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Monthly Review

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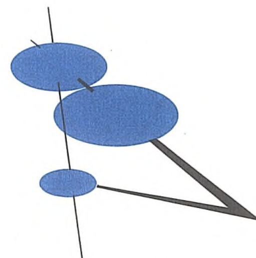
Annual Review Issue



February 1969

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Rising Output—and Prices

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Troubled World

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On the Way to the Bank

Westward Expansion

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This annual-review issue was edited by William Burke and Karen Rusk. Principal contributors to this issue included: William Burke (U. S. business); Herbert Runyon (fiscal-monetary policy); Ernest Olson (balance of payments); Robert Johnston (credit markets); Verle Johnston (U. S. banking); Adelle Foley, Verle Johnston, Yvonne Levy, Donald Snodgrass, and Joan Walsh (District business); Ruth Wilson and Molly Anderson (District banking); Paul Ma and Yvonne Levy (District highlights); and R. Mansfield (artwork). *Monthly Review* is published by the Bank's Research Department: J. Howard Craven, Senior Vice President; Gault W. Lynn, Director of Research.

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Rising Output—and Prices

The U.S. economy recorded an admirable 5-percent gain in real (price-adjusted) GNP last year, but this favorable indicator of economic good health was accompanied by a distinctly unfavorable rise in inflationary pressures. The increase in the general price level—which had been a nominal 1 percent in the early 1960's and 2-to-3 percent annually during the wartime boom of the mid-decade, at length in 1968 reached a worrisome 4 percent.

Explanations for this flaw in the horn of plenty were not hard to find. They were discussed fervently and at length in academia's ivory towers and Washington's marble halls, as well as in corporate boardrooms and country-club locker rooms. (After all, these issues involved not only the theoretical world of Phillips curves, M_1 and M_2, and full-employment budgets, but also the very real world of wage rates, interest rates, and taxes.) Some observers pointed to cost pressures affecting the nation's productive machine, others pointed to the rapid growth of the money supply, and still others pointed to the pressures generated by huge wartime budget deficits.

Year of rising pressures

Cost pressures, as reflected in a tightening employment market and a falling unemployment rate, did appear (at least superficially) to have some connection with the rising price level. During 1968, when the jobless rate dropped to 3.6 percent—the lowest since the Korean war period—prices rose by more than 4 percent. Prices were relatively stable when 5½ percent of the nation's labor force was unemployed in the early years of this decade, but they began to rise as the jobless rate moved towards and then below the "target" rate of 4 percent.

Monetary pressures, as reflected in a rapid rise in the money supply (currency plus checking-account money), also seemed to some observers to have a close connection with the inflationary problem. When the money supply grew by 6 percent or more a year, as it did in 1967-68, inflationary consequences were quite apparent — whereas there was no problem of spillover into price increases in the early years of the decade, when the money supply grew in tandem with the real growth of the national economy. So at least went the theory identified with Chicago's Professor Milton Friedman.

Fiscal pressures, as reflected in the substantial Federal budget deficits of 1967-68, seemed to have an obvious connection with the inflationary problem of this period. The Vietnam episode—like all wartime periods—generated a spending upsurge in excess of the normal potential of the national economy, and an important conequence was a serious upsurge in price pressures. (And an essential cure was the 10-percent tax surcharge and a tightened rein on Federal spending.) The $12-billion deficit of fiscal 1968 (national accounts basis) went hand-in-hand with a sharp rise in the price level, and a shift to surplus in the final quarter of the calendar year in contrast led to expectations of a halt in the inflationary movement.

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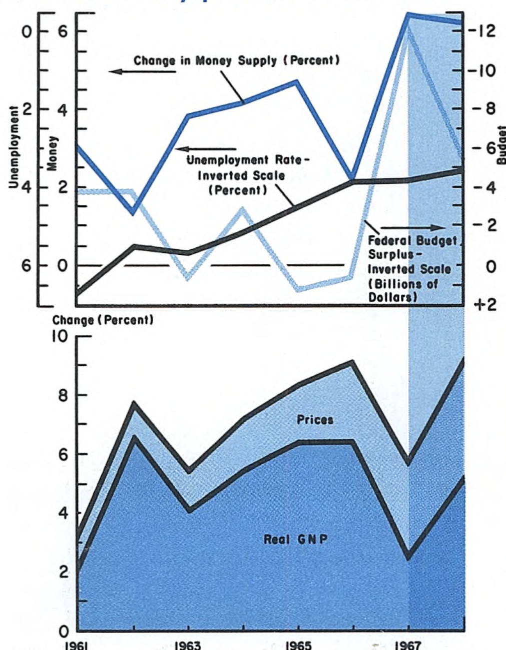
But whatever the reasons, the 1968 scene was marked by a peculiarly thorny problem of inflation which marred an otherwise admirable record of growth. The vastly productive American economy surged ahead as usual, but it encountered some difficulty in containing these inflationary pressures. The scorecard, in any case, showed a 4-percent rise in the general price level—on top of a 3-percent rise in 1967—and fairly widespread advances across the board.

Year of rising prices

Some sectors where prices have risen steadily over time showed more of the same—witness the state-local government sector, where the price level rose by 4 percent in 1968, just as it had in earlier years. Another sector where cost and price increases had long been familiar—residential construction—continued to post an unenviable record in this regard. In fact, the price advance in this sector, which had averaged a high 3-percent in the mid-decade, increased to 5 percent in 1967 and then to 5½ percent in 1968.

GNP rises, but so do prices, as inflationary pressures take over



Business investment, one sector where prices should be kept under control for the sake of the nation's domestic efficiency and its competitive stance abroad, unfortunately joined the price parade too. Following a long sequence of years with relative price stability, the investment sector in both 1967 and 1968 showed a price advance of 3 percent, with motors, machinery and wood products being among the worst culprits. This development, along with the increasing size of U.S. consumer and industrial markets and the impact of strikes and near-strikes on U.S. industrial supplies, contributed to a 23-percent upsurge in the volume of imports, which in turn led to a weakening of the net export surplus in the national accounts.

More immediately apparent was the price escalation in consumer budgets, which showed up in practically all categories of goods and services, and even in areas where a measure of price stability had long been taken for granted. Consumer services, in the past two as in earlier years, posted an average price increase of 5 percent or more. This no doubt could have been expected. But prices of consumer softgoods rose by 3 percent in 1967, and on top of that, by 4 percent in 1968. Moreover, prices of consumer durable goods rose by 1½ percent in 1967 and by 2½ percent in 1968, after a long period when a declining price trend had seemed established.

Year of rising consumption

But whatever their problems, consumers provided the driving force behind the 1968 expansion which generated an enviable 5-percent gain in real (price-adjusted) GNP. Business and government spending, the generators of the boom of the mid-decade, provided strong support to the 1968 boom, but the dominant stimulus was consumer spend-

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ing, which accounted for almost two-thirds of the $71-billion rise, to $861 billion, in total spending.

The consumer buying upsurge was supported by sharp gains in employment throughout the nation. Total civilian jobs rose from 74.4 to 75.9 million between 1967 and 1968, and the number of jobless dropped from 3.8 to 3.6 percent of the labor force over the same timespan. By late year, in fact, the overall rate was down to 3.3 percent, and for married men—the typical family breadwinners — it was down to 1.4 percent.

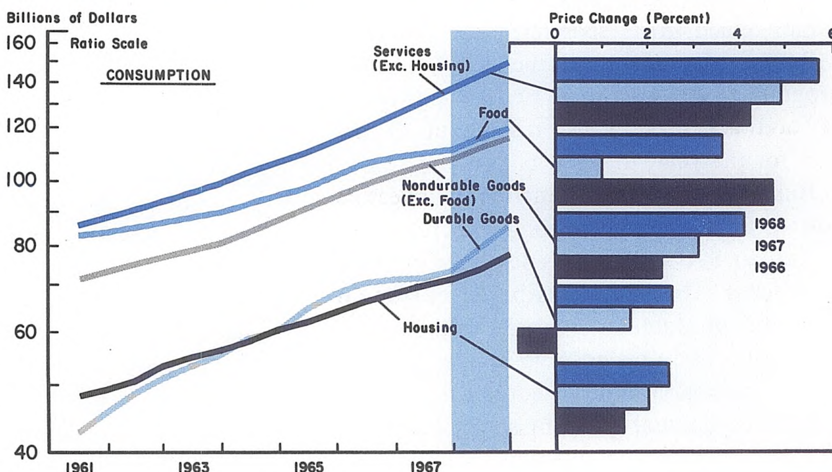
Personal income rose 9 percent during the year to $686 billion, on the heels of both the sharp gains in employment and equally substantial increases in wage rates. In a number of major union contracts negotiated during the year, the median first-year increase in wages and fringe benefits amounted to 7.5 percent, as against 5.6 percent in 1967, reflecting "front loading" or the tendency of wage agreements to concentrate increases in the first year of long-term contracts. In addition, early-'68 increases in social-security benefits and in the minimum wage contributed to the largest upsurge in personal income of the past three years. Much of this was offset in the second half, however, when Congressional enactment of the tax surcharge lifted withholding taxes to the point where they took an extra $6½ billion a year out of consumer incomes.

Money and desire

The boom meanwhile was supported by the average family's willingness to spend. This phenomenon was not always too evident in 1967 and in first-half 1968, when consumers saved close to 7½ percent of their take-home pay. But it was quite obvious in the summer quarter of 1968, when consumers reduced their savings rate to below 6½ percent, in an attempt to maintain their living standards in the face of increased withholdings from paychecks. (Still, the fourth quarter witnessed a somewhat slower spending pace and a higher savings rate.)

But consumers in general, with a lot of money in their pockets and at least a modicum of desire in their hearts, went out and splurged throughout most of the year. (Even when they invested their savings in Wall Street, they fancied such hot-selling items as fried-chicken franchisers and unknown computer-service firms.) They spent over $116 billion on food and beverages and over $76 billion on housing, along with $145 billion on necessary and some not-so-necessary services. Most important, they spent heavily on all types of consumer goods, acting as

Consumer spending splurge accounts for two-thirds of rise in GNP . . . but price increases limit real gains



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though money (if not mini-skirts and Mustangs) were going out of style. The totals were $114 billion for nondurable goods (other than food) and over $82 billion for durables—record totals even after adjustment for substantial price increases. (Price increases amounted to 6 percent for both furniture and apparel, to mention only two obvious examples.)

New-car sales were the best ever. Domestic models, at 8.6 million units, sold below the 1965 pace but were up 14 percent over the 1967 pace. Import sales meanwhile jumped 31 percent to 1.0 million units, and in the process took a record 10.4-percent share of the U.S. market. Still, Detroit's boom seemed to be concentrated in the May-October period, so that new-car inventories began to rise worrisomely in the latter months of the year, reaching 1.44 million at the end of December.

Spending rises elsewhere . . .

Spending gains were also substantial in other GNP sectors, and in some cases were greater percentage-wise than in the consumer area. State-and-local governments increased their spending by the usual 10 percent, to $97 billion. The Federal government, after dominating business trends for several years with a seemingly-inevitable spending upsurge, reined in its spending after midyear, with the enactment of the fiscal-restraint program. Even with that, Federal purchases of goods and services also rose about 10 percent for the year, to $100 billion.

Businessmen in their function as investors posted a surprisingly strong 8-percent increase, to $90 billion, in spending for fixed investment. The boom was based in part on increased production of bricks and mortar, but mostly upon an upsurge in spending for every conceivable type of equipment.

Plant-equipment spending showed a mixed picture when viewed by industry. Durable-goods manufacturers recorded a slight decline in investment spending for the second straight year, reflecting their relatively low (83 percent) rate of utilization of equipment on hand. (Still, perhaps one-eighth of their present capacity could be classified as obsolete and thus due for replacement.) In contrast, public utilities and nonrail transportation firms recorded spending gains of roughly 15 percent, also for the second straight year. In these industries, the long lead times required for delivery of technologically advanced equipment helped maintain expenditure totals; that is, they had to spend heavily in order to keep ahead of their customers' probable requirements of the 1970's.

Businessmen as investors also increased their inventories by $7½ billion—the largest expansion of the decade aside from the Vietnam-related buildup of 1965-66. This expansion reflected the rising prices of materials, plus the desire to beat future price rises, along with the inflation-based expectation of continued increases in business sales. Steel inventories rose sharply during the first half, in anticipation of a strike which never came, but these were worked off without much difficulty during the strong business climate of the second half. But also in the second half, retailers and other businessmen built up substantial stocks in anticipation of heavy sales (they hope) in 1969.

