FEDERAL RESERVE BANK OF

SAN FRANCISCO

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Editor: William Burke

Bank Earnings: More Records

Last year was a profitable—though turbulent—year for the nation's commercial banks, as they joined the large parade of industrial firms reporting record earnings and profits. There was a great deal of churning around during the 1968 financial year: banks experienced a relatively quiet first quarter, a second quarter of considerable monetary restraint, a third quarter of rapid credit expansion (following the Congressional passage of fiscal-restraint measures), and a fourth quarter marked again by the pinch of restraint.

Record interest rates sharply boosted revenues from both loans and securities, although they also contributed to 1968's higher operating costs. Moreover, in the face of the high rates available in the money market, banks managed to hold—in fact, sharply expand—their demand and time deposits during most of the year.

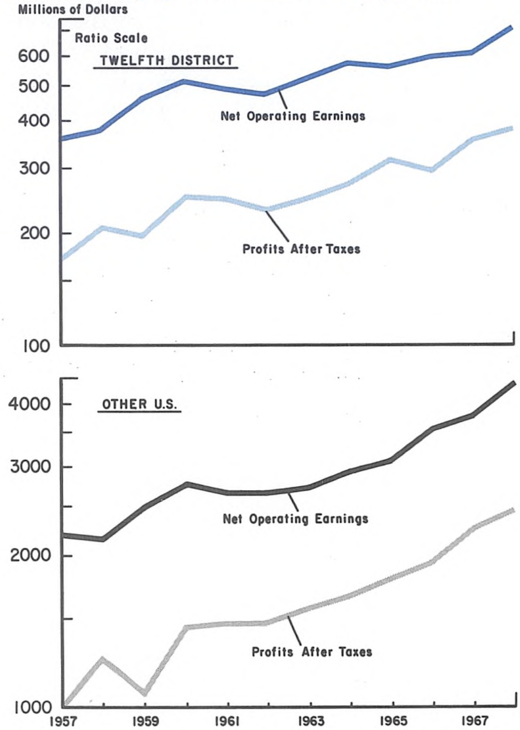
Twelfth District member banks outpaced banks nationally, and in the process they set new peaks in both operating earnings and profits. Net current operating earnings of District banks jumped to $709 million—more than 17 percent above the 1967 figure. Net profits after taxes meanwhile reached $379 million, also a new peak. However, this figure was only 8 percent higher than the 1967 profit figure, because of the capital losses incurred on securities sales and the sharp rise in other non-operating costs.

Western banks posted a 15-percent gain in total operating earnings on the strength of sharp revenue gains from loans, securities, and other sources. Operating expenses of District member banks also spiralled upward, and at a faster pace than in the preceding two years. Nevertheless, costs increased at a slightly slower pace than revenues — the first time this favorable situation had occurred since 1959.*

In view of rising interest rates and profitable investment opportunities, most banks selected 1968 as a "loss" year—a year for selling selected securities and taking capital losses as a tax offset. In many instances, the proceeds from such sales were reinvested in securities bearing significantly higher yields. Therefore, capital losses taken last year may contribute to a higher average return on securities in 1969.

*Earnings data for the last several years are not entirely comparable because many banks are now changing their accounting procedures from a cash to an accrual basis, in line with new disclosure regulations of bank supervisory agencies. For those banks, loan and security ratios may be affected somewhat during the initial change-over period.

Banks' operating earnings rise more sharply than after-tax profits



Loan income soars

Current operating revenues of District member banks jumped from $3.1 billion in 1967 to $3.6 billion in 1968. Three-fourths of this half-billion-dollar increase came from loans, which in the preceding year had accounted for slightly under one-half of the gain. In contrast, revenue from security holdings contributed only one-sixth of 1968's total revenue increase, compared with over one-third in 1967. In many ways, then, 1968 resembled another tight-money year—1966—except that the earlier year's gains were based even more on loan portfolios and even less on security holdings.

Last year's $338-million (16 percent) increase in District banks' loan income depended largely upon a 14-percent rise in the volume of outstanding loans. Record business demand for credit spearheaded the loan expansion, but consumer loans—a category that carries higher effective rates than most other lending categories—also expanded rapidly. More dramatically, however, the average rate of return on loans soared to 7.24 percent—37 basis points higher than 1967's.

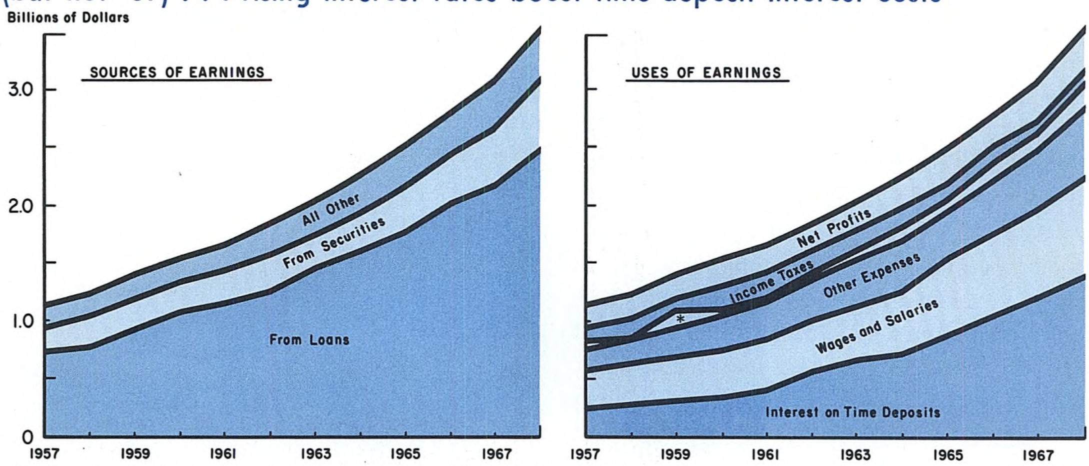
During the year, banks posted four changes in the prime rate — the key rate offered to business customers with top credit rating. The 6 percent rate prevailing at the beginning of 1968 was increased to 6½ percent in early April. There was one interim decrease to 6¼ percent (6 percent at a few banks from late September to mid-November); then two increases in quick succession brought the rate to 6¾ percent as the year closed. As the prime rate rose, other loan rates rose too.

Security income rises

District banks experienced a $74-million (14 percent) rise in security income as they added substantial amounts of securities as well as loans to their asset portfolios. (But although security holdings rose by 10 percent, the expansion rate was only half the pace of 1967, when banks took advantage of lagging loan demand to rebuild their liquidity positions.) Non-Treasury obligations accounted for three-fourths of the increase in bank holdings, just as they did in 1967. In fact, District banks acquired unusually large amounts of municipal issues in the last half of the year, as the volume of such flotations increased contra-seasonally and yields moved sharply upward.

Security yields did not advance as rapidly

Banks obtain vast bulk of earnings from loan expansion—just as in '66 (but not '67) . . . rising interest rates boost time-deposit interest costs



*Net losses on securities and loans, including transfers to and from valuation reserves

EARNINGS AND EXPENSES OF TWELFTH DISTRICT MEMBER BANKS
(MILLIONS OF DOLLARS)

	1968p	1967
Earnings on loans	2,493.8	2,155.5
Interest and dividends on		
U. S. Government securities	284.6	254.9
Other securities	311.1	266.5
Service charges on deposit accounts	207.7	198.8
Trust department earnings	97.0	86.4
Other earnings	163.0	132.6
Total earnings	3,557.2	3,094.7
Salaries, wages, and benefits	869.2	779.9
Interest on time deposits	1,369.6	1,197.8
Other expenses	609.2	513.3
Total expenses	2,848.0	2,491.0
Net current earnings	709.2	603.7
Net recoveries and profits (— losses)[1]		
On securities	— 55.1	— 4.9
On loans	— 132.7	— 115.4
Other	— 18.3	— 9.8
Total net recoveries and profits (— losses)[1]	— 205.9	— 130.1
Net profits before income taxes	503.3	473.6
Taxes on net income	124.4	122.9
Net profits after taxes	378.9	350.7
Cash dividends declared	200.3	193.1

p—Preliminary
[1]Includes transfers to (—) and from (+) valuation reserves
Note: Details may not add due to rounding.
Source: Federal Reserve Bank of San Francisco

in 1968 as in 1967, but they still contributed significantly to the sharp rise in revenues. The average rate of return on bank holdings of U. S. Government securities was 4.80 percent—24 basis points above the 1967 average. (Average yields on Government securities generally were considerably higher than 4.80 percent in 1968, but the average return to the banks was held down by their large holdings of securities acquired earlier at much lower yields.) The average (pre-tax) yield on bank holdings of other securities was 3.88 percent—up 11 basis points over the year.

