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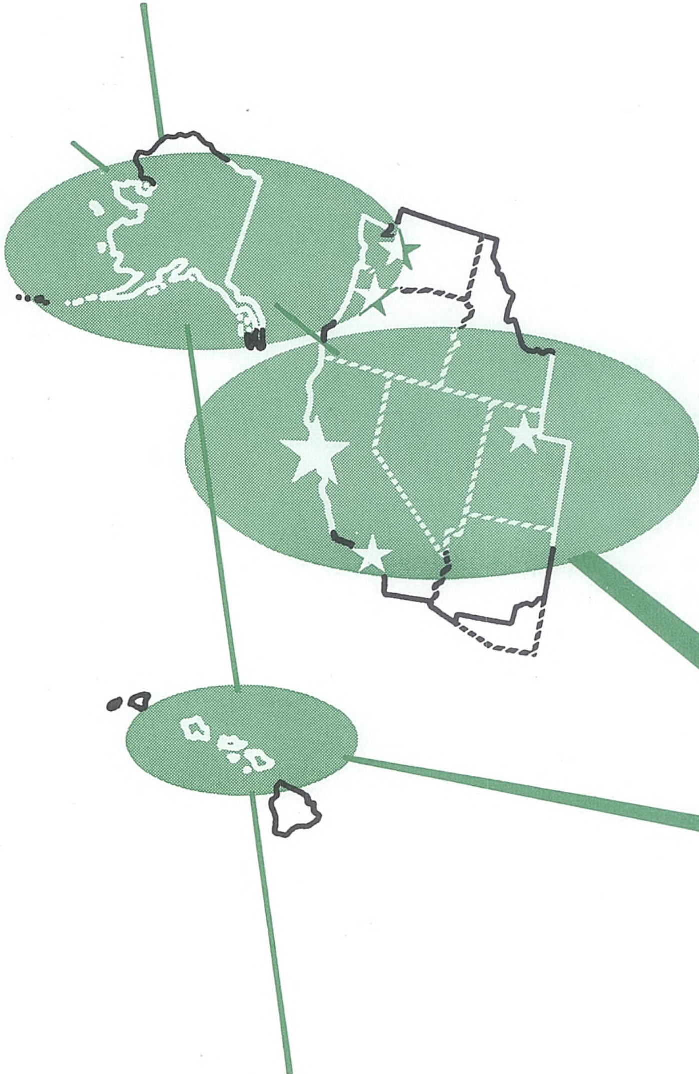
MONTHLY REVIEW



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MAY
1968

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Too Much Good News

. . . Spending rose more sharply than heretofore, but prices rose more rapidly too, pointing up the need for less exuberance.

But Not Enough Restraint

. . . Fiscal policy was still strongly stimulative in the early months of the year, as monetary policy supplied most of the restraint.

Sustained Upsurge

. . . The uptrend in Western business activity was quite evident in early '68, despite some sluggishness in mining and aerospace.

Sustained Credit Demand

. . . Western banks outpaced other banks, increasing their loan portfolios and reducing their security holdings to meet credit demand.

Editor: William Burke

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Too Much Good News

The new Chairman of the Council of Economic Advisers recently summarized the GNP statistics for the benefit of a National Press Club audience — and found room for both encouragement and discouragement. Discussing the record $19-billion first-quarter gain, which lifted GNP to an $827-billion annual rate, Mr. Okun commented: "It represents too much good news. And in our present economic situation, too much good news is bad news."

This record advance came about because of substantially increased purchases by business and government purchasing agents, and especially by consumers. Even the sectors which lagged behind earlier levels — inventory spending and net exports — reflected the over-rapid pace of advance. Inventory accumulation was relatively low, partly because heavy consumer purchases forced retailers to clean out their stockroom shelves, while net exports lagged because foreign producers found it easily possible to expand their share of the American market in the present inflationary atmosphere. So, while current-dollar GNP expanded at a 10-percent annual rate during the quarter, the gain was only partly real, since the buoyancy of demand and the continuance of cost pressures led to a 4-percent (annual) advance in the general price level.

Defense and business buying

Defense spending increased sharply during the winter period, rising by $2½ billion to a $76½-billion annual rate. And, although a number of uncertainties have been injected into budget discussions because of the present peace offensive, most Pentagon watchers expect defense costs to keep rising in coming months. Fiscal 1969 Vietnam cost estimates ($29 billion) are already $2½ billion above the January budget figures. Thus, even if hostilities taper off soon, drastic or immediate shifts do not seem to be in the cards for the nation's massive defense budget.

First-quarter statistics from the business sector showed a surprisingly low level of inventory spending and a surprisingly high level of spending in capital facilities. Fixed investment rose over $3 billion during the quarter to an $87-billion annual rate — the largest quarterly gain for the past two years. A gain of that size did not seem likely at the beginning of the year, in view of the prolonged sluggishness in new machinery orders and the prolonged under-utilization of manufacturers' productive facilities. Moreover, capital appropriations were down 4 percent in the final quarter of 1967 after a year-long slide, and at year-end firms with 56 percent of total manufacturing assets reported they had no present need of increased capacity — as against a 50-percent figure in mid-1966.