. . . especially for housing

Consumers as investors meanwhile accounted for $30 billion in residential construction—over 40 percent above the low-point of the 1966-67 slump. This record spending figure included a sharp rise in housing costs and a shift to higher-quality housing, along with a strong 15-percent increase in the level of housing starts, to about 1.5 million units. The upsurge centered in multiple-housing, which acounted for 40 percent of total starts in 1968, as against only a 20-percent share at the beginning of

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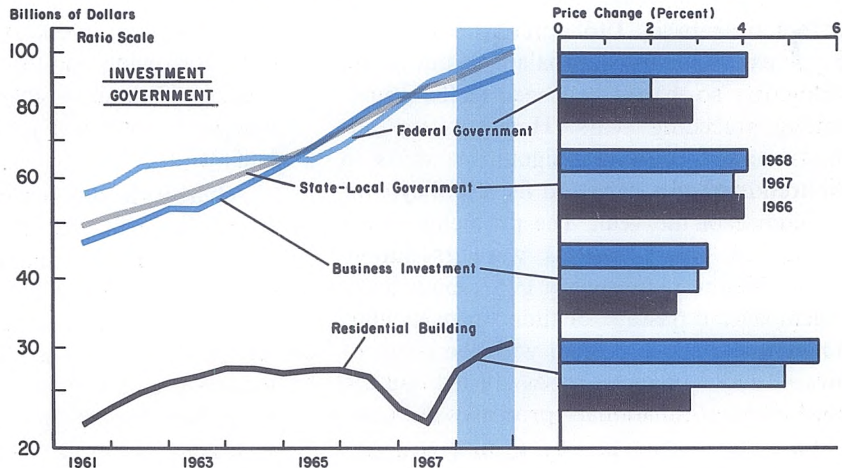
the decade. Apartments, after all, could easily be financed and easily rented; large builders generally were more capable than others of obtaining funds and of avoiding usury ceilings on borrowed funds, and they were attracted to this type of building because of cost pressures for land and labor, the low level of rental vacancies, and the apartment-oriented pattern of demographic growth.

Year marked by sharp recovery in homebuilding and by continued strength in business, government spending



The residential-construction upsurge depended basically on the very strong level of demand, as vacancy rates declined for all types of housing and reached the lowest average level of the past decade. The expansion developed in spite of sharp increases in the costs of construction, of land, and of mortgage money too. The crucial point was that the necessity of expanding the nation's housing stock tended to over-ride the industry's many complicated technical problems.

Altogether, the record of 1968 encompassed heartening gains in production, jobs, and living standards, along with some disheartening economic developments abroad and the erosion of budgets through price inflation at home. A continuation of this price upsurge is not inevitable, given the gradual lowering of price pressures through the imposition of fiscal and monetary restraints. Still, the upsurge reflected the widespread attitude that all actors in the economic drama could spend at a headlong pace without some eventual reckoning. The record of 1969 may prove the fallacy of such reasoning.

The United States, already the wealthiest nation in the world, adds the equivalent of a West Germany to its economic base every five years. With unchanged tax rates, about one-fifth of that growth will be used for federal programs, one-tenth for state and local spending, and the remaining seven-tenths for private purposes. If, as a nation, we decide that the social problems which confront us warrant the devotion of more than one-fifth of economic growth to public programs, there is no economic reason that prohibits our making this choice. But, in the long run, doing so means levying additional taxes upon ourselves by extending the surcharge, closing major tax "loopholes,' or some other form of tax increase.

CHARLES L. SCHULTZE—*Agenda for the Nation*

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. . . So Back to Restraint

Once again in 1968, public policy was expansionary on balance, but more grudgingly so than it had been in the immediately preceding years. However, the annual averages obscured significant shifts in the trends of monetary and fiscal policy over the course of the year. The problems which confronted policy makers were essentially those which were present in 1967, made more urgent by the passage of time. In particular, policy makers had to deal with the onset of several major financial crises abroad and the quickening of inflationary processes at home.

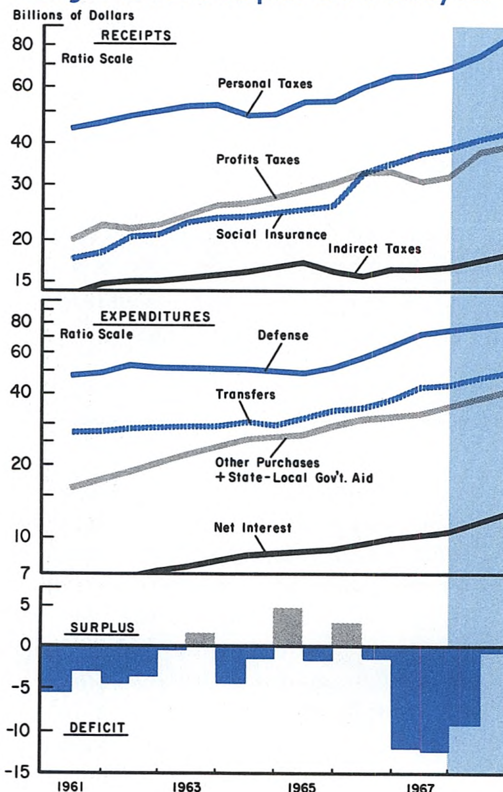
Monetary policy was by turns restrictive, easier, and then again actively restrictive. Fiscal policy was strongly expansionary in the first half of the year, since the Treasury then was a net borrower in a period when it typically repays debt. But subsequent to the midyear passage of the fiscal-restraint package—the Revenue and Expenditure Control Act of 1968—the Federal budget deficit narrowed appreciably, and the budget finally moved to a modest surplus in the fourth quarter. The sharp increase in the demands for credit from all sectors of the economy meanwhile pushed interest rates to new high levels by the end of the year.

Moving toward a surplus

The Treasury set another postwar borrowing record during calendar 1968 with a cash deficit of over $16 billion—up from $10 billion in 1967. During the first half, the Treasury's needs were so pressing that it borrowed a net $4 billion, in contrast to the $8½-billion repayment of outstanding debt in the corresponding six months of 1967. But the scene then shifted dramatically in the second half. The 10-percent surcharge on personal and corporate income-tax liabilities, along with the ceiling on Federal expenditures and authorizations, reduced the Treasury's net cash borrowing one-third below the comparable 1967 figure—about $11½ billion as compared with nearly $19 billion in second-half '67.

Although the tax-increase/expenditure-freeze failed to cool off the economy immediately upon enactment, it did succeed in creating a substantial swing in the Federal budget between the first and the second halves of 1968. The deficit on a national-income-accounts basis—which considers the combined impact of Federal purchases of goods and services, transfer payments, and

Fiscal-restraint package pushes budget toward surplus after midyear



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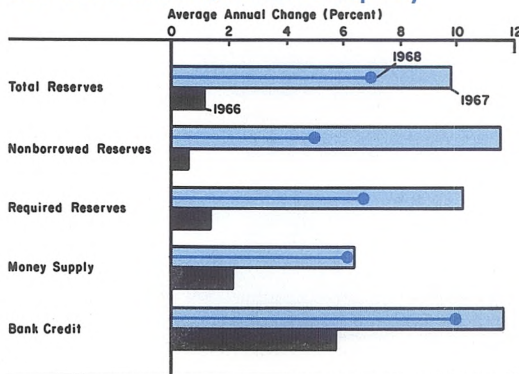
grants-in-aid — amounted to a $9½-billion annual rate during the January-June period, but this dropped below a $1-billion rate in the second half. The Federal budget thus moved from a strongly expansionary force in the first half to a basis of near-neutrality in the second half of the year. While this was considerably better than the $12½-billion rate of deficit in calendar 1967, it was still inappropriate for an economy in which excessive demand was pressing upon fully-utilized resources.

The impact of fiscal policy is expected to be much stronger in 1969 than it was in 1968. This will be felt in a variety of ways. Taxpayers will have to settle accounts retroactively in April for the second quarter of 1968, since no provision was made for that period in the higher withholding schedule that became effective last July. In addition, the social-security tax rate rises in January from 4.4 percent to 4.8 percent of the $7,800 wage base, resulting in a $1.5-billion payroll tax increase for both employees and employers.

The Treasury expects to post a $2½-billion surplus overall for fiscal 1969, which implies a surplus of over $13 billion for the first six months of the calendar year. Most of this surplus will be devoted to the repayment of debt in the second quarter, when revenues reach their heaviest volume. The retirement of Treasury debt will tend to ease the pressure on interest rates in the money market as 1969 proceeds.

Monetary policy tightens somewhat, but bank credit still rises rapidly



Policy tight, yet expansive

Monetary policy in 1968 can be described in terms of variations on the theme of restraint. In January and February, the banking system actually had net free reserves, as member banks' excess reserves exceeded their total borrowings from the Federal Reserve. Policy, however, was moving rapidly toward restraint, so that banks averaged $368 million in net borrowed reserves during the April-June period. Then, in the third quarter, policy eased somewhat, so that banks posted net borrowed reserves of less than $200 million during that quarter. Finally, in November and December, there was a concerted move towards active restraint. All of these changes in monetary policy were influenced by the fiscal situation—by the lack of a restrictive fiscal policy in early 1968, by the enactment of the fiscal-restraint package at mid-year, and by its apparent lack of success in the immediate aftermath.

Monetary policy had started to tighten in November 1967 (after the sterling crisis) and it became progressively tighter as the outlook for a tax increase became dimmer. The Federal Reserve during this period made use of all of the monetary instruments at its disposal.

The discount rate moved from 4 percent to 5½ percent in three steps between November 1967 and April 1968. (But the ceiling rate payable on large-denomination certificates of deposit was increased from 5½ to 6¼ percent for longer-term maturities at the latter time.) Reserve requirements against demand deposits (in excess of $5 million) were raised ½ of 1 percent in January. Open-market operations were used to bring pressure to bear on member-bank reserves, pushing the level of net borrowed reserves past the $400-million mark in April.

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The mid-year passage of the fiscal-restraint package was generally expected to exert an immediate impact on the economy—in fact, some observers even expected a "fiscal overkill." After all, it promised a turnaround of $15 billion (annual rate) in the Federal budget, and thus served as one of the stiffest anti-inflation measures ever taken in our history. A sharp revision in credit-market expectations thereupon developed, and this was reflected in a summer-long decline in money-market rates. A relaxation of monetary restraint was regarded as appropriate in the context of easier money-market conditions, and the discount rate was reduced ¼ of 1 percent in August to keep in step with other interest rates.

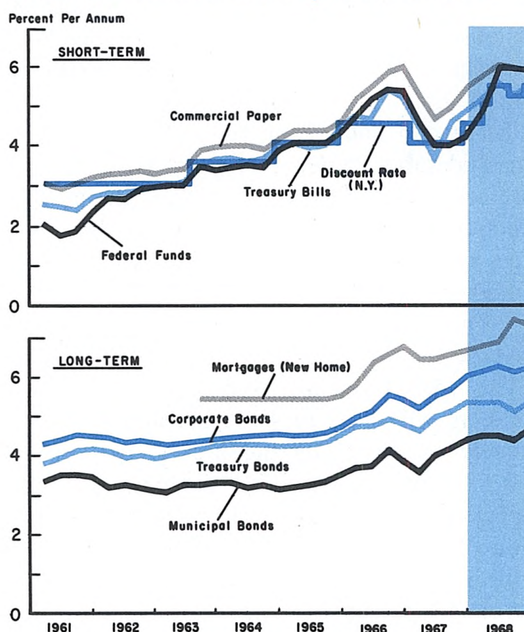
But then, the failure of the tax increase to brake the rate of economic expansion led to a reversal of market expectations during the fall months, exemplified by strong credit demands and rising interest rates. Monetary policy consequently tightened again; the December increase in the discount rate (to 5½ percent) was explained in quite explicit terms as a firming in policy to combat the psychology which regarded inflation as an endemic economic condition.

The growth in the reserve base of the banking system was more modest in 1968 than in 1967, with non-borrowed reserves increasing by 5.2 percent—less than half the 11.5-percent gain of the previous year. However, the money supply grew at an average rate of 6.4 percent in both years, and the expansion in total bank credit was only a little smaller than in 1967—10.2 as against 11.6 percent.

Interest rates rise . . . again

"The highest interest rates in a century" became a familiar and oft-repeated refrain throughout most of the 1967-68 period. The course of both short- and long-term rates was irregularly upward through June 1968, followed by a decline of as much as 30 basis

"Highest rates in a century" becomes familiar money-market tune



points for long-term rates and 40 basis points for short-term rates during the easier July-August period. However, interest rates then started to climb across the board once again, and finally moved sharply higher in December.

