

FEDERAL
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SAN FRANCISCO

Monthly Review

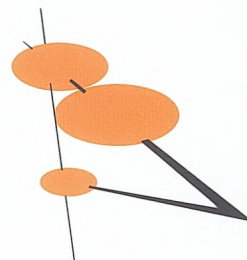
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August 1969

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Editor: William Burke

Prices and Pressures . . .

“**S**traws in the wind” seemed to be the favorite phrase of forecasters at mid-year, as analysts of every persuasion searched for evidence that the stiff medicine prescribed by the nation’s economic policy-makers was indeed succeeding. The proximate goal of curbing economic growth seemed within reach, since the real rate of growth of the national economy was held at close to 2½ percent in the second as in the first quarter of 1969. Still, the final goal of curbing the rapid price upsurge remained out of range, as the general price level continued rising at an annual rate of about 4½ percent in the April-June period, just as it had in the early months of the year.

Some of the straws were hard to find, hidden as they were among statistics which showed a continued growth in employment, industrial production, and the dollar volume of spending. Even so, second-quarter GNP statistics exhibited somewhat less strength in consumer spending and considerably less strength in home construction and defense spending—and even showed a slightly less frantic pace in the business-investment boom.

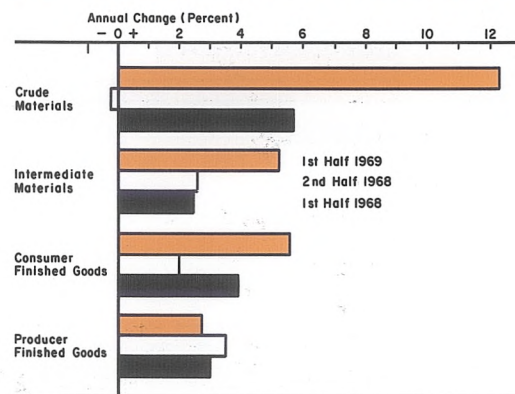
To counteract the inflationary pressures, policymakers worked in tandem throughout the first half of the year to bring the upward-surfing economy under control. With a tight fiscal policy, the Treasury recorded a \$9-billion surplus during this period (national-accounts basis), in contrast to the deficit of like magnitude posted in the pre-surtax atmosphere of first-half '68. With a tight monetary policy, net borrowed reserves of the commercial-banking system averaged roughly \$800 million during the six-month

period—and the reserve position was even tighter at midyear—in contrast to the 1968 average borrowed-reserve position of \$200 million.

Two-thirds inflationary

But the national economy, in the face of these policy pressures, still forged ahead during the spring and early summer months. GNP increased by nearly \$16½ billion during the second quarter to a \$925-billion annual rate. (Incidentally, the Commerce Department’s annual revision of the detailed GNP statistics involved upward adjustments in earlier-announced totals for the last several years.) An increase of that magnitude, which would be quite welcome if resources were amply available, was very unwelcome at this juncture, primarily because it contributed so much to inflationary pressures. Altogether, about two-thirds of the quarterly gain represented price increases.

Sharpest boosts in wholesale prices now show up early in production stage



Abundant signs of the pervasive inflationary threat cropped up at all levels of the economy. There were not only the widely-reported price boosts at the retail level, but more worrisome for the future, there were also continued increases in wholesale markets. Within the wholesale-price index, producer and consumer finished-goods prices went up just about as rapidly as they did during fast-moving 1968, and substantially larger increases developed at the earlier stages of the production process. In particular, prices of crude materials jumped by more than 10 percent—several times last year's rate of increase. Consequently, most observers are now nervously waiting to see whether these sharp boosts within the substructure of the index will work their way into the prices of finished goods, both wholesale and retail.

Sluggishness and strength

Some signs of sluggishness appeared in the basic sources of demand at midsummer, although clearly, they were still not dominant in the overall picture. In the government sector, Federal spending for goods and services showed the continued impact of the

fiscal restraints imposed a year ago, dropping by \$1 billion during the second quarter to a \$101-billion annual rate. Still, this was more than offset by a strong (\$3½ billion) gain in state-and-local government spending to a \$112-billion rate.

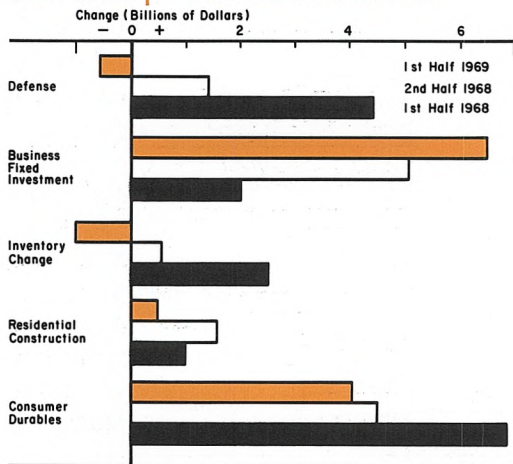
The beginnings of troop withdrawals from Vietnam have apparently set defense spending on a downward curve for fiscal 1970. On the basis of the successive reductions made in the January, April, and July versions of the 1970 budget, a cut of at least \$2 billion each quarter in the annual rate of Federal spending seems likely over the next twelve-month period. (The downtrend will be interrupted in the present quarter, however, by the pay raise for Federal employees which Congress passed last year and made effective this July.) And needless to say, a major portion of the spending decline expected in this fiscal year will come from cuts in defense spending.

