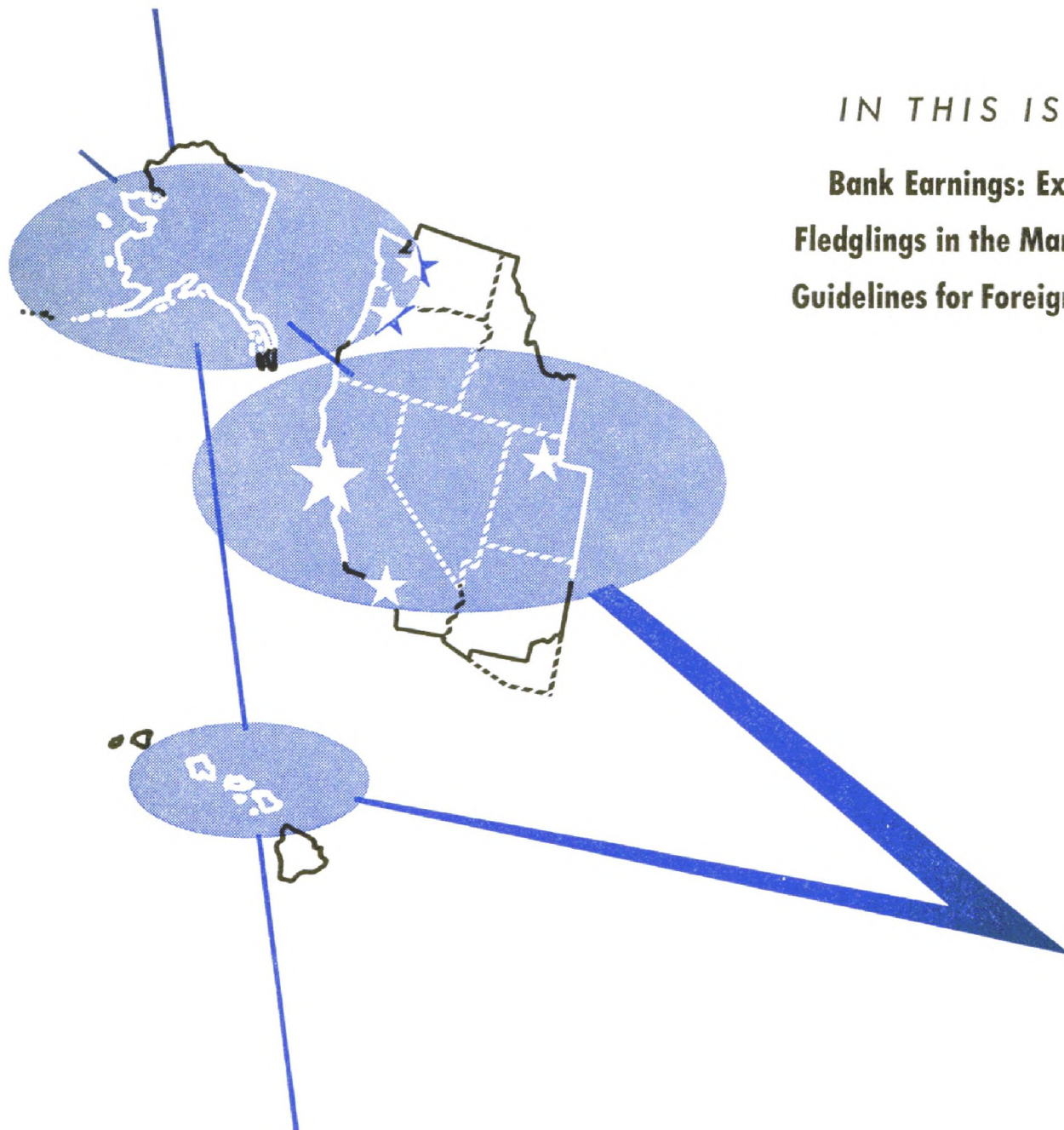


FEDERAL RESERVE BANK OF SAN FRANCISCO

MONTHLY REVIEW

IN THIS ISSUE

Bank Earnings: Excellent
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Guidelines for Foreign Lending



APRIL
1965

Bank Earnings: Excellent

- . . . In 1964, District banks posted earnings and profit records for a second straight year; in 1965, rising interest costs create problems.

Fledglings in the Marketplace

- . . . Their numbers are unbelievable; their job prospects, unsettled; their earnings, uncertain; their spending plans, unlimited.

Guidelines for Foreign Lending

- . . . To help achieve a substantial improvement in the U.S. balance of payments, the Federal Reserve issues guidelines for foreign lending.

Bank Earnings: Excellent

IN the West as elsewhere throughout the nation, commercial banks scored record profits in 1964. Twelfth District member banks reported operating revenues of \$2,258 million and after-tax profits of \$269 million—both all-time highs. Moreover, the increase in after-tax profits was above 8 percent for the second consecutive year, as reduced tax liabilities offset higher losses and transfers to loan and security reserve accounts. In 1964, the rise in after-tax profits at District member banks was double the rate of increase elsewhere in the nation. (In the preceding year, District banks had only a slight edge in profit growth over other banks.) District banks last year experienced a faster growth in operating revenues than in expenses, while the reverse was true for other member banks. The strong District performance was also attributable to a greater-than-national reduction in income taxes and a smaller-than-national loss on loans and securities and transfers to valuation reserves.

But Western banks may have difficulty in matching last year's profit performance in 1965, because an almost certain rise in interest costs. As permitted by the late-Novem-

ber revision of interest-rate ceilings under the Federal Reserve's Regulation Q, many District banks this year are offering 4 percent (a ½-percent increase) on regular savings deposits, along with higher rates on other time deposits.

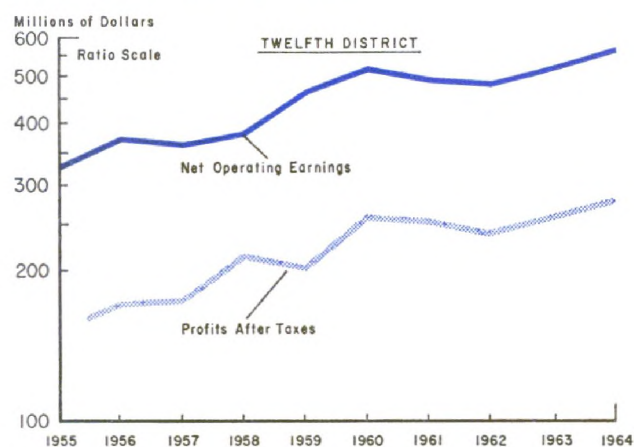
Bank managers consequently are facing a situation comparable to that of 1961-62, when steeply increased interest costs on time and savings deposits cut sharply into profit margins. But the potential impact of increased interest costs is greater now than heretofore, because of the larger absolute amount of time and saving deposits and the higher proportion of these interest-bearing deposits to total deposits. Moreover, if 1964 is any guide, shifts in the sources of credit demand may leave banks with fewer high-earning investment alternatives than were available in other recent years.

Significant loan shifts

The 1964 earnings performance may be hard to surpass, since District member banks last year received more income from every source of revenue than in the preceding year. For example, earnings on loans, the major source of revenue, exceeded \$1.5 billion, as the volume of outstanding loans expanded and the average rate of return rose slightly to 6.37 percent.