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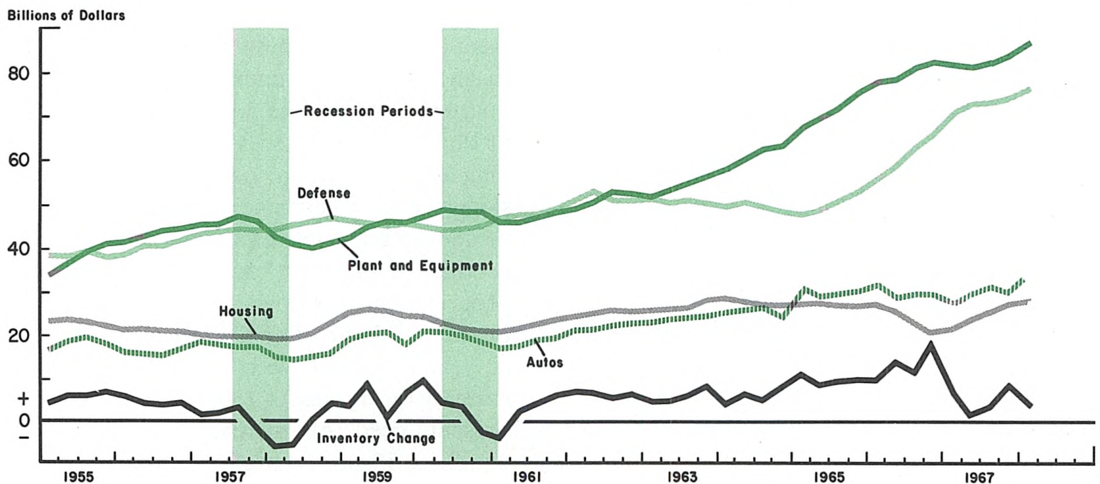
Much of this late-1967 pessimism has now been dissipated, however. Since the capacity utilization rate has now levelled out, manufacturers' profit margins also have stabilized —which means that total profits from factory operations are rising in line with increased production, prices, and sales. Should this situation continue, the earlier signs of sluggishness in the fixed-investment sector may disappear under the impact of industry's increasing confidence over sales prospects and increasing willingness to spend for more efficient facilities.

Inventory strength?

In the inventory sector, the first-quarter spurt in final sales held inventory accumulation to roughly $3 billion, down sharply from the preceding quarter's rate of $9 billion. Yet, substantial strength is still projected in this sector for coming months because of the further accumulation of autos in dealers' hands, completing the recovery from last fall's disruption of auto production — and because of the vigorous accumulation of inventories by steel-using industries, in anticipation of a possible strike following the July 31 deadline in the industry's labor-contract negotiations.

Aside from these exceptional stimuli, the general atmosphere suggests further buildups in stocks. However comfortable the current levels of industrial inventories may be, the change in price expectations of purchasing agents, accompanying the visible change in the price trend, is bound to affect their buying intentions. Purchasing agents, in other words, may respond sharply to the first-quarter experience; in that period, in contrast to the preceding quarter, sales somewhat unexpectedly were quite strong, and inventories somewhat unexpectedly were run down in many areas. Inventory pressures were of course already foreseen because of the special situations in autos and steel, but now these pressures may be accentuated because of the vigorous growth of end-product demand and the strongly inflationary environment of mid-1968.

Over-rapid pace of advance shows up in exuberant spending by business and government purchasing agents—and by ordinary consumers



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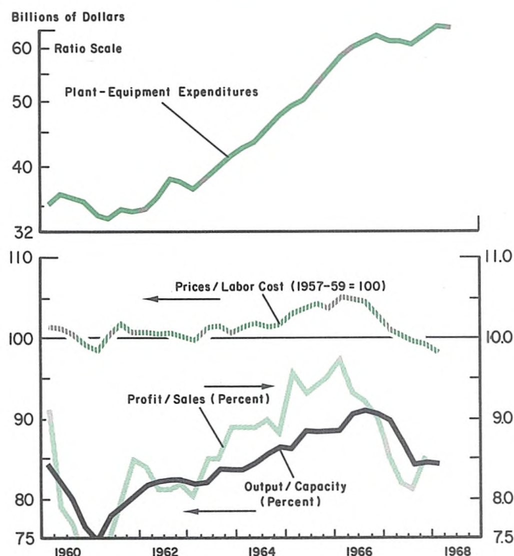
Plant-equipment spending resumes rise despite weak underlying factors



Consumer splurge

Underlying these recent pressures was the first-quarter performance of consumers — a record $17-billion increase and perhaps the most striking (and worrisome) development of the year to date. The increase, which was double the average quarterly increase of the two preceding years, included sharp gains in spending for autos, food, apparel, furniture, medical care, and a host of other items.

The consumer spending boom reflected the record first-quarter increase in personal income, based upon sharp gains in both employment and weekly earnings. Rising earnings were due in part to the February increase in the Federal minimum wage, which affected 7 million workers directly and many millions of other workers indirectly because of their attempt to maintain pay differentials. Non-wage income meanwhile was bolstered by the March increase in social-security payments, although this was offset in part by the larger bite taken out of paychecks by social-security deductions.

Although the spending impact of this rising income was cushioned by a substantial drain into savings, the drain was smaller than it had been during 1967. Specifically, the savings rate dropped to 6.8 percent of disposable income during the first quarter — down from the preceding quarter's 7.5-percent figure.

Housing question mark

Residential construction, which promises to be a question mark this year, rose less than $1 billion to a $28-billion rate in the first quarter, following the sharp year-long recovery from late-1966 slump levels. Housing starts meanwhile continued their steady recovery during the first quarter, reaching a 1.5-million annual rate, or roughly the rate of the 1964-65 period. (Incidentally, the upturn in this industry has strongly stimulated furniture sales, and thus has contributed to the consumer spending boom and the reduction in the consumer savings rate.)

The question mark relates not so much to housing demand but rather to housing financing. With the renewed squeeze on thrift institutions, savings-and-loan associations may be hard put to continue financing mortgages at their recent level of operations. Other traditional mortgage lenders, such as banks and insurance companies, meanwhile may find alternative investments more attractive in view of the continued upsurge in money-market rates. But of course the industry's problems are not simply those related to financing. The rising costs of land and of construction, as well as the existence of several

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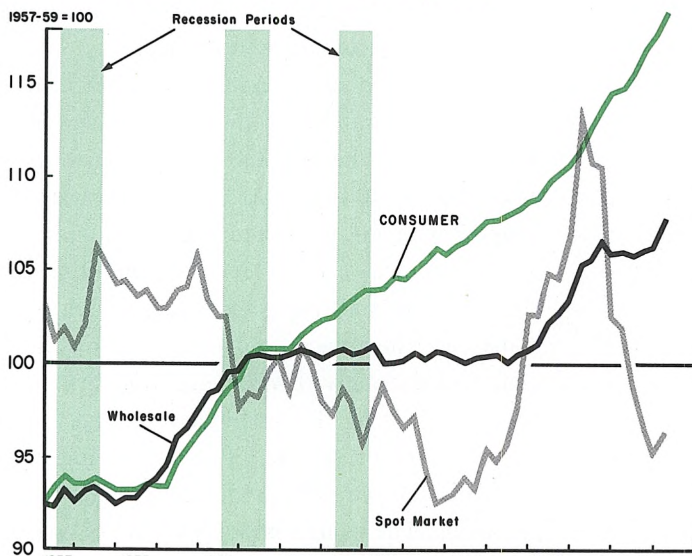
million of young men in Army barracks rather than in the civilian housing market — all dampen the present level of housing demand. But housing experts still assume that, given changes in these factors as well as in the mortgage-financing scene, annual housing starts could rise within a few short years to 2 million units from the present level of 1.5 million.