A few hesitant signs of sluggishness also developed around the business investment boom by mid-summer, although the boom continued bulling along throughout the first half of the year. Business fixed-investment spending, after rising at close to a \$4-billion annual rate in the first quarter, jumped by another \$3 billion, to a \$98-billion annual rate, in the spring period.

At the beginning of the spring quarter, firms owning 48 percent of total manufacturing assets considered their current facilities inadequate to meet their expected sales volume. (The comparable figure during the boom of early '68 was only 40 percent.) At the same time, the carryover of expenditures on projects already underway at that time exceeded \$20 billion—enough to last until the end of the year at the early '69 spending pace.

The latest Commerce survey meanwhile suggests only a 3-percent gain in business-investment spending over the second half of

Some signs of sluggishness seen in major sources of demand



1969—almost entirely outside of manufacturing—in contrast to the first-half's almost 10-percent gain. And although the survey attests to the business sector's compulsion to invest more heavily, the actual outlays may fall short of expectations, judging from the recent evidence of declines in both machinery orders and new capital appropriations. Actual outlays may be limited, too, by the prospective repeal of the investment-tax credit and by the dearth and heavy cost of capital funds.

Several major firms have already announced definite plans to reduce their capital spending. Besides, business firms generally are closely examining their prospective levels of sales in relation to their present plant-utilization (and inventory) ratios. With retail sales now appearing a little soft, businessmen might be well advised to look again at their sales targets and spending plans for 1970.

The somewhat puzzling inventory situation is another factor in their future planning. During second-quarter '69, business inventories expanded at roughly a \$9½-billion rate, considerably above the preceding quarter's rate but still below the sharp build-up of late 1968.

The recent expansion took place despite the heavy costs of carrying inventories and despite the slower growth of consumer demand, which suggests the possibility that some involuntary expansion occurred over the spring period. But whether the expansion resulted from this factor or from a speculative build-up designed to beat inflationary price boosts, businessmen should be under some pressure to keep stocks within line in future months.

Signs of slowdown

Residential construction felt the impact of a tight policy posture this spring and

summer. Annual spending in that sector dropped by \$1 billion, to a \$32½-billion rate, in the second quarter after two years of sharp recovery from the 1966 credit crunch, and further moderation appeared to be in the cards.

Will housing go through the wringer again in 1969 as it did in 1966? Admittedly, housing starts dropped about 10 percent, to a 1.5-million annual rate, between the first and second quarters of this year. (This was roughly in line with the quarterly declines recorded during 1966.) Even so, most housing analysts expect that the industry will maintain a stronger pace this time around, at least partly because of the much greater strength of basic demand at this juncture. And savings and loan associations, the backbone of the mortgage industry, seem better prepared than they were three years ago to deal with a squeeze on mortgage money, partly because they are less reliant now than they were then on the volatile portion of the savings flow.

Consumer spending responded at least tentatively to strong policy pressures this spring, posting a second-quarter gain of less than \$9 billion, to a \$571-billion annual rate, in contrast to the \$11-billion first-quarter increase. Judging from retail-sales data, consumer spending for goods began to fall off somewhat after reaching a peak in April.

Consumer durable-goods spending rose about \$2 billion to a \$90-billion annual rate during the second quarter. The sales performance varied among different sectors, but Detroit, for example, wound up its '69 model year in much better shape than predicted several months ago. This spring's new-car sales were in line with the industry's most optimistic forecasts, while several strikes and several planned plant shutdowns cut into production schedules, so that new-car inventories at mid-year totaled a manageable 1.7 million units.

On balance, the real economy shows signs of slowing down, since real GNP (after price adjustments) has grown only at a 2½-percent annual rate in the first half of 1969, in contrast to a 6-percent growth rate in the pre-restraint period of early '68. The usual concomitants of a slowdown are now appearing: reduced productivity, rising unit-labor costs, and eroded profit margins, to cite only

a few. (And Wall Street is reacting in typical fashion to dwindling profits and dwindling availability of money.) Some observers are impatient with the apparent fact that, in reaching the final goal (curbing inflation), the proximate goal (curbing growth) must first be achieved—but the process appears at least to be underway.

William Burke

... and Restrictive Policy

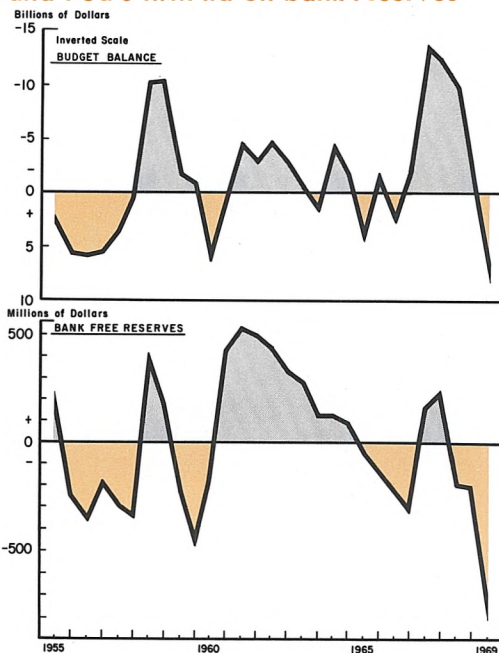
In a qualitative sense, financial-stabilization pressures remained the same throughout January-June 1969; in both the first and second quarters of the year, the Treasury registered a surplus and the Federal Reserve kept the credit markets on a tight leash. However, the degree of restraint was much more rigorous in the second quarter than it had been in the first three months of the year. Indeed, the present combination of a Treasury surplus and the Federal Reserve's firm lid on the reserve base of the banking system represents probably the most restrictive policy package in recent history.