In the fourth quarter, yields of 7 percent or more were fairly common for new corporate and utility bonds coming onto the market. The average on outstanding top-quality corporate bonds reached 6.53 percent—up about 30 basis points from the 1967 high and more than 100 basis points (one full percentage point) above the level of 1966. The average yield on top-rated municipal bonds was 4.57 percent in December, which was more than 40 basis points above the 1967 peak and more than 50 basis points over the 1966 high. The average auction rate for 91-day Treasury bills reached 6.278 percent late in December. And at year's end, the yield curve for the entire list of outstanding Treasury issues stood well above the high reached during the 1966 "crunch."

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Troubled World

In the international sphere, the year was marked by a shift in the U. S. balance of payments from deficit to surplus, along with two major developments in the balance-of-payments structure—a sharp drop in the trade surplus and a substantial increase in foreign purchases of private U. S. securities. The year was also marked by several gold and currency crises, which threatened to destroy the existing pattern of exchange-rate parities if not the world payments system itself.

The balance-of-payments surplus, which began to show up early in the year, became incontestable by the end of 1968 as the U. S. accounts shifted into the plus column according to either of the measures now currently in use. This was a welcome break with our deficit-studded past, but how much of this gain can be conserved and strengthened in the years ahead remains open to question.

The gold and currency crises were major shocks that revealed the need for further development of the international financial system. But measures to strengthen it came quickly. The "Gold Pool" — a vehicle for providing support to the private gold market from certain official reserves—was disbanded early in the year, and the "two-tier" gold-price system was established in its place to more or less separate the official from the private market. The Federal Reserve swap network with other central banks was strengthened by a substantial enlargement of reciprocal credit lines, and at different times during the year, special financial arrangements were undertaken in support of the French franc and the pound sterling. As a result of all these actions, the payments system was strengthened and made less vulnerable to future disturbances.

The year also witnessed further progress toward the establishment of special drawing rights in the International Monetary Fund. Negotiations on a proposed amendment to the IMF articles of agreement were completed, and the amendment was approved by the Governors of the Fund for submission to member governments. As of early December, ratifications were on hand from 23 countries of the 67 needed, representing 44½ percent of the required weighted vote of 80 percent.

Towards balance

Following a severe deterioration in the balance of payments in late 1967, the year 1968 began with the President's January 1 announcement of an expanded program for improving these accounts. Major features included a tightening of existing controls on U. S. capital outflows, including the Federal Reserve's voluntary credit-restraint program, and the imposition of mandatory controls over U. S. direct investment abroad. Other parts of the program—not all of which were implemented—included proposals designed to stimulate exports and to reduce foreign travel and government expenditures abroad. Partly because of the measures taken under this program, particularly the tighter capital controls, and partly because of other factors, the balance began to improve early in the year and continued to do so as the year progressed.

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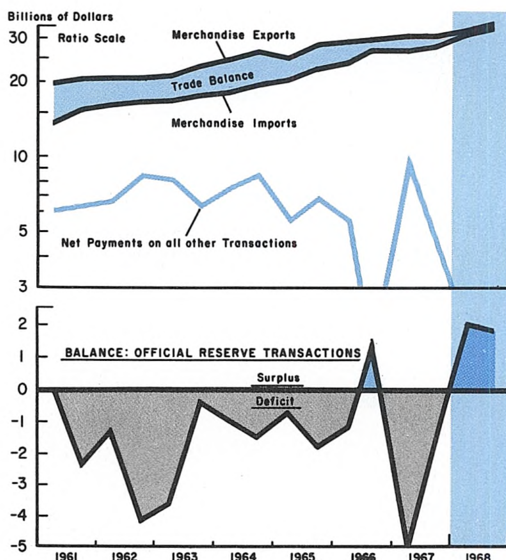
Merchandise-trade surplus weakens, but capital inflow helps U. S. accounts



Preliminary data indicate that at least a modest surplus was achieved during 1968 in each of the measures of the nation's payments balance, in contrast to a deficit of about $3½ billion (by either measure) during 1967. Adjusted for usual seasonal patterns, the liquidity balance moved from a large deficit in the final quarter of 1967 to a small surplus in the third quarter of 1968, and then to a large surplus in the final period of the year. The official-settlements balance, after recording a $1½-billion surplus (seasonally adjusted) in second-quarter '68, maintained a positive (though diminishing) position in each succeeding period. For the first three quarters as a whole, the liquidity deficit was $1 billion less than in the comparable '67 period — as a reflection of heavy foreign official purchases of special Treasury securities—while the official-settlements balance improved by over $3½ billion.

Not all major accounts shared in the improvement reflected in the aggregate balance. The merchandise-trade surplus, which has traditionally been a major help in covering payments on other accounts, degenerated from $4 billion in 1967 to somewhat less than $1 billion in 1968. In 1964, before the current inflation got under way, the trade surplus had exceeded $6½ billion.

Exports rose by 9 percent but imports increased by 23 percent in 1968. The rise in imports was due in part to strikes or strike threats in the copper, aluminum and steel industries, but it was caused even more by the mounting inflation in the U. S. economy. Throughout the year, demand spilled over into the foreign sector, where it was reflected in a continuing expansion in imports of both consumer goods and industrial goods.

The sharp decline in the U. S. trade surplus was paralleled by another major development in our payments structure, but one that contributed to an improvement rather than a worsening of the balance. Foreign purchases of U. S. securities (other than Treasury issues) rose markedly last year, from slightly over $1 billion in all of 1967 to almost $3 billion through the third quarter of 1968 alone. In earlier postwar years, by way of contrast, such capital inflows usually fell well below $400 million.

A capital inflow of this magnitude, of course, has been a long-awaited development. Its realization stemmed in part from the efforts of various business groups to bring about an increase in such investment, generally in line with the recommendations of a 1964 Presidential task force on this subject. The international financial crises of 1968, along with the unsettled political conditions in the Middle East, France and Czechoslovakia, undoubtedly played a part also in stimulating foreign investment in U. S. securities. In addition, the U. S. stock-market boom probably helped to attract investment funds from abroad.

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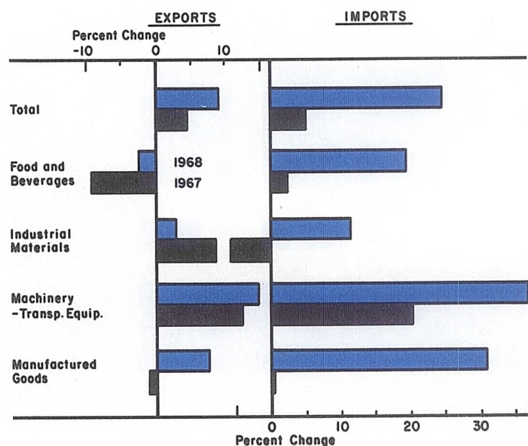
Import boom dominates '68 scene, in both industrial and consumer lines



Gold and currency crises

During the last fifteen months the international monetary system has been subjected to exceptionally severe stresses. The period was marked by four events of major monetary significance: 1) the emergence of a very strong private demand for gold at the time of the sterling devaluation in late 1967, when speculation turned against sterling; 2) a resumption of this speculation in early 1968, which resulted in massive losses of monetary gold and brought on the mid-March gold crisis; 3) the French political crisis brought about by student riots and worker strikes in May; and 4) the speculative onslaught loosed primarily against the French franc and the pound sterling last November. In each instance the principal industrial nations took steps, in large part successfully, to counter these developments.

The first of these disturbances resulted in massive multilateral financial support to help defend the new sterling exchange rate, so as to gain time for the United Kingdom's corrective stabilization policies to take hold. Moreover, arrangements were made later to guarantee the exchange value of part of the sterling reserves of the sterling-area countries.

The second crisis resulted in the termination of the Gold Pool, which had been established in 1961 to stabilize the private market price of gold at the official $35-an-ounce level through the sale and purchase of gold by participating central banks. The Gold Pool was replaced with a two-tier gold market, in which the private market is more or less isolated from the existing monetary gold stock. Under the two-tier system, officially held gold is to be used only to effect transfers among monetary authorities, and such holdings are not to be used to replace any gold which might be sold by a monetary authority on the free market. The official price remains at $35 an ounce, but the price in the private market is now determined by market forces. But there is still some doubt about the treatment to be accorded newly mined gold from the dominant producer, South Africa.

The third (May) crisis, triggered by French student riots and brought to a head by nationwide strike activity, was eventually solved only through the adoption of costly social and economic reforms. During this crisis, the French balance of payments and reserve position weakened, in part because of large outflows of flight capital from France.

The fourth crisis, which occurred in November, involved principally a flight from the French franc and the pound sterling in favor of the German mark. Speculators again became concerned over inflationary tendencies in the French economy and the stability of the franc as France, while still recovering from the spring riots, began to carry out its promised social reforms. At the same time, they became convinced that the mark would be revalued because of the strength of the German balance of payments, particularly its large surplus on trade account. The intensity of speculation in this instance reflected the

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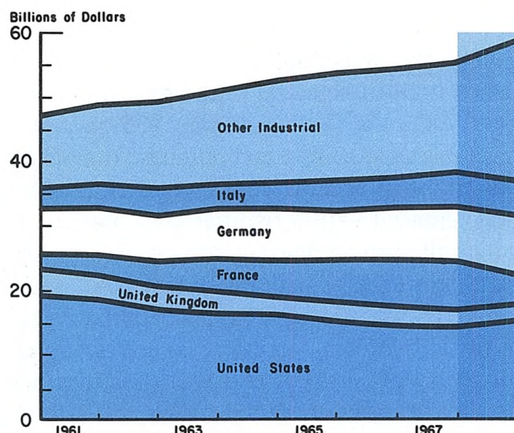
Hectic year ends with drop in French reserves, late '68 turnaround for U. S.



dual incentive to flee from the franc and to profit from an expected rise in the value of the mark.

In the end, the value of neither currency was changed, as adjustment was sought by certain other means. Germany, among other measures, undertook to lower import taxes by four percent and to increase the tax burden on exports by the same percentage. France reinstated exchange controls which had been removed in September, and moreover adopted a number of fiscal and credit measures designed to restrain domestic demand and to improve the balance of payments. In addition, multilateral credits totalling $2 billion were made available to support the franc. The United Kingdom, faced with the sluggish response of its balance of payments to the 1967 devaluation, and vulnerable to the financial winds blowing across the Channel, moved swiftly meanwhile to introduce a number of new restrictive measures—including tighter credit restraints, tax increases of various types, and advance deposits on certain categories of imports.

During this critical period, the Group of Ten and associated industrial nations took other joint actions, in addition to the multilateral financial assistance noted above, to strengthen the payments system against disruptive currency speculation. Most notably, the Federal Reserve's reciprocal swap network with fourteen central banks and the Bank for International Settlements was increased, from $7.1 billion on March 8 to $10.5 billion on November 25. (At the beginning of the previous year, these facilities had totalled only $4.5 billion.) As the year drew to a close, attention was being given to the problem of "recycling" speculative capital flows, so that reserves lost in this way would be returned promptly to the country losing them.

The events of 1968 put the international payments system to a succession of severe tests. These, like other crises of the past quarter-century, were met successfully—to an important degree by using the system's innate capacity to evolve by adjusting its mechanisms to new circumstances and new challenges. Further adaptations of the system are in store for the months ahead as an aftermath of 1968.

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Financing the Boom

Not unexpectedly, the nation's financial markets set another record in 1968, raising some $98 billion to help finance the continued expansion of the economy. The increase over 1967—roughly $15 billion—was larger than that of any other year of the past two decades. Despite continued heavy borrowing by governments, the major new increase in demand came from the private sector, particularly from households.

On the supply side of the market, the pattern was similar to that of 1967. Commercial banks provided a substantial share of the total supply, although not much more in dollar terms than they did in the previous year. In contrast, households became net suppliers of funds directly to markets, after being heavy net sellers of securities in 1967. Otherwise, most sources of supply varied little from their flow-of-funds pattern of the previous year.

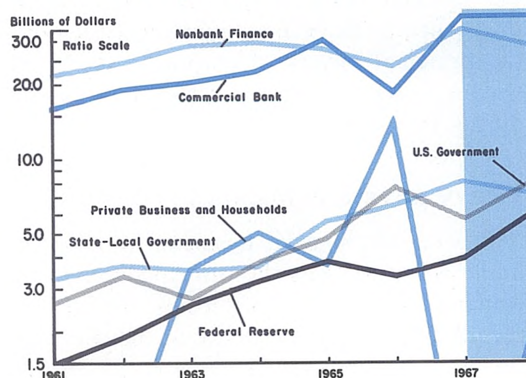
Although the financial markets succeeded in meeting the heavy demands of borrowers, this was not accomplished without paying a price—the price being 1968's record levels of interest rates. In effect, borrowers paid these rates to generate the large volume of funds needed to finance their heavy spending programs. Thus, the price of $98 billions of finance was a year-end high of 7.02 percent for new top-rated corporate bonds, and comparable rates for other securities and loans.