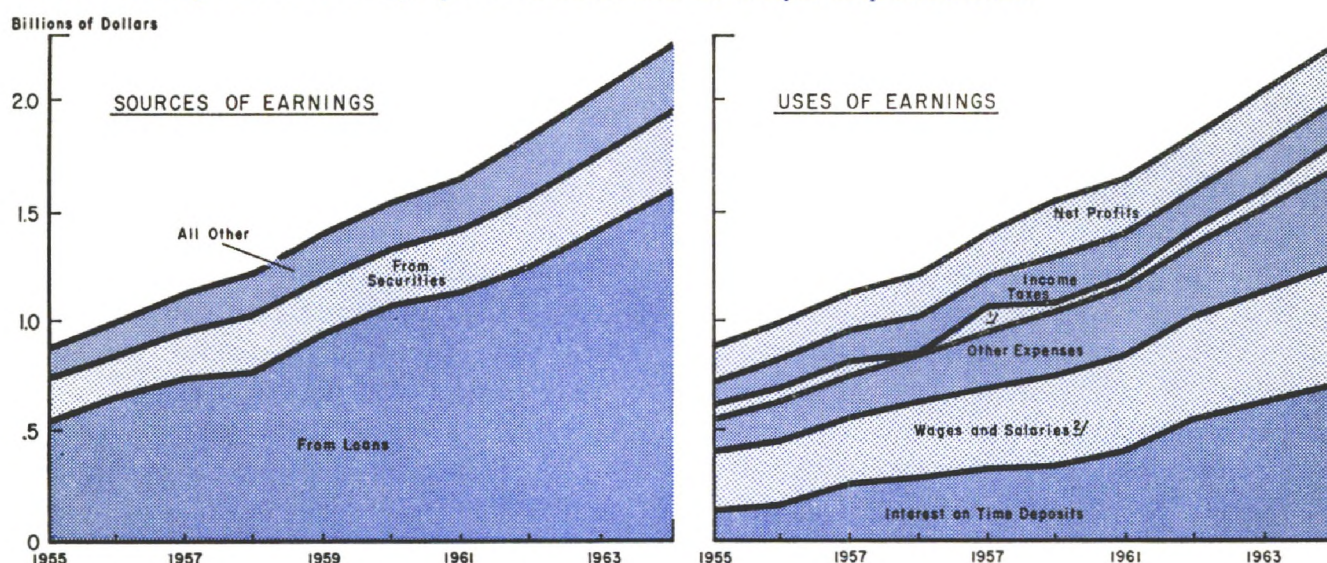
In 1964, District banks departed from their pattern of the two preceding years and directed a larger proportion of total loan funds to the business sector and a much smaller percentage into mortgages. Commercial and industrial loans accounted for more than \$1 billion of the \$2.5 billion gain in total loans. But the average rate of return on business loans remained relatively stable, largely because the rate charged prime commercial borrowers remained unchanged at 4½ percent. This development occurred in the face

Bank earnings and profits rise for second straight year



Source: Federal Reserve Bank of San Francisco.

Higher revenues from all sources bring record profits to District banks ... time-deposit interest payments continue as major expense item



¹ Net losses on securities and loans including transfers to and from valuation reserves.

² Beginning in 1961, this item excludes wages and salaries of those officers and employees who spend the major part of their working time on bank building and related housekeeping functions. Those expenses thereafter are included in "other expenses."

Source: Federal Reserve Bank of San Francisco.

of increasing pressure on bank reserves; in fact, a higher proportion of the total dollar volume of business loans made by District metropolitan banks in 1964 bore the prime rate than in the preceding year. But District banks, like those elsewhere, towards year-end began to firm up their non-price terms of lending.

The major turnaround in lending occurred in mortgage financing. In 1962 and 1963, the real-estate loan expansion averaged about 14 percent; last year the rate dropped to 7 percent. In fact, banks actually recorded a small net reduction in their residential mortgage holdings in the second half of the year.

Why the slowdown? A major factor was the intensified competition from other mortgage lenders. In the face of a slackening demand for mortgage credit—related to a substantial construction decline—funds for such financing remained in ample supply, and so mortgage terms eased and lending rates slightly softened. A second factor was a slowdown in the flow of savings funds into District banks, which was noticeable throughout the last two

years and particularly pronounced in the first half of 1964. Lending officers, in other words, continued to gear their investment in (relatively long-term) real estate loans to the net change in (relatively stable) savings deposits. Finally, a tightening liquidity situation—as evidenced by a rise in the loan-deposit ratio to 68 percent—also tended to make banks more cautious about increasing their long-term asset holdings.

Consumer loans, unlike mortgage loans, maintained a 14-percent growth rate during 1964. In fact, the dollar increase in consumer loans exceeded the gain in real estate loans for the first time since 1960. Auto loans accounted for nearly half of the total increase in bank loans to consumers, as Western auto dealers recorded a new sales record for the third consecutive year.

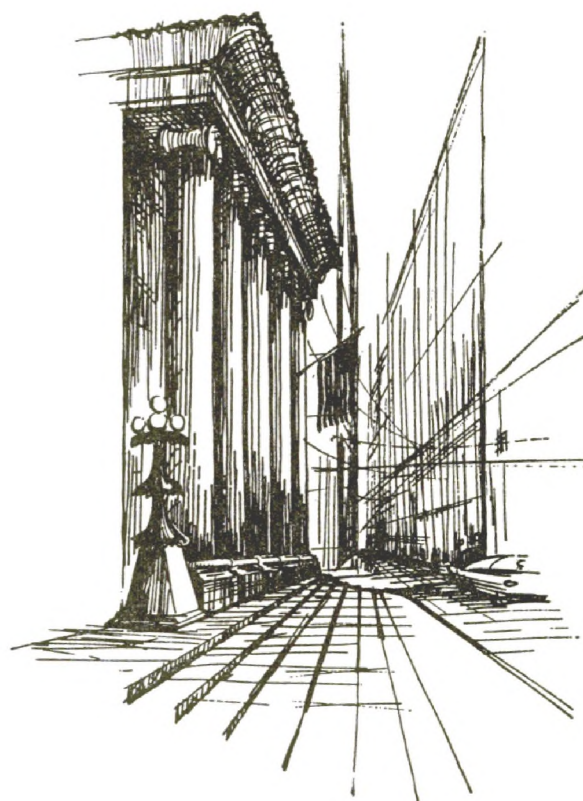
District member banks also increased their revenues from holdings of both U. S. Government securities and other securities. A higher rate of return on Treasury issues, largely due to rising yields on short-term issues during late 1964, more than offset a small net reduction

in total holdings. A 20-basis point rise in average yields on municipal and Federal Agency issues meanwhile produced a greater percentage gain in revenues from that source, despite a slowdown from the 1963 rate of expansion in such holdings. Increases in trust department income and in miscellaneous service charges, fees, and commissions also contributed to the record level of bank earnings.

Tight rein on expenses

On the other side of the ledger, District banks were remarkably successful in controlling costs during 1964. The 11.7-percent rise in total expenses was only slightly higher than the 1963 increase, and it contrasted sharply with the 17.4-percent cost increase of 1962, when interest payments on time and savings deposits soared on the heels of a revision in Regulation Q. That regulation of course was revised again in late 1964, but the revision did not immediately alter interest costs, since most District banks did not make an upward rate adjustment on savings and time deposits until January 1965.

Nonetheless, with a 13-percent gain, interest costs accounted for almost half of the increase in total expenses in 1964. Salary and wage costs meanwhile rose less than 9 per-



cent, and this included the cost of staffing 43 new member banks and 191 additional branch offices throughout the District. Consequently, the spread widened between interest expense on time and savings deposits and wage and salary expense, which was formerly the banks' major cost item.