Policy: leaning on reserves

The second quarter's major monetary policy actions took the form, in early April, of an increase in the discount rate to 6 percent and an increase of ½ percent in reserve requirements against demand deposits in excess of \$5 million. Then in June, the Board of Governors moved to restrict the use of balances due to foreign branches (the principal form of Eurodollar borrowing) and the sales of assets to foreign branches, and also to restrict the use of corporate deposits in the Federal-funds market.

But the most significant changes between the first quarter and the second quarter showed up in the relative rates of growth of bank reserves. Total reserves remained just about unchanged from the first-quarter level,

Policy tight, with Treasury surplus and Fed's firm lid on bank reserves

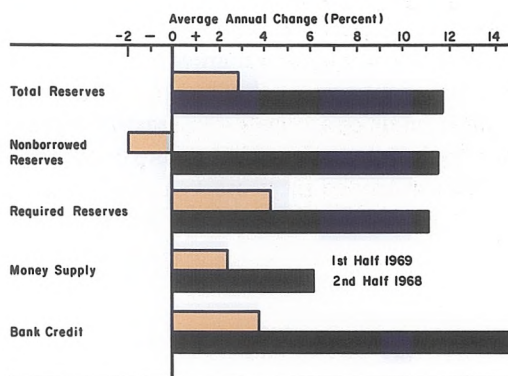


while nonborrowed reserves turned around sharply from a 1.5-percent annual rate of growth to a 6.3-percent rate of decline. This shift reflected the member banks' conservation of excess reserves—and their increasing reliance upon the discount window as a source of reserves. (Member-bank borrowings jumped from a first-quarter average of \$808 million to a second-quarter average of \$1,247 million.) The average level of net borrowed reserves nearly doubled between the first and second quarters, going from \$569 million to \$1,017 million—and in nearly every week since late April, net borrowed reserves reached or exceeded \$1 billion.

Commercial-bank time deposits declined in both of the first two quarters of 1969. The money supply meanwhile increased at a rather modest pace, but at a faster rate in the second quarter than in the first—2.7 as against 1.7 percent, to be exact. (The money supply in its broader definition—currency plus total commercial-bank deposits—thus rose at a 0.1-percent annual rate of growth in the spring period, as against a 2.6-percent rate of decline in the preceding quarter.) Much of the net decline in time-and-savings deposits over the first half-year can be attributed to disintermediation, that is, the conversion of such deposits into demand deposits for the purchase of Treasury bills and corporate securities, which now offer a considerably higher rate of return than do deposits.

Taken as a whole, the policy posture of first-half '69 stands in striking contrast to that of the preceding six-month period, when policy had eased in expectation of a fairly prompt economic response to the sharply restrictive fiscal package of mid-'68. Member-bank reserves thus far this year have grown slowly if at all, depending on definition—in contrast to the 11-percent annual rates of gain recorded in the second half of last year

Slow growth of monetary variables contrasts sharply with '68 growth



—and the money supply has grown at a pace far below the 6-percent rate of second-half '68. Consequently, bank credit has expanded at only a fraction of the 15-percent annual rate of gain of the relatively easy late-'68 period.

The rising cost of obtaining funds provided another gauge of the pressure upon bank reserves this past spring. Confronted with relatively low ceilings on deposit rates, banks have lost CD funds in every week of 1969 to date, so that they have been forced to turn to other sources of supply, such as the Federal-funds market. The Fed-funds rate, which applies to the overnight loans of uncommitted member-bank reserves, moved within a range of 6 to 7 percent in the first quarter, but in May 8 percent was the norm, and in June trading was near or above 9 percent on most days. In mid-July, a new record high was set at 11 percent.

Some of the banks also obtained funds by tapping the Eurodollar market, bringing home the dollars deposited at their foreign branches or other banks abroad. As the competition for Eurodollar balances intensified, the 3-month rate rose from 7¼ percent in early January to well over 11 percent at the end of June. These funds are not subject to reserve requirements, FDIC assessments, or

Regulation Q ceilings, and the effective cost of Eurodollars relative to other sources of bank funds is much less than a comparison of crude interest rates would suggest. As a result, the Eurodollar market has been used to offset some of the pressure on U.S. banks' reserve positions. To counteract this use, the Board of Governors by its recent proposals would place reserve requirements against balances due to each bank's foreign branches in excess of the average May '69 levels of such balances.

Policy: out of the red

The Treasury ended fiscal 1969 with a budget surplus—a little over \$3 billion—thus marking a truly remarkable turnaround from fiscal 1968's \$25-billion deficit. Between the two years, receipts jumped by \$34 billion, while expenditures (including net lending) increased by only \$6 billion.

A fairly sharp shift in the budget, from a deficit in first-quarter '69 to a surplus in the second quarter, conditioned the Treasury's demands upon the credit markets. In the first quarter, on an unadjusted basis, the Treasury had a deficit of \$2 billion and was a very small net borrower from the public. In the second quarter, the surplus amounted to about \$15 billion, and some \$12 billion of this was used to retire debt, principally through redemption of tax-anticipation bills. After adjusting for the wide seasonal swings in receipts, the Treasury recorded a surplus (national-income basis) in both January-March and April-June—and in fact recorded a widening margin of surplus over those periods.