Supplying the money

Commercial banks in 1968 continued to act as the leading supplier of funds, providing some $39 billions, or slightly more than their 1967 total. Yet from a long-run viewpoint, this commercial-bank dominance is somewhat unusual. Throughout most of the past two decades, banks typically supplied a smaller total of funds than the conglomeration of nonbank financial institutions, and they did not take over first place until 1965, when the economy reached full capacity. With the exception of 1966, when restrictive monetary policy slowed the growth of bank assets, the banks have held that place up to the present. Thus this leading role of the banks is perhaps more a sign of the pressures on the financial system than a permanent shift in normal financing patterns—unless of course heavy demand itself becomes the norm.

Nonbank financial institutions, which as a group have been traditionally the principal direct supplier of funds to the credit markets, provided some $28 billion in funds in 1968, down $4 billion from the previous year. Altogether the financial institutions, both bank and nonbank, were the sources of two-thirds

Financial (and other) sectors pressed to meet heavy demands for funds



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of the $98 billion raised during the year. Thus, private financial organizations continued to carry out their basic economic function — providing the bulk of the nation's financial needs.

Nevertheless, in the face of a record volume of funds to be raised, other lenders had to reinforce the private financial sectors. In particular, households switched from being net sellers of $6 billion of securities in 1967 to being net buyers of $7 billion, for a swing of $13 billion. Households recorded their $7 billion of purchases by being major buyers of securities and corporate bonds, although they were also net sellers of corporate stock. Nonfinancial businesses meanwhile provided a larger than usual $5 billion in funds. At the same time, governments at all levels supplied $15 billion, more or less the same as in 1967, although the total included increased purchases of mortgages by federal agencies. Monetary authorities supplied $6 billion — their largest contribution of the last twenty years — and thus provided further indication of the heavy pressure on financial markets.

As would be expected, the reverse side of the financial institutions' heavy lending activity was a substantial increase in their deposit inflows—nearly $30 billion for the banks and about $15 billion for other savings institutions. (In each case, however, the inflows were somewhat smaller than the previous year's flows.) Private insurance companies and pension funds gained some $14 billion in resources. These institutions in turn were the principal buyers of corporate stock, as well as heavy purchasers of corporate bonds during the year.

Heavy private demand . . .

Private nonfinancial business, in 1968 as in earlier years, was the principal source of demand for finance. This sector absorbed a record $36 billion. (This was, however, a smaller share of total borrowing than in the previous year.) Capital expenditures reached approximately $100 billion, an increase of $7 billion over 1967, and higher even than the earlier (1966) record. Gross business saving, while rising by $4 billion to $82 billion, was unable to match the level of capital expenditures, and business thus had to continue to rely upon outside finance, primarily bank loans and new security issues.

Business borrowing from banks was approximately the same as in 1967—about $9 billion. (The previous peak was the $12-billion figure of 1965.) Business also raised $13 billion net in new security issues, or $4 billion less than in the previous year. Gross corporate new issues totaled $21 billion, down from the $24-billion record volume of 1967. A one-third decline in manufacturing issues accounted for almost the entire decline; public-utility issues were about the same as in 1967.

Households accounted for the biggest single source of new private demand. Their borrowing jumped $12 billion for the year to reach $31 billion—a record for this category. The increase was due partly to mortgages, which rose from $10 to $16 billion, and partly to consumer credit, which jumped from $4 to $10 billion. These increases reflected, of course, the sharp recovery in residential construction activity and the boom in consumer durable-goods spending. The $31-billion household demand for funds was not out of line with earlier spending figures, such as the $29-billion level of 1965, but it was nonetheless a major factor in 1968's increased pressure on financial markets.

. . . plus heavy government demand

The financing needs of the Federal government were also a continuing source of pressure on the markets through 1968. Net Federal borrowing was approximately $18 billion—up about one-third for the year—and about $10 billion of this was absorbed

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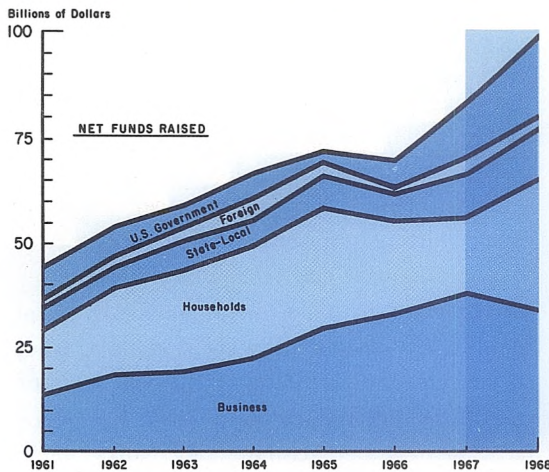
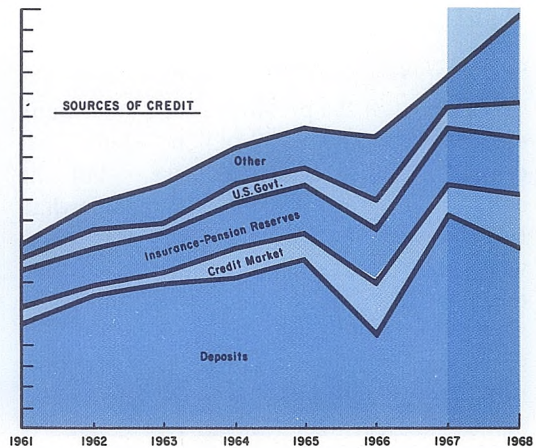
Business sector still heaviest borrower, but consumer and government demands grow even more rapidly . . . credit market again major supplier





by direct issues. Not only was the usual second-quarter cash surplus smaller than normal, but heavy borrowing continued in the second half of the year. A further source of demand was the increased borrowing by Federal agencies, whose non-guaranteed issues rose by about $4 billion, primarily to help finance heavy purchases of private mortgages.

State and local governments meanwhile increased their net borrowing by about $1½ billion, to reach a total of $12 billion for the year. In terms of new bond issues, state and local governments raised slightly over $16 billion, with commercial banks absorbing about three-quarters of that total.

As usual, education issues accounted for the largest share of the total, but their one-third share was almost matched by the transportation-utilities-conservation sector. The share going to industrial-aid issues meanwhile jumped to about 10 percent of the total. These securities, used by local governments to obtain low-cost finance to attract new industry, have increased from $200 million to about $1,600 million in three years' time. But the volume of such issues should be much smaller in the future, since Congress last year passed legislation removing the tax exemption for large issues of this type.

In sum, continued heavy demand for finance by business corporations and state and local governments, along with substantially increased requirements by the Federal government and households, generated another year of record borrowing in the nation's financial markets. Commercial banks were the largest suppliers of funds, as the monetary authorities continued to allow an expansion in the monetary base; but even heavy bank lending was not sufficient to meet all of the demands. The markets had to tap households and nonfinancial businesses for funds and, in the end, also received some support from the monetary authorities. By the end of the year, a record $98 billion was raised for financing the boom. Record highs in market interest rates helped to accomplish this result, but were themselves a sign of the pressures on the financial markets.

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On the Way to the Bank

In many respects, 1968's banking story was a repeat of the previous year's epic. Bank credit rose by about $38 billion—slightly exceeding 1967's record increase — but the composition of bank assets shifted somewhat. Most major lending categories exceeded, while investment portfolios failed to equal, the previous year's gains. Most borrowers also found their credit costs going up, as a succession of increases in the prime lending rate—from 6 percent early in the year to 6¾ percent in December (and to 7 percent early in 1969)—accompanied the rise in market rates of interest.

At the same time, the general rise in yields as the year progressed reduced the attractiveness of the largely inflexible return on time-and-savings deposits, so that the banks experienced a somewhat reduced inflow of funds from consumers, businesses and governmental units.The smaller deposit growth of 1968 also reflected a slower growth in total reserves in response to the monetary authorities' policy of increasing restraint, and an attendant shift from a net free reserve position to one of net borrowed reserves early in the year.

Deposit growth slackened . . .

Total deposits at the nation's commercial banks rose by $30 billion (9 percent) last year in contrast to the $34-billion increase in 1967. With an increase of $9 billion, private demand deposits just about equalled their 1967 gain, as households and businesses both added to their working balances in order to help finance higher levels of expenditures. (The other component of the money supply, currency in circulation, also exceeded the previous year's gain with an increase of $3 billion.) On the other hand, the public sectors generally kept their holdings of demand deposits steady, or reduced them slightly, while shifting more of their funds to interest-bearing deposits and other investments.

The bulk of the gain in the banks' total deposits thus centered in the time categories, which rose by $21 billion (11 percent), or about $4 billion less than in the previous year. Altogether, commercial banks again garnered the lion's share—about two-thirds — of the total inflow of time-and-savings funds into the nation's depositary-type institutions.

Households again accounted for the greater part of the banks' time-deposit increase. (Households, however, preferred to channel their savings into consumer-type savings certificates—up $5 billion over the year —rather than into the lower-yielding passbook accounts.) Businesses, too, made further additions to their holdings of large-denomination time certificates. These CD's increased by about $3 billion at the large commercial banks, despite some run-off at year-end. The problem arose because most banks at that point were paying the maximum permissible rates allowed under Regulation Q—ranging from 5½ percent on 30-day certificates to 6¼ percent on certificates maturing in 6 months or longer — whereas market interest rates had risen above those levels.

Underscoring the banks' deposit growth was a continued, albeit reduced, expansion in bank reserves. As the monetary authorities

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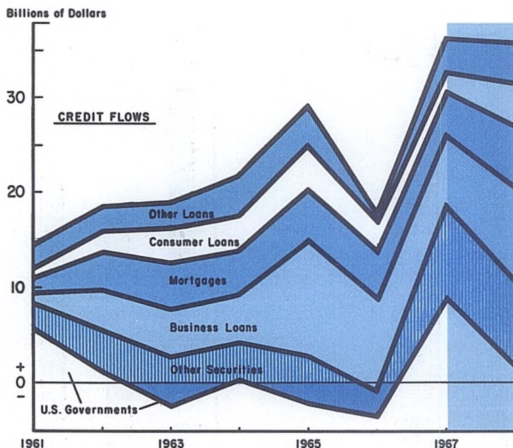
Security holdings grow more slowly, while loans grow at record pace



moved to restrain a credit-fueled, vigorously expanding economy, the rise in total reserves was held down to about 6 percent over the year—substantially less than during 1967—while borrowings from the Federal Reserve discount window through year-end rose by over $500 million. Consequently, the banking system's reserve position shifted from an average of $180 million net *free* reserves during the closing months of 1967 to $278 million net *borrowed* reserves during the final quarter of 1968. The cost of the borrowed funds also increased, as the discount rate, except for one reduction in August, registered a succession of increases from 4 percent in late 1967 to 5½ percent in December 1968.

. . . while lending accelerated

Yet, despite the reduced growth in their deposits and reserves, banks supplied a slightly greater volume of funds to the nation's credit markets in 1968 than in 1967—roughly $38 billion. (Bank-credit expansion was about $5 billion greater than the expansion of domestic-bank deposit liabilities, most of the difference being covered by a substantial increase in Euro-dollar deposits.) Investment portfolios grew by considerably less than a year ago, but loan portfolios grew by a record $27 billion (12 percent). The increase was reflected in most major categories of loans, except loans to farmers and to nonbank financial institutions.

Consumer loans rose by about $4½ billion — double the previous year's gain — with automobile financing accounting for most of the increase. Since commercial banks also increased their outstandings in other consumer-loan categories, they increased their "share" of funds supplied to the consumer-credit market from two-fifths in 1967 to about three-fifths in 1968. Moreover, in their capacity as home buyers, consumers also benefited from an expanded volume of commercial-bank mortgage financing. Real-estate loans rose by $6½ billion, and the banks thus increased their share of the home-financing field from one-fourth to roughly one-third.

Business loans, too, showed an even greater increase than during 1967, with a rise of about $9 billion. The demand for credit was fairly widespread, as 15 of 27 major industry groups borrowed more from their banks than they did the previous year. Trade concerns (both wholesale and retail), the metals industries, textile and apparel manufacturers, public utilities, the construction industry and various service industries accounted for the bulk of the increase in business borrowings. In some cases, most notably public utilities, the increased borrowing from banks was accompanied by a stepped-up volume of debt offerings in the bond market.