SELECTED OPERATING RATIOS OF TWELFTH DISTRICT MEMBER BANKS

(percent ratios)

	1964	1963	Increase or Decrease
Earning ratios:			
Return on loans	6.37	6.35	+ .02
Return on U. S. Government securities	3.58	3.31	+ .27
Return on other securities	3.00	2.80	+ .20
Current earnings to capital accounts	18.13	18.87	— .74
Net profits after taxes to capital accounts	8.66	9.03	— .37
Cash dividends to capital accounts	5.22	5.28	— .06
Other ratios:			
Interest paid on time deposits to time deposits	3.53	3.45	+ .08
Time deposits to total deposits	50.78	49.13	+ 1.65

Note: The ratios in this table are computed from aggregate dollar amounts of earnings and expense items of Twelfth District member banks. Capital accounts, deposits, loans, and securities items on which these ratios are based are averages of Call Report data as of December 28, 1962, June 29, 1963, and December 20, 1963; and as of December 20, 1963, June 30, 1964, and December 31, 1964.

Source: Federal Reserve Bank of San Francisco.

FEDERAL RESERVE BANK OF SAN FRANCISCO

EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS

(millions of dollars)

	1964p	1963
Earnings on loans	1,592.3	1,414.7
Interest and dividends on		
U. S. Government securities	240.4	239.2
Other securities	123.7	105.3
Service charges on		
deposit accounts	160.9	150.5
Trust Department earnings	70.5	62.7
Other earnings	70.2	63.7
Total earnings	2,258.0	2,036.0
Salaries and wages	543.9	499.7
Interest on time deposits	708.6	625.1
Other expenses	442.9	392.7
Total expenses	1,695.3	1,517.5
Net current earnings	562.6	518.5
Net recoveries and profits		
(—losses) ¹		
On securities	— 12.3	+ 6.1
On loans	— 90.9	— 75.7
Other	— 21.4	— 8.1
Total net recoveries and		
profits (—losses) ¹	—124.6	— 77.8
Net profits before income taxes	438.1	440.7
Taxes on net income	169.6	192.5
Net profits after taxes	268.6	248.2
Cash dividends declared	161.8	145.2

p—Preliminary

¹Includes transfers to (—) and from (+) valuation reserve.

Note: Details may not add to totals due to rounding.

Source: Federal Reserve Bank of San Francisco.

Operating earnings of District member banks exceeded operating expenses by a record \$563 million in 1964. Nevertheless, net income before taxes fell about \$3 million short of the 1963 figure because net losses on securities and loans, along with large transfers to reserves, offset some of the gain in operating income.

Net losses on securities rose to \$20 million,¹ nearly 3 times greater than in 1963. Net losses on loans² rose to \$49 million, also well above the net loss of the preceding year. Partly because of these larger losses, net transfers to reserves on loans and securities were substantially higher than in 1963. Other factors contributing to the build-up in reserves were the large increase in the number of new bank openings and the measures taken by some

¹ Includes net charge-offs against valuation reserves on securities.

² Includes net charge-offs to bad-debt reserves on loans and other valuation reserves on loans.

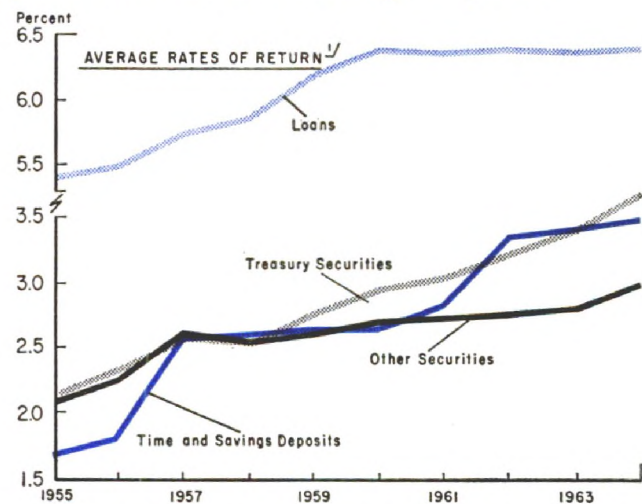
banks in anticipation of a new Internal Revenue ruling on bad-debt reserves.

Banks, like other corporations, benefitted from lower income taxes in 1964. Fortunately for bank profits, the reduction in income taxes more than offset the increase in loss and reserve transfers, so that after-tax profits increased \$21 million above the 1963 figure—and also exceeded the previous profit record set in 1960.

District member banks paid out \$162 million in cash dividends last year—an 11-percent increase over 1963 payments. Some of the increase was due to higher dividend rates, but some was due also to an increase in the amount of common stock outstanding—an increase attributable in large part to the issuance of stock by the District's 43 new member banks.

The major 1964 change in capital costs was in "dividends on preferred stock and interest on capital notes and debentures." This item rose from under \$1 million in 1963 to over \$8 million in 1964, as District banks turned increasingly to capital notes and debentures as a means of strengthening their

Yield on Governments exceeds rate paid on time and savings deposits



¹ Ratios are based on averages of 5 call reports (December, Spring, June, Fall, and December), except for 1963-64, which are based on averages of 3 call reports (December, June, and December).

Source: Federal Reserve Bank of San Francisco.

capital structure. Outstanding capital notes and debentures of member banks rose from \$60 million at the end of 1963 to \$307 million at the end of 1964. This sizable capital increase resulted in a decline in the ratio of net profits before dividends to capital accounts, and in the ratio of cash dividends to capital accounts.

Large banks and small banks both approximated their 1963 gains in 1964. In fact, the direction and relative magnitude of the changes for most individual revenue and expense items were similar for both the 12 largest member banks — \$500 million deposits and over — and all other District banks. But non-operating costs, such as losses and transfers to reserves, tended to limit the rise in after-tax profits at the larger banks to 8.8 percent—down one percent from the 1963 rate of increase. The smaller bank group in-

creased after-tax profits by 5.9 percent, up from the 2.7 percent gain achieved in 1963.

1965?

How are banks now allocating their funds, in light of the higher interest costs on time and savings deposits that they face in 1965? Business demand for credit has displayed greater strength in recent months than in the early part of 1964—although some of the gain may have been due to an upsurge in borrowing in anticipation of tighter loan policies, especially on loans abroad. The late-1964 firming of bank practices in non-price terms of business lending has apparently continued into the current year and, in addition, some banks have shown more selectivity in granting loans at the prime rate. Meanwhile, with consumer spending soaring, consumer borrowing from banks has been maintained at a faster pace

SELECTED RESOURCE AND LIABILITY ITEMS OF ALL MEMBER BANKS TWELFTH DISTRICT, 1963 AND 1964

(millions of dollars)

	As of December 31, 1964	Change From December Dollar	20, 1963 Percent
Net loans¹ and investments	37,199	+ 2,529	+ 7.3
Loans and discounts, net¹	26,230	+ 2,514	+ 10.6
Commercial and industrial loans	8,591	+ 1,133	+ 15.2
Agricultural loans	1,124	— 15	— 1.3
Real estate loans	8,706	+ 537	+ 6.6
Loans to individuals	5,145	+ 639	+ 14.2
U. S. Government obligations²	6,766	— 161	— 2.3
Under 1 year	2,309	+ 598	+ 25.9
1-5 years	2,701	— 872	— 24.4
5 years and over	1,755	+ 113	+ 6.9
Other securities	4,202	+ 177	+ 4.4
Total assets	46,055	+ 3,408	+ 8.0
Total deposits	41,272	+ 3,255	+ 8.6
Demand deposits	20,101	+ 927	+ 4.8
Total time and savings deposits	21,170	+ 2,328	+ 12.3
Savings	15,739	+ 1,082	+ 7.4
Capital accounts	3,324	+ 462	+ 16.1

¹Total loans minus valuation reserves. Selected loan items which follow are reported gross.

²Includes obligations guaranteed by the United States Government.

Note: Details may not add to totals because of rounding.

Source: Federal Reserve Bank of San Francisco.