Two other itemized sources of revenue—service charges on deposit accounts and trust-department earnings — rose by 4½ and 12 percent, respectively. "Other current revenue" — a catch-all category which includes (among other things) revenue from foreign operations and Federal-funds transactions — was again (at 23 percent) the fastest growing item of revenue.

But expenses rise too

Total expenses of District member banks rose 14 percent in 1968 to a record $2.8 billion. This cost increase was greater than in either of the two preceding years — significantly greater than in 1967, in fact.

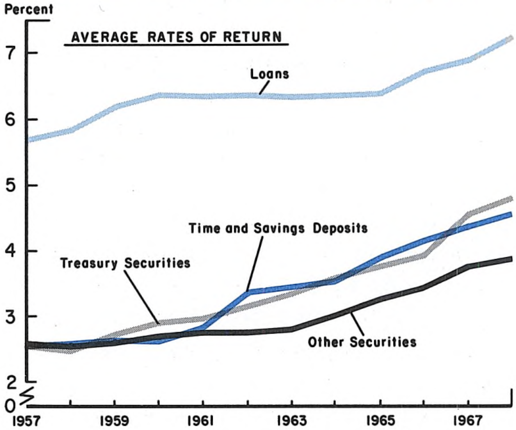
But banks' largest cost item — interest payments on time-and-savings deposits — increased at a slower rate than in other recent years. For one reason, the proportion of total deposits subject to interest payments remained almost constant in 1968, in contrast to significant increases in every other year of the decade. Even so, this major expense item rose by $172 million, partly because of a $3.4-billion (12 percent) increase in the volume of time deposits, and partly because of a 19 basis-point rise (to 4.58 percent) in the average rate paid on such deposits.

Interest rates on time deposits rose for several different reasons. The Federal Reserve Board raised permissible ceiling rates on large-denomination time certificates in mid-April, and many banks paid the new maximum CD rates during the spring and again during the final months of the year. Moreover, many savers continued to transfer funds from regular passbook savings (with 4-percent maximum interest rates) to consumer-type time certificates (with 5-percent rates), and many placed their new savings funds into higher-paying certificates rather than into regular passbook accounts.

Intense competition for deposits and high start-up costs once again inhibited the establishment of new banks in the District, but these same factors also served as a spur to bank mergers. In 1968, only one new member bank was established in the District, but there were thirteen mergers and three withdrawals from System membership—leaving a total of 181 District member banks at the end of 1968. The establishment of new branch offices proceeded at its usual rapid pace, as an increase of 124 offices brought the total to 3,698 by year-end.

Wage, salary, and employee-benefit costs of District member banks rose by $89 million in 1968 — a faster rate of increase than in

Soaring interest rates boost banks' earnings—and deposit costs



either of the two preceding years. Increased payroll expenses reflected — aside from regular wage-and-salary boosts — the staffing requirements for newly established branch offices and newly established banking services. District member banks hired 1,446 additional officers and 6,383 new employees in 1968, for increases of 7 percent in each group.

Banks' borrowing costs rise . . .

As an indication of the year's firmer monetary pressure, District banks paid twice as much ($70 million) for borrowed funds in 1968 as they did in 1967. Early in the year, and again in December, member banks borrowed heavily from the Federal Reserve Bank's discount window, so that their average discounting for the year was three times greater than in 1967. In the last half of the year they also borrowed heavily from other banks through the purchase of Federal funds — idle balances of banks on deposit with the Federal Reserve — and increased their borrowings from the Eurodollar market and from corporations under repurchase agreements.

Not only was the volume of borrowing greater, but the cost of funds also rose during 1968. In 1967 the San Francisco Bank's discount rate had been 4 percent until late November, when it was raised to 4½ percent. In 1968, however, the Bank made four changes: March 15 (5 percent), April 26 (5½ percent), August 30 (5¼ percent) and December 20 (5½ percent). Thus, borrowing became far more expensive for banks in 1968 than in 1967. In addition, the effective rate on Federal funds averaged 5.66 percent —144 basis points above the 1967 average. However, District banks re-lent a large proportion of their interbank Fed-funds purchases to U. S. Government securities dealers, so some of the borrowing costs attributable to Fed-funds purchases actually were offset by interest revenue on such loans.

. . . and non-operating costs cut profits

District banks' net loan losses declined

SELECTED OPERATING RATIOS OF TWELFTH DISTRICT MEMBER BANKS
(PERCENT RATIOS)

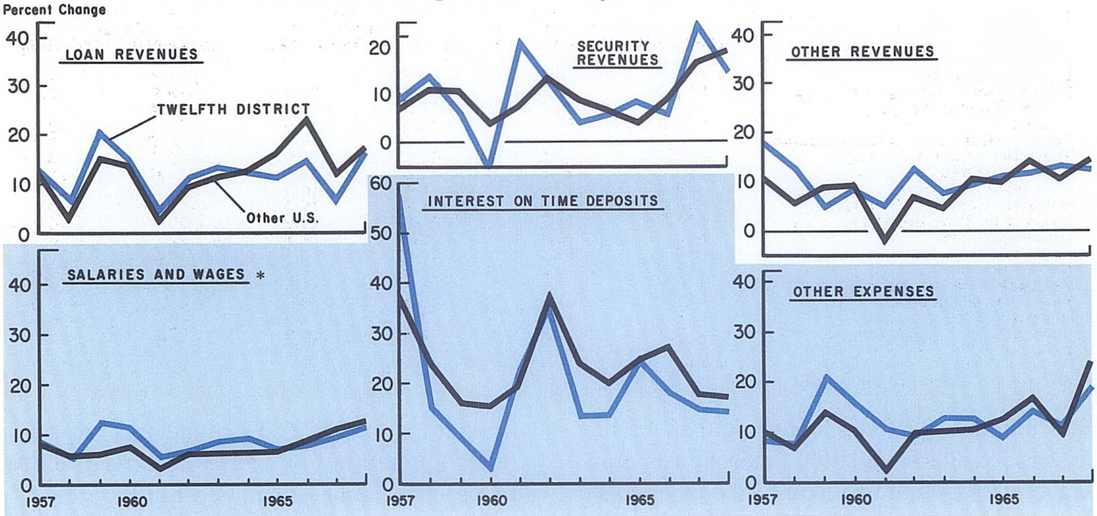
	1968p	1967	Increase or Decrease
Earning ratios:			
Return on loans	7.24	6.87	+ .37
Return on U.S. Government securities	4.80	4.56	+ .24
Return on other securities	3.88	3.77	+ .11
Current earnings to capital accounts	18.26	16.24	+2.02
Net profits after taxes to capital accounts	9.76	9.44	+ .32
Cash dividends to capital accounts	5.15	5.19	− .04
Other ratios:			
Interest paid on time deposits to time deposits	4.58	4.39	+ .19
Time deposits to total deposits	56.88	56.74	+ .14

p—Preliminary

Note: These ratios are computed from aggregate dollar amounts of earnings and expense items of Twelfth District member banks. Capital accounts, deposits, loans and securities items on which these ratios are based are averages of Call Report data as of December 31, 1966, June 30, 1967, and December 30, 1967; and as of December 30, 1967, June 29, 1968, and December 31, 1968.

Source: Federal Reserve Bank of San Francisco

District banks outperform other banks—despite smaller increases in revenues—because of slower growth of expense items



*From 1965 forward, includes employee benefits

slightly — to $73 million — in 1968, reversing the upward movement of the two preceding years. Nevertheless, because of expanded loan portfolios, banks transferred an additional $133 million to their loan-loss reserves. Banks also posted a $57-million figure in net security losses, in marked contrast to 1967's low $6 million figure, and higher even than the $47-million capital loss recorded in tight-money 1966. The net change in reserves for securities was a plus $5 million.

