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In this issue

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May 1969

The Agencies: New Directions

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Deposits: Growth and Seasonals

. . . A new seasonally-adjusted series shows the uneven pace of deposit growth over the 1960-68 era, despite rapid growth overall.

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Editor: William Burke

The Agencies: New Directions

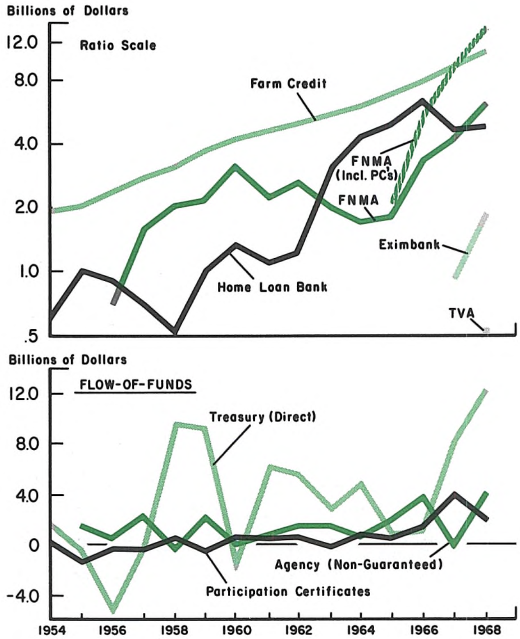
The agency market — more exactly, the Federal Agency Security market—deals in the negotiable debt instruments of a number of agencies which are instrumentalities of the Federal Government but operate apart from the U.S. Treasury itself. The role of the agencies in the nation's financial markets has shifted somewhat over time, and so too has their role in the Federal budget picture. The most striking changes over the past year or so have involved a new approach to the marketing of agency securities and, in particular, a shifting of some agencies from public to private ownership.

One group of agencies provides supplementary long-and short-term credit to the agricultural sector of the economy. These entities—the Federal Land Banks, the Federal Intermediate Credit banks, and the (Federal) Banks for Cooperatives — are supervised by the Farm Credit Administration in the Executive Branch of the Government. Another group of agencies is concerned with the residential-mortgage market — the Federal Home Loan Banks, the Government National Mortgage Association (GNMA, or Ginnie Mae), and the Federal National Mortgage Association (FNMA, or Fannie Mae). Under the terms of the Housing Act of 1968, the former Federal National Mortgage Association was split into two parts, GNMA and FNMA.

These farm-oriented and housing-oriented agencies were, until recently, the only issuers of agency securities, and they still account for the vast bulk of the total securities outstanding in this market. In the present decade, however, the Tennessee Valley Authority (1960) and the Export-Import Bank (1967) have entered the market with their own obligations to obtain financing for powerplant construction and export-support activities, respectively.

The Federal agencies' credit activities were designed originally to acquire funds from the securities markets so as to supplement the sources of financing already available to the areas of their concern—and, in a growing number of cases, almost all of the financing of these agencies is now obtained in this manner.

Agency debt outstanding grows along with Federal financing needs



The financial effects of those activities have developed beyond this original purpose, however. Orderly credit markets of national scope have taken the place of isolated local markets, and, as is true of financing generally, the shift of funds from areas of surplus to areas of deficit has been facilitated.

Most of these agencies are intermediaries —they borrow in order to relend their borrowed funds. Moreover, in many operations they deal directly with other financial institutions and, in certain cases, they use other financial institutions as vehicles in distributing funds to the ultimate borrower. For example, a savings-and-loan association could finance the private purchase of a new home partly on the basis of funds obtainable from its Federal Home Loan Bank.

At the end of fiscal 1968, the former Federal National Mortgage Association was the largest single supplier in the agency market, with $7.9 billion outstanding in participation certificates — FNMA acting as trustee and issuer of certificates in pools of loans and mortgages assembled by individual Federal agencies—and with $5.9 billion outstanding in its own notes and bonds. The Federal Land Banks were next with $5.3 billion, followed in order by the Federal Home Loan Banks ($4.7 billion), Federal Intermediate Credit Banks ($3.8 billion), the Export-Import Bank ($2.6 billion), Banks for Cooperatives ($1.2 billion), and the Tennessee Valley Authority ($0.5 billion). However, only a portion of the total debt now shows up on the Treasury's books under the heading of agency debt, because of the increasing trend toward "privatization" of Government-sponsored corporations.

The amount of debt outstanding in the agency market increased five-fold over the 1958-68 decade, from $5.4 to $34.4 billion —including securities of privately-owned but Government-sponsored agencies — while the Treasury's public debt expanded from $276.4 to $347.5 billion over the same time-span. Thus, agency debt increased by almost half as much as Treasury debt over this period.

Moreover, new issues sold in the agency market amounted to $7.7 billion in calendar-year 1968. This is somewhat less than the $16.4 billion sold by state-and-local governments or the $17.4 billion sold on the corporate-bond market in 1968. Nonetheless, Federal agencies are a powerful source of substantial competition to other borrowers in the capital market, and this competition is growing rapidly; agencies marketed more issues in the single year 1967, and again in 1968, than in the entire first half of this decade.

Agencies and the Treasury

What types of debt instruments are traded in the Federal agency market? The answer is just about every type. The market encompasses bonds and notes ranging in maturity (at issue) from 3 months to 20 years. Some pay interest only at maturity; most pay semi-annually. A few are callable; most are not. Some short-term notes are sold at a discount from par value, in a way similar to Treasury bills. And in addition to bonds and notes, there is the relatively new form of debenture know as the participation certificate (PC's).

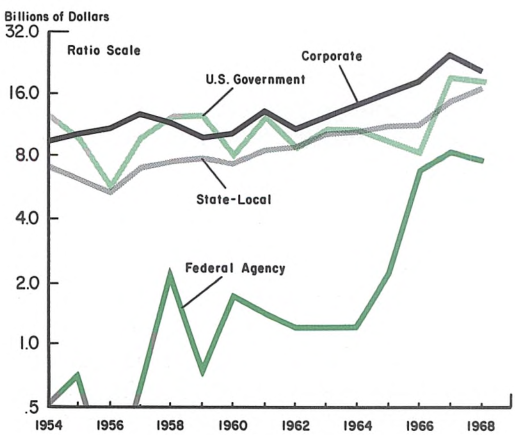
The unique feature of most agency issues, which sets them apart as a special class of investments, is the fact that they are not guaranteed by the Federal Government, even though they are issued by instrumentalities of that Government. (But there are some exceptions; for example, PC's have been fully guaranteed since January 1967.) Legally, they are the responsibility of the issuing agency. They occupy an anomalous position; strictly speaking, they are neither Government nor private debt instruments.