FEDERAL RESERVE BANK OF SAN FRANCISCO

PERCENT CHANGES IN SELECTED EARNINGS AND EXPENSE ITEMS OF TWELFTH DISTRICT MEMBER BANKS

	All		12 Largest ¹		Other	
	1963-64	1962-63	1963-64	1962-63	1963-64	1962-63
Earnings on loans	+ 12.6	+ 13.5	+ 12.1	+ 13.2	+ 14.8	+ 15.2
Interest and dividends on securities	+ 5.7	+ 4.0	+ 5.1	+ 3.2	+ 8.0	+ 7.2
U. S. Government	+ 0.5	— 1.3	— 0.7	— 2.8	+ 5.2	+ 4.2
Other	+ 17.5	+ 18.5	+ 17.8	+ 18.8	+ 15.9	+ 16.7
Service charges on deposit accounts	+ 6.9	+ 8.3	+ 7.0	+ 8.3	+ 7.0	+ 6.8
Trust Department earnings	+ 12.4	+ 10.1	+ 12.9	+ 9.7	+ 9.5	+ 12.0
Other earnings	+ 10.2	+ 3.4	+ 7.9	+ 1.4	+ 19.8	+ 12.0
Total earnings	+ 10.9	+ 11.0	+ 10.5	+ 10.6	+ 12.9	+ 12.7
Salaries and wages	+ 8.8	+ 8.2	+ 8.0	+ 7.7	+ 12.3	+ 10.3
Interest on time deposits	+ 13.3	+ 13.1	+ 13.2	+ 12.3	+ 14.6	+ 17.2
Other expenses	+ 12.8	+ 12.9	+ 11.0	+ 11.9	+ 19.4	+ 17.0
Total expenses	+ 11.7	+ 11.4	+ 11.0	+ 10.7	+ 15.2	+ 14.7
Net current earnings	+ 8.5	+ 9.7	+ 9.0	+ 10.2	+ 6.3	+ 7.2
Net profits before income taxes	— 0.6	+ 7.7	— 1.0	+ 9.0	+ 1.3	+ 2.7
Taxes on net income	— 11.9	+ 7.0	— 13.6	+ 8.0	— 4.7	+ 2.6
Net profit after taxes	+ 8.2	+ 8.3	+ 8.8	+ 9.8	+ 5.9	+ 2.7
Cash dividends declared	+ 11.4	+ 4.2	+ 11.0	+ 3.3	+ 14.1	+ 9.2

¹Includes all District member banks with total deposits of \$500 million and over as of December 31, 1964.

Source: Federal Reserve Bank of San Francisco.

than during the early months of 1964. Thus, business loans and high-yield consumer loans have helped provide the District banks with profitable outlets for funds in the early months of the current year.

Mortgage lending, on the other hand, has continued at the reduced pace of late 1964. Competition and liquidity considerations, as well as mortgage interest-rate considerations, will determine how much the higher savings-

deposit flow of early 1965 will stimulate bank mortgage investment. Meanwhile, with interest rates on Treasury issues remaining relatively stable around late-1964 levels, banks have made seasonal reductions in their holdings of U. S. Government securities at about the year-ago pace. At the same time, they have added to their holdings of tax-exempt securities, in contrast to a net reduction in the year-ago period.

Fledglings in the Marketplace

"To me it seems that youth is like spring, an overpraised season—delightful if it happens to be a favored one, but in practice, very rarely favored and more remarkable, as a general rule, for biting east winds than genial breezes."—Samuel Butler.

THE generation coming of age in the 1960's may be as much of an enigma to economists as it is to moralists and sociologists. What these youth will do with their energies, their skills, and their money is a matter of concern to some observers and of great expectations to others. Thus, manpower experts frequently view with sinking hearts the much-heralded invasion of the labor market by hordes of inexperienced young workers; marketing men just as frequently view with leaping hearts the even-better-advertised invasion of the shopping centers by hordes of eager (if inexperienced) young buyers.

Among all the tangled socio-economic threads, certain trends can be discerned that are consequences of the affluence and technology of the times. Today's youth are generally better educated than any previous generation and are in many ways more worldly-wise. Moreover, the rising expectations of postwar parents have induced rising expectations in their offspring. If the parents of today must assume the onus of over-indulgence towards their young, they must also be credited for earning the money that has provided the clothes and the wheels and the steaks and the surfboards. But now there arises the question: after Father, what?

The ever-younger nation

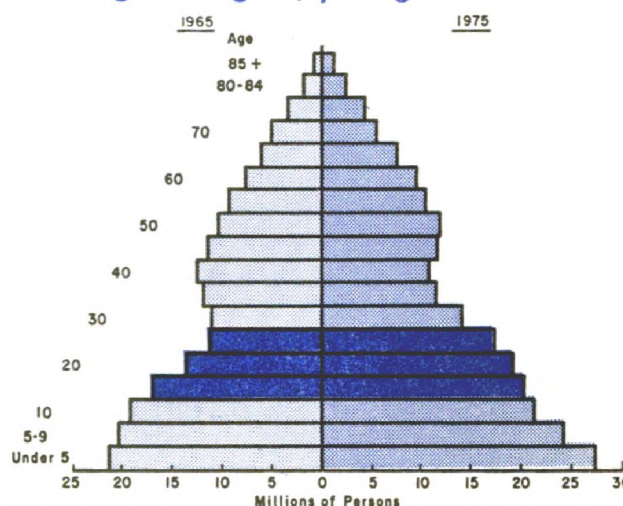
Of the numbers involved, there is no question. Sophisticated forecasting techniques are not needed to measure the future size of the teen-aged and young-adult population, since almost all in these age groups are already born and their mortality rates are very low. Because of the postwar population boom, this segment of the nation's population is growing

much faster than any other. Thus, according to Census Bureau projections, the proportion of the under-25 population to the national total will rise from 45 percent in 1960 to 50 percent by 1985. Between 1965 and 1975 alone, the number of teenagers will grow from about 36 to 42 million, while the number of 20-24 year-olds will increase from about 13½ to 19 million.

The West as usual is the most striking example of this trend. Between 1950 and 1960, the 5-14 age category—today's teens and sub-teens—actually doubled in size in California and increased by 60 percent in other District states, as compared with a 40-percent increase elsewhere in the nation. In the same period, the 15-24 age category—the present young adults—increased 48 percent in California, 22 percent in other District states, and 15 percent elsewhere.

Older adults—the group now over 40—increased about as rapidly as the young adult

Population gains concentrated among teenagers, young adults



Source: Bureau of the Census.

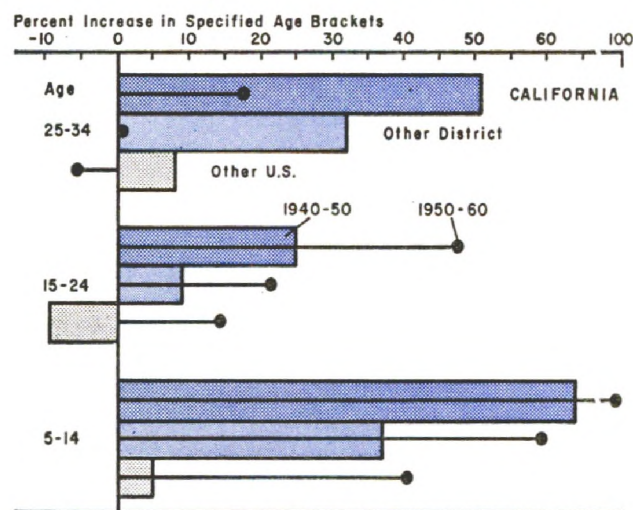
group in each of those three geographic areas between 1950 and 1960. But the "hollow generation" now in its 30's grew at a much slower pace in District states, and actually declined 6 percent elsewhere in the nation. For business decision-makers, however, the big news is the immense bulge in the group which has already overflowed the teen-aged market and is soon to be crowding the market for adult goods as well.