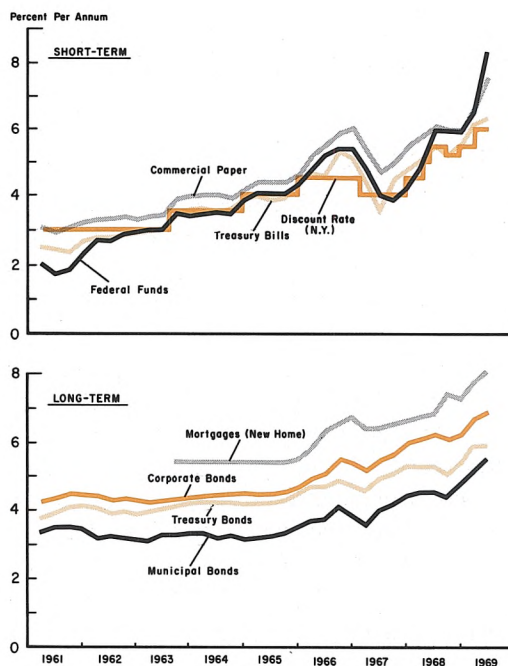
Although Congress failed to make any changes in taxes during the second quarter, it did decide—in early August—to extend the 10-percent income-tax surcharge until the end of calendar 1969. At that point, though, it left in abeyance a number of other

matters, in particular, the complex provisions of a mammoth \$7-billion tax-reform bill.

Adjusting by restructuring

Faced with severe and sustained pressures upon their reserve positions, commercial banks were forced to make a number of adjustments this spring and summer to maintain their outstanding liabilities and to meet the strong demand for loans. On the liabilities side, the banks had to deal with a continuing loss of negotiable time-certificates of deposit (CD's), as maximum allowable interest rates payable on these instruments fell further and further behind other money-market rates. (By July, the yield on 90-day CD's in the secondary market was 8¾ percent, which is 2½ percent above the ceiling on new CD's.)

Interest rates in all areas reach historical highs—again



The runoff of CD's in the second quarter amounted to \$4.3 billion, about \$0.5 billion more than the first-quarter loss. Banks made up most of this time-deposit loss by increasing their reliance on the Eurodollar market, boosting their balances by \$3.7 billion in the second quarter, and they made up most of the remaining difference by increasing their borrowings from the Reserve Banks.

The banking system also adjusted to the pressure on reserves, manifested in the substantial runoff of CD's, through the rearrangement of earning assets. First of all, banks continued to sell off U.S. Government securities during the second quarter, although the annual rate of divestment (9.7 percent) was well below the 26.7-percent rate of liquidation in the January-March period. The banks also sold off—somewhat more reluctantly—municipal securities, with a 2.8-percent rate of decline offsetting a 2.2 percent rate of gain in the previous three-month period.

Total loans rose at an annual rate of 8.6 percent, with strong gains in April and May offsetting a small decline in June. Business loans provided most of the impetus to this upsurge, rising at a 16.7-percent rate in April and May—but even business loans fell off to no gain in June.

Into the wild blue yonder

A recitation of the interest-rate peaks reached in late spring and early summer reads rather like a page torn from the *Guinness Book of Records*. The yield on 91-day Treasury bills broke through the 7-percent mark in early July, after gaining about one full percentage point in a single month. But this was not unique, since all other short-term rates also advanced sharply at this time. In early July, three-month bankers' acceptances (at 8.50 percent) and six-month commercial paper (at 8.63 per-

cent) were each about one percent higher than they had been a month earlier.

These increases came on the heels of the hike in the prime rate, from 7½ percent to 8½ percent, which the banks imposed on June 9. Still, some short-term rates had been rising sharply even prior to that increase; yields on commercial paper and acceptances, for instance, gained 50-75 basis points over the April-May period. Because of this rise, in fact, borrowers tended to switch back to bank financing, and this move then helped set the stage for the prime-rate hike.

The performance of long-term yields was less spectacular, but the upward trend was evident in that sector too. The average yield on outstanding top-quality corporate bonds, after approaching the 7-percent mark in early April, fell back over 20 basis points in May before moving upward to a level of 7.08 percent in mid-July. A number of well-rated new utility issues were sold during this time with coupons of 8 percent or slightly better.

The municipal-bond market was under heavy pressure again as commercial banks, who typically underwrite most new issues, instead reduced their holdings of such securities. Thus, the average yield on top-rated outstanding tax-exempt issues rose from just over 5 percent in late March to 5.60 percent in mid-June. Since the statutory limit for many governmental units is 5 percent, this rise precluded a number of them—including the State of California—from entering the market with new offerings.

Yields on long-term Treasury bonds moved within a somewhat narrower range, however. They declined from a high of 6.05 percent at the end of March to about 5.85 percent in early May, and then rose slowly but consistently through late May and June to about 6.15 percent in early July.

Herbert Runyon

Western Patchwork

The Western economy continued to boom this spring and early summer, but the rather uneven performance of a few areas somewhat marred the outlook. Nonresidential construction and homebuilding led on the positive side, scoring appreciable gains during the spring quarter. By contrast, manufacturing employment—aerospace in particular—weakens over this period.

The unemployment rate in Twelfth District states declined from 4.4 to 4.2 percent between the first and second quarters. (Nationally, the rate edged up slightly to 3.5 percent.) Joblessness declined during the strong months of April and May, but a weaker showing in June brought the rate back up to the first-quarter level.

