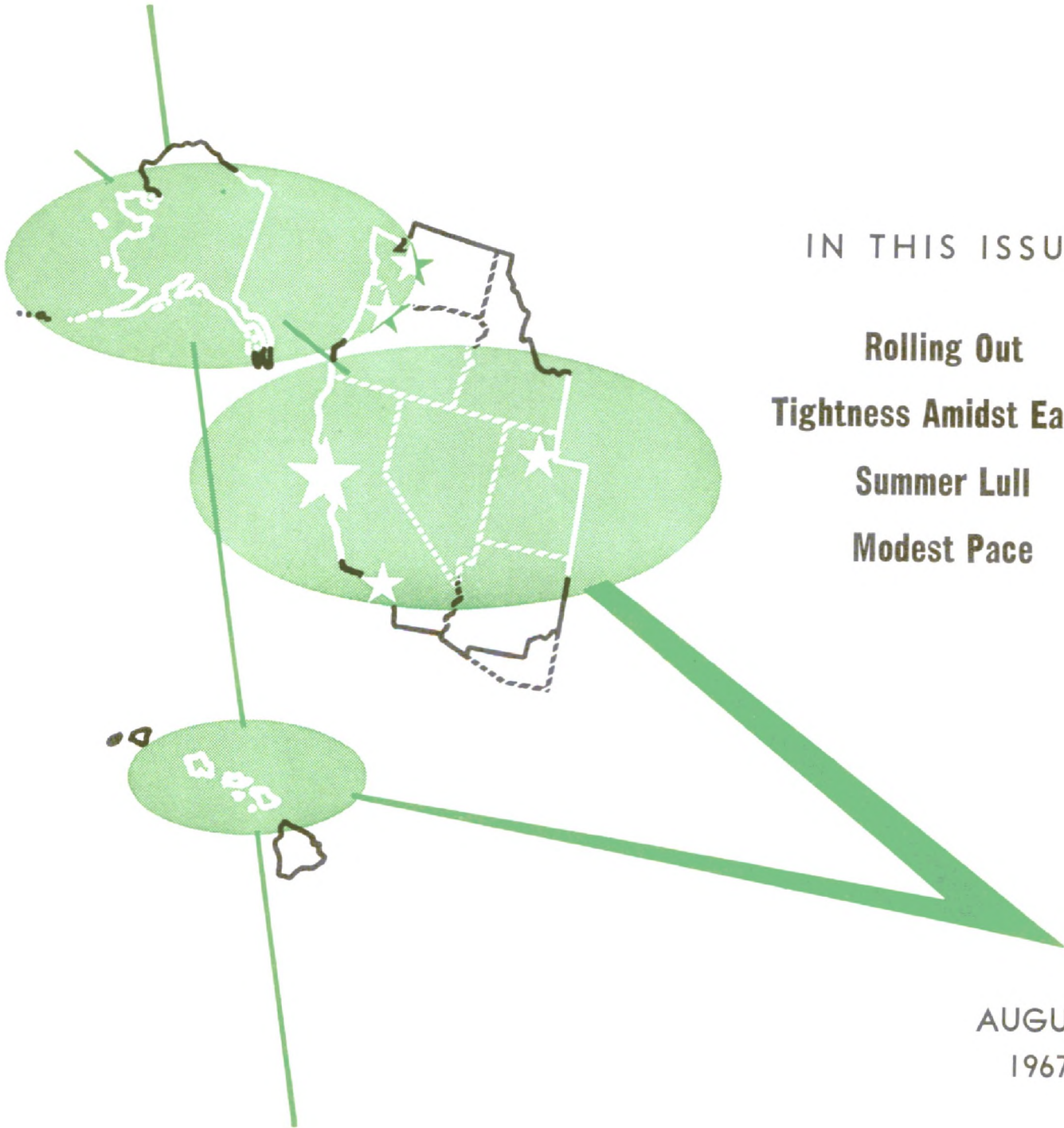


FEDERAL RESERVE BANK OF SAN FRANCISCO

MONTHLY REVIEW



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AUGUST
1967

Rolling Out

... The economy at midsummer appeared to be doing a reasonably good job of readjusting to earlier massive shifts of resources.

Tightness Amidst Ease?

... Despite the easier tone in the markets, long-term rates turned upward in April—and short-term rates followed after midyear.

Summer Lull

... Western business activity lagged behind last year's pace in first-half '67, because of the same pressures operating elsewhere.

Modest Pace

... Some District-bank funds during first-half '67 went into business loans, but most funds went to rebuild security portfolios.

Editor: William Burke

Rolling Out

THE phrasemakers of a decade ago coined a number of metaphors to describe sluggishness in the national economy—"rolling readjustment" and "saucering out" being some of the more notable examples. Economic analysts today, although failing to develop comparable specimens of pompous prose, may yet find that earlier phraseology useful for describing the present business scene.

The economy at midyear appeared to be doing a reasonably good job of readjusting and saucering. In general, it showed strong signs of rolling out from under the problems caused by the massive shifts in spending of the past two years, when resources were pulled into the defense and business-investment sectors and pulled away from the housing and consumer-goods areas.

In the second quarter of 1967, GNP rose by \$9 billion to a \$775-billion annual rate. (Following the annual data-revision process at midyear, the GNP estimate for the first quarter is now about \$2½ billion higher than the figure heretofore used, but the pattern of developments is not changed.) More important, real (price-adjusted) GNP rose by a small amount during the spring months after failing to increase in the January-March period.

Industrial production in July was 2 percent below the December peak, as the early-summer period witnessed increased output of autos, crude petroleum, and defense equipment, along with strike settlements in several major industries. In Wall Street meanwhile a long-anticipated summer rally finally got underway.

Viewing all of this, Economic Adviser Ackley reported to Congress at midyear that "The resurgence of economic activity is clearly on the horizon. There is no longer a

significant risk that inventory adjustment might cumulate into a severe and prolonged slowdown, and there is mounting evidence of growing strength in many areas of the economy."

Clearing the shelves

By midyear, indeed, the inventory readjustment that had generated the early 1967 sluggishness seemed to have accomplished most of its task. The second quarter, in particular, witnessed a sharp slowdown in the rate of inventory expansion. In that period, stocks increased at only a \$½-billion annual rate, in sharp contrast to the \$7-billion rate of the preceding quarter and the clearly unsustainable \$18½-billion accumulation of fourth-quarter 1966. Thus, by midyear, much of the balance was restored that had been lost last fall when final demand began to slow down, provoking a production cutback that was neither prompt nor widespread enough to deal with the problem of bulging warehouses.