But the agencies, under certain circumstances, have the right either to borrow funds directly from the Treasury or to sell their obligations directly to various Government trust and investment accounts. Thus the agencies do have some degree of recourse to the Government. In the case of participation certificates, this recourse is direct and immediate; in the case of other securities, the recourse is not so explicit.

Nevertheless, traders in this market recognize the unique position of agency securities. As one financial publication puts it, "The agencies are quasi-members of the Government family, and should they need assistance Uncle Sam undoubtedly would come to the rescue." Thus, only in the most formal sense would there appear to be any greater degree of risk attached to these securities than to direct Government obligations; in fact, national-bank regulations classify all of the securities of these agencies as "minimum risk" assets.

In addition, the agencies that issue these instruments are, without exception, successful businesses. They are all able to meet their operating expenses, including defaulted loans, out of the fees they charge for their services, and there is every reason to expect that they will continue to do so. Again, the market recognizes this fact; from a strictly business point of view, these instrumentalities stand on their own feet as income producers with sufficient collateral behind their debts to satisfy investors.

Zooming growth of agency issues is major feature of new-issue market



Price and tax status

Nonetheless, all of these issues typically sell at a lower price—that is, at a higher yield—than do comparable Treasury notes and bonds. However, this fact may reflect the less-developed nature of the market for agency securities and the recent rapid rise in outstanding securities, as well as the market evaluation of risk involved. The market indeed is fast growing, even though it is still only about one-tenth the size of the Government-securities market. Between 1961 and 1967 alone, the average daily volume of dealer transactions in agency securities jumped from $75 million to more than $210 million.

Another distinguishing feature of agency issues is their tax status, which sometimes differs from that of regular Government securities and often differs from that of corporate securities. The income from all of these issues is subject to Federal income taxes, but differences arise with respect to state-and-local taxation. Treasury securities are exempt from state-and-local taxes; corporate securities are not; and agency issues, neither fish nor fowl, are exempt in some cases and nonexempt in others.

The question turns on whether or not a given agency's securities are interpreted to be an obligation of the Federal Government. If they are, then, under the Constitution, income from them is exempt from all state-and-local income taxes. As was noted above, none of these securities (except some PC's) are formally guaranteed by the Federal Government, but all of the agencies involved do have some degree of recourse to the Government. To further confuse the issue, the capital stock of the five principal agencies was originally provided by the Treasury but is now largely or totally owned by private investors. However, in each case, private ownership and control is subject to some Federal supervision of general policies and operation. (TVA and Eximbank are still wholly owned by the Government.)

Yet another distinctive characteristic of the agency market concerns the marketing of these securities, with a fiscal agent handling all the details of each sale. For example, the Government National Mortgage Association and the Federal Home Loan Bank system each has its own agent, and the Farm Credit Administration employs one agent to handle the sales of all three of the farm-credit agencies.

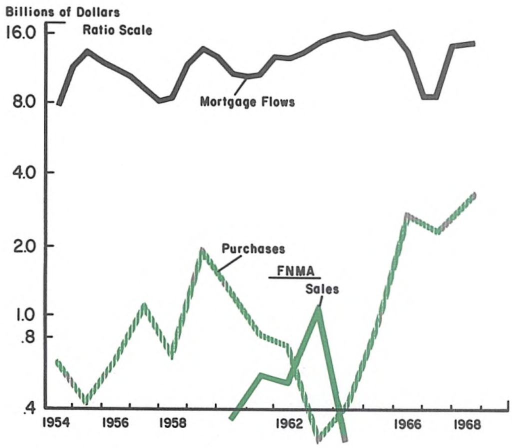
The fiscal agents are responsible for assembling selling groups for the purpose of distributing securities to retail investors. A selling group — composed of Government-bond dealers, banks dealing in securities, stock houses, and similar nationally recognized organizations—differs in several important respects from the type of syndicate that markets corporate and municipal bonds. First, a selling group is set up on a continuing basis, although individual members do enter and leave the group; the typical syndicate, on the other hand, is formed anew to bid on each particular corporate or municipal issue. Secondly, there is no competitive bidding among the group members for an agency issue, whereas several syndicates generally bid against each other for each corporate or municipal issue.

Prior to each sale, the fiscal agent consults with agency officials and with selling-group representatives regarding the amount, coupon, price, and date of sale. The individual agency is responsible for the final determination of terms on its issue. On the sale date, the agent telegraphs the price to the members of the selling group. The members then telegraph or telephone their subscription to the fiscal agent's office in New York, where allotments are made. The new securities are delivered at the Federal Reserve Bank of New York, and payment is in Federal funds at the offering price less the stated commission. (Federal-funds transactions are dealings in member-bank reserves in a Federal Reserve bank.)

New directions: FNMA marketing

The Federal National Mortgage Association (Fannie Mae) changed its mortgage-purchase arrangements about a year ago, largely as a result of lessons learned during 1966, when mortgage money practically disappeared from the market. Fannie Mae, of course, normally provides increased liquidity to the mortgage market through the purchase —whenever private investment funds are in short supply—of mortgages insured by the Federal Housing Administration, guaranteed by the Administrator of Veterans Affairs, or insured by the Farmers Home Administration of the Department of Agriculture. Mortgages

FNMA mortgage purchases provide strong support to market



are purchased from an approved list of holders, including mortgage companies, banks, savings-and-loan associations, life-insurance companies, and any Federal agencies authorized to sell mortgages and to acquire Fannie Mae common stock. Generally, about 70 to 80 percent of total purchases are from mortgage companies, many of which originate mortgages exclusively for resale to Fannie Mae.