After adjusting net current earnings for net losses on loans and securities and other losses, and for transfers to reserves, banks posted $503 million in net profits before taxes. They paid out $124 million for Federal and state taxes, so that net profits after taxes amounted to $379 million. Net profits thus rose by

SELECTED ASSET AND LIABILITY ITEMS OF ALL MEMBER BANKS TWELFTH DISTRICT, DECEMBER 31, 1968
(MILLIONS OF DOLLARS)

	As of Dec. 31, 1968p	As of Dec. 30, 1967	Changes from December 30, 1967 Dollars	Percent
Net loans and investments[1]	51,938	46,073	+5,865	+12.73
Loans and discounts net[1]	37,036	32,476	+4,560	+14.04
Commercial and industrial loans	14,212	12,315	+1,897	+15.40
Real estate loans	10,802	9,831	+ 971	+ 9.88
Loans to individuals	7,181	6,363	+ 818	+12.86
Agricultural loans	1,383	1,326	+ 57	+ 4.30
U.S. Government obligations	6,391	6,038	+ 353	+ 5.85
Other securities	8,511	7,559	+ 952	+12.59
Total assets	63,813	57,246	+6,567	+11.47
Total deposits	56,000	50,778	+5,222	+10.28
Demand deposits	24,152	22,293	+1,859	+ 8.34
Total time and savings deposits	31,848	28,485	+3,363	+11.81
Savings	16,489	16,260	+ 229	+ 1.41
Other time, IPC	10,197	8,022	+2,175	+27.11
Public time	3,940	2,944	+ 996	+33.83
Capital accounts	3,983	3,789	+ 194	+ 5.12

p—Preliminary

[1]Total loans (including Federal funds sold) minus valuation reserves. Selected loan items which follow are reported gross.

Note: Details may not add to total due to rounding. Source: Federal Reserve Bank of San Francisco

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

	All		15 Largest[1]		Other	
	1967-1968	1966-1967	1967-1968	1966-1967	1967-1968	1966-1967
Earnings on loans	+15.7	+ 6.4	+16.5	+ 6.3	+11.3	+ 7.1
Interest and dividends on securities	+14.3	+25.3	+13.7	+28.6	+16.9	+11.6
U.S. Government	+11.6	+16.1	+11.6	+19.1	+11.7	+ 6.5
Other	+16.8	+35.7	+15.5	+38.0	+25.7	+20.7
Service charges on deposit accounts	+ 4.5	+ 5.7	+ 4.1	+ 5.0	+ 6.0	+ 9.7
Trust Department earnings	+12.3	+ 8.5	+13.1	+ 8.6	+ 5.3	+ 8.0
Other earnings	+22.7	+32.3	+22.6	+29.0	+23.6	+16.2
Total earnings	+14.9	+10.0	+15.4	+10.3	+12.3	+ 8.4
Salaries, wages and benefits	+11.4	+ 9.8	+11.7	+10.0	+ 9.9	+ 9.0
Interest on time deposits	+14.3	+14.7	+14.9	+14.9	+10.7	+14.0
Other expenses	+18.7	+10.4	+20.1	+10.8	+12.9	+ 8.9
Total expenses	+14.3	+12.2	+14.9	+12.6	+11.5	+10.5
Net current earnings	+17.5	+ 1.6	+17.9	+ 1.7	+15.1	+ 0.8
Net profits before income taxes	+ 6.3	+11.1	+ 5.5	+12.8	+10.5	+ 2.7
Taxes on net income	+ 1.2	− 7.9	− 0.9	− 8.5	+11.1	− 4.8
Net profit after taxes	+ 8.0	+19.8	+ 7.6	+22.5	+10.2	+ 6.4
Cash dividends declared	+ 3.7	+10.3	+ 4.8	+10.8	− 2.6	+ 6.7

[1]Includes all District member banks with total deposits of $500 million and over as of December 31, 1968.
Source: Federal Reserve Bank of San Francisco

$28 million in 1968 — only one-half of the increase realized in 1967, when non-operating costs (including income tax payments) were unusually low for District banks.

The fifteen largest member banks in the District—banks with deposits of $500 million or over—posted relatively higher gains than other banks in net operating earnings during 1968, because of a faster rate of growth in loan revenues. But high non-operating costs left the largest banks with less than an 8-percent increase in net income after taxes, compared with a 10-percent gain recorded by other District banks.

New factors for 1969?

The new year had hardly begun when banks across the country raised their prime rate to a record 7 percent, and then in mid-March they shattered this record by raising the rate to 7½ percent. This development of course augured well for the future trend of bank revenues—especially in view of the increased volume of loans in their portfolios.

At the same time, banks faced several unfavorable factors on the cost side, reflecting the increased restrictiveness of monetary policy after mid-December. District banks paid higher rates for discount-window borrowings and for Fed-funds purchases, and those banks which turned to Eurodollars as an offset to a loss of CD's found the gross interest quotations on these borrowed funds to be even higher than Fed-funds rates.

In the first two months of 1969, District member banks experienced a (seasonally adjusted) reduction in total deposits — in contrast to the rapid growth in deposits in the latter half of 1968. Declines occurred in time deposits, largely because of run-offs in large CD's, and also in private demand deposits. Furthermore, not much growth can be expected in March and April, as individuals may withdraw more savings than usual to meet their higher Federal income-tax bills.

District banks reduced their loans in January but expanded them in February, on a seasonally adjusted basis. In both months, however, they substantially reduced their holdings of both Treasury issues and other securities, in reaction to the increased pressure on banks' reserves and their significant deposit losses. To the extent that reserve pressures led to security sales, banks were forced to take some unplanned capital losses—which could mean another year of relatively high non-operating deductions from current earnings. Of course, very attractive yields were available to any banks that were able to acquire securities during early 1969.

Ruth Wilson

Western Central Bank

The Federal Reserve Bank of San Francisco completed its 55th year in 1968 with a continued expansion of its central-banking operations. The Bank is a major component of the nation-wide Federal Reserve System, created in 1913 to regulate the flows of money and credit through the national economy.

The twelve regional Reserve Banks, coordinated by the Board of Governors in Washington, D. C., handle a number of central-banking operations for commercial banks, business firms, and governmental units within their respective regions. In the case of the Twelfth District, the Federal Reserve Bank of San Francisco has such responsibilities in the states of Alaska, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, and most of Arizona. Branch offices are located in Los Angeles, Portland, Salt Lake City, and Seattle.

Higher reserves, higher borrowing

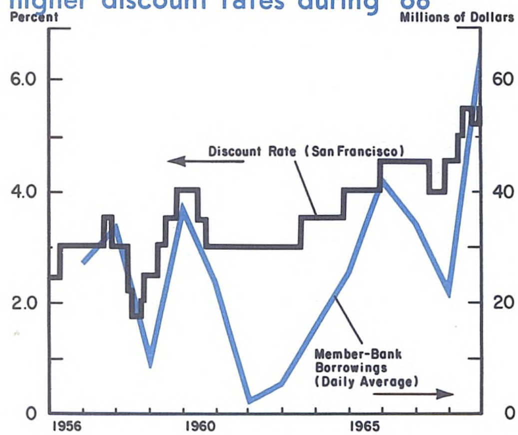
Under the law, each member bank is required to maintain a certain proportion of its deposits in a reserve account with its regional Federal Reserve Bank. At the end of 1968, member-bank reserve accounts at the Federal Reserve Bank of San Francisco totaled \$3.7 billion, up from \$3.4 billion at the end of 1967.

In 1968, the San Francisco Reserve Bank helped member banks make up reserve deficiencies by lending a total of \$12.0 billion, compared with \$4.9 billion in 1967. Daily average member-bank borrowings more than tripled over the year, rising to \$65 million from the 1967 average of \$21 million. This sharp upsurge in borrowing reflected the heavy credit demands and the tight policy pressures on member-bank reserves during the inflationary boom of 1968 — and, as in earlier boom years, it took place in the face of a steep increase in the cost of borrowing.

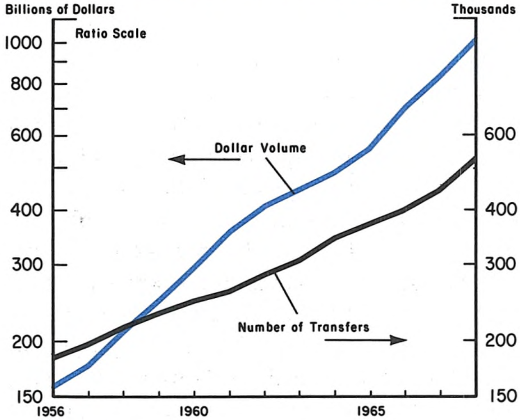
Unsettled conditions in the international monetary situation and continued inflationary pressures and fiscal uncertainties at home resulted in four changes in the discount rate, as was described in the preceding article. (The discount rate—the interest rate charged to borrowing banks—is determined by the directors of each Reserve Bank, subject to review by the Board of Governors.) This rate, which had been 4 percent as late as November 1967, was 5½ percent at the end of 1968.