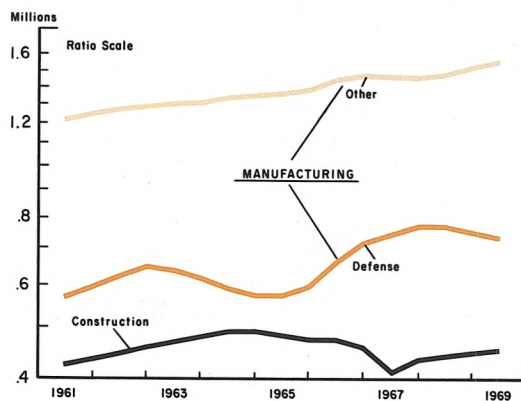
Manufacturing was relatively weak this spring, with total manufacturing employment lower in June than it had been at any time since last September, after adjustment for the usual seasonal swings. Construction employment also declined in June, but strength in April and May meant a 0.6-percent gain in

construction employment over the quarter as a whole. The largest employment increases were recorded by state and local governments, and the trade group was also fairly strong.

District personal income was 8.4 percent higher in the early months of 1969 than in the comparable 1968 period, compared with a 9.0-percent gain elsewhere. The contrast was most striking in manufacturing (aerospace, in particular), because of a declining employment trend to date in 1969, and in construction, because of early-year weakness.

This slower growth in income was reflected in a somewhat lethargic trend in retail sales, with the West's 3-percent January-April growth, year-to-year, comparing with a 5-percent gain elsewhere. Western shoppers, moreover, found no relief from the all-pervasive rising trend in prices. While rising a bit less than nationally, District prices in the second quarter increased at a better than 5.5-percent annual rate, with grocery, medical, and housing costs leading the field.

Aerospace lag, construction upturn, mark early '69 employment pace

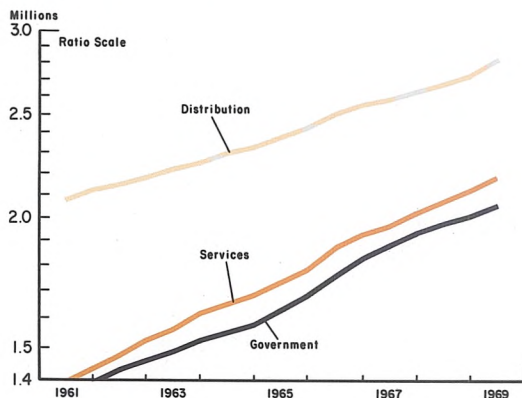


Aerospace down, housing up

Employment in the District's aerospace industry continued to weaken during the second quarter. The 13,000 jobs lost during this period marked the largest quarterly drop of the year-long decline. Elsewhere in the nation, employment remained relatively stable over the spring months.

Weaknesses have developed recently in both commercial and military projects. Deliveries of older-model commercial jet aircraft have declined, while production lines for newer models have just begun to enter operation. Meanwhile, a sizeable number of jobs have disappeared because of the cancel-

State-local governments, trade group, score largest increases in jobs



lation of several large military contracts—in particular, the Air Force's Manned Orbiting Laboratory and a major Army contract for helicopter production.

Supported by gains in all sectors—residential, non-residential, and public works—the pace of construction activity in the District accelerated appreciably during the second quarter. In homebuilding, a sharp recovery followed the first quarter's weather-enforced decline. Housing starts jumped by over 25 percent to 344,000 units (annual rate), in contrast to the 20-percent decline recorded elsewhere. In other construction, District contract awards also rose by about 25 percent over the quarter—far ahead of the rest of the nation. Construction of stores, office buildings, banks, and manufacturing facilities continued to show exceptional strength.

The gains in housing activity, centering in multiple units, were fairly widespread throughout the West this spring. In Seattle, homebuilding lagged behind the exceptionally vigorous pace of a year ago, but in Las Vegas and Boise, work was progressing at double the year-ago pace. Los Angeles, Orange County, and Phoenix showed year-to-year increases of 25 percent or more, underscoring the continuing shortage of housing

in those major population centers, and demonstrating the strong builder and buyer demand for mortgage funds even in the face of extremely high interest rates. Nevertheless, a reduced inflow of savings funds into mortgage-financing institutions suggests that high levels of homebuilding may be hard to maintain, and many observers thus foresee reduced activity in the months ahead.

Raw materials mixed

Forest-product prices plummeted in the spring months as demand weakened in the national housing industry and as Government officials moved to increase available timber supplies from Federal lands. Between late February and late June, Douglas-fir lumber and plywood prices dropped on the average by 40 and 50 percent, reaching levels well below those prevailing a year ago. Vacation shutdowns at a number of mills in early July exerted a firming effect on prices for the moment, but industry sources doubted that these prices could be maintained when production resumed at a more normal pace.

The continuing industrial boom, along with rising prices for copper and other base metals in the European markets, created considerable upward pressure on U.S. metals prices during the spring months. In early May, domestic copper producers raised the price of refined copper 2 cents a pound, and in early August they boosted the price by another 2 cents to a range of 48-48¼ cents a pound. This price, an all-time high, compares with the 38-cents-a-pound price quoted prior to the 1967-68 mine strike.

Strong consumer demand enabled the Pacific Northwest's aluminum producers to raise prices on products accounting for about one-half of total aluminum mill shipments. The increases ranged from ½ to 2 cents a pound.

