco, and Seattle indexes combined. [9] Commercial cargo only, in physical volume, for the Pacific Coast customs districts plus Alaska nd Hawaii; starting with July 1950, "special category" exports are excluded because of security reasons. [10] Alaska and Hawaii are included n indexes beginning in 1950. p—Preliminary. r—Revised.