Reserve Bank personnel helped deal with several changes in stock-market regulations which were promulgated by the Board of Governors during the year. The Board raised margin requirements under Regulations T and U, and also adopted a new Regulation G, extending margin requirements — like those already applicable to brokers, dealers, and banks — to other lenders on credit for stock-market transactions. In addition, Reserve Bank personnel continued to administer the voluntary foreign credit restraint program for banks and nonbank financial insti-

Member banks borrow more at higher discount rates during '68



Over one trillion dollars transferred between this and other districts



tutions, in an effort to alleviate presssures on the nation's balance of payments.

Money . . . coin . . . currency

The transfer of funds between member banks in this Federal Reserve district and member banks in other districts rose sharply in 1968 as in other recent years, largely as a result of increases in Federal funds transactions, check collections, and transactions involving U. S. Treasury obligations. The bulk of these transfers was handled on the Federal Reserve System's leased-wire network — which is scheduled to be replaced by a computerized wire network by the end of 1969. During 1968 almost 505,000 telegraphic transfers were made, amounting to a total dollar value of slightly over one *trillion* dollars. In comparison with 1967, transfers were up 15 percent by number and almost 24 percent in dollar volume.

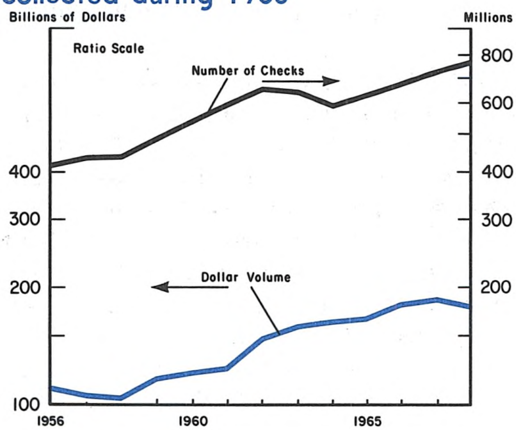
While the so-called "checkless" society may someday become a reality, Western businessmen and households again last year wrote an increasing number of checks. The San Francisco Reserve Bank and branches handled more than 756 million cash items in 1968, an increase of almost 40 million items over the previous year. The total dollar value of checks collected in 1968 was $177 billion —off about 3 percent from the 1967 level, principally because of changes in settlement procedures. The Bank also handled 825,000 noncash items with a dollar value of over $4 billion. This was an 8-percent increase in dollar volume, reflecting the continued expansion in processing of Government letters of credit.

Coin and currency operations continued at a high level in 1968. (A member bank may obtain coin and currency by making withdrawals from its account at the Reserve Bank; a nonmember bank may obtain supplies directly from the Reserve Bank with charges made to a designated member-bank's reserve account.) Coins received and counted totaled 1,416 million pieces with a dollar volume of $154 million. Currency received and counted totaled 760 million pieces with a dollar volume of almost $6.0 billion. Gains for the year were 5 percent or more in each category.

Heavy fiscal activity

The Reserve Banks, acting as fiscal agents for the Federal government, were involved in a variety of activities related to the Treasury's debt operations, including the issuance and redemption of Government securities and the administering of Treasury tax-and-loan accounts. In the Twelfth District these activities continued at a high level in 1968.

Larger number of checks collected during 1968



VOLUME OF OPERATIONS

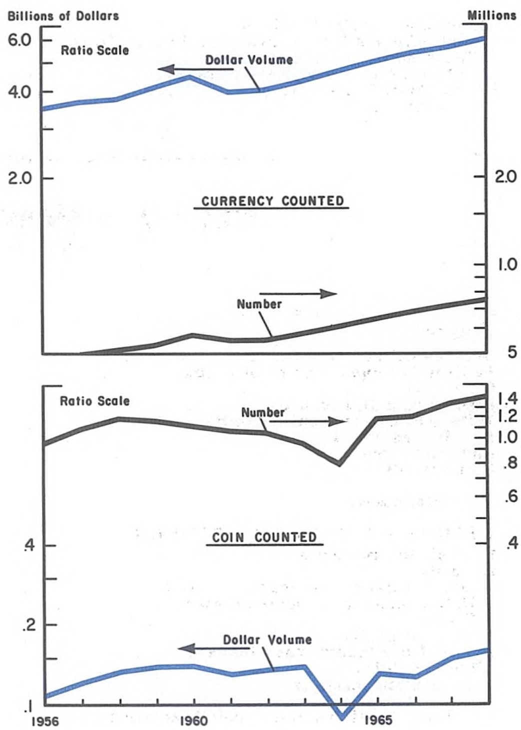
	Dollar Amount (Millions) 1968	1967	1966	Percent Change 1967-68
Checks collected	176,469	182,531	179,457	− 3.3
Noncash collection items	4,423	4,090	2,821	+ 8.1
Coin counted	154	147	124	+ 4.7
Currency counted	5,960	5,499	5,276	+ 8.4
Transfers of funds	1,021,000	823,723	697,399	+23.9
U.S. Savings Bonds handled	1,314	1,341	1,288	− 2.0
Other Government securities handled	63,200	58,745	55,345	+ 7.5
	Number (Thousands) 1968	**1967**	**1966**	**Percent Change 1967-68**
Checks collected	756,525	716,757	676,273	+ 5.5
Noncash collection items	825	827	864	− 0.2
Coin counted	1,415,600	1,343,486	1,186,931	+ 5.4
Currency counted	760,133	716,429	691,048	+ 6.1
Transfers of funds	505	438	390	+15.2
U.S. Savings Bonds handled	28,186	26,243	24,421	+ 7.4
Other Government securities handled	1,032	851	883	+21.2

The volume of marketable Government securities issued, serviced and retired was up 22 percent in number and eight percent in amount over the previous year. (The number was over one million; the dollar volume, over $63 billion.) During 1968, there were 140 offerings of negotiable Government securities, including the regular 13-week and 26-week series of Treasury bills.

The volume of activity in U. S. Savings Bonds continued to grow in 1968 with a 7-percent increase in the number of bonds issued, serviced, and redeemed, to a total of over 28 million. Sales of U. S. Savings Notes (Freedom Shares) increased during the year, as in mid-year the Treasury authorized all issuing agents to sell the Savings Bond-Freedom Share combination over the counter instead of limiting Freedom Share purchases to bond-a-month or payroll-savings plans. In October, paying agents were given authority to redeem Freedom Shares that had been held at least one year.

Another major fiscal-agency function was the processing of Federal tax deposits from employers of employees' withheld income taxes, social-security taxes, and certain other taxes. (These taxes generally are deposited with qualified commercial banks, there being 427 such banks in the Twelfth District.) Both the number of deposits and the dollar amount of processed tax deposits showed substantial increases during the year. Some

Coin and currency transactions increase in number and dollar volume



3.2 million deposits were processed (up 16 percent) and these totaled $13.5 billion in volume (up 17 percent). These increases were due in part to an Internal Revenue Service ruling requiring employers to make *monthly* deposits of withheld taxes over $100.

Other signs of growth

As a part of its supervisory role, the San Francisco Federal Reserve Bank in 1968 examined all state-chartered member banks in the Twelfth District — 40 banks, 299 branch offices, and 35 trust departments. In addition, examinations were made of six foreign-banking corporations headquartered in the District. Field examinations were also conducted in connection with applications by state member banks for the establishment of *de novo* domestic branch offices. The processing of merger applications continued at an accelerated pace in 1968.

In midsummer an examination office was established at the Los Angeles Branch to facilitate the examination of banks and branches in that area. Previously, these assignments had been handled out of the San Francisco Head Office.