High-powered autos

In one key consumer sector, auto spending, the early '68 boom saw spending jump $3 billion to a $33-billion annual rate. Both domestic and foreign producers found ready markets during the first quarter, although April's performance lagged somewhat. Sales of Detroit's products rose from 7¼ to 8¼ million units (annual rate) in the winter period, and sales of imports jumped to a 1-million rate for the first time in history.

Unit sales rose faster than dollar volume, reflecting the sharp market penetration of the low-priced imports, whose sales increased about 45 percent over the early '67 level as against a 16-percent year-to-year gain for domestic products. Foreign cars now account for 10 percent of the U.S. market, matching their 1959 market penetration and rising sharply from the 5-percent level of 1962. (Volkswagen, which accounts for about two-thirds of all imports, now has twice as large a share of the American market as does American Motors.)

Wholesale and consumer price indexes rise at accelerated pace in early '68



High-powered imports

The U.S. business boom, as exemplified by the auto import surge, kept the nation's import trade humming during the early months of the year and contributed to a worrisome decline in the trade surplus. Imports have jumped by one-fifth since last fall, and the excess of exports over imports, at a $1½-billion annual rate in the first quarter, was only about one-fifth the size of the export surplus of three years ago.

The steel industry provides perhaps the best case history of the current import challenge, although autos and copper are also striking examples. Steel imports increased about 7 percent last year to 11½ million tons, while domestic shipments were declining about 7 percent to 84 million tons. And now, industry projections for 1968 indicate import sales of 17 million tons as against domestic producers' shipments of 93 million tons. Thus, imports may increase their penetration to 15 percent of the U.S. market, as against only 10 percent in 1965 and 2 percent during the 1950's. This striking performance reflects both the growth of foreign steelmaking

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capacity and the ability of foreign producers to compete in the U.S. market — but it has been accentuated by the periodic waves of inventory building which have accompanied steel labor-contract negotiations ever since 1959.

Good news and high prices

The 1968 record of "too much good news" has led to an acceleration in the pace of price increases. In March, the wholesale-price index was up to 108.3 from last November's figure of 106.2 (1957-59 = 100). In recent months, the farm-food component of the index has reversed the decline experienced last fall as a result of the expansion of supplies at home and abroad, and the industrial component has continued rising in line with the improvement in business conditions. Industrial prices, which moved sideways during early 1967, have risen 2½ percent since last July. Perhaps the most worrisome increases have occurred in those durable-goods categories — such as autos, furniture, and appliances — whose overall stability had contributed to a dampening of price pressures in the early part of the decade.

Worrisome, too, was the pervasive nature of price increases throughout most business and consumer sectors. In January alone, consumers were faced with higher charges for hospital services, medical insurance, postal rates, and taxi fares — and for those who no longer could afford taxi fare, higher prices for shoes. And in March, purchasing agents reported that no price declines were recorded at wholesale that month — the first such month in the last eight years.

All of the evidence — a 4-percent annual rate of increase in prices, a one-fifth increase in imports since last fall, the highest money rates in a generation, and so on — added up to a picture of too rapid growth. These pieces of evidence, true enough, indicate the existence of cost pressures and of bottlenecks in the economy, but they can be explained largely by the step-up in demand since mid-1967. Admittedly, fiscal pressures through a tax increase will not stop these inflationary tendencies in their tracks. In Okun's words, "Today's demand-pull will be tomorrow's cost-push. But the sooner demand-pull is ended, the sooner price increases can decelerate." Consequently, some fiscal moderation of the over-rapid early '68 rate of advance should permit a turn-around — "A decisive first step on the road back from an unacceptable 4-percent rate of price increase to reasonable price stability at full employment."

William Burke

Western Farm Lending

"On the survey date, almost 100,000 Western farmers were in debt to District banks to the tune of over $1.8 billion. These borrowers represented only 5 percent of all borrowers in the national survey, but their borrowings amounted to 16 percent of the national total of $11.7 billion." . . . These and other findings of the Federal Reserve's 1966 survey of commercial-bank farm lending are found in the booklet, *Western Farm Lending*, published recently by the Federal Reserve Bank of San Francisco.

Copies of this and other Federal Reserve publications are available on request from the Administrative Service Department, Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco, California 94120.

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But Not Enough Restraint

The events of the early months of 1968 hurried public policy a little faster in the direction of restraint. Excessive domestic demand and an unfavorable balance in our international accounts — no strangers in the past couple of years—were sufficiently severe these past months to warrant a policy aimed at slowing down the rate of activity. The shift to a more restrictive policy was somewhat one-sided, however, as the monetary authorities supplied most of the restraint.

But even as interest rates approached or surpassed the levels reached in the "credit crunch" of 1966, serious doubts continued as to whether tight money alone, without an accompanying tax increase, was enough to contain inflationary pressures and to preserve the international stature of the dollar. Fiscal policy was still strongly stimulative in the first quarter of the year, although less so than it was in the second half of 1967.