Under its former mortgage-purchase procedures, Fannie Mae announced the price it would pay for any Government-backed mortgages and thus permitted the sellers of such loans to determine its volume. But in the fast-slumping 1966 mortgage market, Fannie Mae with its pre-announced price generally came in above the market price, and consequently it was deluged by proferred mortgages.

Now, under its new "free market" system, Fannie Mae announces each week the *volume* of mortgages it is prepared to buy and permits the market, through sealed bids, to determine the price it will pay for its purchases. Moreover, it deals in advance commitments to buy mortgages three, six, or twelve months in the future, rather than in immediate purchases. In this way, it guarantees the future availability of money to successful bidders and thus helps smooth out the ups-and-downs of the mortgage market—and meanwhile it assures increased efficiency in the use of its own funds.

In each weekly auction, Fannie Mae accepts bids, starting with the lowest priced, until the pre-announced volume of funds is committed. A maximum is set for each bid so that a single seller, or area, cannot completely dominate the auction. Noncompetitive bids also may be entered, as in weekly Treasury-bill auctions, and these are awarded at the average price of accepted competitive bids.

During the first half of this decade, Fannie Mae purchases ranged from 3 to 10 percent of total FHA-VA mortgages issued, but in tight-money 1966 the agency's share leaped to 27 percent. Then, as the mortgage market improved in 1967 and 1968, the agency's share of Government-backed mortgages declined somewhat. Even so, total secondary-market purchases rose from $1.4 billion in 1967 to over $1.9 billion in 1968 — or close to the $2.1 billion peak of 1966.

In general, net purchases of mortgages tend to coincide with periods of heavy demands on the capital markets. Thus, Fannie Mae made large secondary-market purchases in the 1956-57 period, in 1959 and early 1960, and during the credit crunch of 1966. On the other hand, net sales of mortgages tend to coincide with periods of credit ease, when mortgage loans are easily absorbed in the market — and when investors are actively looking for relatively high-yielding investments within a context of declining long-term interest rates. Thus, sales were concentrated in the recession months of early 1958 and early 1961, but also at times in 1962 and early 1963. Total sales have averaged only about one-fourth of total purchases over the years—not surprisingly, since an aggressive sales policy during tight-money periods would conflict with FNMA's aim of encouraging new homebuilding.

New directions: private ownership

Several Government-sponsored enterprises became privately owned in late 1968, so that their budget figures are now excluded from the Federal budget totals. The Federal National Mortgage Association's secondary-market operations fund, formerly under mixed ownership, became a privately owned venture on September 30. The twelve Federal intermediate-credit banks and the thirteen banks for cooperatives, supervised by the Farm Cerdit Association, became wholly privately owned on December 31. (In this regard, they have joined the twelve Federal land banks, which are co-operatively owned by participant farmers. Similarly, the twelve Federal home loan banks, which are supervised by the Federal Home Loan Bank Board, obtain their funds from capital stock owned by member institutions, as well as from issuance of their own obligations, and from deposits of member institutions.)

In fiscal 1969, several major reductions have occurred in the Treasury's accounts for "outstanding agency debt" because of the conversion of these three types of mixed-ownership enterprises to wholly private ownership. In September 1968, the responsibility for $6.0 billion of Fannie Mae borrowing, heretofore included in the "Federal debt," was assumed by private owners, with a consequent reduction in the total Federal debt as shown on the Government's books. In December 1968, decreases were similarly recorded for $3.6 billion and $1.4 billion, respectively, in outstanding *official* borrowings by the intermediate-credit banks and banks for cooperatives, as these entities were similarly converted to private ownership.

For the housing agencies, this shift was accomplished under the terms of the Housing Act of 1968. The Federal National Mortgage Association has been converted into a privately-owned corporation, with the secondary-market operations under its wing. The Government National Mortgage Association meanwhile has been organized under Federal auspices to handle Fannie Mae's other original functions — the special-assistance and management-and-liquidating functions. (The former provides subsidies for such activities as housing for the aged, and the latter provides mainly portfolio management.)

Insofar as its mission or its basic operating methods are concerned, Fannie Mae remains practically unchanged. It continues to implement Government housing policies while at the same time providing a "reasonable" return to its stockholders. It continues to provide mortgage lenders with fresh funds to support housing activity through its purchases of Government-backed mortgages on the secondary (resale) market when money conditions are tight. Through its recently-devised auction method, however, it should do so more efficiently than heretofore.

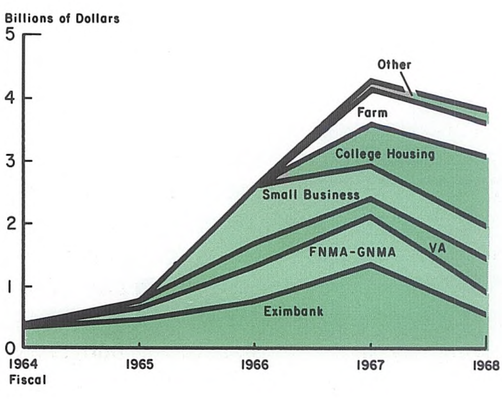
Fannie Mae's ties to the Treasury have been severed in some respects but retained in others. Preferred stock held by the Secretary of the Treasury has been retired through proceeds of a public offering of $250 million in long-term capital debentures. At the same time, Fannie Mae will still be able to call upon the Treasury for up to $2.25 billion in an emergency, since it continues to be considered an instrumentality of the Treasury.

This operational change, by taking secondary-market operations outside of the Government and thereby outside of Federal budget constraints, should help make the agency more responsive to the needs of the general economy. Thus it ameliorates the problem described by HUD Secretary Weaver in Congressional testimony on last year's housing legislation: "Sometimes budgetary pressures require the secondary-market activities to zig where the ends of the building and mortgage-financing industries may be better served if the activities were to zag." On the other hand, it should be recognized that the ends of these industries are best served when they conform to general economic-policy goals.

