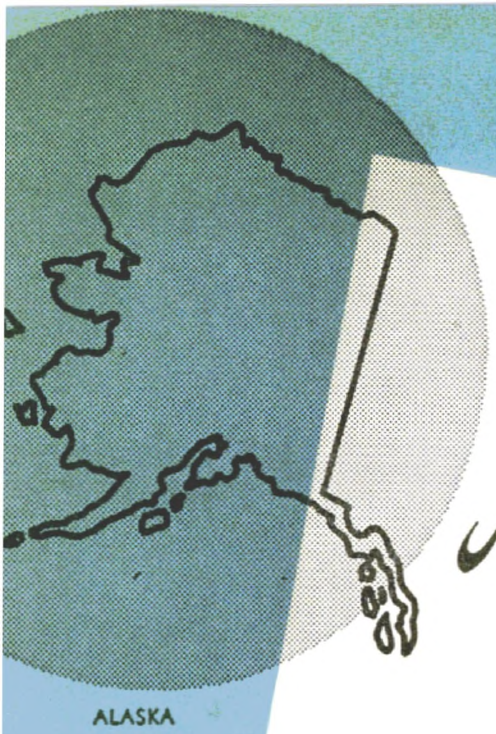
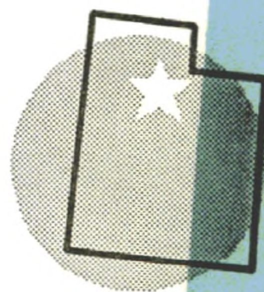
Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO

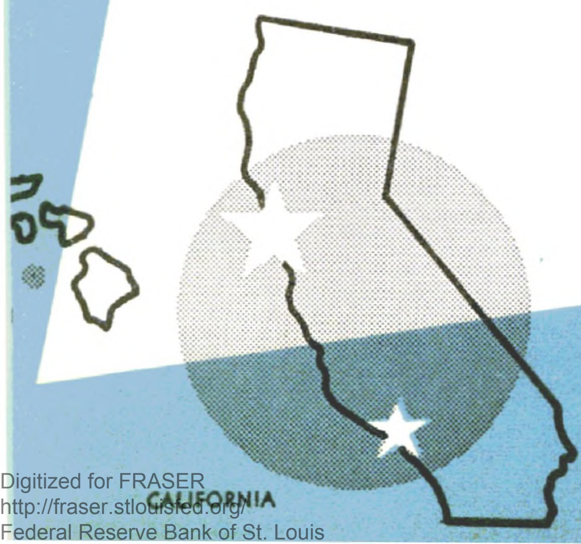
TWELFTH FEDERAL RESERVE DISTRICT

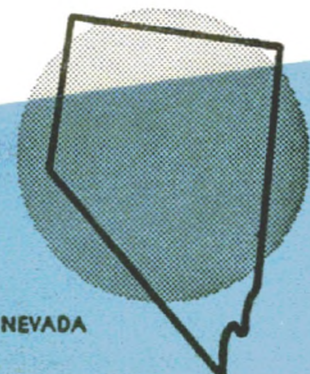


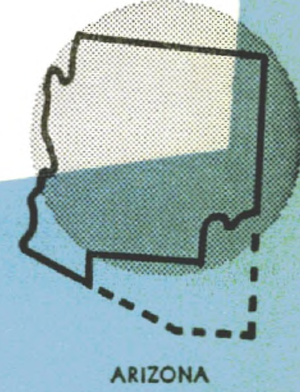


August 1963

In This Issue



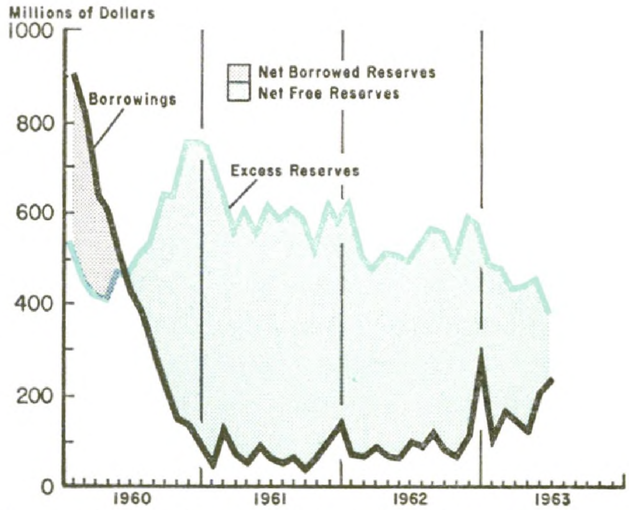




"Somewhat Less Ease" (Financial Review)

In the first half of 1963, the nation's economic posture improved but its balance of payments position did not. The monetary authorities, through their influence on bank reserves and money market rates, consequently were enabled by the economic expansion to direct greater efforts toward the improvement of the balance of payments—specifically, toward the minimization of short-term capital outflows resulting from higher interest rates in other countries. This development reached a climax in mid-July. At that time the Federal Reserve Banks raised from 3 percent to 3½ percent the rate charged for loans made to member banks, and thereby brought to a close the postwar era's longest (three-year) period of stability in the discount rate. At the same time, the Federal Reserve Board raised to 4 percent the maximum permissible rate member banks may pay on time deposits and certificates with maturities from 90 days to 1 year.

Free reserve position narrows as expansion continues.



Source: Board of Governors of the Federal Reserve System.

New world of 3½ percent

The gradual strengthening of credit demands and the slight shifting of monetary policy provided the environment for this new world of 3½ percent. During the first half of 1963, the pressure on the reserve position of member banks increased, as a result of what was officially characterized as "a move to somewhat less ease." The net free reserve position of all member banks (that is, excess reserves less borrowings from the Federal Reserve Banks) fell during the period from about $400 million, the level which had obtained throughout most of 1962, to a June figure of $140 million, the lowest level in three years. The decline was most evident at reserve city banks, which since November have had net borrowed reserves (that is, larger borrowings from the Federal Reserve Banks than excess reserves). A decline in excess reserves, as well as a sharp increase in borrowing from the Federal Reserve Banks in June, contributed to about an $80 million decrease nationally in the average level of free reserves between the first and second quarters of the year.