Readjustment in the trade sector was largely accomplished by late spring. The stock-sales ratio was still high in durable manufacturing, however, at 2.25 in June, after rising from 1.91 in early 1966 to 2.32 in April 1967. The largest buildups occurred in the defense-related and capital-goods industries; a large part of this bulge occurred in work-in-process inventories, presumably in response to the large order backlogs in those industries. On balance, recent performance indicates that the typical firm is not jettisoning its inventories, but instead is attempting to adjust through the normal growth of sales rather than through any sharp decline in stocks.

Enough capacity?

In the capital-investment sector, business spending hovered around an \$81-billion an-

nual rate in the second quarter of the year, thus remaining near the high plateau reached in the last months of 1966. Durable-equipment expenditures tended to edge up during the spring months, but industrial-commercial building continued to decline, as it had throughout most of the preceding year.

In this spring's Commerce-SEC investment-planning survey, businessmen reaffirmed their expectation of a gradual upturn in expenditures. The 1967 total is now projected at 3 percent above the 1966 level, following a 17-percent jump in the 1965-66 period.

The survey showed a definite decline in pressures on industrial capacity. (In a separate Federal Reserve study, manufacturers were reported operating at less than 85-percent capacity in the June quarter, as against the 91-percent level maintained throughout most of 1966.) Manufacturers started fewer investment projects in the first quarter of 1967 than in any other period of the last two years, and the carryover of uncompleted projects meanwhile rose less than seasonally.

In this spring's investment survey, too, planned outlays were revised downward from

earlier surveys, as they always are during periods of business sluggishness. As a result, this sector may not be exceptionally strong in coming months. On the other hand, the spending outlook may receive welcome support from the restoration of the investment-tax credit, and this factor should be reinforced by the rising trend since February in new orders for machinery.

Foreign buying, military buying

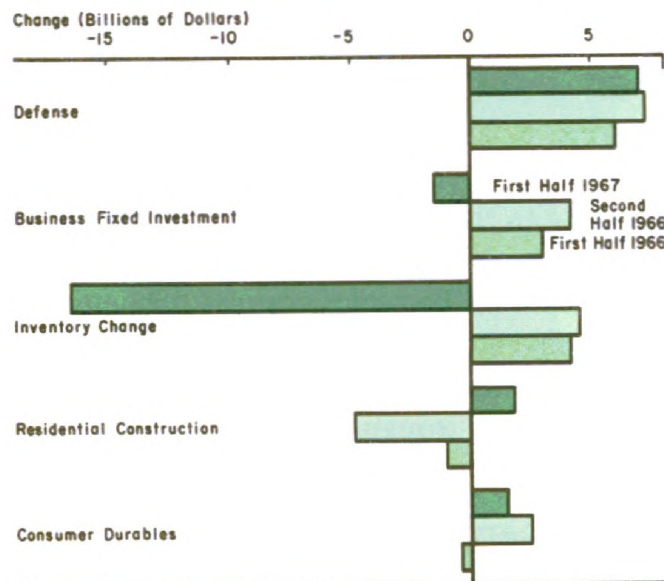
The foreign-trade sector contributed somewhat more to GNP growth recently than it did in late 1966, as net exports exceeded a \$5-billion rate in both of the first two quarters of this year. The improvement was due to continued strength of exports *despite* the sluggishness in the European market, along with a slower growth in import spending *because* of the sluggishness in domestic demand. The import trend happily has been fairly level so far this year, in contrast to the trend in the preceding 12-month period, when total imports of goods and services (including military expenditures abroad) jumped by 17 percent.

In the defense sector, spending continued to rise during the spring period, although more slowly than heretofore. At a \$72½-billion rate, the spending increase in the June quarter was the smallest quarterly gain since late 1965. The trend, of course, continues upward, but the increase in defense and other Federal purchases over the year ahead is now projected at less than half the average gain of the past year.

More consumer buying?

Consumer spending, at a \$489-billion annual rate in the second quarter, rose more sharply than at any other time in the past year, as a recovery in the auto sector went along with average gains in consumer non-durables and services. Even so, increases in consumer expenditures so far this year have not been especially large in terms of recent

Strength in other sectors offset by weakness in business investment



growth of income.

The slowdown in consumer outlays could be traced back to early 1966, a time when purchasing power came under the pressure of higher taxes and prices. Consumers in 1966 had to face heavy income-tax settlements in April, and then the imposition of progressive withholding schedules in May, following a higher social-security tax schedule at the very outset of the year.

Along with this, they had to face a 3.3-percent increase in the consumer price index over the December-to-December period, so that family purchasing power was sharply affected throughout the year. Moreover, income and spending plans in early 1967 were again affected by manufacturing layoffs and reductions in overtime, plus a withdrawal from the labor force of secondary breadwinners, such as housewives and teenagers.

But incomes continued to rise throughout the first half of 1967 despite these retarding factors, and consumer spending thus showed considerable strength by midyear, with recovery sharply noticeable in the auto market. Total spending for autos and parts rose to a \$30-billion annual rate in the second quarter—considerably better than in early 1967 and close to the peak levels reached at several times during the preceding years. Dealers' sales of new domestic cars rose to an 8½-million-unit annual rate during June and continued high in July. For the January-June period as a whole, the domestic industry still had little to crow about, but foreign-car sales during this period were one-sixth ahead of their already fast 1966 pace.

More housing?

New residential construction, at a \$23-billion rate in the June quarter, was at its best level of the past year, although it still lagged somewhat behind earlier peak levels. New housing starts, meanwhile, were up about one-fourth over the late-1966 quarterly low.

Housing at midyear was affected by the clamorous business and state-local demand for long-term funds. The mortgage market at that time registered some increases in rates, along with the reappearance of discounts on FHA mortgages, despite the large flow of funds into the nation's thrift institutions.

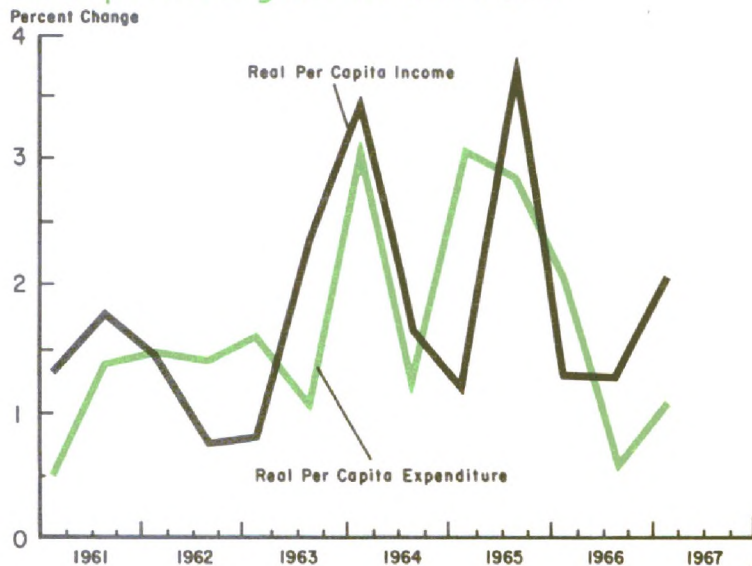
Strong forces, nonetheless, supported the recovery in housing. Continued improvement in consumer income, demographic factors, and reduced vacancy rates, along with the recent improvement in the liquidity of thrift institutions, all contributed to the expectation of a gradual recovery in this key sector of the economy.