But while the nation's banks made more money available to businesses, they also charged more for this accommodation, posting a succession of increases in their lending rates even to top-rated borrowers. In line with and beyond the successive increases in

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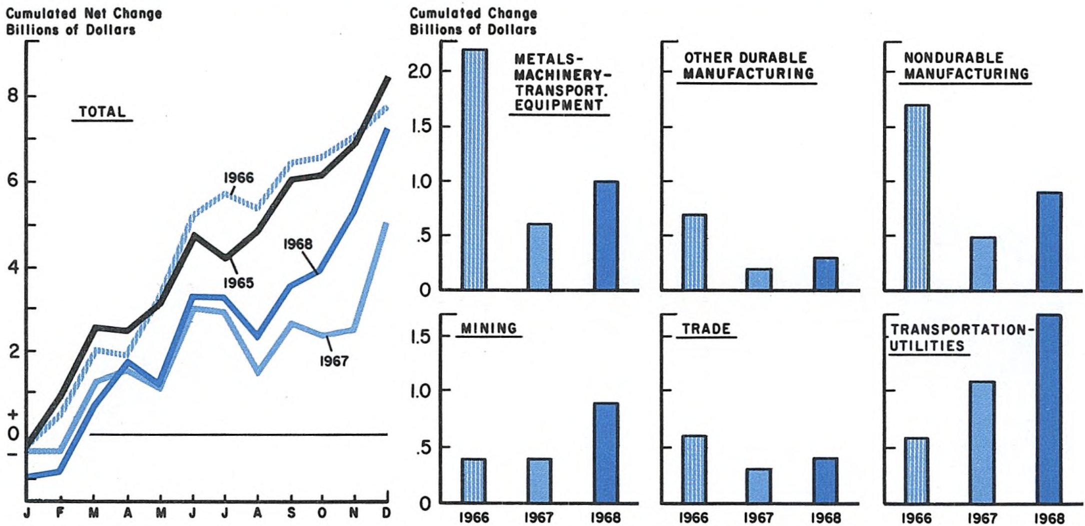
Business loans expand sharply, despite rising cost of money . . . demand for credit widespread, as most industries borrow more



the discount rate—the price the banks themselves must pay for borrowed funds from the Federal Reserve—they increased their lending rate to prime borrowers from 6 percent late in 1967 to 6¾ percent in December of 1968, and raised it further to 7 percent early this year. As a consequence of this development, the weighted average rate on short-term business loans, as reported by banks in 35 centers throughout the nation, rose from 5.96 percent in late 1967 to 6.61 percent in 1968's final quarter.

In sharp contrast to the strong expansion in loans, commercial-bank acquisitions of Federal, state and local government securities moderated during 1968—just the reverse of the situation in 1967. Bank holdings of U. S. Government securities increased about $2 billion for the year, with most of the increase concentrated in longer-term issues. Bank acquisitions of tax-exempt issues, at $9 billion, lagged behind the exceptionally large 1967 increase, but still represented a substantial addition to their portfolio of earning assets.

One traditional measure of bank liquidity —the ratio of short-term Government securities to deposits — held steady at about 6.6 percent between year-end '67 and year-end '68. But a second liquidity measure — the loan-deposit ratio — deteriorated slightly between the two dates, rising from 64 to 65 percent.

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Westward Expansion

The Western economy enjoyed strong growth in nearly all sectors during 1968. Significant gains were recorded in employment, in retail sales, and in the production of both raw materials and finished industrial goods. Several major industries lagged behind their national counterparts—aerospace manufacturing, for instance — but regional business generally shared fully in the national boom.

Thirty million Westerners . . .

Population in Twelfth District states approached 30 million during 1968, leaving just about 170 million other people in the rest of the nation. Although the West's growth rate has dropped since the earlier postwar years, the region is still expanding at twice the national rate, welcoming nearly one-half million new residents last year.

District population has doubled in the last quarter-century and has grown by 10 million since 1954—and by over 5 million since the 1960 Census alone. In a characteristic pattern of diversity, the District includes both the nation's most populous state (California, over 19 million) and its least populous, although geographically largest, state (Alaska, about ¼ million).

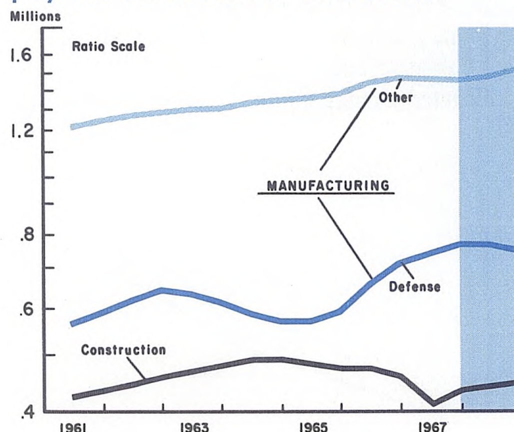
Personal income in the region jumped to more than $111 billion during 1968. This represented an annual increase of more than 10 percent, and was somewhat larger than the advance recorded elsewhere. Among other features, Nevada doubled its rate of income increase from 6 percent in 1967 to 12 percent in 1968.

In keeping with the increased income, retail sales in the West rose by roughly 9 percent, slightly higher than elsewhere, despite signs of weakness toward the end of the year. But along with this went the largest increase in retail prices since the Korean War era, the West paralleling the 4-percent national rise.

. . . can't be wrong

The Western employment picture was brighter in 1968 than in 1967, with the unemployment rate falling from 4.9 to 4.5 percent of the total labor force. (Even so, the regional unemployment rate remained almost one full percentage point above the national rate.) California was primarily responsible for this improvement, as its jobless rate dropped to the lowest level of the past dozen years.

Construction employment gains, but payrolls decline in defense sector



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Employment gains were larger in the West than in the rest of the country, but the District labor force also grew at a greater rate—3.3 percent as compared with 1.8 percent nationally. Total civilian employment rose by 3.7 percent in the District as against 3.1 percent in the nation. However, farm employment was off 0.5 percent in the District and 0.7 percent in the nation.

The West recorded greater-than-national employment gains in all but two sectors — mining and state-local government. Construction employment increased by 5.1 percent in the District as against 1.7 percent in the nation, reflecting the faster pace of residential building activity in the West. Although manufacturing employment also rose faster in the District—1.9 percent as against 1.5 percent nationally—this occurred in the face of a continued decline in aerospace-manufacturing employment.

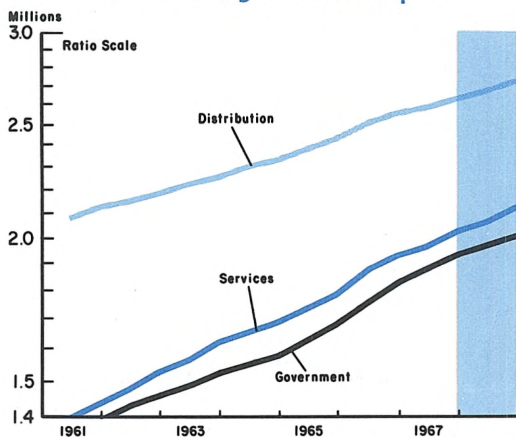
Aerospace—down to earth

Employment at Western aerospace firms dropped by more than 40,000 during 1968, following three years of gains. Jobs in this industry, which had risen sharply during the Vietnam buildup and commercial-aircraft boom, peaked at 756,000 in early 1968 and then started to decline. Elsewhere, aerospace employment rose modestly during the year.

The declines were greatest at California plants, and were caused primarily by cutbacks in the civilian space program and by transitional problems in commercial jet-aircraft production. For some District firms, production was reduced because of completion of major space projects and the uncertainty over future NASA funding. For others, scheduling was hampered by the transitional situation in commercial-transport manufacturing, since production of current models is being reduced while facilities are being prepared to produce the "air bus" and "jumbo" jet—the workhorses of the 1970's.

Sluggish activity in this industry also reflected a 3-percent decline, to $7.8 billion, in the volume of military contracts awarded to District firms in fiscal 1968. Pentagon contract awards for missiles and space systems actually rose during this period, primarily for research-and-development work, but these gains were more than offset by cutbacks in electronics and communications work and in shipbuilding.

Long-term uptrend continues in trade, service, government jobs



Construction—flying high

Housing activity was strong in the West in terms of both housing starts and the dollar volume of new construction. The District homebuilding industry followed up its 1967 recovery effort with a sharp 34-percent gain in housing starts in 1968. (This was double the rate of gain recorded elsewhere.) Single-family housing accounted for over half of the 268,000 housing starts, but the greatest relative gains (here as elsewhere) occurred in apartment construction.

The strength in basic demand stemmed from population growth and in-migration—albeit at slower rates than in earlier years—and from a sustained rise in employment and incomes. Buyers, not deterred by the rise in

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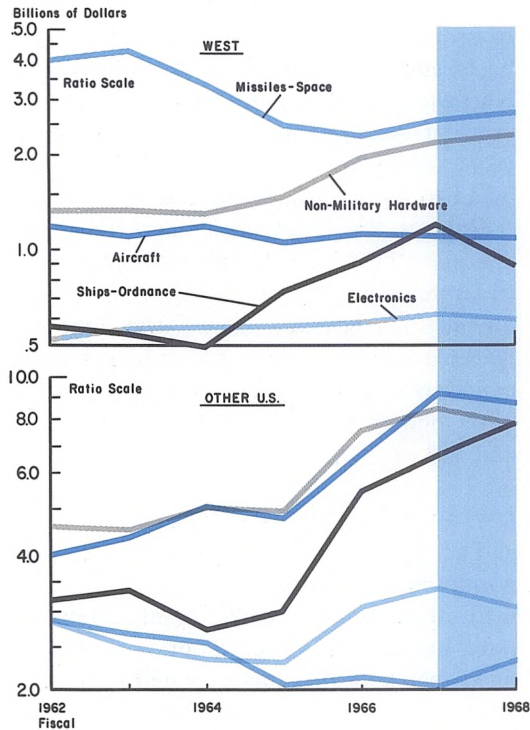
West shows only partial gains in military contract awards



mortgage interest rates to record levels, contributed to a rise in home sales and to a reduction in the inventory of unsold housing.

While homebuilding in the District showed exceptional strength, other types of construction activity revealed less vigor, possibly reflecting such factors as higher borrowing costs and the growing public resistance to rising taxes and the expanded bond-financing of public facilities. Thus, outlays for all nonresidential and heavy construction projects increased only about 4 percent during the year, considerably below the pace maintained in the rest of the nation.

Lumber and steel—in demand

The Western lumber industry raised its production sharply in 1968, reversing the pattern of decline of the previous two years. Even so, prices at the mills moved steadily higher as the year progressed, since lumber output still lagged behind the heavy pace of orders from homebuilders, the Pentagon, and foreign buyers.

A strike at British Columbia mills helped to bolster domestic orders early in the year, and a booming national economy sustained the order pace from then on. By late December, prices for Douglas fir and ponderosa pine had reached levels 40 to 50 percent above those prevailing a year earlier, while key plywood items were selling for prices more than double those of the year before. Two major producers finally tried to halt the price spiral by lowering prices on certain grades of plywood, but their efforts proved futile as other producers continued to post further increases.

The strong construction pace helped the Western steel industry to raise production about 5 percent during 1968, to a record high of 7 million tons. But Western producers, like their counterparts elsewhere, had to deal with a costly labor settlement, calling for about a 6-percent annual boost in wage and fringe benefits over a three-year period—the largest wage increase in the industry since the 7½-percent settlement of 1956. Producers at first attempted to offset the increased labor costs with increased prices, but they were not completely successful in this, largely because of increasingly severe import competition. U.S. imports of steel mill products during the year reached a record high of 18 million tons—up from 11 million tons in 1967—and the Western market received a major share of this total.

Agriculture—generally better

Record highs were set by the Western farm sector in terms of cash receipts to farmers, output of crops, and net income. However, these accomplishments were not shared by farmers in all District states, as agricultural conditions varied somewhat widely.

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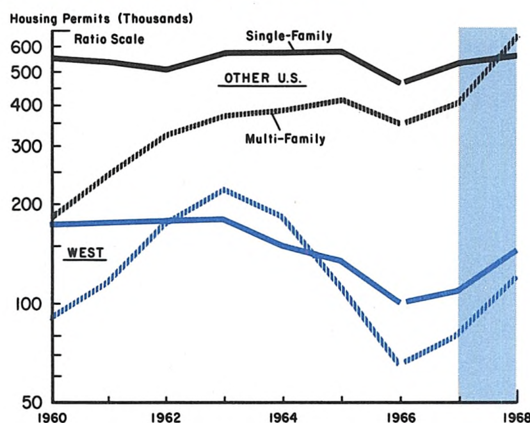
Housing goes up twice as fast in West as in rest of nation



Returns from marketings flowed to District farmers at a record pace during 1968. District cash receipts were 7 percent higher than during 1967, compared with a 2-percent advance in the rest of the country. Nevertheless, increases were generally modest in most states except California, where receipts jumped by 10 percent over the year. In addition, an exceptionally large late-year increase in returns from cotton marketings boosted Arizona's cash receipts by 7 percent.