The course of interest rates was generally upward throughout the six-month period, although most of the increase occurred in May and June as a consequence of tightening money market conditions. The rate of increase varied considerably by type of security and by maturity. The market yield on 91-day Treasury bills, which had risen from 2.75 percent in October to 2.91 percent in January, held near that level until the second half of May. At that point the bill rate started to climb, and in the June 7 auction, the yield reached the 3 percent level for the first time in three years. In July, the Treasury refrained from augmenting the auction bill volume above that of maturing bills, as it had done in earlier months, but yields nonetheless continued upward to 3.25 percent. The longer maturities of bills moved up in concert with the

91-day bill rate, and yields on other money market instruments also sought higher levels.

Returns on intermediate- and long-term Treasury issues registered increases, but the gains were concentrated in the April-June quarter and were of smaller magnitude than the increases recorded for short-term issues. In June, yields on Treasury notes and bonds in the 3-to-5-year maturity range averaged 3.67 percent, while yields on long-term Treasury bonds averaged 4.00 percent. (These figures were 20 and 11 basis points, respectively, above their January levels.) Yields on top-quality State and local issues, which had returned 2.95 percent in January and had risen only two basis points through March, thereafter recorded a sharp upward movement—to 3.08 percent in June—as congestion in the municipals market in the latter weeks of the quarter pushed dealer inventories to record levels.

More money available

The money supply, although rising at a slower pace than in the closing months of 1962, increased at an annual rate of 2½ percent in the January-June period. This increase was substantially greater than the 1½ percent rate recorded in 1962 as a whole. Time and savings deposits meanwhile continued to pour into commercial banks at a rapid rate. These deposits expanded at a 14 percent annual rate in the first half of 1963—a rate substantially above the increases of recent years, except for the extraordinary 20 percent growth rate recorded in January-June 1962.

Commercial bank credit increased $4.6 billion in the first half of 1963—slightly less than in the first half of 1962—but the components of the total showed divergent movements. Total loans (less those to domestic commercial banks) rose $4.2 billion, but only the large tax-connected borrowing in June permitted the dollar increase to exceed that recorded in the first half of 1962. Meanwhile, a substantial reshuffling of investment portfolios occurred, with bank holdings of United States Government securities declining $2.9 billion, and holdings of other securities (chiefly State and local government obligations) increasing $3.3 billion. This half-year gain in other securities was greater than that recorded in any full year prior to 1962; holdings of such securities, in fact, have increased by roughly 50 percent just since the cyclical trough of early 1961.

On a national level, bank lending in the first half of 1963 was dominated by real estate and consumer loan transactions. Activity in both categories expanded steadily throughout the six-month period, approximating the substantial rate of expansion experienced in the comparable period of 1962. Business loan activity expanded following a seasonal first-quarter decline; borrowing in the tax and dividend weeks of mid-June was about the same as in the corresponding weeks of the two preceding years.

Less ease in District

In the Twelfth District, "somewhat less ease" meant tighter reserve positions for reserve city banks. In all months of the period except January and April, these banks were in a net borrowed reserve position—that is, their borrowings from the Federal Reserve Bank exceeded their excess reserves (daily average basis). The volume of borrowing was heaviest in the last two months of the period, both in dollar amount and in the number of banks using the discount window.

Except for the first month and a half of 1963, however, District banks remained consistent net sellers of Federal funds. (Federal funds transactions are carried out with reserves which are on deposit with a Federal Reserve Bank; member banks can lend these reserves to other banks that need funds to meet their required reserves, but the interest rate charged on such transactions seldom exceeds the discount rate at which member banks can borrow from the Federal Reserve

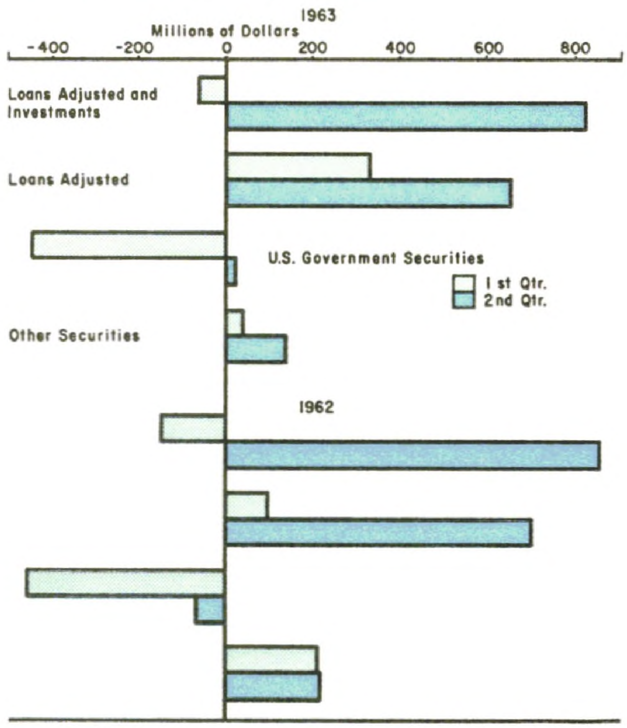
Banks.) Nonetheless, the margin of sales (i.e., loans) over purchases (i.e., borrowings) narrowed in May and early June, partly because of direct pressure on reserves and partly because some banks switched their surplus funds from the Federal funds market into Treasury bills as the relative attractiveness of Treasury bill yields increased.