Rx: How to make money tighter

In the pursuit of a more stringent credit policy, the Federal Reserve has used all of its traditional tools of general monetary control. Thus, the discount rate has been raised three times in five months' time, in half-percentage-point increments, finally reaching 5½ percent in mid-April. The first change came at the time of the devaluation of the British pound and was meant to protect the dollar in the world of international finance. Then, a month later, the December 14 directive of the Federal Open Market Committee stipulated that ". . . System open-market operations . . . shall be conducted with a view to moving slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates. . . ." And then, in mid-January, reserve requirements against demand deposits over $5 million were raised by ½ of 1 percent for Federal Reserve member banks, absorbing $550 million of bank reserves. These three policy actions — representing the first round in the shift of monetary policy away from "moderate ease" and towards restraint—amply illustrate the complementarity of the use of general credit controls.

The discount rate was boosted another ½ of 1 percent on March 15 when the dollar came under intense pressure in the London and continental gold markets. By this time, the member banks were showing net *borrowed* reserves of over $300 million under the impact of tightening open-market operations. Last summer, in contrast, member-bank excess reserves substantially exceeded their borrowings, with net *free* reserves at about $300 million.

The most recent increase in the discount rate, on April 19, was accompanied by an increase in the regulated ceiling on interest rates payable by commercial banks on large-denomination certificates of deposit. The maximum rate was raised from 5½ percent — which many banks were actually paying at the time — to 6¼ percent for maturities of 180 days and longer. This last action was taken to enable banks to compete for the volatile time balances which corporations and other large depositors might have allowed to mature without renewal if and when the yield on short-term investments were to rise well above the 5½-percent level.

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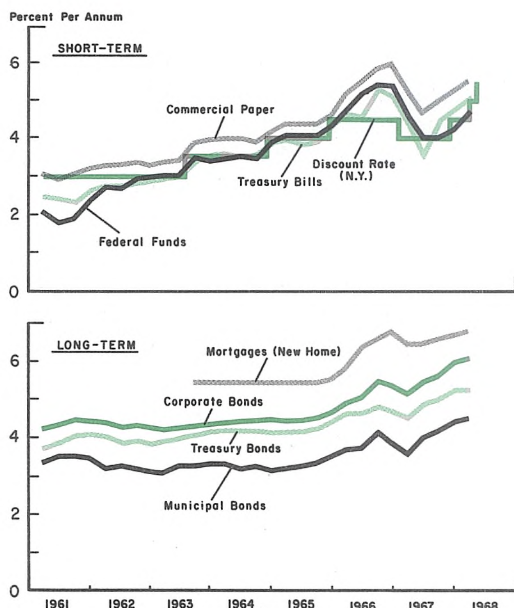
Interest rates: down . . . then up

When the discount rate was raised to 5½ percent, commentators reached far back into the record books to find precedents for such a high rate. In the 1920 inflation the rate was set at 7 percent for all of the Reserve Banks, and in the 1929 stock-market crisis it was boosted to 6 percent by the Federal Reserve Bank of New York. By those earlier standards, today's rate may be considered low; by more recent standards, it is obviously quite high.

The general trend of market-interest rates receded from late '67 highs during the first quarter of 1968. By February, municipal and Treasury bond yields declined 25 and 35 basis points, respectively, from their earlier peaks, while by early March the yield on top-quality corporate bonds fell 17 basis points below the December high. Short-term yields followed substantially the same pattern, with declines ranging from 14 basis points for 91-day Treasury bills to 50 points for 182-day bills.

Market yields react sharply to discount-rate increases



Market yields in all maturities reacted sharply to the March 15 increase in the discount rate. Long-term Treasury bonds regained the 5.49-percent peak of last November, and municipals moved 13 basis points beyond their previous high to 4.28 percent, while yields on 91-day Treasury bills and other short-term instruments rose about 25 basis points. But the subsequent efforts to enter into Vietnam peace negotiations sparked a rally in the prices of Treasury bonds and municipals, so that yields backed down by 20 basis points or more during the early part of April.

In the wake of the April 19 increases in the discount rate and the interest-rate ceiling set by Regulation Q, yields on 91-day bills and other short-term maturities rose by about 25 basis points. Long-term Treasury issues and tax-exempt bonds reacted by moving up by 10 basis points or so, leaving yields still below their mid-March levels. But yields on long-term corporates moved somewhat differently, rising during March and early April to within 4 basis points of their December high. Another striking result of the April 19 increase in the discount rate was a ½-percent increase in the prime rate on commercial-bank business loans, to 6½ percent.

Credit expansion: slowdown

Total bank loans and investments grew at a 6.8-percent annual rate during the January-March period — down from the 7.5-percent rate of the preceding quarter — as a consequence of a slower growth in all asset categories except U.S. Treasury security holdings. The rate of expansion in business loans dropped from 10 to 7 percent over this period. However, the quarterly average hides

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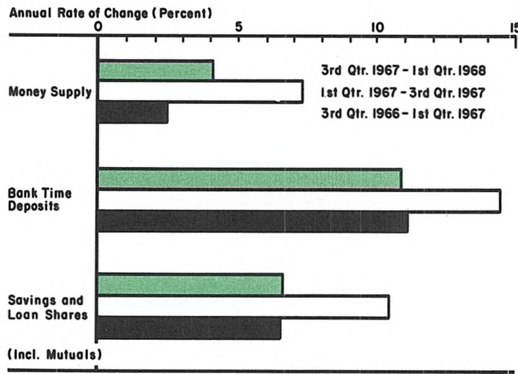
More stringent credit policy reflected in money-supply slowdown



the fact that business-loan demand intensified in March and continued firm into the first half of April.

The money supply grew at a 4.2-percent rate in the first quarter compared to 4.9 percent in the preceding period. But the rate of inflow of time-and-savings deposits, at 6.1 percent in the first quarter, was not much more than half what it was in the last quarter of 1967.

The demands upon the capital market, which in 1967 had driven long-term yields to the highest levels in nearly a century, abated somewhat in early 1968. Corporate flotations, which amounted to $5.3 billion after an $800-million decline from the preceding quarter's level, were smaller than the total for any quarter of last year. But State and local governments, with a $200-million increase in volume to $3.7 billion, posted the largest total since the second quarter of 1967.