Labor and its price

Sluggishness in the labor market was reflected by midyear in rising unemployment. The June rate, 4.0 percent, was the highest rate of the last year and a half, but the rate undoubtedly would have reached that level earlier this year if there had not been a significant downtrend until June in the civilian labor force.

June and July, however, witnessed renewed expansion of employment and of the

Spending responds to income gain after paralleling earlier slowdown



working force, as well as a reduction in the jobless rate to 3.9 percent.

The price of labor at midyear reflected the still intense competition for professional and technical workers, but it did not reflect to any great extent the reduced pressure on the labor market generally. Labor negotiations at this stage were affected by earlier cost-of-living increases and by the effects of the new minimum-wage law, so that wage rates recently have tended to rise as fast as they did a year ago.

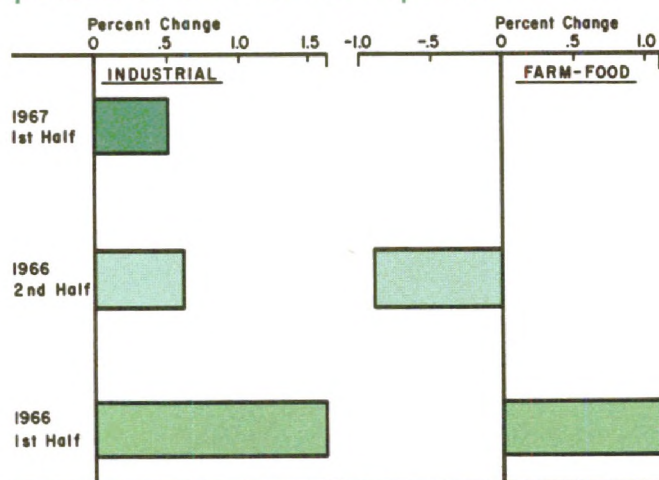
Prices and taxes

Price developments generally remained somewhat mixed. To some extent, they responded to the reduced pressure of demand against available resources. The wholesale price of industrial commodities has held stable at about 106 percent of the 1957-59 base, as price increases for some finished products have offset the continued weakness in industrial materials, now 7 percent below year-ago levels.

But prices at the consumer level reflected the after-effects of the inflationary pressures generated last year, rising to 116 percent of the 1957-59 base in June. The index had risen rather slowly earlier this year because of declining food prices, but it has remained under constant pressure because of the up-trend in non-food commodities and non-rent services—and this pressure increased when food prices turned up again in May.

By midsummer, these conflicting forces brought about a continued gain in income which in turn presaged further strength in market demand.

Sluggish business helps reduce pressures on wholesale prices



In a midyear Congressional appearance, the Council of Economic Advisers foresaw a turn-around in inventory investment, continued strength in business and government purchases, and associated gains in consumer outlays. Given these assumptions, the Council projected a GNP increase over the next year of \$50 to \$60 billion—a gain which at the upper end of the spectrum would exceed the growth in the capacity of the national economy.

The Council argued that without new policy restraints the spending pace would be likely to exceed the permissible upper limit, so that a tax increase would be necessary to moderate the growth of demand. In Chairman Ackley's words: "The economy is not advancing too rapidly today—indeed some further acceleration will be welcomed. But it will not be appropriate for very much longer."
William Burke

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Tightness Amidst Ease?

MONETARY and fiscal policy each provided a substantial amount of stimulus to the national economy during the spring and early summer months. The Federal Reserve bought \$1.6 billion of securities (net) in the second quarter, and this was reflected in a \$245-million average level of free reserves — almost \$200 million above the first-quarter average. The Treasury meanwhile recorded a widening of the Federal budget deficit, from an \$11.9-billion annual rate in the first quarter to a \$14.1-billion rate in the following period (national-income basis). Part of this policy stimulus stemmed from the re-institution of the investment-tax credit, retroactive to March 10.

Growth at the banks

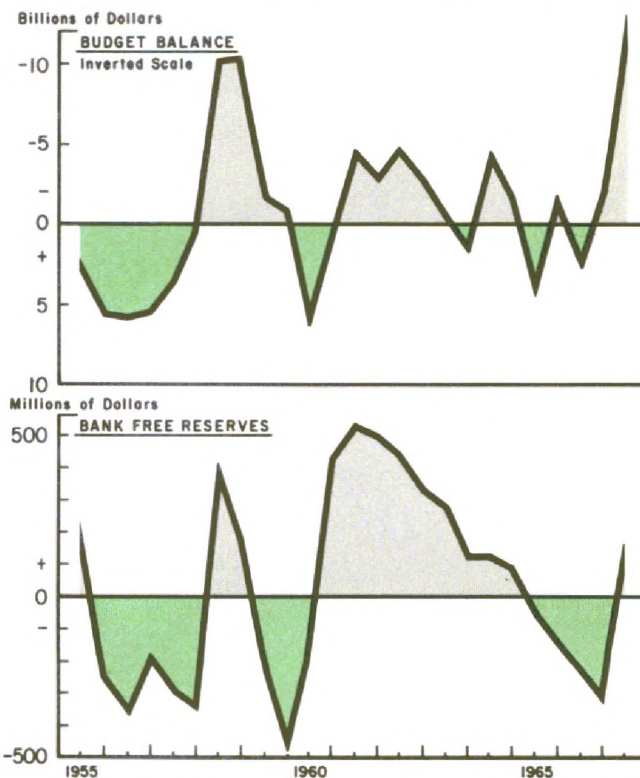
In this atmosphere of ease, commercial-bank credit rose at a 6-percent annual average rate during the spring quarter. Growth was not nearly so marked as in the first quarter, but the January-June period as a whole witnessed a 10½-percent rate of expansion of bank credit—one of the sharpest increases of this fast-growing decade. Moreover, the growth of the money supply speeded up, from a 6-percent to a 7-percent annual rate, between the first and second quarters. This expanded growth reflected the Treasury's inability to build up its cash balance as much as usual during the final quarter of its fiscal year.

While the demand-deposit component of the money supply was thus expanding, time-deposit growth eased slightly, from a spectacular 18½-percent annual rate in the first quarter to a 15½-percent growth in the following period. Large-demonomination certificates of deposit, which had contributed heavily to the first-quarter time-deposit expansion

with a \$3½-billion increase, rose moderately over the next several months, but still reached a near record \$19½ billion by mid-July.