Despite the gradually increasing pressure on reserves, weekly reporting member banks in the District[1] recorded a 2.7 percent increase in bank credit during the January-June period. This increase matched the gain made by District banks in the comparable period of 1962, and was substantially greater than the 1963 gain attained by member banks nationally. In the District as in the nation, loans rather than investments provided the main support for the credit expansion of recent months. Loan demand was stronger at District member banks, however, as can be seen not only from the comparison of rates of increase in outstanding loans—5.4 percent for the District and 2.9 percent for the nation—but also from the fact that the District (unlike the nation) recorded a net liquidation in total security holdings in order to support the expanded loan volume.

Business loan demand, although stronger than in the first half of 1962, was not so strong as was the demand from other sectors. In fact, the latest survey of interest rates at 23 leading District banks fails to provide conclusive evidence of upward pressures on the cost of business borrowing. The average rate on short-term business loans made by District banks in the first half of June, although above the March level, was no higher than the June-1962 level, and the average rate on term loans to business was actually below the rate prevailing in the first quarter of this year. On the other hand, only 27 percent of the total dollar volume of loans made during the recent survey period carried the prime rate—the rate charged business borrowers with the highest credit rating — whereas the corresponding percentages were 37 percent in March 1963 and 45 percent in June 1962.

[1]This discussion is based on data for weekly reporting member banks, since more detailed information is available on a current basis for these banks than for all member banks. Weekly reporting banks—in the District as in the nation—hold about 90 percent of the total assets of all member banks.

Strong loan demand dominates District bank credit picture.

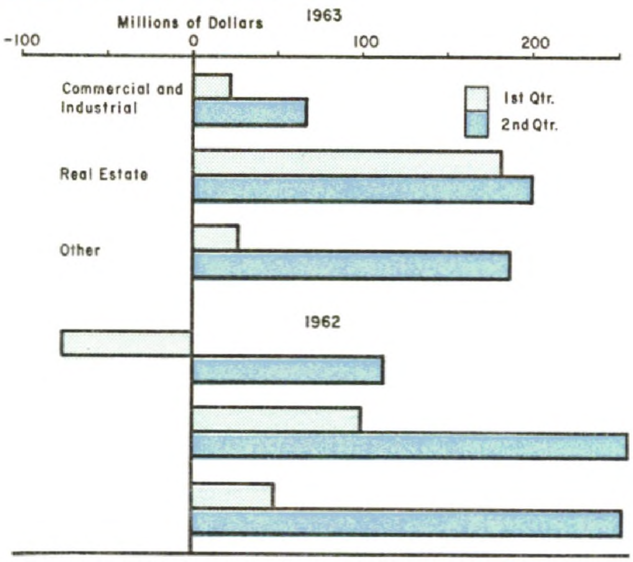


Source: Weekly reporting member bank series, Federal Reserve Bank of San Francisco.

Drive for higher earnings

The loan expansion in the first half of 1963 came predominantly from the real estate and consumer sectors. Mortgage loans alone accounted for $381 million of the $986 million increase in loan portfolios of District banks, on the basis of an unseasonal first-quarter increase as well as continued strength in the April-June quarter. The banks actively sought mortgages throughout this period, despite a slowdown in the rate of expansion of savings and time deposits, in a continuing effort to obtain higher earning assets as an offset to increased time deposit costs. By midyear, the dollar volume of the banks' real estate loans was equal to 41 percent of their total time and savings deposits—slightly above the year-ago level but still below the 48 percent ratio pre-

Mortgage, consumer demand stimulates loan expansion.



Source: Weekly reporting member bank series, Federal Reserve Bank of San Francisco.

vailing at the peak of the last business cycle in June 1960. The high rate of automobile sales meanwhile accounted for the predominant share of an $185 million increase in the "other loan" category.

District banks reduced their investment holdings $233 million in the January-June period, but their holdings of municipals and other tax-exempt securities actually increased, although not so rapidly as in the nation as a whole. This increase, like the increase in mortgage and consumer loans, reflected the intensive search for higher earnings to offset the expense of the large inflow of interest-bearing deposits. To obtain even more funds for such high-earning uses, District banks during recent months also liquidated Treasury securities at a greater rate than did banks nationally.

During the January-June period, District bank portfolios of Government securities showed a shift out of short-term Treasury issues into securities with maturities of 5 years or over. This shift gave support to Treasury debt-lengthening activities, as banks participated rather heavily in February's exchange offering, March's advance refunding, and June's cash offering of 7-year bonds. The first-quarter net reduction in securities maturing within 1-5 years was largely offset in the succeeding three-month period, but the decline in holdings of securities of even shorter maturities continued into the second quarter.

A net expansion of total deposits occurred during the January-June period, with a 7 percent increase in time and savings deposits offsetting a seasonal 6 percent decline in demand deposits adjusted.[1] The reduction in demand deposits was less than the 8 percent decrease recorded in the corresponding period of 1962, and was also less than the percentage decline registered by weekly reporting member banks nationally.

Slowdown in savings?

The increase in savings deposits at District banks in the first half of 1963 was $411 million—a 3.4 percent expansion compared with a record rate of 6.1 percent in the first six months of 1962. Both the first and second quarter gains were considerably below those recorded in the corresponding periods of 1962; in fact, the net dollar increase in the second quarter was the lowest quarterly gain since the third quarter of 1960. The net withdrawal of $110 million in savings in April, concentrated around the personal income tax payment date, suggests a tendency toward somewhat greater volatility in District savings deposits. Moreover, the much greater deposit growth recorded by savings and loan associations reflects the influence of the significant differential between the rates paid by such institutions, particularly in California, and the rates paid by District banks.

In contrast to regular savings deposits, other time deposits of individuals, partnerships, and corporations expanded at a higher rate in the first half of this year than in 1962. Some of the additional deposits attracted recently were in the form of negotiable time certificates, a form of deposit that has become

[1] Total deposits, less United States Government deposits and deposits of domestic commercial banks, and less cash items in the process of collection.