On the other hand, a change in Government silver policy and a slowdown in indus-

trial demand brought about a sharp decline in the price of the white metal. In mid-May, the U.S. Treasury lifted its ban on the private melting and exporting of silver coins and announced that offerings at the Government's weekly silver sale—although open to all bidders—would henceforth be reduced from 2.0 to 1.5 million ounces. While the lifting of the melting ban did not free substantial quantities of silver from hoarded coins as expected, it did help to depress silver values by causing speculators to unload stocks. Thus, by late June, the New York dealer price of silver was down to \$1.56 an ounce—15 percent below its late March level, and lower than at any time since the U.S. Treasury abandoned the \$1.29-an-ounce ceiling in 1967.

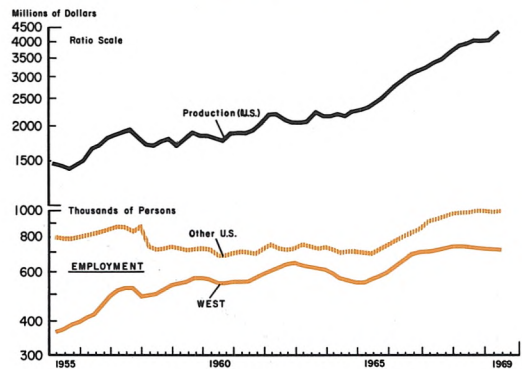
Western steel production remained high during the spring quarter, although slightly below the March peak level. On the basis of this strong performance, producers raised prices on several construction items, including steel bars and structural shapes and plates, by an average of about 5 percent during the spring period, and then boosted prices on most flat-rolled products by a similar amount in late July.

Petroleum, farming prospects

Production of crude petroleum held up well in the West during the spring period, roughly in line with the year-ago pace. However, increased demand for refined products caused District refineries to increase their imports of foreign oil, primarily from Canada.

Drilling problems in the Santa Barbara Channel continued to limit oil deliveries from that area. Drilling has resumed on a few tracts, but the embargo on Federal lands remains in force, and some companies consequently have sued the Federal Government for compensation for the costs they have incurred—including payments for leases and outlays for exploratory activities—and for potential profits now lost. Exploration on

Western aerospace industry declines further as more projects taper off



Alaska's North Slope meanwhile continued at a rapid pace, with about 24 rigs drilling at the end of June. Encouraging shows of oil are reported from wells over 50 miles away from the big Prudhoe Bay discovery.

The flow of funds to District farmers increased sharply during the second quarter, according to preliminary data for the period. Fresh vegetable prices were particularly strong in the spring months, and prices for meat animals also held substantially above year-ago levels. In contrast, citrus prices were considerably lower than a year ago, with marketings up sharply.

District farmers expect to market a near record volume of crops in 1969, on the basis of generally favorable growing conditions. The output of wheat and processing tomatoes may fall below 1968 levels, but cotton output should be greater than last year. The big boost in crop production, however, is expected from deciduous fruits, continuing last year's rebound from the depressed levels of 1967; for example, apple production is scheduled to rise substantially in the Pacific Northwest. Supplies of meat should also be more plentiful than last year, despite the increase in beef prices. At midyear, the number of cattle on feed in the District was one fifth larger than a year ago.

Regional staff

Western Pressures

In the face of an increasingly restrictive monetary policy, commercial banks in the Twelfth District recorded a \$1.3-billion increase in total credit during the second quarter, on a seasonally adjusted basis. This gain, which reversed the first-quarter contraction, represented nearly 30 percent of the nation's total bank-credit expansion for the spring quarter. Yet, for the entire first half of 1969, District banks expanded their credit at an annual rate of only 2.2 percent—below the 3.1-percent rate of growth for banks nationally, and less than one-half the District growth in the tight-money period of first-half 1968.

District banks accelerated their lending pace in the April-June period, increasing their loans by \$1.9 billion. In spite of a record high prime rate—8½ percent in June—business loans accounted for much of this stepped-up pace. To finance the heavy loan demand, District banks reduced their security holdings by a seasonally adjusted \$600 million and then obtained additional funds for lending through increased borrowings from the Federal Reserve and other sources.

Increased reserve pressure during the second quarter was clearly reflected by the \$618-million (seasonally adjusted) decline in District member-bank deposits. Continued attrition in large business deposits and in public time deposits, plus a larger than seasonal reduction in individual savings to meet April tax payments, caused a run-off in time deposits amounting to nearly twice the first-quarter reduction. Meanwhile, a decrease in U.S. Government demand deposits offset a small gain in private demand deposits.

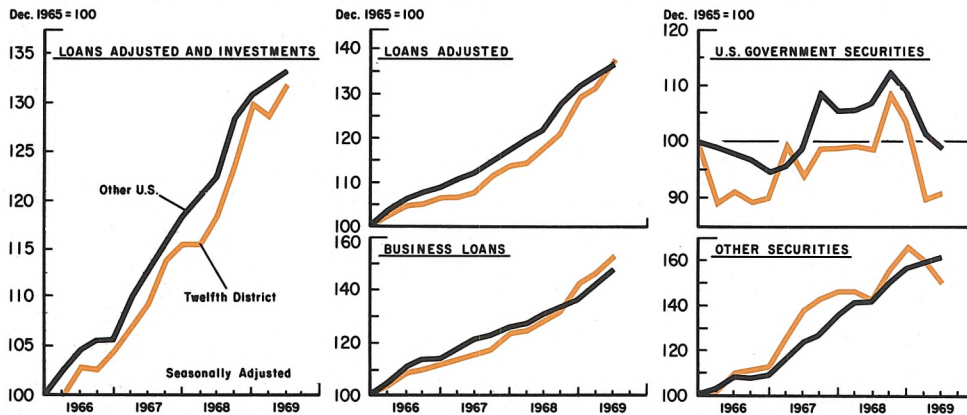
Western banks posted a relatively greater second-quarter expansion in loans, including business loans, than did banks elsewhere. At the same time, they recorded a relatively larger decline in securities (especially municipal issues) than other banks. In deposit categories, Western banks generally followed the national trend in demand deposits, except for wider fluctuations in U.S. Government deposits, but recorded a relatively greater outflow of time deposits.