The reduced credit expansion during the spring quarter developed partly because of a slower growth of loan portfolios, but mostly because of an actual reduction in Treasury security portfolios. (Holdings of other securities, however, continued to rise at a quite rapid pace.) Total loans expanded at a 5-percent annual rate. Business loans grew at twice that rate—a quite respectable performance, although one that was outshadowed by the unsustainably fast expansion of a year-ago. In other sectors, real-estate and consumer loans were up fairly steadily, albeit without any significant strength, and security

Fiscal-monetary policy stimulus helps combat first-half sluggishness



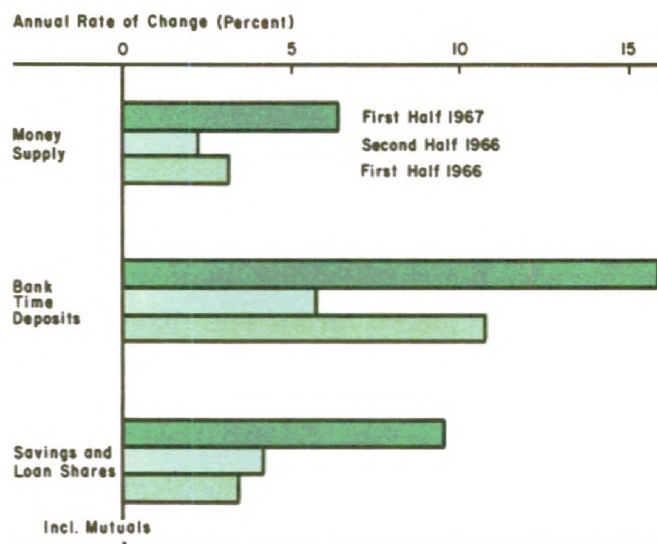
loans declined somewhat, since security dealers needed less financing to carry the reduced inventories brought about by Treasury debt repayment.

The rush to borrow

Despite the generally easier tone created by the strong stimulus from the public sector, the money and capital markets came under increasing pressure by mid-year. Pressures were particularly evident in the capital market, where the sharp uptrend during the spring quarter brought long-term rates back up to last August's peak levels, but after mid-year short-term rates shot upward too.

The rise in long-term rates was occasioned by a strong volume of municipal financing and an unprecedented volume of corporate financing. Publicly offered corporate issues in particular rose very sharply, to a total of over \$7 billion for the January-June period—more than the total for the entire preceding year. And the municipal market was also active; tax-exempt issues rose to \$7.6 billion for this period, for a 24-percent increase over the comparable 1966 figure. Then, to cap the climax, the volume of new corporate offerings for July and August promised to eclipse the record June volume.

First-half '67 marked by growth of money supply and savings flows



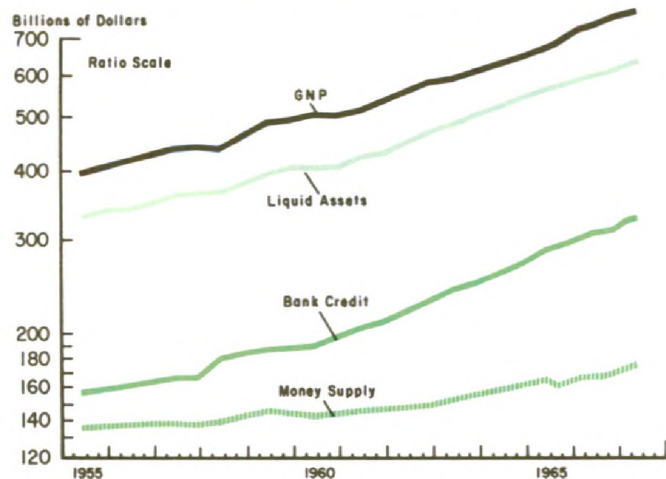
The effect of this tremendous flow of new issues began to be felt around mid-May. By early July the average yield on top quality corporate bonds was up 60 basis points from the February low, to 5.59 percent, and in mid-July a number of top-rated bonds carried coupons of 6¼ percent. The run-up in high-grade municipals paralleled this advance in corporate issues as tax-exempt yields rose to 4.09 percent in mid-July.

The Treasury's role

Corporate and municipal borrowers had little competition from the Treasury during the spring period. The Treasury posted net sales of \$2 billion in participation certificates in pools of Federal loans, but meanwhile it reduced the publicly-held debt by \$9.1 billion, mostly through the redemption of tax-anticipation bills maturing in April and June. Yet, despite the usual heavy inflow of tax revenues, the Treasury increased its cash balance by only \$0.9 billion during the quarter, as against a \$6.1-billion build-up in the same quarter of 1966.

The Treasury, however, will play a completely different role in the markets in the second half of calendar 1967. It will be a

Growth of GNP supported by upsurge in financial sector



large and consistent borrower for the remainder of the year, with cash-financing requirements estimated on the order of \$15-20 billion.

The Treasury undertook the first of these financing operations in early July, with a tender of \$4 billion in tax-anticipation bills and with an additional \$2.1 billion to be raised through the weekly and monthly bill cycles. Then, to refund \$9.6 billion in certificates and notes falling due August 15, the Treasury offered for cash a 15-month certificate bearing a 5¼-percent coupon and priced to yield 5.30 percent. The Treasury may continue to fill most of its new cash requirements in the short-term market, although it is now able to offer rates in excess of the 4¼-percent statutory limit on long-term issues with maturities out to 7 years, thus breaching the previous 5-year maturity limitation on such issues.

The short-term upsurge

Short-term rates moved differently from long-term rates throughout most of the first half of the year, falling fairly consistently from January to mid-June. But an abrupt turnaround then took place, as the market yield on 91-day Treasury bills jumped 82 basis points in a single week's time, to 4.28 percent. This developed on the heels of the Treasury's announcement of its first cash offering of the new fiscal year — and the market's realization of the size of the Treasury's forthcoming requirements. Other money-market rates also moved upward but at a slower pace; yields on bankers' acceptances and prime commercial paper rose by 10 and 12 basis points, respectively.