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

(in millions of dollars)

	TWELFTH DISTRICT				UNITED STATES		
	Outstandings	Net Change			Outstandings	Net Change	
	June 26, 1963	1st Half 1963 Dollars	1st Half 1963 Percent	1st Half 1962 Percent	June 26, 1963	1st Half 1963 Percent	1st Half 1962 Percent
Assets							
Loans adjusted and investments	28,780	+ 753	+ 2.7	+ 2.7	133,116	+ 2.4	+ 1.5
Loans adjusted[1]	19,403	+ 986	+ 5.4	+ 4.9	84,693	+ 2.9	+ 1.8
Commercial and industrial	6,321	+ 90	+ 1.4	+ 0.6	35,559	+ 1.1	+ 1.3
Real estate	6,687	+ 381	+ 6.0	+ 6.5	16,771	+ 8.2	+ 6.5
Agriculture	977	+ 85	+ 9.5	+18.5	1,533	+ 0.3	+ 8.9
Non-bank financial	1,224	+ 204	+20.0	— 1.6	7,292	+ 4.0	— 1.6
Security	348	+ 36	+11.5	+ 2.3	5,694	— 2.1	—18.7
Foreign banks	217	+ 9	+ 4.3	+ 3.3	728	+12.0	+14.0
Other (mainly consumer)	3,968	+ 212	+ 5.6	+ 9.4	19,055	+ 3.7	+ 5.9
U. S. Government securities	6,067	— 419	— 6.5	— 7.4	30,377	— 4.5	— 5.3
Other securities	3,310	+ 186	+ 6.0	+16.9	18,046	+14.1	+18.4
Liabilities							
Demand deposits adjusted	11,755	— 749	— 6.0	— 8.0	62,010	— 6.4	— 7.3
Total time and savings deposits	16,158	+1,026	+ 6.8	+ 9.3	54,856	+ 9.7	+13.5
Savings deposits	12,541	+ 411	+ 3.4	+ 6.1	36,355	+ 4.7	+ 8.2

[1] Exclusive of loans to domestic commercial banks and after deductions 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.

increasingly popular in the District as the national secondary market for such certificates has expanded. This popularity may now increase even further, in view of the recent (July 17) revision of Regulation Q. The revision, which increased the maximum permissible rates of interest payable on time deposits and certificates with maturities of 90 days to one year, gave banks more leeway to maintain rates competitive with those currently prevailing on Treasury bills and commercial and finance company paper.

Lower liquidity, higher earnings

By the end of June 1963, the ratio of loans to deposits[1] at weekly reporting member banks had climbed to 65.0 percent. This ratio was two points above the ratio in December 1962 and just under the record high of 65.2 percent prevailing at the June-1960 business cycle peak. The recent reduction in bank liquidity should be viewed in the light of the notable shift in the composition of District bank assets and liabilities which occurred between 1960 and 1963. For example, time and savings deposits constituted 45 percent of total deposits in mid-1960, but 51 percent of the total in mid-1963. This shift in favor of the type of deposits that generally experience few severe declines decreased the likelihood of deposit fluctuations which might impinge on loan commitments. Moreover, the June-1963 ratio of real estate mortgages to time and savings deposits was actually below the 1960 level, in spite of the large dollar increase in this type of financing during the last year and a half. This situation, along with the continued stability in the ratio of real estate loans to total loans, suggests that District banks have not increased their longer term loan commitments disproportionately.

Another gauge of bank liquidity provides less encouraging news. This measure, the ratio of United States Government securities maturing within one year to total deposits (less cash items in the process of collection), fell substantially in the first 6 months of 1963, from 7.2 to 4.6 percent; nevertheless, it remained above the postwar low of 1.3 percent reached in June 1960.

[1] Total loans, less loans to banks, as a percent of total deposits, adjusted to exclude cash items in the process of collection.

On balance, member banks in the Twelfth District could review their performance in the first six months of 1963 with some satisfaction, since earnings for the period were generally above year-ago levels. This was a reversal of the depressed-earnings situation of early 1962, when bank expenses rose under the pressure of a rising volume of time and savings deposits and a rising level of interest rates paid on such deposits. The intensive efforts undertaken at that time by District banks to adjust loan and investment portfolios toward higher earning assets appear now to have succeeded in offsetting the sharp increase of operating costs.

Savings and loan shifts

Savings and loan associations in the District recorded a very impressive 13 percent gain in savings shares over the year-ago level; the increase exceeded even the previous record of 10 percent established in the first half of 1962. In dollar terms, the increase was about five times as great as the banks' expansion in savings deposits, and twice as great as the banks' increase in total time and savings deposits. The volume of outstanding mortgage loans held by District savings and loan associations also increased at a somewhat higher rate than in the first half of 1962, although competition for mortgages intensified during the period and brought about some downward pressure on mortgage rates.

The expansion in savings and loan associations' mortgage holdings even exceeded the net increase in their acquisitions of funds during the first six months of 1963. Loan commitments, moreover, remained well above the volume of commitments incurred during the first half of last year. Because of this situation, and despite the record savings inflow, advances from the Federal Home Loan Bank and other borrowings by District savings and loan associations rose in the first six months of 1963 above the comparable months of 1962.

Contrary to the recent national trend toward lower dividend rates by savings and loan associations—a move urged by the Federal Home Loan Bank Board—some associations in the District raised their rates effective in July. These conflicting pressures consequently created a perplexing rate structure in the District, particularly in California: several Los Angeles associations moved up to 4.85 percent; San Diego associations generally reduced their rates to 4.50 percent from 4.80 percent, and San Francisco Bay Area institutions announced rates of 4.50 percent, 4.80 percent, and 4.85 percent. A number of the associations stated that lower returns on mortgage loans were the basis for rate reductions, while other associations referred to the strong demand for mortgage loans as the reason for rate increases. Still other associations posted higher rates "to remain competitive."