To handle the Bank's growing data-processing needs more efficiently, a new computer system was installed in the San Francisco headquarters in late 1968. In about a

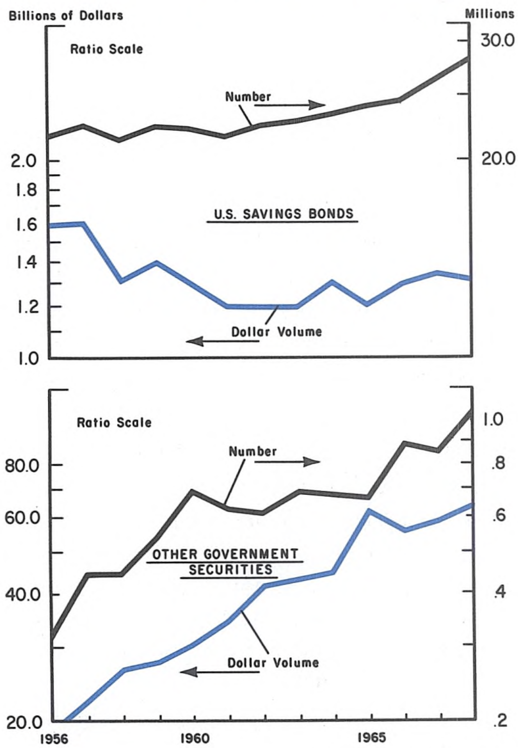
COMPARATIVE PROFIT AND LOSS STATEMENT
(THOUSANDS OF DOLLARS)

	1968	1967	1966
Total earnings	$390,669	302,002	259,985
Net expenses	24,594	22,677	21,700
Current net earnings	366,075	279,325	238,284
Net addition (+) or deductions (—)	+1,131	+341	—168
Distribution of Net Earnings:			
Net earnings before payments to U.S. Treasury	367,206	279,666	238,116
Dividends	4,889	4,513	4,391
Interest on Federal Reserve notes	356,754	270,023	231,975
Transferred to surplus	5,563	5,130	1,750
Total	367,206	279,666	238,116

COMPARATIVE STATEMENT OF CONDITION
(THOUSANDS OF DOLLARS)

	December 31, 1968	December 31, 1967	December 31, 1966
ASSETS			
Gold certificate reserves	1,286,391	1,318,498	1,572,548
Federal Reserve notes of other banks	106,948	81,883	87,148
Other cash	22,756	37,040	32,175
Discounts and advances	7,000	63,000	58,000
Total U.S. Government securities	7,694,527	6,992,563	5,983,146
Uncollected items	908,061	997,972	1,006,392
Bank premises	8,741	8,960	9,390
Other assets	340,492	252,377	160,400
Total assets	10,374,916	9,752,293	8,909,199
LIABILITIES AND CAPITAL ACCOUNTS			
Federal Reserve Notes	5,656,691	5,155,150	4,681,767
Deposits:			
Member banks — reserve accounts	3,656,371	3,441,491	3,248,511
U.S. Treasurer — general account	1,706	119,034	2,495
Foreign	29,040	18,200	20,960
Other deposits	78,455	57,568	84,839
Deferred availability cash items	727,077	762,385	691,929
Other liabilities	56,081	40,096	30,589
Total capital accounts	169,495	158,369	148,109
Total liabilities and capital accounts	10,374,916	9,752,293	8,909,199

Fiscal-agency transactions increase, although savings-bond volume lags



year the new computer will be tied in with the Federal Reserve's nationwide computerized wire network for the transfer of money, securities, and economic data.

Higher assets, higher earnings

Total assets of the Federal Reserve Bank of San Francisco were $10.4 billion on December 31, 1968 — up about 6 percent over the 1967 year-end figure. The increase reflected larger holdings of Government securities in the Federal Reserve System's Open Market Account, of which this Bank's share totaled $7.7 billion at year-end. The average rate of earnings on these holdings was 5.32 percent, compared with 4.66 percent in 1967.

As a result of this higher yield and the increase in average holdings, earnings from this source increased over 25 percent, to $377 million, during 1968. Earnings on member-bank borrowings more than tripled during the year, to over $3 million, reflecting heavier member-bank reliance on the discount window and the higher cost of borrowing. Another major source of earnings ($10 million) was from holdings of foreign securities. (This Bank's holdings amounted to $193 million on a daily average, substantially above the 1967 figure of $74 million.)

Altogether, total current earnings of the San Francisco Federal Reserve Bank expanded from $302 million in 1967 to $391 million in 1968, on the basis of the earnings increases noted above. The Bank's net expenses rose from $23 million to $25 million in the same time-span. About $5 million was paid to member banks in the form of dividends, and roughly $6 million was transferred to surplus to bring that account to the level of paid-in capital stock. Remaining net earnings of $357 million were paid to the U. S. Treasury as interest on Federal Reserve Notes.

Donald Alexander and Karen Rusk

Publication Staff: R. Mansfield, Artist; Karen Rusk, Editorial Assistant.

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Farming: Will '69 Match '68?

Net income of the nation's farmers rose to $14.9 billion in 1968 from the $14.2-billion total of the year before. The 1968 figure has been surpassed only once in the past two decades — in 1966, when the total was swollen by the shortage-inspired price upsurge which developed during that unusual year.

The recent boost in returns reflected a reversal of 1967's sharp price declines as well as a record volume of marketings for many (but not all) commodities. But the advance in marketing receipts was largely offset by the inexorable rise of production costs. Thus, most of the increase in total income depended on higher Government payments — up from $3.1 to $3.7 billion because of heavier payments to feed-grain producers.

Different pattern in '68

Cash returns from marketings jumped 7 percent in the West, as against a 3-percent gain elsewhere, primarily on the basis of increased returns from field crops and a strong recovery for California's fruit and vegetable crops, which had suffered heavy weather damage in 1967. For all District states, crop returns jumped 8 percent to $4.1 billion, while marketings of livestock and products rose 4 percent to $2.8 billion.

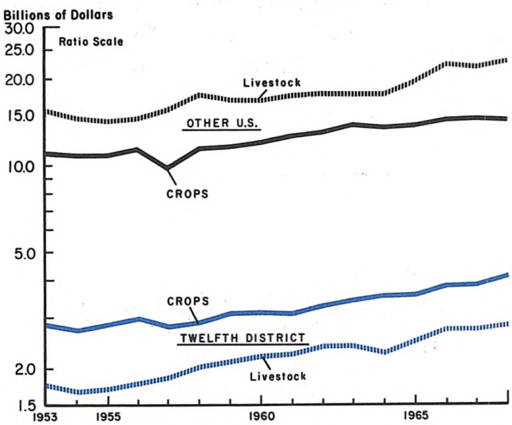
Elsewhere in the nation, cash returns showed a somewhat different pattern. Crop returns were close to their 1968 figure of $14.4 billion, as cutbacks in fruit (mostly citrus) marketings tended to offset heavy marketings of cotton, food grains, and feed grains. Livestock marketings meanwhile jumped 5 percent to $22.8 billion, on the strength of both higher output and higher prices of meat animals.

On the basis of projections developed at the U. S. Department of Agriculture's annual outlook conference this February, the nation's farmers may achieve a slightly lower level of net income in 1969 than in 1968, with farm costs outrunning projected increases in cash marketings and Government payments. The anticipated advance in marketing receipts is based on expected increases in both crop and livestock production; to date, only minor changes are expected in prices received by farmers. The anticipated rise in Government payments is based on expected increases in payments to cotton and wheat producers.

... to affect '69?

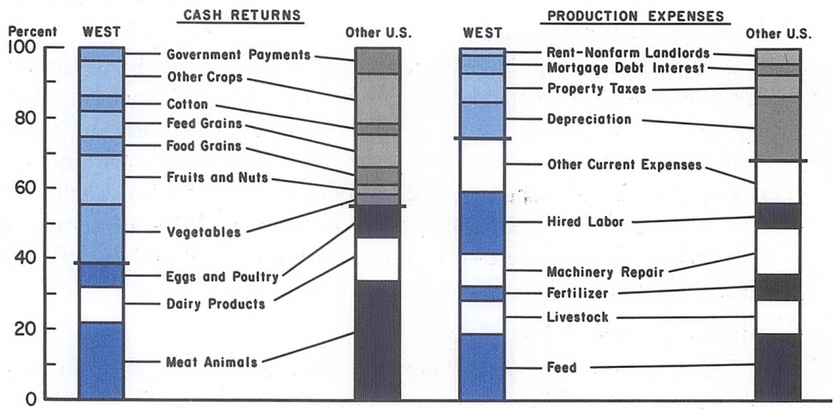
The 1969 income situation for Western farmers will of course reflect these national trends, but it will also reflect the difference in structure between the Western farm

Cash receipts expand for farmers in West as well as elsewhere



economy and that found elsewhere. Generally speaking, the highly diversified Western farm sector bases its prosperity on a different mix of products than the national industry does, and the highly organized Western industry confronts a different structure of costs than that faced by other segments of American agriculture.