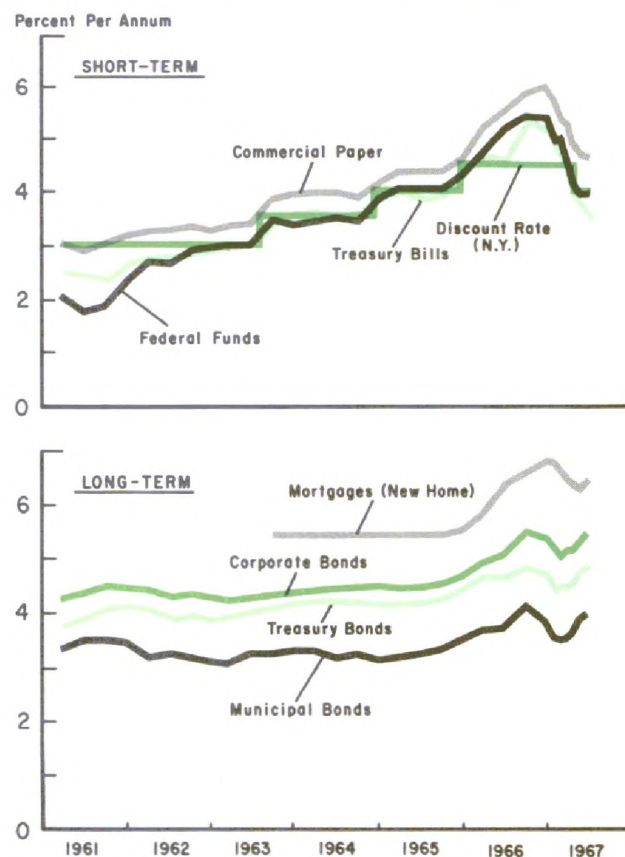
The sharp-second quarter upturn in interest rates was all the more remarkable in that it occurred during a period of monetary ease. In last summer's crunch, upward pressure on rates developed from two directions—the vigorous demand for funds from both the private and public sectors, and the declining

availability of funds because of a strongly restrictive monetary policy. During this spring and summer, monetary policy was less restrictive and demand for bank credit was less strong, but there were very strong demands for financing on the part of corporations and state-local governments. At the same time, new forces were very much in evidence, as the upsurge was sparked by the market's new-found certainty about the size of the Treasury (and private) financing requirements, as well as its uncertainty about the exact dimensions of the Administration's forthcoming tax-increase package.

The tax package

Much of this uncertainty of course disappeared when the Administration unveiled its tax package in early August. The proposal, calculated to bring in \$7.4 billion more rev-

Long-term rates rise but short-term rates fall until midyear



enue in fiscal 1968, centered around a 10-percent surcharge on individual income-tax liabilities (effective October 1) and a 10-percent surcharge on corporate tax payments (retroactive to July 1). In addition, the Administration asked for the postponement of scheduled reductions in excises on automobiles and telephone calls, and requested a speed-up of corporate-tax collections, so that corporations next January would pay estimated taxes on the basis of 80 percent of their liabilities instead of the present 70 percent.

The all-purpose nature of the tax bill was emphasized by the President when he sent his message to Congress. Noting that tax reductions enacted while he was President were saving taxpayers \$23 billion at this year's level of incomes, Mr. Johnson said: "Now

your Government is asking for a return of substantially less than half of those cuts. This is necessary to give American fighting men the weapons, equipment and help they need, to hold the budget deficit within limits and to continue our education, health, poverty, urban and other vital programs."

Viewing the purely financial aspects of the program, Federal Reserve Chairman Martin seconded the President's plea with the following statement: "Nobody likes higher taxes but I am firmly convinced, as I said in Toledo in June, that we must have adequate, effective—and above all—prompt tax action that will reduce the Government's prospective budget deficit to more manageable proportions and at the same time reduce pressures on financial markets. The entire Board shares this view."

Herbert Runyon

TWELFTH DISTRICT BUSINESS

Year and Month	Condition Items of all member banks (millions of dollars, seasonally adjusted)				Bank debits 22 SMSA's (billions \$)	Bank rates: short-term business loans	Total nonfarm employment (1957-59 = 100)	Electric power consumption (1963=100)	Industrial production (1957-59 = 100)		
	Loans and discounts	U.S. Gov't. securities	Demand deposits adjusted	Total time deposits					Lumber	Refined Petroleum	Steel
1959	15,908	6,514	12,799	12,502		5.36	104		109	101	92
1960	16,612	6,755	12,498	13,113		5.62	106		98	104	102
1961	17,839	7,997	13,527	15,207		5.46	108		95	108	111
1962	20,344	7,299	13,783	17,248		5.50	113		98	111	100
1963	22,915	6,622	14,125	19,057		5.48	117	100	98	112	115
1964	25,561	6,492	14,450	21,300	501	5.48	120	112	107	115	130
1965	28,115	5,842	14,663	24,012	535	5.52	125	122	107	120	138
1966	29,858	5,444	14,341	25,900	618	6.32	132	134	103	123	140
1966: June	29,688	4,919	14,780	25,001	622	6.18	131	134	105	128	144
July	29,791	5,071	14,753	25,265	628	.....	131	137	104	130	143
Aug.	29,764	5,473	15,120	25,271	622	.....	131	139	95	119	136
Sept.	29,532	5,190	14,819	25,159	629	6.58	132	140	93	123	140
Oct.	29,583	4,987	14,719	25,085	645	.....	133	137	96	121	142
Nov.	29,538	5,267	14,800	25,318	642	.....	135	135	89	125	142
Dec.	29,858	5,444	14,341	25,900	634	6.62	135	140	97	120	141
1967: Jan.	30,274	5,468	14,437	26,134	638	.....	136	141	98	123	142
Feb.	29,923	5,889	14,376	26,425	644	6.28	137	136	96	119	135
Mar.	29,980	6,483	14,855	26,892	645	.....	136	143	99	121	123
Apr.	29,811	5,634	14,571	27,128	654	.....	136	141	102	124	137
May	29,729	5,852	15,035	27,168	658	6.02	136	145	98	131	133
June	30,071	5,265	15,181	27,460	681	.....	136	143	93		133

Summer Lull

BUSINESS activity in Western states increased only moderately during the spring quarter, as the headlong pace of 1966 faded more and more into the background. Nonfarm employment moved sideways during the April-June period, and incomes and expenditures grew more modestly than heretofore.

The reduced pressures that were so evident on the national scene thus characterized the District scene as well. Actually, many Western areas exhibited a faster expansion of jobs than the nation; Seattle led the parade (as it had done consistently over the last two years) but even there the boom slowed down from its earlier fabulous pace. At the same time, many areas posted a poorer unemployment record despite the slow growth of their labor force. In Pacific Coast states, the jobless rate rose from 4.7 to 5.0 percent over the quarter—a full percentage point higher than elsewhere.

Sluggishness, in the region as in the nation, developed in the commodity-producing industries as the business sector held back on its spending for inventories, buildings, and machinery. Manufacturing and mining firms reduced their combined workforce by ½ percent, and construction firms cut back by 6½ percent, on a seasonally adjusted basis. But here as elsewhere, governmental agencies and financial and service enterprises continued to expand their payrolls during the spring and early summer months.

Nonetheless, the West still outdistanced the nation in terms of total employment, and the income-expenditure trend at least matched the national pace. (By midyear, personal income in District states was running at a \$100-billion annual rate.) But much of the relatively greater strength in

retail sales showed up in auto salesrooms rather than in other retail stores.