California's improved prospects were largely due to an expansion in crop returns —up about 15 percent for the year, on the basis of recovery in the output of deciduous fruits, as well as larger crops of cotton, sugar beets, and processing tomatoes. In the Pacific Northwest, on the other hand, unfavorable growing weather hurt the deciduous fruit crop, and declines in acreage and yields combined to reduce wheat crops in that area.

Returns from livestock marketings advanced rather modestly, but these gains were widespread throughout the District and not limited to only a few states. The improved livestock situation resulted from higher prices and heavier marketings of fed cattle, which offset poorer returns for such items as eggs and turkeys.

Metals, oil—striking it rich

The Western copper industry, resuming normal operations following the April settlement of the prolonged 8½-month labor dispute, immediately raised its price for the refined metal to 42 cents a pound — 4 cents above the pre-strike mark. Demand for the metal picked up considerably both here and

INDEXES OF INDUSTRIAL PRODUCTION — TWELFTH DISTRICT

(1957-59=100)

INDUSTRIAL PRODUCTION	1960	1961	1962	1963	1964	1965	1966	1967	1968
Copper	112	119	127	128	129	140	146	98	125
Lead	76	99	105	103	96	93	118	97	79
Zinc	86	97	101	98	93	89	96	87	68
Silver	91	105	105	105	102	114	131	100	84
Gold	99	92	86	86	85	116	135	104	99
Steel Ingots	102	111	100	117	132	138	140	136	142
Aluminum	101	97	107	118	135	150	165	195	205
Crude Petroleum	95	96	96	97	97	102	112	122	140
Refined Petroleum	104	108	111	112	115	120	122	128	138
Natural Gas	112	121	127	144	148	147	158	147	165
Lumber	98	95	98	98	108	107	103	97	106
Douglas Fir Plywood	120	132	142	160	177	180	180	172	186
Canned Fruit	111	116	121	108	141	109	135	100	133
Canned Vegetables	101	89	106	95	100	97	113	114	120
Meat	107	111	112	115	126	126	130	129	131
Sugar	105	107	113	120	138	137	132	116	132
Creamery Butter	112	120	119	103	103	96	85	105	114

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abroad, especially in the latter part of the year, and the price was raised another 2 cents to 44 cents a pound in early 1969.

Silver production declined slightly, partly because of a strike at a major Idaho lead-silver mine, and also because of the lingering effects of the copper strike, which curtailed the amount of silver produced as a copper by-product. Speculative interest in the metal as a currency hedge, plus the Federal government's termination of silver-certificate redemption, pushed the price of the metal to a record high of $2.56 an ounce around mid-June. The price dropped to $1.94 in late December, but this was still considerably above 1967 levels.

New productive capacity enabled the aluminum industry to achieve a record output despite a strike at a Washington reduction plant. After the signing of a new labor contract, the industry raised its price for both ingot and fabricated products, but inventory liquidation by customers then led producers to discount prices after midyear. However, heavy demand in the final quarter permitted a second 1-cent-a-pound increase in January 1969, bringing aluminum ingot to 27 cents per pound, its highest level in over a decade.

The demand for the petroleum products of Western refineries rose by more than 7 percent in 1968, mainly on the strength of the increasing requirements of auto, truck and jet-transport users. The major petroleum news of the year, of course, was the discovery of what may be one of the world's largest oil fields on the Arctic slope of Alaska. But for its 1968 petroleum supplies, the District relied primarily upon increased production from Southern California and Southern Alaska fields, although it also obtained about 20 percent of its crude from sources outside the District.

The output of the U.S. economy in 1968 was almost equal to the sum of the output of the United States in 1960 and *the output of the Soviet Union in 1968. Since 1960, the spendable income of the average American—after allowing for price increases and taxes—has increased by nearly one-third. By any reasonable standard, this has been a phenomenal performance, which few would have dared to predict a decade ago.*

Yet, today, the mood of the nation is more troubled, and our internal problems seem more stubborn and incurable, than was the case a decade ago. The coexistence of growing affluence and growing social ills has led many to the conclusion that the vision of general prosperity as a solvent of social ills has been a chimera—that GNP has turned out to be a false god.

KERMIT GORDON—*Agenda for the Nation*

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Accelerated Expansion

Western banks started 1968 at a pedestrian pace and ended the year in a fast sprint. In the first six months, loans rose modestly on a seasonally adjusted basis, and bank holdings of securities declined slightly. Then at mid-year, the tempo of credit demands accelerated, particularly from the business sector, and banks expanded credit at a rapid rate throughout the rest of the year. Altogether, Twelfth District banks posted a $6-billion (12 percent) total gain in bank credit, on the strength of a 14-percent increase in loan portfolios—double the 1967 gain—and a slower rate of growth in security portfolios.

District banks experienced a substantial $2-billion (10 percent) gain in demand deposits during 1968. Furthermore, they posted a $4-billion (13 percent) gain in time-and-savings deposits, slightly exceeding 1967's favorable rate of increase. However, the picture was mixed in the latter category — passbook savings showed only a small gain, while consumer-type certificates continued to increase and public time deposits posted a record gain. In addition, banks ended the year with record high outstandings of large-denomination certificates of deposit, even though CD rates bumped up against the legal ceilings in May, June, and again in December.

Because of the favorable deposit flow, the liquidity of District banks was not depleted in 1968 to the extent that it was during the rapid loan expansion and subsequent credit squeeze of 1966. At year-end 1968, the loan-deposit ratio at large District banks was 71.0 percent, moderately above the 1967 figure but still below the 72.4-percent figure reached in the 1966 tight-money period. Furthermore, the banks' ratio of short-term securities (U.S. Governments and municipals) to deposits was 5.6 percent at the end of 1968, slightly better than the ratio at the close of 1967.

Net operating earnings of District banks soared to record highs in 1968 (according to preliminary reports) despite the near-record cost of borrowed funds during most of the year. Banks boosted their earnings on the basis of a substantial expansion of assets and a sharp increase in rates of return from both their security and loan portfolios. They raised the rate on loans to prime business customers in April by ½ percent, to 6½ percent, and they adjusted other loan rates upward from there. After a September reduction, they lifted the prime rate again in December—to 6½ percent and then to 6¾ percent. Earnings began to suffer in the fourth quarter, however, because of sharp increases in the costs of borrowing—whether from other banks, with the Federal-funds rate rising to above 6 percent, or from the Federal Reserve, with the discount rate returning to 5½ percent. To counteract this cost squeeze, banks throughout the nation consequently started 1969 with another boost, to 7 percent, in the prime business-loan rate.

More discounting

District member banks were under greater reserve pressure in 1968 than in the preceding year, as a number of indicators attested.

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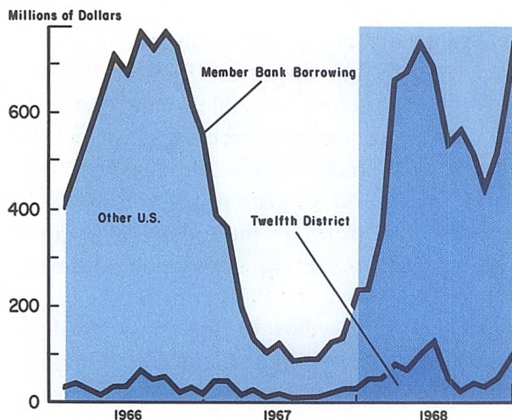
Member banks resort increasingly to Federal Reserve discount window



They resorted increasingly to the Federal Reserve discount window in the first part of the year and again in December, and they borrowed more heavily from other banks through Fed-funds purchases in the last half of the year. Moreover, banks sharply increased their borrowing from corporations (repurchase agreements) and from their own foreign branches (Eurodollars).

In 1968, the reserves which District banks were required to maintain with the Federal Reserve rose $375 million above the 1967 level, due to increases in both demand and time deposits—and to the January increase in reserve requirements. Excess reserves rose only slightly, to $33 million, but borrowing from the Federal Reserve bank averaged $66 million, more than three times the 1967 average. In 1968, therefore, District banks' borrowed reserves exceeded their excess reserves by $33 million—ranging from a high of $67 million in the second quarter to a low of $3 million in the third quarter—in contrast to a small net free reserve position in 1967. (All data in this section are on a daily average basis.)

For 1968 as a whole, large District banks reduced their Fed-funds purchases by about one-third, to $283 million. (Federal funds are the idle balances of banks on deposit with Federal Reserve Banks.) Banks practically recorded a stand-off in their Fed-funds transactions during the first half of the year, but then, in response to the firmer monetary policy, they posted net purchases of $560 million during the last six months. But District banks relent a large proportion of these borrowed funds to securities dealers, and such sales averaged $419 million for the year—only slightly below the record 1967 volume. In 1968, West Coast banks maintained their number-two rank—next to New York City banks—as a money-market center for Fed-funds transactions, in both interbank and securities-dealer categories.

More deposits

Western banks posted a 10-percent gain in total deposits during 1968, on the basis of a substantial increase in demand deposits and a strong second-half performance in the time-deposit category. Seasonally-adjusted demand deposits (excluding U.S. Government and interbank deposits), with gains in practically every month, grew faster in the West than in the rest of the nation over the full year. On the other hand, time-deposit growth was quite modest during the January-June period, as individuals withdrew funds to meet Federal and (steeply higher) State income taxes, and as corporations ran off their large-denomination CD's to take advantage of the more favorable rates offered on other money-market instruments. However, these deposits then accelerated sharply during the second half, so that for 1968 as a whole, time-deposit growth almost matched the high 1967 rate.

In the fourth quarter alone, time deposits of states and political subdivisions increased by a record $1 billion. This figure reflected

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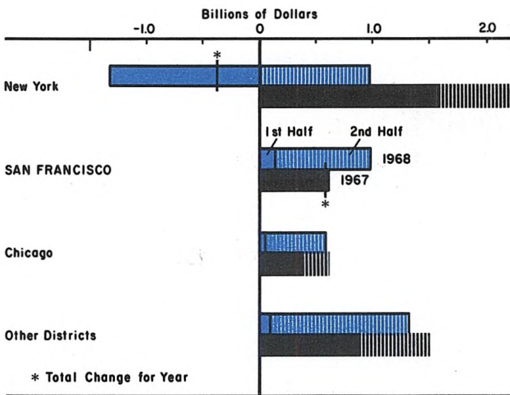
CD expansion concentrated at Twelfth District banks



the investment of some of the proceeds from the heavy second-half marketing of municipal issues. Also, large-denomination CD's increased by $800 million net during the July-December period. When CD offering rates hit Regulation Q ceilings in the second quarter and again at year-end, District banks suffered relatively less attrition than New York City banks, and their net gain over the year far exceeded that of any of the other Federal Reserve Districts.

Yet, in the face of this excellent deposit performance, banks faced 1969 with worries about heavy outflows of deposit funds into the credit markets — disintermediation. In order to combat such outflows, most major banks in California started the year by introducing new forms of individual savings accounts, mostly of the passbook open-account type, with 5-percent interest rates compounded quarterly or even daily.

Business borrowing skyrockets . . .

Twelfth District commercial banks added $2 billion to their business-loan portfolios in 1968, which represented a gain of 16 percent, well above the national rate of increase and higher even than the District's record 1966 pace. On a seasonally adjusted basis, District business loans showed some early-year weakness but then posted a 2-percent average monthly gain throughout the last four months of the year.

Practically every major business category increased its borrowing in 1968. In the durable-goods sector, machinery and primary-metals manufacturers were responsible for the largest share of the increase; whereas food, liquor and tobacco processors were the largest borrowers in the nondurable-goods sector. Mining, retail, and wholesale trade all relied more heavily on bank credit throughout the year. In the public utilities sector, transportation accounted for the largest borrowing increase. As in most years of strong business-credit demand, District banks reduced their holdings of bankers acceptances. Foreign business loans also showed a small decline in 1968.

The average cost of short-term business borrowing remained high during the year, but fluctuated from a low of 6.32 percent in February to a high of 6.85 percent in August, reflecting the several changes in the prime rate. (These rates are based upon the quarterly survey of rates charged at large banks in major metropolitan centers). However, the December increases in the prime rate occurred after the last survey date (November), so that business borrowers were faced with the prospect of paying even higher rates as the year ended.

. . . and mortgage financing jumps

Both District banks and savings-and-loan associations sharply increased their volume of mortgage lending during 1968. At commercial banks, a $1-billion increase in real-estate loan portfolios was more than double the 1967 gain, while at the S&L's, a $2-billion increase in outstanding mortgage loans topped the previous year's gain by over 30 percent. Throughout the District, S&L mortgage lending exceeded the growth in savings

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—which actually lagged behind the 1967 pace—with the difference being financed by increased borrowings from the Federal Home Loan Banks and by resources released by a reduction in S&L liquidity requirements. In addition, S&L's increased by $275 million their commitments to make future loans, bringing total commitments at year-end to $665 million—the highest level in three years.