New directions: Ginnie Mae's PC's

In line with the changes initiated by the Housing Act of 1968, the Government National Mortgage Association has taken over the responsibility for the participation-certficate program. Under this program, Ginnie Mae and a number of other entities — the Veterans Administration, the Small Business Administration, the Farmers' Home Administration, the Department of Health, Education and Welfare, and the Department of Housing and Urban Development—participate as trustors for the loans in which participations are to be sold. Each of these entities enters a trust agreement under which the appropriate agency, function, or department agrees to set certain loans aside on its books, to subject them to trust, and to guarantee the payment of principal and interest on such loans. The trustor fulfills the guarantee when

Drop in PC sales marks decline of multi-agency pooled-loan program



necessary by using appropriated funds as well as program funds to which the entrusted amounts are related.

Ginnie Mae's major role, however, is to serve as trustee to the agreement reached with each of the above organizations. (This fiduciary responsibility is carried out under the agency's management-and-liquidating function.) As trustee, Ginnie Mae issues and sells the loan participations, normally through some underwriting group. The participations are based on the right to obtain principal and interest payments on pooled obligations.

Ginnie Mae, in its corporate capacity, guarantees all payments due on the certificates, and it can borrow from the Treasury to make timely debt-service payments. The GNMA guarantee and the Treasury borrowing privilege have never been needed, however, in view of the lending agencies' guarantee and in view of their obligation to substitute loans for any defaulted loans in the original pool. The GNMA guarantee and drawing authority are designed to provide extra safeguards to help assure a favorable market reception (and lower interest rates) for the participation certificates. A typical offering of PC's will include certificates with a wide range of maturities, from 1 to 20 years.

From its inception in November 1964, the PC program was designed to stimulate expanded participation by investors in the financing of public credit programs. Almost all investors in the agency market are potential purchasers of participation certificates, while in contrast many dealers are constrained by law or preference from dealing in individual mortgages or loans that constitute the pool underlying the participations. Thus the sources that can be tapped to support any particular Federal credit program have been considerably enlarged by the development of this program.

PC sales grew by leaps and bounds for several years, but then began to decline. Sales totaled $0.8 billion during fiscal 1965, the program's first year of operation—except for some earlier Eximbank offerings—rose rapidly to $4.3 billion in fiscal 1967, and then dropped to $3.8 billion in the following year. (To date in fiscal 1969, the only PC sales, $1.3 billion, were recorded last August.) Still, with only small amounts being retired, $11.0 billion worth of participation certificates were outstanding in the agency market in March of this year. Outstanding PC's, in other words, exceeded the outstanding securities of any single agency, and accounted for more than one-fourth of all securities in the agency market.

The PC program has generated a great deal of controversy during its short history, centering primarily around the treatment of PC's in the Federal budget and in the debt limit. Initially, PC sales were considered as a reduction in Government expenditures. But critics of this procedure argued that it was "gimmickry," and that the PC sales were just as much a means of financing budget expenditures as were direct Treasury borrowings.

The controversy was for the most part settled in the last year or so. First, Congressional legislation decreed that participation certificates sold during fiscal 1968 would be treated as Treasury debt, and thus would come under the debt limit. (But this legislation did not include PC issues prior to or after fiscal 1968.) Then the Administration's new "unified" budget changed the treatment of all agency operations, depending on whether the agency in question was *wholly* owned by private entities or had some Government sponsorship. If partially Government-owned, the agency's receipts and expenditures are included with the regular Government accounts. But the new procedures also shift PC sales from the operating budget—where they served to reduce expenditures—to a means of financing the budget.

The new housing legislation not only puts Ginnie Mae in business as trustee for the PC program, but it also empowers that agency to guarantee issues of "mortgage-backed" securities—that is, packaged obligations issued by private firms dealing in mortgages, such as commercial banks, mortgage-banking firms, and Fannie Mae. With the Ginnie Mae guarantee, these securities would have the "full faith and credit" of the Federal Government behind them. They could be sold to pension funds and other large institutions which normally do not deal in individual mortgages because of the paperwork involved, and thus they would provide another way of broadening the financial support of the mortgage market.

Andrew Winnick and William Burke

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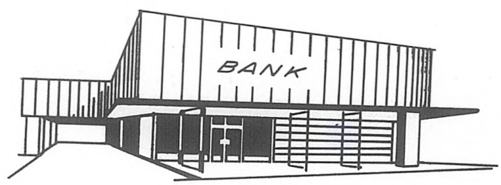
Deposits: Growth and Seasonals

Total deposits at Twelfth District member banks, as well as at banks elsewhere in the nation, practically doubled during the almost uninterrupted economic expansion of the 1961-68 period. By type of deposit, rates of growth varied as follows:

- Total demand and time deposits (subject to reserve requirements) at Western member banks increased at an 8.0-percent annual rate between the beginning and the end of the 1961-68 era. This figure slightly bettered the 7.7-percent figure recorded elsewhere, largely because of a faster rate of growth in the West in the first half of this eight-year period.
- Net demand deposits at Western banks —total demand deposits less deposits due to domestic banks and cash items in process of collection—increased at only a 3.6-percent annual rate over this period, reflecting the lack of growth in this category between mid-1964 and mid-1967. The comparable figure for banks elsewhere was 3.0 percent. In the West, the private-demand deposit component —net demand deposits less U.S. Government deposits—expanded at a 3.9 percent rate while public deposits declined.
- Time-and-savings deposits increased rapidly throughout almost all of the 1961-68 period. In the District, the average annual gain was a strong 11.4-percent; elsewhere in the nation, the annual gain was an even more substantial 14.4-percent figure.

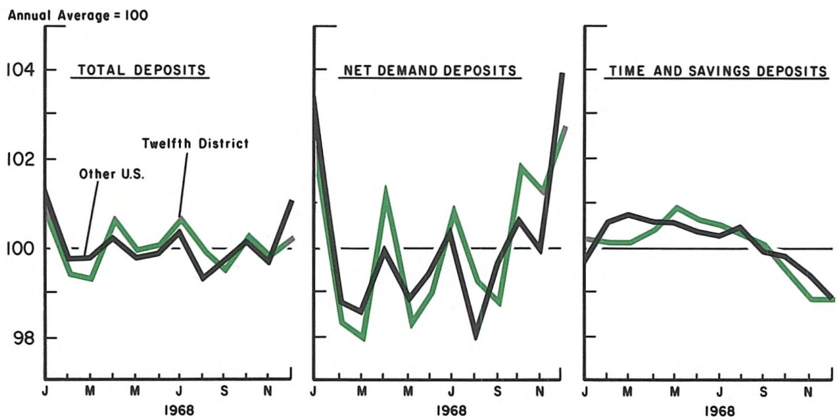
Outline of seasonal patterns

An analysis of seasonally-adjusted data developed by this bank's research staff shows significant differences in various sub-periods of the 1961-68 period. The basic data were computed on a monthly basis in order to pinpoint, as closely as possible, the timing of shifts in deposit flows. These series were constructed by averaging daily deposits for the reserve-statement weeks (ending Wednesday) falling within a given month. A Census Bureau adjustment program was then applied to remove normal seasonal variations from the unadjusted monthly series.