First rung of the ladder

Marketing men guesstimate that about \$11 billion is now jingling in teenagers' pockets. About half of that money is earned and most of the rest comes from allowances. As the young advance in age, of course, more of the money comes from wages and salaries; in fact, households with heads under 25 have an average income of over \$4,100 a year. The number of young people seeking jobs has been growing as their numbers swell but, because of their inexperience and the changing skill requirements of a technological society, it is they who are having the greatest difficulty in obtaining employment.

Not all share equally in today's affluence. The present unemployment problem is pre-

Youth explosion centered in California, other Western states



Source: Bureau of the Census.



dominantly a youth problem, affecting mostly youths from disadvantaged families. Technological change has brought many country boys to the big cities; has made many blue-collar jobs obsolete; has raised the training requirements for white-collar jobs; and has made "less work for mother" and allowed her to enter the labor market in competition very often with young girls looking for clerical work. According to a 1963 survey, the unemployment rate was 13 percent for the 3.7 million high school graduates between the ages of 16 and 21, and it was 27 percent—nearly four times the national jobless rate—for the 3 million with less than 4 years of high school.

The problem is less serious among slightly older workers. Since the recession trough of 1961, for example, the unemployment rate among men aged 20-24 years has been declining about in line with the rate for all workers. But unemployment among teenagers has remained high during this prolonged expansion, and in the past it has responded violently to each slowdown in economic activity.

Identification of the problem has enabled remedial efforts to take form. Thus, the President's budget includes \$2.7 billion for new and continuing education programs in fiscal year 1966, an increase of 75 percent over fiscal year 1965. On-the-job training programs and vocational guidance are being offered by schools and business. And, although the projection of future labor needs remains a very knotty problem, state and federal programs have been launched for just this purpose.

Priorities

But how will the young spend their money, once they have conquered the task of finding steady employment? To answer that question, it is necessary to isolate the stages in a family's buying behavior and to determine the ages at which major purchases are likely to be made. After all, income, saving, and consumption all tend to vary with the stages of the life cycle, stretching from the stage of young adulthood through marriage and childraising and finally on to the solitary-survivor stage.

At the beginning of marriage, a young couple rents living quarters and equips the apart-

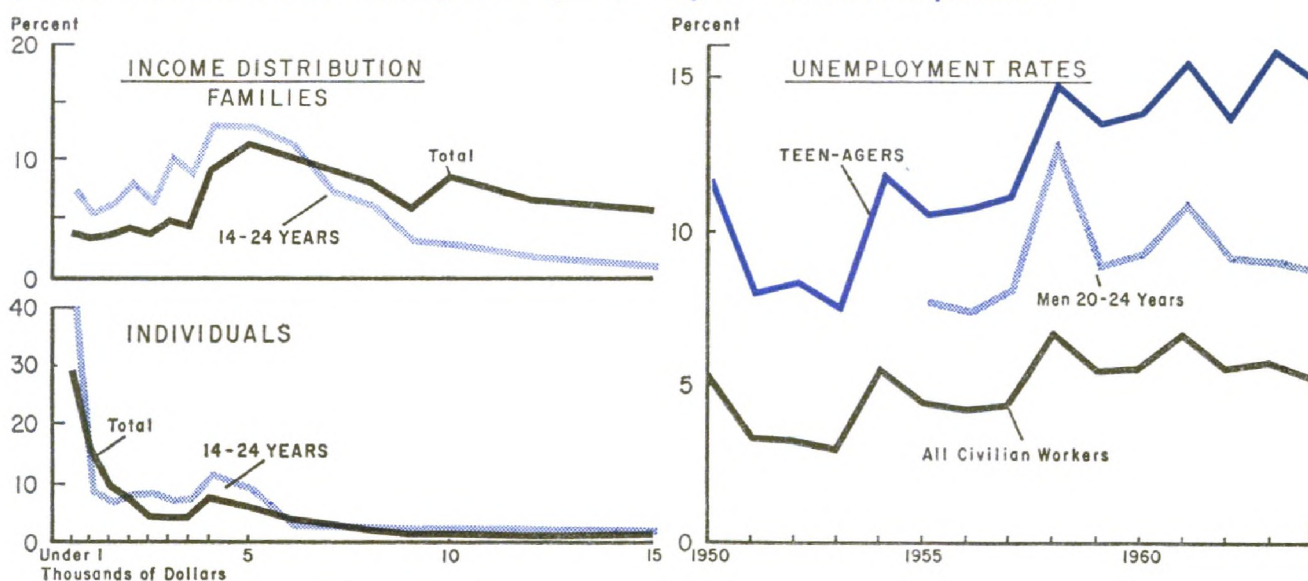
ment immediately with furniture. The furniture is usually made to last while the children are young and then replacement occurs. (Automobiles are made to last as well. The proportion of spending units owning a car less than four years old declines from the time the couple is first married through the early child-raising period; as the children grow older, the proportion spurts again.)

Television ownership reaches its high point at a later stage than ownership of a car. Home ownership comes still later; the proportion of home purchasers, however, is very large among young, married couples with young children. Refrigerators and stoves are bought early in the life cycle, frequently even while the couple is still renting. Washing machines, of course, are most popular with families with young children. The same group, not surprisingly, buys cough syrup at double the national rate and consumes more canned spaghetti sauce than any other group.

What to do with spending money

Teenagers' income might be thought of as almost entirely discretionary. They spend it as fast as they receive it, and thus represent

Young workers concentrated at lower end of income scale . . . joblessness increases among teenagers, despite business expansion



Sources: Bureau of the Census, Department of Labor.

a prime target of advertising promotions. Peer influence, rather than adult influence, hits a peak in the mid-teens, and the yen to conform is very strong. But the \$11 billion or so that teenagers spend for toiletries, cosmetics, records, soft drinks, entertainment, automobiles, apparel, food, cameras, typewriters, fountain pens, ball point pens, sports equipment, and many other products is not the whole marketing story. While the young are being influenced by their peers, they are busy influencing their own parents. Teenagers hold great sway in determining what stores will be visited and what purchases will be made on family shopping expeditions.

After having gone through this "consumer trainee" period, the young adult expects a large inventory of goods immediately upon setting up a home. The typically low incomes and small liquid-asset holdings of the young are thus supplemented by credit. Families under 25 thus tend to operate at a deficit—the only stage in the life-cycle to do so.

In 1961, 48 percent of families with head aged under 25 had a net worth under \$1,000 and, more significantly, 33 percent had negative net worth. About 77 percent of the families in this group owned a car, in most cases a used car. Although about 90 percent of the group had rented homes all or part of the year, the household usually included many expensive pieces of equipment: stove, refrigerator, washing machine, television set, and a number of other electrical appliances.

Young families' expenditures for current consumption totalled \$4,225 in 1961, compared with an average of \$5,038 for all families. With their smaller incomes, the younger group spent proportionately more for shelter, housefurnishings, transportation, and recreation. These sectors accounted for 45.6 percent of total expenditures, compared with 37.7 percent for all families. Food was relatively less important for these young families, which are smaller and do not usually include an

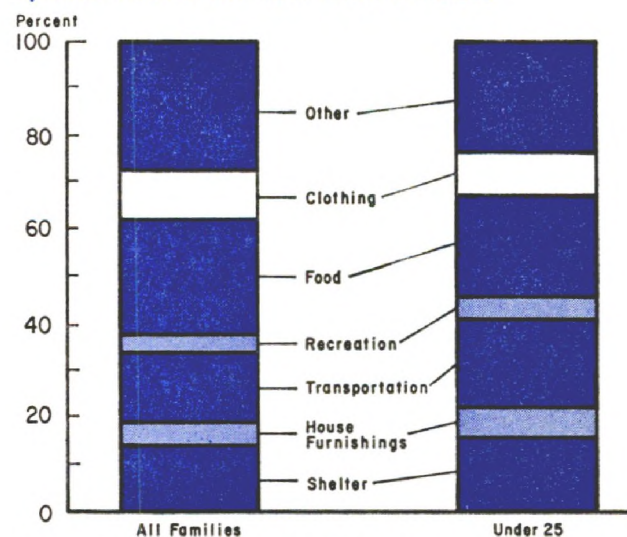
adult as a third member; groceries, for instance, accounted for only 16 percent of total expenditures at this stage, compared with an all-family average of 20 percent.