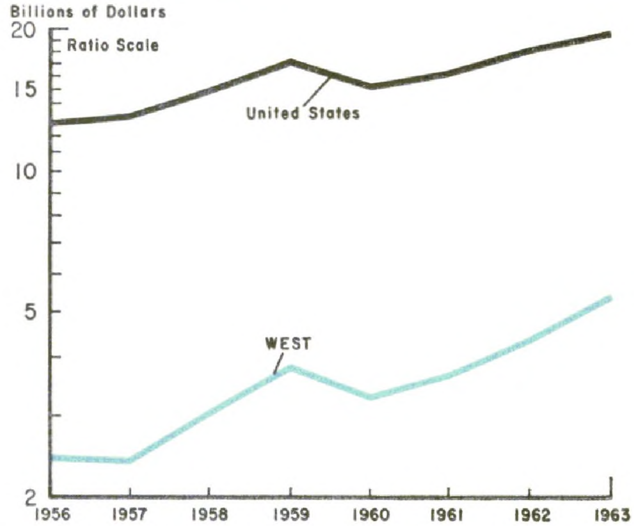
Regardless of these cross-currents in rates, the recent experience of all savings institutions suggested that the District was producing—as well as attracting from outside—an abundance of savings to help meet the capital requirements of the rapidly-growing Western economy.

Housing: Foundations of the Boom

During the current cyclical expansion, builders have offered a record supply of new housing to would-be homeowners and renters in the Twelfth District. During the first half of 1963, for example, they have contracted for housing at a $5.3 billion annual rate—a figure even more impressive than the $4.3 billion total recorded in 1962. Their record performance has been stimulated by the substantial infusion of mortgage credit resulting from the heavy inflow of funds into savings institutions throughout the nation.

Is the industry, however, adding more to the housing stock than can be readily absorbed by those now in the market for new houses and apartments? Can Twelfth District housing activity, in other words, be sustained much longer at the recent record rate? Vacancy data do not provide any clear-cut answer; the vacancy rate for owned housing, which had earlier declined from the 1.6 percent peak attained in early 1959, has recently risen to 1.8 percent, but the rental vacancy rate has drifted downward from its 1960 peak, despite a recent rise to 10.9 percent. In the absence of any clear-cut indication from vacancy data, therefore, the strength of the housing boom in this area can best be gauged from an analysis of the demographic, industrial, and financial factors that have provided the building blocks for the prolonged expansion.

Housing activity strong in 1962, stronger in 1963.



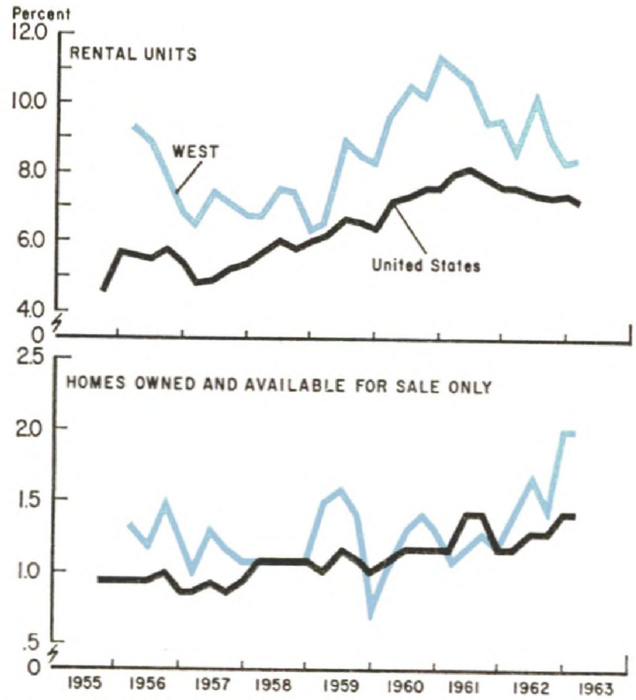
Note: The West is the Twelfth District excluding Alaska and Hawaii. The 1963 figure is the annual rate for the January-June period.
Source: F. W. Dodge Corporation.

When problems arise

The problem of temporary oversupply can arise in rapidly growing areas whenever the building industry—which consists of many small builders and relatively few very large ones—decides that a strong long-term demand for housing can be translated immediately into sales. The success of one apartment building or tract of homes may lead many builders to assume that another building or tract will be equally successful, despite the fact that the one first built may have satisfied demand more or less completely for the time being. In nonresidential building, on the other hand, the sheer size of each project generally necessitates a pre-construction survey of the building's economic potential. A large office building or factory is not likely to be built on the assumption that tenants will be waiting to occupy it upon completion; prior commitments usually exist for at least a major part of the space in each such building. (New York, the exception usually cited, is perhaps the only city in the country where enough "floating demand" for commercial or industrial space exists to justify nonresidential construction of any magnitude on a speculative basis.)

The determination of housing demand in any given area requires, first of all, an analysis of population change. An increase in the number of people in a given area will, generally speaking, give rise to an increase in the number of housing units demanded. The relevant figure, however, will be not the number of people but rather the number of households, since people determine their housing requirements in terms of the size and composition of their individual households.

Vacancy rates rise faster in owned housing than in rentals.



Source: United States Department of Commerce, Bureau of the Census.

The determination of District housing demand also requires analysis of the demographic changes peculiar to the area. The primary factor is the continuation of the large inflow of people into District states, notably into California, over and above the "natural" increase due to births occurring in families already located here (and net of the decrease due to deaths or out-migration). Between 1950 and 1960, the population of the nine District states rose 41 percent, while that of the nation as a whole increased only 19 percent. In terms of households, the comparable figures were 39 percent and 25 percent, respectively.

A second factor is the characteristics of the in-migrants; for example, the young married couples in this group may have substantially different housing needs than the people of retirement age who are also heading West. A third factor is the "hole" in the age structure of the general population resulting from the unduly low birth rates of the 1930's; this factor may have a strong influence on housing demand because of the different impact exerted by different age groups on the quantity and type of housing demanded.