The seasonal-adjustment procedure was applied to two major series, total deposits and time-and-savings deposits. From these series, net demand deposits were derived as a residual, since these deposits are subject to greater irregular movements than are time deposits. Within the demand-deposit category, the adjustment program was applied to the figures for private demand deposits, and the extremely volatile component, U.S. Government (public) deposits, was derived as a residual.

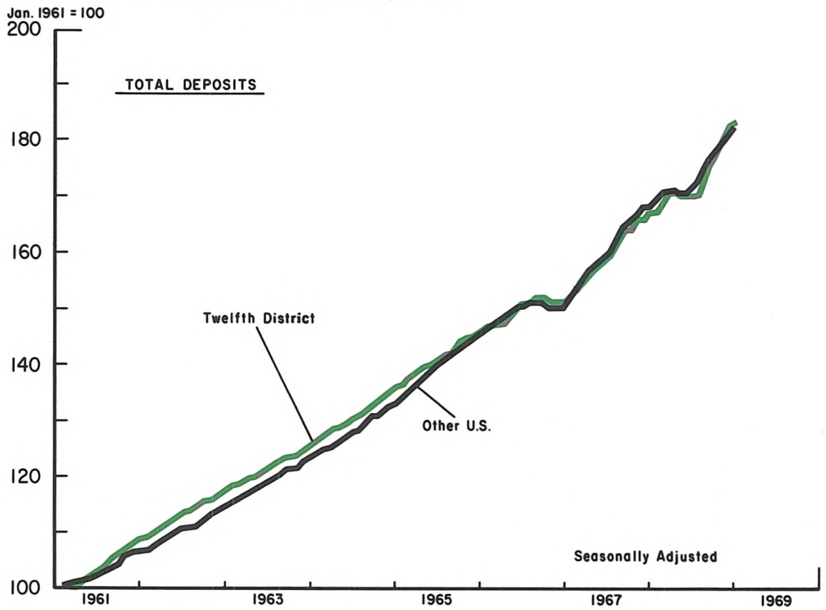
Demand deposits exhibit pronounced seasonal pattern, while time deposits move less sharply



Private demand deposits, in the West as elsewhere, have a pronounced seasonal pattern. They tend to decline through the first quarter, especially in February and March, then rise during April, but decline in May as income taxes are processed and debited to deposit accounts. They exhibit little trend during the summer, but then rise from September to their December peak. But within the overall demand-deposit category, these fluctuations in private deposits are frequently offset by the extremely erratic movements of U.S. Government deposits. (Public demand deposits have also shown wide year-to-year fluctuations, but no overall growth, from 1961 to 1968.)

Time-and-savings deposit flows at Western banks show a well-defined seasonal pattern. They tend to rise in January, decline slightly in February and March, then accelerate sharply in April and May. Subsequently, they tend to decline gradually until November, and then level off in December. Banks elsewhere, however, show a somewhat flatter pattern; their inflows tend to peak in March (with a secondary peak in August) and to decline gradually through November. This difference in seasonal patterns reflects the wide seasonal movements in public time deposits, which are a much larger component of the time-deposit category at Western banks.

Western banks outpace others with 8-percent annual rate of gain in total deposits



Variation in total deposits . . .

District banks' total deposits rose at a 7.8-percent annual rate between January 1961 and July 1966, but this strong upward movement was then broken by the 1966 monetary crunch. As monetary pressures on bank reserves intensified in the latter part of the year, deposits contracted at a 1.1-percent annual rate.

Total deposits, after moving upward at a 10.0-percent rate between January 1967 and March 1968, increased at only a 1.8-percent rate over the following several months, under the impact of rising money rates and a restrictive monetary policy. But following this pause, deposits in second-half '68 expanded at an 18.7-percent rate, in the strongest surge of the entire eight-year period.

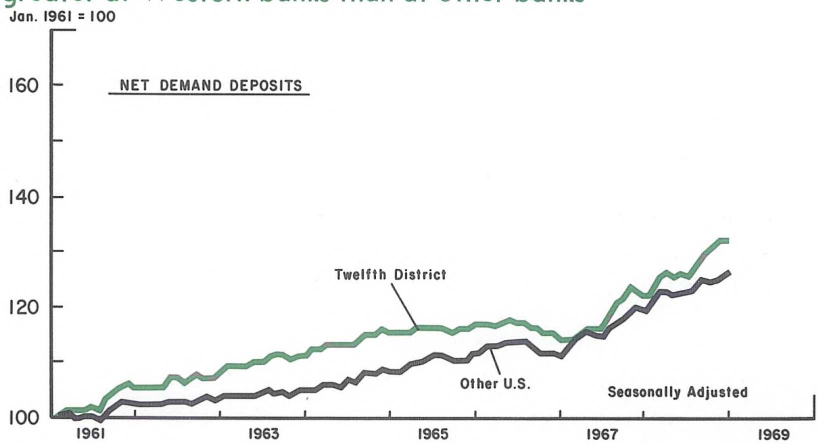
The expansion in total deposits was greater at Western banks than at other banks between early 1961 and mid-1965, and then again in the second half of 1968. But Western banks experienced the same rate of outflow as others during the 1966 tight-money period, and they suffered a more severe outflow than others in the brief pause of second-quarter '68.