In the January-May period, total automotive sales were 8 percent above the year-ago figure in District states—despite a drop in new-car registrations—while declining sharply elsewhere in the nation. The '67 Western market was characterized by some trading up, in terms of both higher-priced car models and increased optional equipment, as well as by a rise in sales of late-model used cars.

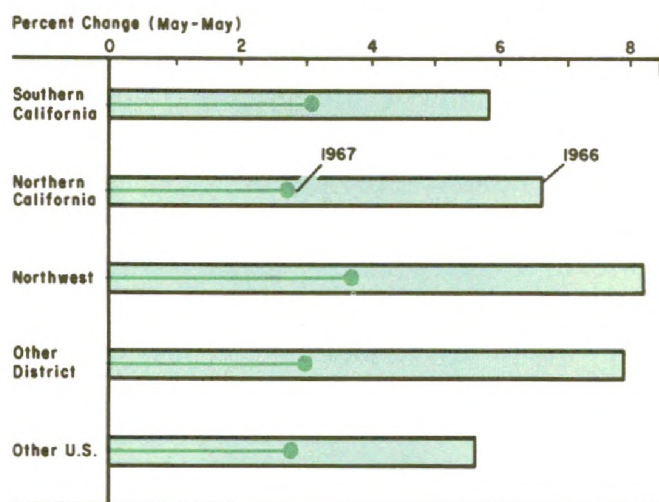
Retail prices in Western metropolitan areas, which had risen somewhat slowly in the winter months, begun to spurt ahead again during the spring period. Major pressures developed from a June boost in food prices (following a half-year-long decline) and from substantial increases in home-owner and transportation costs (especially for used cars). Consumer prices rose by 1.6 percent in Los Angeles during the second quarter—in contrast to a 0.9-percent national increase—and San Francisco experienced a muted version of the same trend. Other major Western areas posted increases which were more in line with the national figure.

Planes and houses

The region's aerospace industry continued to expand, but at a relatively slow pace, during the June quarter. Employment in the industry rose by 5,000 for the second straight quarter, to a midyear level of 707,000—an apt figure in view of the continued popularity of the commercial jet boasting that model number.

A stronger performance could have been expected from the industry, since defense contract awards jumped by one-fourth, to \$2.1 billion, during the preceding (January-March) period. But there were several offsetting factors, such as continued weakness

Employment grows over past year at only half previous year's rate



in space-agency awards and the continued adjustment of commercial-jet production schedules to take account of engine and parts shortages.

Western construction activity showed increasing momentum during the April-June period, despite the forementioned drop in building-trades employment. Most notable was a 31-percent quarterly gain in housing starts, to a 229,000-unit annual rate. Admittedly, this still amounted to only half the 1963 peak figure, but the advance was substantially greater than the average increase for the nation as a whole. Advance indicators, such as residential permits and construction awards, exhibited substantial strength during the spring period; along with an improvement in vacancy rates and a decline in the inventory of surplus housing, these indicators presaged the possibility of a significant upturn in coming months.

Overall, residential awards in District states were up more than 35 percent during the quarter, as against a 9-percent gain elsewhere. Nonresidential building awards meanwhile dipped slightly, reflecting the nationwide slowdown in business investment. But heavy engineering work continued strong, as the volume of awards rose by 11 percent.

Wood and metals

Despite the uncertainties in the construction industry, the region's lumber industry experienced some improvement in prices during the spring and early summer months. The usual spring upturn in orders failed to materialize, but lumber and plywood-sheathing producers were able to raise prices by several dollars per thousand board (or square) feet, in part because of production cutbacks caused by heavy rains and by early-vacation closing of mills. Prices then moved even higher in mid-July when orders began to flow in from wholesalers and retailers in response to the improvement in housing activity.

Aluminum producers in the Pacific Northwest raised primary-metal output to peak levels in the spring period, although shipments for the first half of the year dropped 2 percent below the record pace of a year ago. Two firms meanwhile began to expand their fabricating capacity in recent months; a new producer operating at Bellingham (Washington) announced plans for a facility to produce electrical wire from molten aluminum, and another firm scheduled plans for a Tacoma plant which will produce aluminum rods for heavy-duty electrical conduits.

The regional steel industry, like its national counterpart, continued to be affected by the 1967 cutback in business-investment spending. Despite an upturn in the spring period, Western mills turned out 5 percent less steel during the January-June period than they did a year ago—and output then declined 11 percent below the year-ago level during the first three weeks of July.

Copper mines and smelters, by dint of heavy production, sharply improved their supply situation during the spring period. Demand for the metal meanwhile declined as brass and wire mills reduced their orders in response to the weakness in the auto and appliance industries. But the major cause

of uncertainty at midsummer was the near-complete shutdown which occurred as 37,000 workers struck the eight major domestic copper producers.

Silver and black gold

Western silver producers profited from the recently increased price of the increasingly scarce metal. The rise in world prices began in mid-May, when the Treasury announced that it would henceforth sell only to "legitimate, domestic industrial consumers" and banned exports of the metal and the melting of silver coins. Then in mid-July, when the London spot quotation had risen to \$1.70 an ounce, the Treasury lifted the \$1.293 ceiling price and announced future sales of 2 million ounces a week to domestic consumers on a sealed-bid basis. After that announcement, prices in the London market and the New York bullion market shot upwards again, reaching \$1.89 in late July.

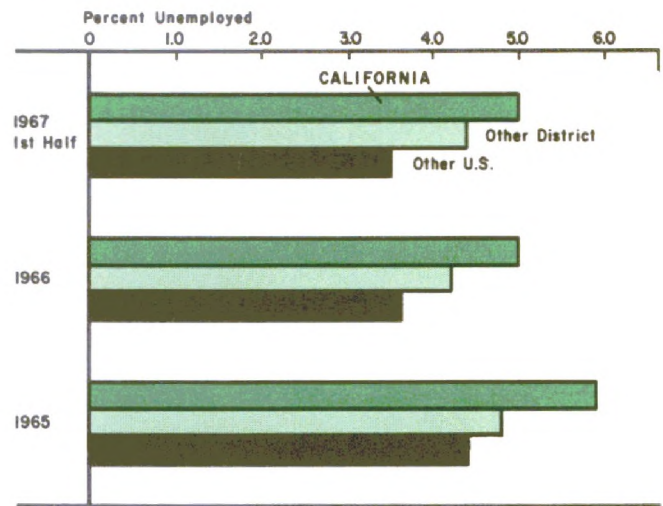
Shortages of Mideast petroleum—"black gold"—which had previously accounted for about one-twelfth of the District's crude supply, failed to hamper refining operations. Indeed, District refinery activity increased seasonally during the spring quarter, as other foreign and domestic sources made up for the short fall in crude imports from Arab countries. Most of the replacement came from other foreign sources. Crude output from District wells and the pipeline flow of crude from other U. S. sources increased only modestly, although the inflow of refined products from both domestic and foreign sources rose significantly.