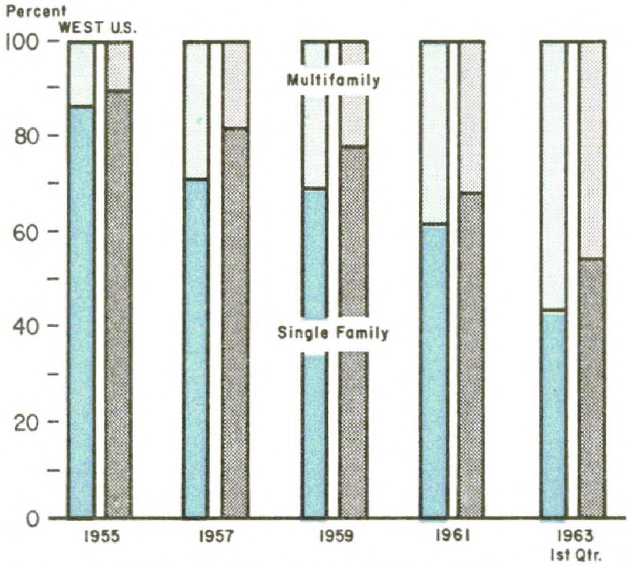
The importance of age

According to the "life cycle" analysis of housing markets, the age of the head of the household exerts a strong influence on the type of housing demanded. Single individuals who form their own households typically want small rental housing. Married couples, on the other hand, tend to have different housing needs depending on their stage in the life cycle. The situation can be shown in tabular form as follows, with the check marks denoting the intensity of preference for different types of housing:

	Owned housing	*Rental housing*
Newlyweds (husband aged 20-25)		√
Children arriving (husband aged 25-35)	√	√ √
Children growing up (husband aged 35-50)	√	
Children grown up (husband aged 50-65)	√ √	√
Retired couple, widow, or widower (65 and over)	√	√

Typically, young married couples will rent until children begin arriving—perhaps even later, depending on the time at which the average husband's income is high enough to permit purchase of the type of home which he feels would meet his needs. Families with growing children, on the other hand, provide the backbone of the home-owner category. Those with grown children who have moved away—the "empty nest" couples—may continue to live in their own homes, but as the age of retirement approaches the balance begins to shift again in favor of rental housing. Preference for rental housing may, in fact, be quite strong among those moving to other areas after retirement. These remarks refer only to the average behavior of American families in the housing market and ignore other types of households—such as single persons or broken families caused by divorce or separation—which may behave dif-

Apartment construction plays dominant role in housing boom.



Source: United States Department of Commerce, Bureau of the Census.

ferently; nonetheless, they indicate the influence of age and composition of household on the basic housing decision.

Between 1950 and 1960, substantial differences occurred in the relative gains of households in different age-groups, both in the District and in the nation. In the Twelfth District, the largest percentage gains were registered by households whose heads were under 25 and over 65; in these categories the increases were more than twice as great as the gain in the (initial home-buying) 25-35 age group. This situation undoubtedly helps account for the strengthening of apartment building and the relative weakening of home building in this District in recent years.

The effects of the low depression-era birth rates may have adversely affected the nation's total housing demand in the recent past. According to the "life cycle" argument, this relatively small segment of the total population—the depression babies—has exerted a double impact on housing demand. It has tended to weaken the total market for housing, and it has concentrated this impact on the present age-group which normally forms the backbone of the market for new homes. The impact has been offset in many District localities, however, by the in-migration of large numbers of young families.

Jobseeking, homeseeking families

Economic change—the maturing of the District economy—has also played a very important role in supporting housing demand in recent years. In the quarter-century beginning in 1929, much of the growth in District population—primarily California population—centered around the development of employment opportunities in aircraft, as well as in petroleum and other resource-oriented industries. Jobseeking, homeseeking families were attracted into the District in large numbers during this stage of Western development by the opportunities created by these "primary" industries. (The leading growth industries of the past decade, electronics and ordnance, developed under the wing of the military aircraft industry during this period, but they have subsequently found new markets with greater long-term growth potential.)

Once an industrial base had been established in this fashion—that is, once the population in the area had expanded to a certain size—consumer markets became feasible for goods which could be produced in the area but had heretofore been shipped in from other parts of the country. The orientation of industry thereupon began to shift toward the consumer rather than toward other producers. Throughout the recent past as throughout the earlier period, however, there was also a steady flow of people westward in search of good climate, a pleasant retirement atmosphere, and the like; this movement, of course, further increased the potential local market for consumer goods.

The broadening and growth of the Western economy have helped to support a record level of housing activity in recent years. In addition, the shift in the industrial structure has tended to cause a shift in the composition of the West's housing market. Many of the

ANNUAL CHANGES IN SAVINGS AND MORTGAGE LENDING AT FINANCIAL INSTITUTIONS

(billions of dollars)

	United States						Twelfth District					
	Commercial banks		Savings & Loan associations		Total		Commercial banks		Savings & Loan associations		Total	
	Savings	Mortgages	Savings	Mortgages	Savings	Mortgages	Savings	Mortgages	Savings	Mortgages	Savings	Mortgages
1962	15.3	3.9	9.4	10.0	27.7	17.1	2.3	1.0	3.1	3.3	5.4	4.4
1961	10.8	1.6	8.7	8.7	21.4	12.5	1.9	0.3	2.3	2.6	4.2	2.9
1960	5.5	0.7	7.5	6.8	14.3	9.4	0.8	−0.1	1.9	1.8	2.7	1.7
1959	2.7	2.8	6.6	7.5	10.5	12.1	0.7	0.9	1.5	1.9	2.2	2.8
1958	7.1	2.1	5.9	5.4	15.3	9.7	1.5	0.5	1.3	1.2	2.9	1.7
1957	5.5	0.6	4.6	4.2	11.8	6.2	1.3	−0.1	0.9	1.0	2.3	1.0
1956	2.2	1.7	4.9	4.3	9.0	8.3	0.3	0.5	1.0	0.8	1.3	1.4
1955	1.5	2.4	4.7	5.1	8.0	9.9	0.7	0.6	0.9	0.9	1.5	1.5

Notes: Totals include mutual savings bank data. Twelfth District data include data for all insured savings and loan associations and mutual savings banks located in District states. Individual items may not add to totals because of roundings.
Source: Board of Governors of the Federal Reserve System, Federal Home Loan Bank Board, and National Association of Mutual Savings Banks.

employees of the rapid-growth industries—electronics and the more esoteric branches of the aircraft and missile industries—are technicians with high educational levels and high living standards. Their increasing importance in the labor force thus tends to upgrade the market prices and housing characteristics of the "average" owned or rented unit. Their influence may also be felt in the location of new housing activity, to the extent that suburban housing is preferred over central-city housing by this type of employee.