. . . reflects demand-deposit swings

District banks' private demand deposits grew at a 3.7-percent annual rate, on the average, between early 1961 and early 1964, and then moved sideways through the summer of that year. The series again expanded until mid-1966, but this gain was more than offset by a sharp 6.5-percent contraction in late 1966 as banks came under heavy reserve pressure. A substantial expansion ensued in January-October 1967; this was followed by a brief pause, and then by another expansion spanning most of 1968. The expansion was strongest in the January-August '68 period, with a 12.0-percent rate of gain.

Western banks posted larger demand-deposit gains than others throughout the 1961-64 period, and also during most of the 1967-68 interval. Thus, they were able to record a larger gain for the period as a whole, despite

Demand-deposit growth, at 4 percent annually, greater at Western banks than at other banks



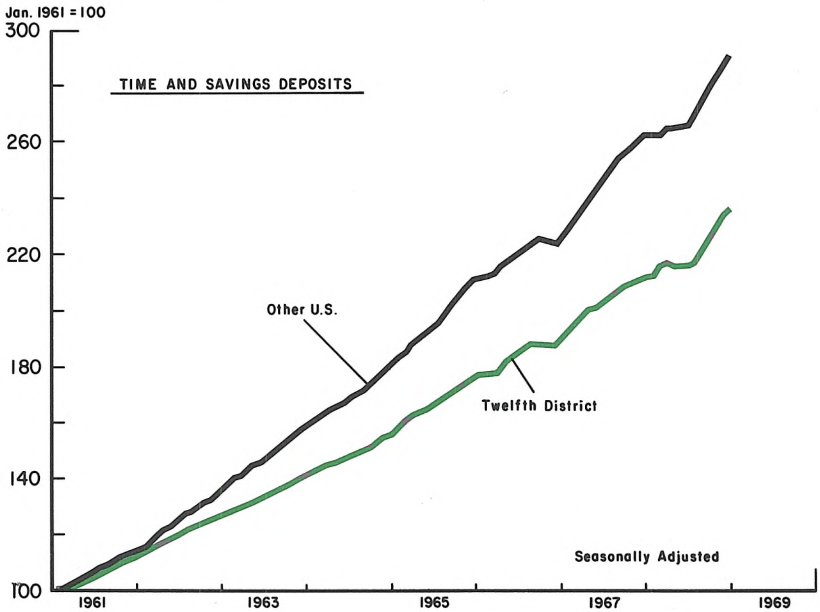
TWELFTH DISTRICT MEMBER BANKS SEASONAL FACTORS FOR DEPOSITS

1968	Total Deposits[1]	Time & Savings Deposits	Net Demand Deposits[2]	Private Demand Deposits
January	100.9	100.2	102.2	103.1
February	99.4	100.1	98.3	98.0
March	99.3	100.1	97.9	98.0
April	100.7	100.4	101.4	101.9
May	99.9	100.9	98.2	96.6
June	100.0	100.6	98.9	97.5
July	100.7	100.5	100.9	99.0
August	99.9	100.3	99.2	98.3
September	99.5	100.0	98.7	99.7
October	100.3	99.4	101.8	101.7
November	99.7	98.8	101.1	102.3
December	100.2	98.8	102.7	103.7

[1]Subject to reserve requirements
[2]Residual series

their relatively larger contraction in late 1966, as well as their more protracted periods of sluggishness in early 1965 and late 1967.

Time deposits grow at rapid 11-percent pace in West, but at even faster pace elsewhere



. . . and time category's wider swings

District banks' time-and-savings deposits grew fairly steadily over the 1961-65 period, at a 12.0-percent annual rate. In 1966's more volatile atmosphere, however, this series fluctuated wildly.

During the first quarter of that year, Western banks posted a net decline in passbook savings—and recorded no growth in total time deposits—because of the intensified competition for savings, especially from savings-and-loan associations. But banks were able to expand time deposits at a 12.0-percent rate in the spring and early summer, when they aggressively bid for funds by offering various savings certificates which carried competitive rates. Nonetheless, the ensuing monetary crunch brought about a reversal of the situation; banks suffered a 0.8-percent rate of decline in the September-November period, as they lost substantial amounts of large-denomination time certificates (and also public time deposits) when market rates rose to a point exceeding the legal rate payable on these CD's.

From November 1966 through March 1968, time deposits resumed their upward trend at about the 1961-65 pace. This movement was halted temporarily in the second quarter of 1968, when rising income taxes caused heavy withdrawals of savings, and when rising market rates (plus a speed-up in corporate-tax payments) generated a sizable run-off in the CD category. But then, in the second half of the year, time deposits spurted ahead at an 18.9 percent annual rate; public deposits increased, because of the temporary lodgment of funds received from a heavy volume of municipal-bond flotations, and business deposits in CD form also rose.

Because of the very rapid growth of time-and-savings deposits at banks elsewhere in the nation, the deposit structure of the two groups of banks came to resemble each other more closely over the course of the 1961-68 period. At the beginning of this period, time deposits accounted for 50 percent of total deposits at District banks, but for only 34 percent of total deposits at other banks—but by the end of 1968, the time-deposit share had risen to 64 percent for District banks and to 54 percent for banks elsewhere.

Ruth Wilson

Z-Day for Consumers

Z-Day is coming. July 1, 1969 is the effective date of Regulation Z, written by the Federal Reserve System's Board of Governors at the direction of Congress, to implement the Truth in Lending Act, a major part of the Consumer Credit Protection Act of 1968.

This pair—the Act and the Regulation—are designed to spell out disclosures (including finance charge and annual percentage rate) that creditors must make to their customers, and to set standards for advertising credit terms.

Disclosure of "the finance charge" will tell the customer how much he is paying for credit. At the same time, disclosure of the annual percentage rate—the relationship of the total finance charge to the total amount financed—will tell the consumer the relative cost of that credit in percentage terms. When the Act is in effect and the general disclosures are in use, people will be able to shop for credit as carefully as they do for merchandise, with the annual percentage rate functioning as a price tag on credit.