Crops and weather

Farm receipts fell below their 1966 pace in the January-May period, primarily because of an 8-percent year-to-year decline in crop receipts. Farm prices generally remained below earlier levels, despite a sharp rise in vegetable prices during June.

Crop production for 1967 as a whole is expected to lag behind the 1966 harvest.

Jobless rates remain stable at about last year's levels



Heavy winter and spring rains are now taking a heavy toll in reduced output of grapes, pears, and apricots. Cotton production is scheduled to drop, partly because of reduced acreage and partly because of lower yields influenced by poor growing weather. On the other hand, wheat production should be much larger because of the reverse reasons—increased acreage and higher yields. In the livestock sector, a reduced level of marketings of fed cattle is indicated for the remainder of the year, in contrast to a relatively strong performance in early 1967, but increased production is anticipated for such other products as turkeys, milk, and eggs.

At midyear, then, the West like the nation appeared to be rolling out from under the readjustment in the business-investment sector which dominated the early part of the year. But a number of important questions remained—the long-standing slump in the regional housing industry, the continued demands of Vietnam on the defense-production sector, and the varied problems of the extractive industries, including labor uncertainty in the copper industry, the Mideast war's impact on petroleum, and the price problems created by the Treasury's depleted silver stockpiles.

Regional Staff

Modest Pace

TWELFTH District bank-credit expansion was two-thirds again as large in the first half of 1967 as in the comparable period of 1966, but most of this year's increase occurred in the January-March period. In April-June 1967, large Western banks added \$385 million in loans and \$224 million in securities, but this expansion was somewhat overshadowed by the massive (over \$1 billion) increase in security holdings recorded in the preceding quarter.

This rebuilding of liquidity positions, which had been severely eroded by the heavy loan demand of late 1965 and 1966, was accomplished largely through heavy acquisitions of municipals and other securities. (Banks reduced their holdings of short-term Treasury securities, although less sharply than a year ago.) For the January-June period as a whole, District banks increased their holdings of securities, other than Treasury issues, twice as fast as their counterparts elsewhere.

Less discounting

In view of the modest pace of credit expansion during the second quarter, District

banks were under less pressure than before to resort to the Federal Reserve discount window or to Federal-funds purchases (that is, to overnight borrowings of reserve balances from other banks). Moreover, there was some easing in reserve pressure because of the March reduction, from 4 to 3 percent, in reserve requirements against savings and Christmas Club accounts and the first \$5 million of other time deposits. Thus, during the second quarter, member-bank required reserves declined from the first-quarter level, despite a rise in (daily average) deposits.

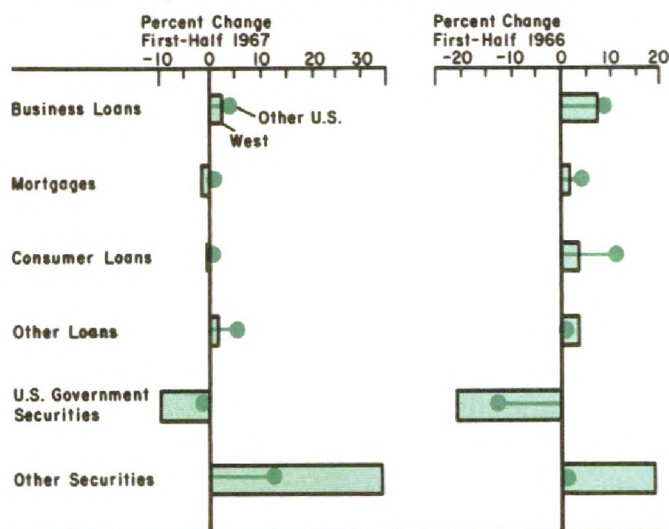
Between the first and second quarters, District-bank direct borrowings from the discount window dropped from \$31 million to \$16 million, and their reserve position shifted from \$3.5 million in net borrowed reserves to \$12.4 million in net free reserves. Over the same timespan, major District banks reduced their net interbank purchases of Fed funds, from \$587 million to \$391 million, and an increasing proportion of their purchased funds were relent to government securities dealers. (All data are on a daily average basis.)

Less loan expansion

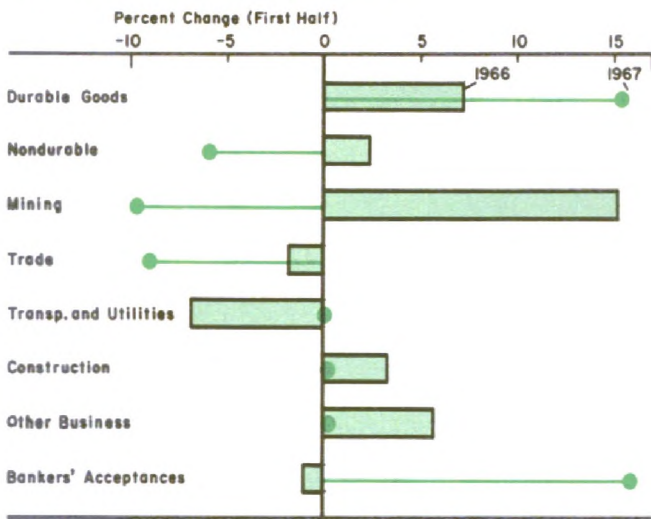
The second-quarter loan expansion was dominated by corporate borrowing, but most of this business-loan demand was concentrated in the month of June. Corporations borrowed in near-record amounts to meet their June 15 tax payments, and they further increased their borrowings over the mid-year statement period. Sales-finance firms and other non-bank financial institutions were also important bank customers during June.

Durable-goods manufacturers, after posting a sharp 17-percent increase in the first quarter, reduced their bank debt slightly in the April-June period. In the nondurable-

First-half '67 marked by upsurge in security investment, not in loans



Durable-goods firms dominate business-lending picture



goods sector, heavy borrowing by petroleum refiners in June more than offset the seasonal repayments by food-liquor-tobacco processors. In the second quarter also, banks increased their loans to public utility and construction firms and expanded their holdings of bankers' acceptances.

District-bank consumer lending showed little trend in either of the first two quarters of 1967. The most important recent development in this sector was the launching of a major credit-card program by a group of large California banks. At this stage, however, auto financing still remained the dominant factor in the consumer-loan picture; direct and indirect auto loans accounted for over half of the instalment credit extended by District banks in the spring months this year.

Signs of life

The Western mortgage market exhibited renewed signs of life around mid-year. District banks posted a \$48-million second-quarter gain and then added \$75 million more in July—although they still had some distance to go to match their 1966 level of outstandings—and District savings-and-loan associations added a respectable \$435 million to their mortgage portfolios during the second quarter.