The West shows several spending differences. Young urban families and single individuals in the West spend less than the national average for restaurant food and housefurnishings, and relatively more on household operations and transportation. More young families own homes and cars in the West than in the nation as a whole. But the share of expenditures for clothing, personal care, recreation, and education is about the same for young families everywhere in the United States.

As the twig is bent

Change—social, cultural, and economic—is feeding upon change during this decade. Future trends in family formation and family size will most likely reflect today's employment situation. But the dominant pattern of the early 1960's of early marriage and relatively short child-bearing period—last child born before parents reach 30—may well continue. This does not mean a decline in total number of births because of the great increase

Young consumers eat less food, spend more on fun and wheels



Source: Department of Labor (1961 data).

in those of marriageable age. It may mean, however, that smaller houses or apartments will be necessary; that instalment credit may rise at an even faster rate than 1964's \$5.6 billion; that a seven million car year may become the low end of the range of automobile sales; and that education costs will continue to skyrocket.

The pessimists, not without reason, dote on the problem of finding employment for this surge of young Americans; in 1965, 3.7 million youths will turn 18, one million more than in 1964. But others dwell on the rosier side, noting that these young people are better educated and therefore better prepared to

handle the kind of jobs opening up. The optimists look forward to a rapid increase in marriages and new households and a resultant rise in consumer spending that will make the Seventies soar even higher than the Sixties. And in view of the Westward concentration of these youthful multitudes, the new products and shifting markets of the next decade may have a far greater impact here than elsewhere. The imaginative Western entrepreneurs who developed these major symbols of youthful energy—the hula hoop of a decade ago and the skateboard of today—undoubtedly will find further uses for their inventive talents in the years ahead.

The Search For Certainty

The deficits in the United States balance of payments and the associated large outflows of gold have aroused widespread interest in the role of gold both in our domestic monetary affairs and in the international payments system.

A booklet, "The Search For Certainty In An Uncertain World," is intended to further public understanding of the facts and issues involved with respect to the role of gold in today's monetary affairs. A brief description of the monetary role of gold from early times to the present provides the background for a lengthier discussion of more recent developments, including the rise in the international importance of the United States dollar and the International Monetary Fund.

The study, published by the Research Department of this Bank, appeared originally as a series of articles in its *Monthly Review*. Copies of the booklet are available on request from the Administrative Service Department, Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco, California 94120.

Guidelines

For Banks and Nonbank Financial Institutions

On February 10, 1965, the President sent to the Congress a message on the U. S. balance of payments in which he presented a program aimed at achieving quickly a substantial improvement in our balance of payments position. This program is of major importance since the balance of payments deficit is a serious national problem. The problem is discussed in the March Monthly Review, pp. 40-44.

A major responsibility in carrying out the President's program was placed on the Federal Reserve System and on the banking and financial community. In this connection, the Board of Governors has now issued guidelines to be followed by banks and by nonbank financial institutions in their foreign lending activities. The guidelines for each group are printed below.

Guidelines for Banks

The following guidelines, designed for use and implementing President Johnson's program for the voluntary curtailment of foreign credit by banks, will be in effect until modified or supplemented. However, they may be changed from time to time in the light of new circumstances and in the light of the experience gained as the program goes forward. The guidelines should be helpful to individual banks as they play their own particular part in the achievement of the President's over-all balance of payments program, and each bank should feel free at any time to discuss its problems with the Federal Reserve Bank of its district.

It is clear that banks, in undertaking a voluntary role in the program, are being called upon to make sacrifices. In restraining the growth of their loans to foreigners they will be foregoing some of the gains that would other-

wise have accrued to them. But, if a voluntary program is to be effective, decisions on future specific loan transactions must be made primarily with an eye to the national interest rather than profits. The achievement of the President's goal will be in the long-term interest not only of the nation, but also of the individual institutions which are now being called upon to forego immediate advantage or gain.

(1) Establish a target base for an individual bank

The objective of the program is that outstanding bank credit to nonresidents of the United States not rise above the amount outstanding at the end of 1964 by more than 5 percent, subject to the conditions set forth in guideline (3).

The following steps are involved in calculating the base, and the amount of credit outstanding on any particular date, for an individual bank:

1. Take outstanding claims of U. S. banking offices on foreigners as of December 31, 1964, as required to be reported on Treasury Department foreign exchange forms B-2 and B-3. Contingent accounts, such as unused balances of letters of credit and commitments to lend, are excluded from the base. (For further information, reference is made to the instructions printed on forms B-2 and B-3.)

2. Subtract from this amount any claims for account of customers included on the forms, as well as any participations in individual loans arranged by the Export-Import Bank or made with Export-Import Bank guarantees.

3. Add any claims not reportable on forms B-2 and B-3, such as long-term foreign securities and permanent capital invested in foreign branches and subsidiaries.

4. Compensating balances, or any other claim on the lending bank of the debtor or of any other person by arrangement or understanding with the debtor, should not be deducted from loans or other claims on foreigners for purposes of determining the base.

5. It is expected that a simplified form for making the above calculations, and for making monthly reports on foreign credits, will be furnished to the banks within a short time.

Banks that are exempted from reporting on the Treasury forms because their foreign credits are below the minimum reporting requirement are nevertheless included in the program.

(2) Participations in Export-Import Bank loans and loans guaranteed by the Export-Import Bank

Participations in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees or insurance, and holdings of "Export-Import Portfolio Fund" participations are excluded from the 5 percent target.

The role of the Export-Import Bank within the framework of the President's program will be coordinated by the National Advisory Council for International Monetary and Financial Problems.

(3) Banks in excess of 5 percent target

It is clearly recognized that some banks may currently be above the 5 percent target because of loans made prior to February 11, 1965, or may subsequently be brought above the target as a result of (a) binding commitments entered into before February 11, or (b) the extension of bona fide export credits, or (c) the extension of credits at the specific request of an agency of the U. S. Government. A bank in such circumstances would not be considered to be acting in a manner inconsistent with the program; however, it should reduce its claims on foreigners to 105 percent of the base as quickly as possible. Even in

the most extreme case, this reduction should be accomplished within the next 12 months.

Such a bank will be invited periodically to discuss with the Federal Reserve Bank of its district the steps it has taken and proposes to take to bring about the reduction of its claims on foreigners consistent with these guidelines.

Banks with bona fide commitments are clearly not being asked to refuse to honor such commitments, even if honoring them involves a temporary excess of lending above the target. However, banks would be expected to seize every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature, and to ensure that drawings under credit lines are kept to normal levels and usage. At time of renewal, all credit lines should be reviewed in light of their consistency with the voluntary foreign credit restraint program. Proposed extensions or renewals of existing bona fide commitments should be reviewed in the same manner.

(4) Loan priorities

Within the 5 percent guideline, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of non-bank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on countries such as Canada and Japan, which are heavily dependent on U. S. financing, and on the United Kingdom, which is suffering from balance of payments difficulties.

Given the probability of some expansion of the end-of-1964 volume of loans for financing exports and the priorities established for the less developed countries, as well as the need to avoid restrictive practices with regard to Canada, Japan, and Britain, it is expected that nonexport credit to the other advanced

countries will be cut back to the extent needed to achieve the goal of the President's program.

Without attempting to specify all types of loans that will need to be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local-currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance of payments difficulties.