Record borrowing

In the second quarter, District member banks borrowed \$131 million (daily average) from the Federal Reserve discount window—almost half again as large as the first-quarter figure. Their net borrowed reserves also rose to \$116 million—one-third higher than in the first quarter. Nevertheless, these large increases were still relatively smaller for District banks than for all member banks.

Intensified reserve pressure showed up in other ways as well, especially as major District banks shifted from being net sellers of Federal funds on interbank transactions to being net purchasers of funds. (Federal funds are idle balances of banks on deposit with Federal Reserve banks.) Their net purchases (borrowings) averaged \$21 million per day for the quarter, compared with average daily sales (lending) of \$157 million in the January-March period. In addition, major District banks purchased \$17 million in Fed funds from brokers and dealers—as against a \$75-million net sales position in the first quarter. (The much-expanded volume of Fed-funds purchases by some individual

Total bank credit at Western banks rises during second quarter despite reduction in security holdings and increased monetary restraint



banks is of course concealed by these aggregate data, as are the heavy, partly offsetting, sales made by those institutions which maintained relatively liquid positions during the April-June period.)

District bank borrowing from other sources rose very rapidly during this period. Banks, for example, increased by a third the amount of their borrowings from nonbank sources under repurchase agreements. Their largest increases, though, were in Eurodollar borrowings — through their own foreign branches, through other banks, or through brokers. In addition to that, a number of District banks borrowed the funds which their holding companies or affiliates had obtained from the issuance of commercial paper. Thus, all possible sources of funds — some old, some relatively new — were utilized by District banks to meet their reserve requirements and to expand their loan portfolios.

Record lending pace

District commercial banks recorded a steep rise in loans in April, on a seasonally adjusted basis, reflecting heavy tax-related borrowing. In May there was a small reduction, but in June there was another large in-

crease, reflecting a substantial rise in loans to brokers and dealers. However, borrowing by commercial and industrial firms accounted for the major part of the overall second-quarter increase. In both April and June, tax borrowing by such firms was far larger than seasonal, in spite of the record cost of credit. Business demand for financing was strongest in the metropolitan areas of California and Washington.

Almost all major business borrowers increased their bank debt during the second quarter. Loans to the durable goods sector rose by \$90 million, with machinery manufacturers accounting for the largest share. In the nondurable-goods sector, heavy financing of food processors and chemical and rubber manufacturers helped account for a \$110-million gain. And loans to public utilities also rose by \$110 million as all categories of utilities sought increased bank financing.

Continued heavy consumer demand for credit — spurred on by spiralling prices — brought about a sharp expansion in bank instalment credit during the second quarter. At Western banks, the increase in such credit was more than double the first-quarter gain. Preliminary data indicate increases in every consumer category — automobiles, other

consumer goods, personal loans, repair and modernization—plus a further expansion in credit extended under credit-card and related plans.

Increased mortgage lending

Both District banks and savings-and-loan associations recorded net outflows of savings during the second quarter, contrary to their early-year performance. District S&L's sustained a \$66-million net outflow of savings, in sharp contrast to the previous quarter's \$430-million gain. For their part, the commercial banks suffered an even larger net outflow of savings and other consumer-type time deposits—all told, a loss of \$190 million, which again contrasted sharply with their previous quarter's \$258-million gain. In both cases, the net loss largely reflected

heavy net withdrawals during early April, when households dipped into their savings to help meet generally higher tax payments. At the same time, the continuing upward shift in money-market rates contributed to the poor savings performance of these institutions, as the rise in yields further reduced the competitive attractiveness of savings in both passbook and certificate accounts.

In spite of this development, the pace of mortgage lending stepped up during the second quarter. Banks expanded their mortgage portfolios by \$175 million—about 50 percent more than during the first quarter. For their part, the S&L's increased their mortgage loans outstanding by a very substantial \$763 million—the largest quarterly gain since 1964 and one in which associations in every District state participated.

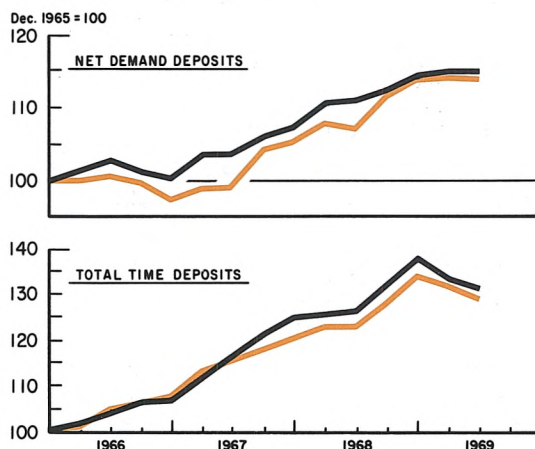
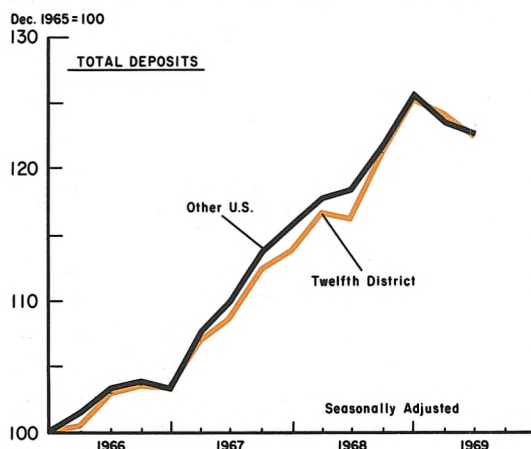
SELECTED ASSET AND LIABILITY ITEMS OF WEEKLY REPORTING LARGE BANKS