The importance of money

The strength generated in the housing market by the demographic and industrial factors cited above has been accentuated in the present expansion by the ready availability of mortgage money. Some economists argue that mortgage credit plays only a passive role in determining the volume of housing activity. Recent experience, however, gives more support to the alternative view which contends that the availability of funds strongly influences the volume, and even to some extent the composition, of real estate investment in any given period. Between 1961 and 1962, in both the District and the nation as a whole, mortgage lending activity increased about 50 percent in response to savings gains of about 30 percent. The increased availability of funds then supported a 12 percent gain for the nation, and a 19 percent gain for the District, in housing contract awards. (F. W. Dodge reports).

The volume of mortgage investments made by lending institutions in a given period is largely conditioned by the rate of savings inflow. Both the composition and the volume of the mortgage inflow, moreover, are affected by the public's choice of institutions to serve as repositories for savings. For example, if savings and loan associations are currently receiving a relatively large volume of savings from the public, the impact of this inflow of funds is likely to be felt more strongly in the home-building sector than in other areas; if commercial banks and mutual savings banks are more favored, however, the relative demands of other sectors—such as the demand for consumer loans or commercial mortgages—will partly determine the volume of funds made available for housing credit.

The current expansion has witnessed a considerable increase in the rate at which savings institutions have received savings from the public. But all lenders—not simply the savings and loan associations—have increased their mortgage loans more or less in step with the increased flow of savings. One possible explanation of this development is the relatively light business demand for bank loans during this cyclical expansion. The business lending situation, in turn, appears related to the development of alternative sources of business funds; one such alternative is provided by "cash flows", that is, internally-generated depreciation allowances and retained earnings.

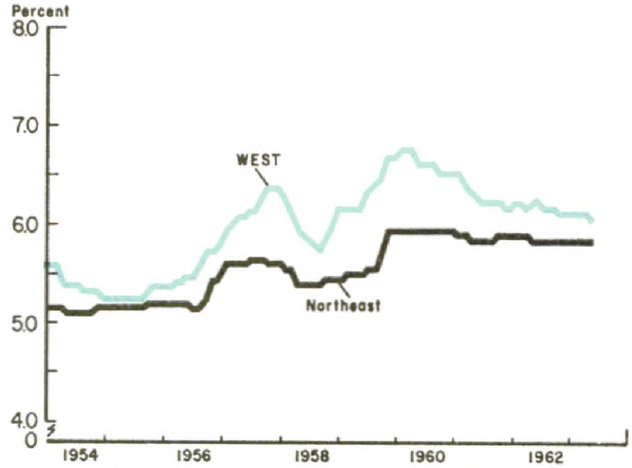
Eastern savings, Western mortgages

The District has benefited substantially from the movement of the increased flow of savings into mortgages. The District, in particular, has benefited from the continued channeling of Eastern savings into Western mortgages. The volume of this inflow is somewhat uncertain, since the data show the amount of mortgages held by institutions located within the District but not those located elsewhere. (Thus, mutual savings bank data underestimate by a considerable margin the importance of those lenders in the District, since they refer only to the mortgage activity of the very small number of such institutions actually located in the area, and not to the loans based on properties located here.) Suffice it to say that the inflow of mortgage funds is always quite sizable, even in periods when lenders are not engaged in a nationwide search for profitable outlets for savings. According to one recent study, out-of-state funds in 1960 accounted for 38.5 percent of total outstanding nonfarm mortgages in California;[1] yet even this figure, which refers only to outstandings, may understate the inflow of savings relative to new mortgages in more recent years.

The inflow of funds for mortgage investment has not, on the whole, been matched by an equally substantial demand for mortgage credit on the part of homebuyers or other

[1] Leo Grebler, "California's Dependence on Capital Imports for Mortgage Investment," *California Management Review* (Spring 1963).

Interest rate differential narrows between West and East.



Source: Federal Housing Administration.

mortgage borrowers. Otherwise, more strength would have been evident in mortgage rates (and prices of FHA-insured fixed-rate loans) than has been the case during the current expansion. Similarly, if demand had been stronger, the narrowing spread between rates in the West and in the Northeast probably would not have occurred, even though a contributing factor in that situation has been the placement of a large volume of funds by Eastern insurance companies and mutual savings banks in Federally-guaranteed or -insured home mortgages on Western property.

In this as in other periods when funds are relatively plentiful, terms are apt to be more liberal and the credit standards by which prospective borrowers are appraised are likely to be less stringent than at other times. This of course is not unusual; evaluation of the creditworthiness of potential borrowers is and always has been one of the means by which the available loanable funds are rationed by lenders. In the present instance, however, many observers have expressed concern regarding the quality of the mortgage credit now being granted. In their view, the increased sales in the housing field—as in the instalment credit area—may have been obtained primarily through the medium of excessively low down payments and excessively easy credit terms.

The concern expressed about the deterioration in quality of new mortgage loans has been emphasized by the performance of some of the loans that were made in the 1958-59 housing boom. A sharp increase in 1960-62 in the percentage of delinquencies and foreclosures on FHA-insured loans was associated to a large extent with housing loans made under relatively easy terms in the 1958-59 period. Hence, there arises the possibility that similar difficulties will develop sooner or later with many of the loans made under easy terms during the present period.