(5) Bank sales of foreign assets to U. S. residents

In general, banks should not expand their lending abroad by selling to U. S. residents (including U. S. banks) claims on foreigners existing as of the base date and replacing such assets with other loans to foreigners. Sales to U. S. residents of foreign securities owned on the base date, which would be free of the interest equalization tax, or of loan participations, could assist an individual bank to stay within the 5 percent target, but would clearly not benefit the U. S. payments position. Therefore, in the event of any such sales the bank's base should be reduced by an amount equivalent thereto.

(6) Banks with no foreign loans outstanding on December 31, 1964

In general, banks with no previous foreign lending experience would be expected not to make foreign loans during 1965. However, bona fide export loans to foreigners may be made in reasonable amounts, provided this financing does not represent a shift from previous U. S. or foreign sources of financing. Banks making foreign loans for the first time should take precautions to ensure that their activities do not become a means through which credit is extended to foreign borrowers who have been denied credit by established lenders cooperating in the voluntary program.

(7) Banks whose previous foreign business has consisted almost entirely of export financing

The few banks falling in this category would ordinarily be expected to keep within the 5 percent ceiling. Since they would have no maturing nonexport loans to provide funds for additional export credits and would therefore need to rely upon nonrenewal of maturing export loans, reasonable amounts in excess of the target from time to time would not be considered in conflict with the program. But every effort should be made by such banks to keep their lending within the ceiling. They should take care to ensure that export loans do not represent a shift from previous U. S. or foreign sources of financing.

(8) Trust departments

Managing officers of trust departments should be made familiar with the voluntary restraint effort. They should bear the purpose of that program in mind by making any acquisitions of foreign obligations for trust accounts. For example, they should not exercise their authority under any trust account to acquire foreign obligations which, in the absence of the restraint program, would have been acquired by the bank for its own account. Pension funds, including those administered by banks, will be furnished separate guidelines, as part of the program to restrain foreign credits of non-bank financial institutions.

(9) Financial transactions for customers

While banks must, of course, follow instructions given to them by their customers, it is expected that, in buying foreign investments for customers, they will be guided by the principles inherent in the President's balance of payments program. They should not encourage customers to place liquid funds outside the United States. Banks should not place with customers foreign obligations which, in the absence of the restraint program, they would have acquired or held for their own account.

(10) Foreign branches

It is assumed, of course, that U. S. banks

having branches, as well as subsidiaries and affiliates, in foreign countries will not utilize them to avoid the foreign credit restraint program for U. S. banks.

Foreign branches have independent sources of funds in the countries in which they are located and from third countries, in many cases through the attraction of Euro-dollar deposits. The balance of payments program is not designed to hamper the lending activities of the foreign branches insofar as the funds utilized are derived from foreign sources and do not add to the dollar outflow. Concern arises only in those cases where the resources are derived (directly or indirectly) from the United States.

Total claims of the head office on overseas branches, including permanent capital invested in, as well as balances due from, branches, represent bank credit to nonresidents for purposes of the program.

(11) Problems of Edge Act Corporations
Edge Act and Agreement Corporations are included in the voluntary credit restraint effort. The foreign loans and investments of such a corporation may be combined with those of the parent bank for the purposes of the program, or separate targets may be set for the parent bank and the subsidiary.

An Edge Act Corporation that has not yet undertaken any significant volume of loans and investments may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to \$2.5 million, even though an equivalent amount of foreign loans and investments had not yet been made as of December 31, 1964.

(12) U. S. branches and agencies of foreign banks

Branches and agencies of foreign banks located in the United States are requested to comply with the principles of the program of credit restraint applicable to domestic banks.

(13) Substitution of export credit for credit for other purposes

Banks should be on the alert to avoid granting credit to domestic customers if the result

would be to aid the latter in making foreign loans or investments inconsistent with the program. Even export credit to foreigners, if it supplants credit previously obtained from foreign sources and thus frees the foreign funds for other uses, may be detrimental to the U. S. payments position.

This is obviously a difficult area and one in which there is considerable room for possible damaging substitution of domestic for foreign financing, and for substitution of export credits to foreigners for other credits to foreigners. In general, success will depend on the ability of banks to identify loans that are inconsistent with the program and on the application of the Department of Commerce program with respect to foreign credit and investment by nonfinancial firms.

(14) Management of a bank's liquid funds
Banks that have placed their own funds abroad for short-term investment purposes, including U. S. dollar deposits outside the United States or the acquisition of non-U. S. money market paper, should refrain from increasing such deposits and investments and should, in a reasonable and orderly manner, seek to reduce them. Since such funds are ordinarily placed outside the United States solely to provide a slightly higher rate of return, they are strong candidates for reduction under the program.

This guideline applies equally to deposits and investments payable in foreign currencies and to those payable in U. S. dollars.

This guideline does not call for a reduction in necessary working balances held with foreign correspondents, although such balances are also considered claims on nonresidents for the purposes of the program.

Tentative Guidelines: Nonbank Financial Institutions

(1) Deposits and money-market instruments

Holdings of liquid funds abroad should be limited to the 1964 year-end total, and the

longer-term objective is to reduce such investments in a gradual and orderly manner to the December 31, 1963, level. Included in this category of liquid investments are dollar-denominated deposits held in foreign banks and foreign branches of U. S. banks; short-term securities of foreign governments and their instrumentalities; foreign commercial paper, finance company credits and bankers' acceptances; and all other negotiable instruments maturing in 1 year or less. Foreign bank deposits denominated in local currencies may be maintained to the extent needed to support ordinary business operations in that country.

(2) Foreign credits with original maturities of 5 years or less

Holdings of investments other than those listed above, and written to have final maturities in 5 years or less, should not be increased by more than 5 percent during calendar 1965. Included in this category are securities, mortgage and others loans, and credits of all other types. The 5 percent growth ceiling is to be measured against the total of all such holdings at the end of 1964, without regard to type of instrument or country of origin. Priority should be given to credits that directly finance U. S. exports, however, and special care should be taken to avoid the extension of credit to borrowers who would have been accommodated by commercial banks in the absence of the voluntary restraint program.

(3) Foreign credits with original maturities over 5 years

In the area of long-term financing, there would seem to be no present need for a guideline under the voluntary restraint program. Developments in the long-term credit area will be followed closely, however, so that we may be alert to excessive foreign financing demands if they should materialize. The issues of industrialized countries are subject to the interest equalization tax, and have been very small in volume since that tax became effective. Borrowing by the less developed countries has been relatively light also, and in any event should not be substantially restricted in view of our national policy encouraging productive investment in these countries. In the case of Canada and Japan, separate agreements will serve to limit aggregate financing in United States capital markets.

(4) Direct investment in foreign branches and subsidiaries

Some types of financial institutions may conduct operations abroad through foreign offices, branches, and subsidiaries. In such cases, institutions are urged to limit their additional investment in these operations to the fullest extent practicable during 1965. Particular care should be taken to restrict any increase in net loans and advances outstanding to foreign branches and subsidiaries; ordinarily, expansion in such credit during 1965 should be held within 5 percent.

In the case of insurance carriers doing business abroad, these guidelines are not applicable to holdings of foreign investments in amounts up to 110 percent of foreign policy reserves.

Western Digest

Banking Developments

As of March 24, total bank credit at Twelfth District weekly reporting member banks was \$183 million higher than at year-end, whereas in the corresponding period in 1964 there was a net contraction in credit. Strong credit demand from the business sector accounted for most of the loan increase. Unusually heavy borrowing in February, supplemented by large mid-March tax borrowing, produced a business loan increase of \$236 million. (In the first three months of 1964, there was a \$36 million net reduction in business loans.) As mortgage-loan volume rose only nominally for the fifth consecutive month, banks also turned increasingly to consumer loans as an outlet for funds. . . . Since year-end, demand deposits adjusted declined seasonally by \$826 million. Time and savings deposits, after expanding by a record \$533 million in January, increased only \$110 million in February and \$37 million in the first four weeks of March. Nevertheless, the net inflow of savings deposits continued at an accelerated pace nearly twice that of a year ago.