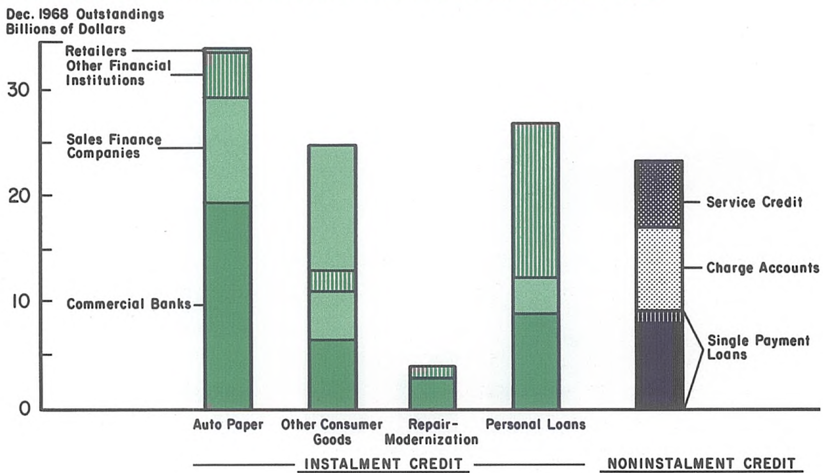
$113 billion to be paid later

The buy-now-pay-later tone of the American marketplace has contributed to making consumer credit one of the fastest growing sectors of the national economy. At the end of 1968 shoppers owed $89.8 billion in instalment credit — with auto loans leading at $34.1 billion followed by personal loans totaling $26.9 billion—and another $23.3 billion in non-instalment credit. All too often, however, consumers are virtually unaware of what the pay-later portion is costing them. In the past, shoppers have been confronted with a bewildering array of credit information—no two disclosures of which are directly comparable. The Truth in Lending provisions assume that most consumers will be able to make intelligent decisions regarding credit buying if they are given the facts.

Truth in Lending does not fix any minimum or maximum charges for credit. It simply insures that a customer is advised of all the costs and conditions of the credit he is seeking. Regulation Z applies to banks, savings-and-loan associations, department stores, credit unions, credit-card issuers, automobile dealers, residential mortgage brokers, craftsmen, doctors, and anyone else who extends or arranges for consumer credit.

During 1968, commercial banks extended $36.3 billion in instalment credit, while ex-

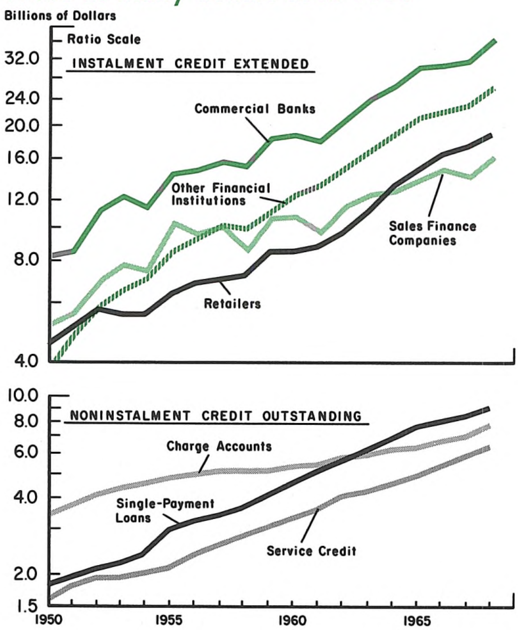
Consumers owed $90 billion in instalment credit and $23 billion in noninstalment credit at end of '68



tensions totaled $15.9 billion for sales-finance companies, $25.8 billion for other financial institutions, and $19.0 billion for retailers. (All of these lenders, except sales-finance firms, extended at least twice as much credit in 1968 as they did in 1960.) The most popular type of noninstalment credit proved to be single payment loans—$9.1 billion outstanding, mostly at commercial banks—while charge accounts totaled $7.8 billion and service credit $6.4 billion at the end of the year.

The primary test of credit covered by the Regulation is not so much the form of the credit as the purpose for which it is extended. Consumer credit is defined as credit offered or extended to an individual for purchases of real estate, household goods, or farm goods for which a finance charge is or may be imposed, or which is repayable in more than four instalments. The regulation assigns all consumer-credit transactions into one of two categories—open-end credit, including credit-card transactions and department-store revolving charge accounts; and credit other than open-end, which includes instalment credit, mainly used by consumers for big-ticket items such as automobiles, refrigerators, washing machines, and television sets.

Consumer-credit field now involves twice as many dollars as in 1960



Some types of credit are exempt from the regulation, such as business and commercial credit, other than for agricultural purposes, and credit to governmental units. Also exempt are securities and commodities transactions with a broker-dealer registered with the Securities and Exchange Commission, along with some types of transactions under regulated public-utility tariffs. Credit exceeding $25,000 is also exempt — except real-estate credit, which is covered regardless of amount. (The Act stipulates the right of a customer to cancel some types of consumer credit arrangements within three business days if his residence is used as collateral.)

Open-end arrangement

Under the open-end arrangement, credit can be extended from time to time with finance charges levied against any unpaid balances each month. With this type of credit the annual percentage rate may be computed by the following method: Divide the finance charge by the unpaid balance to obtain the rate for one month or whatever other time period is used; then multiply this result by 12 or by the number of time periods used by the creditor during the year. In the case of a typical charge of 1½ percent of the unpaid balance with bills presented monthly, the annual percentage rate would be 18 percent.

The following information must be disclosed to those opening a new open-end account:

—The conditions under which a finance charge may be imposed and the period within which payment may be made without incurring a finance charge.

—The method of determining the balance upon which a finance charge may be imposed.

—The method of determining the finance charge.

—The periodic rate or rates used, the range of balances to which they apply and the corresponding annual percentage rate or rates.

—The conditions under which additional charges may be imposed and the method for determining them.

—The conditions under which a creditor may acquire any security interest in any property owned by the customer and a description of the interest which may be acquired.

—The minimum periodic payment required.

Similar information must be sent to customers who already have open-end accounts by July 31 if the account has a collectible unpaid balance on July 1, and by the first billing which follows use of the account for those on which no balance is owed.

Instalment-credit arrangement

For instalment credit, primarily used by customers for purchases of big-ticket merchandise, the annual percentage rate must be computed by one of several alternatives, such as (for instance) the actuarial method.