These borrowing patterns were reflected in the trends of yields for these two types of securities: the return on outstanding municipals broke through the fourth-quarter peak by the end of March, while the average yield on outstanding corporate issues still remained slightly below the December high. The Treasury was a net borrower of $6.4 billion during the first quarter, but all of this amount was in the short-term area.

Fiscal policy: less expansive?

The Treasury ran a substantial deficit in the first quarter, amounting roughly to a $10.2-billion annual rate on the national-accounts basis. This represented a slight decline from the fourth-quarter figure despite increases of $2.4 billion in the rate of defense spending and $1.1 billion in Federal non-defense spending.

After months of deadlock in which the prospects for the Administration's tax-surcharge proposal alternated between bright and gloomy, the House Ways and Means Committee on May 6 brought out the proposed 10-percent increase on personal and corporate income taxes. This tax-boost action was coupled with a promised cut in Federal spending in the neighborhood of $4-6 billion

The details of the tax-spending package were still on the drafting table in mid-May. Several essential points remained undecided, regarding the way in which the $10 billion of additional revenue is to be raised — through a surcharge based upon existing tax rates or through a rise in the basic tax brackets—and regarding the choice of Federal programs to feel the effects of the pruning knife.

Herbert Runyon

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Sustained Upsurge

The West participated widely in the nationwide business boom during the early months of 1968, as a sustained upsurge in employment, income, and retail sales developed throughout the nine westernmost states. There were some obvious trouble spots, especially in the mining towns suffering from the too-long-prolonged copper strike—and, paradoxically, the aerospace industry turned sluggish too — but in most areas the uptrend in business activity was quite evident across the board.

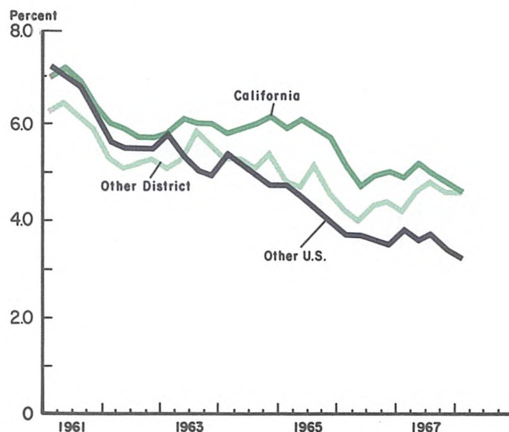
In line with the national pattern, payroll employment increased at about a 4-percent annual rate over the winter quarter. The expansion of employment was marked in practically every industry; however, factory jobs advanced at a pace slightly below that 4-percent average, while building and service trades advanced at a faster pace. The unemployment rate meanwhile declined, also in line with the national pattern. In Pacific Coast states, the jobless rate dropped from 4.7 to 4.4 percent of the labor force over the quarter — but at that level, it still remained substantially above the national rate of 3.6 percent.

Mixed picture in aerospace

But District aerospace employment, in contrast to the national trend, declined by 9,000 workers (a 4-percent annual rate) during the first quarter, reflecting the continued sluggishness of the strategic-weapons and space-vehicle market along with the levelling-out of commercial-aircraft manufacturing. Most dramatically, the sluggishness in this key industry reflects the sharp decline in the West's share of Pentagon spending over the last several years: military prime contract awards in District states, at $8.0 billion in 1967, were only a shade above the 1963 level, whereas spending in other states jumped two-thirds over the same time-span to $29.4 billion.

The outlook for aerospace was brightened, however, by the recent advent of the airbus industry. Orders for over 280 of these tri-jet planes (including firm orders and options) poured in during the last several months, so that total contract volume now stands at $4.3 billion for the two California firms producing the plane. Both versions of the airbus, which should enter service in the early 1970's, will carry over 250 passengers at 600 mile-an-hour speeds over medium-to-long-range hauls.

West jobless rate still high, but follows national trend downward



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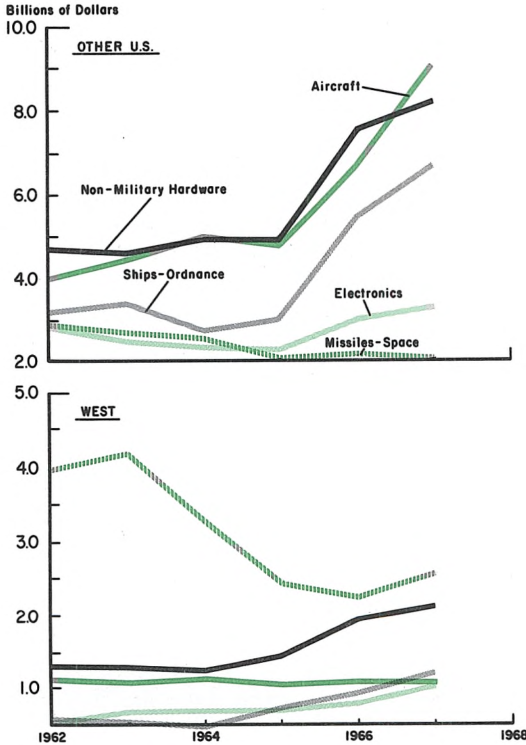
West's share of Pentagon spending drops as missile-space spending sags



Advancing construction activity

Paced by a fairly sharp rise in awards for the construction of heavy engineering projects and a further gain in housing starts, the District generally outpaced the rest of the nation in construction activity during the first quarter. The dollar volume of total construction awards of all types was about a third again as large as in the opening quarter of 1967, and housing starts also showed a further gain, reaching a level fully 70 percent above the year-ago pace, at a 273,000-unit annual rate.

Gains in housing activity were fairly widespread throughout the District, but most notably in the Seattle area, where the housing boom has continued unabated and has thereby prompted some concern over possible overbuilding. In Southern California, starts were slightly below their fourth-quarter level, but were still double their year-ago volume, with multiples accounting for about 45 percent of the total. Even at their recent level, however, starts in the West were still no higher than they were last summer and early fall; in the context of generally firming interest rates and tightening of other mortgage terms, this indicates the possibility of a levelling off in spending in the months ahead.