In spite of the large increase in the volume of funds channeled into housing, mortgage rates rose to record levels during 1968. Yields on conventional new-home loans reached 7.50 percent and higher (7.75 percent in Seattle), considerably above the national average. Meanwhile, increases in yields on a wide range of money-market instruments placed bank and S&L savings and certificate accounts at a competitive disadvantage and contributed to a reduced growth in savings. (The net increase in District S&L savings, although in excess of $1 billion, was 60 percent below the 1967 figure.) A renewed rise in market rates at year-end increased the spread between the bellwether 90-day Treasury-bill rate and the S&L passbook-account rate to about 80 basis points —over double the spread at the time of the 1966 "crunch"—and thereby created fears about the future availability of mortgage money.

SELECTED ASSET AND LIABILITY ITEMS OF WEEKLY REPORTING LARGE BANKS

(dollar amount in millions)

	TWELFTH DISTRICT				OTHER U. S.
	Outstandings	Net Change			Net Change
	Dec. 31, 1968 p	Dec. 27, 1967 to Dec. 31, 1968		Dec. 28, 1966 to Dec. 27, 1967	Dec. 27, 1967 to Dec. 31, 1968
		Dollars	Percent	Percent	Percent
Total loans and investments	$49.671	+5,170	+11.62	+ 8.64	+11.08
Loans adjusted and investments[1]	49,327	+5,647	+12.93	+ 8.27	+11.76
Loans adjusted[1]	35,242	+4,436	+14.40	+ 4.87	+12.32
Commercial and industrial loans	13,672	+2,118	+18.33	+ 7.41	+11.19
Real estate loans	10,487	+ 932	+ 9.75	+ 3.27	+10.82
Agricultural loans	1,244	+ 36	+ 2.98	+ 5.78	+ .42
Loans to nonbank financial institutions	1,670	+ 36	+ 2.20	+ .55	+10.28
Loans for purchasing or carrying securities					
To brokers and dealers:	776	+ 325	+72.06	+11.39	+27.75
To others:	259	+ 76	+41.53	+ 8.28	+ 9.67
Loans to foreign banks	229	— 31	—11.92	—12.46	+14.65
Consumer instalment loans	5,141	+ 636	+14.12	+ 2.81	+12.91
All other loans	2,331	+ 358	+18.14	+13.72	—16.59
Total investments	14 085	+1,211	+ 9.41	+17.40	+10.47
U. S. Government securities	5,904	+ 317	+ 5.67	+ 6.02	+ 2.83
Obligations of states and political subdivisions	7,030	+ 861	+13.96	+25.51	+17.97
Other securities	1,151	+ 33	+ 2.95	+43.15	+10.25
Total deposits (less cash items)	49,299	+5,388	+12.27	+ 9.17	+ 9.77
Demand deposits adjusted	16,999	+1,956	+13.00	+ 5.53	+11.17
Time and savings deposits	30,586	+3,209	+11.72	+10.90	+ 7.67
Savings deposits	15,853	+ 220	+ 1.41	+ 3.28	— .05
Other time deposits IPC	9,683	+1,933	+24.94	+27.51	+15.25
Deposits of states and political subdivisions	3,837	+1,032	+36.79	+ 8.22	+20.57
(Neg. CD's $100,000 and over)	3,876	+ 971	+33.43	+22.21	+ 8.72
Capital accounts	3,809	+ 170	+ 4.67	+ 3.78	+ 7.95
Total assets/liabilities and capital accounts	61,088	+5,811	+10.51	+ 9.46	+13.13

[1]Total loans less loans to domestic commercial banks and net of valuations reserves

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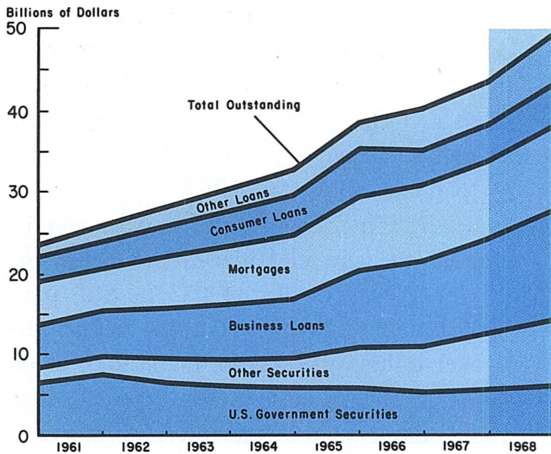
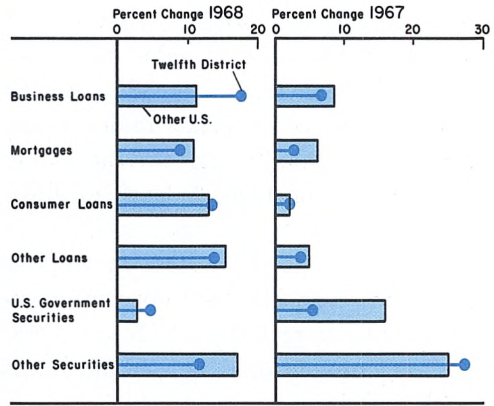
Large District banks post gains in all major assets in 1968 . . . but loans increase at a faster rate than securities





. . . while other uses gain

As 1968 progressed, Western consumers tended to discard their cautious 1967 attitude toward bank credit. Record high levels of personal income, a favorable response to the 1968 auto models, and the widespread inflationary psychology all stimulated an $800-million (14 percent) increase in consumer instalment credit—nearly three times the 1967 gain. Credit-card programs, overdrafts, and other special credit plans continued to expand among District banks, and more customers came to utilize these convenient means of borrowing as time went on.

In 1968 also, District banks increased their loans to agriculture—about a 3-percent gain—and meanwhile expanded their loans to non-bank financial institutions and to security brokers and dealers.

Despite the year's heavy loan demand, District banks increased their holding of U.S. Government securities by 6 percent and of other securities by 11 percent. Even so, this allocation of funds fell far short of the 1967 increases of 9 percent and 31 percent, respectively, in those two categories.

Banks ended the year with expanded portfolios of Treasury notes and bonds maturing within one year. They also posted an increase in over-5-year maturities, and this tended to offset a reduction in intermediate-term issues.

After sharply reducing their holdings of municipals during the first half, Western banks bought these tax-exempt issues at an unprecedented rate in the remaining months of the year. This increased investment was due both to a sharp turnaround in yields and to a very heavy second-half calendar of new municipal issues. The calendar was augmented by an effort on the part of California political subdivisions to meet a deadline under a November-ballot proposition which (if passed) would have severely restricted the future issuance of municipal bonds.

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Western Calendar

The unique regional industries of the Twelfth District—ranging from sugar beets to supersonic tranports—virtually all posted records of solid growth and expansion in 1968, and they are looking forward to more of the same in 1969. The following is a review of some of the major projects initiated or planned during 1968.

CALIFORNIA

Aerospace California aerospace firms reflected the slower rate of growth of defense and space spending in 1968. Nonetheless, their order books remained relatively full when civilian orders were combined with Federal projects.

The defense shopping list in California included the following: $456 million for Poseidon fleet ballistic missiles; $158 million for P-3C Orion anti-submarine aircraft; $124 million for Minuteman III intercontinental ballistic missiles; $95 million for Maverick air-to-ground non-nuclear missiles; $89 million for AM56 Cheyenne combat helicopters; $59 million for the Nerva nuclear rocket propulsion system; $55 million for TOW anti-tank missiles; $43 million for the Chaparral air defense system; $34 million for Phoenix air-to-air missiles; and $30 million for the experimental communications-satellite program. In addition, two California-based firms are working on designs for the Navy VSX carrier-based anti-submarine airplane, a program which is expected to cost $1 billion.

NASA awards to California firms during fiscal 1968 amounted to $1.3 billion, including at least $100 million for four improved Apollo spacecraft for post-lunar missions.

In the commercial field, producers of the mammoth "air-bus" passenger transports are counting on orders for 500 of these aircraft through 1975 and 1,000 through 1980. One firm has received orders for 181 L-1011 planes, valued at over $2.7 billion, and another company has received orders for 138 DC-10s (including options), with a total value of over $2.2 billion.

Metals Three major steel producers announced building plans in 1968: a $35-million expansion of cold-rolled sheet production capacity at a Fontana mill; a $2-million coil-coating facility in Los Angeles; and a $4-million steel-strapping plant in Pittsburg. A steel fabricating plant is also under construction near Antioch.

A new multi-million-dollar aluminum facility will be redesigned at Corona to expand production of premium-grade aluminum castings for the aircraft and aerospace industries.

California also is becoming an important center for the manufacture of the all-aluminum beverage can. A multi-million-dollar plant for producing this product will soon be built in Hayward.

Petroleum After spending $603 million to acquire the Federal offshore leases in Santa Barbara Channel, petroleum firms were somewhat disappointed with initial drilling results, as production failed to exceed 1,200 barrels/day per well. (To compound their problems, almost that much oil escaped daily from a disastrous offshore oil leak that occurred early in 1969.) Still, estimates for 1970 predict total production of 100,000 to 150,000 barrels a day.

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Refinery projects scheduled for completion in 1968 included a 20,000 b/d crude capacity installation in Los Angeles and a 25-percent expansion program in Wilmington. Planned for completion in early 1971 is a $50-million project at Oleum to include a 30,000 b/d unicracking processing unit, a hydrogen-manufacturing unit, and a gasoline reformer.

Chemicals The largest Western producer is building a 450-ton-per-day chlorine and caustic-soda chemical plant in Pittsburg as part of a $20-million expansion and modernization program. The same firm has doubled polystyrene production to more than 100 million pounds per year.

Construction Major skyline-changing projects (planned or underway) included the $635-million Redwood Shores residential community in Redwood City; a $500-million marina residential complex south of Imperial Beach; the $250-million Calabasas Park residential community in the Santa Monica Mountains; a $200-million city development in Orange; a $197-million senior-citizen complex in Agoura; the $150-million downtown revitalization in Oakland; the $100-million International Market Center in San Francisco, and a $100-million industrial park south of Los Angeles. A hotel construction boom in San Francisco is expected to add some 6,000 new rooms within the next few years.

Many hospital modernization and expansion plans were announced. In San Francisco alone more than $140 million will be spent on hospitals during the next five years. Throughout California large construction projects were announced—$80 million will be spent on Kaiser Foundation hospital facilities; $65 million will provide a hospital with ambulatory care and basic-science centers at Stanford; $28 million will be spent on a new general hospital for San Francisco; another $28 million will go for the Veterans Administration Hospital in San Diego; and two $20-million complexes at Corona and San Diego will help complete the picture.

Shipping The San Francisco Bay Area is becoming increasingly important in containerization, as a 140-acre marine terminal with a $30-million complex of container ports rises out of the bay at Oakland.

Another 75-acre terminal for containerships will soon be built at San Francisco's India Basin. An announcement has been made of two other projects, involving about $130 million in containership construction.

Public Utilities Early 1969 completion is expected for the $600-million San Luis Dam, with its water-distribution system and hydro-electric plant of 424,000-kilowatt capacity, and for the $136-million Oroville Dam, keystone of California's water project with a 644,000-kilowatt capacity.

Operations began at the San Onofre nuclear generating station near South San Clemente, an $87-million plant with a capacity of 450,000 kilowatts. Construction started on a $100-million hydro-electric power plant north of Castaic and on an $86-million steam-generating unit in Contra Costa County.

Plans were anounced for construction of two nuclear plants of 1-million-kilowatt capacity each near Diablo Canyon in San Luis Obispo County. Total cost will be about $330 million.

One utility firm plans a $50-million project to drill for geothermal power in an area of geysers, about 80 miles north of San Francisco.

Transportation Approximately $50 billion may be spent on California transportation facilities through 1985. This includes $30 billion for road building and traffic surveillance and control, $3 billion for airport improvement, $2 billion for port expansion,

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and $8 to $12 billion for rapid transit systems centering on Los Angeles, San Francisco and San Diego.

Construction of some 430 miles on California's share of the interstate freeway system during 1969 and 1970 will cost an estimated $1 billion. The 75-mile Bay Area Rapid Transit system (BART) is progressing, albeit somewhat slowly because of shortage of funds. Two other Bay Area speedy transportation plans are under study: a $350-million bus-and-rail transit plan for the West Bay linking BART at Daly City to San Francisco airport and the Santa Clara County line; and a $117-million, 100-mile-per-hour sky train from downtown San Francisco to the airport.