Western farm prospects affected by differences in product mix and in production-cost structure



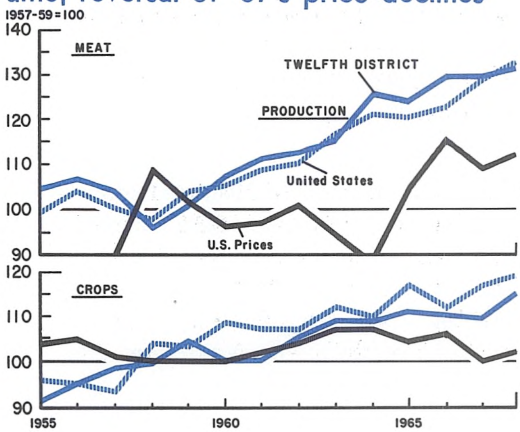
In the Agriculture Department's projections, livestock and products should experience a substantial increase in returns, but since this source accounts for only about 40 percent of farm returns in the District as against 55 percent elsewhere, Western farmers may not benefit to the same extent that others will from this advance. And in view of the modest increase projected for crop returns nationwide, perhaps only a small increase can be expected regionally from this major source of Western farm receipts.

The different structure of production expenses may also bring about a different pattern in net farm income. In particular, Western farms require substantial inputs of hired labor, because of the still-substantial hand-labor requirements of fruit and vegetable growers. (Of course, the West continues to make rapid strides in mechanizing production and harvesting operations.) But hired-labor wage rates nationwide have risen 10 percent over the past year—as against a 3-percent rise in the overall cost of such production items as feed, fertilizer, and machinery. Consequently, Western cost patterns may vary widely from those prevalent elsewhere, especially since hired labor accounts for 17 percent of Western production expenses as against 7 percent in the rest of the nation.

A continuation of such cost trends in 1969 could result in greater cost pressures on Western farm operators than on their counterparts in other regions of the nation. Then again, if the Agriculture Department's projections turn out to be correct and the largest advances in cash returns occur in non-Western specialties, the regional farm economy may find it doubly difficult to match its strong 1968 performance this year.

Donald Snodgrass

Higher receipts reflect more volume, reversal of '67's price declines



Western Digest

Drop in Aerospace Jobs

Western aerospace-manufacturing firms recorded an employment decline of 2,900 in January, as aircraft production continued to slacken. About 714,000 workers are now employed in the regional industry, following the 5-percent drop of the past 12 months. . . . Industry observers expect the downtrend to be halted in the near future, however, as production lines begin to tool up for the next generation of jet transports. For example, prime-contracting and sub-contracting for the model 747 airbus should create new job opportunities in both Washington and California aircraft plants.

Mixed Trends in Housing

Harsh winter weather helped cause a 24-percent drop in housing starts in the West in January. The decline — from an annual rate of 307,000 units in December to a 234,000-unit rate in January — contrasted sharply with a 22-percent gain in the nation as a whole. . . . Continued tightness in the Western housing market meanwhile was indicated by late-1968 vacancy data. During the fourth quarter, the vacancy rate for home-owner units dropped from 1.4 to 1.2 percent, and on rental units, from 6.2 to 6.1 percent. These data pointed to the tightest regional housing market of the past decade — as did also the record levels of (conventional) mortgage rates, which in the West exceeded even the national figure of 7.23 percent in January.

Strengthening Steel Demand

Steel production increased strongly in early 1969 throughout the nation, but especially at Western mills, as the prolonged period of sluggishness that followed the mid-'68 labor-contract settlement came to an end. By late February, Western production was 11 percent above the year-ago level, while production nationwide still lagged 3 percent behind the early '68 pace. The improved production figure reflected not only the strength of total demand but also a slowdown in the import boom, as a result of the East Coast dock strike and the adoption of voluntary quotas by European and Japanese producers. . . . Because of the improved order situation, most producers raised the price for hot-rolled sheets by $12 a ton in mid-February. This latest increase in effect restored the price of the product to the figure that prevailed prior to last November's $25-per-ton rollback.

Petroleum Moratorium

Interior Secretary Hickel declared a moratorium on the sale of offshore Federal leases following the development of a massive oil leak in the Santa Barbara Channel in January. . . . Petroleum producers meanwhile readied plans to exploit Alaska's Arctic bonanza. A 420-mile road between Fairbanks and the new oil field is already under construction, and planning is underway for a 48-inch 800-mile pipeline, costing $900 million, which will carry North Slope petroleum to Valdez on the Gulf of Alaska.

Tall, Tall Timber Prices

Consumers and builders alike have watched lumber and plywood prices soar sky-high over the past year, and they have responded to each rise with increasing displeasure — so much so, in fact, that a White House committee and several Congressional committees have recently begun to investigate the problem. In 1968, on an annual-average basis, the wholesale-price index for Douglas-fir lumber shot upward by 20 percent, while the index for softwood plywood registered a 30-percent gain.

More important, prices this year have moved to still higher ground; between January 1968 and January 1969, the wholesale-price indexes for Douglas-fir lumber and other softwoods jumped 30 to 40 percent, while the index for softwood plywood almost doubled. February figures, moreover, are likely to show much larger year-to-year gains. In late February, the price of random-length Douglas fir 2 by 4's in carload lots for shipment to the East Coast reached $132 per thousand board-feet. That price was 48 percent above the level prevailing a year earlier. The price of dry Douglas-fir studs, another key homebuilding item, reached $140 per thousand board-feet—and *that* was 56 percent above its year-ago mark. Pine prices rose so dramatically in February that many quotes matched plywood's spectacular (double-a-year-ago) price performance.

The lumber-and-wood products category has been by far the fastest rising commodity group in the wholesale-price index. Last year's 13-percent increase contrasted sharply with the 3-percent increase in the overall industrial-commodity index. In fact, the rise in that category was several times greater than the increase registered by any other major industrial group. It far overshadowed, for example, the substantial (4-percent) increase in metal and metal products.

Alarming as it undoubtedly is, the recent spurt in lumber prices should first be placed within a somewhat longer-term perspective. Those buying lumber at today's record prices may find little consolation in the fact, but wood product prices have not advanced significantly over the past decade as a whole. The wholesale-price index for Douglas-fir lumber rose only slightly over the entire 1959-67 period before it jumped sharply in 1968. The softwood-plywood index actually dropped by one-fifth between 1959 and 1967 —under the impact of excess capacity and a declining housing market—before 1968's increase carried it slightly ahead of its 1959 level.

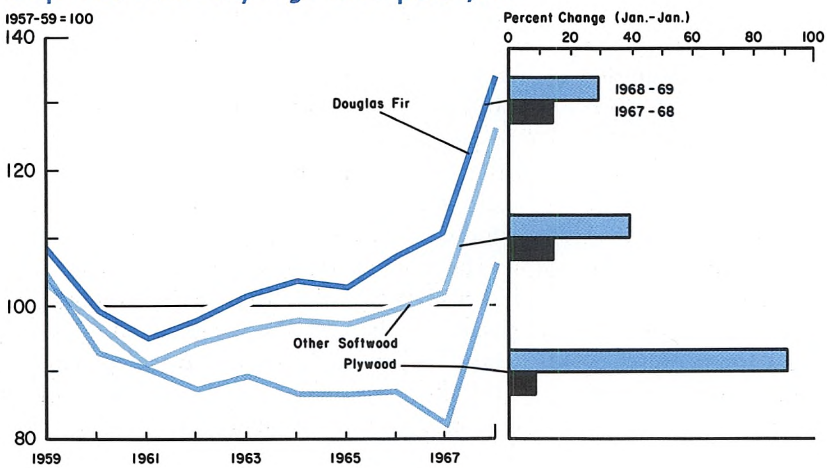
Builders' lament

The National Association of Home Builders—composed of over 50,000 builders in every state of the Union—has recently expressed "deep concern that extensive lumber shortages and resultant price increases could endanger national housing goals and wreck any efforts to provide residences for low- and moderate-income families." National goals, according to the Housing and Urban Development Act of 1968, encompass the construction or rehabilitation of 26 million housing units over the next decade, including 6 million units for low- and moderate-income families, in order to realize the objective of a "decent home for every American family."

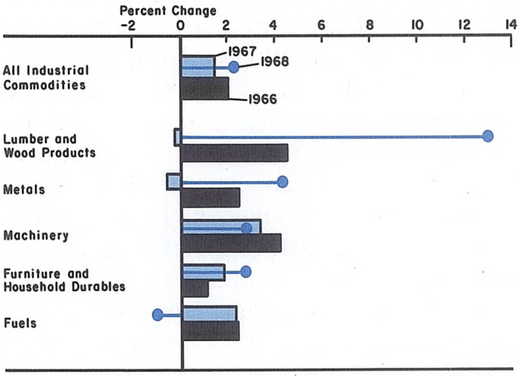
The widespread fears about rising lumber prices stem from lumber's importance as an element in total housing costs. According to various estimates, lumber can account for one-seventh to one-fifth of the total construction cost of a single-family dwelling. Any substantial increase in lumber and plywood prices, therefore, has a dramatic impact on the total cost of the unit. By these calculations, a 40-percent increase in lumber prices could, by itself, raise the cost of constructing a $20,000 home (less land) by as much as $1,600.