Rising raw-materials output

Activity in the Western lumber industry quickened during the winter and early spring in response to the higher level of residential building in this country and the continuation of strikes at mills in British Columbia. As demand grew stronger in the face of log shortages, resulting from rising exports to Japan and last summer's fire losses, lumber prices rose by several dollars per thousand board feet. By mid-April, quotations for dry and green fir had reached near-record or record levels, ranging from $18 to $26 per thousand board feet above those of a year ago.

In late April, the industry's smaller producers won a significant victory in their battle to reduce the spiralling volume of log exports to Japan and thereby to alleviate some of the upward pressure on timber prices. Effective April 22, the government imposed restrictions limiting exports of softwood logs cut on Federal timber lands in the Pacific Northwest to the equivalent of 350 million board feet annually. Exports of logs to Japan from Federal lands had reached 650 million board feet in 1967.

The output of crude petroleum continued to rise during the first quarter as production surpassed 1.2 million barrels per day. Over the past year, crude output in Western states

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has risen by almost 20 percent. Further gains in crude production are anticipated primarily from offshore tracts of Federal land in the Santa Barbara Channel. In addition, more potential oil land has been opened for exploration in Alaska with the first offering of state land in the Bristol Bay area.

Western steel producers, after some early-year sluggishness, benefitted from an upsurge in orders in March, which raised their production for the first quarter 7 percent above the year-ago level. By mid-April, regional producers were pouring 11 percent more steel than a year ago. National production edged upward to an all-time high, however, about 22 percent above the April '67 level, on the strength of heavy strike-hedge orders.

Aluminum producers in the Pacific Northwest similarly responded to a sharp upturn in demand resulting from customer hedge-buying in advance of a possible strike in June, but the order inflow also reflected higher activity in several major consuming industries. As a result of the market improvement, aluminum mill prices tended to firm after several months of weakness.

Mining and farming recovery

Operations in the Western copper industry remained at a virtual standstill throughout the first quarter as the strike became the nation's longest walkout in history. The lengthy dispute came to an end in early April, however, as, one by one, the major companies reached agreements with the striking unions.

In arriving at a settlement, the unions relinquished two goals that had deadlocked negotiations from the beginning: their insistence on common contract expiration dates for all company facilities and uniform economic terms for all workers. But in return, the unions received the largest copper pay boost in history: a 6-percent annual increase in wage and fringe benefits (totalling $1.13 an hour over a period of 39-42 months) for workers at Western mines, smelters, and refineries, along with a smaller increase (valued at 75 cents an hour over a three-year period) for employees at copper fabricating facilities. In an effort to offset these higher costs, producers raised their price for electrolytic copper 4 cents above the pre-strike mark to 42 cents a pound.

District farmers' returns from marketings were substantially higher than a year earlier in the opening months of 1968. Receipts advanced 5 percent in the West, compared with a 2-percent gain in the rest of the country. Contributing importantly to these increased returns were higher prices for citrus fruits and fresh vegetables in Arizona and California. Moreover, receipts from marketings of livestock and products were higher than a year earlier in all District states.

District farmers now plan a slight reduction in plantings of major field crops, although the scheduled decline is less than the 2-percent reduction indicated nationally. The anticipated decline in the West stems primarily from a reduction in wheat acreage in response to a cut in acreage allotments. This cutback should be partly offset by an expected expansion in cotton acreage, since the required diversion of cotton acreage was reduced to 5.0 percent from the 12.5-percent diversion rate for the 1967 crop. Substantial increases in acreage meanwhile are planned for several other crops, including a 23-percent expansion in sugar beets. At the same time, supplies of deciduous fruit are expected to be far more plentiful than last year, when unfavorable growing weather cut output.

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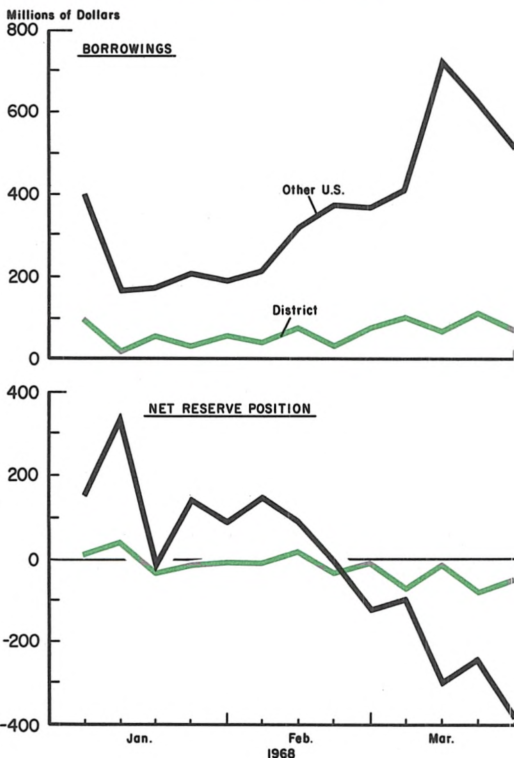
Sustained Credit Demand

Divergence from the national pattern was the most striking feature about Western banks' behavior in the first quarter of 1968. The nation's large weekly reporting banks generally posted declines in total bank credit (loans adjusted plus investments), but the percentage decline recorded by Twelfth District banks was only half that recorded elsewhere. Furthermore, District banks increased their loan portfolios (particularly business and real estate loans) and reduced their security holdings to help meet these contra-seasonal credit demands, at a time when banks elsewhere were reducing their loan portfolios and adding to their security portfolios. The first-quarter District loan expansion, although less ebullient than the upsurge of first-quarter 1966, stood in sharp contrast to the reduction posted in the early months of 1967. (Data in the text and table are not seasonally adjusted.)

In order to cope with stronger-than-seasonal loan demand and higher required reserves, District banks made increased use of the Federal Reserve's discount window. In the first half of the quarter, their borrowings accounted for over one-sixth of total discounting nationwide, and thus they moved to a net borrowed-reserve position, whereas member banks elsewhere remained in a net free-reserve position. But as monetary restraint increased in the last half of the quarter, borrowings at the discount window exceeded excess reserves for banks nationwide.