A $110-million expansion program for San Francisco International Airport will double its passenger capacity and allow for handling 400-passenger jumbo jets upon its completion in 1973. At Los Angeles International Airport a $410-million revenue bond issue will provide two passenger terminals for the jumbo jets and other large transports.

Recreation Californians and out-of-state visitors alike have chosen Los Angeles and Orange counties as their favorite recreation center, with San Francisco coming in second.

More than 9 million people visited Disneyland in Anaheim during 1968, and spent more than $60 million there.

An added California attraction is the new 85-acre Marine World near Redwood City, which opened in July. The first phase of the $9 million project includes whale and porpoise shows, a glass elevator into a shark tank, and a bird sanctuary. Future plans include motels, boatels, and banquet facilities.

Congressional establishment of the 58,000-acre Redwood National Park in northern California should provide an added attraction. The new park is composed of a northern unit in the Mill Creek area of Del Norte County and a southern unit in the Redwood Creek area of Humboldt County. The corridor connecting the two includes a 33-mile stretch of beach. The legislation authorized the appropriation of $92 million to provide for Federal acquisition of private property as well as state-owned land in the area.

PACIFIC NORTHWEST

Aluminum The industry's expansion program, launched in the mid-60s, gained further momentum with the announcement of construction of a new reduction plant. Scheduled for completion in 1972, the $80-million 100,000-ton plant will be located south of Goldendale, near the John Day Dam in Washington.

Several ongoing projects reached various stages of completion in 1968. At the reduction plant at Longview, Washington, the first of three 40,000 ton-per-year potlines came on stream, while a new cable plant also was completed at the site. New potlines also began operation at reduction plants at Wenatchee, Ferndale, and Tacoma, Washington. The completion of these and other projects added 213,000 tons of new capacity to re-

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gional facilities during the 1966-68 period —more than one-third of the total new capacity added nationally—and another 400,000 tons is scheduled for completion by 1972.

Forest Products A strong market for lumber last year stimulated a rash of expansion projects. A mill at St. Helens, Oregon, built a $2-million installation to handle tree-length logs as small as 5 inches in diameter, increasing capacity from 65 to 112 million board-feet a year. Another $2-million project got under way at Springfield, Oregon, to improve utilization of low-value logs through barking and chipping equipment. Construction also began on a $6-million plywood plant at Riddle, Oregon.

Aerospace Defense contracts awarded to Pacific Northwest firms during the year included $35 million for the Minuteman missile program and for B52 aircraft modification. NASA contracts totaled $73 million.

Commercial-airline orders now total over $5 billion for 747 "jumbo" jets, while 26 airlines have orders in for supersonic transports, with a delivery date in 1977.

Petroleum and Chemicals A petroleum refinery expansion was completed in Ferndale, Washington, adding 5,300 barrels per day of crude capacity. Another firm announced plans for a $100-million, 100,000 b/d refinery near Bellingham, Washington, to process Alaskan crude oil for the growing Pacific Northwest market. Exploration continued throughout the year in the coastal region of Grays Harbor County, Washington.

In the chemical field, major expansions were announced in resins and formaldehyde, essential to making plywood and particleboard. Resin capacity will be increased by projects at Kalama, Washington, and Longview, Oregon. Formaldehyde capacity will be boosted at plants in Springfield and Coos Bay, Oregon.

Construction Contracts for construction in 1968 totaled more than $1 billion. Residential building led the boom, primarily in the Seattle-Everett-Tacoma area. Of special interest was a $107-million industrial-recreational-residential plan called Vancouver Lake on 12,000 acres of farmlands and woods along the Columbia River.

Plans were announced for a $46-million World Trade Center in Seattle, including a 32-story office tower, a 27-story hotel and a 200-unit apartment building. Also in Seattle's future are a $30-million shopping center and a $20-million office building. There will be a $50-million shopping center on Hayden Island, Oregon, and a $16-million office building and $15-million complex in Portland.

Some $90 million will be spent at the Seattle-Tacoma airport and $150 million at Portland for air-passenger terminal expansion.

One utility firm announced a target date of 1974 for completion of a $165-million, 1-million-kilowatt nuclear generating station in Oregon. Another has scheduled a $36-million expansion program, involving four new generating units, in Wenatchee, Washington. Also, a $16-million storage dam will be built on the Wynooche River in Aberdeen, Washington.

MOUNTAIN STATES

Copper Resumption of mining operations in April, following settlement of the 8½-month copper strike, increased output above year-ago levels. One copper producer announced a $100-million mine development and modernization plan to boost output 50 percent at its San Manuel property in Arizona, from 40,000 to 60,000 tons of ore per day by 1971. Another producer initiated an $11-million program of expansion at its smelter and powerhouse at Morenci, Arizona. Work continued on a $35-million plant

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to treat silicate copper ore at Ray, Arizona, and on two new open-pit copper mines in the Twin Buttes district of Arizona, at a combined cost of $211 million. Upon completion, these and other projects will raise District capacity from 1.2 to over 1.5 million tons annually by the early 1970s. Meanwhile, an estimated 96 million tons of copper sulfide ore were discovered near Casa Grande, Arizona, and a significant find was made near Ely, Nevada.

Silver The high price for silver in world markets provided incentive for further exploration and development in the Coeur d'Alene district of Idaho. At the Sunshine mine, the nation's leading silver mine, a project was initiated to boost output 25 percent. Work has begun to deepen mine shafts and increase milling capacity at the Galena mine, and reactivation of two old mines was scheduled in the same general area. At Bunker Hill, Idaho, a $40-million project will develop silver-lead deposits and modernize and expand smelting and refining facilities.

Food Processing This industry continued expanding in Idaho, particularly in the fields of frozen and dehydrated potato products and sugar beets. A refinery at Nampa, when completed in late 1969, will double beet-sugar output to 9,400 tons per day, and will thereby become the largest sugar-beet plant in the nation.

Public Utilities A major project was completed at Hells Canyon on the Snake River, with the first generator in operation boosting the total output of Hells Canyon, Browlee, and Oxbow dams to 1.1 million kilowatts.

In Arizona plans call for a $300-million generating plant near Page, with the first unit to be completed in 1974. This would connect with the $830-million Central Arizona Water project.

The $91-million Southern Nevada Water project is under way, with a 200-million gallon/day water-treatment facility, seven pumping plants, a reservoir, and 33 miles of pipeline.

Construction Among numerous announcements of large construction projects was the "world's largest resort hotel" in Las Vegas, to be built at a cost of $150 million. Another highlight was a $100-million community near Scottsdale, Arizona, with a civic and cultural center, parks, schools, residential units, golf courses, and industrial developments.

Other important commercial construction plans included: a $52-million industrial development near Salt Lake Municipal Airport; a $12-million office building in Boise; an $11-million residential complex in Phoenix; and a $9-million shopping-center complex in Tucson. For the area surrounding the Reno/Stead Airport, development plans call for an estate-type residential development and research park with adjacent industrial facilities.

In Arizona, there will be a $22-million civilian air-training center near Chandler, plus two school campuses of $15 million and $8 million in Phoenix and Mesa, respectively.

On the hospital scene there will be three new buildings, one of $9 million in Salt Lake City, and two of comparable size in Boise. A $16-million expansion and modernization plan is on the drawing boards for a medical center in Reno.

ALASKA AND HAWAII

Petroleum and Gas Crude oil production in Alaska reached more than 200,000 barrels a day in mid-1968 and is expected to exceed 300,000 b/d in the year ahead. Major Alaskan fields include Granite Point, Middle Ground Shoal, and McArthur River, each having estimated reserves of more than 100 million barrels.

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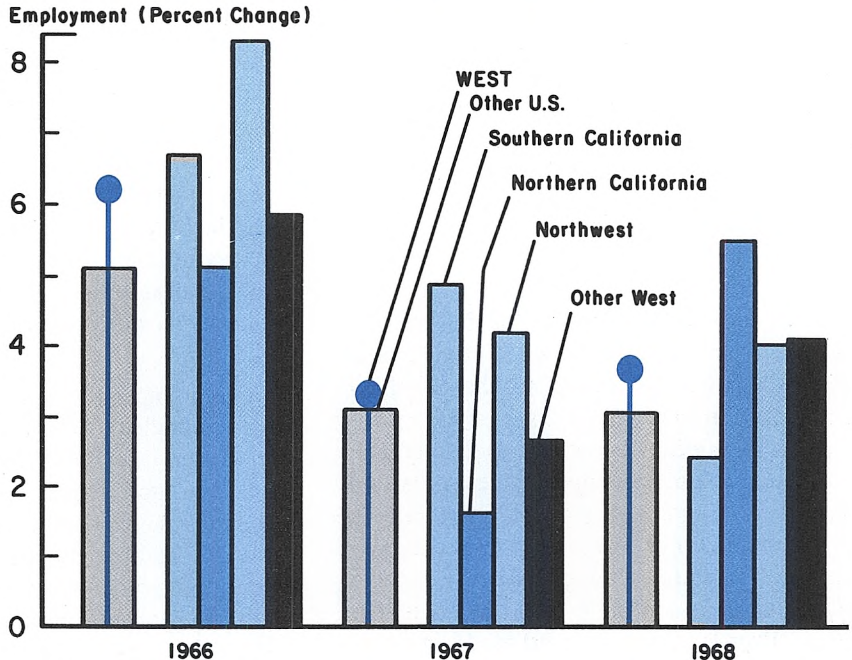
Alaska has known oil reserves of about one billion barrels and gas reserves of about 4.5 trillion cubic feet, but recent discoveries on the North Arctic Slope at Prudhoe Bay will definitely boost these figures. An estimated investment of $600 million will be needed for the construction of a 600-mile pipeline to get the oil to market.



Construction has started on a $13-million, 20,000 b/d oil refinery at Kenai, Alaska. Plans in Hawaii, meanwhile, call for a $20-million, 29,500 b/d refinery at Barber's Point on Oahu, and a $30-million, 30,000 b/d refinery on the island of Hawaii. Completion of these projects will help to fill growing military fuel requirements in the Pacific.

Travel More than a million civilian tourists and 150,000 military personnel and relatives visited Hawaii during 1968. Hawaiian travel was stimulated by an expanded military rest-and-recuperation program, increases in prepaid tours and conventions, substantial improvements in air service between Hawaii and eastern states, and the development of tourist areas outside of Waikiki.

Hotel rooms increased to 22,275 during 1968, and construction over the next two years may boost capacity by two-thirds. In Waikiki a $31-million, 1,200 room hotel is under construction and five other hotels are planned.

Resort development plans progressed on a $250-million community project on the island of Hawaii. The project will provide about 2,000 new rooms in four hotels, plus 1,700 family homes, 1,300 vacation villa condominiums, golf courses and other resort attractions. At Waipouli Beach on Kauai, plans were announced for a $50-million resort development consisting of seven hotels, condominium homes, apartments and shops. A long-range plan for the island of Molokai would add eight hotels and three golf courses, among other facilities.

Another proposed visitor attraction would be an inter-island ferry system with two $11-million ferries, providing expanded freight, passenger and car service between Oahu, Kauai, Maui and Hawaii.

As the year ended, President Johnson and the Civil Aeronautics Board announced a travel bonanza for Hawaii. Some eight air-

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lines were given approval, either for new Pacific routes, or for expanded rosters of cities from which they can initiate flights to Hawaii. President Nixon ordered a re-study of the projected routes, but the need for expanded Pacific air service remained well established.

Travel to the Northland is also on the upswing, with no less than eight cruise liners scheduled to depart for Alaska this summer from Seattle, Vancouver, and California ports. This is in addition to year-round ferry service between Seattle and Alaska.

Forest Products The vast Japanese market for forest products provided the stimulus for further development of the Alaskan economy in 1968. Influenced by this potential for growth, a major U.S. firm purchased nearly 9 billion board-feet of timber in the Tongass National Forest from the U.S. Forest Service and then announced its intention to build an $80-million pulp mill—the third in the Juneau area. Exports of forest products from Alaska have been confined mainly to processed products, rather than logs, because a 1928 law requires local processing of timber cut from Alaskan national forests.

Construction Large construction undertakings in Honolulu included: a $30-million 328-acre subdivision complex, including shopping center and theater; a $27-million complex, including 20-story twin office towers, 6-story garage and commercial building; a $25-million project encompassing a 24-story and a 17-story condominium apartment building and a $20-million Federal building.

In residential construction, planned projects included: a $20-million, 400-home marina community at Hawaii Kai; a $13-million condominium on Waikiki Beach; a $12-million residential complex on the Waialae Nei Ridge; and a $10-million townhouse project on the slopes of Diamond Head. In addition, a $20-million, 272-bed hospital is scheduled with restaurant, convalescent unit, and apartment accommodations for patients' relatives.

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