While the increase in lumber prices has far exceeded the increase in other construction costs over the past year, it would seem unfair to point to the lumber industry as "the" villain in rising housing costs or to blame that industry alone as an obstacle to the achievement of our nation's housing goals. Nearly all construction materials have risen in price over the last year — not to mention the cost of labor. But even more important, sizeable increases have occurred in other parts of the housing-cost package — such as land, financing, and taxes — and these undoubtedly have had an equally substantial impact on total housing costs.

Lumber emerges from bargain basement as prices shoot sky-high over past year



Prices rise for all industrial products, but especially for lumber



Demand versus supply

The recent spiral in lumber and plywood prices provides a classic example of what happens when sharp demand pressures confront a limited current supply. Lumber mills in the Douglas-fir region raised their production by 9 percent in 1968, while mills in the Western-pine (inland) region achieved a 7-percent gain. Plywood mills boosted their production 14 percent to a record 14.7 billion square-feet. (In Washington and Oregon alone, output rose 10 percent to 10.1 billion square-feet — also a record.) Yet, despite these increases, production fell short of rapidly bulging order books. Unfilled orders for softwood lumber at year-end were about a third above the year-ago figure, while stocks were down substantially.

Although recent statistics are unavailable on the consumption of lumber and plywood by major use, the 1967-68 recovery of residential construction undoubtedly has provided a major stimulus to demand. Housing starts in 1968 topped 1.5 million units, after rising from a low of 1.2 million units in 1966 to 1.3 million units in 1967. Moreover, the (seasonally adjusted) pace of private housing starts in January 1969 reached a near-record level of 1.8 million units, and wholesalers consequently bought heavily in expectation of a record year for residential construction.

Subsequent pressure on prices was mostly attributable to supply problems rather than buoyant demand. By the end of February, orders in the Douglas-fir and Western-pine lumber regions lagged considerably below their year-earlier pace. (Incidentally, military shipments to Vietnam, which had jumped sharply during the 1965-67 buildup, declined somewhat during 1968.)

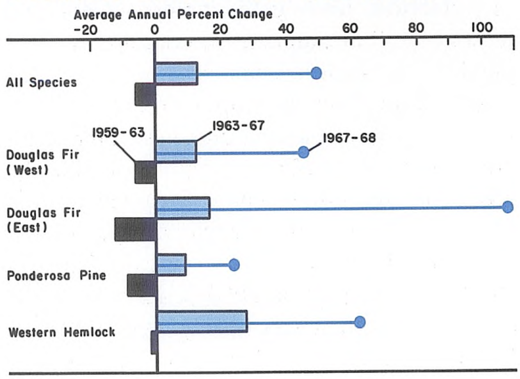
Log-export drain

The industry's ability to raise production further was adversely affected in 1968 by the limited availability of log supplies, as exports from Washington and Oregon—destined mainly for Japan—reached a record for the sixth consecutive year. Log exports during the first three quarters of 1968 almost matched the entire 1967 total, and for 1968 as a whole, exports jumped almost one-third to roughly 2.5 billion board-feet.

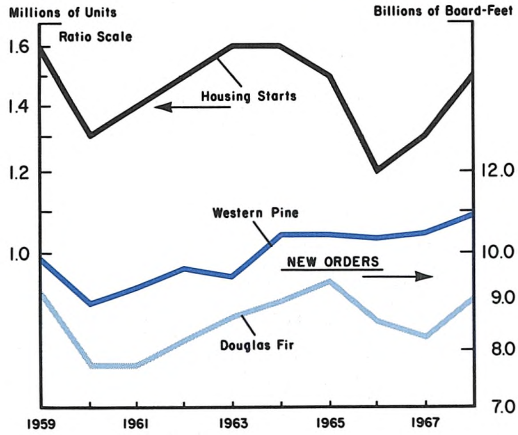
The timber harvest in Washington and Oregon apparently rose little or not at all, so that their exports rose to about 13 percent of the total log supply, up from 10 percent in 1967. In 1960, by way of contrast, log exports amounted only to about 100 million board-feet, or less than 1 percent of the total Washington-Oregon timber supply.

In response to complaints from small- and medium-sized mills that found themselves

All species of timber showed weakness earlier—but not in '68



New orders for lumber
respond to '68 housing upsurge



priced out of the market by the Northwest's log-export boom, the Federal Government took action last April to limit the export of logs from certain Federally-owned lands. At that point, Agriculture Secretary Freeman set an export ceiling by announcing that all but 350 million board-feet of timber sold from Federal lands in western Washington and western Oregon during the next 14 months would require domestic manufacture.

In Secretary Freeman's words, the action was taken "to help the domestic forest-products industry by assisting them in obtaining adequate supplies of logs." He added, "A market situation has developed that has made an increasing proportion of timber from the Northwest unavailable for domestic primary manufacture, leading to unemployment and to some mill curtailment in communities dependent on Federal timber."

But despite this development, exports continued to expand as the Japanese turned increasingly for supplies to regions outside the scope of the ruling. These included private and publicly-owned timberlands east of the Cascade Mountains — the so-called Inland Region — as well as all of California's forests and all state and privately-owned timberlands in the Pacific Northwest. Not surprisingly, then, log exports from California—which had begun to accelerate in 1967—rose five-fold in 1968, to almost 200 million board-feet. Exports from the regions affected by the restriction also continued to rise because the order did not affect contracts already made at the time of the policy decision.

These developments thus prompted further industry pressure to extend the earlier ruling—both in duration and in geographical area. Thus, in October, President Johnson signed — in an amendment to the Foreign Assistance Act — a limitation which restricted log exports from all Federal lands west of the one-hundredth meridian (through Kansas) to an annual total of 350 million board-feet for the 1969-71 period. Exports could exceed that level only if — in the judgment of the Secretaries of Agriculture and Interior —certain species of unprocessed timber were deemed to be surplus to the needs of domestic users. But private and state-owned lands, comprising almost half the total timber supply, are exempted from this limitation.

Fewer mills, more snowstorms

Some industry analysts have argued that mill closures in 1966 and 1967 prevented the industry from expanding production further last year. According to unofficial reports, about 25 plywood plants and 60 sawmills closed down in western Washington and western Oregon during that period alone, because of their inability to pay the high log prices being offered by the Japanese and the larger American mills.

Many Pacific Northwest lumbermen claim, however, that log shortages have placed a limitation only on current production—not on overall capacity. In fact, their viewpoint seems to be substantiated by past production statistics. Small, inefficient, and inadequately financed mills have been dropping out of the industry for many years now, yet this process has not prevented the industry as a whole from raising production in response to rising demand when log supplies have been available. Over 200 lumber mills shut down in the West in the 1961-64 period alone, but despite this 10-percent decline in the total number of mills, production rose more than 13 percent (2½ billion board-feet) during that period. Most of the mills that dropped out of business were small, each having an annual capacity of less than 10 million board-feet. But meanwhile, 42 new mills opened during the same period, each with an annual capacity of at least 25 million board-feet.

This winter's snowstorms — which have dumped up to 30 inches of snow on the ground in key lumber-producing areas — have sharply curtailed recent production. During the worst period (late January), lumber production in the Douglas-fir region dropped to only half-capacity and plywood production slipped to two-thirds of capacity. Despite some subsequent improvement, production in the Coastal (Douglas fir) and Inland regions through late February was 7 percent below the comparable 1968 production level. With logging operations in low elevations sharply curtailed from western British Columbia down to western Oregon, log supplies are likely to remain tight for some time to come.

In this situation, competition among Japanese buyers and domestic producers for available timber supplies has led to heavy bidding for stumpage — timber for sale on the stump. Thus, the average stumpage price for Douglas fir sold from national forests west of the Cascades rose 47 percent in 1968. (The average price in the fourth quarter reached $92.90 per thousand board-feet — more than double the late-1967 quotation.) The 1968 increase was roughly four times the average annual increase in stumpage prices for the entire 1963-67 period.