Required reserves of District member banks increased $90 million between the final quarter of 1967 and the first quarter of this year, partly because of a higher level of deposits and partly because of the January increase of ½ percent in required reserves on net demand deposits in excess of $5 million. As pressure on reserves increased, District banks borrowed heavily from the Federal Reserve Bank, averaging $60 million for the quarter — nearly three times the preceding quarter's average—and experienced a tightening of their reserve position, with net borrowed reserves rising from $3 to $22 million. Major District banks not only made increased use of the discount window but were also net borrowers of Federal funds from other banks and substantial borrowers under corporate repurchase agreements. In total, however, their unusually large sales of Fed funds to Government securities dealers exceeded their purchases from banks, making them net *suppliers* of Fed funds to the tune of over $450 million. (All of the above data are on a daily-average basis.)

Reserve pressure shows up earlier at District banks than at others



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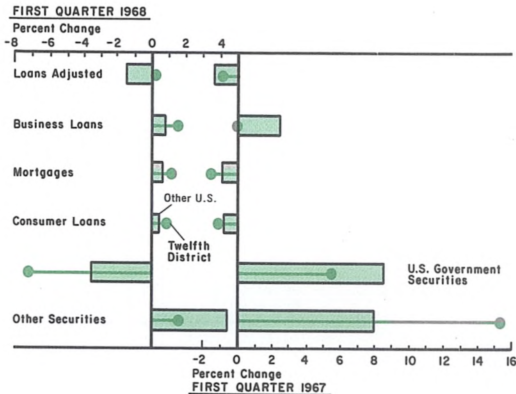
Western banks' loan performance happy reversal of '67 experience



Strength in business loans

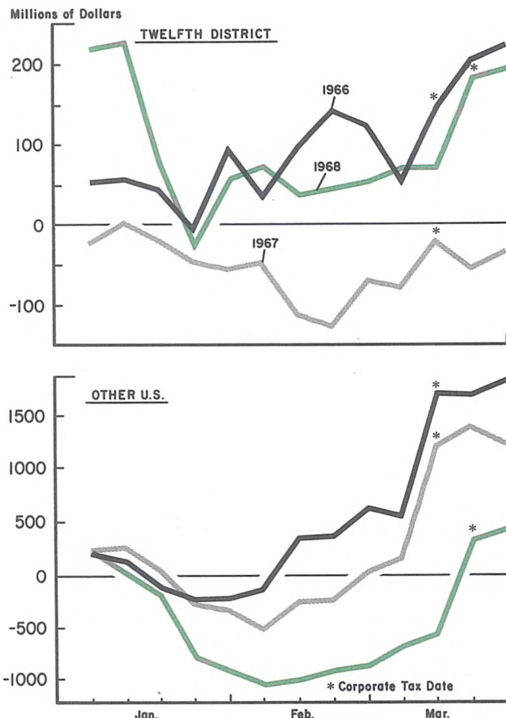
The sustained business demand for bank credit was one of the most noteworthy developments in the first quarter. Business loans outstanding at large District banks remained continuously above the year-end level (except for the final week in January), and the net gain for the quarter reached nearly $200 million. In contrast, business loans at large banks elsewhere declined by more than $1 billion by mid-February, and although volume thereafter increased, it did not exceed the year-end level until the push of tax-related borrowing in mid-March.

Business loan demand in the District was strongest in the durable-goods manufacturing sector, particularly machinery and transportation equipment. Borrower groups in the non-durable goods sector also increased their bank debt, except for seasonal loan repayments in the food, liquor and tobacco category.

Durable goods manufacturers, petroleum refineries, mining, and transportation firms accounted for an unusually large (10-percent) increase in long-term borrowing over the quarter. Since these industry groups also increased their total bank borrowings, their higher volume of term lending probably represents additional financing rather than just a conversion of short-term credits into term loans.

Borrowing costs of Western businessmen at large metropolitan banks were higher in February than in November 1967, the preceding survey period. The increases in average rates—to 6.31 percent on regular short-term loans and to 6.26 percent on revolving-credit loans — reflected the November increase in the prime rate to 6 percent. Further increases in average rates can now be expected on the heels of the recent rise in that basic lending rate.

Western banks show sustained demand for business loans in '68



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Steady expansion in mortgages

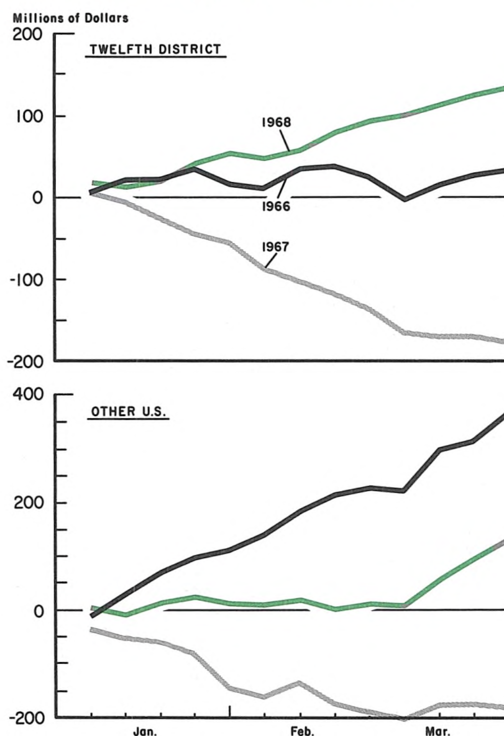
The turn-around in mortgage lending, which began around mid-1967, continued during the first quarter of 1968. Increased demand for residential mortgages, along with the healthier conditions in the housing market resulting from lower housing inventories and vacancy ratios, encouraged banks to allocate a larger proportion of their funds to mortgages. Real-estate loan portfolios jumped $134 million during the quarter, in a sharp reversal of the early '67 performance. In fact, District banks during this period accounted for over half of the entire national gain in real-estate loans.