The basic strength of a housing boom that appears to be so heavily dependent on easy credit may perhaps be questioned. In addition, the difficulties encountered with sales, delinquencies, and foreclosures in some local areas, especially in the category of for-sale housing, have created doubts in the minds of many housing analysts. Nonetheless, the absence of excessive vacancy rates in the District as a whole—especially after a prolonged period of housing activity—indicates the solidity of the demographic and economic underpinnings of the boom. Consequently, as long as builders remain confident about the continued development of employment opportunities in the District and confident about the permanent lure of Western living for both young and old, they are likely to retain a strong measure of optimism about their own long-term sales prospects.

Reprint Available

Reprints of the report "Federal Reserve Open Market Operations in 1962" by Robert W. Stone, Manager of the System Open Market Account and Vice President of the Federal Reserve Bank of New York, which appeared in the April 1963 issue of the *Federal Reserve Bulletin* are available on request from the Federal Reserve Bank of San Francisco or the Board of Governors of the Federal Reserve System, Washington, D. C.

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

(Indexes: 1957-1959=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[4, 5]	Bank rates on short-term business loans[6, 7]	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	19	....	...	...	110	18	53
1933	1,486	720	951	1,609	8	....	...	...	56	11	34
1939	1,967	1,450	1,983	2,267	14	....	...	...	83	19	38
1953	9,220	6,639	10,515	7,997	69	4.14	86	86	108	74	93
1954	9,418	7,942	11,196	8,699	71	4.09	85	84	103	74	93
1955	11,124	7,239	11,864	9,120	80	4.10	90	90	112	82	92
1956	12,613	6,452	12,169	9,424	88	4.50	95	96	112	91	94
1957	13,178	6,619	11,870	10,679	94	4.97	98	101	103	93	97
1958	13,812	8,003	12,729	12,077	96	4.88	98	96	96	98	101
1959	16,537	6,673	13,375	12,452	109	5.36	104	103	101	109	101
1960	17,139	6,964	13,060	13,034	117	5.62	106	103	95	110	103
1961	18,499	8,278	14,163	15,116	125	5.46	108	103	94	115	104
1962	....	....	....	....	141	....	113	109	104	123	...
1962											
July	19,669	7,532	13,535	16,587	144r	....	113	109	106	123	105
August	20,017	7,309	13,255	16,655	144r	....	113	109	105	124	105
September	20,165	7,471	13,446	16,772	143	5.49	114	110	107	122	106
October	20,460	7,471	13,969	16,934	142r	....	114	111	104	121	106
November	20,589	7,501	14,012	16,827	144r	....	114	110	102	128	105
December	21,102	7,608	14,431	17,093	146	5.50	115	111	101	127	106
1963											
January	21,035	7,454	13,917	17,390	146	....	116	111	90	127	107
February	21,403	7,130	13,527	17,532	149	....	116	111	105	128	107
March	21,480	7,130	13,646	17,760	152	5.46	116	111	105	130	107
April	21,714	7,103	14,175	17,868	147	....	116	110	99	118	107
May	21,894	7,069	13,427	18,111	152	....	116	110	103	129	106
June	22,140	7,153	13,610	18,264	152	5.53	116p	108p	...	127	...
July	...	...	...	...	...	....	...	...	...	...	...

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	84	91	61	34	...	89	13	96	61	193	20	55	*
1933	35	54	39	17	...	15	11	55	...	...	12	...	...
1939	62	70	49	35	16	70	17	82	43	190	16	41r	1
1952	101	112	90	77	92	100	61	86	81	101r	33	61r	18
1953	102	114	95	82	105	98	69	71	56	113	51	70	41
1954	101	111	92	83	85	90	73	67	57	96	44	71	28
1955	107	111	96	90	102	104	82	84	72	117r	52r	80	35
1956	104	109	100	97	108	114	89	101	105	91	75	86	69
1957	93	106	103	93	114	113	95	117r	124	96	95	93	97
1958	98	98	96	99	94	101	97	89	86	96	92	95	91
1959	109	96	101	108	92	86	107	95	90	108	112	113	112
1960	98	95	104	101	102	112	115	122	123	120r	133r	117r	142r
1961	95	96	108	105	111	119	124	126	134	104	134	116	145
1962	97	96	111	111	100	128	...	...	...	...	...	...	...
1962													
June	94	96	112	94	103	130	128	104	121	59	156	132	170r
July	98	96	115	115	84	112	128	82	85	74	154	122	172
August	95	97	114	117	89	115	134	116	130	76	168	136	186
September	98	96	113	115	90	119	134	105	121	61	137	122	145
October	98	97	112	120	88	127	132	96	105	72	158	154	161
November	104	97	113	115	91	127	135	93	91	99	163	127	183
December	103	97	113	121	100	127	...	154	157	143	134	124	140
1963													
January	101	96	113	122	100p	125	...	...	...	...	...	...	...
February	94	96	111	118	114p	130	...	...	...	...	...	...	...
March	104	97	110	122	127p	134	...	...	...	...	...	...	...
April	89	98	108	105	138p	135	...	...	...	...	...	...	...
May	...	98	112	111	145p	127	...	...	...	...	...	...	...
June	...	...	...	111	131p	...	...	...	...	...	...	...	...

[1] Adjusted for seasonal variation, except where indicated. Except for banking and credit and department store statistics, all indexes are based upon data from outside sources, as follows: lumber, National Lumber Manufacturers' Association, West Coast Lumberman's Association, and Western Pine Association; 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. Department of Commerce. [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] A new index now combining not only Los Angeles, San Francisco, and Seattle food indexes but also Portland. Reweighted by 1960 Census figures on population of standard metropolitan areas. [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. * Less than 0.5 percent.