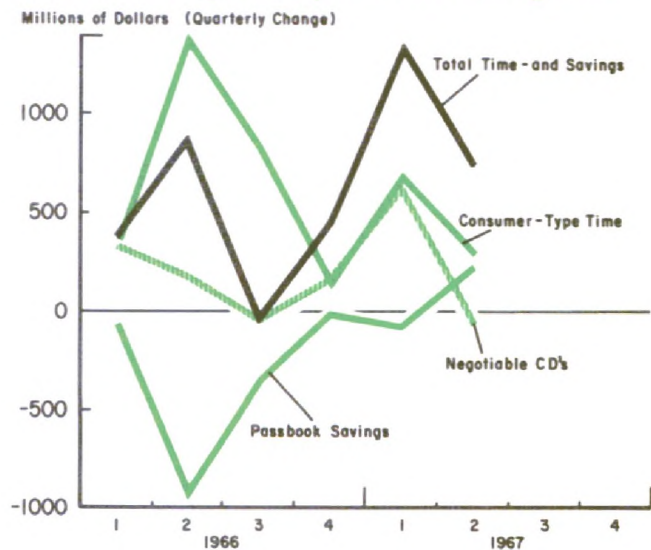
The turnaround, however, was accompanied by a mid-May firming of mortgage yields, which stemmed from the unusually heavy corporate demand for funds in the nation's capital market. As a reflection of these pressures, secondary market rates on 30-year 6-percent FHA mortgages rose 18 basis points in the Western market to a mid-year level of 6.51 percent, and contract rates on conventional first mortgages rose 10 basis points to 6.80 percent. Rising pressures were also reflected in a sharply expanded volume of offerings to the Federal National Mortgage Association.

Quickened savings inflow

The spring and early summer months also witnessed a quickened inflow of savings into Western financial institutions. District member banks posted a second-quarter increase of over \$1 billion in total deposits (daily average basis), mostly in time-and-savings deposits, which increased \$740 million. Most significant was a \$216-million gain in passbook savings, after five successive quarterly declines. Other consumer-type time certificates also rose, although more slowly than before, while large denomination CD's dropped by \$70 million, mostly around the June 15 corporate-tax date.

S&L associations in District states received

Passbook deposits begin to grow . . . other categories post smaller gains



\$843 million in loanable funds from the public during the April-June period. (This inflow made possible a \$389-million repayment of borrowings from the Federal Home Loan Bank.) The net growth in savings was below the first-quarter expansion—new savings and withdrawals were both down—but it stood in welcome contrast to the \$446-million decline of the year-ago period.

The favorable savings-and-loan performance continued into the July reinvestment period, notwithstanding both a further rise in yields on competing investments and the Federal Home Loan Bank Board "rollback" in the maximum rates payable by member associations on new savings. The Bank Board action entailed a reduction in the regional differential previously allowed the S&L's in the states of California, Nevada, Alaska, and Hawaii. For associations in those states, the maximum rate on passbook savings was cut from 5¼ to 5 percent, payable on investment certificates with a maturity of 3 years or over.

For associations elsewhere, the prevailing maximum of 4¾ percent on passbook savings was kept generally intact, but a maximum of 5¼ percent was permitted on investment certificates with only 6 months' maturity.

In sum, the performance of Western financial institutions reflected the sluggishness of the regional economy over the first half of the year. The modest expansion of business activity brought about a modest expansion in business lending, although not one to compare with the unsustainably large gain of a year-ago. Reduced pressures also permitted a welcome rebuilding of liquidity, exemplified by the strong build-up of banks' municipal-bond portfolios—and by the heavy repayment of S&L borrowings. Bank asset adjustments were conducted quite efficiently, since earnings reports for the first half of the year generally made for pleasant reading in bank boardrooms.

*Ruth Wilson and
Verle Johnston*

**SELECTED ITEMS FROM WEEKLY CONDITION REPORT OF LARGE BANKS
IN THE TWELFTH FEDERAL RESERVE DISTRICT**
(dollar amounts in millions)

	TWELFTH DISTRICT Net Change				U. S. MINUS TWELFTH DISTRICT Net Change		
	Outstanding 6/28/67	Second Quarter 1967		Second Quarter 1966	Outstanding 6/28/67	Second Quarter 1967	
		Dollars	Percent	Percent		Percent	Percent
ASSETS							
Loans adjusted and investments ¹	\$41,706	+609	+ 1.48	+ 4.40	\$150,120	+1.45	+ 3.31
Loans adjusted ¹	29,354	+385	+ 1.33	+ 3.43	106,690	+2.53	+ 4.80
Commercial and industrial	11,000	+288	+ 2.69	+ 4.94	52,784	+2.99	+ 5.64
Real estate	9,110	+ 48	+ .53	+ 1.52	18,437	+2.04	+ 3.07
Agricultural	1,204	+ 37	+ 3.17	+ 7.13	671	+2.13	- 1.79
To non-bank financial institutions	1,575	+171	+12.18	+ 5.12	8,695	+5.93	+10.25
For purchasing and carrying securities	530	-267	-33.50	+ 5.60	5,520	-5.56	+12.65
To foreign banks	258	- 7	- 2.64	-10.71	1,080	-4.42	- 2.58
Consumer installment	4,352	+ 27	+ .62		11,703	+2.33	
To foreign governments, etc.	120	0	0	+ 2.93	950	-1.25	+ 0.20
All other	1,693	+ 79	+ 4.89		9,306	+3.75	
Total securities	12,352	+224	- 1.85	+ 7.13	43,430	-1.09	- 0.38
U. S. Government securities	4,724	-829	-14.93	- 2.95	19,402	-8.55	- 5.62
Obligations of states and political subdivisions	6,518	+844	+14.87		21,212	+6.12	
Other securities	1,110	+209	+23.20	+16.08	2,816	+4.10	+ 4.43
LIABILITIES							
Demand deposits adjusted	14,039	+123	+ .88	- 2.88	145,867	+1.28	- 1.14
Total time deposits	26,732	+740	+ 2.85	+ 3.79	72,116	+2.82	+ 1.66
Savings	15,239	+216	+ 1.44	- 5.80	32,500	+1.33	- 3.35
Other time, I.P.C.	7,491	+250	+ 3.45	+40.98	27,626	+3.09	+ 9.23
States and political subdivisions	2,941	+238	+ 8.81	+ 7.82	6,724	+2.75	- 0.69
(Neg. CD's \$100,000 and over)	2,962	- 70	- 2.31	+ 8.62	16,191	- .47	+ 4.66

¹Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross.
NOTE: Quarterly changes are computed from March 29, 1967 — June 28, 1967 and from March 30, 1966 — June 29, 1966.