Mortgage portfolios at Western savings-and-loan associations increased about $280 million during the quarter—again, in a sharp reversal of the year-ago performance. S & L mortgage lending, however, was not as expansive as in late 1967, because of a reduced rate of savings inflows and a steady firming of mortgage rates. Conventional loans on new homes carried a record rate of 7.20 percent on April 1, or about 40 basis points above the average rate nationally.

Lending, investing pressures

Reflecting the strong upsurge in consumer spending, Western banks increased their consumer instalment loans by $46 million during the first quarter, in contrast to a decline in the comparable months of 1967. Farmers also sought more credit from Western banks in early 1968 than a year earlier, probably as a consequence of the reduction in income suffered by farmers last year. In another major sector, District banks last quarter financed an unusually large part of the credit needs of brokers and dealers in U. S. Government securities. During February and early March, when dealer inventories were high and financing needs large, District banks accounted for about one-third of total bank-

Steady expansion in mortgage loans contrasts sharply with '67 slump



financed loans to Government securities dealers.

Financial pressures being what they were, Western banks had little opportunity to rebuild their security portfolios in early 1968, as they did in 1967. Large District banks actually reduced their holdings of U.S. Treasury issues by $419 million, with a $718-million decline in Treasury bills alone. At the same time, they increased their holdings of tax-exempt municipal issues by $123 million, but this was less than one-sixth of the expansion in the year-ago period.

Mixed deposit picture

Large District banks increased their total deposits (less cash items) by $455 million between December and March. Demand de-

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SELECTED ITEMS FROM WEEKLY CONDITION REPORT OF LARGE BANKS IN THE TWELFTH FEDERAL RESERVE DISTRICT

(dollar amounts in millions)

	Twelfth District				U.S. Minus Twelfth District		
		Net Change				Net Change	
	Outstanding 3/27/68	First Quarter 1968 Dollars	First Quarter 1968 Percent	First Quarter 1967 Percent	Outstanding 3/27/68	First Quarter 1968 Percent	First Quarter 1967 Percent
ASSETS							
Loans adjusted and investments[1]	$43,446	−234	− .54	+ 2.07	$160,003	− .90	+ 1.34
Loans adjusted[1]	30,856	+ 50	+ .16	− 1.21	110,723	− 1.55	− 1.31
Commercial and industrial	11,750	+196	+ 1.70	− .25	54,766	+ .80	+ 2.42
Real estate	9,689	+134	+ 1.40	− 1.93	19,575	+ .68	− .99
Agricultural	1,255	+ 47	+ 3.89	+ 2.19	699	− .99	− 1.50
To non-bank financial institutions	1,365	−269	−16.46	−13.07	8,034	−13.08	−14.61
For purchasing and carrying securities	588	− 46	− 7.26	+17.55	6,188	−11.50	− 2.79
To foreign banks	224	− 36	−13.85	−10.77	1,162	− 1.02	−11.86
Consumer instalment	4,551	+ 46	+ 1.02	− .84	11,920	+ .43	− 1.38
To foreign governments, etc.	104	− 10	− 8.77	− 3.23	955	− 2.35	− 8.71
All other	1,871	+ 12	+ .65	+ .37	10,088	− .65	− 2.12
Total securities	12,590	−284	− 2.21	+10.86	49,280	+ .60	+ 8.23
U. S. Government securities	5,168	−419	− 7.50	+ 5.75	21,897	− 3.68	+ 8.49
Obligations of states and political subdivisions	6,292	+123	+ 1.99	+15.52	24,331	+ 4.70	+ 7.85
Other securities	1,130	+ 12	+ 1.07	+16.01	3,052	+ 1.19	+ 8.97
LIABILITIES							
Demand deposits adjusted	14,957	− 86	− .57	− 2.10	61,700	− 4.40	− 3.24
Total time deposits	28,110	+733	+ 2.68	+ 5.44	77,024	+ 1.86	+ 7.91
Savings	15,758	+125	+ .80	− .63	33,362	+ .65	− .06
Other time, I.P.C.	8,421	+671	+ 8.66	+19.36	31,256	+ 2.10	+16.81
States and political subdivisions	2,629	−176	− 6.27	+ 4.51	7,435	+ 9.32	+14.54
(Neg. CD's $100,000 and over)	3,290	+385	+13.25	+27.56	17,264	− .92	+22.39

[1] Exclusive of loans to domestic commercial banks and after deduction of valuations reserves; individual loan items are shown gross.
NOTE: Quarterly changes are computed from December 27, 1967 — March 27, 1968 and from December 28, 1966 — March 29, 1967. Data are not seasonally adjusted.

posits adjusted, with only an $86-million drop, declined less than seasonally. But time deposits, although rising by $733 million, fell considerably short of the gain recorded in the comparable period of 1967. The net inflow of personal deposits slightly exceeded that of a year earlier; passbook savings rose by $125 million, and consumer-type time certificates drew $487 million in net new funds. (Heavy attrition in both these deposit categories occurred in mid-April, however, as withdrawals were made to meet income-tax payments.) On the other hand, public time deposits dropped by $176 million, in contrast to a substantial increase in the year-ago period, and large negotiable CD's rose less rapidly than in the 1967 period.

The District's CD performance still remained noteworthy, for the $385-million first-quarter increase in outstandings represented a net gain of 12 percent—the largest increase of any District. In sharp contrast, New York City banks during this period posted an 11-percent reduction in outstanding CD's. But the heavy mid-April attrition, here as well as elsewhere, set the stage for the raising of interest-rate ceilings on these large-denomination certificates.

Savings-and-loan associations in District states meanwhile recorded a first-quarter slowdown in savings inflows and (according to preliminary reports) substantial withdrawals during April. The net increase in January-March totalled about $400 million—roughly in line with the recent national experience, but less than half the size of the inflow into Western associations in the year-ago period. The heavy April withdrawals reflected the impact of increased income-tax payments (especially in California), the diversion of funds into a rising stock market, and the attractiveness of record yields on alternative market instruments.

—Ruth Wilson and Verle Johnston

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