Employment and Unemployment

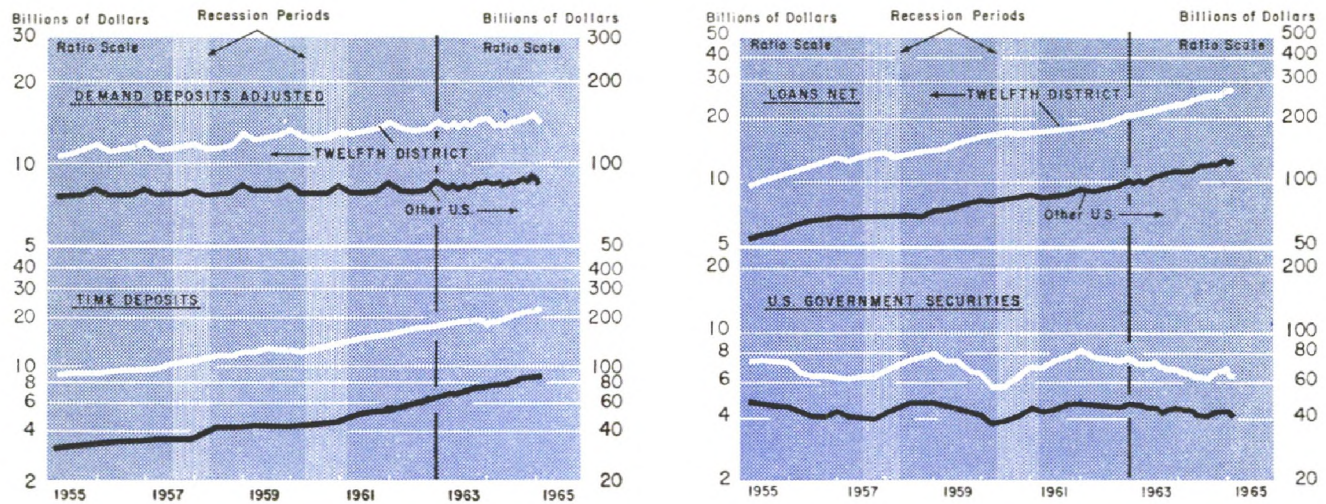
Nonfarm wage and salary employment in Pacific Coast states increased 0.7 percent in February. . . . The construction industry showed the way with a 4.4-percent increase, while manufacturing added 0.5 percent. In defense-related industries, employment declined 0.2 percent—a smaller loss than in other recent months. . . . Preliminary estimates indicate a substantial decline in the region's unemployment rate during February. (All data seasonally adjusted)

Farm Labor Developments

The District agricultural situation has been clouded by the end of the bracero program on December 31, 1964. About 64,000 foreign-contract workers were employed in California alone at the 1964 seasonal peak. Now, with Mexican workers largely excluded from this country, growers are complaining about the difficulty of finding enough workers for the forthcoming harvest season. . . . Some District lenders have been reluctant to advance credit to farmers who are unable to provide assurance of an adequate supply of labor to produce and harvest this year's crops. Similarly, some food processors have been reluctant to offer contracts to farmers for this year's produce. . . . District growers have appealed for a restoration of the bracero program, but Labor Secretary Willard Wirtz, on a late-March inspection trip, continued to oppose such a move. Secretary Wirtz contended that recruitment efforts so far have attracted enough American citizens to handle this season's crops. He conceded, however, that some Mexican help may be needed later at the harvest peak. But first, he said, growers must offer potential American workers "the maximum possible wages and working conditions." . . . The Office of Economic Opportunity meanwhile allocated \$3.8 million under the anti-poverty program to assist California's migrant farm workers. About half of the grant will be used for seasonal housing units, which can be moved from area to area as harvest needs dictate.

FEDERAL RESERVE BANK OF SAN FRANCISCO

Condition Items of all Member Banks — Twelfth District and Other U. S.



Source: Federal Reserve Bank of San Francisco. (End-of-quarter data shown through 1962, and end-of-month data thereafter; data not adjusted for seasonal variation.)

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 Seasonally Adjusted				Bank debits Index 31 cities ^{5, 6}	Bank rates on short-term business loans ^{7, 8}	Total nonagri- cultural employ- ment	Dep't. store sales (value) ⁶	Industrial production (physical volume) ⁶		
	Loans and discounts ³	U.S. Gov't. securities	Demand deposits adjusted ⁴	Total time deposits					Lumber	Refined ³ Petroleum	Steel ³
1952	8,712	6,477	10,052	7,513	59	3.95	84	73	101	90	92
1953	9,090	6,584	10,110	7,994	69	4.14	86	74	102	95	105
1954	9,264	7,827	10,174	8,689	71	4.09	85	74	101	92	85
1955	10,816	7,181	11,386	9,093	80	4.10	90	82	107	96	102
1956	12,307	6,269	11,580	9,356	88	4.50	95	91	104	100	109
1957	12,845	6,475	11,384	10,530	94	4.97	98	93	93	103	114
1958	13,441	7,872	12,472	12,087	96	4.88	98	98	98	96	94
1959	15,908	6,514	12,799	12,502	109	5.36	104	109	109	101	92
1960	16,612	6,755	12,498	13,113	117	5.62	106	110	98	104	102
1961	17,839	7,997	13,527	15,207	125	5.46	108	115	95	108	111
1962	20,344	7,299	13,783	17,248	141	5.50	113	123	98	111	100
1963	22,915	6,622	14,125	19,057	157	5.48	117	129	103	112	117
1964	25,561	6,492	14,450	21,300	169	5.48	...	139	109	115	132p
1964											
February	23,520	6,818	14,222	19,500	168r	...	119	137	114	115	117
March	23,691	6,961	14,272	19,566	167r	5.47	119	133	114	113	149
April	23,929	6,563	14,215	19,773	170r	...	119	134	102	111	140
May	24,126	6,493	14,199	19,813	168r	...	119	139	106	112	139
June	24,443	6,380	14,376	19,896	169r	5.46	119	137	105	114	131p
July	24,912	6,161	14,369	20,152	168r	...	119	141	113	115	121p
August	24,965	6,212	14,377	20,235	172r	...	120	143	107	118	121p
September	25,282	6,480	14,689	20,473	167r	5.51	120	137	108	121	129p
October	25,165	6,519	14,587	20,602	170r	...	121	139	111	117	132p
November	25,339	6,685	14,503	20,792	172r	...	121	150	106	113	149p
December	25,561	6,492	14,450	21,300	168r	5.48	122	142	106	115	140p
1965											
January	25,853	6,337	14,430	21,669	179	...	122	152	...	116	137p
February	26,120	6,659	14,453	21,878	176	...	123	146	142p

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, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; nonagricultural employment, U.S. Bureau of Labor Statistics and cooperating state agencies.

² Figures as of last Wednesday in year or month. ³ Total loans, less valuation reserves, and adjusted to exclude interbank loans. ⁴ Total demand deposits less U.S. Government deposits and interbank deposits, and less cash items in process of collections. ⁵ Debits to demand deposits of individuals, partnerships, and corporations and states and political subdivisions. Debits to total deposits except interbank prior 1942. ⁶ Daily average. ⁷ Average rates on loans made in five major cities, weighted by loan size category. ⁸ Not adjusted for seasonal variation. ^{*} Banking data have been revised using updated seasonal factors. Monthly data from 1948 available on request from the Research Department of this Bank. p—Preliminary. r—Revised.