Here is an example of how the actuarial method would work. With a bank loan of $100 repayable in 12 equal monthly instalments at a 6-percent add-on finance charge, the annual percentage rate would be 11 percent. In this case the borrower would repay $106 over one year but would have use of the $100 loan only until he made his first payment. At that point he is repaying part of the principal and has less money at his disposal.

Using the same set of circumstances but this time with a 6-percent finance charge discounted in advance, the annual percentage rate would be 11½ percent. That's because the customer in this case would receive $94, must repay $100 and again would have full use of the loan only until he made his first payment.

For credit other than open-end, the customer must be furnished the following information as applicable, plus additional information relating to the type of credit extended:

—The total dollar amount of the finance charge, except in the case of a transaction to finance a dwelling.

—The date on which the finance charge begins to apply if different from the date of the transaction.

—The annual percentage rate.

—The number, amount and due dates of the payments.

—The sum of these payments, except in the case of a first mortgage to finance purchase of a dwelling.

—The amount or method of computing any default, delinquency or similar late-payment charges.

—A description of any security interest to be acquired by the creditor.

—A description of any penalty charge for prepayment of principal.

—The method of calculating the finance charge in the case of prepayment and a statement of charges deducted from any rebate.

The Federal Reserve Board has prepared sets of tables which are available to creditors to determine annual percentage rates. The two booklets—one for regular payments and one for irregular payments, or multiple advances—are available for $1 each or 85 cents in lots of 10 or more from the Federal Reserve Board in Washington, or from any of the 12 Federal Reserve Banks.

All credit advertising is covered by Truth in Lending. Under the regulation, no advertisement may advertise a specific amount of credit or instalment unless the creditor ordinarily arranges terms of that type. Also, no advertisement may spell out a specific credit term unless all other terms are stated clearly and conspicuously. For example, statements such as "only $3 per week," "two years to pay," and "no money down" will not be allowed unless a more complete disclosure of terms is given.

Although Regulation Z has been issued by the Federal Reserve Board, enforcement will be supervised by nine different Federal agencies. These agencies are: The Federal Reserve Board for State banks which are members of the Federal Reserve System; the Federal Deposit Insurance Corporation for other insured State banks which are not members of the Federal Reserve System; the Comptroller of the Currency for national banks; the Bureau of Federal Credit Unions; the Federal Home Loan Bank Board for federally insured savings and loan associations; the Interstate Commerce Commission for industries it regulates; the Civil Aeronautics Board for airlines; the Agriculture Department for creditors under the Packers and Stockyards Act; and the Federal Trade Commission for all other creditors, such as retail stores, small loan companies, service establishments, and professional people. Creditors who willfully and knowingly violate the Truth in Lending law or Regulation Z face a maximum criminal penalty, upon conviction, of a $5,000 fine, a year in jail, or both. A creditor who fails to make the required disclosures may be sued by a customer for twice the amount of the finance charge, but not less than $100 nor more than $1,000, plus court costs and attorney's fees.

In order to provide creditors with complete information on Regulation Z, printed copies of the Regulation and statute, together with an explanatory question-and-answer series on Truth in Lending, are being sent to creditors through the agencies enforcing the law.

Karen Rusk

Silver: End of an Era

The Treasury in mid-May lifted its ban on the melting and exporting of silver coins, thus freeing large amounts of the metal for industrial use. In following the recommendation of the Joint Commission on the Coinage, the Treasury noted that the two-year-old melting ban "no longer either keeps silver coins in circulation or contributes to the Treasury's supply of silver coins." Industry sources estimate that old silver coins still outstanding, if turned in for melting, would yield about 1.7 million ounces of silver—more than ten times the current annual silver requirements of U.S. industry.

The Treasury also announced a reduction in the amount of silver to be offered at its weekly auctions. Henceforth, 1.5 million instead of 2.0 million ounces will be offered each week in the sale held by the General Services Administration, and the auction will be open to all instead of only to domestic industrial users. In addition, the department announced that it would ask Congress to authorize the minting of silverless half-dollars and dollars, to replace the part-silver part-copper half-dollars and the all-silver coins that have virtually disappeared from circulation. Finally, it announced plans for the sale of 2.9 million rare silver dollars through a GSA "bid-sale" arrangement designed to net anywhere between $15 million and $75 million.

Western Digest

Credit Gain During Tax Week

Large District banks showed a sharp increase in bank credit over the mid-April tax date. Total credit rose $800 million during the tax week, mostly because of a $751-million increase in loans. (Almost one-third of the loan increase was in securities loans.) . . . Business borrowing soared by $214 million—compared to a $75-million gain in the comparable year-ago week. Thus, between mid-March and mid-April, large District banks accounted for 29 percent of the national increase in business loans and for 27 percent of the increase in total bank credit. . . . Borrowing by Western business firms was fairly widely dispersed among major industrial categories during the mid-April tax week. The heaviest borrowers, however, were retail-trade firms and public utilities.

Rebound in Housing Starts

Housing starts in the West rebounded sharply in April to a 361,000-unit annual rate after a 46-percent recovery in March from February's depressed levels. The April figure showed a gain of 11 percent over a year ago, resulting in the highest rate since February 1964. The April increase contrasted with a 5 percent overall decline in starts in the rest of the nation. . . . Builders' demand for mortgage financing appeared to be fairly strong in early spring, with the critical question centering more around the availability of funds and offering terms rather than the high cost of mortgage funds (8 percent or more). On the supply side, vacancy rates still appeared to be falling in most metropolitan areas of the District, with the exception of Seattle.

Strength in Metals Markets

Steel production remained strong at Western mills during the early spring period. Throughout most of April, production fell below the rapid March pace, but it was still higher than during the inventory boom of a year ago. District producers felt enough confidence in their markets to raise prices on hot-rolled bars and semi-finished products by an average of 3.6 percent in late April. . . . Several other price increases occurred in metals markets during the spring period. Major aluminum producers raised prices on a number of sheet products, accounting for about half of all mill shipments, and lead producers meanwhile posted their fourth price increase of the past six months. Then, in early May, major copper producers raised the domestic price of refined copper from 44 to 46 cents a pound, and most leading fabricators immediately followed suit.

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

Individual and bulk copies are available by writing to:

Administrative Services Department
Federal Reserve Bank of San Francisco
400 Sansome Street
San Francisco, California 94120