Data Not Seasonally Adjusted
(Dollar amounts in millions)

	TWELFTH DISTRICT					U. S. MINUS TWELFTH DISTRICT				
	Outstandings		Net Change			Outstandings		Net Change		
	June 25, 1969		Second Quarter 1969		2nd Qtr. 1968	June 25, 1969		Second Quarter 1969		1968
			Dollars	Percent				Percent	Percent	
Total loans and investments	\$50,339		+ 996	+ 2.02	+ 3.33	\$181,697		+ 2.61	+ 3.26	
Loans adjusted and investments ¹	49,686		+1,752	+ 3.66	+ 3.01	177,002		+ 2.11	+ 1.97	
Loans adjusted	37,281		+2,317	+ 6.63	+ 4.50	129,049		+ 4.55	+ 4.33	
Commercial and industrial loans	14,591		+ 775	+ 5.61	+ 4.05	63,803		+ 4.20	+ 3.87	
Real estate loans	10,817		+ 175	+ 1.64	+ 2.57	22,503		+ 2.53	+ 3.65	
Agricultural loans	1,371		+ 108	+ 8.85	+10.87	706		+ .86	- 3.97	
Loans to nonbank financial institutions	1,665		+ 241	+ 16.93	+10.04	9,834		+10.09	+11.19	
Loans for purchasing and carrying securities										
To brokers and dealers	957		+ 696	+266.66	+19.49	4,301		+25.17	+ 5.11	
To others	274		- 4	- 1.44	- 4.46	2,592		- .77	+ 1.89	
Loans to foreign banks	285		+ 20	+ 7.55	+ 2.23	1,428		+ 3.70	+ 1.46	
Consumer installment loans	5,409		+ 186	+ 3.56	+ 4.65	14,218		+ 4.92	+ 4.65	
All other loans	2,522		+ 134	+ 5.61	+ 6.21	12,574		+ .24	+ 2.38	
Total investment	12,405		+ 565	+ 4.36	+ 6.24	47,953		+ 3.92	+ 3.33	
U. S. Government securities	4,356		- 547	- 11.16	- 5.86	18,158		- .88	- 5.84	
Obligations of states and political subdivisions	6,881		- 4	- .06	+ 2.40	26,744		- .90	- .89	
Other securities	1,168		- 14	- 1.18	+ 6.34	3,051		+ 1.19	+ 4.83	
Total deposits (less cash items)	47,475		- 80	- .17	+ .56	154,775		- 2.17	+ .76	
Demand deposits adjusted	16,074		+ 55	+ .34	+ .61	62,328		- 1.79	+ 1.91	
Time and savings deposits	29,766		- 471	- 1.56	+ .14	74,201		- 5.08	- 1.71	
Savings deposits	15,152		- 429	- 2.75	+ 1.27	32,398		- 2.08	- .74	
Other time deposits IPC	10,198		+ 18	+ .18	+ 1.27	31,082		- 6.63	- 1.13	
Deposits of states and political subdivisions	3,347		- 9	- .27	+ 9.94	6,424		-12.68	- 3.93	
(Neg. CD's \$100,000 and over)	3,144		- 394	- 11.14	- 7.78	12,126		-20.51	- 7.35	

¹Total loans less loans to domestic commercial banks and net of valuation reserves

Western banks experience greater time-deposit attrition (despite smaller CD loss) than other member banks in spring period



The S&L's loan expansion was financed by the liquidation of holdings of cash and Government securities, by a further increase (\$515 million) in advances from the Federal Home Loan Banks, and by other types of borrowing. (At midyear, District associations accounted for about one-half of total borrowings by all associations in the entire nation.) At the same time, commitments for future mortgage loans declined slightly over the quarter, but at the end of June still stood at \$592 million — substantially greater than the monthly average level of commitments during 1968.

Further attrition in deposits

District member banks registered an increase in private demand deposits (seasonally adjusted) in each month of the second quarter. But banks posted a small net decline in total demand deposits over the quarter, be-

cause of extremely wide fluctuations in U.S. Government deposits in May and June.

Total time deposits meanwhile followed a downward trend, with heavy attrition in May and June (seasonally adjusted). Consumer-type time deposits fell consistently throughout the quarter, but the loss in passbook savings was heaviest over the April tax-payment date. The rate of attrition in large negotiable CD's was higher than in the January-March period, although Western banks continued to have a much smaller attrition rate than commercial banks elsewhere.

In the light of these developments, banks everywhere consider the outlook rather dismal for any significant growth in time deposits—at least until there is some downward movement in the structure of money-market rates.

Ruth Wilson and Verle Johnston

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