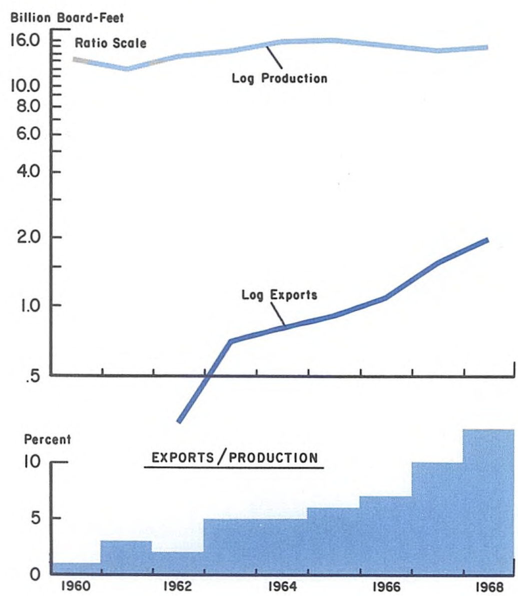
Supply versus demand

If the "allowable cut" is insufficient to meet current demands for lumber, a sharp increase in supplies clearly will be required if the increased wood demands of the future are to be met. But just as clearly, producers' willingness to make advance stumpage commitments at today's prevailing sky-high prices —thus subjecting themselves to a cost-price squeeze if lumber prices should decline — suggests their strong confidence in the future trend of prices for the finished product.

According to the housing goals set down in the Housing and Urban Development Act of 1968, the construction of new and rehabilitated homes could exceed 2 million units by the early 1970's—and could even double 1968's rate of 1.5 million units by 1975. If this pace of homebuilding is achieved, the use of lumber in residential construction (including mobile homes) could rise from 14 billion board-feet in 1968 to well over 20 billion board-feet by 1975.

Lumber of course will be needed for more than just residential purposes, since homebuilding historically has accounted for not

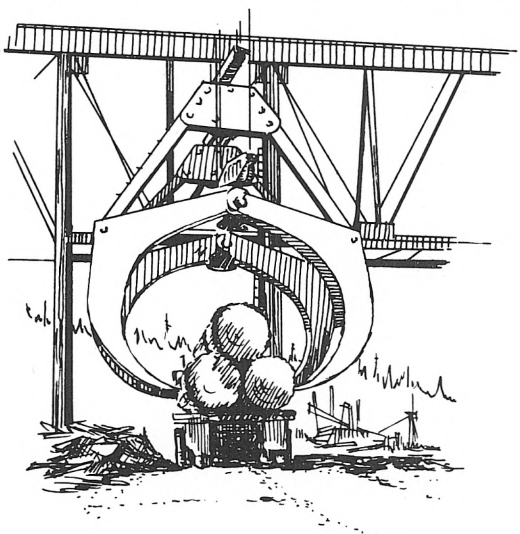
Exports jump to 13 percent of Northwest's timber harvest



much more than one-third of the total lumber consumed in this country. If past patterns prevail, lumber consumption, including that used in nonresidential construction, could rise from 41 billion board-feet in 1968 to well over 60 billion board-feet by 1975 . . . And these increased demands do not include those expected in other forest-product areas, such as plywood, pulp and paper, and a host of other uses.

The expected increase in wood-products demand naturally has stimulated much discussion regarding the adequacy of timber supplies, the methods of increasing timber yields and growth, and the financial obstacles to optimum management of public lands. Foresters generally concede that the burden of meeting the large increase in future demand for timber will fall heavily upon the Western region of the country and within that region upon the Federal land-management agencies, namely the U.S. Forest Service and the Bureau of Land Management.

The West — including the Pacific Coast and Rocky Mountain states — accounts roughly for three-fourths of all the softwood lumber and four-fifths of all the softwood plywood produced in the entire nation. Virtually all of the nation's remaining stands of old-growth sawtimber are concentrated in that region, with a major portion in Oregon, Washington, and Idaho.



The key: Federal lands

Federal lands are by far the largest single supplier of raw material for the forest-products industry, accounting for slightly over one-half of the commercial forest land in the Pacific Coast states and two-thirds of the commercial timberland in the West as a whole. Most Western mills are dependent on public timber to some extent, with the dependency of the small and medium-sized mills being particularly great. Private timber, which met most of the demand during earlier decades, has declined steadily as a source of timber during the postwar period.

Federal foresters and other lumbermen agree that the most promising opportunities for increasing the annual allowable cut in the West are to be found through intensified management of our public and private forests. In their eyes, the basic problem facing the forest-products industry is one of increasing growth-per-acre sufficiently over the long run to offset the decline in available timberland which results from the withdrawal of commercial lands for roads, power lines, dams, wilderness areas, and parks. (Two such parks were established in 1968: Redwood National Park in California and North Cascades National Park in Washington.)

The managers of the Federal forests emphasize one point: any sustained increase in the allowable cut on national forests must be preceded by such measures as reforestation of nonstocked land, thinning, stand improvement, more complete salvage, increased protection against destructive agents, and increased access-road construction. When those measures are taken, according to U.S. Forest Service studies, the allowable cut on national forests in the Douglas-fir region could eventually be increased by two-thirds through intensified timber culture.

The producers of forest products generally believe that the allowable cut on national forests could be increased at the present time, without endangering future supplies, by means of accelerated harvesting of overmature stands and shorter rotation periods (the growing period required before second-growth timber may be harvested). Achieving a compromise between their position and that of the Federal forest managers may depend upon Congressional appropriation of enough funds to allow the intensified forestry work necessary to assure adequate timber growth to compensate for shorter-term liquidation of old-growth timber.

Unsatisfied with long-term solutions, however, builders and lumbermen early this year began to press for more immediate answers to the log-supply problem. The newly formed Joint Coordinating Committee of the Housing and Forest Products Industries asked for an immediate increase in the annual timber harvest from Federal lands, consistent with good management practices, while the National Association of Home Builders called for an embargo on all exports of timber, lumber and wood products.

Public pressures soon brought some concrete results. To begin with, Congress responded to the widespread demands for a study of the lumber industry's problems, as was noted at the outset.

In addition, President Nixon took steps in late March to relieve the pressure on prices. The President issued several directives: to the Defense Department, to hold its purchases to a minimum; to the Agriculture and Interior Departments, to increase Federal timber sales by 910 million board-feet; and to the Interstate Commerce Commission, to help relieve the boxcar shortage which has hampered the movement of lumber from the Northwest's forests to the nation's building sites.

The lumber industry obviously must deal with the rapid rise in the price of its products if it hopes to ward off a widespread switch-over to substitute materials. In the meanwhile, in the absence of increased timber, it is striving to make the most out of what is available by improving utilization of its log supplies.

Yvonne Levy

State-Local Borrowing: 1966

The impact of tight money on the 1966 borrowing plans of large state-and-local governments in the Twelfth District was analyzed in an article which appeared in the October 1968 *Monthly Review*. Copies of this article are still available, along with detailed tables comparing the experience of Western units and large governmental units elsewhere during the year 1966.

Copies are also available of a similar report which analyzes the borrowing experience of *smaller* governmental units during the 1966 tight-money period. Smaller units participating in the Federal Reserve survey included counties with less than 250,000 population, municipalities with less than 50,000 population, school districts with less than 25,000 enrollment, and special districts with less than $5 million in debt outstanding.

Single copies of either or both reports (with tables) can be obtained upon request from the Administrative Services Department, Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco, California 94120.

Publications

Silver: End of an Era (32 pp. 1969) — Report on silver coinage, industrial developments, and silver mining in the West

Copper: Red Metal in Flux (60 pp. 1968) — Historical study of copper mining, copper markets, and the outlook for the future

Farm Lending in the West (20 pp. 1968) — Results of 1966 farm loan survey

Credit — and Credit Cards (12 pp. 1968) — Report on recent developments in bank credit cards and check credit plans throughout the nation.

Law of the River (16 pp. 1968) — Report on present and future sources of water supply for the Pacific Southwest to meet its 21st-century needs

Price Tag on the Nation's Health (12 pp. 1968) — Report on medical care costs

Wages and Prices . . . Men of Steel (20 pp. 1968) — Two labor-market articles

Centennial Summer (12 pp. 1967) — Report on Alaskan industrial and resource development as providing vast potential for growth of this area

Trees, Parks and People (12 pp. 1967) — Study of the economic issues involved in the Redwood National Park along California's northern coast

Down the Ways (12 pp. 1967) — Report on U.S. and foreign shipbuilding industries

Aluminum—Lightweight Rebounding (24 pp. 1966) — Study of aluminum production and aluminum markets and their importance in the national economy

Men, Money and the West (60 pp. 1964) — Historical survey of national and regional developments and growth over the past half-century

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